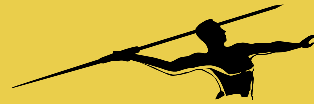
LendingClub



Lending Club Investment Analysis

Conducted by
Javelin Strategy & Research
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Executive Summary

Since making its first peer-to-peer loan in June 2007 up until December 18th, 2008, Lending Club has facilitated $23.6 million in loans, connecting consumer borrowers with lender members seeking reliable investment returns through its online social network. Borrowers typically are seeking to refinance credit card debt or other higher-rate loans, though some seek to pay for one-time events or to fund a small business. On average, they borrow $8,249 funded by 48 lender members each investing $169 per loan.

During that same period, Lending Club funded approximately 53% of the loans originated through the platform. That was partly because it suspended loans from individual lender members for a six-month period in 2008 while it sought registration with the Securities and Exchange Commission. Lending Club completed that registration in October 2008 and currently is the only peer-to-peer platform to complete that process.

Applying underwriting criteria agreed upon with WebBank, the loan originator for the platform, Lending Club grades loans into 35 different classes, with higher-risk loans assigned higher interest rates. The stated interest rate for all loans issued through Dec. 18, 2008 was an average of 12.34%, with a median of 12.29%. The prospectus for the Lending Club notes, available at www.lendingclub.com, contains a more complete description of the platform's operation.

At the close of November, the overall investment return averaged 9.05%, with a median return of 10.48%, based on a Weighted Average Return on Invested Capital (WAROIC). That calculation accounts for Lending Club's 1% service charge, as well as for loans paid off early, hobbled by late payments or defaulted.

As of December 18th, 2008, nearly 12.4% of Lending Club's loans, 10.7% of the dollars funded through the platform are still too fresh to have required a repayment. In terms of both number of loans and dollars lent, nearly 75% of Lending Club loans were current loans. About 8.8% of loans -- representing 8.3% total dollars funded, or about $1.6 million -- suffered from late payments or ended in default. The remaining loans were either paid off early or in a 15-day grace period.

If an individual had invested $10,000 on June 1st, 2007 in a representative group of loans on the site, the value of that individual's account at Lending Club would have grown to $11,594 by November 2008 (assuming reinvestment of payments received). That return would have outpaced other common investments or indexes such as the Standard & Poor's 500 Index ($6,289), the Nasdaq Composite Index ($6,605), 1-year CDs ($10,678) and 6-month Treasury bills ($10,501). This comparison factors in Lending Club's 1% service charge but does not include fees and other transaction costs for the other investments. This comparison does not factor in differences in liquidity between Lending Club notes and the other investments or indexes. Notably, Lending Club notes can only be sold through the Note Trading Platform that was made available recently (on October 14, 2008) and there is no assurance that liquidity will develop on that platform.

Introduction

The concept of peer-to-peer lending – sometimes known as P2P, person-to-person or social lending – is hardly new. Families, friends, religious groups and community groups have long engaged in making loans without the formal involvement of financial organizations. But the practice increasingly will shift online as Web 2.0 capabilities evolve. Today, several online start-ups are serving as matchmakers for borrowers shopping for lower interest rates and investors hunting for higher investment returns.

Though still in its infancy, online peer-to-peer lending has the opportunity to grow into a multibillion-dollar industry, with the liquidity crisis and prolonged recession fueling a need for alternative forms of credit and investment opportunities. Borrowers typically have turned to peer-to-peer lending to refinance higher-cost credit card debt, to pay for one-time purchases like a wedding or to fund a small business. A Javelin online survey of more than 6,000 respondents in November 2007 indicated that only about 4% of respondents had borrowed or lent with a peer-to-peer lending service, but the potential demand for such services is highest among consumers who want to pay down credit card debt.[1] Americans had accumulated $880 billion in credit card debt by late 2007, or about $5,400 per U.S. adult.

The Javelin survey indicated that 58% of U.S. adults were likely to carry a balance on at least one credit card over a six-month period. Of those, 44% indicated they would be likely to use an unsecured peer-to-peer loan to pay off their balances. That means Americans could turn to peer-to-peer loans to refinance as much as $159 billion in credit card debt in 2012, according to Javelin estimates.

Since making its first loan in June 2007, Lending Club of Sunnyvale, Calif., has facilitated $23.6 million in loans through Dec. 18, 2008. In April 2008, Lending Club sought to become the first peer-to-peer platform to register its program with the Securities and Exchange Commission. Lending Club suspended individual loan investments during a six-month review, reopening to lender members and introducing a note trading platform on Oct. 14, 2008. Achieving this milestone has set the bar for the peer-to-peer lending market. In the wake of Lending Club's SEC registration, two competitors have followed suit, suspending new loans during the regulatory process.

To thrive, the peer-to-peer lending industry will need:

- A supply of willing borrowers and investors– and the recession could provide a ready supply of both. Borrowers will be eager to find an alternative source of affordable credit, while investors will be motivated to find higher investment returns.
- Consumer awareness and trust in this nascent market. Javelin data underscores that this industry is in its infancy, but such online platform must overcome the recent spate of worrisome headlines about peer-to-peer lending and the economy, and document an investment track record that will lend legitimacy to this alternative investment.

[1] **Person-to-Person Lending: Strong Consumer Demand Forecast Calls for Bank Partnerships**, Javelin Strategy & Research, December 2007.

Introduction

- A viable, active secondary market for loans that will make such investments liquid. Developing a secondary market such as the note trading platforms offered by FOLIO*fn* to trade Lending Club notes should provide investors with the flexibility they need to manage their portfolios and cash-flow needs. As of Jan. 12, 2009 selling a note at or below par[2] took on average 1 day and 15 hours on the FOLIO*fn* note trading platform.

[2] A note is considered being sold at par when the selling price equals the outstanding principal of the note augmented by any accrued interests earned since the last monthly payment date.

Key Findings

How Does Lending Club Work?

Though Lending Club also funds borrower loans directly, it primarily acts as the middleman between individual lender and borrower members seeking unsecured loans ranging from $1,000 to $25,000. The company runs a credit check to sift out any applicants with FICO scores less than 660 or who fail to meet its other guidelines. The underwriting criteria for loans originated through the Lending Club platform are established by agreement with the lender, WebBank, a Utah industrial loan company, which assigns the borrower loans to Lending Club after origination. Lending Club typically does not verify income and employment information, but it sometimes does so in cases involving larger loans or when conflicting information arises. Lending Club then sorts each application into one of 35 loan grades and assigns an interest rate. Stated interest rates ranged from 7.37% to 20.11% as of Jan. 12, 2009, with higher-risk loans bearing higher interest rates. Borrowers pay a processing fee determined by their loan grade that may range from 0.75% to 3.50% of the principal amount borrowed.

Qualifying lender members can browse through loan listings on Lending Club's Web site or use its "Lending Match" tool to analyze which loans they would like to fund in part or in whole. Investors typically buy small stakes of less than $200 in unsecured three-year notes that correspond to portions of a borrower's loan. So, for example, a lender member might invest in a $200 note representing 2% of a $10,000 loan. Many investors build account portfolios of notes corresponding to portions of more than 25 loans to diversify their risk.

During the period analyzed, borrowers took out $23.6 million in loans overall. On average, borrowers obtained loans of $8,249, funded by 48 investors. Typically, loans are fully funded within two weeks or delisted, with many smaller loans funding within as few as two days.

Total dollars lent	$23.6 M
Total number of loans	2,890
Total number of notes	139,888
Mean notes per loan	48
Mean loan size	$8,249

How do Investors Make – or Lose – Money?

Like a bank, investors stand to profit if borrowers steadily repay their loans. Lending Club collects the borrower's monthly payments and any late-payment fees and directs them proportionately to each lender member's account, minus a 1% service charge. Lender members may hold the notes until they are paid off or offer them for sale through FOLIO*fn*'s note trading platform, which was introduced Oct. 14, 2008.

Key Findings

But loans are unsecured, and there is no guarantee loans will be repaid as expected. Some borrowers will repay their loans early, creating interest-rate risk if rates have fallen. The bigger risk, however, is that borrowers will fall behind in their payments or default on their loans. Delinquent accounts generally are handed over to outside collections agencies if borrowers are more than 30 days behind in their payments, but lender members' returns decrease if borrowers default.

How Much do Lender Members Invest?

About $23.6 million has been invested on the Lending Club platform through mid December 2008. On average, lender members invest $6,501, building investment accounts comprised of 37 notes worth $169 apiece. However, many individual investors maintain smaller investment accounts, typically comprised of fewer than 10 notes.

Total invested	$23.6 M
Number of notes	133,517
Number of lenders	3,636
Mean notes per lender	37
Mean note	$169
Mean total lent per lender	$6,501

What are the Typical Investment Returns?

The Lending Club platform grades loans into 35 categories, assigning higher rates to higher-risk loans. The average stated interest rate for all loans was 12.34%, with a median rate of 12.29%.

Of course, some borrowers pay off loans early, some fall behind in payments or default altogether, plus Lending Club levies a 1% service charge. Accounting for such events, the overall investment return averaged 9.05%, with a median return of 10.48%, based on a Weighted Average Return on Invested Capital (WAROIC).[3]

The WAROIC formula provides a performance benchmark that is based on a comparison of actual cash flows and invested capital. It takes into account changes in principal, interest payments, monthly service fees, late fees and defaults from Lending Club's inception through Dec. 18, 2008.

[3] For more details on WAROIC, see the methodology on pg. 10

Key Findings

How Many Performing Loans Run Full-Term? How Many are Paid Early or are Troubled?

As of December 18th, 2008, out of a total of 139,888 notes , nearly 74.6%, or 104,379, corresponded to performing loans. In dollar terms, that represented 74.7%, or nearly $17.7 million[4]. The remaining notes, comprising nearly $6 million, either had been paid off early, suffered from late payments, ended in default or were issued so recently that the first payment had yet to come due. Here's a breakdown as of December 18th, 2008:

Prepayments: About 4.4% of outstanding loans were paid off ahead of schedule, accounting for 6,117 notes. Pre-paid loans accounted for a total of $1.2 million and 5.3% of the total amount lent out.

Grace Period: Lending Club allows a 15-day grace period for borrowers to become current before payments are deemed late. A total of 1,742 loans, or 1.2%, fell into this category. They comprised $190,521 of loans, or .8% of dollars loaned.

Late Payments: A total of 351 notes were 16 to 30 days late, accounting for less than 1 percent of notes and dollar volume, or $92,926. In addition, 5,920 notes were in the 31- to 120-days-late category, accounting for 4.2% of notes and 4.1% of loan dollar volume, or $959,135.

Defaults: A total of 3,963 notes comprising $591,463 ended in default. That translated into 2.8% of total notes and 2.5% of the total dollars borrowed.

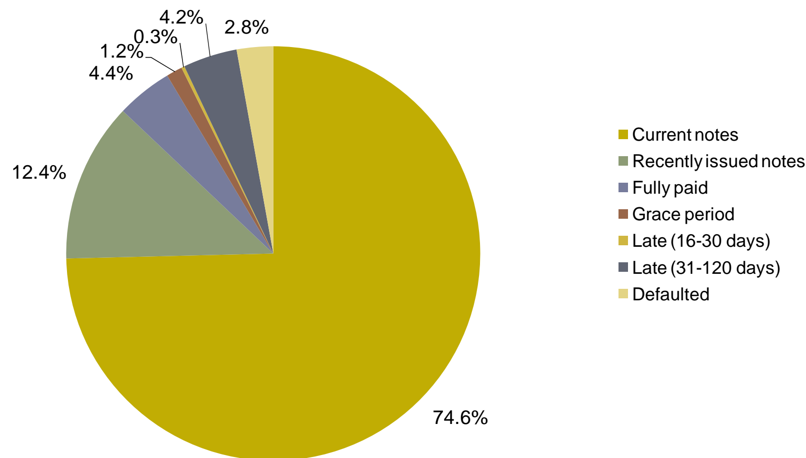
Recently Issued Notes: About $2.5 million in notes were still too fresh to even trigger the first month's payment. These 17,416 notes -- accounting for nearly 10.7% of the loan volume and 12.4% of all notes issued -- were not included in the analysis of investment returns.

	No. of notes	Pct of notes		Dollars[4]	Pct. of dollars[4]
Current notes	104,379	74.6%	$	17,664,000	74.7%
Recently issued notes	17,416	12.4%	$	2,534,025	10.7%
Fully paid	6,117	4.4%	$	1,252,825	5.3%
Grace period	1,742	1.2%	$	190,521	0.8%
Late (16-30 days)	351	0.3%	$	92,926	0.4%
Late (31-120 days)	5,920	4.2%	$	959,135	4.1%
Defaulted	3,963	2.8%	$	591,463	2.5%
Total of all notes	139,888	100.0%	$	23,636,025	100.0%

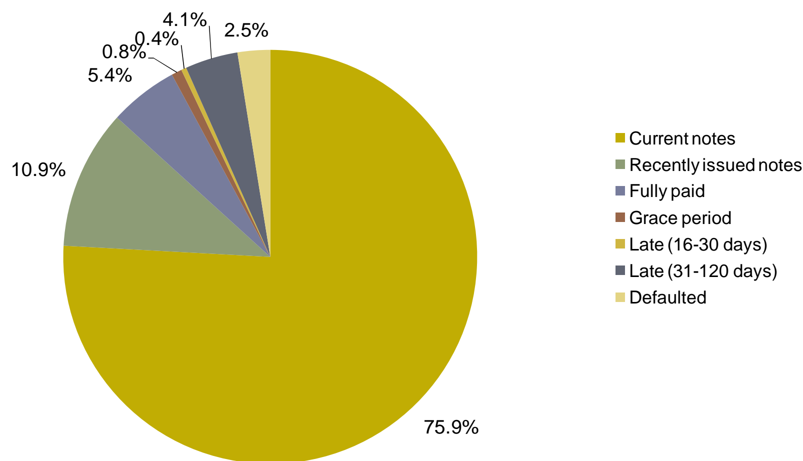
[4] For non-current notes (those that are defaulted, late or in a grace period) only the outstanding principal of the note is counted in the dollars that have defaulted. Principal that has previously been paid is considered current

Key Findings

Status of Notes Lent



Status of Dollars Lent

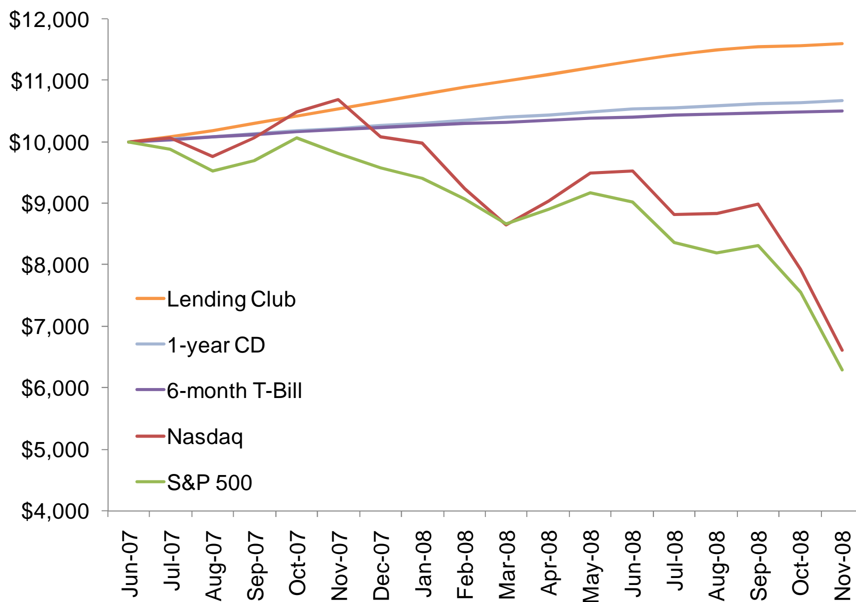


Lending Club Peer-to-Peer Lending vs. Other Investments

These are tumultuous times for investors, with risks and volatility inflicting pain across most investment classes and around the globe. That has been borne out during Lending Club's short history, a period in which stock markets have plummeted in value, triggering a flight to safety that sent investors scurrying to buy government bonds and certificates of deposit. In December, the Treasury sold short-term T-bills with a negative real yield as money markets and other big investors sought refuge for their cash.

If an individual had invested $10,000 in June 2007, a typical (median) [same comment as above] loan portfolio through Lending Club would have grown to $11,594 by November 2008. That return would have outpaced other common investments or indexes such as the Standard & Poor's 500 Index and the tech-stock heavy Nasdaq Composite Index, which suffered staggering losses that would have left the investor with $6,289 and $6,604, respectively. Meanwhile, the same investment in government-insured 1-year CDs and rock-solid 6-month Treasury bills would have grown to $10,678 and $10,501, respectively. (This comparison factors in Lending Club's 1% service charge but does not include fees and other transaction costs for the other investments.)

This comparison also does not factor in differences in liquidity between Lending Club notes and the other investments or indexes. Notably, Lending Club notes can only be sold through the Note Trading Platform that was made available recently (on October 14, 2008) and there is no assurance that liquidity will develop on that platform. Past performance is not necessarily an indicator of future performance.



Methodology

This analysis covers all loans facilitated through Lending Club from June 14, 2007, through Dec. 18, 2008, based on data provided by Lending Club. While some of the data is publicly available, and Lending Club represented the data provided to Javelin as being a complete and accurate representation of all loans during the stated period, it was not possible for Javelin to independently verify this.

Lending Club paid Javelin Strategy & Research a total of $23,500 to perform this analysis.

Javelin's forecast of the peer-to-peer lending market is based on data collected online from a random-sample panel of 6,000 respondents in November 2007. The overall margin of sampling error is +/- 1.27 percentage points at the 95% confidence level.

The following terms are used repeatedly in this report:

Loan: The dollars borrowed at a stated interest rate to be repaid over 3 years by the borrower. A loan is often funded by multiple investors, each of which purchases a note from Lending Club.

Loan Grade: Each loan is categorized into one of 35 loan grades which determine the interest rate of the loan as well as the borrower's processing fee. Loan grades are determined by factors such as:

- The borrower's FICO score
- Requested loan amount
- Currently open accounts
- Number of credit inquiries in the past six months
- Utilization of credit limit
- Length of credit history

Note: The instrument in which lender members invest, the proceeds of which are used to fund a loan that the lender members designate. Prior to October 14, 2008, the notes were promissory notes representing direct obligations of each borrower. The notes issued after that date are special limited obligations of Lending Club (Member Payment Dependent Notes) as described in detail in the prospectus.

Stated Interest Rate: The agreed upon interested rate defined by WebBank/Lending Club's assigned loan grade.

Methodology

Weighted Average Return on Invested Capital (WAROIC): A measure of performance that is based on a comparison of actual cash flows and invested capital, accounting for current loans, prepayment, defaults and late payments. An individual lender's WAROIC in month N is calculated using the variables and formula below:

- *$Principal_i$:* Principal of all notes outstanding in month i
- *$Interest_i$:* Interest received of all notes outstanding in month i
- *$LateFees_i$:* Late fees received (if any) of all notes outstanding in month i
- *$ServiceCharge_i$:* the monthly service charge on received payments (1%) in month i
- *$Default_i$:* Outstanding principal of any notes that defaulted in month i

Expressed as a formula, for any period from month 1 to month N, where *i* is the recurring monthly period, WAROIC equals:

$$\left(1+\frac{\sum_{i=1}^{N}\left(\left(\frac{Interest_i+LateFee_i-ServiceCharge_i-Default_i}{Principal_i}\right)*Principal_i\right)}{\sum_{i=1}^{N}Principal_i}\right)^{12}-1$$

What is WAROIC? WAROIC is a measure of performance based on funds actually received by lender members, net of our service charge. We make deductions from WAROIC to account for defaulting member loans. We refer to these deductions as "default status" amounts. As explained below, default status amounts are equal to the outstanding principal amount of any Note for which the corresponding member loan is 120 days or more delinquent.

How is WAROIC calculated? We calculate WAROIC for each Note as follows: after a Note is issued and the first Note payment date arrives, we add any interest and any late fees paid to the lender member in respect of the Note, net of our 1.00% service charge. (We do not make any addition to reflect principal repaid to lender members in respect of the Note.) Next, we divide this result by the outstanding principal amount of the Note. This yields a fraction. The final steps in the calculation involve expressing this result as if it had occurred over twelve months. To do this, we add 1, raise the result to the twelfth power, and then, from this result, subtract 1. This result is the WAROIC, which is expressed as a percentage.

The WAROIC calculation is repeated on a monthly basis for each Note for which it is being calculated. As the calculation is repeated, the interest and late fee amounts, net of our 1.00% service charge, are recalculated, to reflect any additional interest and late fees received and service charges assessed in respect of the Note. Also, although we do not make any additions to this amount to reflect repaid principal, we subtract the entire principal amount of the Note from the interest and late fee amount if the corresponding member loan has become 120 days delinquent (a status we refer to as "default status"). Because member loan default status requires 120 days of delinquency, this status cannot occur until the Note has been issued and outstanding for at least 120 days. If default status occurs, this subtraction takes place in the monthly calculation for the month in which the default status

Methodology

occurs. As the calculation is repeated, the outstanding principal amount of the Note, by which we divide the net interest, late fee and service charge amount, is also recalculated to reflect additional months in which a principal amount has been outstanding, as well as any regular principal repayments and any prepayments that have reduced the amount of principal outstanding. Because default status involves a *subtraction*, the WAROIC can range from a negative number to a positive number. WAROIC cannot, however, be higher than the stated interest rate for any given Note.

All of the data used in the calculation of WAROIC for the lender member's account is available to the lender member on his or her account page.

What are some examples of the WAROIC calculation? The calculation of WAROIC for a group of Notes can be illustrated as follows. Assume, for example, that a lender member purchases 50 Notes, each with an original principal amount of $200 and each bearing interest at 8.00%. Assume that all of the member loans corresponding to the 50 Notes fully perform for 12 months. The WAROIC at the end of 12 months would be 7.83%.
Now assume, for example, that a lender member purchases 50 Notes, each for a principal amount of $200 and each bearing interest at 8.00%. In this example, assume that 45 of the member loans corresponding to the 50 Notes fully perform for 12 months. Assume that five member loans fully perform for the first two months they are outstanding, but in the third month, cease performing and enter default status in the seventh month. Because these five member loans have entered default status, we subtract the principal amounts of the five corresponding Notes in the monthly calculation for the seventh month. The result is a negative number, and the WAROIC at end of 12 months would be -4.19%.

What are the limitations of WAROIC? WAROIC is just one way a lender member could calculate the return on funds they have invested through the Lending Club platform. We think it is the most useful and accurate way to measure investment performance because it takes account of both our service charge and delinquent corresponding member loans. However, there are other methods for evaluating the historical or potential investment return on fixed-income securities that a lender member could choose to use instead, and you should take such other methods into consideration.