SHINNECOCK PARTNERS

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Moody's Analyzes Marketplace Lending
by Alan Snyder

Moody's, the respected, century-old credit rating company, made even more famous in the movie adaptation of Michael Lewis' book, *The Big Short*, recently released a research report on the high growth alternative lending space. (Please contact us if you are interested in receiving a copy of this report.) Unsurprisingly, their focus dwells on the securitizations that have taken place, $8.4 billion and counting. Spreads have widened a bit as volume has ramped up. The deals done so far have been focused on consumer and student loans. There is more growth ahead as over 100 companies enter the marketplace platform space. Globally, China remains the largest market while the U.K. matures and Europe grows at an accelerating pace.

Like any high growth category, legal and regulatory scrutiny is sure to increase. For example, in the Madden v. Midland Funding LLC case, the U.S. Court of Appeals for the Second Circuit questioned the relationship between the issuing bank and the lending platform, i.e., who really is the issuer, and the efficacy of getting around state usury laws by using a third party bank to originate loans in name only. This case has been appealed to the Supreme Court, which has subsequently asked for a recommendation from the solicitor general as to whether or not to hear the case. If the solicitor general recommends a hearing it would take place during the fall 2016 session. For the moment, the ruling by the Second Circuit stands, but only impacts loans in New York, Connecticut and Vermont and their allowable rates.

Lenders are adjusting by not lending in those jurisdictions or by lowering the rates charged, developing new approaches including retentions by the issuing banks to mitigate the impact of the ruling, and in some cases, waiting to see if other jurisdictions take up the issue.

As we read, listen to others, and continue to explore the total alternative lending space (not just platforms), we remain convinced that the multi-strategy diversified approach, such as that employed by Shinnecock, remains the safest course. There will be unforeseen bumps in the road, but if investors build a portfolio with domain expert diversity and a broadly defined segmentation reaching beyond marketplace/platform lending, we believe they will be protected, and best yet, enjoy attractive yields.

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The Supreme Court declined to hear Madden vs. Midland, letting the lower court ruling stand, effectively leaving in place state usury caps in New York, Vermont and Connecticut for non-national banks. However, by not hearing the case and possibly siding with Madden, it avoided "nationalizing" the ruling. President Obama's administration chose a middle ground, urging the court to not hear the case while saying the lower court's ruling was in error.

The battle is expected to continue.