Why I Decided to Liquidate My Lending Club Account

Over the last few years I have been a cautiously optimistic, relatively early adopter of investing in unsecured peer to peer loans. I first start dabbling by opening small taxable Lending Club and Prosper accounts in late 2011 and early 2012 respectively. After promising initial results on those tiny amounts, in the Fall of 2012 I began making substantial investments in Lending Club notes via a Roth IRA as this investment not only has high expected returns, but also is maximally tax-inefficient. Eventually, I would dedicate 5% of my portfolio to the asset class, almost all of which was in that Lending Club Roth IRA account. I felt like I did my research and was quite aware of the various risks associated with the investment and felt the probable rewards were worth the risk.

My returns in the asset class were quite good over the years. My XIRR spreadsheet shows the following returns:

- 2012: 12.7%
- 2013: 13.2%
- 2014: 11.3%
- 2015: 10.0%
- 2016: 7.1%

for an annualized return of 9.9%, which was certainly higher than the average investor on the platform was seeing. The low correlation with the rest of my portfolio was also a major benefit. The hassle factor was not insignificant, but I eventually found ways to automate it. As a financial blogger, I was given free access first to the services of Interest Radar and then to the services of NSR Invest. They both worked a little bit differently, but each was useful for my primary purpose of not having to manage each individual $25-50 note manually.
Over the years, the platforms began to be more and more dominated by larger firms and the only way to buy the “good notes” was to either pay one of those firms or otherwise have a computer buy them automatically for you. But my returns were still within the 8-12% range I felt I needed to be getting in return for the risk I was taking. So what happened to cause me to want to leave Lending Club? There were a number of factors.

**# 1 Desire For A Simpler Portfolio**

Long-term readers are familiar with the portfolio we’ve been using for years. It’s not perfect by any means but sticking with it has served us well. The only real change made in the last decade was substituting these P2PLs for a few of the bonds in the portfolio. However, as discussed in an upcoming post, I’m finally biting the bullet to simplify the portfolio significantly. As I’ve said many times, I think three asset classes is the minimum in a diversified portfolio and I think there are real benefits in increasing that to about seven asset classes. There may be some minimal benefits in going from seven to ten, but beyond ten (like my portfolio) you’re really just playing with your money.

**# 2 Less Hassle If I Die**

One great benefit of a simplified portfolio is that it is easier for your heirs and/or their financial advisors to sort things out when you die. If I were to die today, all of the asset classes I invest in would be relatively easy to liquidate and deal with except for my investments at Lending Club and Prosper. I simply don’t want my wife to have to deal with this hassle. Now, I thought about this up front. In fact, that was a major reason why I opened that Roth IRA at Lending Club instead of Prosper (because Lending Club let you sell late notes and Prosper didn’t.) Back then you could relatively easily sell your notes, perhaps over a week or two, and move on with your life. What I have discovered since I started to liquidate my notes is that it isn’t nearly as easy to do so as I had hoped, and it appears it has become significantly harder than it was a few years ago.
Untracked powder is always worth the price of entry

NSR Invest has a relatively new and slick feature that allows you to sell your notes at a range of prices automatically. It was implemented shortly before I decided to liquidate and I’ve been very grateful for it. What has been disappointing, however, is just how slowly those notes sell, through no fault of NSR Invest. Now most of my notes are good notes. They’ve given me great returns and are current. But even so, the market for them seems pretty thin. As of the time of writing this blog post, I’ve had all my notes on the market continuously for over two months at various prices. I was able to sell a few at a premium, but not nearly as many as I expected. I was able to sell more at par and even more at slightly below par. But after three months, I’ve only managed to sell about 70% of them (about $32,000 worth.) I’m getting close to having my initial investment back (about $34,000) and I’ve still got $14,000 worth of notes. So the final returns on this investment aren’t even close to in. Interestingly, the taxable account notes sold a lot faster than the Roth IRA notes. I think part of the issue is that the sub- $25 notes sell a lot better than the $25-50 notes that constitute most of my investments since I went to NSR Invest. Another minor issue with the NSR Invest selling feature is that they don’t let you sell notes for more than a 60% discount and nobody will buy notes that are 3 months late without a larger discount. In fact, it’s pretty tough to sell late notes at all. I probably won’t be discounting notes any more than I’ve already done and will just let payments trickle in for years at this point. My rollover back to Vanguard for 70% of the investment should take place any day now (I hope, they’re really slow right now.)

In addition, Prosper decided last November that it wasn’t going to let you sell your notes at all. It used to be they just didn’t let you sell the late ones, but by the time I decided to liquidate, it was no longer an option. It looks like I’ll be a Prosper investor for the next 5 years too whether I want to be or not. No big deal, it’s only $500, but it’s still a bit of a hassle to have no secondary market for those.
A more annoying feature of this liquidation is trying to decide how much cash drag is worth paying extra transfer fees for. While there are no fees to get into Lending Club and its chosen IRA Provider Self Directed IRA Incorporated, there is a $100 fee for a partial transfer out and a $250 fee to close the account. Now these were all disclosed and I was aware of them, but I had hoped to just have to pay the one time $250 fee when I eventually left. Now that it looks like full liquidation will take years, it’s probably worth paying one or two of those partial transfer fees to minimize the cash drag.

There are several investments in this asset class available to accredited investors that allow you to not only spread your investments across multiple platforms but also to really minimize the hassle in this asset class. However, the minimums on them are $250K+, which was four times what I was willing to dedicate to the asset class at this point in my life.

# 3 Dropping Returns

While my returns have been quite good over the years, the overall trend is not encouraging, particularly in the last year. Now, whether that should be blamed on my switch to NSR Invest, on the shenanigans at Lending Club, on the maturing of the asset class with the entry of institutional players or what, the fact remains that returns are dropping out of the range that I expected for the risk I was taking (8-12%). My current returns for this year so far are -1.3%, but that’s mostly due to the fact that I’ve sold some notes at a discount.

# 4 Cockroach Theory

As I’ve discussed many times over the years, the main risk with P2P Lending is platform risk. I always knew that a certain percentage of borrowers were going to default. That was all baked into my projections. I expected a high default rate, but when you’re getting 18-30% interest on the notes, you can afford to have a lot of them default and still get a great return. Platform risk, i.e. the risk that Lending Club goes out of business, was the more worrisome risk to me due to the way this is all structured. In 2016, there were a few “cockroaches” that became visible at Lending Club. It turned out the CEO, Renaud Laplanche, and his family had been borrowing from the company to make it look like its volume was higher in order to attract outside investor money. That wasn’t a huge deal financially, except for the loss of trust. Then there was a finding that proper accounting standards weren’t being followed with one account. Lending Club made it right and fired Laplanche, but it seemed two cockroaches had snuck out from under the counters and it made me wonder how many more were under there, especially considering that Lending Club was the flagship of the peer to peer lending fleet. Other investors and perhaps even the borrowers have surely been wondering the same thing and perhaps that’s why my returns dropped for 2016 and perhaps that’s why I’m having a harder time liquidating than I anticipated.

At any rate, I found myself wanting to watch and see what happened rather
than contribute more money to the account. For month after month I delayed my periodic Roth IRA rollover to the account. It was slowly becoming a smaller and smaller portion of my portfolio, well less than the 5% my investing policy statement committed me to put in there. Then one morning in the Fall I found myself waking up early and thinking about my Lending Club investment. Two or three days of that and it was decided. I don’t need investments I lose sleep over. If I was unwilling to commit additional capital, I probably shouldn’t leave the old capital there either. After discussion with my wife and our obligatory three month wait dictated by our Investing Policy Statement, we decided to start liquidating.

# 5 More Attractive Investments

Another factor that played into our decision was the appearance of more attractive investments for our money. As regular readers know, the last couple of years I’ve been dabbling more and more into real estate. While we aren’t particularly interested in direct ownership and especially management of income properties, some of the syndicated and private fund options meet our requirements for high returns, low correlation with our stocks, bonds, and even publicly traded REITs, and acceptable amount of transparency and liquidity. In fact, most of the crowdfunded platforms routinely offer 9-10% 1 year hard money loans backed by the property itself. We figured if we can get 9% on a loan backed by an asset, why would we invest in an unsecured loan that was only giving us a 9% return, especially with all of that hassle? As we simplify our portfolio and dedicate a slightly larger portion to real estate, that portion had to come from somewhere and the P2PL allocation seemed an obvious place for some of it.

# 6 Little Synergy With The Blog

One of the things I had hoped would occur as I wrote periodically about my Peer to Peer Lending experience was that it would provide a little boost to the blog income. I have an affiliate marketing deal with both Prosper and Lending Club such that if a reader opens an account after going through my links I get a small commission. I’ve learned two things about affiliate marketing deals over the years, however, both of which severely limited the amount of income I earned from Lending Club and Prosper.

1. The purchase has to be essentially a no-brainer. In any affiliate situation, I’m going to write about all the negative things I know about because I want to be fully transparent with my readers. But if you write about a bunch of negatives, nobody signs up for the deal. So, no surprise, I never had very many takers with this deal.
2. I have to be able to offer something special to the reader that they can’t get by going directly to the company’s site, like the bonus money for refinancing your student loans. I had nothing to offer that was unique with the P2PL sites.

At any rate, the bottom line was that Lending Club and Prosper affiliate commissions never really amounted to much and I’ve become much pickier about
future affiliate partnerships.

In conclusion, investing in Peer to Peer Loans did work out well for me. My overall returns were not only positive but impressive. It was far more hassle than I ever expected, both getting in and getting out. And when the real risk actually showed up, it bothered me a lot more than even the 2008 stock market downturn.

What do you think? Did you ever invest in P2PLs? Why or why not? How did you do? Have you made any changes due to the events at Lending Club in 2016? Why or why not? Comment below!