AUTONOMOUS NEXT

European Digital Lenders

How operating efficiency is helping digital lenders attack at $150 billion annual origination market across the Eurozone in 2018

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Table of Contents

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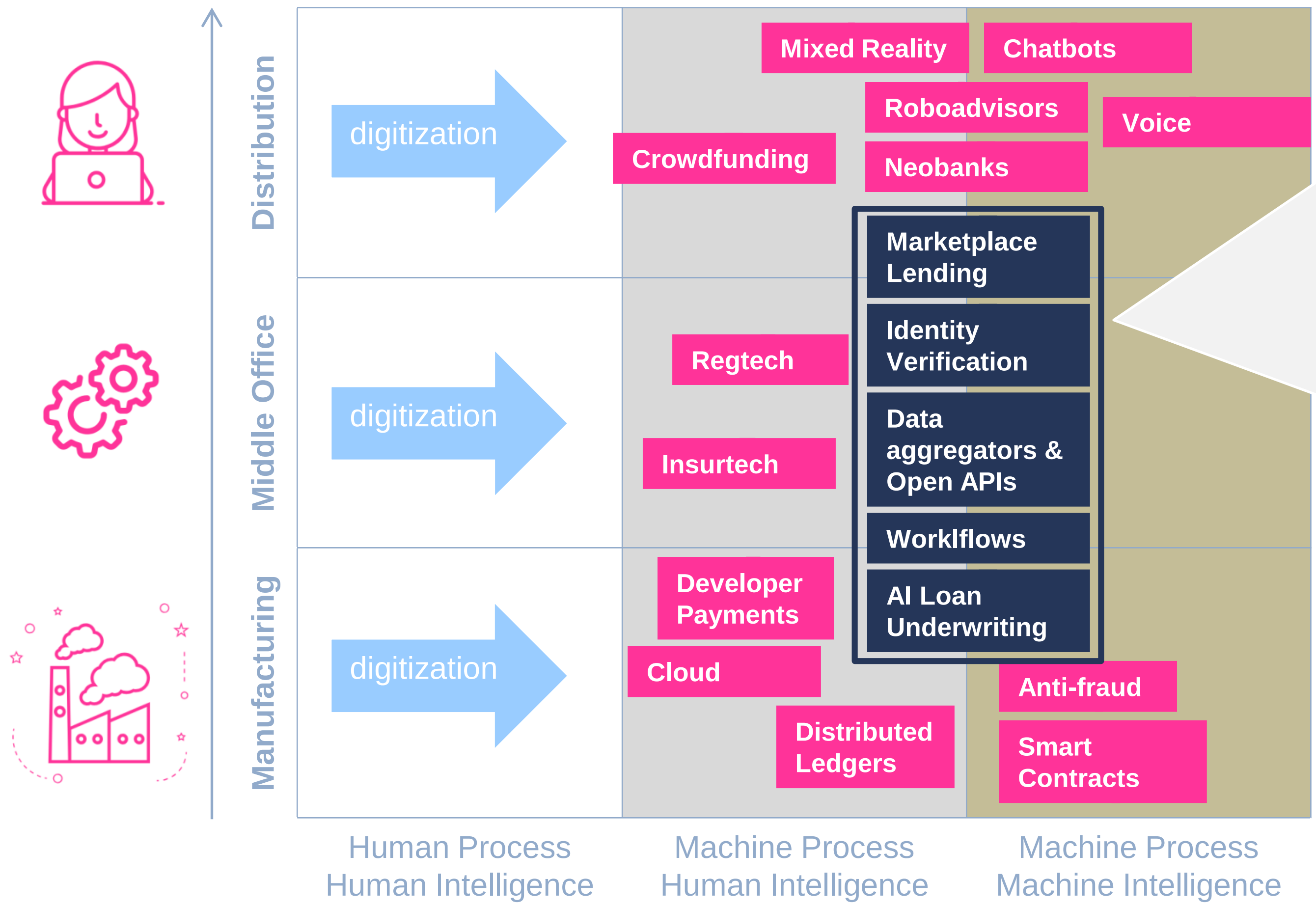
Emergence and Financing of the Digital Lending Model

Overview

- **Digitization is a secular theme across the economy, working its way through financial services**
  - We see the transformation of human processes into machine processes through automation, and the shift from human to machine intelligence through machine learning, across the front, middle and back offices of lenders
  - The digital lending theme started in 2005 with P2P startups facilitating financing between a crowd of human lenders and underserved borrowers; but institutional investors, such as hedge funds and endowments, have entered the space to supply less fickle pools of capital to digital lenders, who became “marketplaces” to intermediate the financing
- **Developments in European digital lending have progressed, but they lag the American and Asian markets; within Europe, the UK leads in both venture and originations**
  - We analyze non-mortgage consumer loans (e.g., credit cards, auto loans, student debt) and SME loans; notably the product set preferred across the word differs meaningfully (e.g., Europe sees invoice financing but not student debt)
  - The addressable market is $150B in annual originations and $450B in outstanding loans; currently there are $8 billion in originations across the geography; venture funding approximately $500 million per year
- **While the digital lender model promises low costs, the cost of capital has been a challenge**
  - The high cost of capital experienced by digital lenders hurts pricing from being competitive with banks, with surprise expenses, like legal fees or new product development eating into their margins
  - Financial incumbents like BBVA, Nordea and Goldman have been going through their own digital transformation, challenging digital lenders from the perspective of a more stable capital base
- **Efficiencies have been achieved in operations; in particular, digital identity & KYC/AML solutions offer significant improvements to the onboarding and screening processes**
  - We provide several case studies showing that investment into digital lending workflows and technologies is an economic benefit from a customer experience and marginal cost perspective
  - Digital KYC/AML solution providers are leveraging AI to reduce customer screening and false-positive alerts by 40-70%

Source: Autonomous NEXT

Digital lenders digitize both the distribution element of lending, as well as the underwriting process underneath



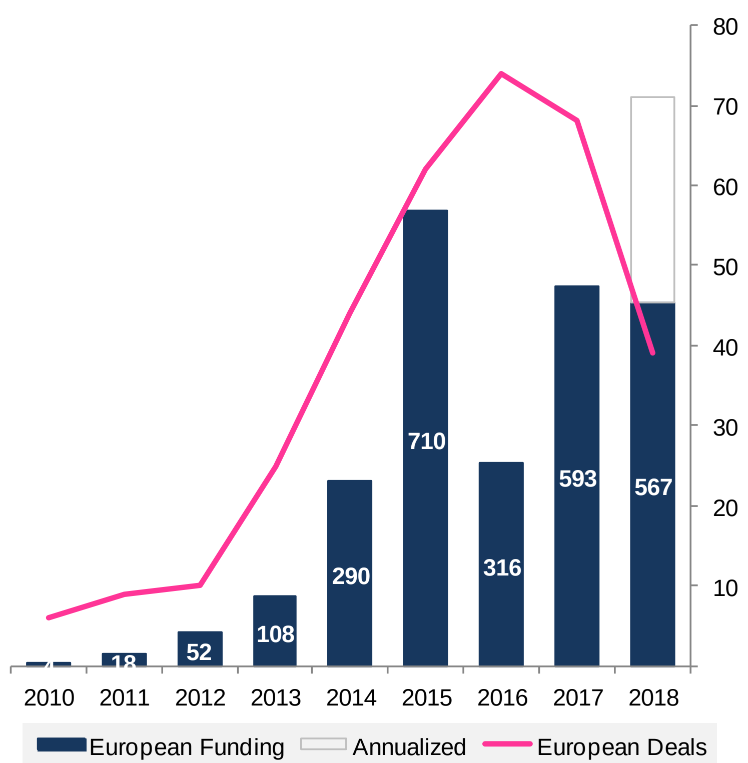
Digital Lending Stack

- Marketplace lenders are innovating the customer acquisition experience through democratization and new channels
- Customer onboarding and processing is becoming more efficient with identity verification technology
- Underwriting loans is a big data problem where information on the borrower is critical, and APIs and data aggregation help
- Machine learning companies are focusing on borrower creditworthiness whilst transforming the middle and back office

Source: Autonomous NEXT

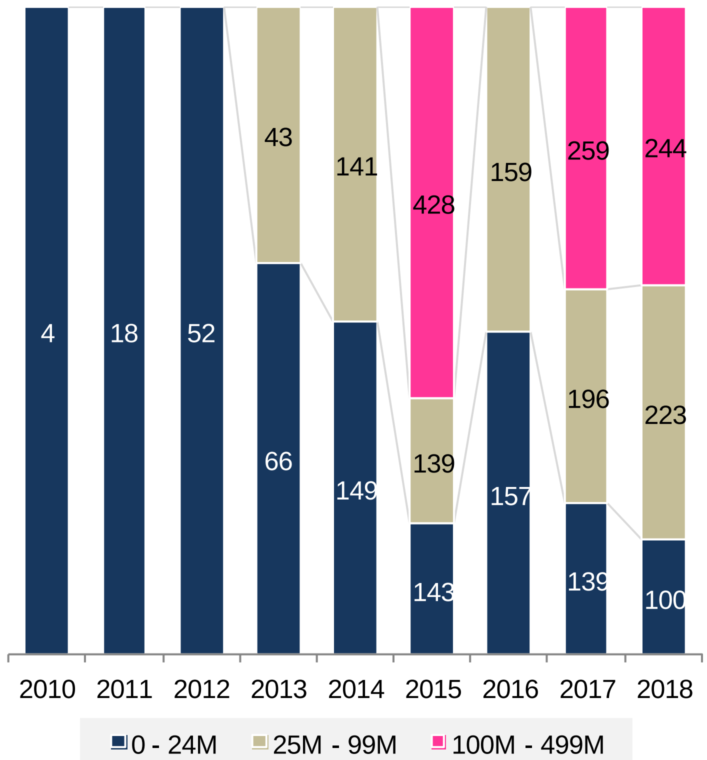
In Europe, the market is still seeing productive funding, though investment stage maturity lags behind

European Digital Lenders VC ($MM)



- Annual investment into the space is between $500 and $800 million, with 2018 looking like a strong year

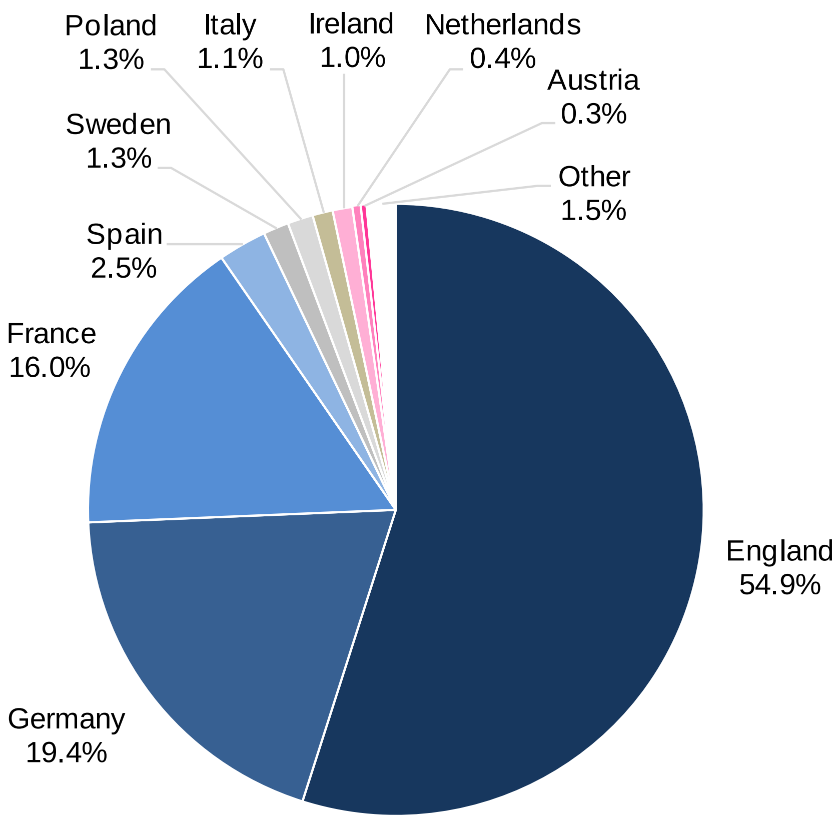
Capital by Check Size ($MM)



- However, the maturity of the check sizes is only starting to catch up with the US and China (e.g., 2013 was first US $100mm check)

England, Germany and France lead in cumulative digital lender venture investment ...

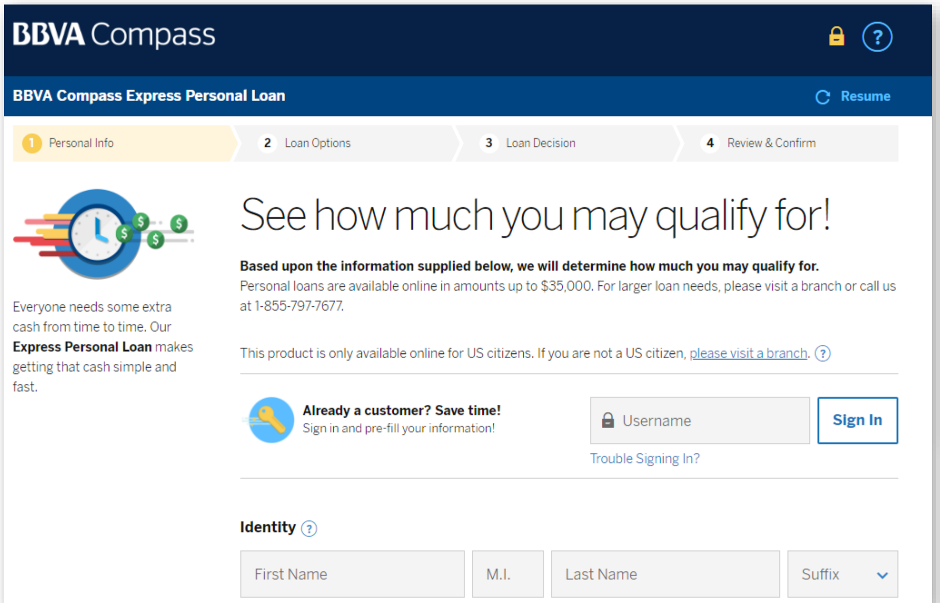
2010-2018 Venture Funding by Country

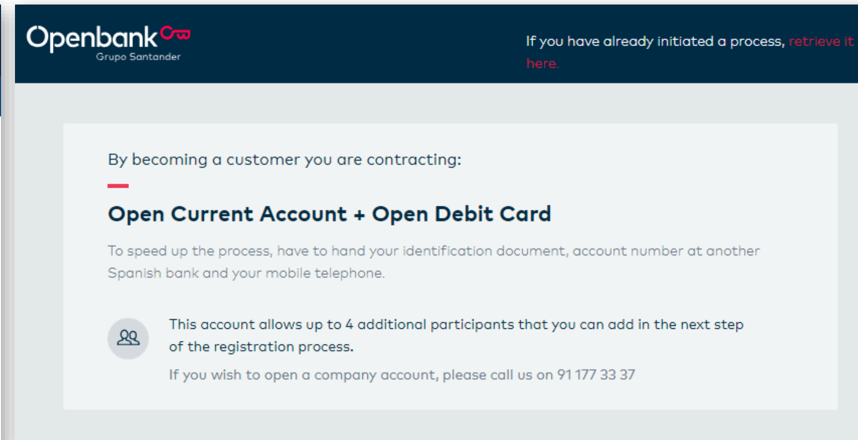


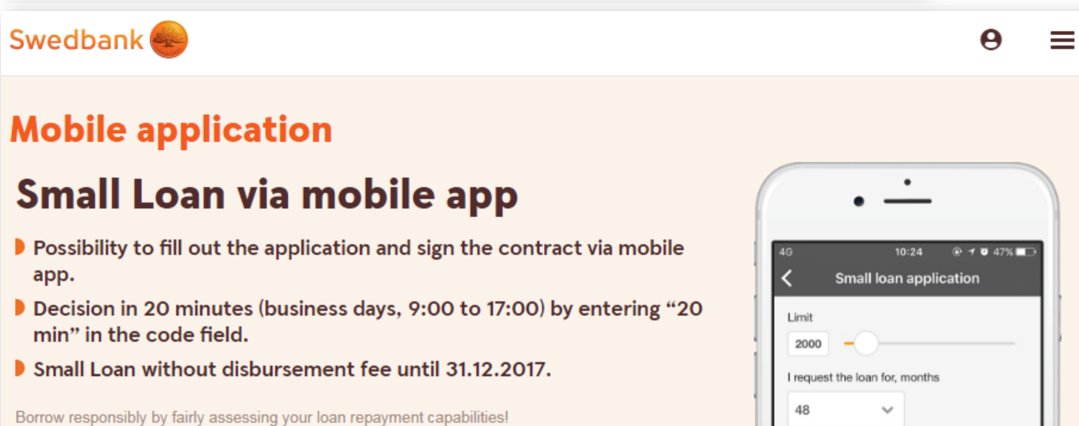
- The United Kingdom has seen the most cumulative investment into digital lenders since 2010, with 55% of the total
- Germany is the second largest, with meaningful activity in 2011, 2015 and 2016; France follows with large investments in 2010, 2011 and 2018
- Given the relatively smaller size of the other countries, and less developed venture capital ecosystems, we are not surprised to see fewer local companies getting started
- Spain, the Netherlands, and Sweden are also strong in digital banking offerings, despite the lower venture investment figures
- As shown on the following slide, incumbents like Nordea, Swedbank, Santander and BBVA have created mobile-first and online lenders which closed the opportunity to startups

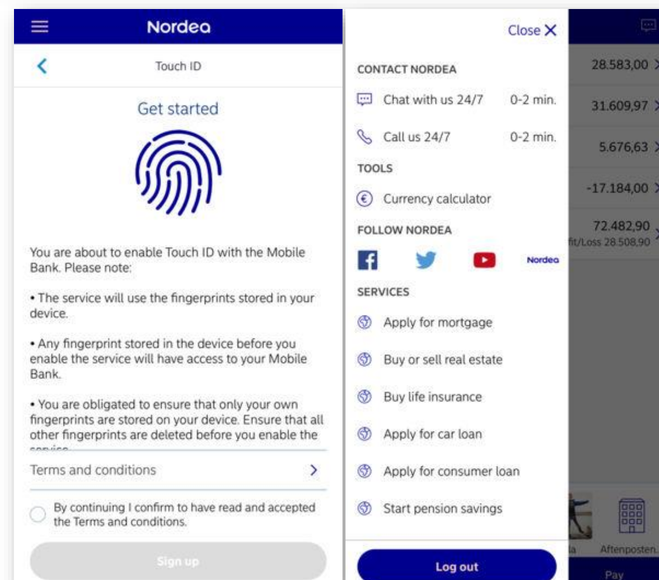
Source: Autonomous NEXT analysis using Pitchbook Data, as of August 20, 2018

Spain and the Nordics lead via digital-first incumbents







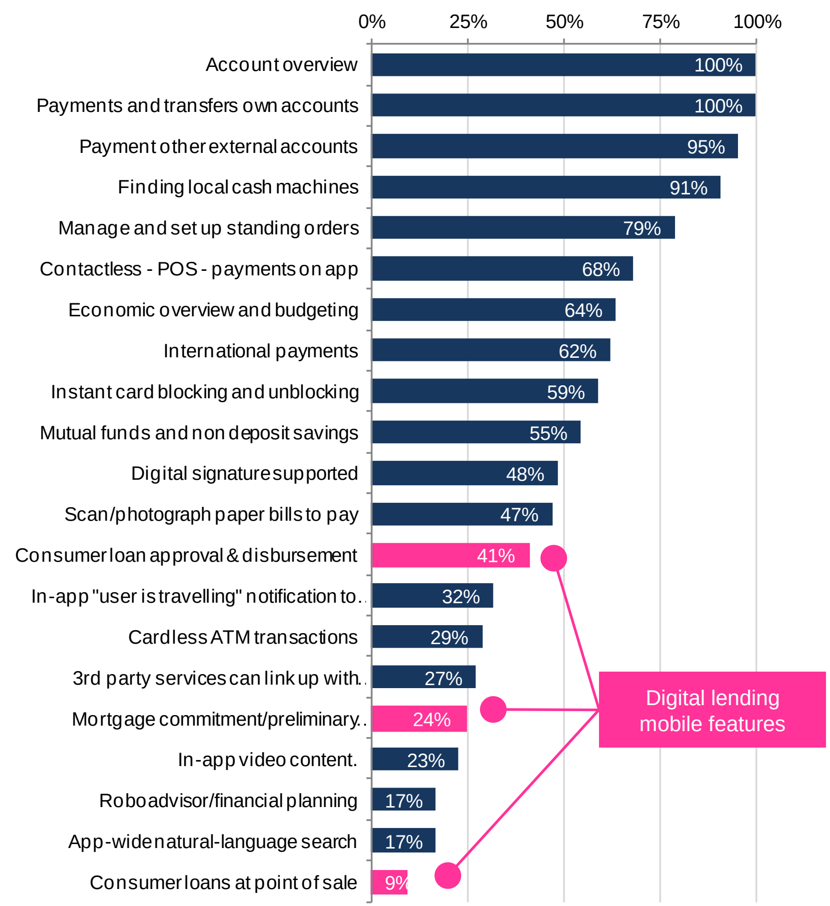


Source: *Company websites*

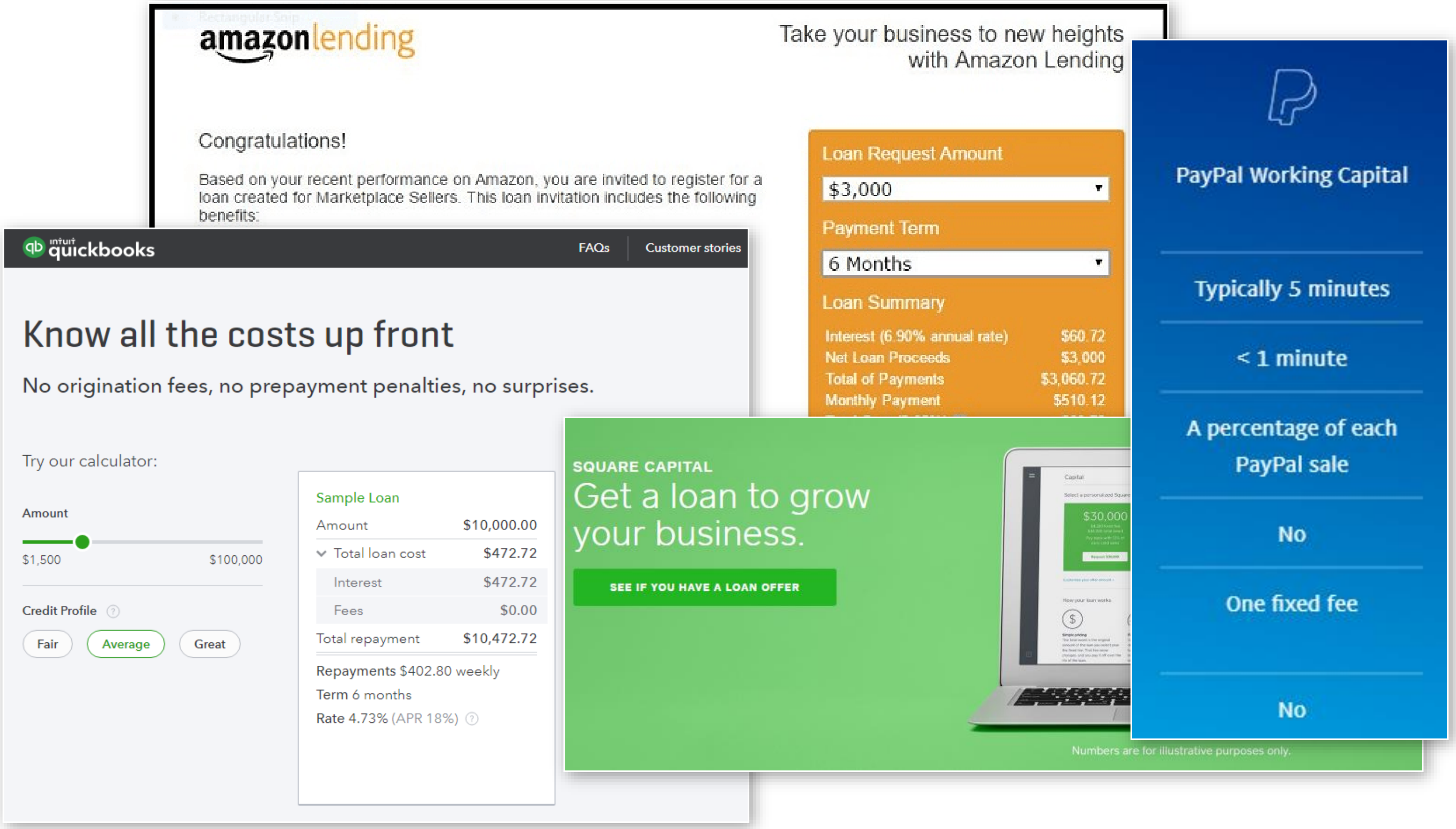
Traditional global banks are adopting the digital lender model and enabling it within their digital apps

- Goldman has built Marcus as part of its private equity arm as a $1 billion revenue opportunity
- Instead of using P2P/marketplace sources, the bank is lending out its own balance sheet
- Since founding, over $1 billion in origination for prime consumers with FICO scores of 660+
- Planning to expand into UK as an employee service

Mobile App Features of Top 50 Banks (% Respondents Have Feature)



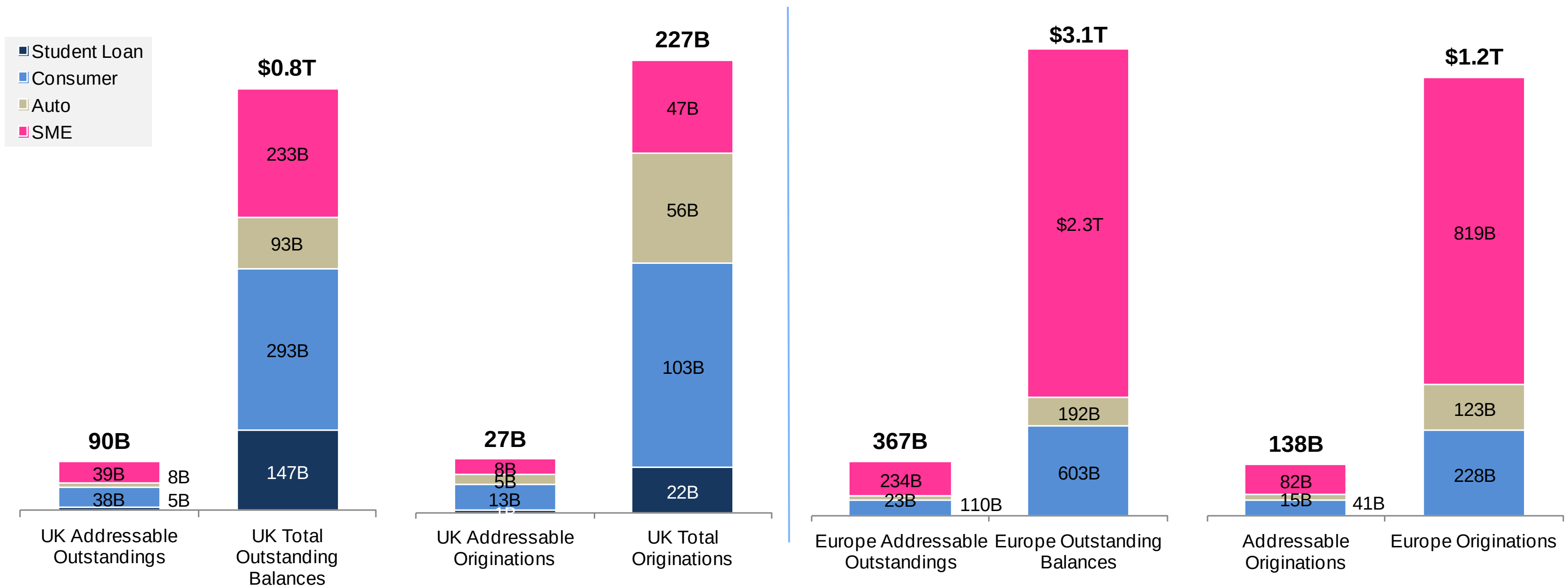
Big tech firms (Amazon, Square, PayPayl and Intuit) also see credit-as-a-feature to be a platform enhancer



Macro Overview of the Digital Lending Landscape

Europe: Addressable market for Digital Lenders is $150 billion in originations, or $450 billion in outstanding debt

Addressable and Total Market Size ($T)

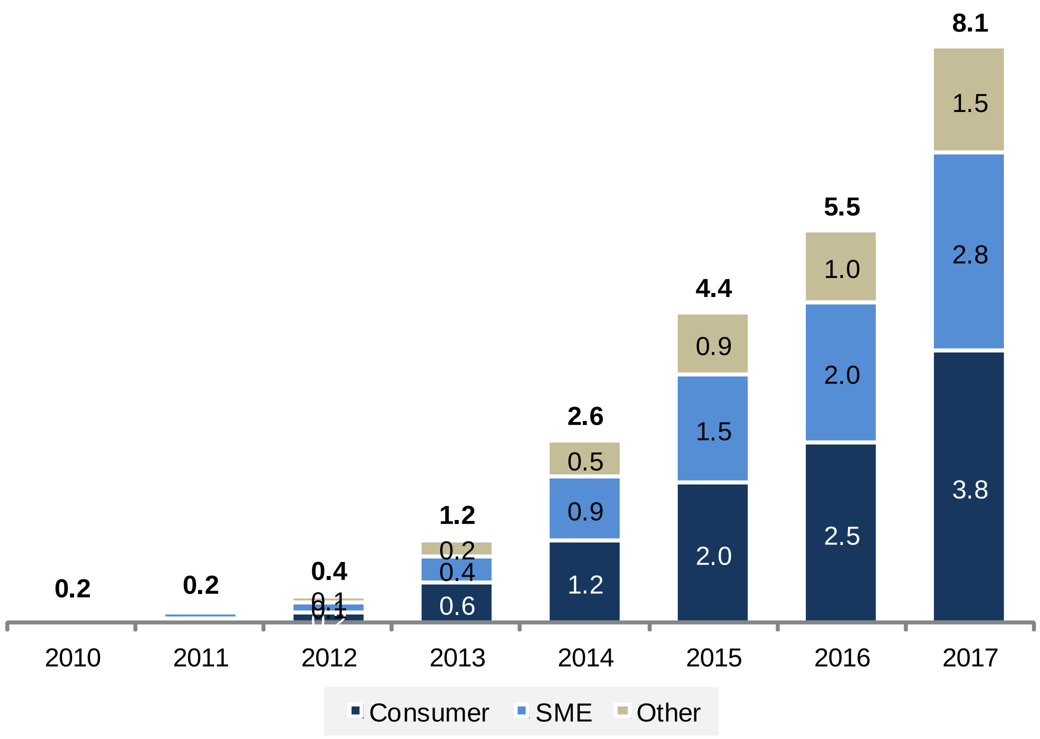


- The UK lending market has $750 billion in balances and $225 billion in originations, while continental Europe sees $3 trillion in outstanding balances (driven largely by SMEs, which generally borrow from banks and not investors) and $1.2 trillion in originations; student debt is not a meaningful category in Europe
- To arrive at the total addressable market, we haircut these figures based on our learnings from the United States and the potential for each market segment to absorb new types of products
- The addressable market for all of Europe is $450 billion of outstanding and $150 billion of originations

Source: Autonomous NEXT, ECB, World Bank, Bank of England

Europe: Digital Lenders have grown to $8 billion in originations per year, not including incumbents like BBVA

Digital Lender Originations ($B)



Approximate revenue pool

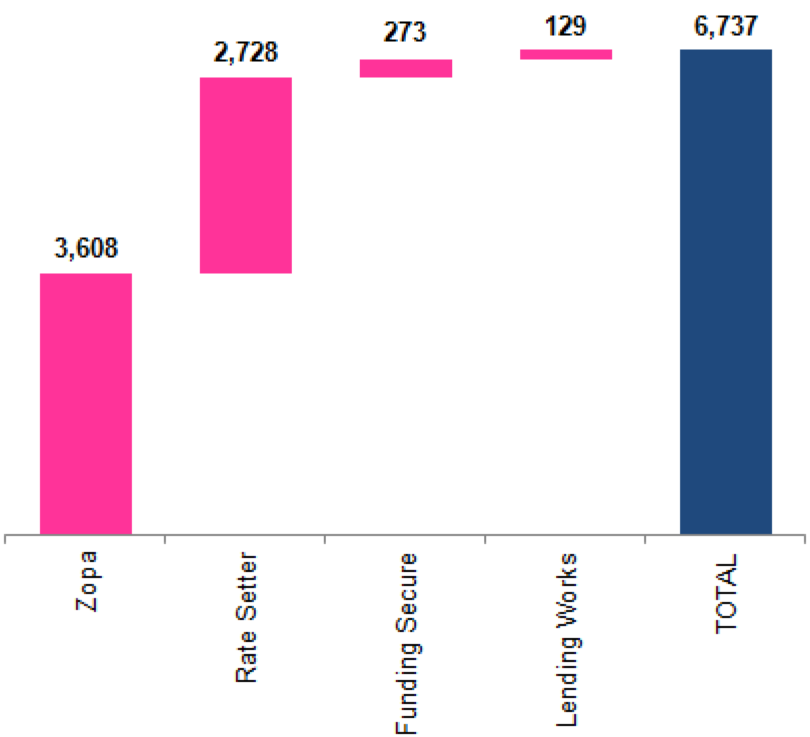
9MM	12MM	22MM	59MM	128MM	218MM	275MM	404MM

- Digital lender originations in the UK and Europe have grown from less than $400 million in 2012 to $8 billion in 2017
- This represents a 10% penetration of the short-term addressable market for the industry segment
- Notably, trade invoice financing and crowdfunded commercial real estate debt are a meaningful category (14% cumulative) in this geography, while not so yet in the United States
- Further, private digital lending student loan financing has not yet penetrated the European markets for structural reasons
- We estimate these originations translate into an industry revenue pool of $400 million, which is feasible given $40+ million revenues for Zopa, Funding Circle

Source: Autonomous NEXT, AltFiData.com

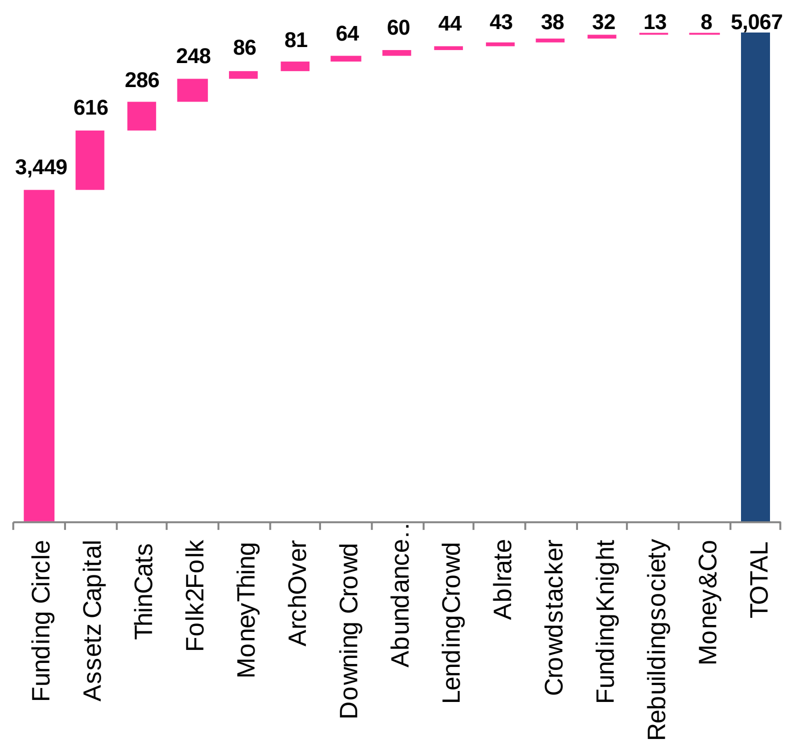
In the UK, the lion's share (51%) of cumulative originations are by Zopa & Funding Circle

Consumer Lending Product, Cumulative Volume by Lender (£MM)



- Looking at digital consumer loans, 94% of cumulative originations are dominated by Rate Setter & Zopa
- Digital consumer lending is highly concentrated with a 49% share of the UK marketplace lending market

Business Lending Product, Cumulative Volume by Lender (£MM)

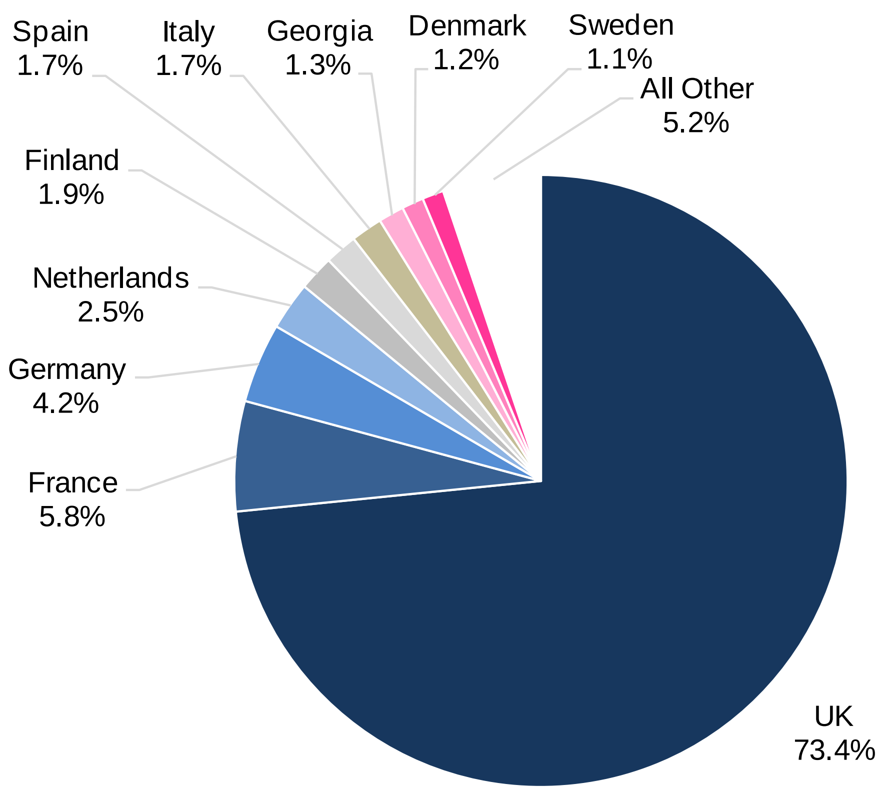


- Digital business lenders account for 37% of the UK marketplace lending market
- Funding Circle's first-to-UK market approach has earned them 68% cumulative originations

Source: AltFiData.com , p2pfa.org.uk

The majority of marketplace lending is still happening in the UK, which highlights the continental opportunity...

2016 Alternative Finance Volumes by European Country

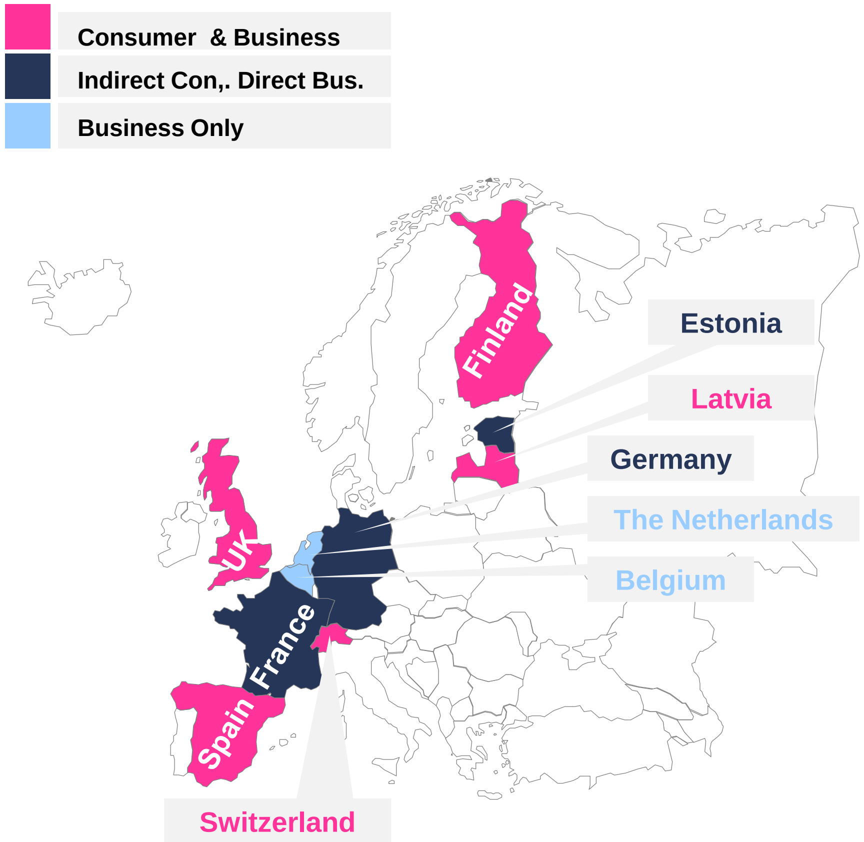


- The United Kingdom has origination volumes of $2.8 billion in consumer loans, $2.4 billion in SME related loans, and $1.5 billion in other marketplace lending, for a total of $6.6 billion
- The rest of Europe is seeing volumes of $1 billion in consumer loans, $400 million of SME related loans, and a small amount of others, with a total of $1.4 billion overall in originations
- The next three largest countries are seeing alternative financing originations (including some crowdfunding platforms) of $460 million in France, $340 million in Germany, and $200 million in the Netherlands

Source: Autonomous NEXT, Cambridge University

... yet this is partly complicated by a fragmented regulatory landscape

European P2P Lending Regulatory Landscape



- Europe's use of applicable rules used to assess whether forms of P2P lending -- either lending to consumers (2C), or to businesses (2B or both) – should be authorised or not is fragmented
- P2P lending platforms based in Belgium and The Netherlands are restricted to only offer investments in 2C loans, unless they are registered as regulated financial institutions
- In the UK, Spain, Estonia, and Finland, however, both 2C and 2B direct and Indirect lending are permitted by law, explaining their dominance in the European P2P lending market with a combined European market share of 80%
- Regulatory approaches are far from established, with many marketplace lending platforms being treated as banks by many regulators in several European jurisdictions (France, Germany, and Estonia)

Source: OrcaMoney, Adrien van den Branden on Medium
** Note – Indirect loans represent those where the platform does not contract with the parties*

But there is a growing and vibrant European digital lender ecosystem, including both startups and incumbents

Source: Autonomous NEXT

P2P Marketplace platforms are helping those that cannot get access to capital in the traditional fashion

Startup

SME Loans | **Full Suite (Student, Auto, Home, SME, Consumer)** | **Consumer Lending**

- Indirect P2P marketplaces act as brokers in matching investors/lenders and borrowers, apart from this the platform performs identity, credit, and anti-money laundering checks on borrowers and coordinates advances and repayments on behalf of the two parties, charging fees for such services.
- Platforms such as Auxmoney and Bondora offering returns between 3% and 40% (theoretically), which is in line with the 5.65% average interest paid by Mintos to each investor on their platform

- Direct P2P marketplaces place alot more discretion on both parties to match with each other using loan metrics (ratings, loan amount, loan length) to discern the fit
- UK-based SME P2P marketplace lenders: Rate setter, Zopa, and Funding Circle offer lender returns between 3.7% and 7.8% whilst consumer P2P lender Fixura offers returns between 8% and 26% depending on the loan’s rating and length, the difference in return range can be attributed to the low default risk of SME loans vs. Consumer loans

Source: Autonomous NEXT, Revenue.land

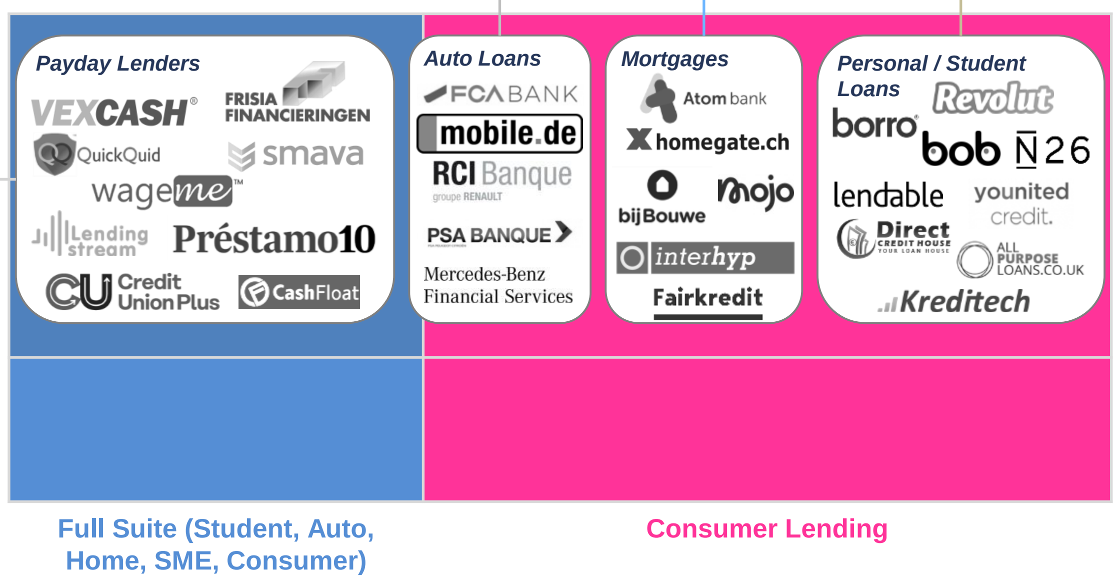
Neobanks and mobile-first apps also expanded quickly into the space, often leveraging investor balance sheets

- Front facing interfaces harnessing the capabilities of machine learning, open APIs, and data analysis to provide almost instant lines of credit to underbanked borrowers

- Dealers and lenders are collaborating together & with 3rd party providers to enhance the customer experience by providing integrated platforms for research/education, pre-approvals, digital document management, loan servicing, & ancillary features

- Overhead minimal digital-only platforms providing value in the form of either digital mortgage brokers via an AI capability (Mojo) or access to a network of brokers (Atom Bank) to source the best mortgage at the lowest cost

- Borrowers are becoming more empowered with data and insights into their financial health offered via these digital platforms.
- Alternative data availability gives those with bad credit scores the ability to get their loans approved at personalised rates & terms



Several incumbent institutions focus on tech-enabled products and platforms for corporate and SME segments

- Post credit crunch & financial recession, banks are still unwilling to extend large lines of credit to SMEs, leaving financing gaps in an increasingly significant portion of the market
- Platforms like ezbob and Boost Capital use credit ratings and/or demonstrable future income and/or asset ownership, as well as data analytics & machine learning on unstructured data to form the basis to approve the short-term loan and do so in a short period of time

- While new agile lending startups seek to disrupt the traditional bank's market for loans ,the most apparent disadvantage these firms face is that they don't hold the reputational nor capital measures necessary to impact the books of traditional banks
- Although traditional banks offer some form of digital capability around lending, the majority still remain behind on technological capabilities to onboarding, processing, underwriting and funding leaving them to partner with or acquire startups focussed in these spaces

Digital

Small Business Finance Platforms

Boost Capital, fleximize, YouLend, Spotcap, Postbank (Solutions for your tomorrow), iwoca, ezbob, Avanseo, RAIZE

Incumbent

Traditional Banks

Credit Suisse, Deutsche Bank, BBVA, HSBC, Barclays, Swedbank, comdirect, Santander, Danske Bank, Nordea

SME Loans

Full Suite (Student, Auto, Home, SME, Consumer)

Consumer Lending

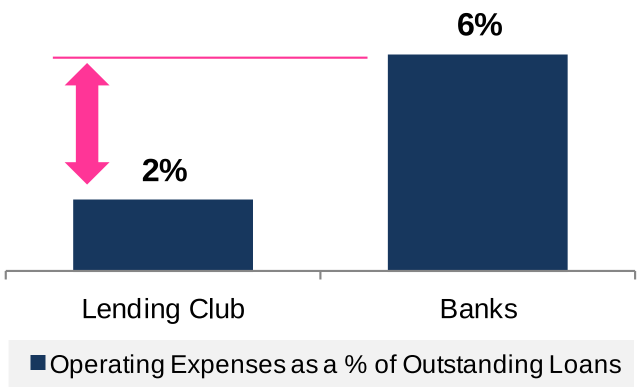
Understanding Customer Economics and the Funnel

Digital Lenders promised a more efficient operating model, but struggle with expensive cost of capital

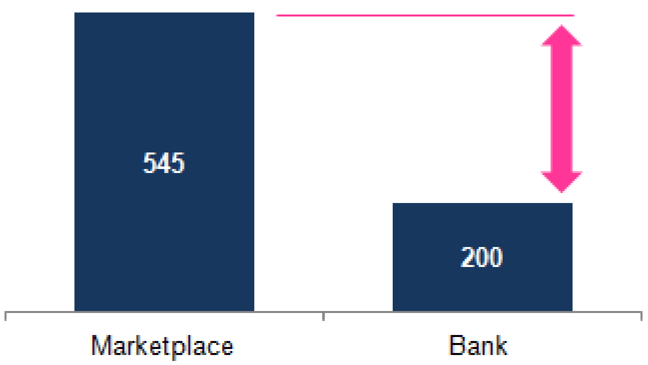
Overview

- Marketplace lending promised a "different" approach to underwriting with a lower expense base compared to banks, which have bloated expense bases and face never-ending regulatory scrutiny
- By disaggregating deposit gathering (regulated, cumbersome) from lending (profitable, underserved), marketplaces were looking to create a business model advantage
- In concept, they could offer the same products as banks at more competitive prices, while still earning a profit and satisfying a consumer need for investment returns greater than available in deposit accounts
- However, fintechs struggle to be the low cost provider due to a much higher cost of capital (e.g., 550 bps vs. 200 bps), as well as spending more than expected on (1) new product development and (2) increased legal expense

Expected Economics (2015)

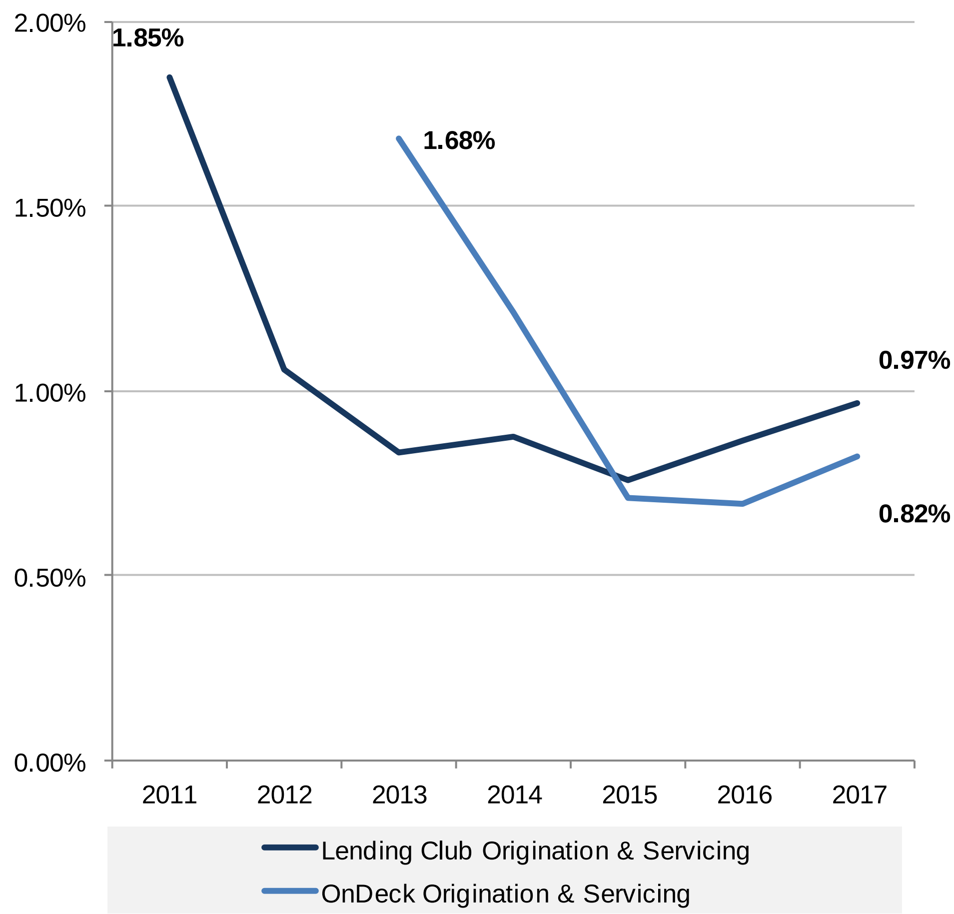


Bank Loan vs. MPL Capital Cost (2018)



But origination and servicing costs have decreased 50% relative to originations as lenders scaled their

Originations and Servicing as % Originations



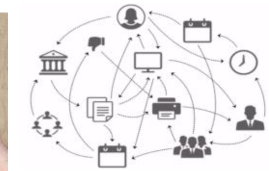
- Scale has helped companies like Lending Club take origination and servicing cost down from $200 to $100 per loan
- For context, costs for AML/KYC processes alone range from $2.50 for a basic check. For a bank, when this process is loaded with staff costs, it can range between $10 to $150 per AML/KYC check alone
- Mobile digital identity solutions could drive those figures down by 40-70%
- Associated with better marginal economics in the digital model, however, are the fixed costs of product and software upgrades; perhaps those are ongoing expenses in a digital-first offering
- While full operating expenses at Lending Club reach up to 7% of originations, this still compares favorably to the 12-15% at traditional lenders like OneMain Financial, which is saddled with a branch network and a legacy operating model

Source: Autonomous NEXT, Company Filings (Lending Club, OnDeck, OneMain), Consult Hyperion & Mitek Systems

This reflects a meaningful room for improvement -- traditional lending onboarding can take up to 6 weeks ...





Customer Management → **Credit Analysis** → **Credit Presentation** → **Decision & Approvals** → **Monitoring** → **Portfolio Risk Mgmt**

2 – 6 Weeks*

Customer Management

- Gather basic customer background & financial info available
- Run necessary KYC/AML checks on the customer
- 25% prospects can drop due to KYC friction

Credit Analysis

- Compile a full credit profile of the customer
- Conduct a ratio & scenario analysis
- Perform a full risk assessment

Credit Presentation

- Prepare info for credit presentation to risk department

Decision & Approvals

- Risk department analyze all documentation
- Risk department consider policies & business rules
- Decision to approve or decline loan is made

Ongoing

Monitoring

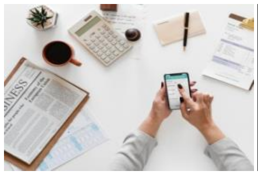
- Asset requires management & risks monitored
- Loan covenants are to be followed by loan officer
- Frequent audits ensure covenants are upheld

Portfolio Risk Mgmt

- Manage exposures to the loan portfolio based on pre-set risk-based portfolio limits

Source: Autonomous NEXT, Pexels, csbccorrespondent.com, BCG Analysis, Celent
** Note – Dependent on loan type*

... while the digital process may be as fast as a minute






1 – 10 Minute(s)*

Customer Management

- Customer-facing web portals & APIs facilitate onboarding
- Business rules & CRM integration automate loan process & workflow

Credit Analysis

- API-enabled digital data collection from 3rd parties
- Automated financial spreading
- Integrated CRM & credit analysis tools finalise rating

Credit Presentation

- Automated loan structuring tool builds the asset
- Collateral management system defines the loan terms
- Electronic credit memo is produced

Decision & Approvals

- Pre-screen using credit profile
- Automated decisioning process
- Ping for human judgment if required

Ongoing

Monitoring

- Integrated digital covenant solutions
- Automated notifications if covenants not met
- Testing applied to ensure security of system

Portfolio Risk Mgmt

- Automated business reporting tools & portfolio governance takes place throughout the origination process

Source: Autonomous NEXT, Pexels, csbccorrespondent.com, BCG Analysis
** Note – Dependent on loan type*

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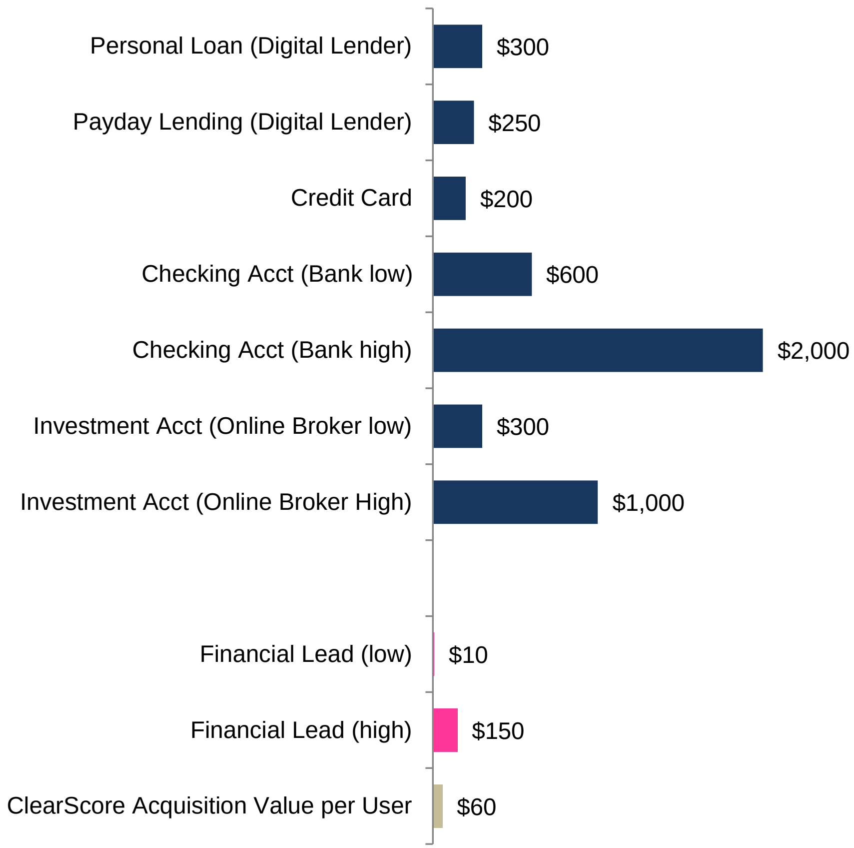
Customer acquisition costs for financial products across industries are between $200 and $2,000

Costs of Customer Acquisition by Product



- Unlike other consumer tech apps, financial technology applications face high customer acquisition costs due to complexity of the product
- Costs range from $200 to $2,000 per client depending on product, branch network of issuing institution, and effectiveness of marketing spend
- For digital only players, leads alone cost $10-150 from aggregators like Zillow and Mint.com; and such leads likely convert at 5-20% into opened accounts. As another example, a £275 million acquisition of ClearScore by Experian can be interpreted as paying $60 per 6 million users, similar to buying a lead.
- Optimizing the conversion of leads into users is a massively valuable process, that can reduce acquisition costs by an order of magnitude.
- Since each additional screen on a website / app to (1) open an account, (2) share information, or (3) collect AML/KYC data can lead to 10-30% audience drop off, workflow digitization can generate billions in value to industry

Source: Autonomous NEXT, Novantas, Morningstar, Quora, CB Insights, Celent, Company filings

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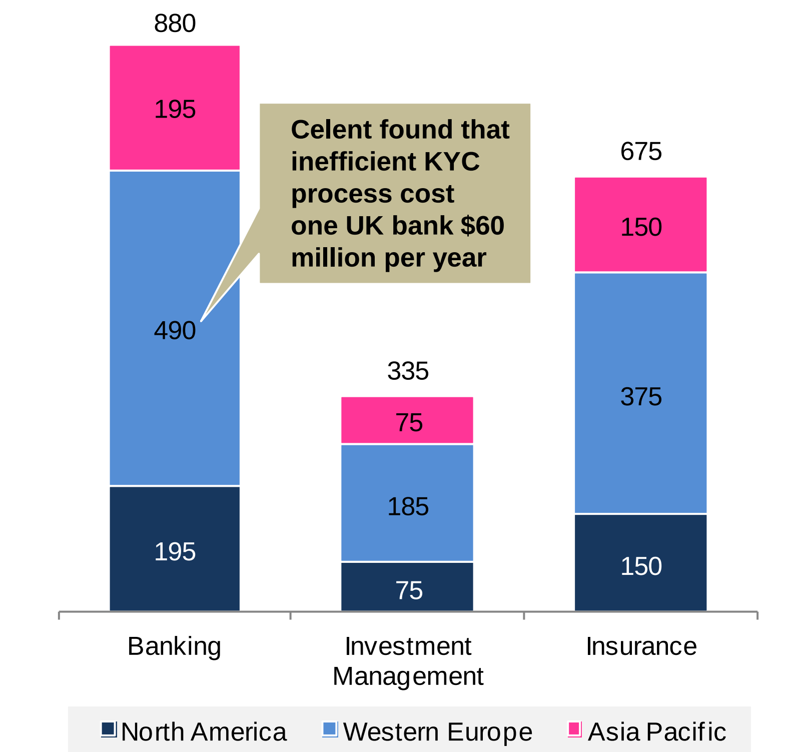
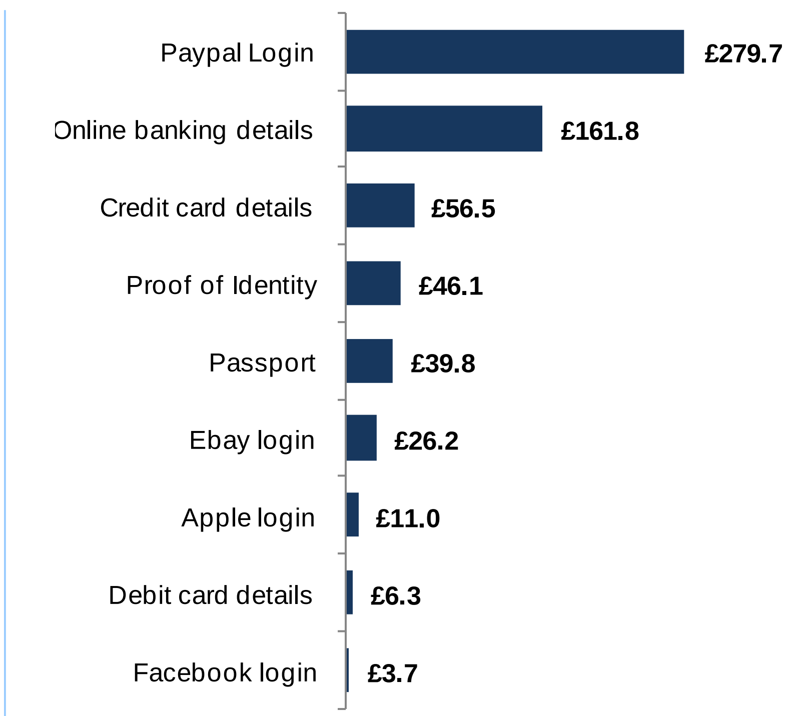
Digital identity and onboarding presents opportunity to improve customer acquisition funnels

Identity Solutions Revenue Pool ($MM)



- The revenue pool for identity and account opening solutions in financial services is $2 billion globally
- We see opportunities across banking, insurance and investment management

Dark Web Identity Purchase Prices



- Verifying customer identity securely is valuable
- For example, over 1 billion identities were stolen last year alone; and can be purchased relatively cheaply as shown above on the Dark Web

Source: Autonomous NEXT , McKinsey , Civic, Cifas – Wolves on the Internet, Celent

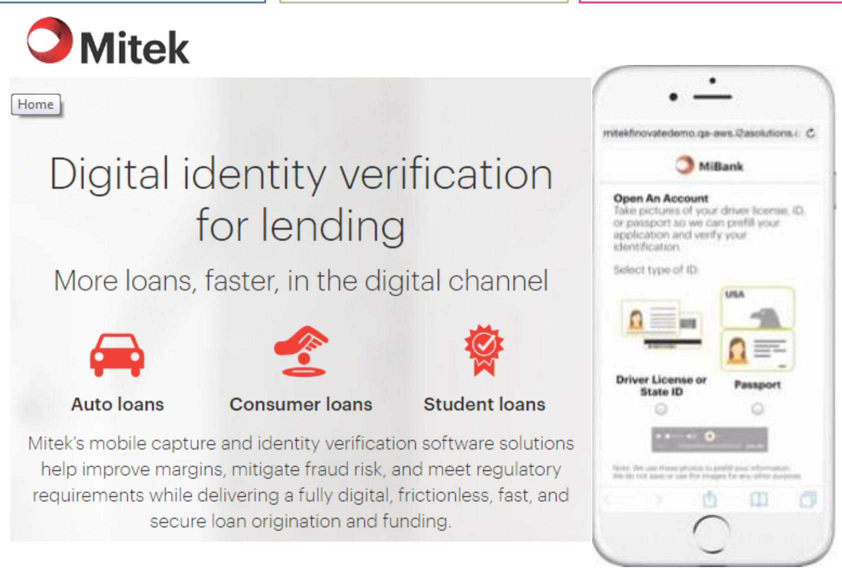
Example: Mitek's identity verification software is making considerable impacts in customer onboarding efficiency

Mitek

Global Identity Verification Software Solutions Provider

- Mitek provides AI and machine learning enabled mobile capture and identity verification software
- Mitek's software is used by more than 80 million consumers worldwide
- Notable clients include digital lender: Kabbage, consumer finance giant: Synchrony Financial, global money transfer company: MoneyGram International, and hardware security and authentication player: Yubico
- Mitek-specific solutions enabling loan onboarding efficiency via doc capture and authentication engine:
  - Mobile Fill, identity document data extraction and application pre-fill extraction
  - Mobile Verify, identity document verification
  - Face Comparison, Selfie compared to photo on document
  - Mobile Docs, doc capture

Reduction in time required for credit scoring	Solution is embedded in the apps of over	Reduction in customer onboarding time
98%	**6,100 clients**	**99%***



Source: Mitek website, Nocks Case Study, Celent Identity Verification study
** Reference to the Nocks Case Study where onboarding time was reduced from 12 hours to 5mins*

Example: ComplyAdvantage's AML database & API has reduced both screening and false positive alerts

ComplyAdvantage

KYC/AML screening for customer onboarding & monitoring

- ComplyAdvantage has built and actively curates a database of individuals, organisations, & associated entities that pose financial crime risk
- Leverages artificial intelligence and machine learning to identify and react to risks and suspicious behaviour in real-time, reduce false positives, and conduct deeper due diligence
- The database updates 30,000 existing profiles everyday, analyses 5 million articles per day, and monitors over 10,000 data sources to build reputational maps for its data set
- Connection to the database is made via API with an average uptime of 99.98%
- Contrast such a machine-ready AML/KYC product with the manual research undertaken during a traditional bank underwriting

Reduction in Screening Workload	Decrease in false positive alerts	No. Of firms that rely on CA's AML data & Tech
70%	84%	200+

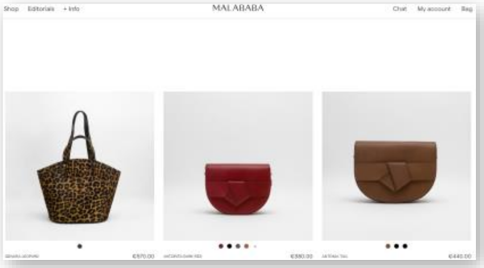
Source: Complyadvantage.com, IntechForums.com

Example: Aplazame shows that interest-free finance at e-commerce checkouts drives sales and consumer goodwill

aplazame — **Credit As a Service in E-Commerce**

Malababa

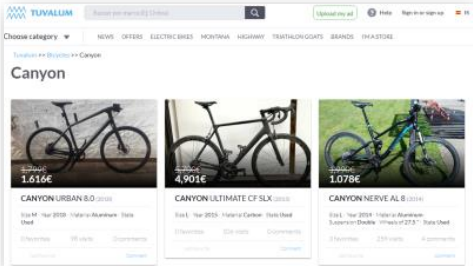
The Fashion firm used Aplazame to test the potential of instant 0% financing as a tool for marketing



- **120%** Increase financed sales
- **23%** Increase basket size (avg)
- **50%** of 1 month's sales in 3 day test

Tuvalum

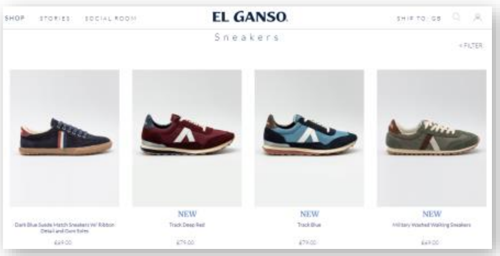
The cycling marketplace placed instant financing at the center of its marketing strategy



- **24.5%** total sales are now financed
- **12%** Increase basket size (avg)
- **19%** of total sales are promo driven

El Ganso

The Spanish based fashion firm used Aplazame to run a 10 day instant 0% financing campaign



- **100%** 10 day Increase in financed sales
- **44%** 10 day Increase in avg basket

- Aplazame's approach to partner with major e-commerce sites and run instant zero interest finance campaigns has paid off increasing the average basket size in the 3 campaigns above by 26%
- 65% of shopping carts are abandoned in Spain, Aplazame's instant solution enhanced conversion rates by 20% via their comprehensive identity verification and fraud reduction capabilities

Source: Aplazame Case Studies provided by Mitek Systems

Example: Darien Rowayton Bank's building of digital lender Laurel Road paid off with 50% growth in loan originations

DRB
DARIEN ROWAYTON BANK

Traditional Consumer Lender →

laurel road
A Division of Darien Rowayton Bank

- Darien Rowayton Bank of Connecticut US, once a traditional community bank, implemented an in-house built loan origination platform which enables an end-to-end digital lending process centred around student loan consolidation/refinancing called Laurel Road
- Laurel Road offers zero origination fees, and fills out loan qualification criteria automatically using data aggregation via API's with 3rd parties
- Laurel Road's main competitors are SoFi and First Republic

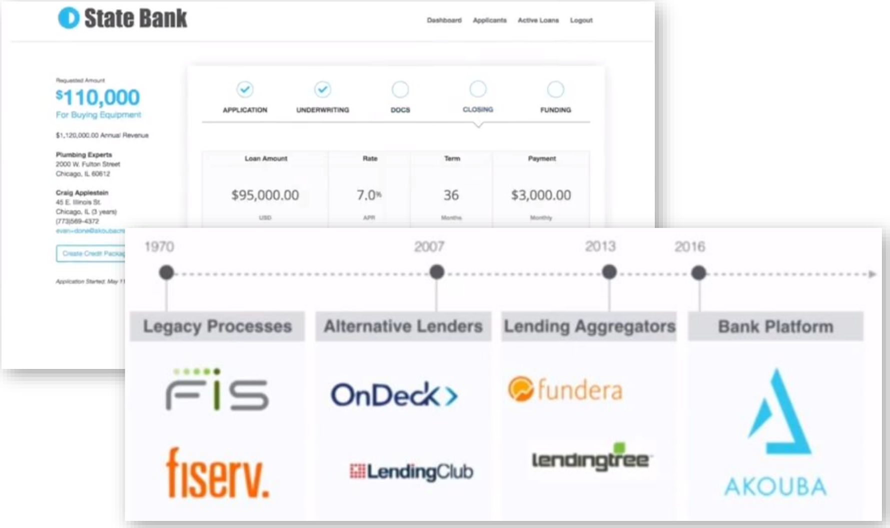
Average saved by borrowers	Growth in originations	Growth in student lending business
$20k Per Loan	**+50% YoY**	**+60% In 6 months**

Example: Burling Bank white labelling of Akouba cut down processing time and created 30% cost savings per loan

BURLING BANK ⟷ **Small & Medium sized Digital Lender** ⟷ AKOUBA

- Burling Bank is a full-service, privately owned community bank based in Chicago US engaged with digital lending platform Akouba to enhance the efficiency of Burling's small business lending and underwriting processes
- Akouba white labelled their product to Burling, making it easier to integrate with vendors bringing efficiency to data collection and internal analysis process
- Akouba's digital lending solution includes 9 features, such as an omnichannel application & borrower portal, pipeline view & lead generation, automated document management, workflow tracking etc.

Decrease in time to offer loan using Akouba	Business loan processing time	Cost savings per loan
50% - 80%	48 Hours	20 – 30%



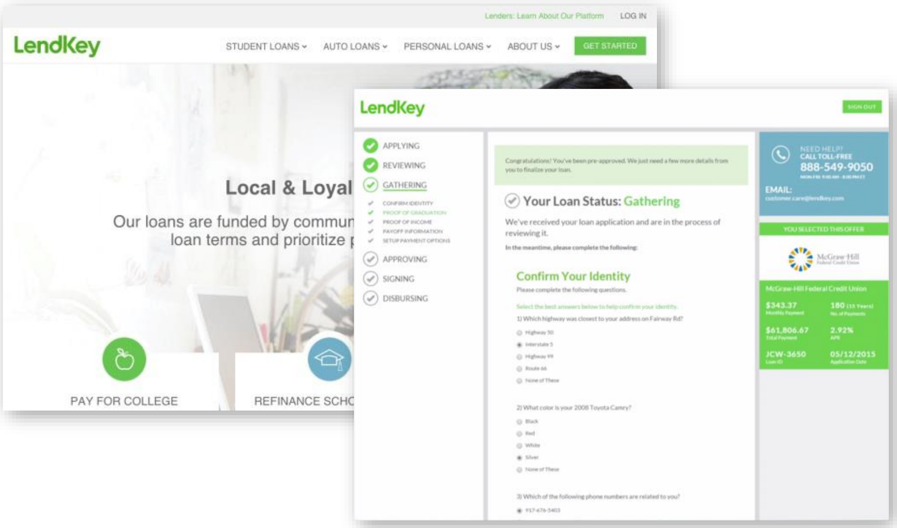
Example: LendKey's lending-as-a-service customer centric approach has aggregated 68,000 clients from partners

LendKey

Online Lending Platform & Online Marketplace

- LendKey partnered with 11 financial institutions to catalyse student loan refinance demand among their customer base using direct mail as the medium for contact
- Customer profiles and each institution's prequalification underwriting criteria were used to select candidates
- The form of customer contact was made via personalised branded direct mail guiding each customer to a URL specifically customised to each institution and each targeted customer
- 1.4% of respondents had their loans approved

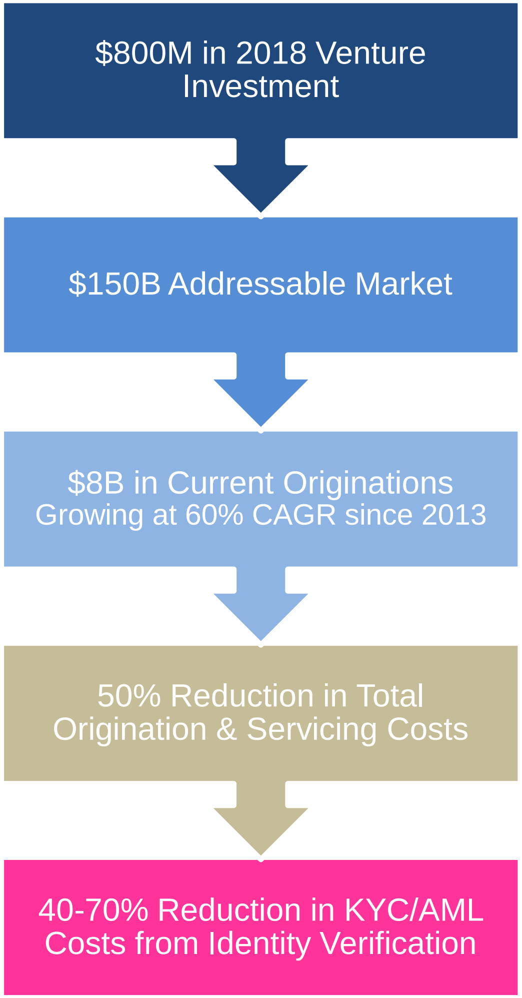
Customer response rate (above industry avg.)	Number of student loan refinance applications	Total refinanced student loans disbursed
3.25%	+500	+$5.2M



Key Takeaways

Takeaways

- **Growth of annual digital lender originations within the UK and Europe is promising an addressable market of $150B in originations and $450B in outstanding loans**
  - Annual venture investment within the European digital lending market is showing signs of maturity and a strong upward trend led by the UK, France, and Germany with 2018 set to raise between $500M - $800M
  - The UK has originations of $6.6 billion vs. Europe’s $1.4 billion, highlighting the extent of the continental market opportunity; however the European regulatory landscape complicates the entry of new Fintechs, with marketplace lending platforms being treated as banks by regulators in key jurisdictions
- **Operating model efficiency via digitization is growing increasingly important given cost of capital issues faced by digital lenders in pursuit of a competitive advantage over banks**
  - The marketplace approach to disaggregate deposit gathering from lending has proven unsuccessful to earn a competitive advantage over banks due to the higher cost of capital, new product development and legal expenses
  - While scale has helped reduce origination and servicing costs by as much as 50% for the likes of Lending Club, investment into digital lending workflows and technologies can reduce loan processing times from weeks to minutes
- **Digital identity Verification presents an opportunity to improve customer acquisition and reduce onboarding costs**
  - Digitization of the origination/servicing workflow leads on average to 30% cost reduction and 80% speed improvement
  - Within identity, new solutions can reduce KYC/AML costs by 40-70% as well as improve the customer experience, potentially lowering the cost of customer acquisition



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