September 30, 2015

Marketplace Lending RFI
U.S. Department of the Treasury
1500 Pennsylvania Ave NW., Room 1325
Washington, DC 20220

Dear Sir or Madam,

The American Bankers Association (ABA)[1] and the Consumer Bankers Association (CBA)[2] (together, the "Associations") are pleased to provide the following comments to the United States Department of the Treasury (Treasury) in response to its request for information on Online Marketplace Lending.

Emerging technologies are quickly changing the way financial institutions connect with their consumers enabling them to innovate and offer new products and services. Banks have embraced innovation and continue to do so in order to better serve their consumers. Banks have always led in bringing financial technology to customers. Installing ATM networks allowed customers instant access to their money anywhere in the world. Online banking has made it possible to manage money and pay bills from the comfort of home. Checks can now be deposited by smart phone and are scanned at the point of sale. Even today banks look to leverage the latest technologies to provide products and services that meet the diverse needs of their customers.

Innovation in finance has the potential to add meaningful benefits to consumers and spur economic growth by making capital available to growing small businesses. However, we must take care that this innovation is responsible, and that the benefits outweigh the risks for consumers and businesses. It is noteworthy that a large share of innovation seen today is

[1] The American Bankers Association is the voice of the United States' $15 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.
[2] The Consumer Bankers Association is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

developing outside of the regulated banking industry. Today, new nontraditional financial services providers have entered this space and are now offering financial services directly to consumers.

The Associations believe that all financial services providers must **protect consumers**, ensure a **level playing field of regulation** through uniform supervision and enforcement, and be **regulated by activity**. Adherence to the following fundamental principles will ensure a strong financial system that best serves the needs of consumers and small businesses across the country.

- **Consumer Protection – Consumers must have a clear understanding of their rights and responsibilities in the financial system.** Federal law provides for numerous protections for consumers when they borrow. Consumers expect this same level of protection in all financial services interactions, regardless of the provider.

- **Level Playing Field – All lenders should operate by a similar set of rules and standards.** This ensures that all participants have parallel financial incentives to innovate, and eliminates anomalies in the market driven solely by government policies that are enforced against some players but not others. Varying levels of regulatory enforcement should never encourage consumers to utilize financial services with fewer protections.

- **Activities Based Regulation – Regulation should focus on the activities being performed, rather than the delivery channel.** Good regulation helps identify risks and control for them. Many innovations, at their core, are traditional banking products. By focusing on the activity taking place, regulators are best able to assess the risks being presented to consumers and the system.

Consistent with these principles, this letter will make the following four points that must be considered when evaluating online marketplace lending:

- Online marketplace lending fundamentally resembles traditional lending,
- Activities-based regulation is key to responsible innovation,
- Oversight is needed to ensure compliance with appropriate regulations; and,
- Sustainability remains a concern.

Online Marketplace Lending Fundamentally Resembles Traditional Lending

Online lending is just a new delivery channel for a product that has existed for thousands of years. Consumer and small business lending is critical to the American economy. Our hometown banks have always provided consumer loans that help families reach their financial goals and the small business loans that drive local growth.

Online marketplace lending presents a novel delivery channel for consumer and small business loans. A number of nonbank providers have entered the space commonly referred as marketplace lending. These companies provide platforms that underwrite loans that are then sold off in a marketplace or held on balance sheet. A number of banks have also developed platforms that are capable of originating loans online.

These platforms utilize the large amount of consumer data that is now available along with algorithms to determine credit worthiness and automatically underwrite a loan. This automation has the potential to substantially lower the costs and increase the speed of making a loan. These lower costs ultimately benefit borrowers, as lenders are able to pass along those savings in the form of lower cost loans. Automation reduces the time that banks must spend to underwrite unsecured consumer loans, allowing banks to make these loans to more consumers. The automated underwriting also means that all borrowers receive loan approval and funds more quickly."

The rapid growth of marketplace lending clearly shows that there is value to online origination processes. Online consumer and small-business lending has seen substantial growth in the past decade. It is estimated that these platforms originated $12 billion in 2014. Lending Club alone is estimated to have originated $2.7 billion of currently outstanding loans, making it larger

than 97% of banks. Although much has been made of the novelty of these platforms, their core products differ little from traditional loans.

Most Resemble Traditional Loans - The loan products offered by these lenders closely resemble personal loan products offered by banks. They are typically fixed rate, term based (with maturities ranging from 36-60 months), and are fully amortizing (with the loan paid-off at the end of its set term). The rates offered by these companies are often comparable to those offered by banks. The largest difference to borrowers is that marketplace lenders typically charge an upfront fee of up to 5 percent that is rolled in the consumer's outstanding balance.

Small business loans originated by marketplace lenders tend to vary more than consumer loans. These platforms utilize algorithms and data to eliminate many of the burdensome costs associated with underwriting and processing a small loan. These loans are often short-term, and significantly costlier than traditional loans. For example, OnDeck's average APR during the second quarter of 2015 was 46.5 percent[3]. Many offer traditional loan products; however, some have implemented alternative repayment methods. One model that has been tested by some payments providers is payments-based repayment. Under this model, a business' loan is repaid by their payments processor taking a set percent of their sales transactions until the principle and interest are repaid.

Target Traditional Borrowers – There has been extensive discussion about the ability to bring financial services to unserved and underserved borrowers. To date, these platforms have done little to serve these borrowers. Credit decisions continue to rely primarily on credit scores, rather than alternative metrics. The largest consumer lenders in the space focus exclusively on prime borrowers. Lending Club, for example, has a minimum credit requirement that includes a FICO score of at least 660[4]. Prosper requires a minimum FICO score of 640 to post a loan.

[3] OnDeck 2Q-2015 Quarterly Earnings Report
[4] Typically borrowers with FICO scores greater than 620/660 are considered to be Prime.

The majority of loans being made through these platforms are designated for refinancing of existing debt. Refinancing accounts for 57 percent of Lending Club's loans, with an additional 21 percent slated for credit card payoff. Accordingly these loans are going to borrowers who have existing access to credit. And while there may be potential to expand credit access, there is little evidence of it to date.

Funding - The largest differentiator between bank loans and alternative loans is the funding source. The business of banking is fundamentally one of maturity transformation. Banks take in funding in the form of short-term deposits and extend longer-term loans while holding the risk on their balance sheet.

Non-bank lenders however have a very different funding structure. Originally, this segment was referred to as peer-to-peer lending. These platforms served to connect individual investors with individual borrowers. However, as they have matured the funding for these loans has increasingly come from large institutional investors such as hedge funds. Lending Club, in its 10-K filing acknowledges that one of its key risks is that "[a] relatively small number of investors account for a large dollar amount of investment in loans funded through our marketplace.[5]"

Activities Based Regulation is Key to Responsible Innovation

Innovation in financial services has the ability to benefit consumers across the country and drive growth in our economy if done responsibly. New technologies allow financial service firms to connect with consumers in new ways and offer them products that may better fit their needs. However, these innovations may introduce new risks to both consumers and the system as a whole. With any innovation, it is important that we fully understand the risks that it might pose and ensure that those risks are controlled.

To ensure that the benefits of these new technologies reach all creditworthy customers we must ensure that we are innovating responsibly. To consumers, a loan is a loan. They do not differentiate between lenders, and expect the same protections whether they borrow from a

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[5] Lending Club 10-K 2014 Page 16

bank or a non-bank. There are numerous bank consumer protections in place to protect borrowers, from transparency in pricing to fair collection methods and data protection. We must ensure that these protections apply to all bank-like activities that involve lending or servicing. The bottom line is, consumers should receive the same protections whether they choose to borrow from a bank or a nonbank.

ABA believes that activities-based regulation is the best way to ensure that innovation is undertaken responsibly. Simply put, consumers should receive the same protections whether they borrow from a bank or a nonbank marketplace lender. Any activities that involve lending or securitization should be subject to the same regulation, whether offered by a bank or a non-bank.

Non-bank marketplace lenders typically rely on a relationship with an originating bank to facilitate all regulatory compliance. Despite this, they remain the primary point of contact for borrowers, who apply for and pay off loans through their platform. Based on the consumers' interaction with the nonbank lender's platform, they may not understand that there is often a bank involved in the lending process.

When regulation is done right, it adds value to consumers and lenders alike. All lenders should operate under the same set of rules and be subject to consistent enforcement of those rules. Good regulation should not stifle innovation. If an innovation truly adds value, it will continue to do so under the same rules as other players. If it does not, it is simply creating an economic incentive that encourages consumers to utilize financial services with fewer protections.

As such, all lenders should be subject to equal regulation regarding:

> **Transparent Pricing -** The federal Truth in Lending Act (TILA) and its implementing Regulation Z already requires all lenders to provide borrowers with standardized and understandable information regarding their loan. These include the conditions and pricing of the loan. Many marketplace lenders typically rely primarily on an originating bank to provide these disclosures and simply facilitate the delivery of these documents.

Fair Lending – The Equal Credit Opportunity Act (ECOA) ensures that lenders cannot discriminate in any aspect of the credit decision based on race, sex, color, age, religion, national origin marital status, or whether a portion of the applicant's income comes from any public national assistance program. This applies to the application and approval, as well as servicing and collection.

Data Security – Marketplace lenders collect personal and sensitive data from applicants, and should take adequate measures to protect it. Both banks and marketplace lenders are subject to the data security requirements established in the Gramm-Leach-Bliley Act (GLBA). However the two are subject to vastly different sets of implementing regulations and regulatory guidance. Banks are subject to more demanding standards issued by the federal financial regulators, while alternative lenders are subject to the more flexible standards issued by the Federal Trade Commission (FTC). As a result, alternative lenders are subject to lighter data security requirements and face lower odds of an enforcement action or sanction.

Alternative lenders may also collect a customer's bank account login information for their online banking profile. Consumers often do not realize that by authorizing a 3rd party to access their account, they are forfeiting many of the protections that banks offer and may be exposing themselves to fraud or loss.

Collections Methods – Any collection agents or services that a lender uses must comply with the federal Fair Debt Collection Practices Act (FDCPA) when collecting overdue payments.

Oversight is Needed to Ensure Compliance with Appropriate Regulations

Consumer protection laws, such as the Truth In Lending Act and the Equal Credit Opportunity Act extend to loans originated through non-bank online platforms. However there is often little to no oversight to ensure that these regulations are being followed by non-bank lenders.

It is not enough to simply put rules in place that protect consumers. We must ensure that these rules are clearly articulated and that lenders fully comply. Although existing consumer protection laws generally apply to alternative lenders, it is not always clear that they are being enforced.

Banks are subject to stringent and regular examination by state and federal agencies who proactively address concerns before an issue arises that could impact consumers. Currently alternative lenders have little regulatory oversight and typically only see examinations in response to consumer complaints. Consumer protections mean little unless there is oversight to ensure that they are being applied fairly, uniformly, and consistently.

Increased regulatory engagement, including oversight and supervision, will ensure that rules are being followed so that consumers receive the same protections from alternative lenders that they have come to expect from banks. Moreover, this engagement will provide clarity to alternative lenders that will allow them to more fully integrate into the financial system.

> **Good Supervision Should Add Value –** Supervision should add value to enhance the practices of individual lenders and ensures that consumers remain protected. This can help individual lenders operate successfully and better serve their customers and communities. Regulators should take a more active role in the supervision of alternative lenders.
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> The Consumer Financial Protection Bureau (CFPB) has taken steps in its recent enforcement actions to target nonbank lenders. However more can and must be done. Issues must be addressed proactively, rather than after consumers have been harmed.
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> **Regulatory Clarity Benefits Everyone –** Increased regulatory engagement will benefit all participants in online marketplace lending. This engagement will ensure that the rules are being followed and enforced so that borrowers receive their legal protections, regardless of the lender.
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> In fact, lack of compliance is one of the largest risks identified by these non-bank lenders. In their annual report Lending Club addresses this uncertainty by noting "We

may not always have been, and may not always be, in compliance with all of these laws. Compliance with these laws is also costly, time consuming and limits our operational flexibility.[6]"

Clearly, regulatory risk is a concern for some of the nonbank lenders. In fact, six pages of Lending Club's annual report are dedicated to potential regulatory risks.

In particular it mentions uncertainty about how CFPB enforcement of regulations could impact its business model. "There continues to be uncertainty as to how the CFPB's strategies and priorities, including in both its examination and enforcement processes, will impact our businesses and our results of operations going forward. Actions by the CFPB could result in requirements to alter or cease offering affected loan products and services, making them less attractive and restricting our ability to offer them[7]."

The need for examination and oversight is also evidenced by the "Small Business Borrower's Bill of Rights," released by a number of leading marketplace lenders. This highlights the need for oversight in an industry where none exists. Banks, however have substantial oversight in the form of ongoing supervision and examination by federal regulators.

Increased clarity about how these regulations apply will benefit all parties in the lending process. Consumers will have a clear understanding of their protections when borrowing. Banks will have certainty that these companies are operating legally and will be more willing to work with them. Clarity will also benefit the alternative lenders, who will have certainty under which to develop their businesses. Moreover, this oversight will afford alternative lenders increased legitimacy.

Sustainability remains a concern

Access to loans for consumers and small businesses is critical to the health of our economy. As lending activity shifts to not-traditional platforms such as online marketplace lenders, we must

[6] Lending Club 10-K 2014 P27
[7] Lending Club 10-K 2014 Page 28

consider the sustainability of their model and its ability to meet the credit needs of our dynamic economy,

Marketplace lenders rely heavily on new originations as an income source. Many do not hold the loans that they originate and receive none of the interest paid them. As such their primary sources of income are origination and servicing fees. Origination fees alone accounted for 92 percent of Lending Club's revenue in 2014. This model may not be sustainable as interest rates normalize in coming years. As interest rates rise, originations tend to slow. Exacerbating this problem is the fact that the majority of the funding for these platforms comes from institutional investors. As returns on other assets improve, the cost of loans on the platform may increase substantially.

Conclusion

Technological innovation will continue to change the way banks interact with their customers. As this innovation continues, we must ensure that consumers receive the same protections regardless of their financial service provider. Currently, nonbank marketplace lenders are subject to little oversight. This oversight is critical to ensuring consumers receive the protections guaranteed them by federal law.

The Associations appreciate the opportunity to comment on the Treasury's request for information on online marketplace lending. If you have any questions or would like further explanation of our comments please contact ABA's Robert Morgan (email:rmorgan@aba.com phone: 202-663-5387) or Denyette DePierro (email:ddepierr@aba.com phone:202-663-5333).

Sincerely,

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