

Client Update

Regulators Set Sights on Online Marketplace Lenders

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Over the last few months, the online marketplace lending industry has increasingly come under scrutiny from a wide range of government entities on both the federal and state level, including the Department of the Treasury (“Treasury”), the Office of the Comptroller of the Currency (the “OCC”), the Federal Trade Commission (the “FTC”) and the California Department of Business Oversight (the “DBO”). However, the Consumer Financial Protection Bureau’s (the “CFPB” or “Bureau”) recent announcement that it will begin accepting complaints from consumers regarding those lenders particularly raises the specter of increased governmental regulation of the industry.¹ Although no new requirements have been imposed on online marketplace lenders, increased oversight of the industry appears likely.

BACKGROUND

Although the marketplace lending industry emerged before the global financial crisis, it flourished in its aftermath as credit markets tightened and borrowers turned to less conventional institutions to seek out capital. At its inception, marketplace lending consisted mainly of smaller peer-to-peer (“p2p”) lenders, *i.e.*, matchmaking services that brought together borrowers looking for relatively smaller credit lines with investors willing to provide higher-interest non-recourse loans. As the economy tanked, the marketplace lending industry grew,

¹ Consumer Financial Protection Bureau, Press Release: “CFPB Now Accepting Complaints on Consumer Loans from Online Marketplace Lenders” (Mar. 7, 2016), available at <http://www.consumerfinance.gov/newsroom/cfpb-now-accepting-complaints-on-consumer-loans-from-online-marketplace-lender/>. Notably, the collection of complaints regarding online loans is not entirely new. Indeed, the CFPB did not include a new product category for “online marketplace loans” in its complaint database; instead, recognizing that such lenders provide a variety of loans, the CFPB directed consumers to select the appropriate loan product (consumer, student or mortgage) when submitting a complaint.

and continued to grow during the economic recovery, with certain industry leaders generally reporting very low default rates since their inception. Though there have been recent signs of a slowdown in the market with rising delinquency rates, the industry has largely continued to be viewed as a “win-win” for consumers and investors, offering borrowers access to credit with attractive rates and investors with highly attractive risk-adjusted returns.² However, with the growth of the p2p industry, the investor side of the equation has become increasingly more complicated, with a number of larger financial institutions and institutional investors and highly structured financial transactions. Meanwhile, concerns have been raised that the rapid growth of the industry, including the use by many providers of alternative data in lieu of traditional credit underwriting, might pose certain risks to consumers.

CFPB

Created by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB has broad authority governing standards that may apply to a variety of consumer loans, including those issued through online marketplace lending. Some eyebrows were raised when the CFPB’s Fall 2015 regulatory agenda³ stated that the CFPB would begin “pre-rule activities”⁴ for defining larger participants in the markets for consumer installment and vehicle title loans in September 2016. Although it remains unclear how broadly the Bureau intends to define the term “consumer installment loan,” with the announcement that the Bureau is accepting consumer complaints regarding online marketplace lending, it now seems possible that the CFPB will broadly define consumer installment loans in its larger participant rule so as to include online marketplace lending. This development could be a sea change for the industry. Such a rule would allow the Bureau to conduct on-site examinations and general monitoring of the largest

² Lending Club, Lending Club Statistics, available at <https://www.lendingclub.com/info/demand-and-credit-profile.action> (last accessed Mar. 25, 2016); Kevin Wack, “Marketplace Lender’s Big Investors Grow Anxious,” *American Banker*, Feb. 25, 2016.

³ Kelly Cochran, “Fall 2015 Rulemaking Agenda,” *CFPB Blog* (Nov. 20, 2015), available at <http://www.consumerfinance.gov/blog/fall-2015-rulemaking-agenda/>.

⁴ Pre-rule activities generally include studies, requests for information, Small Business Regulatory Enforcement Fairness Act panels, as well as consumer and industry outreach. It may also include Advanced Notice of Proposed Rulemakings, although the Bureau generally indicates when it is contemplating such action. Although agencies provide time frames for certain actions, these are often aspirational and not a concrete statement of when an agency will act.

marketplace lenders,⁵ and could include rules requiring registration of non-depository lenders to facilitate the CFPB's supervision.

Other regulators, including the Federal Deposit Insurance Corporation (the "FDIC") and the Securities and Exchange Commission (the "SEC"), have previously scrutinized aspects of marketplace lending activity.⁶ However, neither the FDIC nor the SEC examined or supervised the companies or their operations more generally.⁷ A larger participant rule, therefore, would be a seismic shift in the federal regulators' approach to the industry, allowing the CFPB to proactively assess risks to consumers and review whether companies are complying with requirements of federal consumer financial law.

Gathering complaints has previously been a first step down the road to CFPB supervision of the largest industry participants. For example, the CFPB began accepting complaints about student loan servicers in March 2012,⁸ proposed a larger participant rule in March 2013⁹ and finalized the rule in December 2013.¹⁰ The Bureau followed a similar process (with a similar timeline) in the context of defining larger participants in the auto finance industry: the Bureau began taking

⁵ The Bureau has the statutory authority to define a consumer financial industry and supervise "larger participants" in that industry. 12 U.S.C. § 5514(a)(1).

⁶ General Accounting Office, "Report to Congressional Committees: Person-to-Person Lending: New Regulatory Challenges Could Emerge as the Industry Grows" (Jul. 2011) at 3, available at <http://www.gao.gov/new.items/d11613.pdf>.

⁷ The SEC focused on the companies' required disclosures and investor protection issues and the FDIC reviewed certain programs' compliance with applicable lending, consumer protection and financial privacy laws, based on their business relationship with a FDIC-supervised bank. See Deborah Bach and Rob Blackwell, "FDIC Disciplines WebBank," *American Banker*, Jul. 16, 2001, available at http://www.americanbanker.com/issues/166_135/.

⁸ Consumer Financial Protection Bureau, "Student Loan Ombudsman Annual Report" (Oct. 2012), available at http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

⁹ Consumer Financial Protection Bureau, "Notice of Proposed Rulemaking: Student Loan Servicing Larger Participants" (Mar. 2013), available at http://files.consumerfinance.gov/f/201303_cfpb_nprm_larger-participants-student-loan-servicing.pdf.

¹⁰ Consumer Financial Protection Bureau, "Final Rule: Defining Larger Participants of the Student Loan Servicing Market" (Dec. 2013), available at http://www.consumerfinance.gov/f/201312_cfpb_student-servicing-rule.pdf.

complaints in March of 2012¹¹ (though it launched the auto loan complaint system with comparatively very little publicity), issued its proposed larger participant rule in September 2014,¹² and released its final rule in June 2015.¹³ If the Bureau were to follow a similar timeline here, a proposed larger participant rule could arrive as early as next spring. Below is a timeline comparing the Bureau’s prior larger participant rulemakings with a possible marketplace installment lending larger participant rule.

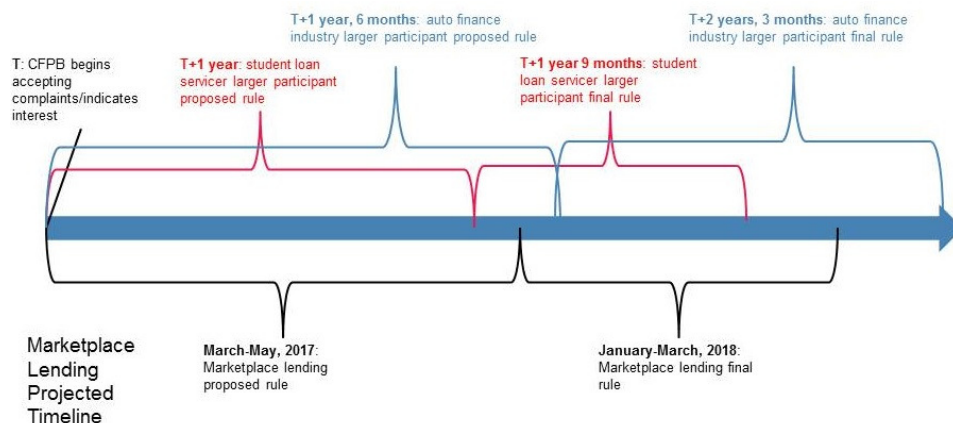


Figure 1: Marketplace Lending Projected Timeline

Even without direct supervision of the largest participants, by announcing its collection of consumer complaints, the Bureau has signaled its increased focus on the industry. Consumer complaints traditionally have been a rich source of data for the Bureau on customer experience, and the data have been used by the Bureau to spot trends, support new regulations or take enforcement action.

¹¹ Sartaj Alag, “Who Is Going to Help You with Your Complaint about an Auto or Installment Loan?,” *CFPB Blog* (Mar. 12, 2012), available at <http://www.consumerfinance.gov/blog/who-is-going-to-help-with-your-complaint-about-an-auto-or-installment-loan/>.

¹² Consumer Financial Protection Bureau, Proposed Rule: “Defining Larger Participants of the Automobile Financing Market” (Sep. 2014), available at http://files.consumerfinance.gov/f/201409_cfpb_proposed-rule_lp-v_auto-financing.pdf.

¹³ Consumer Financial Protection Bureau, Final Rule: “Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service” (Jun. 2015), available at http://www.consumerfinance.gov/f/201506_cfpb_defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile-leasing-activity-as-a-financial-product-or-service.pdf.

TREASURY, THE OCC, FTC AND CALIFORNIA

In addition to increased scrutiny by the CFPB, other regulators are beginning to scrutinize marketplace lending activity. Last July, Treasury issued a request for information on marketplace lending (the “RFI”), including a request for comments on how the financial regulatory framework should evolve to support the safe growth of this industry.¹⁴ Treasury received over 100 responses from companies and individuals to their 14 questions about the industry, its operations and potential impact. In a speech discussing the RFI, a Treasury official noted that although Treasury seeks to foster the growth of the industry, it “will also be vigilant in ensuring that innovation does not undermine important privacy and consumer protection priorities.”¹⁵

In late March, the OCC released its white paper *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective* on March 31, 2016 (the “White Paper”), with comments due on May 31, 2016.¹⁶ Although the White Paper focuses on FinTech issues more broadly, it likely will also have an impact on marketplace lenders, as the OCC has authority to review nonbanks that act as service providers for national banks and federal savings associations under the agency’s jurisdiction. The OCC has stated that it plans to use the White Paper as a means by which to understand how it can communicate the “rules of the road” to third-party nonbanks that engage in such relationships with banks.

The White Paper focuses on eight principles: (1) support responsible innovation; (2) foster the OCC’s culture to be receptive to such innovation; (3) leverage agency experience and expertise; (4) encourage innovation that allows for fair access and fair treatment of consumers; (5) further safe and sound operations through effective risk management; (6) encourage banks to integrate responsible innovation into their strategic planning; (7) promote ongoing dialogue through formal outreach; and (8) collaborate with other regulators. In furthering these eight principles and its ongoing dialogue on issues related to FinTech, the OCC

¹⁴ United States Department of Treasury, “Public Input on Expanding Access to Credit Through Online Marketplace Lending” (July 16, 2015), available at <https://www.treasury.gov/connect/blog/Documents/RFI%20Online%20Marketplace%20Lending.pdf>.

¹⁵ Antonio Weiss, Counselor, Treasury, Remarks at the Information Management Network Conference on Marketplace Lenders (Oct. 29, 2015).

¹⁶ OCC, “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective” (Mar. 31, 2016), available at <http://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-39.html>.

plans to hold a forum on June 23, 2016 on the White Paper and to conduct “innovator fairs” for companies to dialogue with OCC subject matter experts. Although still in its early stages, the OCC has indicated that the White Paper is the first step in an ongoing understanding of the market and that its approach will focus less on actual technology or proprietary information, but rather on how companies, including marketplace lenders, manage risks.

In April, the FTC similarly announced it would be holding a forum exploring the growing world of marketplace lending and its implications for consumers on June 9, 2016.¹⁷ The forum will examine the various models used by companies in this area, the potential benefits to consumers and possible consumer protection concerns, including how existing consumer protection laws might apply to companies participating in the marketplace lending space. The interest in the industry by federal regulators is only likely to increase given the recent call for an update to the General Accountability Office report on p2p lending.¹⁸ We would expect the report to build upon a previous report¹⁹ in outlining the regulatory structure of p2p, including the federal regulators responsible for the oversight and regulation of p2p lending markets, and examining whether additional or alternative safeguards are needed.

States are also beginning to scrutinize the industry. In December 2015, the DBO announced an inquiry into marketplace lending in order to “assess the effectiveness and proper scope of our licensing and regulatory structure as it relates to these lenders.”²⁰ The resulting report from the DBO revealed how much the industry had grown in recent years: the total dollar amount of

¹⁷ Federal Trade Commission, “Press Release: FTC to Host Financial Technology Forum on Marketplace Lending” (Apr. 14, 2016), available at <https://www.ftc.gov/news-events/press-releases/2016/04/ftc-host-financial-technology-forum-marketplace-lending>.

¹⁸ “Letter from Senators Merkley, Brown and Shaheen to Gene L. Dodaro, Comptroller General of the United States, Government Accountability Office” (Apr. 18, 2016), available at <https://www.merkley.senate.gov/imo/media/doc/Letter%20to%20Gene%20L.%20Dodaro%204.18.16.pdf>.

¹⁹ General Accounting Office, *supra* note 6.

²⁰ California Department of Business Oversight, Press Release: “California DBO Announces Inquiry into ‘Marketplace’ Lending Industry” (Dec. 11, 2015), available at http://www.dbo.ca.gov/Press/press_releases/2015/DBO%20Inquiry%20Announcement%2012-11-15.pdf.

transactions by online marketplace lenders increased by almost 700% between 2010 and 2014. The DBO's action indicates that, as seen in the mortgage servicing, payday lending and debt collection industries, federal and state regulators may continue to examine similar issues, which could result in coordinated investigations and enforcement actions.

BEST PRACTICES FOR ONLINE MARKETPLACE LENDERS

With the increased scrutiny on marketplace lending, online marketplace lenders should give serious thought to building out the compliance functions within their institutions, including reviewing policies and procedures, monitoring and staff training to meet industry standards and address regulatory requirements that apply to consumer financial products and services. In particular, lenders should enhance their complaint management functions to effectively monitor the CFPB's complaint portal, improve their own internal complaint portals to encourage their customers to contact them directly and respond promptly and proactively to any complaints received. As noted above, the CFPB has mined consumer complaint data to determine whether investigations or enforcement actions are appropriate and has looked to complaint data in evaluating whether or not additional regulation is warranted. Consequently, lenders should develop robust analytics to review consumer complaints to identify consumer pain points and mitigate potential regulatory or reputational risks. In addition, lenders should carefully review all of their consumer-facing disclosures to determine whether they accurately and effectively convey product terms and features.

In conjunction with their internal reviews, marketplace lenders should also consider and closely review compliance by their third-party originating banks as well as by other third parties that service these loans or otherwise interact with borrowers. Further, given the significant role investors play in the marketplace lending model, marketplace lending platforms may want to reevaluate the obligations they place on these financial institutions regarding regulatory compliance, and review how borrower information is shared or transferred to third-party investors. Adjustments to policies and procedures in the near-term could prevent regulatory headaches down the road.

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Please do not hesitate to contact us with any questions.