

Will marketplace lending be ready for increased regulatory scrutiny?



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On July 16, 2015, the Department of the Treasury (Treasury) submitted a Request for Information (RFI) in an effort to better understand the impact of online marketplace lending on small businesses, consumers, and the broader economy.

Treasury is seeking information to help policymakers better understand the various business models of and products offered by online marketplace lenders,

the potential for online marketplace lending to expand access to credit to historically underserved market segments, and how the financial regulatory framework should evolve alongside the online lending marketplace to support the safe growth of the industry, among other topics. The comment period will be open until August 31, 2015.¹

What are Treasury's areas of interest?

Treasury is interested in a broad range of elements of online marketplace lending. Specifically, the RFI is in the form of 14 questions addressing the areas of interest illustrated below.

1	 Business model	Understanding of different business models in MPL, including market segmentation
2	 Electronic data	Risk of the role of electronic data in MPL
3	 Borrower segmentation	Business model for borrower segments
4	 Underserved markets	Expanding access to credit to underserved market segments
5	 Customer acquisition	Understanding of marketing channels and partnerships to reach new customers
6	 Underwriting process	Assessment of creditworthiness and repayment ability including credit risk considerations
7	 Reliance on traditional institutions	Reliance on traditional model, regulatory guidance, state requirements
8	 Operational practices	Loan servicing, fraud detection, credit reporting, collections, and third party management
9	 Government role	Facilitate positive innovation; non-bank v. bank participation in MPL; how can government address disadvantages?
10	 Alignment of interests	Lenders "skin in the game" to align interests with investors; understanding of risk retention for pooled and non-pooled loans
11	 Potential for borrower harm	Privacy considerations, cybersecurity threats, consumer protection concerns, and other potential harm
12	 Investor considerations	Understanding of investor interests, operational arrangements, financing options, and financial leverage for investors
13	 Secondary market	Advantages and disadvantages of a larger secondary market
14	 Other trends	Other key areas to monitor as the market develops

¹ Notice and request for information, "Public Input on Expanding Access to Credit through Online Marketplace Lending," US Department of Treasury, released July 16, 2015.

What do lessons learned from prior waves of regulatory change suggest about preparing for potential future regulation here?

Because one of the stated purposes of the RFI is to receive public comments on “how the financial regulatory framework should evolve to support the safe growth of this industry,” the RFI signals potential new regulation for the marketplace lending industry.

Although it is not yet clear if and how the Treasury or other agencies intend to change marketplace lending regulation, industry participants may be able to leverage lessons learned from waves of regulatory change that affected other consumer credit asset classes and other business models. For example, the Consumer Financial Protection Bureau (CFPB) expanded the scope of its direct supervision over new categories of non-bank “larger participants” in consumer financial markets in several rounds of rulemaking. The resulting rules expanded

CFPB supervisory scope to cover larger consumer reporting bureaus, consumer debt collectors, student loan servicers, international money transferors, and non-bank auto lenders.

In each case, companies that began preparing to meet CFPB standards well in advance of the final rules found that they were better able to adapt to those expectations without unduly distracting them from operating their business. For example, companies were able to take action to conform their compliance frameworks to the standards in the CFPB Supervision and Compliance Manual over a timeframe of their own choosing. That lesson learned seems equally applicable here – online marketplace lenders will be better able to adapt to new regulation without disrupting their business if they start taking action now.

10 questions to ask yourself about potential impacts

The expected future regulatory change may range from capital and risk retention requirements to regulatory standards for marketing practices and debt collection practices. Therefore, marketplace lending participants seeking to get ahead of the regulatory change may want to

proactively analyze the potential impacts of new regulation on their business model, capital structure, operating processes, and compliance management programs. To that end, we identify below 10 questions that might help focus those efforts:

- 1 What are the potential impacts of risk-retention requirements on your business model?
- 2 What changes would you make in your business model if the availability of secondary market liquidity increases?
- 3 How are your bank partnerships structured, and do you have a plan if those partnerships are challenged by court or regulators?
- 4 Have you considered the fair lending implications of how you use alternative data for credit decisions?
- 5 Do you take applicants’ ability to repay into consideration in your underwriting process?
- 6 Do you know your third-party service providers’ compliance and risk management protocols, and do you have an effective system in place to monitor their activities?
- 7 How does your compliance program compare to the elements described in the CFPB Supervision and Examination Manual?
- 8 Even if you do not participate in securitizations today, would your servicing platform meet the requirements of investors, trustees, and credit rating agencies?
- 9 Are you sharing and managing borrower’s non-public personal information with affiliates, business partners, and third-party service providers consistent with regulatory standards?
- 10 What are your information security and cyber defense protocols, and are they routinely tested?

Will you be ready for the change?

While the outcome and timing of changes are uncertain, it is clear that regulatory change for online marketplace lenders is on the horizon and that market participants will be better able to adapt to that change if they begin to take steps to prepare for change now. Based on what we have seen with other waves of regulatory change, participants that take

potential changes into their strategic planning and invest in their operational and compliance processes will outperform those that wait.

Please contact us for a deeper discussion on change management and compliance management programs for online marketplace lending.

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