



# ICLG

## The International Comparative Legal Guide to: **Lending & Secured Finance 2017**

### 5th Edition

A practical cross-border insight into lending and secured finance

Published by Global Legal Group, with contributions from:

Advokatfirma Ræder DA  
Ali Budiardjo, Nugroho, Reksodiputro  
Allen & Overy LLP  
Anderson Mori & Tomotsune  
Asia Pacific Loan Market Association  
Cadwalader, Wickersham & Taft LLP  
Carey  
Chadbourne & Parke LLP  
Chiomenti  
Cravath, Swaine & Moore LLP  
Crales & Urcullo  
CUATRECASAS  
Davis Polk & Wardwell LLP  
Debevoise & Plimpton LLP  
Drew & Napier LLC  
E & G Economides LLC  
Estudio Saco-Vertiz & Landerer  
Freshfields Bruckhaus Deringer LLP  
Gonzalez Calvillo, S.C.

HSA Advocates  
Holland & Knight LLP  
HSBC  
IKT & associates  
K&L Gates LLP  
Khan Corporate Law  
King & Spalding LLP  
King & Wood Mallesons  
KPP Law Firm  
Lakatos, Köves and Partners  
Latham & Watkins LLP  
Lee & Ko  
Lee and Li, Attorneys-at-Law  
Loan Market Association  
Maples and Calder  
Marval, O'Farrell & Mairal  
McMillan LLP  
Milbank, Tweed, Hadley & McCloy LLP  
Montel&Manciet Advocats

Moore & Van Allen, PLLC  
Morgan, Lewis & Bockius LLP  
Morrison & Foerster LLP  
Nielsen Nørager Law Firm LLP  
Orrick Herrington & Sutcliffe LLP  
Pestalozzi Attorneys at Law Ltd.  
Pinheiro Neto Advogados  
Proskauer Rose LLP  
Rodner, Martínez & Asociados  
Shearman & Sterling LLP  
Skadden, Arps, Slate, Meagher & Flom LLP  
The Loan Syndications and Trading Association  
White & Case LLP





**Contributing Editor**

Thomas Mellor, Morgan, Lewis & Bockius LLP

**Sales Director**  
Florjan Osmani

**Account Director**  
Oliver Smith

**Sales Support Manager**  
Paul Mochalski

**Editor**  
Sam Friend

**Senior Editors**  
Suzie Levy, Rachel Williams

**Chief Operating Officer**  
Dror Levy

**Group Consulting Editor**  
Alan Falach

**Publisher**  
Rory Smith

**Published by**  
Global Legal Group Ltd.  
59 Tanner Street  
London SE1 3PL, UK  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
Email: info@glgroup.co.uk  
URL: www.glgroup.co.uk

**GLG Cover Design**  
F&F Studio Design

**GLG Cover Image Source**  
iStockphoto

**Printed by**  
Stephens & George  
Print Group  
April 2017

Copyright © 2017  
Global Legal Group Ltd.  
All rights reserved  
No photocopying

ISBN 978-1-911367-46-8  
ISSN 2050-9847

**Strategic Partners**



**Editorial Chapters:**

1	<b>Loan Syndications and Trading: An Overview of the Syndicated Loan Market –</b> Bridget Marsh & Ted Basta, The Loan Syndications and Trading Association	1
2	<b>Loan Market Association – An Overview –</b> Nigel Houghton, Loan Market Association	7
3	<b>Asia Pacific Loan Market Association – An Overview –</b> Janet Field & Katy Chan, Asia Pacific Loan Market Association	12

**General Chapters:**

4	<b>An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions –</b> Thomas Mellor & Marcus Marsh, Morgan, Lewis & Bockius LLP	15
5	<b>Global Trends in the Leveraged Loan Market in 2016 –</b> Joshua W. Thompson & Caroline Leeds Ruby, Shearman & Sterling LLP	20
6	<b>Escrow Funding in the Term Loan B Market –</b> Meyer C. Dworkin & Samantha Hait, Davis Polk & Wardwell LLP	26
7	<b>Commercial Lending in a Changing Global Regulatory Environment: 2017 and Beyond –</b> Bill Satchell & Elizabeth Leckie, Allen & Overy LLP	30
8	<b>Acquisition Financing in the United States: 2017... Uncertainty! –</b> Geoffrey R. Peck & Mark S. Wojciechowski, Morrison & Foerster LLP	33
9	<b>A Comparative Overview of Transatlantic Intercreditor Agreements –</b> Lauren Hanrahan & Suhrod Mehta, Milbank, Tweed, Hadley & McCloy LLP	39
10	<b>A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements –</b> Sarah M. Ward & Mark L. Darley, Skadden, Arps, Slate, Meagher & Flom LLP	46
11	<b>The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasts –</b> Michael C. Mascia & Wesley A. Misson, Cadwalader, Wickersham & Taft LLP	56
12	<b>Recent Developments in U.S. Term Loan B –</b> Denise Ryan & David Almroth, Freshfields Bruckhaus Deringer LLP	59
13	<b>The Growth of European Covenant Lite –</b> James Chesterman & Jane Summers, Latham & Watkins LLP	65
14	<b>Yankee Loans – What You Need to Know –</b> Alan Rockwell & Denise Gibson, Allen & Overy LLP	68
15	<b>Debt Retirement in Leveraged Financings –</b> David A. Brittenham & Scott B. Selinger, Debevoise & Plimpton LLP	76
16	<b>In re Motors Expands Future Claimants' Rights at Expense of 363 Purchasers –</b> George E. Zobitz & Omid H. Nasab, Cravath, Swaine & Moore LLP	82
17	<b>The Continuing Evolution of Middle Market Lending –</b> Sandra Lee Montgomery, Proskauer Rose LLP	87
18	<b>An In-house Legal Team's Views on the Roles and Responsibilities of External Deal Counsel on Lending Transactions –</b> Clifton Prabhu & Charles Bronowski, HSBC	93
19	<b>The Section 363 Sale Process: Key Considerations for the Prepetition Secured Lender –</b> Zachary H. Smith, Moore & Van Allen, PLLC	97
20	<b>Distributed Ledger Technology, The Internet of Things (IoT) and Artificial Intelligence and Cognitive Analytics: The Future of Trade Finance is Rapidly Approaching –</b> Josias Dewey, Holland & Knight LLP	102
21	<b>Marketplace Lending –</b> Vanessa Spiro & Edward Dartley, K&L Gates LLP	108
22	<b>Overview of Sanctions Programs Affecting the Lending Market in the United States –</b> Joseph F. Giannini & Adrienne Sebring, Chadbourne & Parke LLP	114

**Country Question and Answer Chapters:**

23	<b>Andorra</b>	Montel&Manciet Advocats: Audrey Montel Rossell & Liliana Ranaldi González	119
24	<b>Argentina</b>	Marval, O'Farrell & Mairal: Juan M. Diehl Moreno & Diego A. Chighizola	125
25	<b>Australia</b>	King & Wood Mallesons: Yuen-Yee Cho & Elizabeth Hundt Russell	134
26	<b>Belgium</b>	White & Case LLP: Hadrien Servais & Nathalie Colin	142
27	<b>Bolivia</b>	Crales & Urcullo: Andrea Mariah Urcullo Pereira & Daniel Mariaca Alvarez	149
28	<b>Botswana</b>	Khan Corporate Law: Shakila Khan	156

Continued Overleaf →

Further copies of this book and others in the series can be ordered from the publisher. Please call +44 20 7367 0720

**Disclaimer**

This publication is for general information purposes only. It does not purport to provide comprehensive full legal or other advice. Global Legal Group Ltd. and the contributors accept no responsibility for losses that may arise from reliance upon information contained in this publication. This publication is intended to give an indication of legal issues upon which you may need advice. Full legal advice should be taken from a qualified professional when dealing with specific situations.

Country Question and Answer Chapters:

29	<b>Brazil</b>	Pinheiro Neto Advogados: Ricardo Simões Russo & Leonardo Baptista Rodrigues Cruz	164
30	<b>British Virgin Islands</b>	Maples and Calder: Michael Gagie & Matthew Gilbert	172
31	<b>Canada</b>	McMillan LLP: Jeff Rogers & Don Waters	179
32	<b>Cayman Islands</b>	Maples and Calder: Tina Meigh	188
33	<b>Chile</b>	Carey: Diego Peralta	195
34	<b>China</b>	King & Wood Mallesons: Jack Wang & Stanley Zhou	202
35	<b>Cyprus</b>	E & G Economides LLC: Marinella Kilikitas & George Economides	209
36	<b>Denmark</b>	Nielsen Nørager Law Firm LLP: Thomas Melchior Fischer & Brian Jørgensen	217
37	<b>England</b>	Allen & Overy LLP: Darren Hanwell & Temi Esho	224
38	<b>Finland</b>	White & Case LLP: Tanja Törnkvist & Oona Lilja	233
39	<b>France</b>	Orrick Herrington & Sutcliffe LLP: Emmanuel Ringeval & Cristina Radu	240
40	<b>Germany</b>	King & Spalding LLP: Dr. Werner Meier & Dr. Axel J. Schilder	250
41	<b>Greece</b>	KPP Law Firm: George N. Kerameus & Ilianna Sotiria Koraki	262
42	<b>Hong Kong</b>	King & Wood Mallesons: Richard Mazzochi & David Lam	270
43	<b>Hungary</b>	Lakatos, Köves and Partners: Szabolcs Mestyán & Andrea Spisák	277
44	<b>India</b>	HSA Advocates: Anjan Dasgupta & Harsh Arora	285
45	<b>Indonesia</b>	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Ayik Candrawulan Gunadi	295
46	<b>Ireland</b>	Maples and Calder: John Breslin & David Burke	303
47	<b>Italy</b>	Chiomenti: Giulia Battaglia & Gregorio Consoli	310
48	<b>Ivory Coast</b>	IKT & associates: Annick Imboua-Niava & Othser Henri Tella	319
49	<b>Japan</b>	Anderson Mori & Tomotsune: Taro Awataguchi & Yuki Kohmaru	325
50	<b>Korea</b>	Lee & Ko: Woo Young Jung & Yong-Jae Chang	333
51	<b>Mexico</b>	Gonzalez Calvillo, S.C.: José Ignacio Rivero Andere	341
52	<b>Norway</b>	Advokatfirma Ræder DA: Kyrre W. Kielland & Anne Christine Wettre	348
53	<b>Peru</b>	Estudio Saco-Vertiz & Landerer: Carlos Saco-Vertiz Tudela & Jaime Sabat Pancorvo	357
54	<b>Russia</b>	Morgan, Lewis & Bockius LLP: Grigory Marinichev & Alexey Chertov	366
55	<b>Singapore</b>	Drew & Napier LLC: Valerie Kwok & Blossom Hing	373
56	<b>South Africa</b>	Allen & Overy LLP: Lionel Shawe & Lisa Botha	382
57	<b>Spain</b>	CUATRECASAS: Manuel Follía & María Lérida	391
58	<b>Sweden</b>	White & Case LLP: Carl Hugo Parment & Tobias Johansson	401
59	<b>Switzerland</b>	Pestalozzi Attorneys at Law Ltd.: Oliver Widmer & Urs Klöti	408
60	<b>Taiwan</b>	Lee and Li, Attorneys-at-Law: Hsin-Lan Hsu & Cyun-Ren Jhou	417
61	<b>UAE</b>	Morgan, Lewis & Bockius LLP: Ayman A. Khaleq & Amanjit K. Fagura	425
62	<b>USA</b>	Morgan, Lewis & Bockius LLP: Thomas Mellor & Rick Eisenbiegler	437
63	<b>Venezuela</b>	Rodner, Martínez & Asociados: Jaime Martínez Estévez	448

# Marketplace Lending

K&L Gates LLP



Vanessa Spiro



Edward Dartley

## Introduction

Innovations in financial technology (“fintech”) are transforming the provision of financial services to consumers and small businesses in ways that are at once profound and mundane. The nascent online lending – or “marketplace lending” – industry is a key beneficiary and driver of this innovation. Marketplace lenders marry third party capital providers with potential consumer and small business borrowers via data-driven online platforms. Most online platforms focus on one market segment, such as consumer loans, small business loans, student loans, real estate loans or microfinance.

While the industry has enjoyed steady growth over the last several years, marketplace lending remains a relatively small part of domestic and global lending markets. The evolution of the online consumer lending industry can be traced in the bewildering array of names that have been used to describe it. Originally known as “peer-to-peer” or “P2P” lending, it began with a focus on facilitating lending by individual investors to individual consumer borrowers. Over time the terminology changed to reflect the increasing variety of financial products offered by online platforms, the evolution of their funding strategies and the growing involvement of institutional investors in the online consumer lending market, which in many ways crowds out the individual “peer” investors that originally supported the industry.

With the continued growth and evolution of marketplace lending, now is an opportune time for loan market participants to gain an understanding of marketplace lending and consider ways in which this new segment of the financial services industry may offer opportunities for loan market participants. In this article, we explain the mechanics of marketplace lending, provide an overview of the existing regulatory framework and explore whether marketplace lending may present opportunities for loan market participants.

## What is Marketplace Lending?

### Where Did It Come From?

Marketplace lending moves the timeless practice of individual lending to an online platform (“Platform”) where algorithms and other technology are used to rapidly and efficiently match prospective borrowers seeking credit with prospective lenders seeking to invest capital. Early “peer-to-peer” Platforms provided an alternative to traditional banks by offering small loans to individuals that the banking industry could not profitably service and who might not otherwise have access to credit. Without the expenses associated

with traditional banking establishments, such as maintaining and staffing brick-and-mortar branches and complying with regulatory capital and other prudential requirements, Platforms were able to minimise costs, thereby making smaller personal and business loans economically feasible. Following the financial crisis in 2008, many consumers were unable to obtain credit from traditional lenders on reasonable terms – or any terms at all. This, combined with the lack of applicable banking regulations and the speed with which tech-savvy non-bank Platforms could source borrowers online and use algorithms to automate credit determinations, made Platforms a viable and attractive alternative to financial institutions and marked a turning point in their popularity.

### How Does It Work?

The structure and process of marketplace lending has evolved over the years. While there are variations, the following is a description of how many Platforms are typically structured. The lending process begins on the website of a Platform operator (an “Online Lender”) where prospective borrowers and prospective lenders register to participate. Platforms typically allow prospective lenders to specify certain investment criteria, such as credit attributes, financial data and loan characteristics, which, together with the Platform’s proprietary credit algorithms, help lenders model targeted returns and construct their loan portfolios. Investors typically also deposit funds in a segregated deposit account maintained by the Online Lender in amounts sufficient to cover any prospective loans they have expressed an interest in funding.

Prospective borrowers complete loan applications and the Online Lender uses that information to determine whether a prospective borrower and proposed loan meet the Platform’s lending standards. If the standards are met, the Online Lender assigns a proprietary credit rating and interest rate to the loan. Those details, together with certain information, are posted on the Platform website (unless the Online Lender decides to fund the loan on its own balance sheet) and prospective lenders determine whether they would like to fund all or a part of the loan.

Once there are sufficient commitments from prospective lenders to fund the loan, the Online Lender either originates the funded loan directly or through an affiliated or third-party bank or licensed lender that advances the principal amount of the loan. The originating bank typically deducts an origination fee from the funded loan amount, and a portion of that fee is paid by the originating bank to the Online Lender as a transaction fee. The relationship between the Online Lender and originating bank is often governed by a loan account program agreement.

Next, the originating bank sells and assigns, and the Online Lender purchases and assumes, the funded loan from the bank at the face amount using lender funds on deposit with the Online Lender. As consideration for the originating bank's agreement to sell and assign the funded loan, the Online Lender typically pays the bank a periodic fee (usually monthly) in addition to the purchase price of the loan.

After the Online Lender purchases the funded loan, it may choose to hold the loan on its own balance sheet, but often the loan is transferred into a trust that will then issue "payment dependent notes" to lenders that meet eligibility requirements ("Platform Note"). Each Platform Note represents an allocated share of all principal and interest payments received by the Online Lender for a specific loan, net of service fees charged by the Online Lender. Platform Notes are typically non-recourse and entitle the holder to principal and interest payments to the extent paid by the borrower. Platform Notes may be unsecured obligations, secured obligations or structured as participation interests or payment intangibles that represent a beneficial ownership interest in a portion of a specific loan. In these circumstances, the lenders assume the credit risk on the loan and the Online Lender services the loan on behalf of the lenders.

The process described above contemplates multiple lenders funding a single loan and receiving fractional interests. Platforms may also offer whole loans. In the case of a whole loan, an Online Lender may sell entire portfolios of loans to lenders that want to hold loans on their own balance sheets either in a single portfolio or on a flow-through basis. Unlike Platform Notes, whole loans are sold through master loan purchase agreements, with the loan purchaser also executing a master servicing agreement with the Online Lender.

## Overview of Regulatory Framework

Despite increasing attention from regulators, there is no comprehensive framework for the regulation of marketplace lending. Instead, industry oversight remains a relative patchwork of efforts by different agencies, both federal and state, acting directly and indirectly. Below we provide an overview of the regulatory framework that surrounds the marketplace lending industry.

### Securities Act

Unlike the corporate loans that loan market participants are accustomed to, Platform Notes are "investment contracts" and therefore considered "securities" under the Securities Act of 1933 (the "Securities Act"). Platform Notes may be offered in public offerings made pursuant to a registration statement that has been filed with the Securities and Exchange Commission ("SEC"), but because registration is expensive and time consuming, Online Lenders may choose to offer Platform Notes in exempt transactions, typically in private placements under Regulation D. Alternatively, Online Lenders may choose to offer Platform Notes in unregistered public offerings pursuant to Regulation A, as amended.

#### *Private Placements*

Rule 506 of Regulation D provides issuers engaged in private placements with a "safe harbor" that ensures such offerings will be exempted from registration. Issuers have two options under the safe harbor: Rule 506(b) and Rule 506(c). Rule 506(c) was recently added to Regulation D pursuant to the Jumpstart Our Business Startups Act (the "JOBS Act") to broaden the scope of permitted private placement communications with prospective investors.

Both Rule 506(b) and 506(c) allow issuers to offer an unlimited amount of securities to an unlimited number of investors so long

as they are "accredited investors" as defined in Rule 501(a) under Regulation D.<sup>1</sup> Both rules also require the issuer to undertake some level of review of the investor's status as an accredited investor, either before providing offering materials or before the ultimate sale.<sup>2</sup> However, a key difference between the rules is that Rule 506(b) prohibits the use of general solicitations and advertising, whereas Rule 506(c) does not include similar limitations. The effect of this difference is that an Online Lender engaged in an offering of Platform Notes under Rule 506(b) must limit its marketing communications to prospective investors to avoid being considered engaged in a general solicitation. This makes Rule 506(c) more appealing so long as issuers are able to adequately verify the accredited investor status of investors.<sup>3</sup>

Regardless of whether an offering is made under Rule 506(b) or Rule 506(c), a Form D must be filed in each state in which an offering is made pursuant to Regulation D. The cost of these multistate filings may lead an Online Lender to consider limiting each offering to purchasers in a discrete number of states.

#### *Public Offerings Pursuant to Regulation A and A+*

Regulation A was initially adopted to create an exemption for certain public offerings of limited sizes. However, due to the conditions it imposed, issuers more frequently used Rule 506. As a result, Regulation A was amended by the JOBS Act in 2015 and subsequently became known as "Regulation A+". Regulation A+ permits qualifying issuers to engage in public offerings of securities up to a specified annual limit that depends on whether the issuer is a Tier 1 issuer (up to \$20 million) or a Tier 2 issuer (up to \$50 million). As with a registered offering, Regulation A+ requires that the issuer provide specified disclosures to investors and file an offering statement with the SEC. Though Regulation A+ provides greater flexibility than Regulation D, the annual volume limits make it an impractical option for an Online Lender that intends to have continuous offerings. Accordingly, it is only a feasible option for smaller Online Lenders that are still in the process of increasing their volume.

#### *Registered Offerings on Form S-1*

In order for Platform Notes to be offered to the public without the volume restrictions of Regulation A+, they must be offered and sold pursuant to a registration statement that is filed with the SEC. The offer and sale may be registered on either Form S-1, for continuous offerings or Form S-3, for a securities shelf. Both approaches present significant limitations on the Online Lender's ability to offer multiple series of Platform Notes using a single base prospectus. In addition, issuers who file for continuous offerings are subject to ongoing requirements to monitor and update the prospectus. As a result, the registration process may be expensive and time consuming.

#### *Blue Sky Laws*

State securities laws ("Blue Sky laws") also require registration of publicly offered securities unless an exemption applies. In most states, the only exemption from registration available for Platform Notes is an exemption for sales of securities to certain classes of institutional investors, such as banks, insurance companies, investment companies, pension funds and similar institutions. Because Platforms tend to market offerings broadly, this will result in multiple state registrations.

#### *Secondary Trading*

Investors should also consider the resale restrictions that apply under the securities laws. The way in which the Online Lender originally sold the Platform Notes to the investor will dictate the applicable resale restrictions. Investors that purchase Platform Notes in a registered public offering or under Regulation A+ will be able to

resell them without restriction under the Securities Act. However, investors may encounter resale restrictions at the state level.

Platform Notes that are issued and sold in a private placement under Rule 506 are “restricted securities” as defined in Rule 144 under the Securities Act. Restricted securities may not be resold unless the offer and sale are registered under the Securities Act or are made in a transaction that is exempt from the registration requirements of Section 5 of the Securities Act. Registering an offering of Platform Notes is not practical because of the time and expense involved. The three main transactional exemptions under the Securities Act are Rule 144, Rule 144A and Section 4(a)(7). Unfortunately for those hoping to develop a broad trading market for unregistered Platform Notes, these exemptions come with significant restrictions. Rule 144 imposes either a six-month or one-year holding period on potential sellers,<sup>4</sup> and Rule 144A’s requirements have the effect of limiting purchasers to large institutional investors.<sup>5</sup> In contrast, Section 4(a)(7) requires that securities only be outstanding for 90 days and allows for a broader universe of purchasers by specifying that they only need to be accredited investors. Section 4(a)(7) also requires that sellers not be subject to certain disqualifying events and not offer the securities through general solicitation or advertising. This latter requirement poses challenges for those seeking to develop online trading platforms for Platform Notes, but Section 4(a)(7) still presents the most feasible approach for secondary trading of Platform Notes. As with unrestricted securities, Blue Sky laws are also a consideration.

---

#### Exchange Act, Advisers Act and Investment Company Act

---

##### *Exchange Act*

Securities sold pursuant to an effective registration statement under the Securities Act also become subject to ongoing reporting requirements under Section 15(d) of the Exchange Act. These include annual (Form 10-K) and quarterly (Form 10-Q) reports that require significant effort to prepare.

Transaction-based compensation has long been regarded by the SEC as a hallmark characteristic of a broker-dealer under Section 15 of the Exchange Act.<sup>6</sup> Therefore, an Online Lender could potentially be required to register as a broker-dealer under the Exchange Act if it were to charge a sales commission or receive other transaction-based compensation upon the sale of Platform Notes. In order for an Online Lender not to be considered a broker-dealer, the compensation paid to it should be based on a spread between the amounts received on underlying loans and the amounts paid to investors on the associated Platform Notes. Origination and servicing fees related to the underlying loans also would not be considered transaction-based compensation in relation to the sale of Platform Notes.

Online Lenders considering establishing an online trading platform to facilitate secondary trading of Platform Notes should note that any such platform would need to be operated by a registered broker-dealer. The Exchange Act would likely also require such an electronic platform to register with the SEC as an “alternative trading system”.

##### *Investment Adviser Registration*

The Investment Advisers Act of 1940 (the “Advisers Act”) requires investment advisers to register with the SEC unless an exemption applies. Section 202(a)(11) of the Advisers Act defines an investment adviser as a person who, for compensation, engages in the business of advising others as to the value of securities or advisability of investing in, selling, or purchasing them. In order to avoid potential registration and regulation as an investment adviser

under the Advisers Act and similar state laws, Online Lenders should not charge separate compensation for advice regarding, among other things, the advisability of investing in Platform Notes generally, which Platform Notes to purchase, or any other topic related to the value of Platform Notes.

##### *Investment Company Registration*

As described above, with the evolution of funding models for marketplace lending, Online Lenders have increasingly held loans on their balance sheets or in a subsidiary or other controlled entity. If those loans are deemed securities, the Online Lender (or any affiliate holding the loans) may be an investment company as defined in the Investment Company Act of 1940 (the “Investment Company Act”). This is because the Investment Company Act generally treats any company that holds more than 40% of the value of its total assets in investment securities as an investment company.<sup>7</sup> If the Online Lender or an affiliate were an investment company, it would be required to register as such with the SEC and it would be subject to regulation under the Investment Company Act. An Online Lender could not function under the Investment Company Act. Among other things, the Investment Company Act’s restrictions on affiliated transactions would likely prohibit the Online Lender from issuing and/or acquiring the loans that serve as the basis for the Platform Notes.

Several exemptions from the definition of investment company are available to Online Lenders. The applicability of these exemptions in a particular case would depend on the precise model used and the types of loans the Online Lender holds. The Investment Company Act analysis applicable to a particular Platform would also depend on a wide range of facts and circumstances. These could include such matters as whether loans are made primarily to consumers or to businesses, the purpose of the loans, whether loans are secured and, if so, the nature of the collateral and the nature of the sponsor’s business and balance sheet.

---

#### Other Issues

---

While the Securities Act, Exchange Act, Advisers Act and Investment Company Act impose significant requirements on marketplace lending activities, various other federal and state regulators and laws and regulations, including state usury and licensing laws, data privacy laws, anti-money laundering laws and consumer-protection laws, also have the ability to impact marketplace lending.

##### *Prudential Regulatory Considerations*

The fintech industry, and marketplace lending in particular, are receiving increased focus from the prudential regulators. While the marketplace lending industry is too small to give rise to systemic financial stability concerns, regulators have expressed concern about several areas where marketplace lending could be misused in dangerous ways. For example, the Federal Reserve has been concerned that Online Lenders’ powerful algorithms and data crunching ability could lead to a gradual reintroduction of redlining practices that would be illegal for regulated financial institutions.

On the other hand, the prudential regulators and the United States Treasury have been open to the growth of online lending in principle. The Office of the Comptroller of the Currency (the “OCC”) was particularly active in 2016,<sup>8</sup> concluding the year with a December announcement that it would consider fintech company applications for special purpose bank charters.<sup>9</sup> In May 2016, the U.S. Department of Treasury issued a white paper summarising the responses it received to its July 20, 2015 request for information on the marketplace lending industry and providing recommendations on how to promote “safe growth” of the industry.<sup>10</sup> Each of these

initiatives faces particular challenges, and state banking regulators have taken their own direction in important matters. For example, the Conference of State Bank Supervisors has questioned the OCC's authority to grant a fintech charter as proposed, and New York's anti-bank partnership legislation, described in more detail below, invites scepticism about the prospects for convergence of marketplace lending with traditional banking.

#### *State Usury and State Licensing*

While some Platforms originate loans through affiliated banks or licensed lending companies, many acquire the loans they originate from banks that act as lenders of record for the underlying loans. Using a federally insured depository institution to serve as lender of record, sometimes referred to derisively as "rent-a-charter", affords the benefits of federal preemption to subsequent assignees of the loan, including the Platform and its investors. Under federal preemption, a loan can be originated nationwide without the lender being licensed in any state, and the loan can bear an interest rate and fees that are permitted in the home state of the lender of record, regardless of the borrower's location. There have been some relatively recent challenges to this view of preemption in various jurisdictions, including West Virginia and New York. Consequently, there is a lack of clarity in certain jurisdictions as to whether federal preemption will protect assignees from running afoul of state usury laws.

Some states, including New York, Colorado, Vermont and West Virginia, seek to regulate the "bank origination" model of marketplace lending by introducing legislation to require state licensing of entities that merely market loans to their residents, even if those entities do not originate the loans. For example, the New York Budget legislation has recently proposed expanding lender licensing requirements by requiring that entities that solicit loans in state and also purchase or otherwise acquire from others the loans or facilitate financing those loans with respect to all loans of \$25,000 or less (consumer) or \$50,000 or less (commercial) bearing an interest rate above 16% be subject to licensing and possibly the same usury requirements that would apply to a non-licensed lender. Violation of the licensing requirements renders the loans void and unenforceable.

#### *Privacy, Data Protection and e-Commerce*

The nature of the business and the contractual arrangements of Platforms and Online Lenders raise a variety of issues that may be material to investors. Data privacy is an important issue for Platforms, and the disclosure of the applicable risks and compliance issues is relevant to the securities offering process. Privacy policies may be material, as well as whether the Online Lender provides its borrowers the privacy notices required under federal law. Another material area of concern may be seen in Platforms' terms of use, particularly to the extent that they are subject to rules governing electronic commerce. Platform users typically consent to electronically sign all agreements presented to them on the Platform, to be bound by their electronic signature, and to receive all documents and notices electronically.

#### *Anti-Money Laundering and Bank Secrecy Act*

The current political climate has focused attention on the intersection of the marketplace lending industry and regulatory concerns relating to counterterrorism and national security. Notably, marketplace lending is subject to anti-money laundering laws and regulations under the Bank Secrecy Act as amended by the USA PATRIOT Act. Non-bank Platforms may not be directly subject to these obligations, but depending on their structure and services offered, a

Platform may be subject to regulation as a money-services business, a money transfer system, an investment company, an investment adviser, or a broker-dealer. These regulatory concerns indirectly affect investment managers and their investors.

#### *Consumer Protection*

To the extent that an online lending marketplace is involved with loans to consumers, the rules enforced by the Consumer Financial Protection Bureau are a material consideration for the companies and their investors. These include the Truth in Lending Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act and the Consumer Credit Protection Act. There may also be applicable state laws to the extent that federal law does not have preemptive effect. These affect disclosures, indemnifications and other material issues.

### **How Might Marketplace Lending Evolve to Attract Loan Market Participants?**

Marketplace lending has greatly evolved from its early days of peer-to-peer lending driven by sheer necessity, and traditional banks and Platforms have since partnered in several different formats. These partnerships combine a bank's source of capital and its customer database with the time-saving technology and access provided by a Platform. Examples include partnering in the origination space such as the arrangement between WebBank and Lending Club, where WebBank originates loans that it sells to Lending Club, and the partnership between Regions Bank and Avant to leverage Avant's platform to offer unsecured loans to Regions Bank customers. Some large financial institutions have announced that they are building out their own Platforms to service retail customers and small businesses in a manner that mimics the partnership of Platforms and banks.

Do these connective partnerships and products provide an attractive opportunity for loan market investors? As currently constructed, these arrangements do not represent immediate opportunities for loan market participants. The underlying products, home mortgages, credit cards and auto loans, are not typically the kinds of loans in which loan market participants invest. Nor are the borrowed amounts for those kinds of loans generally sufficient for investors seeking to trade individual corporate loans, as each loan is often significantly less than \$1 million, the minimum threshold for a debt trade in the corporate loan market. Another hurdle for Platforms with respect to building a product for the loan market investor is the role of the Online Lender or its servicer. Loans originated online are serviced by the Online Lender or, if funded pursuant to a notes issuance, by a servicer similar to those in other securitisation products. The Online Lender or servicer is contractually obligated to act in prescribed ways within set deadlines upon loan defaults. Accordingly, to the extent that asset class is interesting to loan market participants, it would more likely be pursued only by those loan market investors that pursue those kinds of assets or securitisation products. In the traditional corporate loan market setting, there is a loan agent who performs significant loan administrative tasks and duties, including those directed by the lender group, which has the ability to collectively agree to direct the loan agent to take, or not to take, actions and seek remedies in times of borrower distress.

However, if Platforms can deliver larger loan amounts efficiently and quickly, it is possible that marketplace lending could expand to service larger commercial business borrowers. This evolution could provide the impetus for building loan market investor demand for such loans, which demand, in turn, would fuel more lending opportunities for Platforms.

The logical next step for Platforms to increase commercial business borrower activity is to infiltrate the lower middle market lending market, conservatively defined as loans aggregating less than \$100 million per borrower, and/or borrowers with an annual EBITDA of greater than \$10 million or so. This market tends to be supported by club deals, a small group of lenders who often hold the debt to maturity; liquidity in the secondary trading market is not a focus. The loan structures are fairly conservative and the loan documentation contains significant protections in favour of the lenders, including the imposition of ongoing reporting obligations on the borrower. The club of lenders willing to participate in this process could select a manager for their Platform that is highly regarded and who could serve as loan agent for the club group. The loan documentation would include typical loan market reporting and other covenants and would need to grant the lender group, not the Online Lender, with its traditional and customary input on collective action matters. In addition, the tenor of these loans would need to be consistent with middle market expectations, typically five or six years, rather than the shorter Platform loan tenor currently in place. With these tweaks to the online platform loan structure, it is possible that lower middle market borrowers could find their capital needs well met by the online lending platform model. The benefits to both the borrower and the club participants would be the ease of execution in a highly cost efficient manner.

Success in the lower middle market could lead online marketplace lenders to consider expanding into larger corporate loans that are widely syndicated. The trading protocols of this market include a minimum trading threshold of \$1 million, soft call protection, expectations of transparency into the market for such loans, rules regarding non-disclosure of confidential information and often the need for consents to trade, together with documentation requirements for such trades. The Online Lender or a selected servicer would need to serve the role of loan agent for purposes of addressing these trading protocols, and others, including the maintenance of a loan registry.

Additionally, the borrowers for whom these Platforms are available would likely impose eligibility requirements with respect to possible assignees of their debt, including outright prohibitions on competitors or specified others purchasing the debt or receiving information under the loan documentation. Would the Online Lender of a Platform be expected to police this? Such outcome seems unlikely, but there might be a perceived decrease in control over these matters if a Platform, rather than a traditional financial institution with a longstanding business relationship with the borrower, is responsible for these tasks.

The corporate loan market is a bespoke market, with its own protocols and idiosyncrasies that may prove challenging to marketplace lending's entry into the arena absent some modifications to online marketplace lending to address these matters. The functions performed by loan agents are not easily transferred to Platforms without a corresponding replacement in some form for the administrative and active role of the bank agent. Loan market participants expect certain rights in managing the credit, such as the receipt of ongoing reporting, measurement of financial performance and a vote on collective action matters, and borrowers expect the right to know the identity of their lenders and have consent rights over debt assignees, none of which is currently granted by Platforms. Platforms arose to meet specific capital needs of consumers and small businesses not met in the financial crisis or in the waning support from traditional banks in those markets thereafter. If Platforms build critical mass and overcome the burden and costs of regulatory overlay, it is conceivable that there will be opportunities to craft products that entice loan market investors to participate in loans originated online.

## Endnotes

1. Generally, the term "accredited investor" includes companies with total assets of more than \$5 million, companies in which all equity owners are accredited investors, natural persons with a net worth (alone or with a spouse) of more than \$1 million, and natural persons with an individual income in excess of \$200,000 in each of the two most recent years, or joint income with a spouse in excess of \$300,000 in each of those years, and a reasonable expectation of reaching the same income level in the current year. Under Rule 506(b), an issuer may also offer securities to up to 35 non-accredited investors, but doing so imposes certain disclosure requirements.
2. An Online Lender that offers Platform Notes in reliance on Rule 506(b) must have a reasonable belief that each prospective investor who views offering materials for the Platform Notes are "accredited investors". An Online Lender that offers Platform Notes in reliance on Rule 506(c) must take reasonable steps to "verify" that all persons who ultimately purchase Platform Notes are "accredited investors". The staff of the Securities and Exchange Commission has indicated that the verification standards under Rule 506(b) and Rule 506(c) are not materially different. *See generally* SEC, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 78 Fed. Reg. 44771 (July 24, 2014) (discussing the factors to consider in determining whether a method constitutes "reasonable steps to verify", including: the nature of the purchaser and the type of accredited investor that the purchaser claims to be; the amount and type of information that the issuer has about the purchaser; and the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount).
3. The safe harbor methods for verification generally include reviewing Internal Revenue Service forms reporting income, reviewing certain statements of assets provided by regulated financial entities in conjunction with consumer reports describing liabilities, and obtaining written confirmation from certain registered entities that they have taken reasonable steps to verify accredited status.
4. Rule 144 allows a non-affiliate of the issuer to resell unregistered securities without registration if the investor has held the securities for either six months or one year, depending upon whether or not the issuer is a reporting company under the Exchange Act.
5. Rule 144A allows non-issuers to resell unregistered securities without registration if they are sold to a "qualified institutional buyer" (a "QIB") and certain other requirements are met. To qualify as a QIB, a purchaser must be an entity and, with few exceptions, it must hold at least \$100 million in securities investments.
6. Brumberg, Mackey & Wall, P.L.C., SEC Staff No-Action Letter (May 17, 2010).
7. Investment Company Act, Section 3(a)(1)(C).
8. Office of the Comptroller of the Currency, Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016); Office of the Comptroller of the Currency, Recommendations and Decisions for Implementing a Responsible Innovation Framework (Oct. 2016).
9. Thomas J. Curry, Comptroller of the Currency Regarding Special Purpose National Bank Charters for Fintech Companies, Georgetown University Law Center (Dec. 2, 2016); Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (Dec. 2016).
10. U.S. Department of the Treasury, Opportunities and Challenges in Online Marketplace Lending (May 10, 2016).



**Vanessa Spiro**

K&L Gates LLP  
599 Lexington Avenue  
New York, NY 10022-6030  
USA

Tel: +1 412 355 6355  
Fax: +1 412 355 6501  
Email: [vanessa.spiro@klgates.com](mailto:vanessa.spiro@klgates.com)  
URL: [www.klgates.com](http://www.klgates.com)

Vanessa Spiro is a partner at K&L Gates, focusing on banking and asset finance. She has substantial experience in leveraged finance and represents financial institutions and other creditor entities and borrowers (corporates, sponsors and other capital end-users) in connection with acquisition financings, cash flow and asset-based transactions and other finance matters. She also has significant experience in restructurings, workouts, distressed debt matters and debtor-in possession and exit financings. Ms. Spiro has been recognised for her work in both *The Legal 500* and *New York Super Lawyers*, and she has been listed in *Who's Who of American Women* and *Who's Who of American Lawyers*. She has been quoted by numerous media outlets and has appeared on Bloomberg Television to discuss loan market conditions.

**Edward Dartley**

K&L Gates LLP  
599 Lexington Avenue  
New York, NY 10022-6030  
USA

Tel: +1 212 536 4874  
Fax: +1 212 536 3901  
Email: [ed.dartley@klgates.com](mailto:ed.dartley@klgates.com)  
URL: [www.klgates.com](http://www.klgates.com)

Ed Dartley is a partner at K&L Gates and concentrates his practice on all facets of the asset management industry, with particular focus on advising clients in the fintech and marketplace lending (peer to-peer). With over a decade of experience as in-house counsel and chief compliance officer with an asset management group of registered investment advisers and private equity fund managers, Mr. Dartley has deep in-house experience and a unique perspective on how asset management works from the inside. Mr. Dartley continues to utilise this experience by serving as general counsel to a number of clients of the firm. Mr. Dartley also is a founding member of the Bloomberg Alternative Marketing Council, an advisory board founded by Bloomberg to define best practices in marketing for the alternatives industry.

## K&L GATES

K&L Gates comprises approximately 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organisations and individuals. As technologies and regulatory guidelines shape the burgeoning segment, lawyers in our Marketplace Lending Practice can assist sector participants in achieving their business and investment objectives, while managing risks. Whatever market niches, strategies, and algorithms our clients wish to develop, we work side by side with them to innovate and navigate the legal, regulatory, and commercial challenges of this evolving consumer debt market segment. We leverage our deep experience in consumer financial services regulation, e-commerce regulation, private equity, private fund formation, cybersecurity, finance and IP to provide holistic support to market participants and provide the legal underpinning to innovation in the delivery of financial services in marketplace lending.

## Other titles in the ICLG series include:

- Alternative Investment Funds
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Investigations
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Enforcement of Foreign Judgments
- Environment & Climate Change Law
- Family Law
- Fintech
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Outsourcing
- Patents
- Pharmaceutical Advertising
- Private Client
- Private Equity
- Product Liability
- Project Finance
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks
- Vertical Agreements and Dominant Firms

**glg** global legal group

59 Tanner Street, London SE1 3PL, United Kingdom  
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255  
Email: [info@glgroup.co.uk](mailto:info@glgroup.co.uk)

[www.iclg.co.uk](http://www.iclg.co.uk)