The Current State of Marketplace Lending and Investing

Recent legal and regulatory developments are affecting the ways that marketplace lenders and investors do business — and their impact will continue to be felt well into the future. This is a turbulent time in this developing industry and senior members of Pepper Hamilton's Marketplace Lending practice sat down for a podcast to discuss some of the industry's most significant issues and their implications leading into the 2016 Marketplace Lending + Investing Conference. Highlights from the podcast follow.

For more on these topics, listen to the full Pepper podcast at

http://www.pepperlaw.com/podcasts/stateofmpl

Madden v. Midland Funding

The *Madden* case's effects continue to reverberate throughout the industry. In June, the U.S. Supreme Court rejected Midland Funding's petition for a writ of certiorari. With the Court's denial to review the Second Circuit's holding, the case now moves back to the district court, which will focus on the choice of law issue and whether the holder of a loan can rely on the "valid when issued" doctrine under the applicable law.

Marketplace lenders and investors have been navigating the issues raised by *Madden* since the Second Circuit published its opinion in May 2015, with many taking a "wait and see" approach. Some, however, have amended their loan origination activities in response to the case to make sure, at a minimum, that the loans fall within the usury rules of New York, Connecticut and Vermont (the states comprising the Second Circuit).

CashCall Case and the True Lender Analysis

In August, the U.S. District Court for the Central District of California issued its ruling in *Consumer Financial Protection Bureau v. CashCall, Inc*. The court's holding applied the predominant economic interest test to find that CashCall, the loan servicer, was the true lender instead of the lender established by a tribal member that originated the loans. The court pointed to a number of determinative factors in its analysis, including that CashCall funded the loans and that the lender only held the loans for two days before transferring them to CashCall.

This is potentially an unwelcome result for the marketplace lending industry, but there is hope. *CashCall* is a fact-specific holding and provides a checklist of practices to avoid. Notably, banks should ensure there is an independent source of funding for loans and should avoid short holding periods. Originating lenders should also consider keeping "skin in the game" to bolster the case that they are the true lender.

Other Pending Cases

While *Madden* and *CashCall* are the biggest cases affecting marketplace lending, the industry should pay attention to a few others on the horizon. In Pennsylvania, the *Kane v. Think Finance* case alleges that Think Finance was the true lender in made loans in Pennsylvania. Meanwhile, in *Bethune v. LendingClub Corp*., the plaintiff accuses the marketplace lender of violating New York's state usury laws. Both cases are in their early stages, but Pepper Hamilton's marketplace lending team will be watching them closely as they progress.

FDIC Guidance

On the regulatory front, the Federal Deposit Insurance Corporation (FDIC) issued guidance in August on what activities a bank needs to undertake when originating loans for third parties, such as marketplace lenders. The extensive list of steps provided by the FDIC addresses underwriting, securities issues and compliance, with the net effect of banks needing to treat loans originated for marketplace lenders as if they will remain on the bank's balance sheet, which might raise costs.

CFPB Complaint Portal

The Consumer Financial Protection Bureau (CFPB) is also showing increased interest in marketplace lending. This summer, it announced that it would begin taking complaints about marketplace lenders through its complaint portal, and the agency has begun an initiative to start collecting data on small lenders, like marketplace lenders.

The complaint portal is a "Yelp type" database for logging feedback and complaints regarding the financial service industry, and these complaints are used as part of the CFPB's enforcement policy. Marketplace lenders should ensure they have a robust complaint resolution process to avoid complaints progressing to the CFPB, and investors should consider evaluating CFPB complaints when conducting due diligence before an investment, as a large number of complaints could indicate compliance issues.

Pepper Hamilton LLP
Attorneys at Law

Whole Loans and Securitizations

Recent industry trends seem to indicate that fewer investors are turning to securitizations and are instead looking elsewhere for yield and liquidity. While this trend is partly fueled by uncertainty caused by cases like *Madden* and *CashCall*, it is also a result of the ongoing debate as to whether whole loans are securities.

If whole loans are deemed securities, it could raise a number of concerns, including implicating broker-dealer regulation for those moving loans. The law on this point is still unclear, however, and regulators have been addressing the issue through the enforcement process instead of the rulemaking process. Until there is a clearer answer on the whole loans question, we expect to see some reluctance on the part of investors to consider securitizations.

Industry Transparency

There has been a growing push toward greater transparency within the marketplace lending space, and those lenders that do well with investors tend to be the most transparent. To increase transparency, marketplace lenders should focus on disclosures, reporting and providing a depth of detail about their business to investors. This may include disclosing borrower underwriting criteria to investor groups.

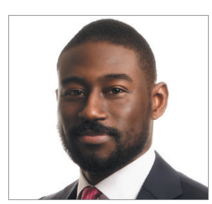
Come talk to us @ Booth 100

Julia D. Corelli
215.981.4325
corellij@pepperlaw.com

Richard P. Eckman
302.777.6560
eckmanr@pepperlaw.com

Gregory J. Nowak
212.808.2723
nowakg@pepperlaw.com

Todd R. Kornfeld
212.808.2724
kornfeldt@pepperlaw.com



Esuga T. Abaya
215.981.4340
abayae@pepperlaw.com

THE POWER OF COMMUNITY

No two players in the marketplace lending industry are alike. We represent clients worldwide in all segments of marketplace lending – platforms, investors, service providers, and even banks – to help them identify the legal issues that arise from their chosen approach to the market and we tailor legal solutions to their specific business objectives, risk tolerances and market constraints. We know marketplace lending companies – Pepper Hamilton LLP.

Berwyn
Boston
Detroit
Harrisburg
Los Angeles
New York
Orange County
Philadelphia
Pittsburgh
Princeton
Silicon Valley
Washington
Wilmington

pepper.law

Pepper Hamilton LLP
Attorneys at Law