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Marketplace Lenders: The CFPB's Surveillance Begins

Marketplace lenders have been quite a bit in the news these days. Just about every aspect of this business model is being looked at by investors and regulators – particularly the regulators and most particularly the CFPB!

Just yesterday, the Bureau announced that it would start tracking complaints relating to online marketplace lending. From this we can infer – given the CFPB's past method of rulemaking by enforcement – that these complaints will lead to heightened scrutiny, which will lead to non-judicial proceedings, which will lead to enforcement by settlement.

The Bureau will be adding these complaints to its complaint database, and especially that part of the database that involves “financial technology,” the term applied to the systemic technological process whereby individuals and even small businesses obtain access to loans funded by investors. This initiative was not just a tactic spawned out of its own regulatory mandate, since it was established after the Treasury sent out a request for information about the industry's operation last summer.

Director Richard Cordray has stated that the Bureau wants to ensure that consumers know exactly what to expect when they are seeking a loan. The CFPB's *modus operandi* reminds me of the policing equivalent of “taking names and numbers,” for, to quote Director Cordray, by collecting complaints, the CFPB will have a “better idea of how the marketplace lending industry works.” Having collected the complaints in Stage 1, probably Stage 2 will start the examination and non-judicial proceedings, thereafter to Stage 3, where settlements will flourish without adjudication of the claims in a court.

States Cordray:

“When consumers shop for a loan online, we want them to be informed and to understand what they are signing up for...All lenders, from online startups to large banks, must follow consumer financial protection laws.”

I dare say that most of us would agree with such a platitude!

The Bureau has also issued a consumer bulletin on marketplace lenders, highlighting

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[February 2016 \(3\)](#)

[January 2016 \(2\)](#)

issues that consumers should consider before they take out a loan using this type of loan origination platform.

How did marketplace lending get started? Online marketplace lenders – otherwise known as “peer to peer lenders” – actually began to grow as a result of the 2008 financial crisis. The goal of the marketplace lender was to offer credit financing to consumers and small businesses that were being shut out of the traditional banking system. These lenders saw their loan volumes surge after 2008, due to the fact that many banks strongly tightened their underwriting standards, resulting in more and more potential borrowers being denied credit. In effect, both consumers and small businesses, having been pushed aside with few financial resources, found marketplace lenders a viable option.

These are not large loans. Typically, they are small, with small businesses applying for loan amounts under \$100,000 and consumers applying for even smaller loan amounts. So this business model is a volume-based proposition. Unit volume is the key metric, and volume is very high. So high, it seems, that the Treasury claims this segment of the lending industry originated about \$12 billion in loans in 2014.

Upstream of the marketplace lender are the investors that purchase a cache of the loan units. The investors are mostly institutional; for example, pension funds, hedge funds, and so forth. Like many past instances of loan product securitization, this is Wall Street all the way! Companies that have made it to the top tier are such as Prosper Marketplace and Lending Club.


Lenders that sell their loans to investors are subject to all state and federal consumer financial protection laws as well as, where applicable, regulation by the Securities and Exchange Commission; and, to the extent that an investor has an alliance with a bank, that bank is also subject to the rules set forth by its prudential regulator.

But, oddly, there simply is no specific federal regulation at this time for online marketplace lenders – which leads us back to the Treasury's interest and, *mutatis mutandis*, the CFPB's escalation of monitoring and probable enforcement by settlement.

Since the Bureau has said that it expects to release a “larger participant” rule for consumer installment and vehicle title loans, such a rule giving the CFPB the authority to examine and directly supervise the largest firms in an industry, it is quite likely that this new rule will either directly state its application to marketplace lenders or be interpreted to include them.

Clearly, marketplace lenders have been responding to the financing needs of consumers and small businesses. It is equally obvious that consumers and small businesses want the financing being offered. Therefore, it will be important to determine whether any new regulations will constrain the fulfillment of those needs.

Jonathan Fox
President & Managing Director
Lenders Compliance Group

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