



# MARKETPLACE LENDING ASSOCIATION

## TESTIMONY OF NATHANIEL L. HOOPEES

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On behalf of the Marketplace Lending Association (MLA), thank you Chairman Luetkemeyer and Ranking Member Clay for the opportunity to testify before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit.

The MLA represents the marketplace lending industry, and our goal is to promote a transparent, efficient, and customer-friendly financial system by supporting the responsible growth of marketplace lending, fostering innovation in financial technology (fintech), and encouraging sound public policy. MLA limits its membership to marketplace lending platforms (MPPs) that meet specific standards of safety and responsibility toward consumers and the overall marketplace. To that end, MLA members must (i) be transparent with consumers about APR / annualized interest rates, penalties, and fees, by disclosing them up front and in plain English; (ii) not offer so-called “payday” or “high-cost installment loans” that are above the 36% APR threshold set by the FDIC; and (iii) adhere, in facilitating loans to small businesses, to the Responsible Business Lending Coalition’s Small Business Borrowers’ Bill of Rights or to an equivalent self regulatory standard.<sup>1</sup>

As the Chairman and Ranking Member know, fintech – and marketplace lending in particular – is no longer just an idea or a possibility, it is now a proven solution to a long-standing problem – the lack of access to a wide range of affordable credit options for tens of millions of working Americans, recent graduates, and millions of small businesses. This industry is effectively serving the broad American “middle class” that remains our engine for economic growth and prosperity. It is also bringing greater democracy to investment in credit – providing investment opportunities once only available to the wealthiest or largest institutional investors in society. MPPs are delivering new, beneficial products to consumers, in locations that many banks no longer can serve; and increasing needed competition in key markets.

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<sup>1</sup> See <http://www.borrowersbillofrights.org>

However, much work still needs to be done for more of the American “middle class” to fully realize and benefit from the potential of MPPs specifically and fintech more broadly. This Subcommittee and the full Committee can build on its previous work to make that happen with the following:

- Awareness: Hearings like this one are pivotal to making more Americans aware of the financial services MPPs have to offer. MLA strongly encourages this Subcommittee to hold more hearings and for members to meet with small businesses and consumers in their districts who are taking advantage of the new products on the market today. In certain products – such as student loan refinancing – MPP borrowers can save more than \$20,000 dollars via lower interest costs.<sup>2</sup> Yet according to a recent report by the Federal Reserve of Boston, only 25% of consumers “have heard of marketplace lending or recognize any of the names of the largest marketplace lenders.”<sup>3</sup> As that percentage increases – with this Subcommittee’s help – the benefits of MPPs will become more well-known and the impact of the innovating services of MLA’s membership will drive economic growth even more.
- Reaching the Underserved: MPPs are reaching communities that have traditionally been unbanked and underbanked. We encourage this Subcommittee to continue to explore how MPPs are accomplishing that in a responsible way to help millions of Americans secure a better financial future for themselves, for their families, and for the small businesses that create long term wealth. To that end, MLA would like to thank Rep. Emanuel Cleaver (D-MO-5), a member of the full Committee, for his thoughtful investigation of “Small Business Fintech” lending. Among Rep. Cleaver’s findings was the conclusion that “Fintech loans are more likely to be used by minority-owned businesses.”
- Opportunities for Congress: There are a series of bipartisan bills that MLA encourages Congress to take up and pass as soon as possible, including the Protecting Consumers’ Access to Credit Act of 2017 and the IRS Data Verification Modernization Act of 2017. In addition, Congress, led by this Committee, should encourage the revitalization of FDIC-

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<sup>2</sup> <https://commonbond.co/refinance-student-loan>

<sup>3</sup> <https://www.bostonfed.org/publications/current-policy-perspectives/2017/us-consumers-awareness-and-use-of-marketplace-lending.aspx>

supervised industrial loan companies (ILC), support the Special Purpose National Bank (SPNB) charter now under consideration by the OCC, reaffirm the powers of banks to build responsible third-party partnerships.

### **What are Marketplace Loans?**

The groundbreaking development and use of technology and data by MLA members makes it possible to interact with consumers on their terms, whether it is through a mobile device or on a computer, and make much faster underwriting decisions that are responsible and dependable. The innovative financial products delivered over that technology are helping millions pay off expensive credit card debt at lower rates, manage family emergencies, refinance student loan balances, save on interest when making necessary large purchases, and support small businesses.

The advanced technology that enables these products benefits both consumers and small business. Faster underwriting and adaption to mobile tailored to meet customer needs. In fact, a recent survey conducted by MLA with our industry partners confirmed that marketplace lending is working for small businesses. 95% of businesses surveyed that secured a loan online say it enabled or drove business growth – the capital made it possible to expand the number of locations, purchase new equipment, and manage cash flow. 98% of those borrowers said they would take out another loan from a marketplace lender and 70% said they have more lending options than they did just 5 years ago.<sup>4</sup> It is clear that new online options are helping address the small business credit gap that has persistently plagued our economy.<sup>5</sup>

In consumer fintech lending, two of the biggest misconceptions of the industry – perhaps developed back in the very earliest days of online lending – is that the loans are mostly short term loans that carry high rates. A second myth is that they are lightly regulated. The marketplace loans that have been widely embraced by consumers nationwide are neither of those things. The fintech data tracking firm dv01 advises that more than one million unsecured marketplace personal loans were issued last year – with an average loan balance of approximately \$14,000 and a term

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<sup>4</sup> <http://onlinesmallbusinesslending.org>

<sup>5</sup> <http://static1.squarespace.com/static/55ef54f0e4b099741343c590/t/5740396a7c65e42453c5a468/1463826794900/Bicameral+Briefing+on+the+Small+Business+Credit+Gap+FINAL.PDF>

of greater than 4 years – far from being a small dollar, short term loan. MPPs offering consumer loans do so at an average of 14.7% APR and 100% of the loans are below the 36% APR threshold.<sup>6</sup> Approximately \$25 billion in such loan volume currently outstanding. To address the second myth, these are well regulated loans, subject to all the same consumer lending standards as any other consumer loan, with significant oversight from a wide array of federal and state prudential and consumer protection regulators.

Online unsecured personal loans from marketplace lending platforms have become a critical alternative option for borrowers looking for an affordable transparent path out of higher cost (often credit card) debt. The growth of these unsecured fintech-driven personal loans has been propelled in large measure by consumers looking to avoid carrying revolving credit card debt at a high APR by using a personal installment loan to consolidate their existing revolving credit card debt into a fixed term loan; by consumers who want and need better choices. For the sake of a quick comparison, a review of all the credit card offers on bankrate.com reveals that APRs on such products consistently range from 14.75% - 27% APR. With more than \$1.023 trillion in credit card debt now outstanding, many borrowers need lower APR options to refinance and pay down their consumer debt.<sup>7</sup> This has yielded billions in savings for borrowers. LendingClub alone estimates that it has provided borrowers with over \$2.4 billion in savings from lower interest rates.

### **Reaching the Underserved**

To sum up another challenge that many MLA firms are working so hard to solve: the vast majority of American consumers reliably pay their debt obligations, yet less than half of Americans consistently qualify for prime credit. We believe we are making progress on this problem. Late last year the CFPB awarded the first ever no-action letter to Upstart Network, an MLA member company that uses alternative credit data and modeling in credit decisions.<sup>8</sup> And six months ago, the Federal Reserve of Philadelphia released a report that relied on data from Lending Club, one of the largest MPPs, and concluded in part that “lending activities by [F]intech lenders seem to have filled the credit gap”; and that the use of alternative data “has enhanced financial inclusion and allowed some borrowers to be assigned better loan

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<sup>6</sup> <https://www.dv01.co>

<sup>7</sup> <https://www.americanbanker.com/news/credit-card-debt-hits-all-time-high-of-1023-trillion-fed>

<sup>8</sup> <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/>

ratings and receive lower priced credit.”<sup>9</sup> LendingClub has also reported that it had 5x the representation of loans to minority owned businesses, and 4x the representation of women-owned businesses, compared to traditional bank conventional business lending.<sup>10</sup>

As the Philadelphia Fed study highlights, marketplace lending is well-positioned to help address the problem of access to responsible credit for several reasons. First, loan decisions by marketplace lenders are typically based on a more comprehensive picture of a potential borrower’s credit profile than just a FICO score which has not proven particularly predictive. As a result, marketplace lenders are able to offer more affordable financial products to a population of borrowers who are often not being offered choices by traditional brick and mortar banks. Second, marketplace lending platforms are also able to make decisions much faster than traditional lenders and do so with much greater transparency and ease for the borrower.

### **Opportunities for Washington**

Success to date has been accomplished in spite of a federal and state legal and regulatory framework that was designed for a 19<sup>th</sup> and early 20<sup>th</sup> century banking system. Imagine what could be possible if that legal and regulatory framework was updated for the 21<sup>st</sup> century with its dramatically changed technologies, opportunities and needs. What is needed is a framework and system that supports, rather than hinders, the development of MPPs and other fintech companies, one that encourages these companies to develop innovative consumer friendly financial products that better meet the needs of all Americans.

That is the opportunity for Congress, led by this Subcommittee, and state regulators across the country – to better support innovation, start-ups and small businesses, new jobs and, most importantly, consumers. Creating a better environment for desirable growth is underpinned by two important objectives. First,

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<sup>9</sup> <https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-17.pdf?la=en>

<sup>10</sup> Comparison based on % of lending, by dollar amount, drawing on BISG analysis of LendingClub business loans 2014-2017. Benchmarked to bank data in Senate Committee on Small Business and Entrepreneurship, “21st Century Barriers to Women’s Entrepreneurship,” July 23, 2014, and Temkin, Kenneth et al, “Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs,” Urban Institute. January 2008.

consumers benefit from greater product and service availability when those products are responsible products. Second, increased competition serves consumers and the economy – and so all market participants – traditional banks and the latest FinTech firms – should be encouraged to innovate and promote transparent, efficient, and customer friendly financial products. As internet access becomes widespread, especially within unbanked and underbanked communities, there is opportunity to secure access to financial products offered at APRs that are orders-of-magnitude lower than storefront payday loans, rent-to-own products, pawn shops, or other high-cost options.<sup>11</sup> Increased availability of products in underserved urban and rural markets helps to address a reduction in “brick and mortar” bank branches.

However, to fully realize the potential of those efforts, action by Congress is needed. This includes passing the *Protecting Consumers’ Access to Credit Act of 2017* (HR 3299), the *IRS Data Verification Modernization Act of 2017*, supporting the Office of Comptroller of the Currency’s (OCC) efforts to create a Special Purpose National Bank Charter (SPNB) for qualified fintech firms, reaffirming powers of banks to build responsible third-party partnerships, and the revitalization of FDIC supervised industrial loan company (ILC) charters. MLA strongly supports the efforts of the FDIC and the OCC to facilitate the interstate activities of state and national banks that work with MPPs and was very encouraged by the comments last week of the FDIC Chair nominee, who suggested that under her tenure, the FDIC would make decisions on ILC applications that are submitted. Experience has shown that ILCs are well-regulated banks with a clear purpose for our financial system.<sup>12</sup>

### **Protecting Consumers’ Access to Credit Act of 2017**

In November of last year, the House Financial Services Committee reported out the *Protecting Consumers’ Access to Credit Act of 2017*, a bill sponsored by Rep. Patrick McHenry (R-NC-10), Rep. Trey Hollingsworth (R-IN-9), Rep. Gregory Meeks (D-NY-5), and Rep. Gwen Moore (D-WI-4). The bill would address the 2015 decision by the U.S. Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC* that ignored a well-established principle of banking law – the “valid-when-made doctrine” – that a loan whose interest complies with applicable state law at the time of origination remains valid when sold, transferred, or assigned to third-parties.

The valid-when-made doctrine is critical to a healthy financial system, small

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<sup>11</sup> <https://ag.ny.gov/consumer-frauds/rent-own>

<sup>12</sup> <https://www.americanbanker.com/opinion/six-myths-about-ilcs-corrected>

businesses, and consumers because it ensures liquidity in the credit markets, thereby reducing the cost of credit to borrowers. Both the OCC and President Obama's Solicitor General are on record as opposing the *Madden* decision, suggesting that the decision rests on a misunderstanding of Section 85 of the National Bank Act and existing Supreme Court precedent.<sup>13</sup>

Unfortunately, the Second Circuit's unprecedented decision in *Madden* created uncertainty and illiquidity in the credit markets, negatively impairing the availability and price of credit to consumers and small businesses in the three states that comprise the Second Circuit – New York, Connecticut, and Vermont. Specifically, the decision has frustrated a bank's ability to sell, assign, or transfer credit receivables (except to other banks) in the three impacted states, which then reduces the liquidity and value of those assets. This reduction in liquidity and asset value leads lenders to charge borrowers higher rates to compensate for the reduced liquidity and value of the loan assets. A recent study from researchers from Columbia, Fordham, and Stanford showed a post-Madden 52% decline in credit availability for borrowers in those 2<sup>nd</sup> Circuit states with credit scores under 625.<sup>14</sup>

The importance of passing the *Protecting Consumers' Access to Credit Act of 2017*, therefore is well known to this Subcommittee and the full Committee, which approved the bill by an overwhelming vote of 42-17. As Rep. McHenry said when he introduced the bill, "By codifying long-standing legal precedent with the valid-when-made doctrine, we ensure that low and middle-income Americans can access our financial markets. But this bill does more than promote financial inclusion, it also increases stability in our capital markets which have been upended by the Second Circuit's unprecedented interpretation of our banking laws."

Some have suggested that further amendment to this legislation may be needed to ensure that the legislation does not lead to any unintended consequences or predatory payday lending. It is relevant to point out here that the Center for Responsible Lending has highlighted in a written report that strong guidance from federal bank regulators has to-date been "generally successful" at stopping the emergence of bank-payday lending partnerships.<sup>15</sup> Today, this guidance from both the

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<sup>13</sup> <https://www.lexology.com/library/detail.aspx?g=756adff1-6026-4037-8c66-9e1cb60f1fcd>  
<https://supreme.justia.com/cases/federal/us/32/103/case.html>

<sup>14</sup> [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2780215](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215)

<sup>15</sup> <http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf>

FDIC and OCC remains on the books, and it has been seen by market participants and issue experts as effectively banning all banks from partnering with so-called payday lenders.<sup>16</sup> The MLA therefore remains encouraged that the House will move this bipartisan bill, which has also been introduced in the Senate by Sen. Mark Warner (D-VA), Sen. Gary Peters (D-MI), Sen. Steve Daines (R-MT), and Sen. Pat Toomey (R-PA).

### **IRS Data Verification Modernization Act of 2017**

Marketplace lenders offer innovative financial products to underserved consumers because of the use of data points beyond FICO scores and the speed by which lending decisions are made. One simple IT upgrade at the IRS would help marketplace lenders serve customers even better.<sup>17</sup> The *IRS Data Verification Modernization Act of 2017*, which was introduced in the House by Rep. McHenry, Rep. Earl Blumenauer (D-OR-3) and Rep. Nydia Velazquez (D-NY-7) and in the Senate by Sen. Cory Booker (D-NJ) and Sen. Mike Crapo (R-ID), would implement an application programming interface (API) at the IRS to replace the cumbersome, manual process required today where borrowers file what's called a 4506-T form giving the IRS permission to send summarized transcripts of a borrower's tax returns to a lender or another third-party.

Lenders then use those transcripts to confirm the details of a loan application. However, unless the borrower pays additional fees to expedite the process, which many small businesses and low-to-middle income consumers are not able to do, the process can take weeks, which is often too late to impact a loan decision. With an API, which is essentially a specification that allows one program to request data from another one securely and in real-time, replacing the 4506-T form process would lead to significant benefits for borrowers, including securing a better rate because the lender has a more complete picture of the borrower's credit history. Over time, this simple technological fix could lower risk in originated portfolios, allowing for improved loan pricing and even a less risky financial system as it becomes possible for lenders to easily and cheaply verify loan applications with

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<sup>16</sup> <https://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf>

<sup>17</sup> <https://techcrunch.com/2017/12/30/how-a-simple-tech-upgrade-at-the-irs-could-transform-the-economy/>



API-enabled tax data. It would also significantly speed up the disbursement of credit to consumers and businesses in real-time, allowing them to better plan expenditures and investment decisions. Automating the costly manual processing of 4506-T forms at the IRS could also improve the IRS' own operating efficiencies and reduce costs. We welcome the news that a legislative hearing will be held soon on this issue in the Ways and Means Committee.

### **OCC Special Purpose National Bank and ILC Charters**

MLA strongly encourages members of this committee to support the SPNB charter that is currently under consideration by the OCC as well as the ILC Charter. A SPNB charter proposal was first introduced by the OCC under the leadership of former Comptroller Thomas Curry in 2016 and has since received support from the new Comptroller of the Currency, Joseph Otting.

The 50 states continue to play a vital role in setting standards and policing bad practices inside their borders, but forcing marketplace lenders to obtain and maintain licenses in each and every state frustrates innovation and imposes a fractured and inconsistent legal and regulatory regimen on national platforms serving customers over the internet. Meanwhile, incumbent national institutions bypass those state rules while not necessarily delivering credit products that best meet the current and future needs of underserved urban and rural communities.

That is why, in addition to reducing uncertainty by supporting the valid-when-made legislation, the MLA strongly encourages this Committee to support giving marketplace lenders at least the option to apply for a national bank charter. The proposal under consideration by the OCC strikes the right balance of promoting greater innovation but doing so within the constructs of existing national bank laws and regulations. As with previous generations of innovative products, like credit cards, the OCC proposal recognizes what this Committee knows so well – that the business of banking is not static – and the agency is working within its existing authority to create a single national regulatory option for financial technology firms.

The promise of a SPNB charter is a crucial first step that can ultimately yield immense benefits for consumers and businesses, especially for those located in a so-called “capital desert” where affordable credit options are scarce. Those potential borrowers can use the internet to gain access to the best products available to meet their needs. It is important to remember that the OCC proposed SPNB charter will simply be an option for national online lending platforms as an alternative to

partnering with an existing bank or obtaining and maintaining licenses in all 50 states, which in turn could impose outdated and arbitrary restrictions that are likely not even applicable to platforms that facilitate products exclusively on the internet. Still, the MLA is encouraged by preliminary steps that state regulators – led by the Conference of State Bank Supervisors (CSBS) – have taken to start making it easier for responsible, internet based direct lending platforms to operate and comply with laws and regulations in multiple states. The fact that CSBS is making this effort is an acknowledgment that there are serious pro-innovation and pro-consumer reforms that need to be made to the state framework; however, we believe, that this effort will be a long and challenging process and that Congress should also encourage the OCC and FDIC to move forward with the SPNB and ILC charter options quickly. To that end, MLA is strongly encouraged by the FDIC Chair nominee’s stated goal of simplifying the ILC chartering process where possible.

Ultimately, we believe that our financial system will not reach full potential in terms of the products, services, and efficiencies it can provide for consumers and small businesses until there is a workable charter option and a much more harmonized state regulatory framework that addresses the needs of a 21<sup>st</sup> century market environment. Ensuring there is a charter option available that facilitates a nationwide footprint could help enable our U.S. banking regulatory framework to remain at the forefront of the technology and innovation that has been emerging domestically and abroad.

### **Reaffirming powers of banks to build responsible third party partnerships**

Marketplace lending platforms today often work in partnership with banks to compete with traditional unsecured credit offerings – typically credit cards. In a properly structured partnership with a bank, borrowers benefit from the same regulatory protection and oversight as a direct bank customer. The issuing bank partnership structure involves rigorous and ongoing monitoring of a fintech platform by the fintech platform’s internal compliance staff, the bank, and the bank’s regulator. This includes regular compliance testing, third party audits, and ongoing compliance training. These partnerships also bring FinTech platforms under the authority of the FDIC under the Bank Service Company Act.

Further, far from discouraging partnerships, the FDIC has issued proposed supplemental guidance, provided in Financial Institution Letter 50 (FIL 50), that applies to all FDIC-supervised institutions that engage in third-party lending.<sup>18</sup> It

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<sup>18</sup> <https://www.fdic.gov/news/news/financial/2016/fil16050b.pdf>

recognizes a number of different lending partnerships: “Institutions originating loans for third parties; institutions originating loans through third parties or jointly with third parties; and institutions originating loans using platforms developed by third parties.” The proposed guidance emphasizes that institutions should take a number of steps to manage these relationships, including:

- Establishing a “third-party lending risk management program and compliance management system (CMS) that is commensurate with the significance, complexity, risk profile, transaction volume, and number of third-party lending relationships. Consistent with existing guidance, the risk management program and CMS should address risk assessment, due diligence and oversight, and contract structuring when selecting and managing individual third-party lending relationships.”
- “For institutions that engage in significant lending activities through third parties, the proposal includes increased supervisory attention, including a 12-month examination cycle, concurrent risk management and consumer protection examinations, offsite monitoring, and possible review of third parties.”

The key point is that the FDIC has, with FIL 50 and elsewhere, recognized that marketplace lending platforms that operate as a service provider to an issuing bank partner can provide significant benefits to borrowers by offering responsible and innovative credit products, within a strong regulatory framework. There appears to be little doubt where the FDIC stands on this issue, and I would urge the committee to take a close look at the FDIC’s work and similarly find ways to encourage bank partnerships as you contemplate further legislative action. The MLA also acknowledges and appreciates the recent legislative work by Chairman Luetkemeyer to help clarify the power of FDIC supervised banks to partner with third-party service providers pursuant to Section 521 of the Depository Institutions Deregulation Act of 1980 (DIDA). A reaffirmation of those powers could create market certainty that is currently lacking as a result of sporadic, wildly inconsistent and at times ill-conceived judicial decisions.

## **Conclusion**

To conclude, there are numerous other ways that Congress and this committee can promote both competition and innovation in financial services. For example, the MLA encourages this Committee to take a leadership role in promoting and

preserving the rights of consumers to access and grant permission to their banking and other transaction information safely and securely. Doing so will foster competition and innovation and will empower more Americans to benefit from financial technology. Unfortunately, certain financial institutions have at times attempted to restrict consumers' control and use of their own financial data. The law of the United States, however, is clear: consumers should be in control of their own financial information. Policymakers should consider ways to support reforms to the definition of an 'accredited investor' so that all investors with an understanding of financial markets have access to the full range of investment opportunities. Finally, efforts to bring greater high speed internet penetration to our underserved communities are crucial to ensure that fintech options are truly available to everyone, and we urge policymakers to continue to take steps towards that goal.

Our hope is that lawmakers will ensure that innovation and competition continues to be welcome in our banking regulatory system by modernizing and clarifying laws where appropriate, and supporting multiple avenues for responsible nationwide lending, including through a bank partner model, the availability of appropriate national charter options and a more harmonized state regulatory framework. That concludes my testimony.

Thank you for the opportunity to appear before you today.