Regulation of Marketplace Lending
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By any account, marketplace lending has experienced explosive growth over the past five years, from approximately $1 billion in originations in 2010 to $12 billion in 2014 and $36 billion in 2015, according to some estimates. While the industry has experienced a bit of turmoil in 2016, it increasingly has attracted the attention of traditional banks and regulators alike.

By way of background, marketplace lenders generally accept loan applications online and apply proprietary, computerized formulas to evaluate the applications and render quick approval decisions. Lending Club, Prosper and SoFi are examples. Through a focus on automation, quick decisions, fast funding and easier processes, these online platforms have become a popular alternative to traditional bank financing, primarily with consumers and small businesses. While the models can vary, generally the marketplace lender uses investor money to fund loans directly or partners with a traditional bank to facilitate the transaction and purchases the loan from the bank.

Over the last year, we have seen increased interest in regulation of marketplace lending at both the federal and state level. Among others, the U.S. Congress, U.S. Treasury, Office of the Comptroller of the Currency (OCC), Consumer Financial Protection Bureau (CFPB) and the California Department of Business Oversight have focused in some way on the current and potential regulation of marketplace lenders. The CFPB announced in March 2016 that it would begin accepting complaints from consumers regarding marketplace lending. This move could be a precursor to the CFPB's planned supervision of and proposed rules regarding marketplace lending. While much of the regulatory attention is focused on regulation of marketplace lenders themselves, regulators also have been focusing on banks that do business with marketplace lenders.

Banks' business relationships with marketplace lenders can vary widely. Among these variations, banks can: originate loans to borrowers then sell the loans to marketplace lenders; purchase loans originated by or jointly with marketplace lenders; use marketplace lenders' platforms to originate loans; or refer customers to marketplace lenders' online platforms. While this article gives a general overview of some of the regulatory input to date regarding these third-party lending arrangements, the risks and compliance considerations will be highly dependent on a specific transaction or arrangement in which a bank engages.

The Federal Deposit Insurance Corporation (FDIC) has said the most on this topic. In its winter 2015 Supervisory Insights, the FDIC provided an initial overview of the marketplace lending model, due diligence considerations and risk identification when engaging with marketplace lenders. More recently, on July 29, 2016, the FDIC issued proposed guidance for third-party lending, which carries forward many of the themes introduced last year as well as specific expectations for institutions that engage in third-party lending. The guidance supplements the FDIC's Guidance for Managing Third-Party Risk and applies to all institutions that engage in third-party lending, which the FDIC defines as an arrangement that relies on a third party to perform a significant aspect of the lending process, including originating loans for third parties, through or jointly with third parties or using platforms developed by third parties.

At the outset, the proposed guidance reiterates the current regulatory theme of board involvement and accountability. Among other things, the FDIC expects that the board and senior management are ultimately responsible for managing activities conducted through third-party lending relationships, and for identifying and controlling the attendant risks. The proposed guidance identifies (and details) risks that may arise from third-party lending relationships, including specific strategic, operational, transaction, pipeline and liquidity, model, credit and compliance risks. To address these risks, institutions are expected to establish risk management programs and policies which, at minimum, should establish:

- limits as a percent of total capital for each third-party arrangement and for the program overall, relative to origination volumes, credit exposures, growth, loan types, and levels of credit quality;
- minimum performance standards for and independent reviews and management oversight of third parties and reporting processes (including board reporting);
- credit underwriting, administration, and quality standards;
- a consumer complaint process; and
- an adequate training program.

Perhaps more importantly, the proposed guidance also outlines supervisory considerations and develops new examination procedures for institutions with significant third-party relationships. Among others, the FDIC identifies the following expectations:

- credit underwriting and administration standards that are established and enforced by the institution, not the third party;
- the institution's ultimate responsibility for ensuring compliance with consumer protection, fair lending and BSA/AML requirements and safeguarding of customer information;
- heightened capital expectations to reflect the risk in an institution's third-party lending program;
- prompt loan loss recognition and appropriate allowances for loan and lease losses; and
- increased liquidity and profitability analyses.

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For institutions with significant third-party lending programs relationships, the examination cycle will be at least every 12 months and include concurrent risk management and consumer protection examinations. In addition, examiners will conduct targeted examinations of significant third-party lending arrangements and may also conduct targeted examinations of other third parties where authorized.

While the FDIC has been at the forefront of regulating banks' business with marketplace lenders, the OCC and Federal Reserve have been focusing on this area as well. The OCC has said that it is keeping tabs on partnerships between marketplace lenders and national banks to ensure that banks don't cede loan underwriting standards to their new partners. The Federal Reserve has cautioned that banks should "carefully consider regulatory compliance" in purchasing loans or dealing with marketplace lenders, while a Federal Reserve Bank of

Cleveland study expressed concerns regarding data security and privacy and clear disclosure of product features and loan terms by marketplace lenders.

Comments on the FDIC's proposed guidance initially were due September 12, 2016, but that period has been extended until October 27, 2016. Banks that are considering doing business with marketplace lenders are urged to read the proposed guidance, here: https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf.

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