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MARKETPLACE LENDING RFI

Ms. Laura Temel
Attention Marketplace Lending RFI
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW, Room 1325
Washington, DC 20220

Re: Marketplace Lending Request For Information

Dear Ms. Temel:

I am a Partner in the law firm Manatt, Phelps & Phillips, LLP, based in the Firm's New York Office. Celebrating its 50th anniversary in 2015, Manatt is comprised of over 500 attorneys and professionals practicing in eight offices from coast to coast. Manatt is one of the few law firms that offers a comprehensive Marketplace Lending practice as part of our Business, Finance and Tax Department. I am a member of this practice group along with approximately 25 of my colleagues. Our offices are fortuitously located at the four hubs of marketplace lending activity: New York, San Francisco, Los Angeles and Washington, D.C. This gives our practice a "four corners" perspective.

I am also honored to serve as the Chair of the Practising Law Institute's annual Crowdfunding and Online Direct Lending Conference, where we bring together the leading legal practitioners in the marketplace lending space to tackle the most important and pressing issues.

The views I express in this letter are mine alone, and do not necessarily represent the views of my partners or the Firm's employees or clients. Given the diversity of our client base, expressing the views of our clients in a single letter is futile.

We have over 50 clients that span the universe of participants in the space, including:

- originators across the three main verticals (consumer, small business and real estate),

- service providers that provide value-added resources to the industry,
- banks that operate to originate loans for lending platforms, and
- investors in the industry itself and in the loan products produced by originators.

Our investor clients include investment banks, commercial banks, private equity firms, hedge funds, family offices, closed-end funds and foreign platforms. We work with the very largest originators down to the earliest start-ups. .

Because of the scope and breadth of our practice, we see a lot of deals and have dealt with many of the situations that recur in navigating the legal and regulatory landscape, from licensing and lending issues to investment advisor, broker-dealer and SEC registration/exemption issues.

Below are some of your questions along with brief responses. Because many of the questions overlap, and to control the length of this response, I have combined my responses into one and confined my remarks to general principles of law and regulation. I have had input in comment responses to this RFI from some of our clients, and so much of my specific answers lie in those responses as well.

1. There are many different models for online marketplace lending including platform lenders (also referred to as "peer-to-peer"), balance sheet lenders, and bank-affiliated lenders. In what ways should policymakers be thinking about market segmentation; and in what ways do different models raise different policy or regulatory concerns?

9. What roles, if any, can the federal government play to facilitate positive innovation in lending, such as making it easier for borrowers to share their own government-held data with lenders? What are the competitive advantages and, if any, disadvantages for non-banks and banks to participate in and grow in this market segment? How can policymakers address any disadvantages for each? How might changes in the credit environment affect online marketplace lenders?

10. Under the different models of marketplace lending, to what extent, if any, should platform or "peer-to-peer" lenders be required to have "skin in the game" for the loans they originate or underwrite in order to align interests with investors who have acquired debt of the marketplace lenders through the platforms? Under the different models, is there pooling of loans that raise issues of alignment with investors in the lenders' debt obligations? How would the concept of risk retention apply in a non-securitization context for the different entities in the distribution

chain, including those in which there is no pooling of loans? Should this concept of "risk retention" be the same for other types of syndicated or participated loans?

11. (partial) Do existing statutory and regulatory regimes adequately address these issues in the context of online marketplace lending?

12. What is the current availability of secondary liquidity for loan assets originated in this manner? What are the advantages and disadvantages of an active secondary market? Describe the efforts to develop such a market, including any hurdles (regulatory or otherwise). Is this market likely to grow and what advantages and disadvantages might a larger securitization market, including derivatives and benchmarks, present?

How to Think About the Industry

Platform lenders, balance sheet lenders and bank-affiliated lenders all compete for borrowers in similar ways. They have more in common on the front end than they have differences. The differences between these platforms is the investor experience. Balance sheet lenders lend and hold, marketplaces generally originate and distribute borrower payment-dependent notes, and bank-affiliated lenders and platforms focused on institutional investors generally originate and sell whole loans to investors or originate and syndicate loans to secured lenders. The quandary for regulators is the contradiction of "skin in the game/risk retention" and traditional norms of safety and soundness.

Regulatory Approach to the Industry

Loans on a platform balance sheet is a true regulatory Rorschach test: to the lending regulator it appears dangerous and brings to mind bloated balance sheets of loans from the recent Great Recession which might lead to systemic risk and a government bailout. To the investor regulator, these same loans add a sense of fairness and security knowing the platform's funds (and their founders' and partners' funds) stand behind their underwriting standards. I personally believe that skin in the game is a knee-jerk reaction to the absence of a better regulatory framework. Skin in the game for 10% will not save the other 90% of investor money if the platform cannot underwrite a loan properly or timely file a UCC financing statement or Form D. Skin in the game will not prevent defaults from faulty computer underwriting algorithms or from any single borrower who is bent on committing fraud or simply refusing to pay. In lieu of skin in the game, I would be in favor of forced investor diversification across loan. Diversification is much more effective means of spreading and controlling risk.

Marketplace lenders sit on a continuum between pure play technology providers ("we are just a website" is a familiar refrain) and full-service financial institutions. As they are pushed

closer to the bank side of the continuum, costs increase and innovation is stifled. As they move close to the technology side, efficiency increases but perhaps safety and soundness lose ground. I often marvel at the advances and speed of marketplace lenders and their ability to crunch huge amounts of data efficiently and drive attractive investor returns. The industry challenge is to demonstrate that in the race to be first, fastest and most efficient, and better than their rival, we do not lose sight of the fact that behind every loan is a human being, an investor, a story.

Regardless of the technological advances, impressive as they may be, integrity and thoughtfulness must rule the day. The machines are only as good as the people inputting the data, writing the code and performing due diligence. Even an "automated" underwriting algorithm must be carefully monitored and adjusted to take account of changing economic factors. There is still no substitute for common sense. The industry has to be mindful of the tremendous responsibility that has been bestowed on it as it adapts new technology to existing law. Sometimes it is more efficient in the beginning stages to operate in the "exception world" instead of embracing regulation. I believe that nearly all operators in the industry with whom I have met have the best of intentions and are looking to do the right thing while maintaining their profit model.

Regulatory developments in marketplace lending generally originate through old federal and state laws that pre-dated the Internet. Case law tends to create tremendous uncertainly and crystal-ball gazing as to whether one's conduct is close enough to a defendant as to merit any change in behavior or business plan. Many cases are contradictory from jurisdiction to jurisdiction. Regulators should be mindful of industry uncertainty and developments that threaten to stifle growth and be willing to have an open dialogue with respect to the issues. Frequently Asked Question pages and brief policy statements would be tremendously helpful, as much of the law is difficult to apply to new technologies and ways of doing business.

There is tremendous diversity in the players in this space. I believe that marketplace lending regulation cannot be a one-size-fits-all exercise. Sweeping federal regulation is not warranted in my view and would not be effective. A loophole will develop and then the other players will conform to that loophole as has been the case with other regulatory schemes. On the other hand, advisory dialogues on specific situations would address the needs of the industry and its stakeholders and create a level playing field for industry participants.

I encourage the Department and other regulators to reach out to the industry and engage in a productive dialogue of the key issues outside of the enforcement context.

Secondary Market

As the Department points out in its question, a secondary market does not yet exist in marketplace lending. It is still a "lend and hold" or "lend and securitize" market. The reason a secondary market has not developed is not because of regulation. A broker-dealer with an alternative trading designation could create a secondary market. Indeed, we have seen the development of secondary markets in the pre-IPO equity market, for example. If and when it becomes profitable to run a secondary market, one will be built. The problems now are primarily (i) that loan and payment-dependent notes are not standardized- each is an esoteric entity of differing amounts from different borrowers, (ii) that marketplace loans generally have high prepayment risk, making valuation very tricky and (iii) securitization has emerged as a more efficient way to recycle capital for investors and originators with large amounts of loans to sell.

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Once again, I appreciate the opportunity to participate in this dialogue. Should you desire to discuss any answers in greater detail, I am happy to do so.

Respectfully submitted,

/s/ Brian S. Korn

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Partner
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