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Marketplace Lending: A CFPB Perspective

I am glad to have this opportunity to speak to you today on the marketplace lending industry.

The Consumer Financial Protection Bureau was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act as the nation's first federal agency with a mission of focusing solely on consumer financial protection. Our goal is to make consumer financial markets work for American consumers, responsible businesses and the economy as a whole. In the wake of the financial crisis of 2008-2010, the President and Congress recognized the need to address widespread failures in consumer financial protection and the rapid growth in irresponsible lending practices that preceded the crisis. To remedy these failures, the Dodd-Frank Act consolidated most federal consumer financial protection authorities in the Bureau.

At the CFPB, I lead the Installment Lending and Collection Markets team in the Research, Markets, and Regulations Division. The Division is responsible for articulating a research-driven, evidence-based perspective on consumer financial markets, consumer behavior, and regulations. We inform the Bureau's thinking on priority areas, identify areas where Bureau intervention may improve consumer welfare, and support efforts to ensure regulations achieve their objectives without imposing, unnecessary, undue burdens.

The Installment Lending and Collections Markets team covers: (1) student lending and auto finance, and (2) other types of installment lending, including (a) closed-end unsecured personal loans generally ranging from $1,000 or $1,500 to about $10,000 (or, when motor vehicles are taken as collateral in a refinancing, up to about $20,000) that are made mostly by state-licensed, branch-based finance companies, (b) closed-end transactions in the form of purchase-money loans or installment sales contracts to acquire such items as recreational equipment, furniture, consumer electronics and other big-ticket items, and (c), of course, online, including marketplace, installment lending with which you all are very familiar. My team also covers the debt collection, debt settlement, debt relief, and credit counseling markets.

There are three other Markets teams at the CFPB. Those teams cover, respectively, (1) mortgage lending, (2) credit cards, prepaid cards, and emerging payments, and (3) deposits, credit reporting and credit information, and short-term, small-dollar lending such as payday and auto title lending.

As laid out in the Dodd-Frank Act, the purpose of the CFPB is to ensure that all consumers have access to markets for consumer financial products and services and that those markets are fair, transparent, and competitive. In pursuing that purpose, Congress set five explicit objectives for the Bureau, one of which is the responsibility to foster innovation in consumer financial products and services. Consumer-friendly innovation can drive down costs, broaden access, improve transparency, and make people's lives better.

Evolving technologies are driving constant change in today's consumer financial marketplace. We recognize, however, innovators may have difficulty navigating existing regulatory schemes or weighing the risk of regulatory uncertainty arising from novel issues of how existing laws will be applied to unforeseen products and approaches.

To help overcome these challenges, in November of 2012, the CFPB launched *Project Catalyst*. Catalyst's mission is to support innovators in creating consumer-friendly financial products and services, and it has approached that mission in a number of ways.

First, Catalyst has opened lines of communication by engaging extensively with innovators across the financial services industry. We have heard from innovators in cities including San Francisco, New York, and Austin. We estimate that over the past two years, dozens of fintech companies have taken advantage of office hours and other opportunities to directly engage with the Bureau. This continues to be an important part of our work to understand and monitor the evolving technologies that are driving change in today's consumer financial marketplace.

Second, Catalyst has engaged in collaborations with innovators. For example, we have entered into research pilots with a number of fintech companies such as BillGuard, Simple, and Plastyc to gain insight into how consumers were using products these companies have brought to market. We also have entered into research pilots with several established companies, such as American Express, H&R Block, Barclaycard and Clarifi to learn about the impact of particular innovations these companies introduced into their preexisting product suite. Of course, that data sharing is one-way, does not contain personally identifiable information, and appropriate precautions are taken to ensure that individual consumers cannot be identified through the data.

In 2013, under our authority in Section 1032(e) of the Dodd-Frank Act, we finalized a policy to promote trial disclosure programs that allow companies to apply for a waiver of disclosures mandated by regulations administered by the Bureau to test potential disclosure improvements on a trial basis. Most recently, in February of this year, we finalized our no action letter policy, which establishes a process for companies to apply for a statement from Bureau staff that would reduce regulatory uncertainty for a new product or service that offers the potential for significant consumer-friendly innovation.

Through our outreach to industry as well as our market monitoring efforts, it is evident that marketplace lending is a widely talked-about area of innovation. It is also an area that we continue to carefully monitor, as we do in other consumer finance markets.

On March 7, the Bureau published a consumer bulletin outlining the types of things that consumers should consider before applying for and obtaining a loan from a marketplace lender or other type of lender. At the same time, we announced that we are accepting complaints about products and services from marketplace lenders. We have been expanding our complaint handling since we first opened our doors and have received complaints about marketplace lending. Every complaint we receive gives us insight into problems people are experiencing in the marketplace and helps us identify and stop unfair practices before they become major issues. We also encouraged consumers to use our “tell your story” platform to share with us their marketplace lending experiences, good or bad.

I want to note one other point from the consumer bulletin. We advised borrowers to keep in mind that marketplace lending is a young industry and does not have the same history of government supervision and oversight as banks and credit unions. We also stated, however, that marketplace lenders (and platforms) are required to follow the same federal laws as other lenders. Again, to be clear, consumer marketplace lending is not “unregulated,” as some have suggested.

Now for some perspective on the industry. The CFPB believes that marketplace lending has the potential to provide consumers with both potential benefits, such as broader access to less expensive credit and potential risks– risks that we are monitoring but that are difficult to assess at this early stage in the development of the industry.

Before I proceed further, I want to note that when marketplace lending is broadly defined, as it has been by the Treasury Department and others, there are myriad different business models in the marketplace lending industry, and those business models may differ substantially from one another. For example, some marketplace lenders partner with one or more banks to issue loans, while others use state lending licenses to issue loans themselves. For any specific marketplace lender, the potential benefits and risks I am about to outline may apply in varying degrees, depending on the particulars of that lender's business model.

With that in mind, at its core marketplace lending is a new way of connecting consumer borrowers with pools of capital. This opens the door to new entrants in the consumer finance space. In the past, to enter the consumer lending business, an entrepreneur would need to have either a sizable balance sheet of its own or a sizable warehouse line from some commercial lender, at least until the new company could access the capital markets through securitization. The marketplace lending model changes that, and reduces barriers to entry by creating a means of linking consumers interested in obtaining a loan with individual and institutional investors willing to fund the loan.

Significantly, the focus of marketplace lenders to date has been largely on product areas that have received less recent focus from traditional lenders. In the consumer space, marketplace lending has been dominated by unsecured installment loans, a product category which seems to be marginal for many banks, which instead emphasize credit cards as their primary product for unsecured consumer lending. (Volume is growing as well in student, auto, and mortgage lending, largely in the refinancing space.) While my comments today focus on consumer lending, I will note that marketplace lending has also been expanding in the small business lending space, another area where banks appear to have had less of an appetite for originations in recent years.

Marketplace lending is a new industry built upon 21st century technology and is not saddled with legacy systems or legacy costs. A marketplace lender that properly harnesses this advantage can offer consumers a fast and convenient means of applying for a loan with a positive user experience. It also means that marketplace lenders may have a cost advantage over traditional lenders that must recover the costs of their bricks and mortar. However, physical outlets remain a proven method of acquiring new customers; marketplace lenders – like all online businesses – need to find alternative means of acquiring customers. Interestingly, many marketplace lending platforms have turned to direct mail – a decidedly older marketing channel – to acquire new customers.

Whether in the end the costs of online, including marketplace, lenders will be lower than those of traditional lenders remains to be seen.

In addition, marketplace lenders may be able to use new technology approaches to be more effective and sophisticated in underwriting than at least some traditional lenders. Most consumer lending today relies upon predictive scoring models which use algorithms built from consumer reporting company data. Some marketplace lenders assert that machine learning provides a more sophisticated means of analyzing credit data. Other marketplace lenders believe that there are other data – such as transactional data – that can add predictive power to the more traditional consumer reporting agency data. Of course, the introduction of new types of data or new methods of analyzing data in making credit decisions may introduce fair lending risk and other risks for consumers. The Bureau is mindful of and monitoring both the potential benefits and risks.

At the same time that the Bureau sees potential benefits to consumers from the marketplace lending business model, the Bureau also sees risks. I've already mentioned a couple. There is, as I noted, a risk that the marketplace lenders will incur acquisition costs which will make their products non-competitive. There also is a risk that marketplace lenders will engage in underwriting that raises fair lending concerns.

Those risks are not unique to marketplace lending. They are inherent in any online lending business and, indeed, in newly-created brick-and-mortar lending programs as well. But there are a couple of risks that are more particular to marketplace lending that I would like to discuss.

To begin with, marketplace lending is, at bottom, an originate-to-distribute business model in which the marketplace lenders often have little skin in the game. Such business models could delink the incentives of marketplace lenders from the investors they serve, which was one of the contributing factors to the 2008 financial crisis. However, it is worth noting that some marketplace lenders have put in place measures to mitigate such risk, for example, by holding some loans in their portfolio and by making loan-level data publicly available.

The experience of the financial crisis also points to a second risk inherent in the marketplace lending business model. In an economic downturn, it is inevitable that delinquencies will rise; this is true even if marketplace lenders are able to do a better job of identifying risk than traditional lenders. It is even more true if the marketplace lenders underwriting does not hold up through a downturn. Increases in delinquencies will create the need for more intensive loan servicing, which means higher servicing costs. This is true in other markets and we have seen these issues in mortgage servicing. At the same time, in a downturn, loan originations – which often provide a substantial percentage of the platform's revenue – will decline. It is unclear whether marketplace lenders' have adequate loan servicing infrastructure or the ability to scale that infrastructure quickly and effectively in the event of a downturn.

In sum, at this point, it is simply too soon to know whether marketplace lending will be able to realize its potential as a means of delivering credit at a lower cost to consumers (and small businesses) who have the ability to repay the loans they obtain or whether the marketplace lending business model will prove unable to sustain itself through a full business cycle. We encourage the industry to put consumers' interests first in marketing, loan underwriting, origination, servicing, and collections. The Bureau will continue to closely follow developments in the marketplace lending industry. We welcome input from stakeholders across the spectrum about the benefits and risks of marketplace lending and about any actions the Bureau might consider taking that would help marketplace lending realize its positive potential and mitigate the risks to consumers.

Thank you.

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