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Submitted electronically through Regulations.gov
Laura Temel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 1325
Washington, DC 20220

Re: Marketplace Lending RFI, TREAS-DO-2015-0007-0001

The National Consumer Law Center®, on behalf of its low income clients, appreciates the opportunity to submit these comments in response to the Department of Treasury's request for information on online marketplace lending.

The National Consumer Law Center® (NCLC®) is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys and their clients, as well as community groups and organizations that represent low-income and older individuals on consumer issues. NCLC is also the author of the Consumer Credit and Sales Legal Practice Series, consisting of twenty practice treatises and annual supplements, including Consumer Credit Regulation and Fair Credit Reporting.

While the marketplace loan market is heavily focused on small business loans, some lenders make loans to consumers. Today, prime consumers are the main target, but there are signs that some marketplace lenders may be interested in moving into subprime markets. While businesses are not our constituency, we also note that many small businesses need the same protections as consumers, and yet are unprotected by consumer protection laws.

The marketplace lending market can increase competition and produce many benefits for consumers. Some of the marketplace loans on the market today tend to have relatively low rates and also transparent rates that are not obscured with high fees. Despite today's extremely low interest rate environment, many consumers are trapped in credit card debt, private student loans and other forms of credit at high rates that lenders will not refinance, even for borrowers who are keeping up with payments. Marketplace loans can offer options for these consumers and for others who seek a loan at a reasonable price below credit card rates.

Nonetheless, as others have commented, we do not believe that there is anything unique about marketplace lenders that should lead to any weaker consumer protections or regulatory exemptions. To the contrary, we fear that the market today is developing with little oversight and some signs of problems. We therefore appreciate the Treasury Department's request for information and attention to this new market.

In these comments, we will briefly mention several issues that are not unique to marketplace lending but that could become, and in some cases already are, potential problems. In particular, we are concerned about:

- **Use of consumer data** in ways potentially inconsistent with the protections of the Fair Credit Reporting Act, privacy rights, and fair lending laws.
- Skewed origination incentives that could lead to **poor underwriting.**
- The mandatory or default **use of preauthorized electronic payments**, which can weaken consumers' control over their bank accounts, cause bank account closures, and create incentives for weaker underwriting.
- **Evasion of state laws**, including usury caps, consumer protection laws, and licensing and oversight requirements
- The use of **lead generators,** which could lead to the sale of sensitive financial information, potential for fraud, and other problems prevalent in the online payday loan market.

Use of Alternative Data and Underwriting Models

Many marketplace lenders boast about their use of alternative forms of data and new underwriting models derived from that data. Data is also used to identify "leads" and to sell those leads and sometimes the associated data to lenders.

Several potential problems can arise from the use of alternative data, including:

- Accuracy.
- Compliance with credit reporting laws.
- Disparate impacts caused by use of data associated with race or other factors.

In March 2014, we issued the report: Big Data: a Big Disappointment for Scoring Consumer Creditworthiness.[1] This report analyzed big data's promises to make better predictive algorithms that in turn can make better products available to the unbanked and underbanked. Unfortunately, our analysis concluded that big data does not live up to its big promises.

Big data proponents argue that multiplying the number of variables will expand access to borrowers with thin credit files. Expanding the number of data points also introduces the risk that inaccuracies will play a greater role in determining creditworthiness. Given these indications of accuracy problems, we conducted our own survey for our Big Data report of the information maintained on consumers by big data brokers. Even given our initial

[1] Persis Yu et al., National Consumer Law Center, "Big Data, a Big Disappointment for Scoring Consumer Creditworthiness (March 2014), http://www.nclc.org/issues/big-data.html.

skepticism, we were astonished by the scope of inaccuracies among the data brokers we investigated.

We are also concerned with big data brokers' attempts to evade the Fair Credit Reporting Act (FCRA). NCLC's analysis shows that many big data brokers could be considered consumer reporting agencies and subject to the FCRA. The FCRA imposes substantial duties on the CRA. Three of the most important functions of the FCRA deal with accuracy, disclosure, and the right to dispute items on the report. It is highly unlikely, given the size of the data set and the sources of information, that the companies that provide big data analytics and the users of that data are meeting these FCRA obligations. The Federal Trade Commission has warned companies that the presence of a disclaimer stating that reports should not be used for FCRA purposes is not sufficient to avoid FCRA coverage.[2] We hope that regulatory agencies will continue to take similar actions.

Additionally, we have serious concerns about the discriminatory impact of using big data to determine a consumer's creditworthiness. Because big data scores use undisclosed algorithms, it is impossible to analyze the algorithm for potential racial discriminatory impact. According to the companies' marketing materials, consumers are judged based upon data generated from their Internet usage, mobile applications, and social media. However, access and usage of these sources vary by race and socioeconomic status, and thus, as the FTC noted in its May 2014 Data Broker report, any algorithm based upon them may have racial disparities.

Use of social media poses special risks. For example, African Americans tend to have lower incomes and lower credit scores than white Americans. If a borrower's application or pricing is based, in part, on the creditworthiness of her social circles, that data can lead to clear discrimination against minorities compared to white borrowers with the same credit scores.

Finally, proponents argue that big data underwriting can increase access to credit and lower costs. But the marketplace loan market today is largely focused on prime borrowers, who have demonstrated creditworthiness and access to credit. These models are unproven in other contexts. To the extent that online underwriting models decrease costs, it may also be at the expense of a true ability to pay analysis that focuses on affordability, as discussed below. Our analysis of payday loan alternatives that use big data found that some of the loans are arguably "less bad" than traditional payday loans but that the products had very high costs and were not genuinely affordable alternatives.

We also share the privacy concerns discussed at greater length by the U.S. Public Interest Research Group, the Center for Digital Democracy and others with regards to the impact of targeted advertising on all Americans, most of whom have no idea that their personal data shape the offers they receive and the prices they pay online.

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[2] FTC, Blog: "Background screening reports and the FCRA: Just saying you're not a consumer reporting agency isn't enough" (Jan. 10, 2013), https://www.ftc.gov/news-events/blogs/business-blog/2013/01/background-screening-reports-fcra-just-saying-youre-not.

Inadequate Underwriting for Ability to Pay

The cornerstone of responsible lending is underwriting for ability to pay. Ability to pay means that the borrower is able to afford to make the payments due on the loan on its original terms while meeting other expenses without reborrowing.

We are concerned about signs that the structure of the marketplace lending market may undercut incentives to properly underwrite the loans. Much like the toxic mortgages that led to the financial crisis, marketplace loans are often securitized and sold off quickly after they are originated. Lenders who make money by the origination process regardless of the ultimate outcome of the loan could be too eager to make loans without sufficient evaluation. Moody's Investor Services has warned that marketplace lenders do not have "skin in the game," a significant stake in how securitizations of their loans perform.[3] While Moody's concern is the protection for investors, inadequate underwriting can also leave consumers with debt they cannot afford to repay.[4]

These concerns are exacerbated by the unproven nature of big data underwriting, and indeed by the fact that use of big data to underwrite is not necessarily aimed at determining whether the consumer can afford the loan. Lenders may be too eager to push out loans quickly without gathering documentation of a borrower's income and expenses. One borrower "said the ease with which he could borrow from marketplace lenders — he took out four loans within 19 months in addition to his multiple credit cards — enabled him to live far beyond his means. In July, Mr. Mansour filed for bankruptcy."[5]

That experience does not appear to be unique. Indications that a growing number of marketplace loan borrowers are filing for bankruptcy is another warning sign of unaffordable lending.[6] As discussed below, other lender practices may also lead to unaffordable loans.

Compulsory electronic repayment

Marketplace lenders generally operate online and seek to have a purely electronic process. For example, the New York Times recently reported that Prosper borrowers "must allow the company direct access to their bank accounts so it can electronically deduct loan payments," and that a Lending Club loan "defaults to automatic bank withdrawals" but permits borrowers to opt out of the electronic withdrawals by calling or emailing the

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[3] Moody's Investor Services, Press Release, "Moody's: Unique risks in marketplace versus traditional lending" (May 5, 2015), https://www.moodys.com/research/Moodys-Unique-risks-in-marketplace-versus-traditional-lending--PR_324544 ("Moody's, Unique Risks"). *See also* Michael Corkery, "Pitfalls for the Unwary Borrower Out on the Frontiers of Banking," New York Times (Sept. 13, 2015), http://www.nytimes.com/2015/09/14/business/dealbook/pitfalls-for-the-unwary-borrower-out-on-the-frontiers-of-banking.html?hp&action=click&pgtype=Homepage&module=mini-moth&region=top-stories-below&WT.nav=top-stories-below&_r=1. ("Pitfalls, NY Times").

[4] Pitfalls, NY Times, *supra* ("Marketplace companies do not suffer losses directly if the borrowers default, which may embolden them to lower their credit standards, Moody's said.").

[5] Pitfalls, NY Times, *supra.*

[6] *See* Pitfalls, NY Times, *supra.*

company, with a $7 processing fee for each paper check.[7] It is also possible that some marketplace lenders, like online payday lenders, refuse to disburse loans electronically if the consumer does not want to authorize electronic repayment.

When the borrower is a consumer, such practices may run afoul of the Electronic Fund Transfer Act, which prohibits any person from requiring repayment by preauthorized electronic fund transfer as a condition of credit.[8] Courts have found that lenders may not require the consumer to authorize electronic payment as a default method, even if the contract permits the consumer to use other forms of payment.[9] While Regulation E permits a modest discount to the interest rate or another "cost-related incentive" to pay electronically, [10] the rule does not permit practices that cross the line from an incentive to coercion and it may not permit nonmonetary incentives.

Automatic electronic repayment can be an important convenience for consumers and can help them to pay bills on time. But the EFTA ban on compulsory electronic repayments is an important protection that helps consumers to maintain control over their bank accounts. It enables consumers to prioritize their bills and prevents lenders from grabbing the consumer's paycheck before food or rent is paid.

Lenders who rely too heavily on automatic electronic repayment may do inadequate underwriting to ensure that the borrower can truly afford to repay their loans. For example, the Consumer Financial Protection Bureau recently proposed ability to pay requirements for higher cost installment loans that use preauthorized payments:

> While some installment lenders may analyze a consumer's finances in some detail, the Bureau is concerned that lenders who take a preferred means of collecting on a loan through account access or a security interest in the vehicle have little incentive to go beyond confirming that the consumer has some periodic income. The failure to determine whether a consumer can afford to repay the loans while meeting other major financial obligations and living expenses heightens the risk that the consumer will end up with an unaffordable loan.[11]

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[7] Pitfalls, NY Times, *supra.*

[8] 15 U.S.C. § 1693k.

[9] See Fed. Trade Comm'n v. Payday Financial, L.L.C., 2013 WL 5442387 (D.S.D. Sept. 30, 2013) (lender violated compulsory use provision because loan was conditioned on agreement to repay by EFT despite right to cancel EFT payments even before first payment); Pinkett v. First Citizens Bank, 2010 WL 1910520 (N.D. Ill. May 10, 2010); O'Donovan v. CashCall, Inc., 2009 WL 1833990 (N.D. Cal. June 24, 2009) (finding violation of EFTA despite fact that borrowers could cancel authorization before the first payment); West Virginia ex rel. McGraw v. CashCall, Inc., et al., No. 08-C-1964 (W.V. Cir. Ct. Sept. 10, 2012) (same), available at www.nclc.org/unreported.

[10] Regulation E, Official Interpretations § 1005.10(e)-1.

[11] CFPB, Small Business Advisory Review Panel For Potential Rulemakings For Payday, Vehicle Title, And Similar Loans: Outline Of Proposals Under Consideration And Alternatives Considered at 21 (Mar. 26, 2015), http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf.

Underwriting to ensure that a lender will collect payments is not the same thing as ensuring that the consumer has the ability to make loan payments while also meeting other expenses. Indeed, "Moody's noted in a report this year about Prosper that the automatic withdrawals made it more likely that 'strapped borrowers' would pay their marketplace loans ahead of other expenses."[12]

Borrowers who set up preauthorized electronic payments can also lose control of their finances and even lose their bank accounts. This phenomenon is frequently seen in the payday loan market.[13] While NACHA rules and Regulation E give consumers the right to revoke authorization and stop preauthorized electronic payments,[14] lenders do not always comply. Borrowers may be forced to close their accounts to stop the payments. Yet once they lose a bank account, consumers may find that they are blacklisted from opening up another one.[15]

There are already reports that some marketplace lenders are making it difficult to stop electronic payments and have led to bank account closures.[16] Recurring charges may not stop even after the borrower files for bankruptcy protections.[17]One marketplace lender, OnDeck, is even reported to have continued to make electronic withdrawals from a new bank account that the borrower opened after closing the first one. While the borrower in that case was a business, which is not protected by the Electronic Fund Transfer Act, the authorization for electronic repayment is governed by NACHA rules. Chasing the borrower to a new account that the borrower did not designate for electronic repayment would not meet Regulation E and NACHA requirements for a clear and readily understandable authorization.[18]

Compliance with State Law

State laws regulate loans offered to consumers, including interest rate caps and licensing requirements. As discussed at greater length in the comments of the Center for Responsible Lending, state laws create important protections for borrowers. Financial institutions are often exempt from these laws, but the laws do apply to nonbank lenders.

While the key players in marketplace loans are not financial institutions, they often partner with those institutions in an effort to set up structures that will evade state laws.

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[12] Pitfalls, NY Times, *supra.*

[13] Pew Charitable Trusts, Fraud and Abuse Online: Harmful Practices in Internet Payday Lending (Oct. 2014) ("In Pew's survey, one-fifth of online borrowers report that banks closed their accounts or that they did so themselves because of online payday loans."), http://www.pewtrusts.org/en/research-and-analysis/reports/2014/10/fraud-and-abuse-online-harmful-practices-in-internet-payday-lending ("Pew, Fraud and Abuse Online").

[14] *See* NCLC, Consumer Banking and Payments Law § 5.3.7 (2013 & online supp.).

[15] NCLC, Issue Brief: Introduction to Account Screening Consumer Reporting Agencies (October 2014), http://www.nclc.org/images/pdf/credit_reports/ib-cra-screening.pdf.

[16]Pitfalls, NY Times, *supra* ("Some borrowers like Mr. Mansour said they ended up closing their bank accounts because they thought it was the only way to stop the lenders from taking out the money.").

[17] *See* Pitfalls, NY Times, *supra.*

[18] NCLC, Consumer Banking and Payments Law §§ 5.3.1.1, 5.3.1.2 (2013 & online supplement).

Marketplace entities market, underwrite, and service the loan as well as market the securities and deal with investors. The financial institution may have little to do with the loan other than originating it and quickly selling it off. As in other rent-a-bank arrangements, the financial institution's role may be little more than a fig leaf to justify preemption of state laws.

Years ago, regulators put a stop to rent-a-bank arrangements used by payday lenders.[19] More recent court decisions have also rejected rent-a-bank arrangements and bolstered the role of state law.[20] But nonbank entities continue to attempt to use financial institutions to shield themselves from state lending laws. We believe that state laws offer important protections that should not be evaded.

Lead generation practices and misuse of consumer data

Finally, we are concerned about the role of lead generators in marketplace lending. Lead generators gather data about potential borrowers and sell it to the highest bidder. In the payday loan market, that data can sometimes include sensitive financial information such as Social Security numbers and bank account numbers. Indeed, many websites that appear to be lenders taking loan applications are in fact merely collecting data to sell.[21]

These lead generators cause several problems. First, if they are obtaining consumer report information, they may violate the Fair Credit Reporting Act, which prohibits using consumer reports for marketing purposes. More troubling, the buyers of that information could use sensitive information for fraudulent purposes. For example, consumers who never actually took out a payday loan have been targeted by phony debt collectors and have been subject to unauthorized charges against their bank accounts.[22] We hope that these problems do not spread to the marketplace loan market.

Conclusion

The marketplace loan market has enormous potential to offer affordable loans to consumers and businesses alike. As the market develops, it is essential that borrower protections be built in and potentially problematic practices eliminated before they become large problems.

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[19] *See* NCLC, Consumer Credit Regulation § 9.6.1 (2012 & online supp.).

[20] Madden v. Midland Funding, LLC, No. 14-2131-cv, 2015 WL 2435657 (2d Cir. May 22, 2015); Final Order On Phase II Of Trial: The State's Usury And Lending Claims, State of West Virginia, ex rel. v. CashCall, Inc and J. Paul Reddam, Kanawha County Circuit Court, Civil Action No.: 08-C-1964, Sept. 10, 2012. http://bit.ly/16lOhAe (upholding the state's claim that CashCall was the de facto lender in violation of the state's usury limit, while finding that CashCall purchased all loans made under the arrangement from First Bank of Delaware three days later and clearly bore the economic risk of the loans).

[21] Pew, Fraud and Abuse Online, *supra*.

[22] Pew, Fraud and Abuse Online, *supra*, at 11-12; Press Release, Federal Trade Comm'n, "FTC, Illinois Attorney General Halt Chicago Area Operation Charged With Illegally Pressuring Consumers to Pay 'Phantom' Debts" (April 10, 2015), https://www.ftc.gov/news-events/press-releases/2015/04/ftc-illinois-attorney-general-halt-chicago-area-operation-charged.

Thank you for the opportunity to submit these comments and for your efforts to ensure the safety and fairness of the marketplace loan market.

Yours very truly,

Lauren Saunders
Associate Director
National Consumer Law Center (on behalf of its low income clients)