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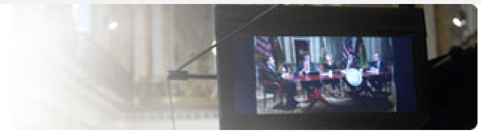

Remarks by Counselor Antonio Weiss at the Information Management Network Conference on Marketplace Lenders

10/29/2015

As prepared for delivery

NEW YORK – I would like to thank the Information Management Network for hosting this conference and for inviting Treasury to participate today.

As all of you certainly know, online marketplace lending has introduced a new way for consumers and small businesses to access credit. Industry players are expanding the pool of capital available to consumers and small businesses by attracting new investors, many of whom are in this room today. They are also employing new sources of data and new technologies to make nearly instantaneous credit decisions. In short, they are changing the market for unsecured credit in ways that have caught the attention of borrowers, investors, traditional lenders and policymakers.

At Treasury, we are interested in the potential for these developments to expand access to credit to groups of consumers and small businesses that are often underserved by traditional lending channels. For example, small business loans are often sub-scale for traditional lenders, but now these businesses can receive funding decisions within 48-72 hours on loans under $250,000.

Despite the presence of well-established players, some in existence for nearly a decade, this industry is still in its early stages. Online marketplace lending is just a fraction of the small business and consumer lending markets, though it is growing rapidly. It has evolved from a “peer-to-peer” model to one largely funded by institutional investors, often in partnership with brick and mortar banks. The industry has reached a point of maturation and economic significance that merits a more direct and open dialogue among borrowers, lenders, investors and policymakers.

Treasury’s Request for Information, published in July, opened that dialogue by seeking input from the broadest possible range of stakeholders. We followed the release of the RFI by organizing a conference at Treasury that brought together industry participants and academics to discuss the most salient issues. We clearly struck a chord, because our largest event space at Treasury was overwhelmed, with standing room only.

At Treasury, we will seek to foster, not impede, innovation that increases competition and broadens access to affordable credit for creditworthy borrowers and businesses. But we will also be vigilant in ensuring that innovation does not undermine important privacy and consumer protection priorities. And we plan to continue our work in close dialogue with our regulatory partners.

In my remarks today, I will discuss the central themes that emerged from the comments received, and briefly lay out the work ahead.

Treasury released the RFI to open a dialogue about many different elements of marketplace lending. First, we wanted to learn more about the industry’s business models and product offerings. Second, we wanted to gauge the potential for online marketplace lending to expand access to credit to historically underserved borrowers. Finally, we wanted to ask how the financial regulatory framework should evolve to support the safe growth of this industry. This marked the beginning of a process that will inform our consideration of appropriate policy responses.

By the time the comment period closed on September 30, we had received 99 responses from individuals, businesses, advocates and trade associations. I now want to touch on six key themes that emerged from the responses.

First, marketplace lending is currently serving mostly prime and near-prime borrowers consolidating debt from credit cards or student loans. This does allow borrowers to obtain lower cost loans. However, expanding access to these products further down the credit spectrum remains largely an aspirational goal. For example, many lending platforms have minimum credit score requirements, effectively barring participation by many low- and medium-income households.

Small businesses have also historically been underserved, but here there is clear potential for growth. Structural challenges in the small business lending market often make it difficult for business owners to obtain affordable credit. While larger businesses typically rely on banks for 30 percent of their financing, small businesses receive fully 90 percent of financing from banks. However, small business lending has high fixed costs for banks– it costs about the same to underwrite a $5 million dollar loan as a $200,000 loan. And we know that many small business owners are unable to access the credit they need to grow their businesses. Marketplace lending has the potential to unlock access to the capital markets for these borrowers.

Second, many noted that new underwriting models have yet to be tested through a full credit cycle. A key innovation has been the use of new sources of data to augment traditional credit assessments. Small business lending platforms are using models that pull in real time data and financial statements to make quicker funding decisions. And consumer lending platforms are using alternatives to traditional credit scores to determine whether an applicant with limited credit history, for example, may nonetheless be creditworthy. It is too soon to tell, however, if these alternatives perform better than traditional models at predicting creditworthiness, particularly in a more difficult economic environment.

On a related point, we also heard that the increasing amount of nontraditional data used in credit underwriting decisions may raise consumer protection questions, specifically questions regarding compliance with fair lending obligations. Just because a credit decision is made by an algorithm, does not mean it’s fair. Consumer advocates noted that, while data has the ability to make fast and blind credit assessments, it also has the potential to create unintended correlations that lead to discriminatory lending or penalize customers without a large digital footprint. Advocates expressed concern that the new credit models are a “black box” and applicants have no recourse if the information being used is incorrect.
This is an area of real concern for consumers even when they have more robust protections. The existing model is far from perfect, but applicants at least have the right to check – and correct – their personal data that gets used in credit decisions.

Third, many commenters highlighted the need to establish a level playing field. All borrowers—businesses as well as consumers—should have the same protections. Small businesses are run by people. Those people receive protection as individual consumers, but when they are called "small businesses" they get no protection. Moreover, those same protections should apply whether the lender is a traditional bank, an online marketplace lender, or another non-bank entity.

Competition and innovation are welcome, but innovators should compete on a level playing field to offer an improved borrower experience.

A common refrain is that policymakers should be mindful of the regulatory framework already in place, and work together to ensure that it applies equally and fairly to all types of borrowers and lenders. For example, community banks operate within a framework of prudential oversight and with a business model that has developed based on personal relationships, with direct accountability to depositors, borrowers, and their communities. These commenters argued that in order to ensure competition leads to a better borrower experience, the same standards of transparency and accountability should apply to both bank and non-bank lenders.

Fourth, commenters almost universally agreed on the need for, and benefits of, greater transparency. To my mind, this means clear, simple terms that borrowers and investors can understand. For small businesses, transparency requires standardized all-in pricing metrics, so that a business understands a loan's true cost and can make like-to-like comparisons across different loan products. For consumers, transparency should encompass clear terms and conditions, on both mobile and desktop devices, and simple payment plan options. And for all borrowers, it should include standardization of disclosure and credit performance. For investors, transparency means, at a minimum, standardized representations and warranties.

The fifth theme was the growing number of partnerships that online marketplace lenders are forging with banks, community development financial institutions (CDFIs), or other businesses. Partnerships can allow banks to leverage these new models and, in return, allow marketplace lenders to access new customers. Some marketplace lenders are also partnering with CDFIs, who may be able to extend credit to borrowers that marketplace lenders would otherwise be unable to serve. As these partnerships develop, they may bring the benefits of new credit models to borrowers in low income communities, who could potentially have the most to gain from access to more affordable credit.

The final theme concerns risk retention. As expected, stakeholders expressed a range of views about the application of risk retention requirements to marketplace lending. Many noted that risk retention would have different outcomes on different business models—for example, favoring balance sheet lenders over platform lenders. Some in the industry have argued that transparency on loan pricing, product features, and performance can mitigate the need for online platforms to hold credit risk. Public disclosure of loan characteristics and product features, the argument goes, may reduce information asymmetries and align the interests of investors and marketplace lenders. Also, some say, non-economic interests, such as reputational risk from making bad loans, already serves as "skin in the game" for lenders. Others believe risk retention is necessary, and point to statutory risk retention requirements for assets that are securitized.

So these are the themes. What comes next?

Treasury is still analyzing the comments we received from the RFI. And we are working with our regulatory partners to better inform our collective understanding of the issues. Treasury will continue to monitor developments in this important and rapidly evolving marketplace.

Our guiding principle will remain to seek the broadest possible access to safe, affordable and sustainable credit. We will be mindful to preserve and promote the American entrepreneurial spirit in the growing financial technology industry. However, as I said earlier, we must not allow innovation to undermine consumer protections, privacy concerns, and other important policy priorities. We will need to find a balance.

Treasury is not a regulator in this area. But we will continue to work with both federal and state regulators to ensure that innovation in lending proceeds within a framework that protects borrowers and preserves safety and soundness. Federal and state regulators will all have an interest in the way this market evolves.

And what is the role of industry?

With great promise comes great responsibility. And here the private sector has a special duty. In August, a coalition of lenders, advocates, and academics released The Small Business Borrowers Bill of Rights, a social contract for responsible small business lenders willing to commit to fair and transparent practices for small business borrowers. Signatories to this bill pledge to support borrowers' rights to transparent pricing and terms, non-abusive products, responsible underwriting, fair treatment from brokers, inclusive credit access, and fair collection practices. This is a great example of progress that can be made by working collaboratively. Policymakers will need to assess whether these efforts are successful in creating high standards across the industry.

As this market continues to grow, it is incumbent upon the industry to lead efforts to ensure safety and soundness, transparency, and equal borrower protections.

In this regard, there remains a real lack of innovation in backend operations. The heavy reliance by marketplace lenders on a small number of servicing and collections firms has been a cause of concern from consumer advocates. As we've learned in mortgages and consumer loans, poor servicing can have devastating effects, especially for struggling borrowers. We encourage entrepreneurs to focus attention on constantly improving the borrower experience, from customer acquisition straight through to collections in the event of delinquency or default.

We look forward to furthering the public dialogue that we began with the RFI and continued with the Treasury conference in August. Business models, practices, and economic conditions are constantly evolving, and we will continue to seek input from the broadest possible array of stakeholders as our work progresses.

Thank you for inviting me to speak, and enjoy the rest of the conference today.

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