September 30, 2015

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 RFI (docket id# TREAS-DO-2015-0007)

Dear Ms. Temel:

The Securities Industry and Financial Markets Association (SIFMA[1]) is pleased to have the opportunity to provide input to the Department of the Treasury related to its request for information on marketplace lending (RFI).

While SIFMA members themselves do not operate marketplace lending platforms, they are involved in advisory services, financing, legal counsel, research, underwriting, and other activities related to marketplace lending. As such, we are providing feedback on a limited number of the questions posed in the RFI, primarily those which relate to funding lending and secondary markets for the loans.

We would be pleased to discuss any of these responses in more detail at your convenience. I may be reached at 212-313-1126 or ckillian@sifma.org.

Regards,

Christopher B. Killian
Managing Director
Securitization

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

7. Describe whether and how marketplace lending relies on services or relationships provided by traditional lending institutions or insured depository institutions. What steps have been taken toward regulatory compliance with the new lending model by the various industry participants throughout the lending process? What issues are raised with online marketplace lending across state lines?

Structures used for Marketplace Lending

Marketplace lending is conducted using a number of different origination structures. In some marketplace programs, loans are originated by insured depository institutions -- national banks, state-chartered banks, savings banks, or credit unions -- that may partner with a platform operator. In other programs, the platform operator may itself be a state-licensed lender, or may operate in a manner that is exempt from, or otherwise does not require, state licensing. Some platform operators use a combination of these different origination models. These origination models are not unique to marketplace lending. Each of these origination models is already in use on other lending markets, including auto loans, credit cards, private student loans, personal loans and health care loans.

In all cases, marketplace lending programs rely on relationships with banks for services – such as the disbursement of proceeds through the ACH system, and the processing of borrower payments whether by ACH, check, or other methods.

Regulation of Marketplace Lending

The origination of loans through online marketplaces is subject to certain laws and regulations, including by many laws that govern bank participants and other lending programs. The specific laws that apply depend on the nature of the borrowers (consumer or business), the type of loan product, the structure of the program (bank-issued or state-licensed), and other factors. Likewise, these factors also determine which state or federal regulators may have enforcement or supervisory jurisdiction. This is also true of non-marketplace programs, which can be subject to different laws and the jurisdiction of different regulators depending on how they are structured and offered. Regulation of marketplace lending is important to secondary market investors in loans and securitization, as it goes in part to judgments of the creditworthiness of the underlying loans and the quality of the investments they make.

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?

Current risk retention regulations ("Risk Retention Regulations"), as adopted by the joint regulators[2] (the "Joint Regulators") to implement the requirements of Section 15G of the Securities Act of 1934, as amended ("Section 15G"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[3] are designed to protect investors in asset-backed securities. As discussed in the adopting release[4] (the "Risk Retention Adopting Release"), risk retention under Section 15G is intended to "provide securitizers an incentive to monitor and ensure the quality of the securitized assets underlying a securitization transaction, and thus, help align the interests of the securitizer with the interests of investors."[5] Such regulations will be applicable to asset-backed securities backed by marketplace loans beginning in December of 2016. For the reasons set forth below, we believe that the Risk Retention Regulations adequately align such interests in securitizations of marketplace loans.

The Risk Retention Regulations do not apply to transactions involving sales and purchases of marketplace loans on a whole loan basis by institutional parties outside of securitization transactions. As discussed below, we believe that introducing concepts of risk retention into such transactions would not add sufficient value or be consistent with the goals of risk retention.

Securitizations

Under the Risk Retention Regulations, the "securitizer"[6] is primarily responsible for compliance with risk retention requirements. The lending platform in the typical securitization of marketplace loans done to date has not acted as a securitizer, but instead has sold the loans to

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2 The joint regulators consist of the Office of the Controller of the Currency (the "OCC") of the Department of the Treasury, the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation (the "FDIC"), the Federal Housing Finance Agency (the "FHFA"), the Securities and Exchange Commission (the "SEC") and the Department of Housing and Urban Development ("HUD").

3 Pub.L. 111–203, H.R. 4173.

4 The adopting release of the Joint Regulators, including the SEC's Release No. 34-73407, at 79 Fed. Reg. 77602.

5 79 Fed. Reg. 77602, at 77604.

6 The "securitizer" with respect to a securitization transaction is the "depositor" or "sponsor" of the asset-backed securities. A "depositor" is "(1) [t]he person that receives or purchases and transfers or sells the securitized assets to the issuing entity; (2)[t]he sponsor, in the case of a securitization transaction where there is not an intermediate transfer of the assets from the sponsor to the issuing entity; or (3) [t]he person that receives or purchases and transfers or sells the securitized assets to the issuing entity in the case of a securitization transaction where the person transferring or selling the securitized assets directly to the issuing entity is itself a trust." A "sponsor" is defined as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."

another entity that has acted as the sponsor and, therefore, as the securitizer.[7] Risk retention is designed to protect ultimate investors in asset-backed securities by requiring the securitizer to have "skin in the game," and thereby be incentivized to assure, through due diligence and contractual commitments, that the underlying assets are of satisfactory quality. It is not intended to protect securitizers or other intermediaries, who are typically large institutions that are able to protect themselves through due diligence, appropriate representations and warranties and other contractual provisions.

The Risk Retention Regulations do, however, permit the securitizer to allocate the risk retention obligations to originators[8] contributing at least 20% of the securitized assets, up to their *pro rata* share of such assets. In view of the fact that such risk retention generally is achieved by the originator's purchase (and agreement to hold) its relevant share of the issued asset-backed securities,[9] the originator would retain risk in the entire pool of securitized assets, not just those contributed by it. The Risk Retention Adopting Release notes that, if an originator were permitted to retain risk only in the loans it contributes, "[t]he operational burden on both securitization sponsors and federal supervisors to ensure that retention is held by originators on the correct individual loans would, for many different asset classes, be exceedingly high."[10] Section 15G and the Risk Retention Regulations otherwise explicitly avoid imposing risk retention obligations on intermediate holders of the assets unless those holders are themselves securitizers engaging in a securitization transaction. Essentially, regardless of whether risk is retained by a securitizer or an originator, the party retaining risk is incentivized to cause other contractual parties in the transaction to act in a manner which aligns their interests with the interests of investors as well, thereby achieving the objectives of risk retention.

There is no reason to treat loans originated through marketplace lending differently from other asset classes in securitizations for purposes of risk retention. Several other asset classes (including, in particular, residential mortgage loans) generally follow the same origination and distribution model as marketplace loans, including origination in accordance with criteria designed to satisfy purchase criteria of intermediate holders, and subsequent resale on a whole loan basis to institutional parties and/or subsequent securitization. All such asset classes present similar concerns regarding misalignment of interests, and such issues can be addressed in the same way for all such asset classes, and are in fact addressed by the Risk Retention Regulations.

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[7] To the extent a lending platform itself were to act as a securitizer, risk retention obligations would appropriately apply to such lending platform.

[8] For purposes of the Risk Retention Regulations, an "originator" is defined as "a person who (1) [t]hrough an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security and (2) [s]ells the asset directly or indirectly to a securitizer or issuing entity." The Risk Retention Adopting Release indicates that the originator includes "only the original creditor under a loan or receivable – and not a subsequent purchaser or transferee." 79 Fed. Reg. 77602, at 77609.

[9] The purchase price may be payable either in cash or by a reduction in the purchase price paid for the assets originated by the originator. *Ibid.*

[10] 79 Fed. Reg. 77602, at 77666.

In conclusion, imposition of risk retention requirements on intermediate holders (such as lending platforms) between originator and securitizer that are not themselves securitizers would impair the efficiency of the transaction without demonstrated benefit and should not be imposed.

Non-Securitization Transactions between Institutional Parties

The Risk Retention Regulations do not cover individual or bulk purchases by institutional parties of marketplace loans on a whole loan basis for the purpose of investment or warehouse financing because there would be no securitization transaction. However, the "investors" in such transactions are institutional parties that do not in such cases require the protection of a special risk retention rule. Unlike investors in asset-backed securities, they have the opportunity to conduct their own due diligence and are not dependent on information in disclosure documents. As a result, there is considerable transparency in such transactions, without dependence on other parties who may have conflicting interests. Furthermore, they are able, and have the knowledge, to negotiate terms of the sale directly with the seller, and can contractually arrange for recourse to the seller for losses to the extent agreed as part of the business transaction. Once again, there is no reason to distinguish marketplace loans from other asset classes in comparable transactions.

Similar reasoning supports that conclusion that such institutional parties also do not require the protection of "risk retention" in connection with other types of syndicated or participated loans [We do not, however, believe it is appropriate for us to express a further view as to the needs of participants in markets for other types of syndicated or participated loans in the context of this Request for Information.]

"Peer-to-Peer" Transactions

True "peer-to-peer" transactions in which investors purchase notes backed by individual loans do not involve a pooling of loans, and [are generally regarded as transactions that] are not [expected to be] subject to the Risk Retention Regulations. Our members do not participate widely in that market and we leave further comment on such transactions to more active participants.

12. What factors do investors consider when: (i) investing in notes funding loans being made through online marketplace lenders, (ii) doing business with particular entities, or (iii) determining the characteristics of the notes investors are willing to purchase? What are the operational arrangements? What are the various methods through which investors may finance online platform assets, including purchase of securities, and what are the advantages and disadvantages of using them? Who are the end investors? How is the use of financial leverage for investors? How is leverage typically obtained and deployed?

What factors do investors consider when investing in notes funding loans being made through online marketplace lenders?

For the most part, the factors considered by investors in notes funding loans being made through online marketplace lenders are the same factors that are considered by investors in notes funding other loans and receivables, namely the following:

- Capital Markets Considerations
  - Terms of the loans and of the related notes; i.e. rate, term, and payment terms
  - Mismatches, if any, between the terms of the loans and the notes
  - Assurance as to the federal tax treatment of the notes

- Credit Considerations
  - Credit of the underlying loans
  - Loan origination criteria
  - Any historical performance data

- Bankruptcy Protection
  - Separation of the credit of the originator, the servicer and other parties to the financing from the credit of the notes ("True Sale" and "Non-Consolidation" Opinions)

- Servicing
  - Servicer
  - Loan servicing arrangements
  - Back-up servicer
  - Verification agent

- General consumer lending laws and regulations

What factors do investors consider when doing business with particular entities?

Similarly, the factors relating to originators of marketplace loans, as well as the non-originator platforms that facilitate the origination of marketplace loans, that are considered by capital markets investors are substantially the same as the factors relating to originators of other forms of forms of loans and receivables that are considered by capital markets investors in securities backed by such other forms of loans and receivables.

Two distinctions are worth noting.

- As marketplace lending does not have a long history, there is considerably less data and experience available for such consideration relating to notes backed by marketplace loans.

- In addition, in certain programs, marketplace loans are originated by the platforms themselves, and in other programs by banks from which the platforms buy the loans. In either case, investors will be interested in the origination and underwriting criteria used to originate the loans, whoever may be the originator, and the credit history of loans originated pursuant to those criteria.

Characteristics of the notes investors are willing to purchase

Transactions have included the gamut of the capital stack (senior, mezzanine and subordinate notes), fixed and floating, rated and unrated. Notes are typically (i) level pay, fully amortizing, or (ii) subject to a set revolving period followed by an amortization period.

Credit enhancement usually takes the form of overcollateralization, subordination, excess spread and a reserve account (commonly a non-declining reserve account).

Structural features common to most notes include a cumulative default trigger and the use of excess spread to pay down notes until a target overcollateralization level is reached.

What are the operational arrangements?

A common operational arrangement is where loans are originated and funded by a state-chartered bank and offered to the technology based lending platform (or subsidiaries or affiliates of the platform).

In other instances, the technology based lending platform (or subsidiaries or affiliates of the platform) obtains specific state lending licenses and originates and funds the loans directly. In either instance, the technology based lending platform underwrites and markets the loans.

What are the various methods through which investors may finance online platform assets, including purchase of securities, and what are the advantages and disadvantages of using them?

- Whole loan sales - simplicity
- Participation interest
- Variable funding notes – investor demand
- Revolving credit facilities – investor demand for longer maturities
- Term notes

- Securitization – classes tailored to meet investor demands; ratings possible

Who are the end investors?

End investors include insurance companies, mutual funds, hedge funds and other non-bank lenders and investors.

13. 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?

What is the current availability of secondary liquidity for loan assets originated in this manner?

The types of secondary market liquidity for marketplace loans, among others, include the following:

- Whole loan purchases. Loans are purchased directly from the platform by funds, finance companies or other purchasers. Sometimes the purchasers agree on a committed basis to purchase loans that satisfy a specified list of eligibility criteria on a "flow" basis from time to time after the loans are originated. Other transactions involve the one-time purchase of discrete loan pools.
- Funds. Funds have been particularly active purchasers of marketplace loans. The funds often hope to obtain a leveraged return by financing their purchases through the issuance of asset backed securities.
- Warehouse facilities. Warehouse facilities are used to finance marketplace loans prior to their securitization, often while the portfolio is building up to a sufficient size for an efficient ABS offering. Warehouse facilities are provided by banks, asset-backed commercial paper conduits, funds or other lenders.
- Asset-backed securities. Marketplace loans have been securitized in rated and unrated ABS offerings. The securities issued may be tranched or untranched.

Many of the forms of secondary market liquidity discussed above, including whole loan purchases and warehouse facilities, ultimately depend on a thriving securitization market.

What are the advantages and disadvantages of an active secondary market?

An active secondary market would enable more marketplace loans to be originated and funded. This would in turn allow more companies to enter the business, thereby increasing the competition among lenders in the marketplace. Increased competition would likely lower the borrowing costs for consumers at all credit levels, make more credit available to consumers and provide more product choice to consumers by increasing the variety of credit available to meet their needs. All of these factors would contribute to a healthy economy by keeping interest rates low and helping to ensure consumer access to credit.

Describe the efforts to develop such a market, including any hurdles (regulatory or otherwise).

Madden vs. Midland Funding, LLC

Recently some questions have been raised in the context of marketplace programs based on the Second Circuit's decision in *Madden v. Midland Funding, LLC*, No. 14-2131-cv, 2015

U.S. App. LEXIS 8483 (2d Cir. 2015). In the *Madden* decision, a buyer of delinquent debt sought to collect a charged-off credit card account, including interest assessed after the sale of the debt by the lending bank to the debt buyer. The lending bank no longer had any interest in the loan. Under those facts, the Second Circuit concluded that the National Bank Act did not preempt the plaintiff's state law usury claim.

The defendants in the *Madden* case petitioned for rehearing or rehearing *en banc* before the Second Circuit, and SIFMA filed an amicus brief supporting that petition.[11] On August 12, the Second Circuit denied the petition for rehearing. Nevertheless, we continue to believe that *Madden* decision was wrongly decided because it overlooked the long-standing, fundamental principle of usury law that the assignee of a loan stands in the shoes of the assignor, and is entitled to collect the interest provided for in the contract. Moreover, the *Madden* decision could significantly interfere with banks' exercise of their federally granted lending authority because it would undermine the secondary market for loans – on which banks depend.

In marketplace programs, loans that are originated by banks are typically sold either to investors or to the platform operators – the platform operators typically then sell the loans to institutional investors or sell interests in the loans to retail investors. There has been some concern that *Madden* could be extended to this situation, and that the investors or other owners of the loans might be unable to collect the interest that the consumer agreed to pay when the loan was originated by the lending bank. We believe that this conclusion is incorrect, for at least three reasons:

- The *Madden* case was wrongly decided, and should be reversed for all of the reasons identified in SIFMA's brief and the briefs filed by the defendant and by other *amici curiae*.

- The *Madden* case is distinguishable, because it involved the collection of a delinquent debt by a debt buyer, long after charge-off and when the lending bank had no further interest of any kind. In marketplace programs, by contracts, the lending banks maintain ongoing oversight of the loan programs. In addition, these loans are sold by the banks shortly after origination, usually for par value or something close thereto; this is not a debt collection situation where the debt buyer pays pennies on the dollar and then seeks to collect.

- Even if the *Madden* case were correctly decided as a matter of federal preemption law, state contract and usury law provides that assignees of loans are entitled to collect loans at the contract rates, even if the assignees lack the authority to originate such loans directly.

As a result, while the risks of the *Madden* case are now being evaluated in the marketplace loan industry, we do not believe that this is ultimately a decision that will threaten the further development and success of marketplace platforms.

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[11] http://www.sifma.org/issues/item.aspx?id=8589955206

Is this market likely to grow and what advantages and disadvantages might a larger securitization market, including derivatives and benchmarks, present?

The ability of the market to grow depends very much on the growth of a securitization market for marketplace loans.

A larger securitization market would likely result in lower funding costs for lenders, which would translate to lower borrowing costs for consumers. Additional advantages would be a greater ability to "match fund' financing liabilities with the cash flows of the loans and allow originators and servicers to achieve greater economies of scale. Originators and servicers in other asset classes have found that a larger securitization market enables them to better and more accurately price the risks of their loans and that the discipline of securitization reporting helps them to run a better business.

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