ALTERNATIVE LENDING

REGULATORY CHALLENGES FRONT AND CENTER

Thomas A. Brooks
(202) 552-2356
tbrooks@clarkhill.com

Jane C. Luxton
(202) 572-8674
jluxton@clarkhill.com

Joann Needleman
(215) 640-8536
jneedleman@clarkhill.com

Leaders of the Consumer Financial Services Regulatory & Compliance Practice Group

CLARK HILL

ARIZONA | DELAWARE | ILLINOIS | MICHIGAN | NEW JERSEY | PENNSYLVANIA | WASHINGTON, DC | WEST VIRGINIA

DISCLAIMER

This information is not intended to be legal advice and may not be used as legal advice. Legal advice must be tailored to the specific circumstances of each case. Every effort has been made to assure this information is up-to-date. It is not intended to be a full and exhaustive explanation of the law in any area. It should not be used to replace the advice of your own legal counsel.

WHAT IS
ALTERNATIVE LENDING?

CLARK HILL

UNIQUE ASPECTS

- Can operate outside traditional federal insured chartered financial institutions or possibly outside traditional regulatory oversight
- Use of technology to facilitate underwriting and loan products

PLAYERS AND LOAN TYPES

- Banks & Non Banks
- Enablers & disrupters
- Consumer and commercial (small business)
- Marketplace lending (peer to peer) – uses investment capital and data driven platforms to lend directly or indirectly
- On-line lending – uses advance data algorithms for underwriting
- Payday, installment and auto title

WHAT IS THE CURRENT REGULATORY FRAMEWORK?

CLARK HILL

CURRENT REGULATORY FRAMEWORK

- State Law Requirements – licensing, usury & advertising
- Traditional Consumer Protection Laws (ECOA, BSA, FCRA, FDCPA, E-Sign, EFTA and others)
- CFPB – UDAAP

REGULATORS' APPROACHES TO ALTERNATIVE LENDING

CLARK HILL

OCC

- OCC: White Paper “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective”
  - Asking for comments on how it should approach understanding of new products and services its banks might offer
  - Risks must be addressed through effective corporate governance, due diligence and internal controls

FDIC

- FDIC: Cautious Approach if partnering with MPL or AL
  - Banks should examine risks that could include third-party, credit, compliance, liquidity, transaction, servicing, and bankruptcy risks
  - Provided a long list of due diligence efforts by banks
  - Banks are accountable for complying with all relevant consumer protection and fair lending laws and regulatory requirements and <u>cannot assign this responsibility</u> to a marketplace lending company

FEDERAL RESERVE

- Federal Reserve: Open to see how technological advances can help more loans to small businesses and consumers--BUT
  - Banks should consider compliance issues, especially compliance with laws and regulations dealing with fair lending and unfair or deceptive acts or practices in the origination and underwriting of the loans
  - Ensure that algorithms don't result in disparate impact

TREASURY

- "Opportunities and Challenges in Online Marketplace Lending," is the result of the Treasury Department analysis of its Request for Information "Public Input on Expanding Access to Credit through Online Marketplace Lending"

WHITE PAPER COMMON THEMES

- Using technology to underwrite in new ways is an innovation and a risk
  - Expedites underwriting and reduces costs, but could have disparate impact and fair lending issues
- Expand credit to underserved markets
  - Join with banks to expand lending to consumers and small businesses
- New methodologies are untested in a full economic cycle
  - Will new business models and underwriting tools work in a downturn

COMMON THEMES (CONT.)

- More protections needed for small business borrowers
  - Lower costs and faster decisions, but not subject to same oversight as banks
- Greater transparency (true cost of the loan) for borrowers and standardized documents for investors
- Secondary market for whole loans not developed—need more transparency to develop uniformity in issuances

COMMON THEMES (CONT.)

- Regularity clarity is needed—how will the regulators treat ALs
  - Consumer protection: All lenders comply with laws
  - Small business protection: Should they receive same protections as consumers
  - Cybersecurity and Fraud: Should MPLs undergo cybersecurity examinations

RECOMMENDATIONS TO DEVELOP THIS MARKET

- More protections for small businesses
- Ensure sound borrower experience and back-end operations: Economic downturn = more delinquencies = disruptions for borrowers and lenders
- Increased marketplace transparency for borrowers and investors
  - Standard reps and warranties and consistent reporting to investors

RECOMMENDATIONS (CONT.)

- Expanded credit access to underserved markets
- Allow greater access to government held data
  - Verify income and assets more quickly
- Develop interagency working group to foster development of use of technology

CFPB APPROACH

- Now accepting complaints from consumers encountering problems with loans from online marketplace lenders

- Recently issued a Marketplace Lending Consumer Bulletin. The Bulletin provides tips for consumers who want to take advantage of credit offered by marketplace lenders.

- Payday Rule

RECENT DEVELOPMENTS

- Lending Club – CEO departure and evidence of problematic lending practices
- CFPB Office of Small Business Lending Markets
- Congress pushing CFPB – Bi-Partisan Letter to Treasury
- Changes to ECOA – CFPB has authority

CURRENT IMPACT

- Banks have to adopt technology
- Both banks and lenders cannot ignore statutory and regulatory responsibility (consumer centric)
- Regulators are challenged to understand non-traditional underwriting methodologies
- Data – a blessing and a curse for an ability to pay

STATE REGULATORY CONCERNS

CLARK HILL

HOW STATES FIT INTO THE PUZZLE

- Consideration of a Federal Limited Purpose Charter
- Results of RFI in California and recent RFI in NY

PAYDAY RULES

CLARK HILL

PAYDAY PROPOSED RULE

- Proposed June 2, 2016
- Covers (1) short-term payday and auto title, and (2) longer-term installment loans where all-in fees exceed 36%
- Comment deadline – Sept. 14, 2016

KEY ELEMENTS

- Ability to repay determinations required for both
- Lenders prohibited from collection attempts on a consumer's account without providing three (3) days' advance written notice
  - Collection attempts limited to two times, unless the borrower specifically provides additional authorization
- All lenders must use credit reporting systems to report and obtain loan information
  - These reporting systems would be considered consumer reporting companies under federal law, and must be registered with the CFPB

PAYDAY AND SHORT-TERM AUTO LOANS

- Renewals/rollovers allowed only if borrower can show materially improved financial situation
  - Mandatory 30-day cooling off period after 3rd loan
- Alternative (payday and s/t auto)
  - Up to $500
  - Consumer must have no outstanding short-term or balloon payment debt, or have had short-term loans for more than 90 days in prior 12 months
  - Extensions require at least 1/3 paydown

ALTERNATIVES FOR LONGER-TERM LOANS

- Lenders can use NCUA “payday alternative loans” (interest cap of 28% and application fee of $20)

- Alternatively, lenders can offer loans with roughly equal payments, all-in cost no more than 36%, and a “reasonable” origination fee, so long as lender’s projected default rate stays below 5%. If default rate exceeds 5%, origination fee must be refunded. Total loan limits also apply.

IMPLICATIONS FOR PAYDAY/INSTALLMENT

- CFPB estimates a 70% revenue drop – for alternative approach – and that a "large number" of storefronts will close
- Particularly strong consequences for rural lenders expected
- CFPB basing impacts on qualitative judgments, not numerical analysis
- Market will likely move toward installment, where permitted by law

BROADER IMPLICATIONS

- Ability to repay requirements (underwriting/counseling/data)
- Back door interest rate caps
- CFPB disregard of statutory requirements (cost-benefit analysis, availability of credit to rural and underserved consumers)
- CFPB disinterest in state regulations
- SBREFA process likely to play a role, indirectly
- Litigation of final rules should be expected

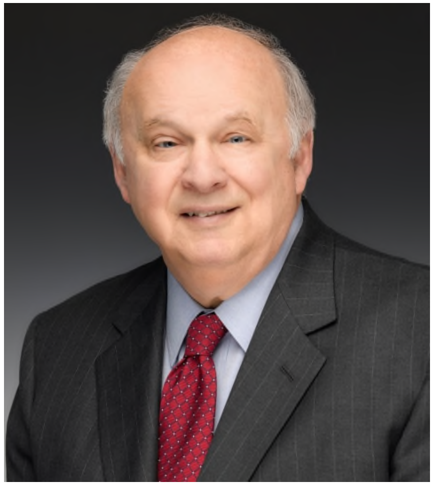
WRAP-UP

CLARK HILL

QUESTIONS?

CLARK HILL

THANK YOU



Thomas A. Brooks
(202) 552-2356
tbrooks@clarkhill.com

Jane C. Luxton
(202) 572-8674
jluxton@clarkhill.com

Joann Needleman
(215) 640-8536
jneedleman@clarkhill.com