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FinTech Forum: A closer look at marketplace lending

Duane Pozza and Helen Wong
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Innovative financial technology is changing the way consumers borrow, share, and spend money, offering the promise of increased convenience and access to financial services. The FTC is hosting a series of FinTech events to broadly explore the implications of this financial technology for consumers, building on the agency's longstanding focus on technological innovation and extensive enforcement experience in the area of non-bank financial practices. We kicked off the series on June 9, 2016, by discussing marketplace lending, a fast-growing sector that facilitates all kinds of online loans for consumers. Our panelists – who included researchers, industry participants, government representatives, and consumer advocates – had a robust discussion about the ways in which marketplace lending can expand credit opportunities for consumers, its potential challenges and consumer protection issues, and where the market and regulation is headed.

One point we heard again and again – and the one we highlight here – is that many existing laws and regulations already apply in this space, regardless of the novel technologies used. The FTC has long emphasized that existing consumer protection principles apply even when new technologies are introduced – for example, in staff's 2013 mobile payments report, and in enforcement actions involving unauthorized charges from Apple to T-Mobile.

Let's run down a few potential consumer protection issues that have been flagged, the laws that already apply, and even a few cases the FTC has brought to address these issues. Marketplace lenders who are focused on individual consumers should keep these issues in mind. (We'll leave the discussion of business lending for another day.)

What is marketplace lending?

Marketplace lenders are typically online non-bank financial companies that leverage technology to reach potential borrowers, evaluate creditworthiness, and obtain credit sources for loans. Marketplace lenders tout the ability to provide consumers with a faster, cheaper, and easier way to get credit than some traditional lenders. Participants at the June 9th Forum also discussed the potential for marketplace lenders to reach and provide credit to borrowers with limited credit histories and to historically underserved communities. Marketplace lending has seen huge growth, and, as a presentation by the FTC's Office of Technology Research and Investigation showed, has expanded to include loans for purposes as wide-ranging as education, mortgages, and medical expenses.

What kinds of laws apply?

Market participants are subject to a number of laws and regulations that govern how they deal with consumers. These include the FTC Act, the Truth in Lending Act (TILA), the Electronic Fund Transfer Act (EFTA), the Fair Credit Reporting Act (FCRA), the Gramm-Leach-Bliley (GLB) Act, the Equal Credit Opportunity Act (ECOA), and the Fair Debt Collection Practices Act (FDCPA). These govern market activities from loan disclosures to credit reporting to privacy practices to debt collection. We won't run through all of them now, but here are some consumer protection issues that may crop up when dealing with marketplace lending.

Lending Disclosures and Advertising

All lenders, including marketplace lenders, are required to make sure their disclosures – whether on websites, in ads, in loan documents, or anywhere else – are non-deceptive. Section 5 of the FTC Act of course prohibits deceptive acts or practices, and TILA requires specific disclosures in certain circumstances. Also, market participants who may not be lenders, but are involving in lending, such as advertisers, can be subject to Section 5 and TILA advertising rules.

Market participants don't need to look far for guidance on how disclosures can pass muster. As just one example, take the FTC's case against online lender AMG Services. The FTC prevailed in arguing that AMG Services violated Section 5 by prominently representing to consumers a total loan cost that indicated consumers would pay one finance charge, even though the loan was actually structured to continue for multiple finance periods so the consumer would pay multiple finance charges, and that its inaccurate loan terms violated TILA. In addition to enforcement actions, the FTC has issued guidance such as .com Disclosures, which should be particularly helpful for market participants who provide their services through mobile devices.

Use of online data

Marketplace lenders often use consumer data outside traditional measures like FICO scores to make credit decisions. Some of this information is gathered from consumers, and some may be collected from public sources by the lender. While at least one panelist at the FinTech Forum suggested that lenders are not predominantly relying on novel data sources to make credit decisions, it's difficult to get a full picture of what kind of data is being collected and used because lenders' credit algorithms are generally proprietary.

In other contexts, the FTC has seen issues with sensitive consumer information being exposed in the marketplace, and marketplace lending participants should keep in mind the existing legal constraints on transfer and disclosure of sensitive information. For example, the FTC has brought actions against lenders in the LeapLab and Sequoia One cases, alleging that they violated Section 5 by selling consumers' sensitive financial information, such as Social Security numbers, to non-lenders who misused that information. Market participants must also keep in mind consumer privacy protections under Section 5 and the Privacy and Safeguards Rules of the GLB Act, and take appropriate steps to secure consumer data. In addition to numerous enforcement actions, the FTC has issued guidance such as Start With Security, a primer for companies to build strong data security practices from the ground up – clearly relevant for companies collecting a wide variety of sensitive personal data to make lending decisions.

Marketplace lenders must also ensure that their practices don't run afoul of fair lending and credit reporting laws. ECOA generally prohibits discrimination in lending on a prohibited basis, such as race, color, religion, national origin, sex or marital status, age, or receipt of public assistance. And marketplace lenders should also be aware that if they are selling or using consumers' financial data for the purpose of making credit decisions, they may be subject to certain requirements under the FCRA, such as accuracy requirements or a requirement to provide adverse action notices to consumers if credit is denied. These and other concerns with the potentially problematic use of big data to make lending decisions are discussed in more detail in the FTC's Big Data report.

Preauthorized electronic payments

Preauthorized electronic withdrawals from bank accounts are one way to pay loans, but lenders must abide by consumer protections in this area as well. In particular, EFTA prohibits lenders from requiring consumers to repay by preauthorized electronic fund transfers as a condition of extending credit. The FTC has successfully brought law enforcement actions against lenders to enforce this provision; in Payday Financial, for example, a lender that required consumers to make preauthorized electronic payments as a condition of a loan agreement was found to violate EFTA.

Servicing and debt collection

What happens when a consumer has difficulties paying off a loan or defaults altogether? We heard at the FinTech Forum that marketplace lenders appear to have different models in this regard. Some service loans in-house, while others don't keep the loans on their balance sheets and rely on third parties for servicing and, if necessary, debt collection. All lenders (including marketplace lenders) and servicers that collect on debts must comply with Section 5, and, in some instances, the FDCPA. The FTC has brought enforcement actions under Section 5 against lenders and servicers that engaged in conduct such as misrepresenting the amount owed (Consumer Portfolio Services), calling repeatedly and continuously with the intent to annoy, harass, or abuse (Green Tree), and unfairly disclosing debts to consumers' coworkers and employers (Cash Today). Observers have noted that marketplace lenders have yet to be tested through a down credit cycle. When that happens, consumer protections in areas like debt collection will be all the more important.

What to take away

Marketplace lending has seen enormous growth and generated intense interest. We heard much at the forum about the potential benefits that marketplace lenders can provide and different perspectives on where the market may head. Regardless of how it develops, existing consumer protection laws provide an important backdrop and should always be kept in mind by market participants. Innovation for the benefit of consumers is only helped by following basic consumer protection principles.

And there's more news on the FinTech front. The FTC just announced **October 26, 2016**, as the date of the next FinTech Forum, covering crowdfunding and peer-to-peer payments. We'll follow up soon with more information.

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