Columbia Law School Global Law and Business Seminar: Introduction to Fintech Law

July 26, 2022, Morning

Todd H. Baker

Senior Fellow, Richman center for business, Law & Public Policy, Columbia University

Class Outline

- Session #1
  - Introduction to FinTech
- Session #2
  - Fintech Toolkit: The Business Model Canvas, Public Policy, Law & Regulation
- Session #3
  - FinTech Business Models—Consumer & Small Business Lending
- Session #4
  - Fintech Business Models– Alternatives to Payday and Overdraft: Earned/Early Wage Access
- Session #5
  - Fintech Business Models-- Payments Innovation
- Session #6
  - Fintech Business Models– Bank Charters & Fintech Access
- Session #7
  - Open Banking in the US and EU—Approaches and Outcomes
- Session #8
  - The Challenge of Crypto Regulation in US

Agenda

- **Fintech Business Models: FinTech Consumer & Small Business Lending**
  - **LendingClub 2015**
    - **Business Model**
    - **Public Policy**
    - **Legal and Regulatory**
  - **FinTech Lender Business Model Wrap Up**

Questions?

“Unbundling” the Bank--FinTech Lending

Review: Banks are a Bundle of Financial Services

- **What a Bank Does**
  - **Makes Loans**
  - **Takes Deposits**
  - **Initiate & Receives Payments**
  - **Facilitates Investments**
  - **Ancillary Services**

Most B2C FinTech Starts by **Unbundling** Single Bank Functions Using Technology….

- Bank
  - Makes **Loans**
  - Takes **Deposits**
  - Initiate & Receives **Payments**
  - Facilitates **Investments**
  - Advice and Ancillary Services

- FinTech Unbundlers
  - LendingClub
  - Aspiration
  - Nerdwallet
  - Square Cash
  - Betterment
  - Others

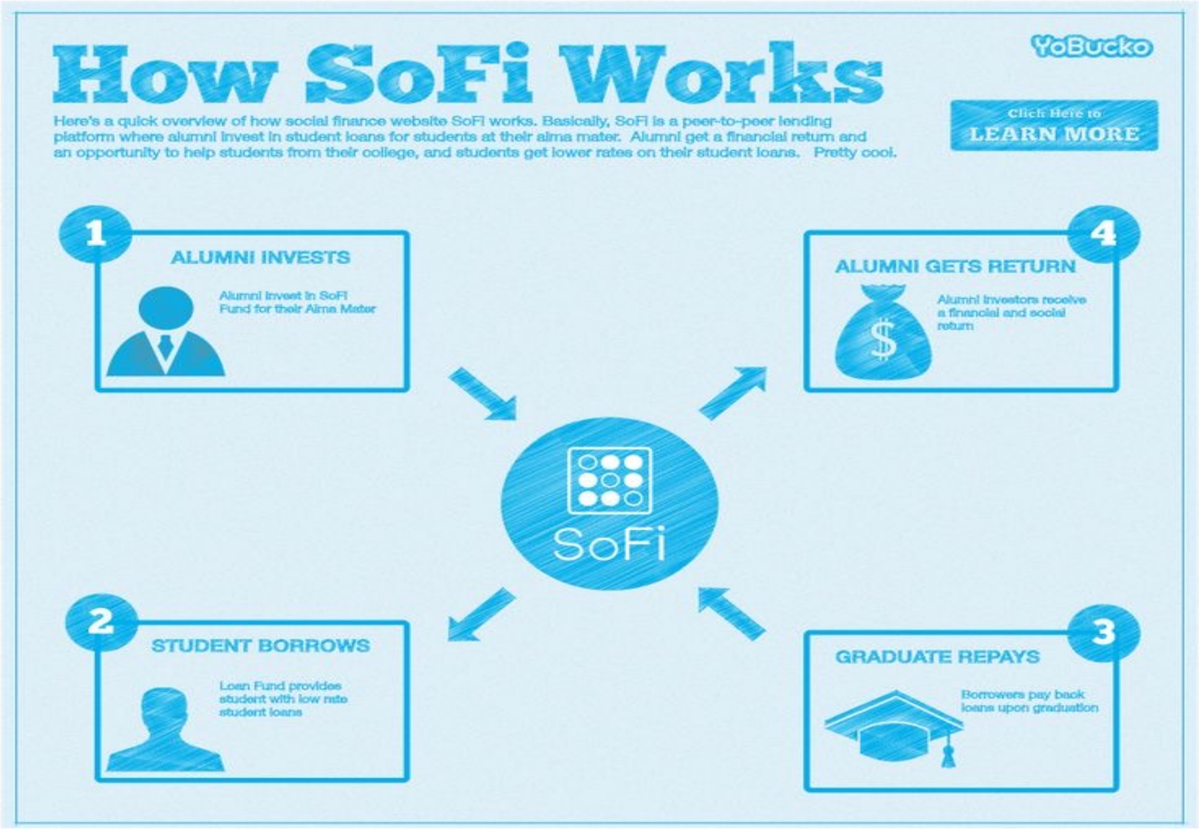
Unbundling of a Bank

B

FinTech Lending—the Promise of Greater Financial Inclusion and Lower Cost Through Digital Data

P2P: The Original Dream of FinTech Lending

- True "Person to Person" Lending (P2P) Between Individuals
  - No Intermediary, Just a "Marketplace" Facilitated by Borrower Information
  - Marketplace Facilitates But Doesn't Lend



But “True” P2P Quickly Gave Way to More Traditional Business Models

- Limited Individual Funding Capacity & High Demand from Yield-Starved Institutions Drove Quick Pivot Away from P2P
- Whether You Call it Marketplace, or Alternative or Online Lending—Today’s FinTech Finance Companies are Fairly Traditional “Intermediators,” but powered by technology
- Funded Primarily by Institutional Investors, Credit Hedge Funds, Banks, Family Offices and Asset Managers
- Some Still Follow Some Version of “Marketplace” Distribution Model, frequently combined loans on balance sheet and securitizations
- And More Recently…Failure and/or “Bankification”

Alternative Business & Funding Models for Online Lending--2019

- Balance Sheet Model
  - Traditional "Finance Company" in Structure
  - Originates Loans to Hold on Balance Sheet
  - Adds Leverage by Borrowing Against or Securitizing Loans

- Marketplace or Combo Model
  - Operates P2P Marketplace for Loan Sales
  - May Also Hold or Securitize

OnDeck

PROSPER

Kabbage

LendingClub

Questions?

LendingClub 2015

What was LC's 2015 Business Model?

- Two-Sided Digital Marketplace Serving Two Audiences
  - Borrowers
  - Investors
- Transaction-Based Revenues

LendingClub 2015

LENDINGCLUB CORPORATION

The following selected consolidated financial data should be read in conjunction with " *Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations* " and the consolidated financial statements included in this Report (in thousands, except share and per share data).

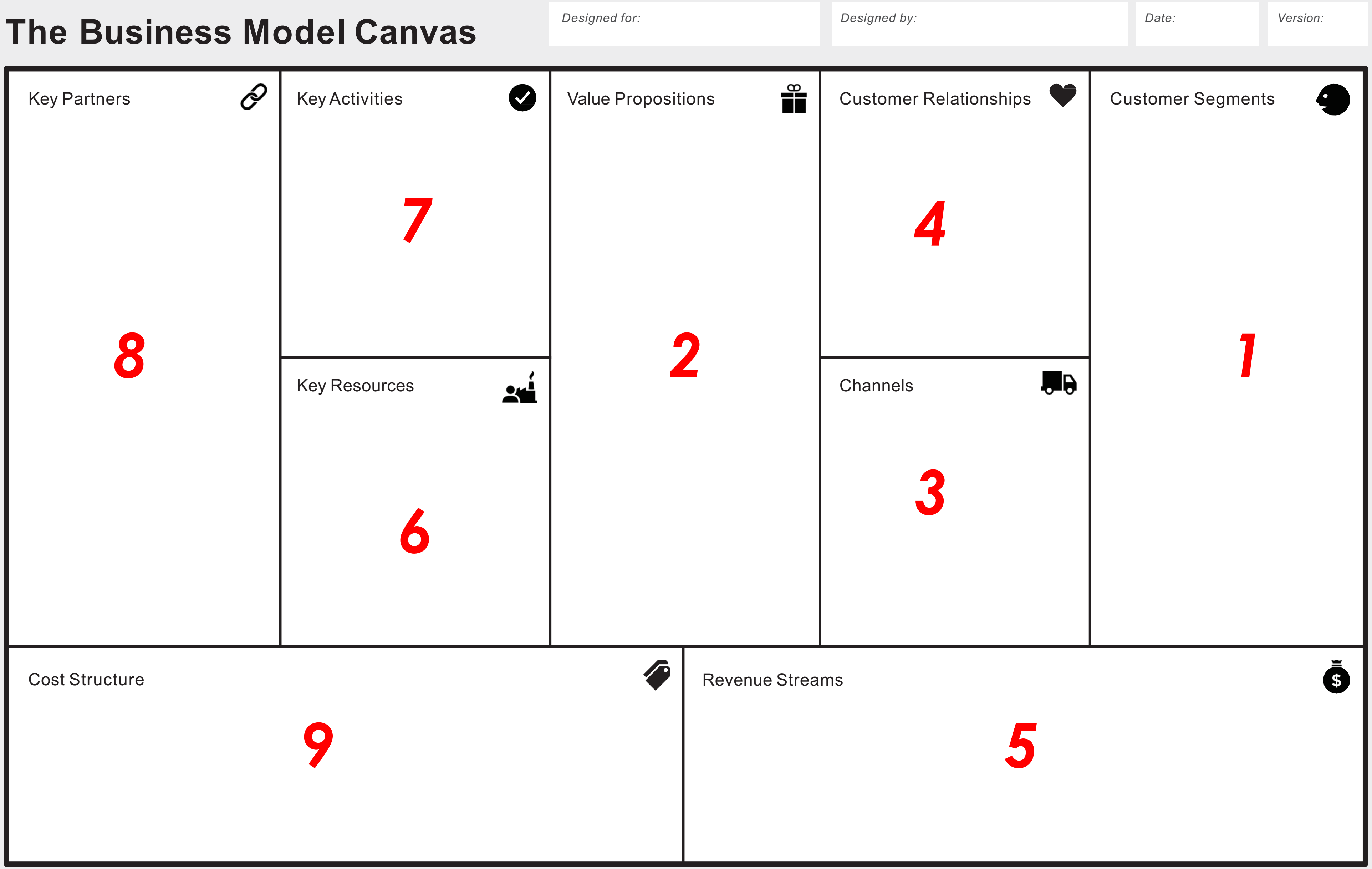
Years Ended December 31,	2015	2014 (1)	2013	2012	2011
	(audited)	(audited)	(audited)	(unaudited)	(unaudited)
Statement of Operations Data:					
Transaction fees	$ 373,508	$ 197,124	$ 85,830	$ 30,576	$ 10,981
Servicing fees	32,811	11,534	3,951	1,929	951
Management fees	10,976	5,957	3,083	824	103
Other revenue (expense)	9,402	(1,203)	5,111	716	495
Total operating revenue	426,697	213,412	97,975	34,045	12,530
Net interest income (expense) and fair value adjustments	3,246	(2,284)	27	(238)	222
Total net revenue	429,943	211,128	98,002	33,807	12,752
Operating expenses: (2) (3)					
Sales and marketing	171,526	85,652	37,431	18,201	11,402
Origination and servicing	61,335	37,326	17,978	7,589	4,758
Engineering and product development	77,062	38,518	15,528	4,855	2,289
Other general and administrative	122,182	81,136	19,757	10,024	6,572
Total operating expenses	432,105	242,632	90,694	40,669	25,021
Income (loss) before income tax expense	(2,162)	(31,504)	7,308	(6,862)	(12,269)
Income tax expense	2,833	1,390	—	—	—
Net income (loss)	$ (4,995)	$ (32,894)	$ 7,308	$ (6,862)	$ (12,269)
Net income (loss) per share attributable to common stockholders:					
Basic (4)(6)	$ (0.01)	$ (0.44)	$ 0.00	$ (0.17)	$ (0.35)
Diluted (4)(6)	$ (0.01)	$ (0.44)	$ 0.00	$ (0.17)	$ (0.35)
Weighted-average common shares - Basic (4)(6)	374,872,118	75,573,742	51,557,136	39,984,876	34,744,860
Weighted-average common shares - Diluted (4)(6)	374,872,118	75,573,742	81,426,976	39,984,876	34,744,860

December 31,	2015	2014 (1)	2013	2012	2011
	(audited)	(audited)	(audited)	(unaudited)	(unaudited)
Consolidated Balance Sheet Data:					
Cash and cash equivalents (6)	$ 623,531	$ 869,780	$ 49,299	$ 52,551	$ 24,712
Securities available for sale	297,211	—	—	—	—
Loans at fair value (5)	4,556,081	2,798,505	1,829,042	781,215	296,100
Total assets (1)(6)	5,793,634	3,890,054	1,943,395	850,830	326,797
Notes and certificates at fair value (5)	4,571,583	2,813,618	1,839,990	785,316	290,768
Total liabilities	4,751,774	2,916,835	1,875,301	798,620	294,262
Total stockholders' equity (6)	$ 1,041,860	$ 973,219	$ 68,094	$ 52,210	$ 32,535

(1) In April 2014 , the Company completed the Springstone acquisition. The Company's consolidated financial statements include Springstone's financial position and results of operations from the acquisition date.

(2) Prior period amounts have been reclassified to conform to the current period presentation, as discussed above.

The Business Model Canvas



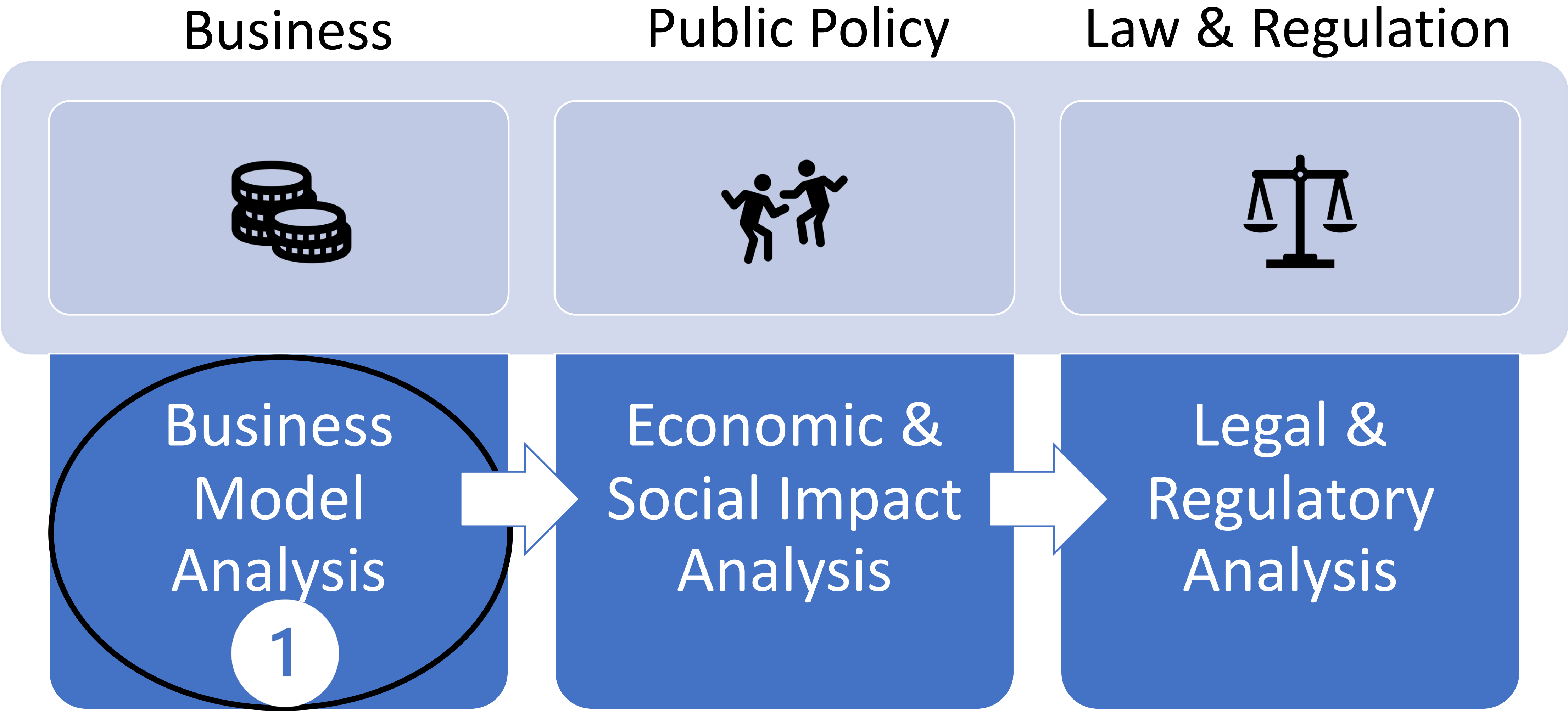
DesigneD by: Strategyzer AG

The makers of Business Model Generation and Strategyzer

Strategyzer

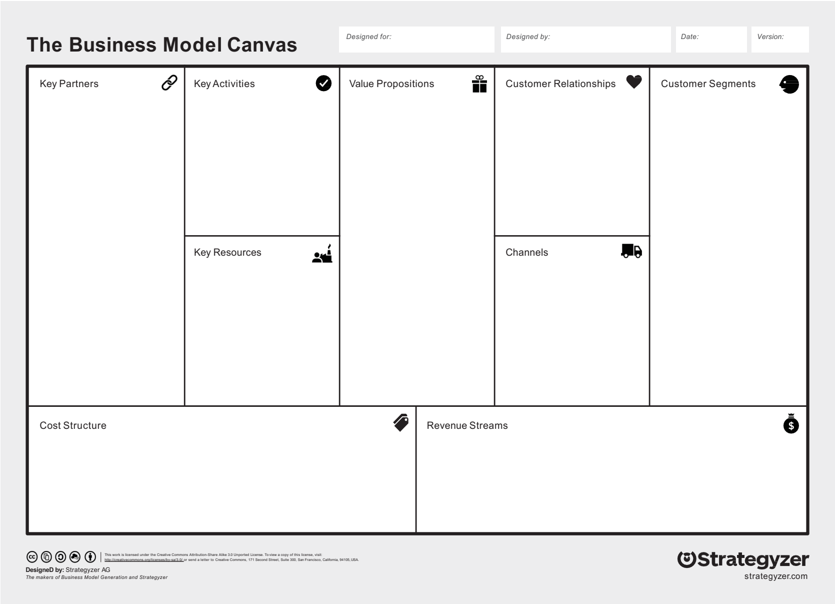
strategyzer.com

1st Dimension: Business Model Analysis



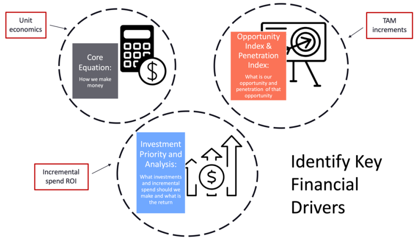
1 Tools for FinTech Business Model Analysis

1A: Canvas



1B: Supplements

Key Product Insights
- Customer Segment
- Product Function
- Product Value Prop
- Pricing Structure
- Who else pays/subsidizes?
- Use of Banking Rails
- Product Structure & Behavior
- Data/AI



Identify Key Financial Drivers

1C: Risks

Financial Services Risks:
- Credit risk
- Market risk
- Operational risk
- Liquidity (Funding) risk
- Reputational risk
- Legal, regulatory & political risk
- Data/AI risk
- Systemic risk

9 building blocks

- Customer Segments
- Value Proposition
- Channels
- Customer Relationships
- Revenue Streams
- Key Resources
- Key Activities
- Key Partners
- Cost Structure

Financial Services Risks:
Credit risk
Market risk
Operational risk
Liquidity (Funding) risk
Reputational risk
Legal, regulatory and political risk
Data management/AI risk
Systemic risk

The Business Model Canvas

LendingClub 2015

Designed by:

Date:

Version:

Key Partners

Key Activities

Key Resources

Value Propositions

Customer Relationships

Channels

Customer Segments

Cost Structure

Revenue Streams

The Business Model Canvas

Designed for: LendingClub | Designed by: | Date: | Version:

Key Partners

Key Activities

Key Resources

Value Propositions

Customer Relationships

Channels

Customer Segments

Institutional Investors, Banks, Asset Manager, Individuals

Mass Market Borrowers

Cost Structure

Revenue Streams

The Business Model Canvas

Designed for: LendingClub | Designed by: | Date: | Version:

Key Partners	Key Activities	Value Propositions	Customer Relationships	Customer Segments
		High Yield Fixed Income Investments With Short Duration and Transparent Metrics Best Prices for Risk Fast, Easy Access to Credit		Institutional Investors, Banks, Asset Manager, Individuals Mass Market Borrowers
	Key Resources		**Channels**	

Cost Structure	Revenue Streams

The Business Model Canvas

Designed for: LendingClub | Designed by: | Date: | Version:

Key Partners

Key Activities

Key Resources

Value Propositions

High Yield Fixed Income Investments With Short Duration and Transparent Metrics

Best Prices for Risk

Fast, Easy Access to Credit

Customer Relationships

Channels

Website

Brokers

Referral Partnerships

Customer Segments

Institutional Investors, Banks, Asset Manager, Individuals

Mass Market Borrowers

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Customer Relationships

Transactional Consumers

Data-Driven Repeat Investors

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Mass Market Borrowers

Cost Structure

Revenue Streams

Transaction, Investor and Servicing Fees/Gain on Sale

The Business Model Canvas

Designed for: LendingClub | *Designed by:* | *Date:* | *Version:*

Key Partners

Key Activities

Key Resources

Lending & Investor Platforms

Value Propositions

High Yield Fixed Income Investments With Short Duration and Transparent Metrics

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Transaction, Investor and Servicing Fees/Gain on Sale

The Business Model Canvas

Designed for: LendingClub | Designed by: | Date: | Version:

Key Partners

Key Activities

Platform Development & Maintenance

Credit Analytics

Investor Support

Marketing

Key Resources

Lending & Investor Platforms

Value Propositions

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Transaction, Investor and Servicing Fees/Gain on Sale

The Business Model Canvas

Designed for: LendingClub | Designed by: | Date: | Version:

Key Partners

Credit Bureaus and Data providers

Loan Investment and Securitization Partners

Fronting Bank

Referral and Advertising Partners

Key Activities

Platform Development & Maintenance

Credit Analytics

Investor Support

Marketing

Key Resources

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Channels

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Brokers

Referral Partnerships

Customer Segments

Institutional Investors, Banks, Asset Manager, Individuals

Mass Market Borrowers

Cost Structure

IT Infrastructure/Software Devvelopment/Sales & Marketing/G&A

Revenue Streams

Transaction, Investor and Servicing Fees/Gain on Sale

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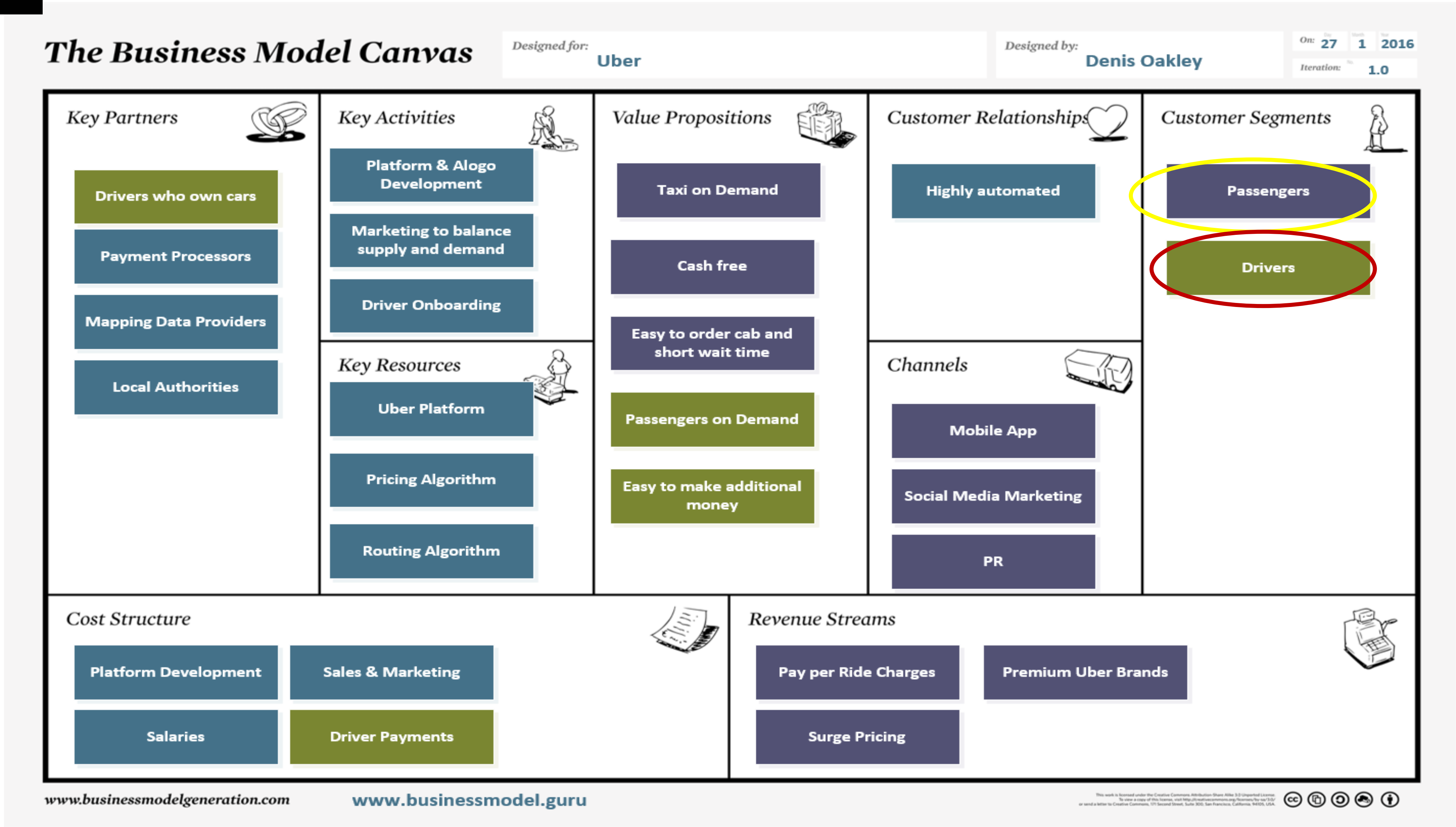
Uber: Two-Sided Platform



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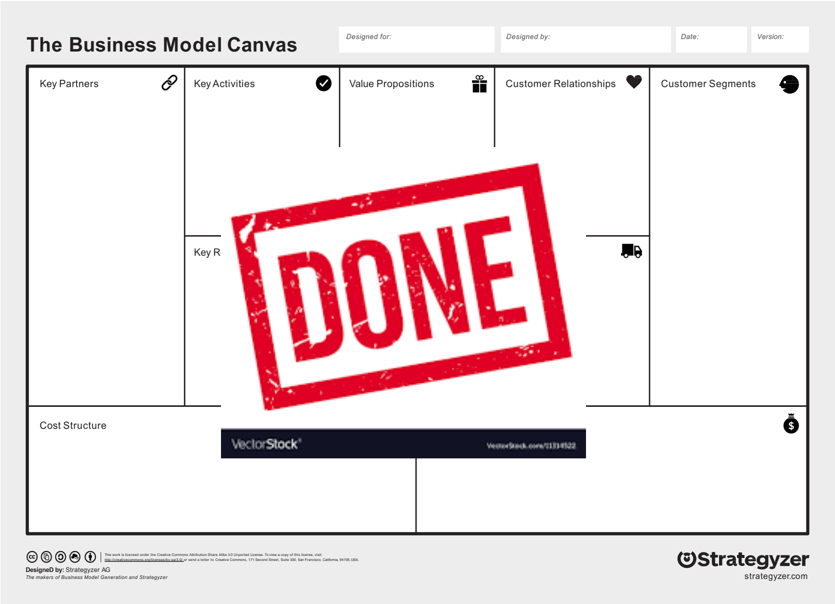
Questions?

1 We’ll Use Only One Supplementary Tool

1A: Canvas



1B: Supplements

Key Product Insights
Customer Segment
Product Function
Product Value Prop
Pricing Structure
Who else pays/subsidizes?
Use of Banking Rails
Product Structure & Behavior
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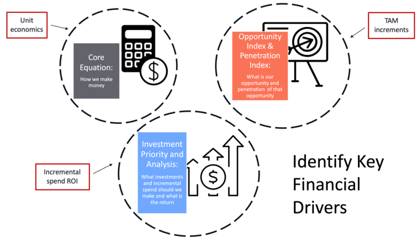

Identify Key Financial Drivers

1C: Risks

Financial Services Risks:
Credit risk
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Liquidity (Funding) risk
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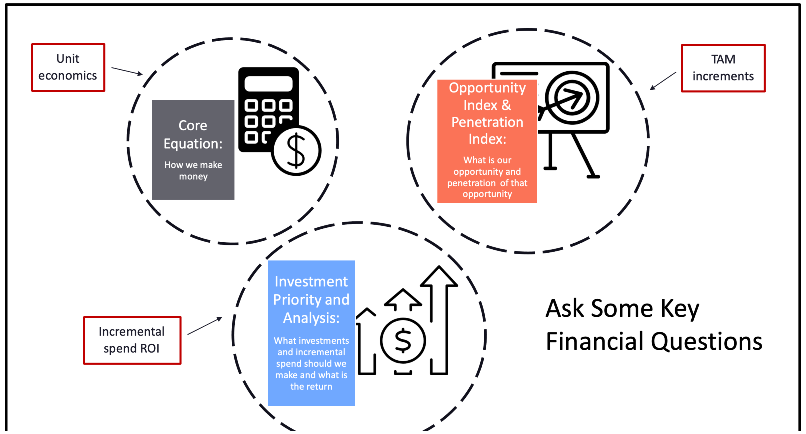


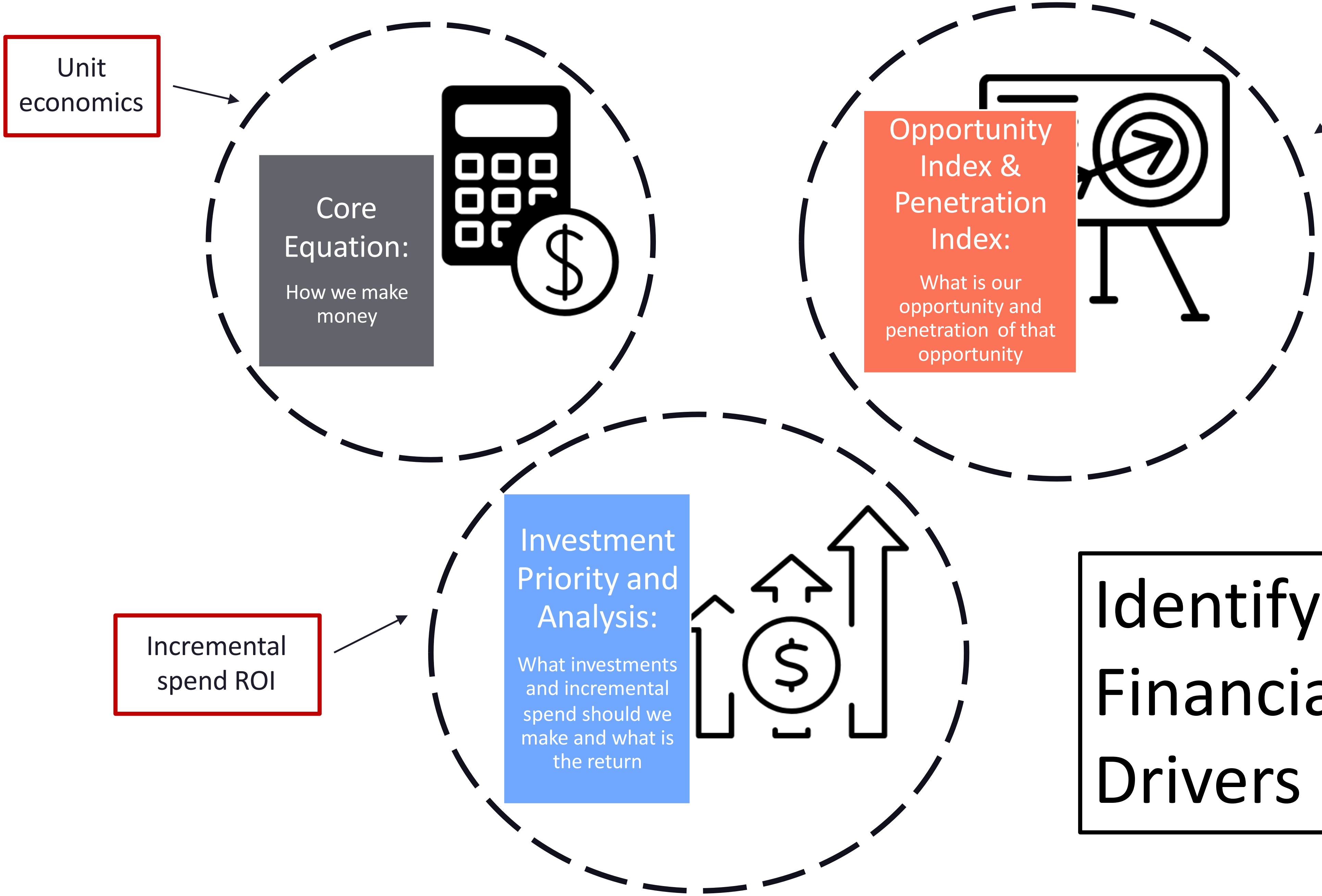
A FinTech's valuation is a function of its Life Time Value of customers, divided by Customer Acquisition Costs

Valuation = $f(LTV/CAC)$

LTV: Life Time Value of Customer

CAC: Customer Acquisition Cost

Business Model Analysis 1B: Key Financial Drivers



Identify Key Financial Drivers

LENDINGCLUB CORPORATION

Transaction fees grew 20%

As of and for the Year Ended December 31,	2017	2016	2015	2014 (1)	2013
Statement of Operations Data:					
Net revenue:					
Transaction fees	$ 448,608	$ 423,494	$ 373,508	$ 197,124	$ 85,830
Investor fees (2)	87,108	79,647	43,787	17,491	7,034
Gain (Loss) on sales of loans (2)	23,370	(17,152)	4,885	(3,569)	3,862
Other revenue (2)	6,436	9,478	4,517	2,366	1,249
Net interest income and fair value adjustments:					
Interest income	611,259	696,662	552,972	354,453	187,507
Interest expense	(571,424)	(688,368)	(549,740)	(356,615)	(187,447)
Net fair value adjustments (2)	(30,817)	(2,949)	14	(122)	(33)
Net interest income (expense) and fair value adjustments (2)	9,018 8,294	5,345 3,232,000	3,246	(2,284)	27
Total net revenue	574,540	500,812	429,943	211,128	98,002
Operating expenses: (3)					
Sales and marketing	229,865	216,670	171,526	85,652	37,431
Origination and servicing	86,891	74,760	61,335	37,326	17,978
Engineering and product development	142,264	115,357	77,062	38,518	15,528
Other general and administrative	191,683	207,172	122,182	81,136	19,757
Class action litigation settlement	77,250	—	—	—	—
Goodwill impairment	—	37,050	—	—	—
Total operating expenses	727,953	651,009	432,105	242,632	90,694
Income (loss) before income tax expense	(153,413)	(150,197)	(2,162)	(31,504)	7,308
Income tax expense (benefit)	632	(4,228)	2,833	1,390	—
Consolidated net income (loss)	(154,045)	(145,969)	(4,995)	(32,894)	7,308
Less: Loss attributable to noncontrolling interests	(210)	—	—	—	—
LendingClub net income (loss)	$ (153,835)	$ (145,969)	$ (4,995)	$ (32,894)	$ 7,308

Operating expenses grew 68%

Questions?

Business Model Analysis 1C: Special Financial Services Risks

Financial Services Risks:
Credit risk
Market risk
Operational risk
Liquidity (Funding) risk
Reputational risk
Legal, regulatory and political risk
Data /AI risk
Systemic risk

Special Financial Services Risks

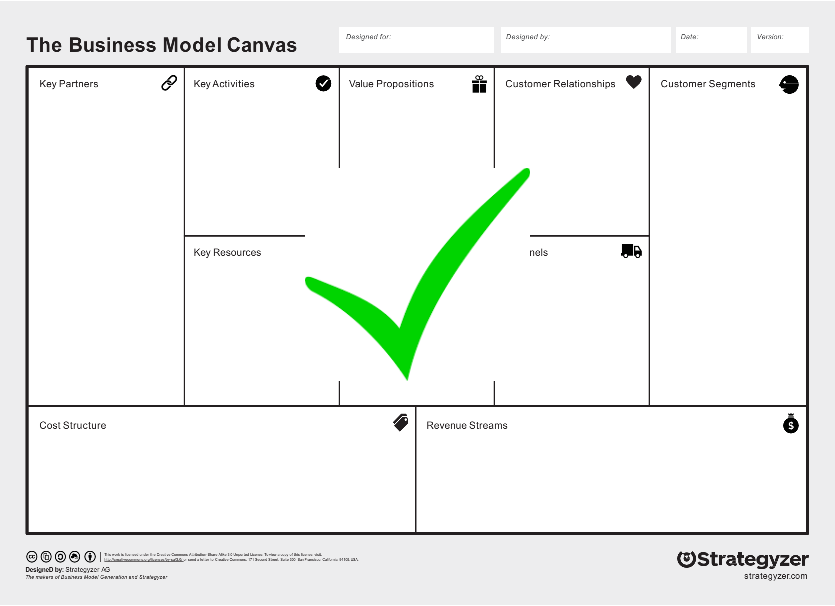
- **Credit risk**
- **Market risk**
- **Operational risk**
- **Liquidity (Funding) risk**
- **Reputational risk**
- **Legal, regulatory and political risk**
- **Data /AI risk**
- **Systemic risk**

LendingClub 2015 Risk Canvas

- **Credit risk. …** High, but expressed through liquidity/funding cost/availability not credit costs
- **Market risk. ...** High due to reliance on volatile fixed income market
- **Operational risk. ...** Moderate
- **Liquidity (Funding) risk. ...** Very High
- **Reputational risk. ...** Very High (LaPlanche)
- **Legal, regulatory and political risk. …** High (Fronting Bank model)
- **Data Management/AI Risk. …** High
- **Systemic risk. ...** Low??

1 FinTech Business Model Analysis is Complete

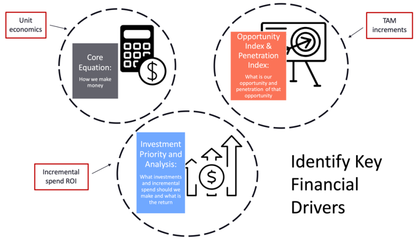
1A: Canvas



1B: Supplements

Key Product Insights

Customer Segment
Product Function
Product Value Prop
Pricing Structure
Who e ...es?
Use of
Produc ...navior
Data/A



Identify Key Financial Drivers

1C: Risks

Financial Services Risks:

Credit risk
Market risk
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Liquid ...g) risk
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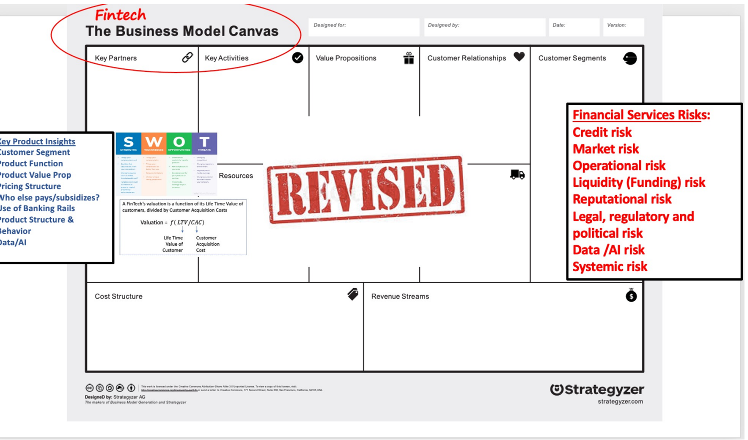
Systemic risk

Questions?

Now: Add Second Dimension: **Public Policy**



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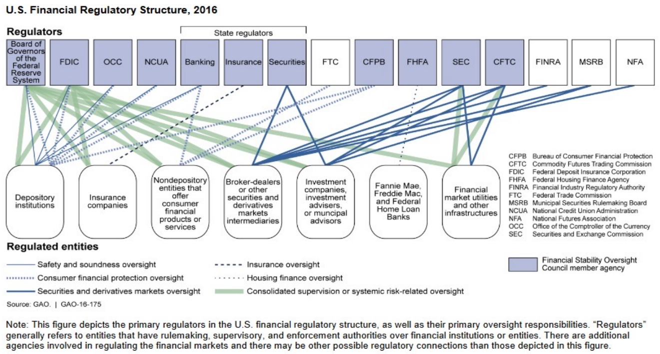

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3

Public Policy Analysis

Policy Screens for Consumer FinTech

Utility/Scalability

- Utility: Cost/Avoidance vs. Alternatives
- Delivery at Scale Possible?

Inclusivity/Exclusivity

- Wealth/Income/Race/Ethnicity/Sex/Disability

Alignment Analysis

- The incentives imbedded in a fintech business and/or product model and consumer interests

Data Utilization

- Source/Privacy/Control

Systemic Impact

Utility

- “Utility” is the ability of the financial products offered by a company to either (a) provide a superior substitute for current products in producing financially healthy outcomes, or (b) provide an effective mechanism for consumers to avoid the use of current products producing financially unhealthy outcomes.
- A product is a “superior” substitute if it provides substantially equivalent functionality at a significantly lower price or with a product structure that would be likely to avoid outcomes adverse to consumer financial health.
- In considering Utility in either of the two alternative meanings noted above, take into account a time element, in that companies sometimes describe their products as part of an explicit multi-step path for the consumer culminating in increased Utility through (i) the ability to access a superior substitute (i.e., credit on standard terms and pricing) and/or (ii) financial resilience through improved financial capacity.

Utility

Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information

Julapa Jagtiani
Federal Reserve Bank of Philadelphia

Catharine Lemieux

* On average, personal loans from LendingClub Bank are offered at an APR of 15.95% with an origination fee of 5.00% and a principal amount of $15,800 for loans with term lengths of 36 months, based on current credit criteria and an analysis of historical borrower data from 1/1/21 to 4/12/21. For credit card purchases made in March 2021, the average APR was 20.29%, according to publicly available information published by TheBalance.com. If you pay off a credit card balance of $15,010 with an APR of 15.95% over 36 equal monthly payments, you will pay $5,152 in total finance charges. If you obtain a loan with a term of 36 months and an amount financed of $15,010 (principal amount of $15,800 with an origination fee of $790) at 15.95% APR, you will pay $3,975 in total finance charges over the term of the loan, a savings of $1,177 as compared to the average credit card.

Fintech has been playing an increasing role in shaping financial and banking landscapes. Banks have been concerned about the uneven playing field because Fintech lenders are not subject to the same rigorous oversight. There have also been concerns about the use of alternative data sources by Fintech lenders and the impact on financial inclusion. In this paper, we explore the advantages/disadvantages of loans made by a large Fintech lender and similar loans that were originated through traditional banking channels. Specifically, we use account-level data from the Lending Club and Y-14M bank stress test data. We find that Lending Club's consumer lending activities have penetrated areas that could benefit from additional credit supply – such as areas that lose bank branches and in those in highly concentrated banking markets. We also find a high correlation between interest rate spreads, Lending Club rating grades, and loan performance. However, the rating grades have a decreasing correlation with FICO scores and debt-to-income ratios, indicating that alternative data is being used and performing well so far. Lending Club borrowers are, on average, more risky than traditional borrowers given the same FICO scores. The use of alternative information sources has allowed some borrowers who would be classified as subprime by traditional criteria to be slotted into "better" loan grades and therefore get lower priced credit. Also, for the same risk of default, consumers pay smaller spreads on loans from the Lending Club than from traditional lending channels.

Utility

In a nutshell, fintech borrowers who initially improved their credit scores by consolidating some of their credit card debt saw a deterioration in those scores months down the line as they began to use their credit lines to consume more goods, from purchasing a car to buying everyday items, the researchers found.


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RESEARCH & IDEAS

The Dark Side of Fintech Borrowing

25 OCT 2020 | by Rachel Layne

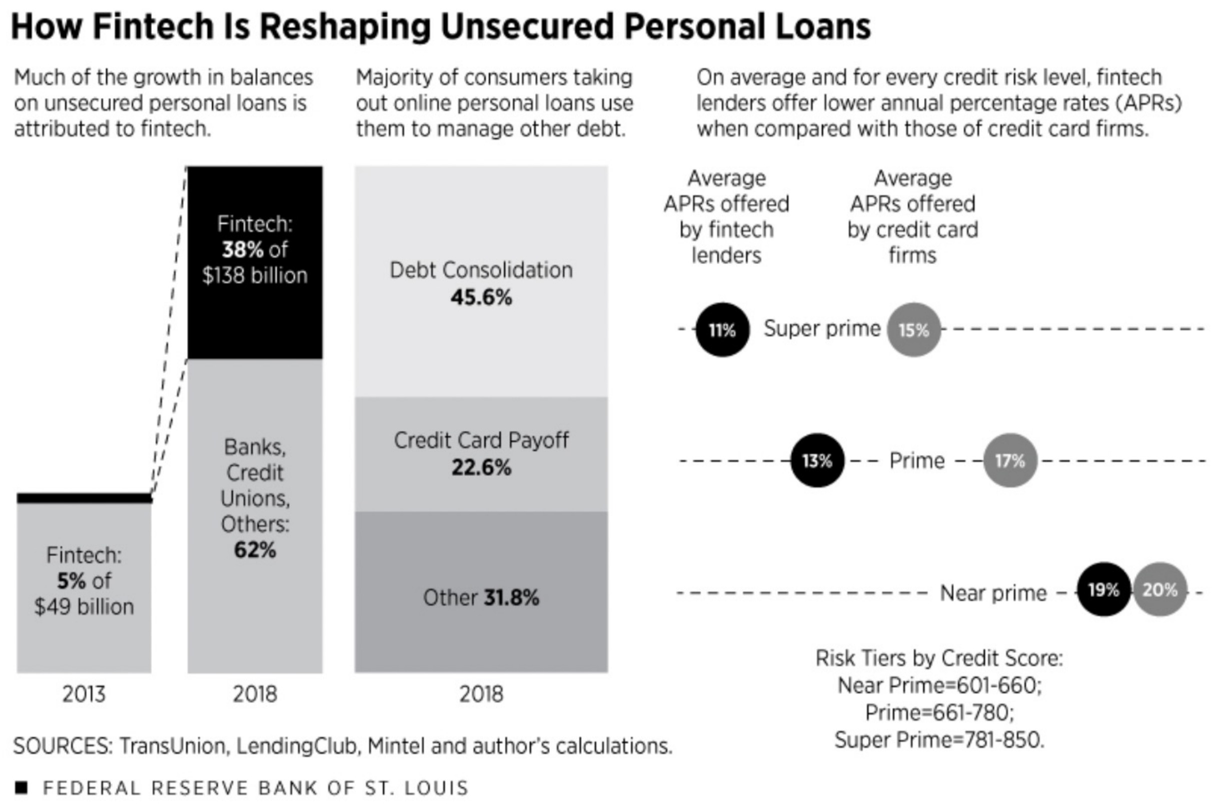
Fintechs have revolutionized the banking industry, but some customers end up worse for the experience, according to research by **Marco Di Maggio** and colleagues.

Scalability

- "Scalability," is the potential for a company's business model to support rapid penetration of the market to serve a significant percentage of total available households.
- Scalability is important in that positive or negative policy effects are maximized to the extent that a business is scalable
- In assessing Scalability, consider various impediments to scale, including
  - funding and capital requirements
  - operational complexity
  - technology constraints
  - regulatory structure
  - reliance on third-party infrastructure and
  - length of sales cycle
- Focus on key revenue and expense drivers from the business model analysis to ask whether a company appears capable of generating an appropriate return on capital only if Scale is reached.
- Also assess whether, and to what extent, external assistance or subsidy—from employers, non-profits or government--would be required to serve a significant portion of low-income households, or to accelerate the scaling process.

Scalability

Figure 1



[back to text]

Inclusivity/Exclusivity

- "Inclusivity/Exclusivity" has several dimensions:
  - whether a company's products are appropriate for the full range of consumer income/wealth segments (e.g., savings accounts), or are designed for and marketed to high, middle, or low-income/wealth consumer segments (e.g., private banking vs. payday lending)
  - whether the makeup of the company's customer base, or the profitability of its business model or products, is skewed towards particular income/wealth or protected class segments
  - whether company's practices have a disparate impact on, or are otherwise discriminatory with respect to, protected classes defined by race, ethnicity, sex, and/or disability
  - Special attention should be paid to a company's data and AI practices

Inclusivity/Exclusivity

Consumer-Lending Discrimination in the FinTech Era*

Robert Bartlett
School of Law
UC Berkeley
rbartlett@berkeley.edu

Adair Morse
Haas School of Business
UC Berkeley & NBER
adair@berkeley.edu

Richard Stanton
Haas School of Business
UC Berkeley
rhstanton@berkeley.edu

Nancy Wallace
Haas School of Business
UC Berkeley
newallace@berkeley.edu

February 2019

Abstract

Ethnic discrimination in lending can occur in face-to-face decisions or in algorithmic scoring. The GSEs' model for pricing credit risk provides us with an identified setting to estimate discrimination for FinTech and face-to-face lenders, as well as to offer a workable enforcement interpretation of U.S. fair -lending laws using the court's justification of legitimate business necessity. We find that face-to-face and FinTech lenders charge Latinx/African-American borrowers 6-9 basis points higher interest rates for purchase mortgages, consistent with the extraction of monopoly rents in weaker competitive environments and from profiling borrowers on shopping behavior. In aggregate, Latinx/African-American pay $750M per year in extra mortgage interest. FinTech algorithms have not removed discrimination, but two silver linings emerge. Algorithmic lending seems to have increased competition or encouraged more shopping with the ease of applications. Also, while face-to-face lenders discriminate against minorities in application rejection, there are reasons to believe FinTechs may discriminate less.

Alignment

- "Alignment" or "Misalignment" is a measure of the extent to which the incentives (primarily financial) imbedded in a fintech business and/or product model are **aligned or misaligned** with consumer interests measured by changes in consumer financial health.
- Understanding Alignment is critical to evaluating the public policy impact of any fintech business model

Eight Indicators of Financial Health

SPEND	SAVE	BORROW	PLAN
1 Spend less than income	3 Have sufficient liquid savings	5 Have manageable debt	7 Have appropriate insurance
2 Pay bills on time	4 Have sufficient long-term savings	6 Have a prime credit score	8 Plan ahead financially

Alignment Assessment Process

- Use output from Business Model Analysis to identify financial incentives imbedded in in Fintech business and/or product model
  - Pay particular attention to product structure & behavioral incentives on consumer experience
- Assess whether provider incentives work to improve or degrade customer financial health
  - Empirical analysis of outcomes data if available
  - Normative assessment based on experience if data unavailable (e.g., default is bad/savings is good)

Data Utilization

- Assess the extent to which a company follows evolving best practices in the sourcing, utilization and protection of consumer personally identifiable information.
  - CFPB Principles For Consumer-Authorized Financial Data Sharing and Aggregation
  - Financial Health Network Data Sharing Principles
  - GDPR Standards
  - California Data Privacy Rules

Data Utilization

FACTS	WHAT DOES LENDINGCLUB DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: • Social Security number and income • Account balances and transaction history • Credit scores and employment information
How?	All financial companies need to share customers' personal information to run their everyday business. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons LendingClub chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does LendingClub share?	Can you limit this sharing?
For our everyday business purposes - such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or report to credit bureaus	Yes	No
For our marketing purposes - to offer our products and services to you	Yes	No
For joint marketing with other financial companies	Yes	Yes
For our affiliates' everyday business purposes - information about your transactions and experiences	Yes	No
For our affiliates' everyday business purposes - information about your creditworthiness	Yes	Yes
For our affiliates to market to you	Yes	Yes

Systemic Risk

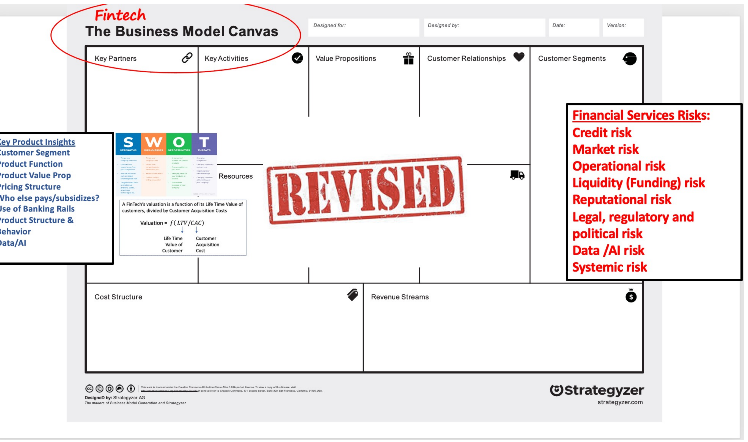
- Refer to Business Model Risk Assessment

Systemic Risk

- “The impact of an MPL disruption on the real economy is likely to be much more severe than is commonly recognized. Imagine the consequences a decade from now if 8% of consumers and 16% of small business borrowers can’t find replacement loans quickly from traditional lenders in an MPL liquidity squeeze, especially borrowers who may not meet traditional bank credit standards. As MPLs enter more sectors of the U.S. lending market, such as commercial real estate, healthcare, student and single-family lending, the impact will be even greater. The rapid withdrawal of credit to so many Main Street consumers and businesses could be devastating to the U.S. economy. “

Questions?

Now: Add Third Dimension: **Law and Regulation**



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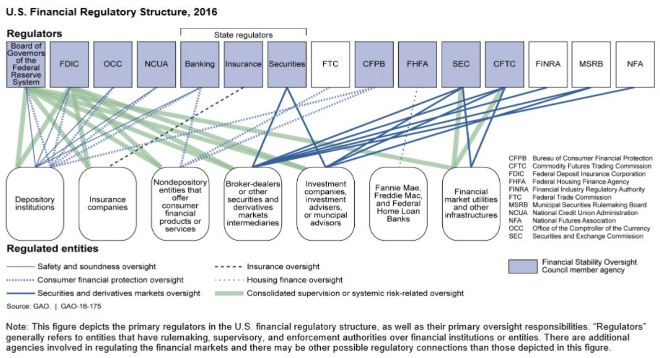

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2

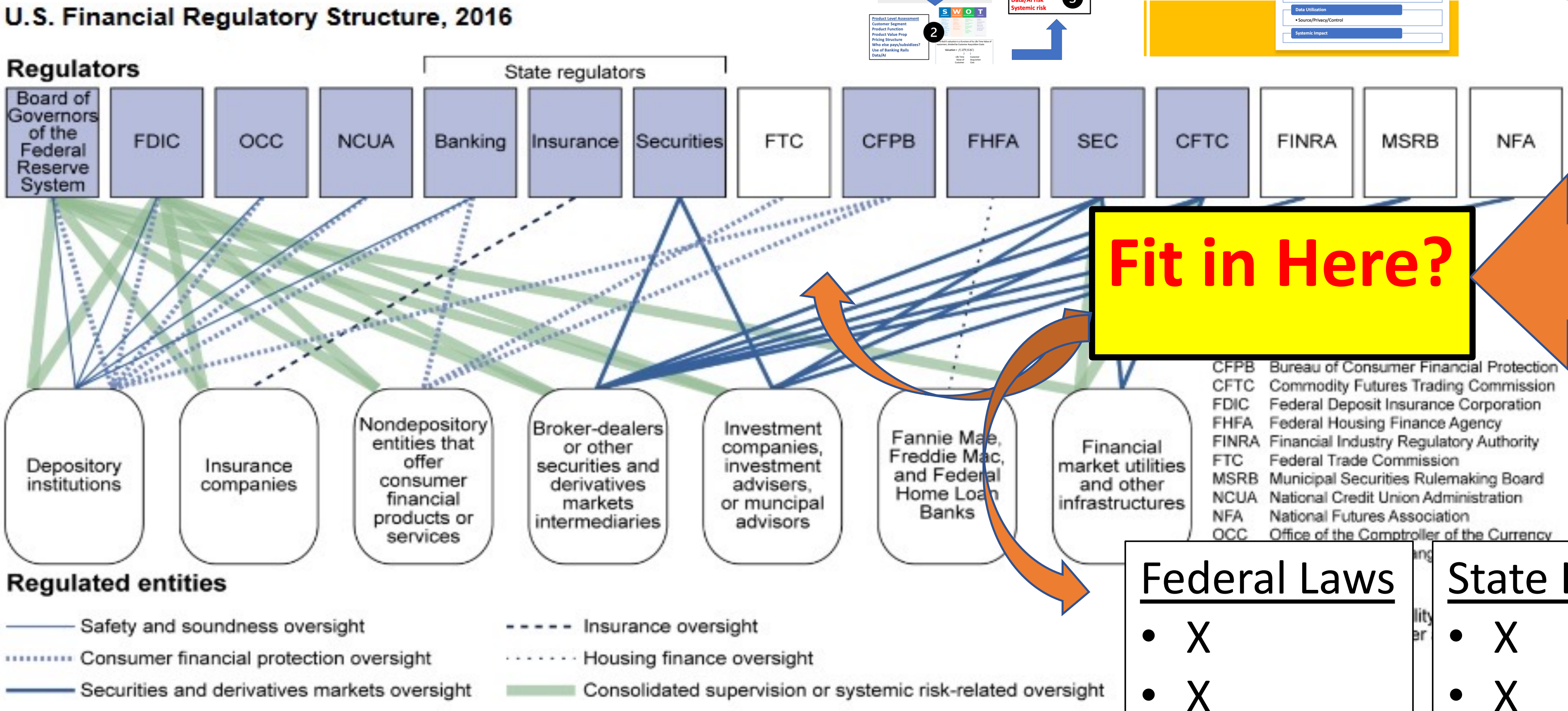
3

Legal and Regulatory Analysis

Tools for Legal/Regulatory Analysis

How Do These…

Fit in Here?



Source: GAO. | GAO-16-175

Note: This figure depicts the primary regulators in the U.S. financial regulatory structure, as well as their prima
generally refers to entities that have rulemaking, supervisory, and enforcement authorities over financial institu
agencies involved in regulating the financial markets and there may be other possible regulatory connections t

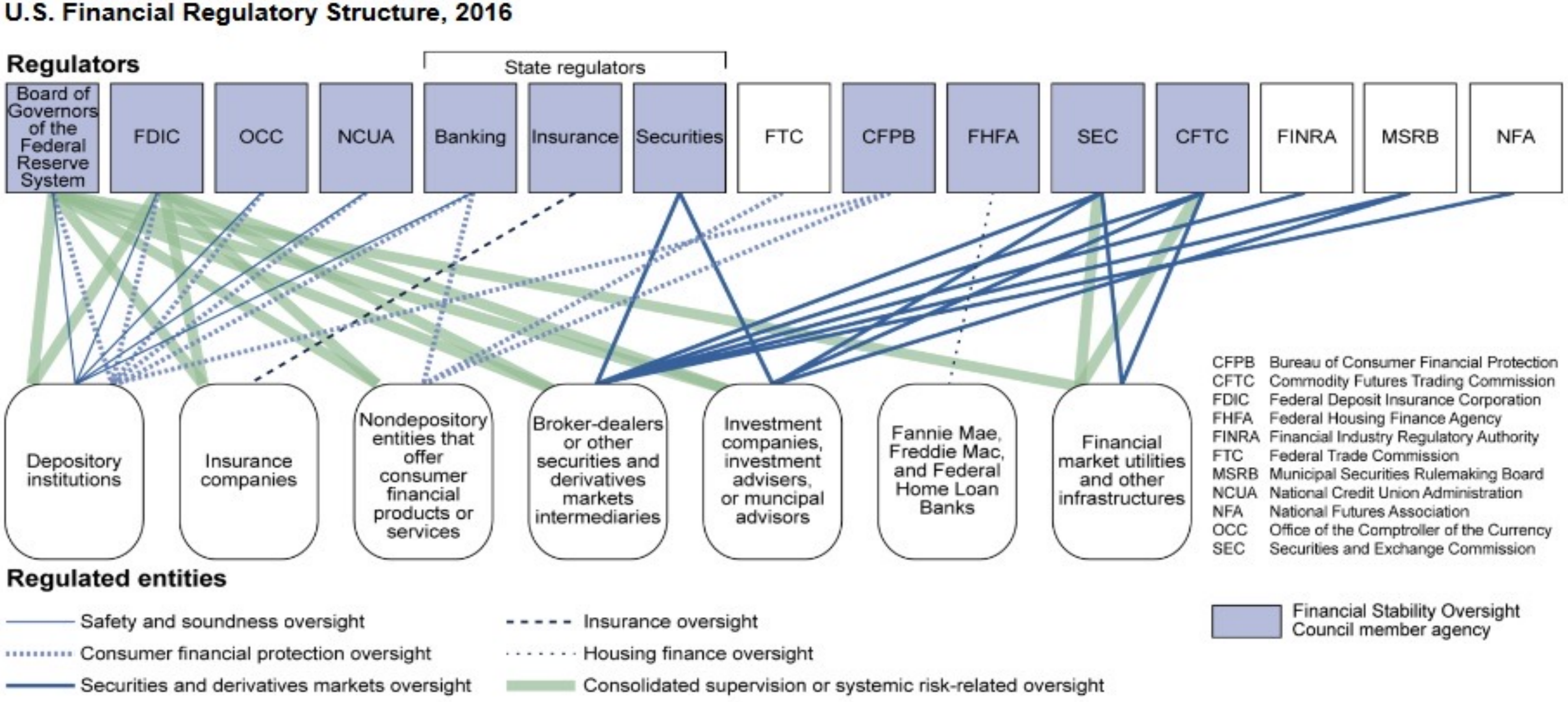
Federal Laws

- X
- X
- X
- X

State Laws

- X
- X
- X
- X

Assess How Many Ways Fintech is Regulated Directly and Indirectly



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Use the Waterfall…

Banking Regulation

- Bank Holding Company/Volker
- Bank Service Provider Oversight
- Use of Partner Bank for Lending, Deposits or Payments

Does fintech's **provision or use** of banking services bring regulation? If so, how and from what agency?

- **Fed**
- **OCC**
- **FDIC**
- **State**

Securities or Commodities Regulation

- Is it a Security?
  - Registrable or Exempt
  - Broker Dealer, Investment Company, Exchange
- Is it a Commodities Derivative?
  - Commodities Exchange

Does fintech create, or facilitate holding or trading in, securities or commodities derivatives? If so, how?

- **SEC**
- **CFTC**
- **State**

State Activities Regulation

- Lender Licensing
- Usury
- Money Transmission
- Privacy

Are fintech's products or activities subject to specific state financial and consumer protection laws?

- **State**

Federal Activities Regulation

- TILA, ECOA. EFTA, FCRA
- BSA/AML
- Privacy

Are fintech's products/activities subject to specific federal financial and consumer protection laws?

- **CFPB**
- **FTC**

Identify and Assess Laws Applicable to FinTech

Federal Laws

- x
- x
- x

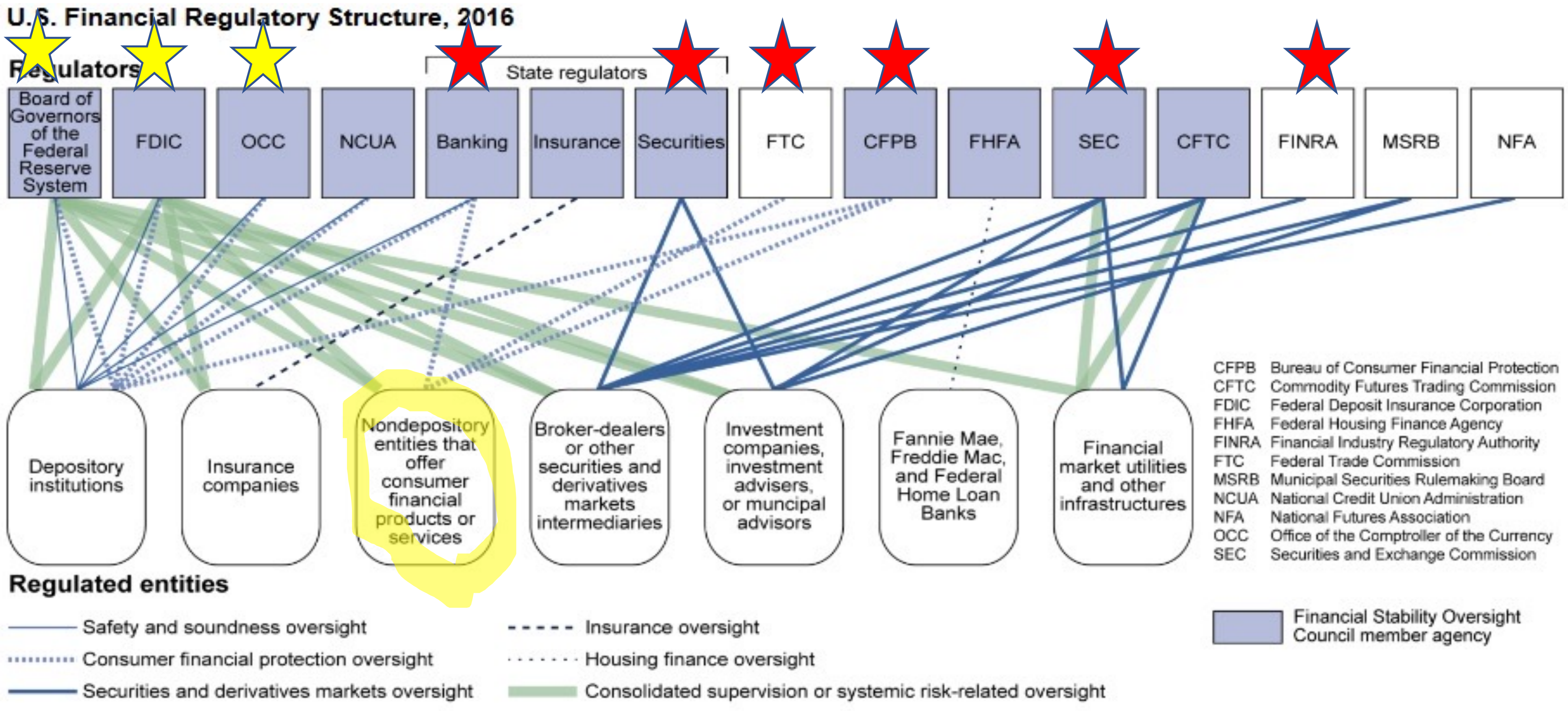
State Laws

- x
- x
- x

LC Regulatory Structure 2015

Direct Regulation

Indirect Regulation



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Two-Sided Platform: Lending and Funding, Drive Both Standard and Novel Regulatory/Legal Questions

- Lending Side
  - Federal and State Consumer Lending Laws & Compliance
  - State Licenses
  - Usury Statutes
  - Money Transmission Issues
  - Use of ”Fronting” Partner Banks
  - Data and Aggregators
  - Is it a Loan?
- Investor Side
  - Securities Laws
    - Sale of Loans
    - Securitization
    - Asset Management Vehicles

Loan Rate Structures Compared

Lending Club

- APRs for loans through LendingClub range from 10.68% to 35.89%.
- All personal loans through LendingClub have fixed rates and fixed monthly payments.

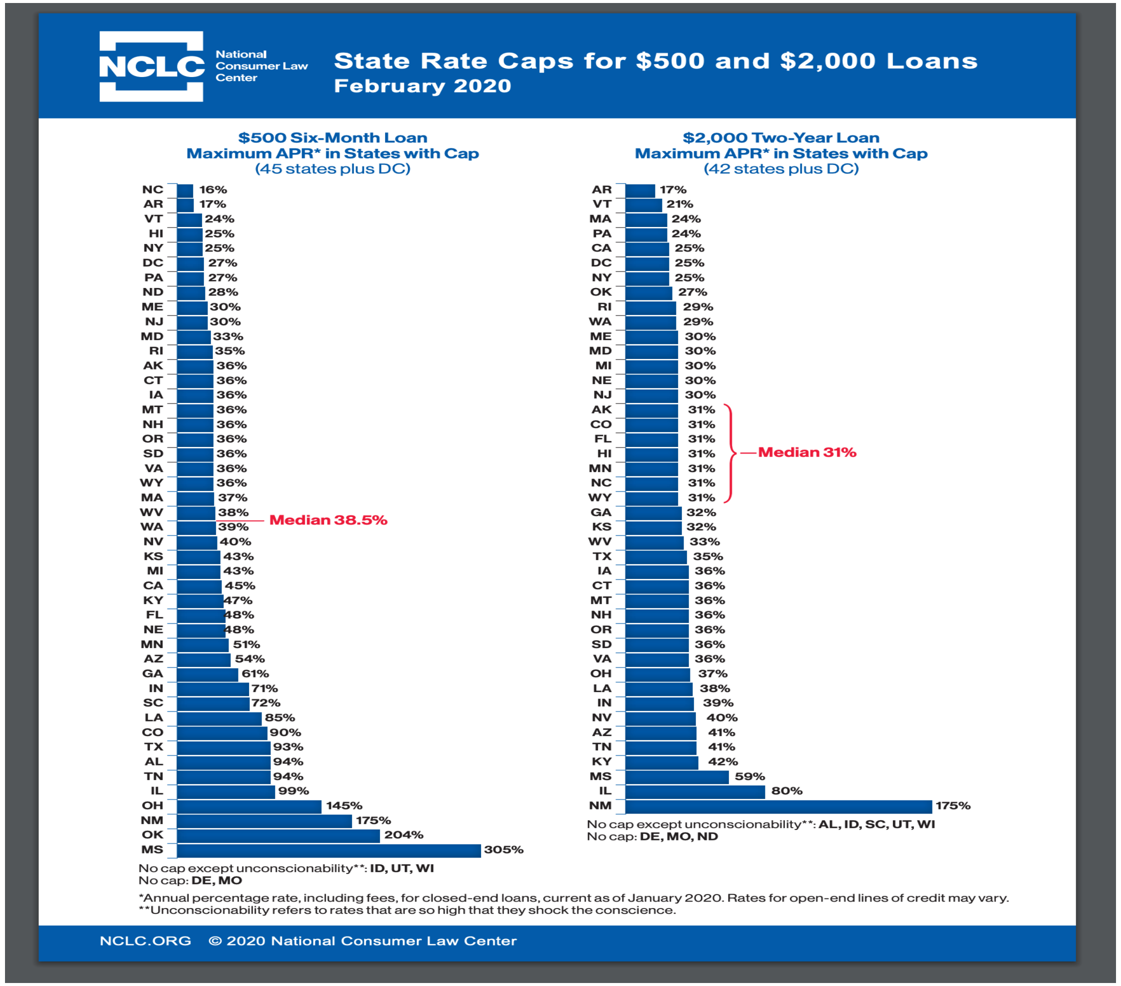
Opp Loans

- The average OppLoans customer has a credit score of 560, makes under $45,000 a year and borrows $1,350 at an average annual percentage rate of 140%, according to the company.

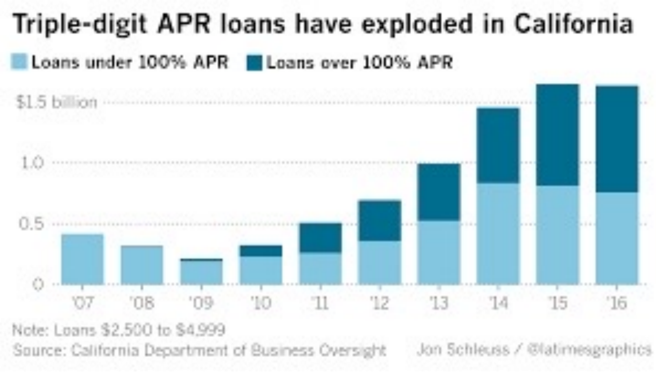
LendingClub

opploans

Usury Law Caps Small Consumer Installment Loans



Usury Laws are Being Strengthened in Many Places



- The California State Legislature passed the Fair Access to Credit Act, which blocks lenders from charging more than 36% on consumer loans of $2,500 to $10,000.
- Previously, there was no interest rate cap on loans over $2,500, and the state's Department of Business Oversight found over half of these loans carried annual percentage rates of 100% or more.

At the Same Time Many Assert that Rate Caps Limit "Financial Inclusion"

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OCTOBER 24, 2019 8:28AM

Financial Inclusion without Finance? The Misguided Quest to Limit Choice in Consumer Credit

BY DIEGO ZULUAGA

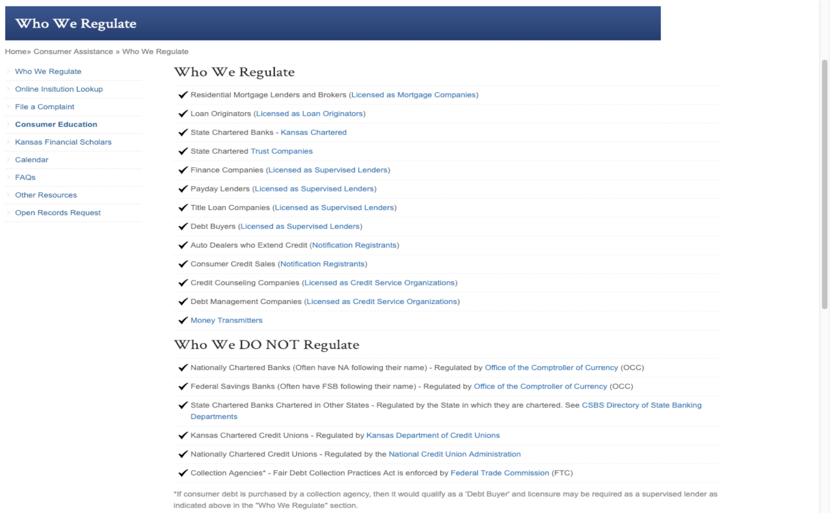
On October 21, I had the pleasure to give the research keynote address at the annual conference of the Financial Services Centers of America (FiSCA) in Miami. The below is a transcript of my speech, in which I critiqued some policymakers' attempts to promote financial inclusion by restricting consumer choice and giving the government a larger role in credit allocation. In light of historical experience in the U.S. and elsewhere, I offered market competition as a more effective policy to ensure all Americans can achieve financial security.

*****

> The legislator, who knows nothing, nor can know any thing, of any one of [the borrower's] circumstances, who knows nothing at all about the matter, comes and says to him—"It signifies nothing; you shall not have the money: for it would be doing you a mischief to let you borrow it upon such terms."—And this out of prudence and loving-kindness!—There may be worse cruelty: but can there be greater folly?
>
> Jeremy Bentham, "Defense of Usury," 1787

Lending: Two Basic Legal/Regulatory Compliance Models

- State Licensing



Who We Regulate

Home» Consumer Assistance » Who We Regulate

- Who We Regulate
- Online Insitution Lookup
- File a Complaint
- Consumer Education
- Kansas Financial Scholars
- Calendar
- FAQs
- Other Resources
- Open Records Request

Who We Regulate

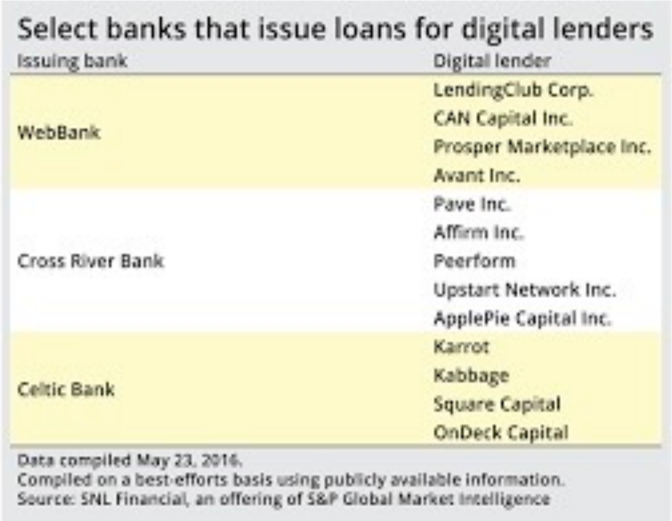
- ✔ Residential Mortgage Lenders and Brokers (Licensed as Mortgage Companies)
- ✔ Loan Originators (Licensed as Loan Originators)
- ✔ State Chartered Banks - Kansas Chartered
- ✔ State Chartered Trust Companies
- ✔ Finance Companies (Licensed as Supervised Lenders)
- ✔ Payday Lenders (Licensed as Supervised Lenders)
- ✔ Title Loan Companies (Licensed as Supervised Lenders)
- ✔ Debt Buyers (Licensed as Supervised Lenders)
- ✔ Auto Dealers who Extend Credit (Notification Registrants)
- ✔ Consumer Credit Sales (Notification Registrants)
- ✔ Credit Counseling Companies (Licensed as Credit Service Organizations)
- ✔ Debt Management Companies (Licensed as Credit Service Organizations)
- ✔ Money Transmitters

Who We DO NOT Regulate

- ✔ Nationally Chartered Banks (Often have NA following their name) - Regulated by Office of the Comptroller of Currency (OCC)
- ✔ Federal Savings Banks (Often have FSB following their name) - Regulated by Office of the Comptroller of Currency (OCC)
- ✔ State Chartered Banks Chartered in Other States - Regulated by the State in which they are chartered. See CSBS Directory of State Banking Departments
- ✔ Kansas Chartered Credit Unions - Regulated by Kansas Department of Credit Unions
- ✔ Nationally Chartered Credit Unions - Regulated by the National Credit Union Administration
- ✔ Collection Agencies* - Fair Debt Collection Practices Act is enforced by Federal Trade Commission (FTC)

*If consumer debt is purchased by a collection agency, then it would qualify as a 'Debt Buyer' and licensure may be required as a supervised lender as indicated above in the "Who We Regulate" section.

- Fronting Bank Partnership



Select banks that issue loans for digital lenders

Issuing bank	Digital lender
WebBank	LendingClub Corp.
	CAN Capital Inc.
	Prosper Marketplace Inc.
	Avant Inc.
Cross River Bank	Pave Inc.
	Affirm Inc.
	Peerform
	Upstart Network Inc.
	ApplePie Capital Inc.
Celtic Bank	Karrot
	Kabbage
	Square Capital
	OnDeck Capital

Data compiled May 23, 2016.
Compiled on a best-efforts basis using publicly available information.
Source: SNL Financial, an offering of S&P Global Market Intelligence

Or Both…

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OppLoans › Rates and Terms

Rates, Terms and Licenses

Opportunity Financial LLC State Information

Currently Offering Installment Loans

Alabama
Delaware
Georgia
Idaho
Illinois
Mississippi
Missouri
Nevada
New Mexico
South Carolina
Texas
Utah
Wisconsin

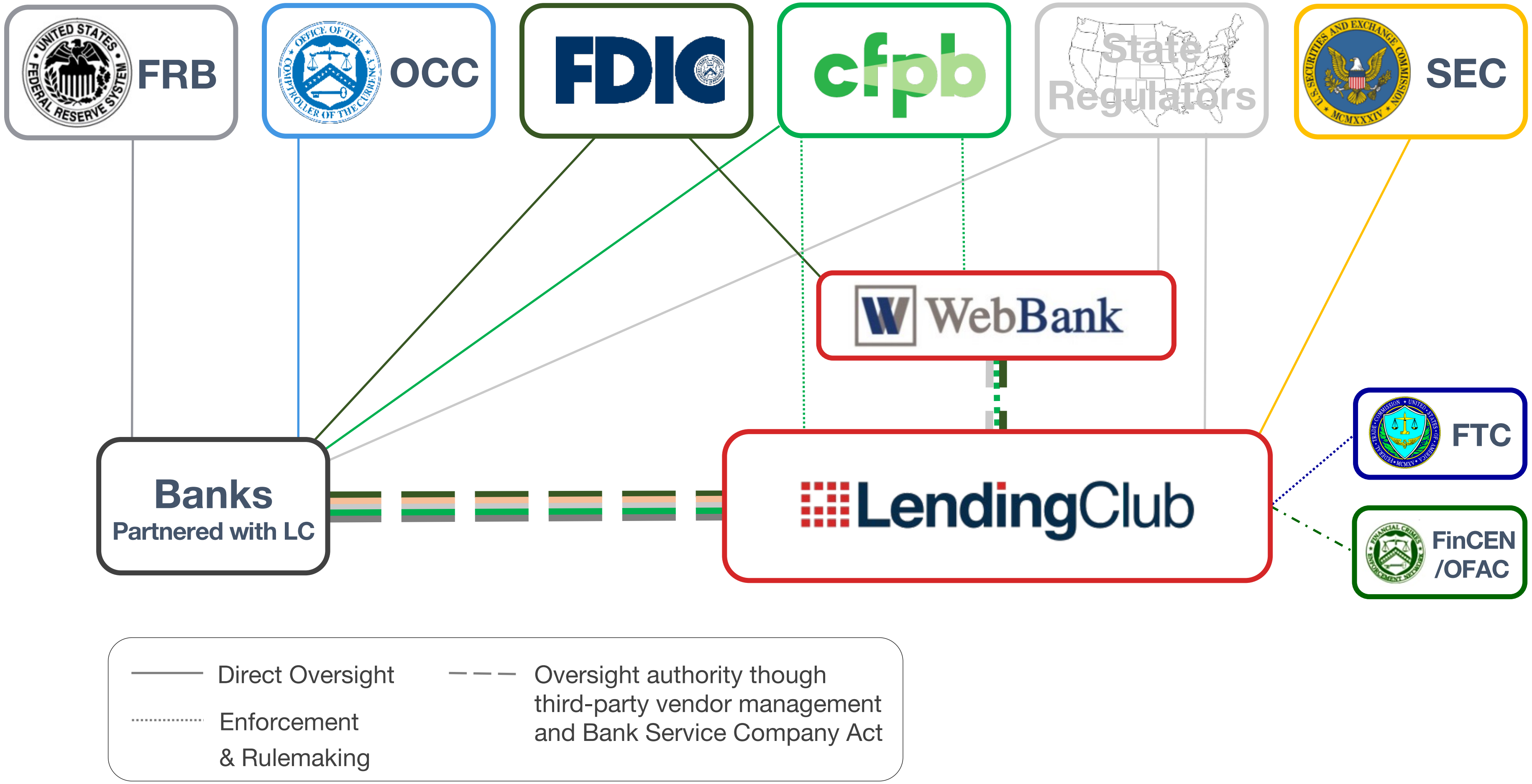
Loans originated and funded by our lending partners.

Alaska
Arizona
California
Florida
Hawaii
Indiana
Kansas
Kentucky
Louisiana
Maine
Michigan
Minnesota
Montana
Nebraska
North Dakota
Ohio
Oklahoma
Oregon
Rhode Island
South Dakota
Tennessee
Virginia
Washington
Wyoming

Model 1: Operating Through State Licenses

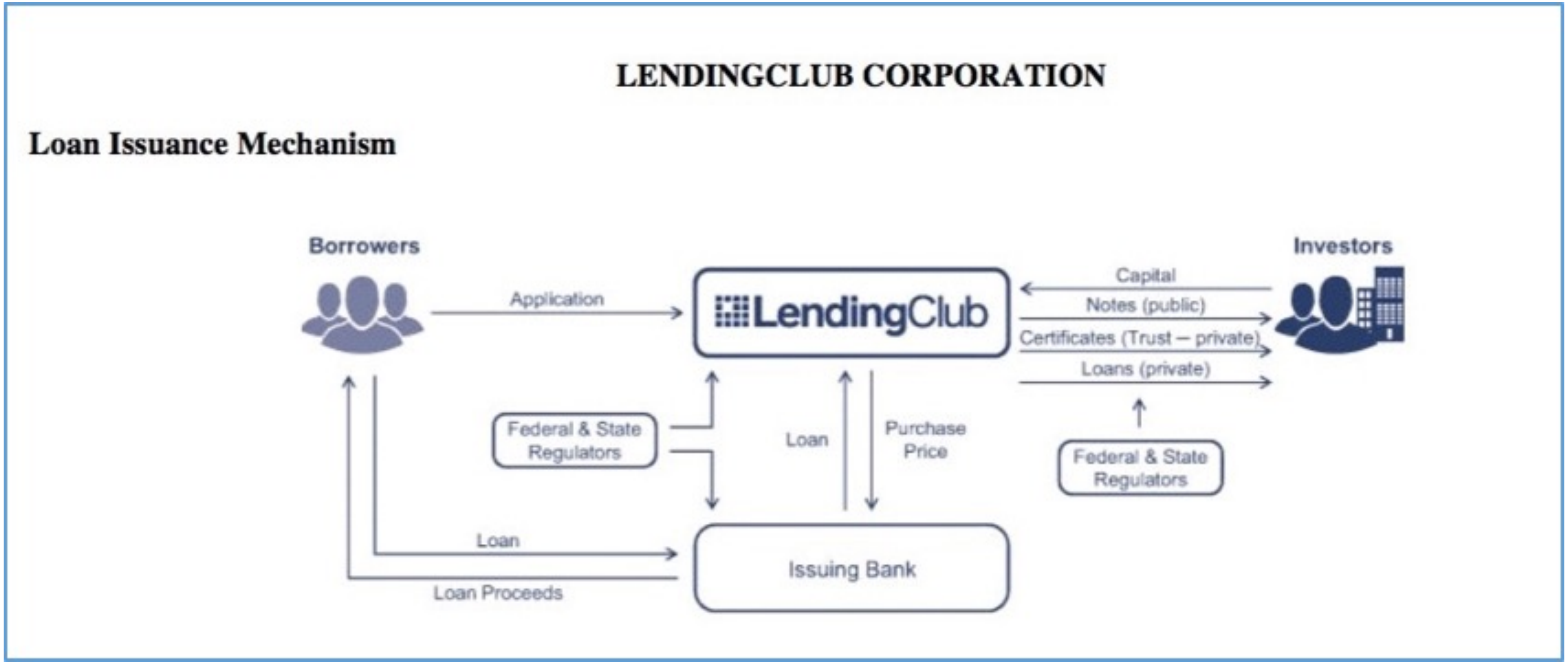
- Can be challenging to offer a nationwide product given differing state requirements
- Difficult to compete with higher-cost credit cards from banks, which do utilize bank preemption powers
- Some outdated state laws (e.g. require physical branches, must be incorporated in-state) but this is changing
- Usury: Wide diversity of interest rate and fee restrictions including 8 states w/ caps under 18%, and 18 states with origination fee prohibitions that can preclude the marketplace lending model

Model 2: Bank Partnership

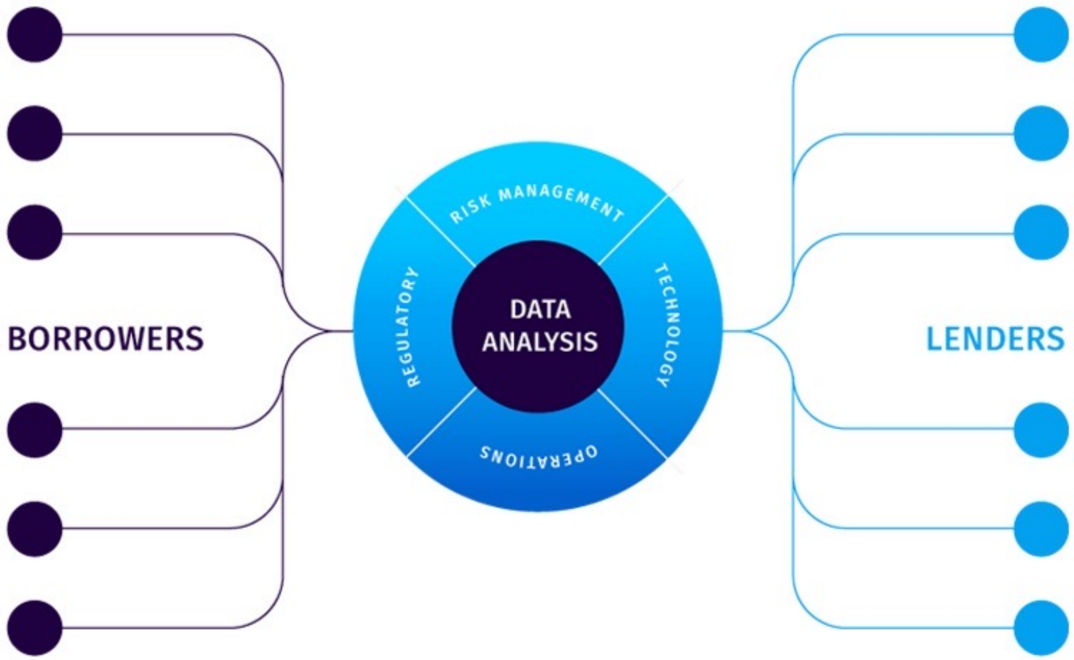


Notes: WebBank is a Utah-chartered industrial bank, member FDIC, for whom Lending Club operates lending programs. All core consumer and small business loans facilitated by Lending Club are issued by WebBank under banking law. Regulatory structure of banks is described only insofar as it relates to regulatory authority over Lending Club. CFPB oversight of banks represents banks with $10B+ in assets. FDIC, OCC, FRB supervision of banks is dependent on the bank charter type, i.e. national bank, state FDIC member bank, state FDIC non-member. All of these participate in the LC platform. State regulators shown here include banking, securities, and lending regulators. FinCen/OFAC line represents reporting under AML/BSA.

Lending Club Flows 2015



What Does the Fronting Partner Bank Do?



Funding: Straightforward Securities Law Applies

SEC: [T]he Prosper notes are ***securities*** *under [*Reves v. Ernst & Young, 494 U.S. 56 (1990)] *because: (i) Prosper lenders are motivated by an expected return on their funds; (ii) the Prosper loans are offered to the general public; (iii) a reasonable investor would likely expect that the Prosper loans are investments; and (iv) there is no alternate regulatory scheme that reduces the risks to investors presented by the platform.*

The notes offered by Prosper are investments. Lenders expect a profit on their investments in the form of interest, which is at a rate generally higher than that available from depository accounts at financial institutions. Prosper's website has included statements that the Prosper notes provide returns superior to those offered by alternative investments such as equity stocks, CDs and money markets.

Lenders rely on the efforts of Prosper because Prosper's efforts are instrumental to realizing a return on the lenders' investments. . . . Prosper established and maintains the website platform, without which none of the loan transactions could be effected. Prosper provides mechanisms for attracting lenders and borrowers, facilitating the exchange of information between borrowers and lenders, coordinating bids, and effecting the loans. It provides borrower information to potential lenders via the loan listings, including credit ratings.

. . . Furthermore, under the terms of the notes, Prosper has the sole right to act as loan servicer of the notes. In this capacity, Prosper collects repayments of loans and interest, contacts delinquent borrowers for repayment, and reports loan payments and delinquencies to credit reporting agencies. Prosper also exclusively manages the process of referring delinquent loans to collection agencies for payment, and selling defaulted loans to debt purchasers. Since the lender does not know the borrower's identity, the lender would be unable in any event to pursue his or her rights as a noteholder in the event of default.

. . . ***Rather, the Prosper lenders rely on Prosper's continued operation of the platform in order to transact and to recoup any gain on their investments.***

Funding: A Problem if You Ignore it

SEC Outlines Its Reasoning For Shutting Down P2P Lender Prosper

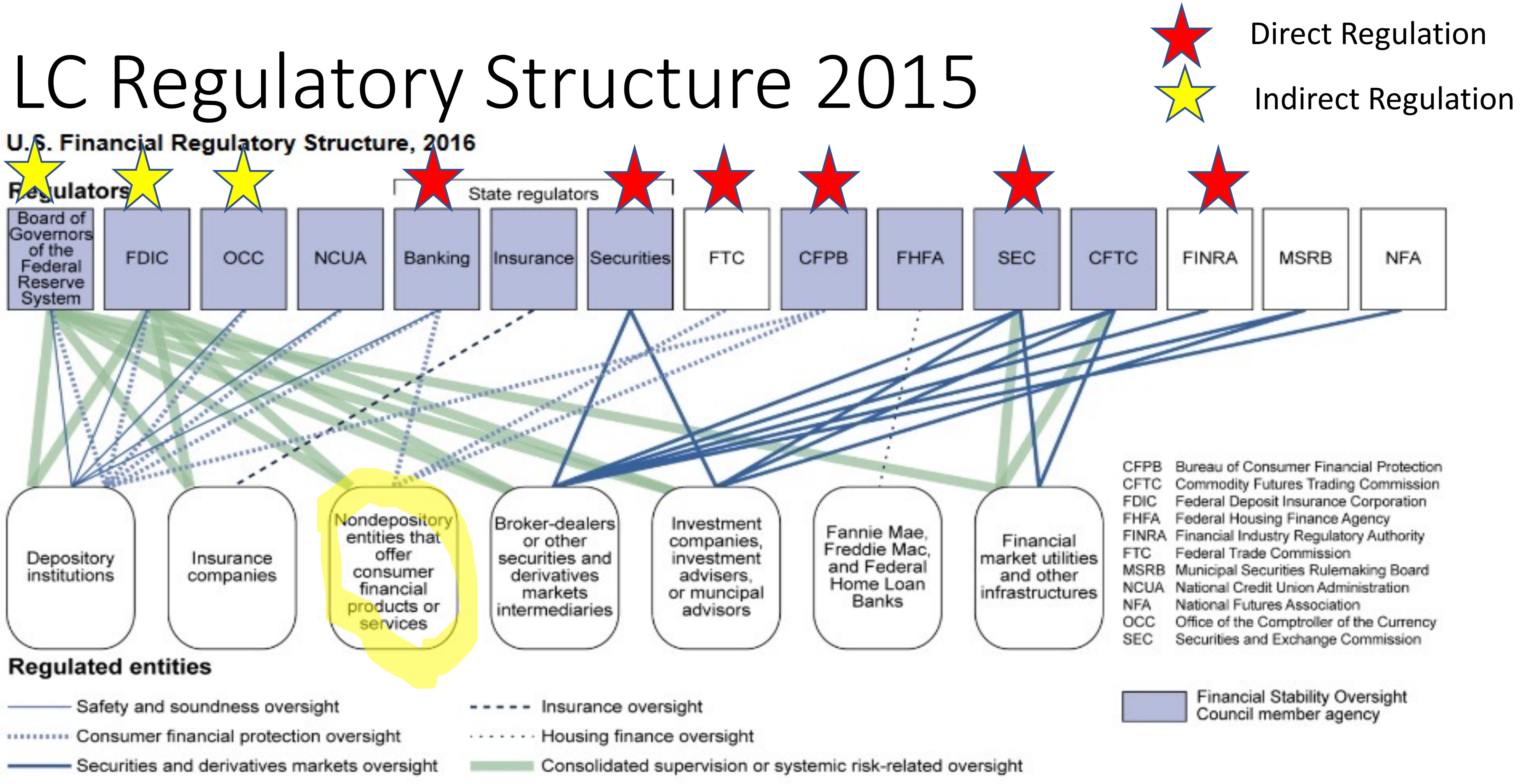
Erick Schonfeld@erickschonfeld / 10 years ago

Last month, peer-to-peer lender Prosper stopped all new lending on its site because of scrutiny by the SEC. Prosper agreed to register under the Securities Act, a process which can take months.

Yesterday, the SEC issued its formal cease-and-desist letter (embedded below or download PDF), outlining its reasoning for characterizing Prosper as a seller of investment, something prosper had vigorously resisted in the past by arguing that it was merely a marketplace matching lenders and borrowers. But the SEC is having none of that.

And it is not just **Prosper,** but all P2P lenders, that are on notice. Loanio, a new entrant into the P2P lending arena that just launched last month, has suspended new loans until it registers with the SEC as well (see notice below). And last April, competitor Lending Club was the first P2P lender to temporarily cease operations (the SEC approved its registration, and its members are now lending again in about half the states, including California which gave it the go-ahead last week).
The SEC letter makes clear why it considers Prosper a seller of securities and why it should be regulated by the SEC:

LC Regulatory Structure 2015



Source: GAO. | GAO-16-175

Note: This figure depicts the primary regulators in the U.S. financial regulatory structure, as well as their primary oversight responsibilities. “Regulators” generally refers to entities that have rulemaking, supervisory, and enforcement authorities over financial institutions or entities. There are additional agencies involved in regulating the financial markets and there may be other possible regulatory connections than those depicted in this figure.

Partial List of Laws Lending Club is Subject To

- TILA (Truth in Lending)
- ECOA (Equal Credit Opportunity)
- FCRA (Credit Reporting)
- FDCPA (Debt Collection)
- GLBA (Privacy)
- SCRA and MLA (Military Lending)
- EFTA (Electronic Funds Transfers)
- NACHA Rules (ACH)
- ESIGN (Electronic Signatures)
- BSA (Anti Money Laundering)

- Federal & State Securities Laws
- Federal & State Banking Laws (to extent serving as contractor)
- State Lender and Loan Broker Laws
- State Consumer Collections & Advertising Laws

Questions?

Madden and True Lender

Marketplace Lender Legal Issues

"Valid When Made" and
Madden vs. Midland Funding

No. 15-610

In the Supreme Court of the United States

MIDLAND FUNDING, LLC, ET AL., PETITIONERS

v.

SALIHA MADDEN

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

"True Lender" Issues

Madden v. Midland

- Class of claims arising from Second Circuit decision in *Madden v. Midland Funding, LLC (786 F.3d 246)* in 2015
  - Facts: A non-bank debt buyer charged interest on a defaulted credit card account at rates permissible at origination only because the original creditor was a bank.
  - Holding: The non-bank could not rely on preemption arguments available to the bank that permitted charging interest in excess of state law limitations.
- Serious questions as to the breadth of the ruling and whether the defendant raised the right arguments at trial to avoid waiving defenses
- While cited by other courts, not adopted outside of Second Circuit.

Madden v. Midland

- Express Preemption Regarding Interest Rates –
  - National Bank Act § 85 - Permits national banks to “charge on any loan . . . Interest at the rate allowed by the laws of the State, Territory, or District where the bank is located . . . ”
  - FDIA § 27(a) (12 USC 1831d) - Provides that any federally insured state-chartered bank “may, notwithstanding any State constitution or statute, which is hereby preempted for the purposes of this section, . . . charge on any loan interest . . . At the rate allowed by the laws of the State, territory or district where the bank is located . . . “

Madden v. Midland

- Implied, or Conflict Preemption Under *Barnett Bank*, 517 U.S. 25 (1996)
- Absent express preemption, implied preemption may be found where:
  - (i) the federal statute creates a scheme of federal regulation “so pervasive as to make reasonable the inference that Congress left no room for the States to make reasonable the inference that Congress left no room for the States to supplement it.”
  - (ii) federal law may be in “irreconcilable conflict” with state law, where compliance with both laws is a “physical impossibility,” or where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”

Madden v. Midland

- Dodd-Frank Section 1044 (12 USC § 25b) –
- State consumer financial laws are preempted only if
  - Application of a State consumer financial law would have a discriminatory effect on national banks (compared to state chartered banks)
  - In accordance with *Barnett,* the state consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers and any preemption determination under this subparagraph may be made by a Court or the OCC on a case-by-case basis
  - Preemption arises other than from Title 62

Madden v. Midland

- Valid-when-made doctrine provides that a loan that is valid at its origination cannot become usurious based upon subsequent sale or other events after origination.
- US Supreme Court originally recognized this doctrine almost 200 years ago.
- New York and other states have long recognized that a loan that is non-usurious at its inception cannot become usurious by reason of any subsequent transaction. *See, e.g.*, *Munn v. Comm'n Co.*, 15 Johns. 44, 55 (N.Y. Sup. Ct. 1818); *Tuttle v. Clark*, 4 Conn. 153, 157 (1822); *Knights v. Putnam*, 20 Mass. (3 Pick.) 184, 185 (1825).

True Creditor

- Bank partner program structure is critical to determining whether loans are validly originated and remain valid through the various transfers involved in marketplace lending.
  - Valid origination = The bank must be the “true lender” in the relationship.
  - Maintaining validity through transfers = Programs must address the “*Madden*” risk.
- The “true lender” issue is not unique to marketplace lending and case law has developed in connection with credit cards and payday lending.
- Courts have applied a number of legal standards to analyze “true creditor”, including named lender, totality of the circumstances and predominant economic interest.

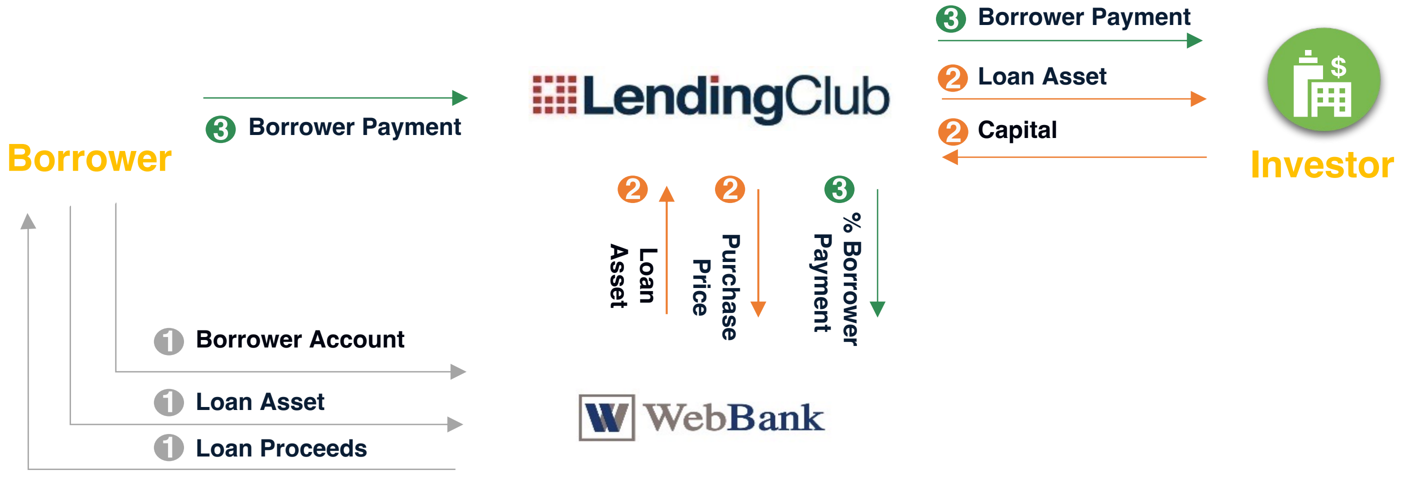
MAYER | BROWN

True Creditor

- *Krispin v. May Dep't Stores Co.*, 218 F.3d 919 (8th Cir. 2000) – "It makes sense to look to the originating entity (the bank), and not the ongoing assignee (the store), in determining whether the NBA applies."
- *Sawyer v. Bill Me Later, Inc.*, 23 F.Supp.3d 1359 (D.Utah2014) – Bank true lender on facts, but "court would still be required to dismiss …claims as preempted by Section 27 "even if it were not the true lender"
- *CashCall, Inc. v. Morrisey*, 2014 WL 2404300 (W.Va. Sup. Ct. 2014) – "the 'predominant economic interest test' [is] the proper standard to determine the true lender"

MAYER | BROWN

Lending Club Flows Post Madden



1 WebBank establishes borrower account and issues loan

- Borrower establishes account with WebBank
- WebBank issues loan
- WebBank funds loan
- WebBank pays LendingClub a transaction fee

2 After 2 business days, WebBank sells loan and retains borrower account

- Issuing bank earns 2-5 calendar days of interest
- Loan asset sold to LendingClub
- LendingClub pays for the loan asset and sells it to an investor

3 LendingClub services the loan

- WebBank earns percentage of borrower's monthly payment
- LendingClub provides borrower payment to investor (net of fees)

Changes in Response to Madden/True Lender

1 **WebBank establishes borrower account and issues loan**

Borrower establishes account with WebBank

WebBank issues loan

WebBank funds loan

WebBank pays LendingClub a transaction fee

2 **After 2 business days, WebBank sells loan and retains borrower account**

Issuing bank earns 2-5 calendar days of interest

Loan asset sold to LendingClub

LendingClub pays for the loan asset and sells it to an investor

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LendingClub provides borrower payment to investor (net of fees)

Madden "Fix"--OCC & FDIC final rules to affirm the "valid-when-made" doctrine

OCC

- The OCC's rule, which was made final on May 29, is fairly simple. The OCC amended 12 C.F.R. 7.4001 and 12 C.F.R. 160.110 to state that "[i]nterest on a loan that is permissible [under either 12 U.S.C. § 85 or 12 U.S.C. § 1463(g)(1)] shall not be affected by the sale, assignment, or transfer of the loan." In other words, the OCC has amended its regulations to re-state the valid-when-made doctrine.
- According to Brian Brooks, Acting Comptroller of the Currency, the new rule "supports the orderly function of markets and promotes the availability of credit by answering the legal uncertainty created by the 'Madden' decision" and "allows secondary markets to work efficiently and to serve their essential role in the business of banking and helping banks access liquidity and alternative funding, improve financial performance ratios, and meet customer needs."
- The rule clarifies that the interest rate on a loan originated by a national bank or federal savings association, if permissible at the time of origination, will continue to be a permissible and enforceable term of the loan following a sale, transfer, or assignment of the loan, regardless of whether the third party debt buyer is a federally chartered bank.

FDIC

- The FDIC's final rule, published on June 25, adopts 12 C.F.R. part 331, containing similar language to the OCC's final rule. The rule is based upon section 27 of the Federal Deposit Insurance Act (FDI) (12 U.S.C. § 1831d), which allows qualifying out-of-state banks to export the interest rate limit of their home states while lending in other states.
- The new rule confirms that, under section 27, the permissible interest on a loan is determined when the loan is made and will not be affected by the sale, assignment, or other transfer of the loan. For consistency, the FDIC intentionally patterned its final rule after the OCC's final rule.
- FDIC Chairman Jelena McWilliams said in a statement, "The final rule accomplishes three important safeguards for the stability of our financial system by promoting safety and soundness, solidifying the functioning of a robust secondary market, and enabling the FDIC to fulfill its statutory mandate to minimize risk to the Deposit Insurance Fund (DIF)."

OCC and FDIC Litigation

Three-state attack on the OCC's "Madden fix" rule

By **Jeremy T. Rosenblum** & **James Kim** on August 3, 2020

POSTED IN FINTECH, OCC, REGULATORY AND ENFORCEMENT, USURY

As previously reported, the OCC recently adopted a final rule (the "*Madden* fix") designed to resolve the legal uncertainty created by the Second Circuit's decision in *Madden v. Midland Funding*, which held that a non-bank that purchased charged-off loans from a national bank could not charge the same rate of interest on the loans that the national bank charged under Section 85 of the National Bank Act (NBA). The *Madden* fix codifies the position of the Office of the Comptroller of the Currency (OCC) under Section 85 and 12 U.S.C. §1463(g) (a near-identical provision of the Home Owners' Loan Act (HOLA)) that the assignee of a loan made by a national bank or federal savings association may charge the same interest rate that the bank or savings association is authorized to charge under federal law. It amends 12 CFR part 7 and part 160 to add, respectively, Section 7.4001(e) and Section 160.110(d), which provide:

> Interest on a loan that is permissible under [12 U.S.C. 85] [12 U.S.C §1463(g)(1)] shall not be affected by the sale, assignment, or other transfer of the loan.

In a lengthy complaint filed on July 29, 2020, the States of California, Illinois and New York sued the OCC to set aside the *"Madden* fix," claiming that it is "arbitrary, capricious, an abuse of discretion, or otherwise contrary to law," "in excess of

Seven states and D.C. file lawsuit challenging FDIC "Madden fix" rule

By **Jeremy T. Rosenblum** on August 25, 2020

POSTED IN FDIC, LITIGATION AND COURT DECISIONS, USURY

Three weeks after California, Illinois and New York sued the Office of the Comptroller of the Currency (OCC) to enjoin its final rule purporting to override the Second Circuit's *Madden* decision as to national banks and federal savings associations, in a complaint filed on August 20, 2020 in the same California federal district court, California, the District of Columbia, Illinois, Massachusetts, Minnesota, New Jersey, New York and North Carolina have sued the FDIC to enjoin its similar rule as to state banks.

The central allegations in the new complaint generally track those made in the lawsuit against the OCC. The new complaint alleges:

- The rule is "arbitrary, capricious, an abuse of discretion, and not in accordance with law; it is in excess of statutory jurisdiction, authority, and limitations, and short of statutory right; and it is taken without observance of procedure required by law."
- The plain language of the governing federal statute applies only to interest that an FDIC-insured state bank may charge. Allegedly, the FDIC's rule represents an expansion of the FDIA's preemption of state law interest rate

OCC "True Lender" Rule Repealed

News Release 2020-139 | October 27, 2020

Office of the Comptroller of the Currency Issues Rule

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WASHINGTON—The Office of the Comptroller of the Currency (OCC) today issued a rule that determines when a national bank or federal savings association (bank) makes a loan and is the "true lender," including in the context of a partnership between a bank and a third party.

Banks' lending relationships with third parties can facilitate access to affordable credit. However, increasing legal uncertainty regarding such relationships may discourage banks and third parties from partnering, limit competition, and chill the innovation that results from these partnerships. This may ultimately restrict access to affordable credit.

After carefully considering the comments, the OCC is adopting a final rule to resolve this uncertainty. The rule specifies that a bank makes a loan and is the true lender if, as of the date of origination, it (1) is named as the lender in the loan agreement or (2) funds the loan. The rule also specifies that if, as of the date of origination, one bank is named as the lender in the loan agreement for a loan and another bank funds that loan, the bank that is named as the lender in the loan agreement makes the loan.

The rule also clarifies that as the true lender of a loan, the bank retains the compliance obligations associated with the origination of that loan, thus negating concern regarding harmful rent-a-charter arrangements.

The rule takes effect 60 days after publication in the *Federal Register*.

REGULATION

OCC's 'true lender' rule repealed by House

The Trump-era regulation allowed fintechs to partner with banks in states without interest rate caps to offer high-interest loans.

Do OCC and FDIC “Valid When Made” Actions “Fix” the Problem?

- State Lawsuits Pending Against OCC and FDIC Valid When Made Rules
- Congressional Review Act Rejection of OCC “True Lender” Rule (FDIC Did Not Attempt to Write Such a Rule)
- Practical Effect on Bank/Fintech Partnerships is Unclear is Unclear Given True Lender Uncertainty

New State Laws

Maine Adopts Legislation Aimed at Bank-Model Lending

Financial Services Law

August 06, 2021

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For at least the past 20 years, Maine has capped interest rates for most closed-end unsecured loans at 30% for loans of $2,000 or less, and at 18% on loans of $4,000 or more. See, e.g., 9-A M.R.S.A. Sec. 2-401.

Following the lead of Illinois, Maine has now adopted legislation attempting to circumvent federal preemption of these caps for bank-model loans.

What Happened

Tracking largely the same text as the Illinois bill that we previously reported on (and which is now law), the Maine legislation purports to subject an entity to its interest rate caps if the entity "holds, acquires or maintains, directly or indirectly, the predominant economic interest in the loan," "markets, brokers, arranges or facilitates the loan and holds the right, requirement or first right of refusal to purchase the loan or a receivable or interest in the loan," or the "totality of the circumstances" otherwise indicates attempted evasion of the interest rate cap. The totality of the circumstances test looks to whether the terms of the arrangement provide for indemnity to an otherwise exempt entity (like a national bank), whether the nonexempt entity predominantly designed, controls or operates the loan program, and whether the nonexempt entity directly lends in other states.

Like in Illinois, transactions that violate the interest rate cap are declared "void and uncollectible" including as to the principal. Maine law previously provided for merely a waiver of fees and portions of the finance charges in the event of a violation. The law also specifies that the loan may not be referred for collection or reported as delinquent.

A similar bill is pending in New Mexico (HB 149 and SB 66).

Other Lending Club Legal Issues

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Home » News & Events » Press Releases » FTC Charges Lending Club with Deceiving Consumers

FTC Charges Lending Club with Deceiving Consumers

April 25, 2018

Defendant promises "no hidden fees" but charges them anyway

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FOR RELEASE

TAGS: deceptive/misleading conduct | Bureau of Consumer Protection | Consumer Protection | Credit and Finance | Credit and Loans

The Federal Trade Commission has charged the LendingClub Corporation with falsely promising consumers they would receive a loan with "no hidden fees," when, in actuality, the company deducted hundreds or even thousands of dollars in hidden up-front fees from the loans.

"This case demonstrates the importance to consumers of having truthful information from lenders, including online marketplace lenders," said Reilly Dolan, acting director of the FTC's Bureau of Consumer Protection. "Stopping this kind of conduct will help consumers make informed choices about loan offers."

As stated in the FTC's complaint, Lending Club recognized that its hidden fee was a significant problem for consumers, and an internal review noted that its claims about the fee and the amount consumers would receive "could be perceived as deceptive as it is likely to mislead the consumer." An attorney for one of the company's

LendingClub

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LendingClub Reaches Settlement with Federal Trade Commission

07/14/2021

SAN FRANCISCO, July 14, 2021 /PRNewswire/ -- LendingClub Corporation (NYSE: LC), the parent company of LendingClub Bank, America's leading digital marketplace bank, today announced that it has entered into an agreement with the Federal Trade Commission (FTC) which, subject to court approval, will conclude the agency's previously disclosed investigation and litigation (the Settlement).

LendingClub

"While we have never agreed with the FTC's allegations, we appreciate the important role the FTC plays to protect consumers and are pleased to have reached an agreement that resolves the agency's concerns," said LendingClub Chief Administrative Officer Brandon Pace. "We look forward to continuing our mission to empower our members on their path to financial health."

Pursuant to the terms of the Settlement, LendingClub will make an $18 million payment for consumer remediation, an amount already accrued for in prior periods. The Settlement does not include any admission of liability, and LendingClub does not expect that the Settlement will impact its current operations or its financial outlook disclosed on April 28, 2021. LendingClub strives to maintain exceptional customer satisfaction ratings and is a leading example of innovating to expand credit to underserved consumers. To date, LendingClub has helped more than three million Americans improve their financial health.

Other Legal Issues

U.S. SECURITIES AND EXCHANGE COMMISSION

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Press Release

Rela

SEC Charges LendingClub Asset Management and Former Executives With Misleading Investors and Breaching Fiduciary Duty

FOR IMMEDIATE RELEASE
2018-223

Washington D.C., Sept. 28, 2018 — The Securities and Exchange Commission today charged San Francisco-based LendingClub Asset Management LLC (formerly known as LendingClub Advisors LLC) and its former president Renaud Laplanche with fraud for improperly using fund money to benefit LendingClub Corporation, LCA's parent company that Laplanche founded and for which he served as CEO. LCA and Laplanche along with Carrie Dolan, LCA's former CFO, also were charged with improperly adjusting fund returns.

All three have agreed to settle the agency's charges against them and will pay more than $4.2 million in combined penalties. The SEC also barred Laplanche from the securities industry.

DealBook/ Business & Policy

Renaud Laplanche, Ousted at Lending Club, Returns as Rival to His Old Firm

Questions?

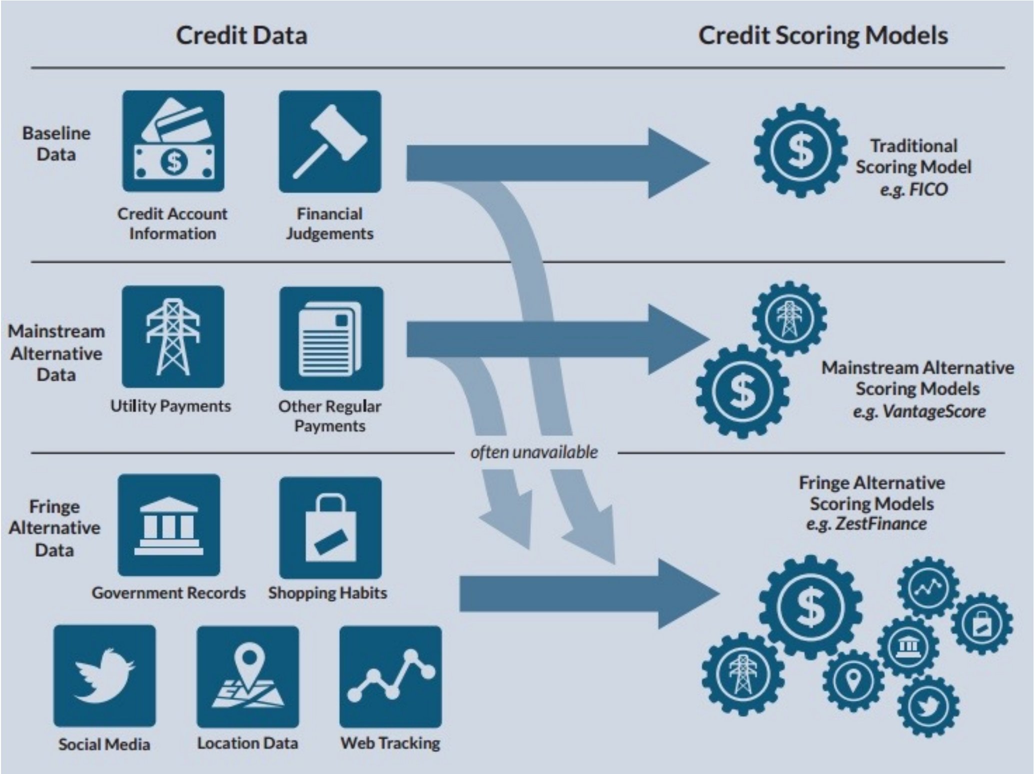
LendingClub 2015 Fintech Lender Business Model Wrap Up

FinTech Lenders Have Many Advantages Over Banks

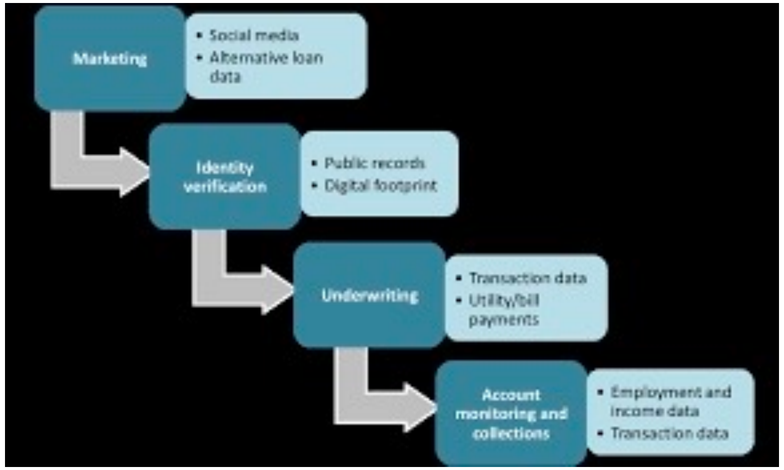
- Decisioning and Delivery are **Faster** in Digital-Only FinTechs
- No Reliance on Legacy IT Architecture Means Quick Development and Deployment
  - Cloud Storage and Control of Full IT Stack Above Core
- **Better UX**
- Expertise with Digital and **Alternative** Data
- True Marketplace Model is a Distribution Innovation
- Operational Costs Should **in Theory** be Lower than Bank

Alternative Data is A Growing Part of Alt-Lender Models

What is it?



How is it used?



CFPB Study Shows Inclusion Benefits

According to the CFPB, Upstart Network's credit underwriting model uses traditional underwriting data like borrowers' income and assets, along with various categories of alternative data, including information related to borrowers' education and employment history.

The results provided from the access-to-credit comparisons show that the tested model approves 27% more applicants than the traditional model, and yields 16% lower average APRs for approved loans.

- This reported expansion of credit access reflected in the results provided occurs across all tested race, ethnicity, and sex segments resulting in the tested model increasing acceptance rates by 23-29% and decreasing average APRs by 15-17%.
- In many consumer segments, the results provided show that the tested model significantly expands access to credit compared to the traditional model. In particular, under the tested model, the results provided reflect that:
- "Near prime" consumers with FICO scores from 620 to 660 are approved approximately twice as frequently.
- Applicants under 25 years of age are 32% more likely to be approved.
- Consumers with incomes under $50,000 are 13% more likely to be approved.
- **With regard to fair lending testing, which compared the tested model with the traditional model, the approval rate and APR analysis results provided for minority, female, and 62 and older applicants show no disparities that require further fair lending analysis under the compliance plan.**

But The Risks from Data are Apparent Also

Other Customer Risks are Mostly About Public Policy Choices

- Using fronting bank means usury limits don't apply—is that a good or bad thing?
- Is faster and easier—immediate decision by consumer—ever a good thing when it comes to borrowing? Sometimes?
- If someone uses a LC loan to pay off a credit card, won't they just borrow up again and double their leverage?

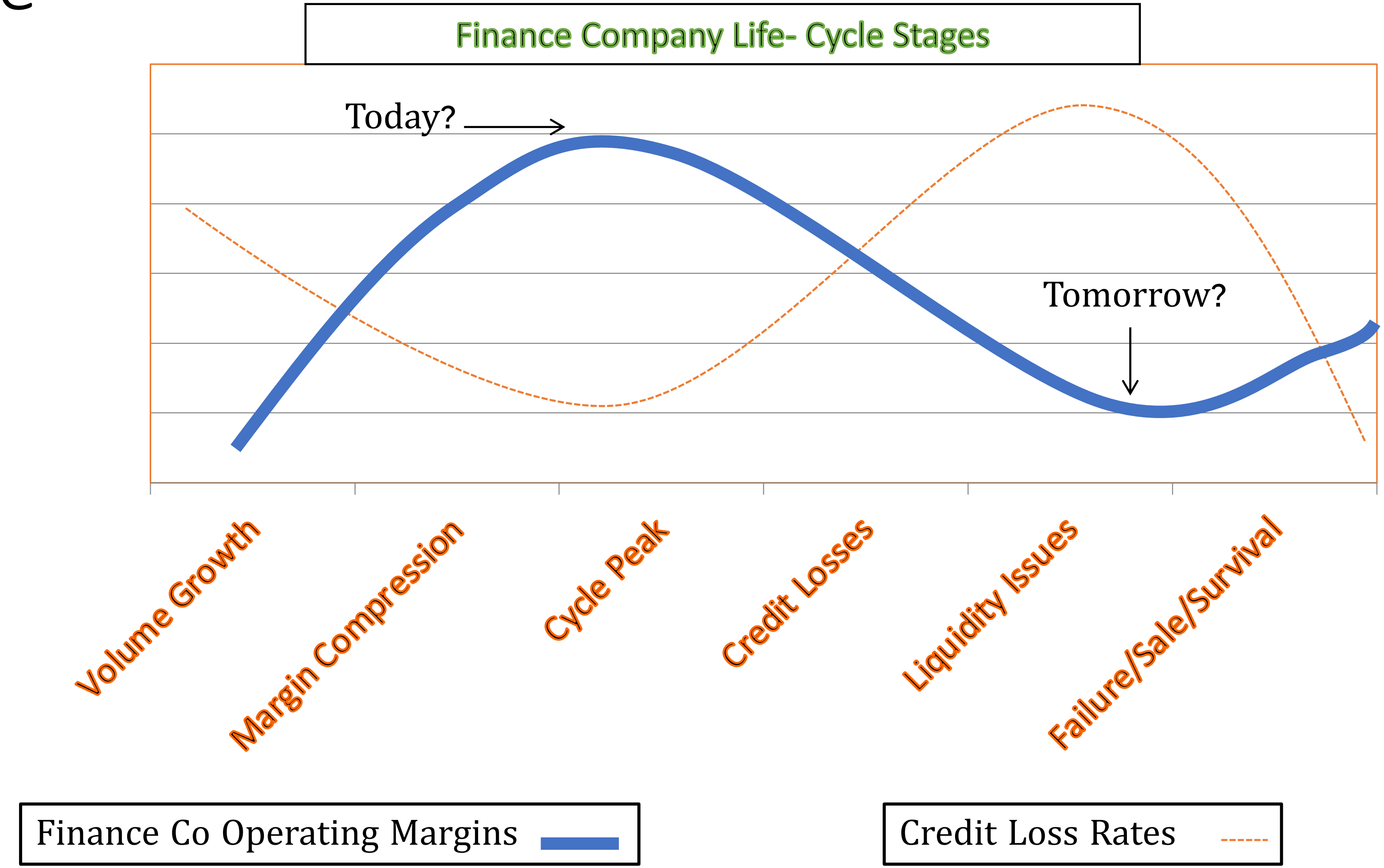
FinTech Lenders Also Have Business Disadvantages

- Funding Alternatives for FinTechs are More Expensive and Much More Volatile than Bank Deposits
- Single Product Focus of Many FinTech Lenders Increases Credit Risk
- Markets Impose Higher Capital Levels for FinTech Balance Sheet Lenders than for Banks
- No FinTech Lender has Been Through a Full Credit Cycle so Loan Performance Under Stress Untested

Most of the Disadvantages are Those of Any Finance Company

- **A Non-Bank Lender**
  - Can't Accept Deposits
  - Not Subject to Comprehensive Safety/Soundness Regulation
  - Subject to Product Regulation
- **Originates Niche Loans Mostly Outside of Bank Credit/Terms Box**
  - Typically Higher Risk/Subprime, but Sometimes Just High Knowledge-Intensity Niche Lending (e.g., Medical Receivables)
- **Often Dependent on "Repeat Borrowers" and Loan Extensions/Loan Rollovers to Manage Credit Outcomes**
- **Dependent on Capital Markets for Liquidity**
  - Funded from Wholesale Sources
  - Capital Levels Set By Liquidity Providers
- **High but Highly Cyclical Returns**
  - Higher Absolute Returns and Returns Beta Than Banks
- **Rapid Growth Model With Shorter Corporate Life Cycle**
  - Entrepreneur Founders
  - Low Barriers to Entry Encourage "Me Too" Competition
- **Direct Marketing and Broker-Based Originations**
  - Direct Mail, Phone, Brokers
  - Some branch-based models still exist today
- **Non-Traditional Credit Modeling**

Finance Companies are Creatures of the Credit Cycle



Only Finance Companies With Bank Deposit Liquidity Survived 2007-2008 Liquidity Crisis

- Became/Bought/ Bought By a Bank **<u>Before Crisis</u>** and Survived

- **<u>Failed</u>** and Bailed and "Banked"

- **<u>Failed</u>** Outright

Pretty Much Everyone Else….

Until Recently Fintech Lenders Were As Reliant on on Capital Markets Funding as Pre-Crisis Peers

Leading Fintech Lenders 2018

SoFi
Kabbage
Square
PROSPER
LendingClub
OnDeck
Funding Circle
CAN CAPITAL

<u>All</u> Were Financed Through the Capital Markets

- Securitization
- Institutional/Family Office/Individual P2P Sales
- Bank Lines
- Term Loans
- Venture Capital

Attractive Borrowing Facilities

The Cost Disadvantage of Balance Sheet Lenders is Large

($ millions)

As of September 30, 2018

Borrower	Type	Maturity Date	Weighted Average Interest Rate	Principal Outstanding	Borrowing Capacity
Funding Debt					
OnDeck Asset Securitization Trust II LLC	Securitization	April 2022 (1)	3.8%	$225	$225
OnDeck Account Recievables Trust 2013-1 LLC	Revolving	March 2019	4.7%	$121	$214
Recievable Asset of OnDeck, LLC	Revolving	November 2018	5.3%	$112	$120
OnDeck Asset Funding II LLC	Revolving	August 2022 (2)	4.4%	$111	$175
Prime OnDeck Recievable Trust II, LLC	Revolving	December 2018	4.7%	$111	$125
Loan Assets of OnDeck, LLC	Revolving	October 2022 (3)	4.1%	$95	$100
Other Agreements	Various	Various (4)	7.4%	$44	$81
Total Funding Debt			**4.6%**	**$819**	**$1,040**
Corporate Debt					
On Deck Capital, Inc.		January 2019 (5)	6.5%	-	$30

Cost of Deposits for Bank of America:
0.37%

Bank of America

(1) The period during which new borrowings may be made under this facility expires in March 2020.
(2) The period during which new borrowings may be made under this debt facility expires in August 2021.
(3) The period during which new borrowings may be made under this debt facility expires in April 2022.
(4) Maturity dates range from January 2020 through June 2021.
(5) In October 2018 the debt facility was amended to extend its maturity to January 2019.

But the True Marketplace Lenders Face the Most Severe Challenge

- **A True Marketplace Lender is a Captive to its Loan Buyers**
  - Relies on "Gain on Sale" to generate revenue
    - This <u>accelerates</u> revenue relative to balance sheet lender
  - If it stops originating loans, it ceases to generate new revenue and starts to lose money immediately
    - No net interest income from loans on balance sheet
    - Small amount of servicing revenue
    - Given ongoing expense growth, profitability requires continuous growth in originations
  - Investor loan pricing is highly sensitive to both credit performance of prior loans and debt market conditions
    - Any stumble and investor interest either becomes more costly or dries up entirely
  - Result: Investors have the upper hand on pricing
- **It's the Proverbial "Hamster Wheel"**

Why FinTech Lenders Should be Banks: Todd Baker Lending Club Analysis (Nov. 2016)

- It's pretty basic math — a 14 per cent loan (the Lending Club average) held at a 1 per cent bank cost of funds leaves a 13 per cent interest margin before credit losses every year over the time it holds the loan.
- If we factor in 6 per cent annual credit losses (Lending Club's current portfolio loss rate) **a bank would get 7 per cent in annual net interest margin from holding those loans**.
- **By contrast, Lending Club earns a 2 per cent "margin" from its fees**. The company's loan investors take almost all the economic value for themselves.

The Systemic Risk is Real…Todd Baker (2015)

- “The impact of an MPL disruption on the real economy is likely to be much more severe than is commonly recognized. Imagine the consequences a decade from now if 8% of consumers and 16% of small business borrowers can’t find replacement loans quickly from traditional lenders in an MPL liquidity squeeze, especially borrowers who may not meet traditional bank credit standards. As MPLs enter more sectors of the U.S. lending market, such as commercial real estate, healthcare, student and single-family lending, the impact will be even greater. The rapid withdrawal of credit to so many Main Street consumers and businesses could be devastating to the U.S. economy. “

The Solution for Many? Get a Bank Charter

- Buy or Start Bank
  - Lending Club acquiring Radius Bank
  - Square secured an ILC bank charter
  - SoFi acquiring a bank
- Sell Company or Technology
  - Kabbage sold to American Express
  - OnDeck sells to subprime consumer lender Enova

Questions?

Lending Club 2021

Lending Club buys Radius Bank

LendingClub Banking

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LendingClub Announces Acquisition of Radius Bank

02.18.20

First U.S. Fintech to Announce Acquisition of a Bank, Now Poised to Reimagine Banking

Enhancing LendingClub's Ability to Serve its Members, Grow its Market Opportunity, Increase and Diversify Earnings, and Provide Resilience and Regulatory Clarity

Radius Bank Radically Improved LC's Strategic and Financial Flexibility

Overview | Press Releases | Filings & Financials | Corporate Governance | News & Market Data | Investor Resources

LendingClub

"Our first full quarter operating a digital bank was the most profitable quarter in LendingClub's history," said Scott Sanborn, LendingClub's CEO. "This is the beginning of a dramatically enhanced earnings trajectory for the business. Our transformation is fueled by our competitive advantages, which include our 3.5 million-plus members, deep data capabilities, marketplace model as well as our more efficient operating platform. Our earnings are being bolstered by our bank, which is generating a new stream of recurring net interest income that is only beginning to contribute to our bottom line results."

Strong Revenue Growth and Accelerated Return to Profitability Reflects Effective Execution on Strategic Priorities.

- Total sequential revenue growth of 93%, reflecting growth in marketplace revenue and increased net interest income from the retained portfolio of consumer loans.
- Marketplace revenue grew 86% sequentially, primarily reflecting 105% growth in origination fees and a 132% increase in gains on loan sales as loans sold through the marketplace doubled.
- Net interest income grew 148% sequentially to $45.9 million, as the bank's loan portfolio (excluding PPP loans) grew 27% sequentially, propelled by growth in the consumer loan portfolio of 145% to $795M.
- Deposits grew to $2.5 billion, helping fund growth in the bank's loan portfolio.
- Sequential origination growth of 84% as we returned to market leadership and leveraged our expanded predictive science and credit decisioning capabilities, which drove a substantial increase in our end-to-end application conversion rate.
- Strong revenue growth and positive operating leverage drove record earnings and an accelerated return to profitability.
- Consolidated net income of $9.4 million included $56.7 million of notable items: $34.6 million of Current Expected Credit Loss (CECL) provisioning which reduced reported earnings and reflects rapid growth in the bank's loan portfolio, $19.6 million of net revenue deferrals on retained loans, and $2.5 million of non-recurring expenses.
- Entered into a settlement agreement with the Federal Trade Commission (FTC), which concludes the agency's previously disclosed investigation and litigation. Pursuant to the terms of the settlement, LendingClub will make an $18 million payment for consumer remediation, an amount already accrued for in prior periods.

Radius Bank Radically Improved LC's Strategic and Financial Flexibility

Balance Sheet Data:

Loans and leases held for investment, net, excluding PPP loans	$ 1,791,492	$ 1,414,900	$ —	$ —	$ —	27 %	N/M
PPP loans	$ 507,553	$ 664,400	$ —	$ —	$ —	(24) %	N/M
Total loans and leases held for investment, net	$ 2,299,045	$ 2,079,300	$ —	$ —	$ —	11 %	N/M
Total assets	$ 4,370,101	$ 4,491,089	$ 1,863,293	$ 1,979,457	$ 2,452,599	(3) %	78 %
Total deposits	$ 2,539,704	$ 2,373,437	$ —	$ —	$ —	7 %	N/M
Total liabilities	$ 3,607,742	$ 3,757,954	$ 1,139,122	$ 1,245,565	$ 1,706,457	(4) %	111 %
Total equity	$ 762,359	$ 733,135	$ 724,171	$ 733,892	$ 746,142	4 %	2 %

]Radius Bank Radically Improved LC's Strategic and Financial Flexibility

Loan originations (in millions) [3]**:**

Marketplace loans	$	2,182	$	1,139	$	912	$	584	$	326	92 %	569 %
Loan originations held for investment	$	541	$	344	$	—	$	—	$	—	57 %	N/M
Total loan originations	$	2,722	$	1,483	$	912	$	584	$	326	84 %	735 %

Radius Bank Radically Improved LC's Strategic and Financial Flexibility

	As of and for the three months ended					% Change	
	June 30, 2021	March 31, 2021	December 31, 2020	September 30, 2020	June 30, 2020	Q/Q	Y/Y
Operating Highlights:							
Noninterest income	$ 158,476	$ 87,334	$ 72,597	$ 57,750	$ 21,421	81 %	640 %
Net interest income	$ 45,905	$ 18,506	$ 2,899	$ 13,294	18,937	148 %	142 %
Total net revenue [(1)]	$ 204,381	$ 105,840	$ 75,496	$ 71,044	$ 40,358	93 %	406 %
Consolidated net income (loss)	$ 9,371	$ (47,084)	$ (26,655)	$ (34,325)	$ (78,471)	N/M	N/M
EPS – basic	$ 0.10	$ (0.49)	$ (0.29)	$ (0.38)	$ (0.87)	N/M	N/M
EPS – diluted	$ 0.09	$ (0.49)	$ (0.29)	$ (0.38)	$ (0.87)	N/M	N/M
LendingClub Bank net interest margin	5.51 %	3.33 %	N/A	N/A	N/A		
Servicing portfolio AUM (in millions) [(2)]	$ 10,741	$ 10,271	$ 11,002	$ 12,267	$ 13,962	5 %	(23) %

LendingClub 2021 Risk Canvas is Different

- **Credit risk. …** High, but expressed through liquidity/funding cost/availability not credit costs
- **Market risk. …** High due to reliance or LOWER ıle fixed income market
- **Operational risk. …** Moderate
- **Liquidity (Funding) risk. …** Very Hig LOWER
- **Reputational risk. …** Very High (LaPlanch LOWER
- **Legal, regulatory and political risk. …** High (Fro LOWER? ank model)
- **Data Management/AI Risk. …** High
- **Systemic risk. …** Low??

Today LendingClub Emphasizes Financial Health in All its Businesses

- https://www.lendingclub.com/research/financial-health

Is your financial health affecting your quality of life?

In partnership with The Harris Poll, LendingClub conducted a 5,000-person study into Americans' financial health, their overall well-being, and the obstacles to getting financially fit.* Where do you fall on the financial health spectrum, and – more importantly – how can you improve? Below are our insights into improving your financial health.

Questions?