

Dear Senator Toomey,

Thank you for the opportunity to provide you our legislative proposal to increase economic growth and job creation by facilitating capital formation. Funding Circle is the leading global online marketplace for small business financing operating in the United Kingdom, U.S., Germany and the Netherlands since 2010. In the UK, Funding Circle pioneered the peer-to-peer (P2P) marketplace enabling retail investors to purchase nonrecourse notes representing fractional interests in specific underlying small business loans which helped increase the flow of capital to SMB during the financial crisis. Today, Funding Circle has more than 91,000 investors in the UK lending \$6.8 Billion directly to 61,000 small businesses making Funding Circle the largest online SMB lender in the UK representing 25%+ market share.

However, in the U.S., Funding Circle is unable to operate such a program because of the costs and difficulties of securities law compliance. Further, the SEC's disclosure guidelines were largely developed long before internet-based investing developed and accordingly do not allow marketplace lending platforms to maximize their reach and effect. The regulatory costs and limitations, imposing significant barriers to entry and ongoing expense, are in turn imposed on prospective investors, who are unable to access alternative, diverse investment opportunities. As a result, we have to significantly reduce our ability to facilitate capital formation which is more important now than ever as we navigate the COVID-19 crisis.

In 2012, Congress recognized that federal securities laws were unduly impeding small business capital formation and directed the SEC to implement a "Crowdfunding Exemption" from Securities Act registration for the investment and sale of equity and debt securities. Regulation Crowdfunding, which was implemented by the SEC in November 2015, included certain restrictions that make the exemption unusable by marketplace lenders:

- Section 4(a)(6) and the Rules<sup>1</sup> can only be used to provide financing to companies and not to individuals, and, therefore, cannot be used to provide credit directly to consumers. While this still allows incorporated small businesses to access credit, it eliminates consumer loans and small business loans to sole proprietors;
- The Rules prohibit platforms from evaluating the merits of the offering which, in practice, prevents platforms from credit underwriting and subsequently pricing the risk of the loan (by setting interest rates); and
- Aggregate amount of securities sold by the issuer may not exceed \$1.07 million in any 12-month period. The SEC considers marketplace platforms as "co-issuers" of the securities and applies the same limit to the platform as it does the borrower whose loan backs the security making the Section 4(a)(6) exemption unviable for marketplace lending platforms. This is evidenced by the fact that most Regulation Crowdfunding offerings are non-debt securities.

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<sup>1</sup> [eCFR Title 17, Chapter II, Part 227](#)

In light of the above rules, the implementation of the Crowdfunding Exemption failed to fully achieve its objective of allowing businesses to offer and sell securities through online marketplaces, particularly debt.

We propose that Congress should create a safe harbor exemption for marketplace lending platforms as co-issuers and to not place a cap on the aggregate amount of securities they help facilitate for borrowers/issuers and to allow the disclosure requirements to be tailored to the lending platform itself – its approach to credit assessment, collection of late or defaulted loans, historic lending performance and its operational robustness. In our experience, providing investors with the means to assess historic performance and operational stability are important; we believe that informed decision-making is more powerful than relatively arbitrary rules which artificially constrain investor choice.

Alternatively, the Congress should consider amending the Crowdfunding Exemption to:

1. Create a safe harbor exemption for marketplace lending platforms as co-issuers and to not place a cap on the aggregate amount of securities they help facilitate for borrowers/issuers while maintaining the cap on primary issuers;
2. Allow platforms to evaluate the merits of the offering through underwriting, interest rate pricing and investor yield; and
3. Eliminate the restriction on financing for individuals (i.e. sole props).

Considering that Congress created and the SEC successfully implemented an exemption framework for equity crowdfunding which is inherently riskier than loan-based debt securities, it seems there is sufficient evidence to support and a clear need for the inclusion of marketplace lending in the Crowdfunding Exemption.

I am including a copy of a letter from the Marketplace Lending Association to the SEC which includes more information and details regarding this issue.

If I can provide any additional information, please do not hesitate to contact me.

Sincerely,

Ryan D. Metcalf

Head of Public Policy and Regulatory Affairs, U.S.

[Ryan.Metcalf@fundingcircle.com](mailto:Ryan.Metcalf@fundingcircle.com) (e) 202-285-1572 (c)

Linkedin: <https://www.linkedin.com/in/ryandmetcalf/>

85 2nd Street, Floor 4 | San Francisco, CA 94105

**Via Electronic Mail:**  
**rule-comments@sec.gov**

September 23, 2019

Secretary, Securities and Exchange Commission,  
100 F Street, NE, Washington, DC 20549-1090

**RE: Marketplace Lending Association Comment on CONCEPT RELEASE  
ON HARMONIZATION OF SECURITIES OFFERING EXEMPTIONS (File  
Number S7-08-19)**

Dear Sirs and Madams:

The Marketplace Lending Association (the “**MLA**”)<sup>1</sup> appreciates the opportunity to comment on the Securities and Exchange Commission’s concept release on harmonization of securities offerings under the 1933 Securities Act (the “**Concept Release**”). The MLA commends the SEC for soliciting input on ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.

MLA members see firsthand the difficulties faced by many individuals and small businesses in need of affordable capital and the complexities and costs of misaligned securities regulations burdening their platforms’ abilities to help provide a connection between borrowers and investors.

MLA members understand the careful balance between providing greater access to financing and the informational needs and protections required of investors. Many MLA members were founded to solve these shortfalls, including through innovative business models and technological advancements. With this background, the MLA puts forward observations of the current regime and

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<sup>1</sup> MLA is an association of technology-enabled lending companies with a mission to promote transparent, efficient, and customer-friendly financial systems by supporting the responsible growth of marketplace lending, fostering innovation in financial technology, and encouraging sound public policy. Our members include two-sided platforms that connect borrowers and investors, technology-enabled platforms that lend from their balance sheets, and hybrids of these two models.

follows with principles and proposals that our members believe would create an efficient and safe framework in which both borrowers and investors have increased access to our capital markets.

#### **A. Background: MLA Members' & Marketplace Lendings' Roles in Facilitating Access to our Capital Markets**

The MLA is an association of 30 organizations<sup>2</sup> operating in the marketplace lending industry. Our goal is to promote transparent, efficient, and customer-friendly financial products by supporting the responsible growth of marketplace lending, fostering innovation in financial technology, and encouraging sound public policy. Our members' marketplaces are user-friendly, internet-based platforms that promote efficient matching of investors and borrowers. These platforms allow investors to access stable, predictable returns by diversifying their portfolios through the purchase of a variety of loan and loan-backed security products, in turn enabling creditworthy consumers and small businesses to efficiently access financing to grow, create jobs, and support local communities.

The MLA limits its membership solely to those marketplace platforms that meet its standards of safety and responsibility towards borrowers and investors. To gain membership in the MLA, platforms must:

1. have at least one year of operating history;
2. be transparent with borrowers about annualized interest rates, penalties, and fees, by conspicuously disclosing them up front and in plain English;
3. not offer so-called "payday" or high-cost installment loans; and
4. adhere, in lending to small businesses, to the Small Business Borrowers' Bill of Rights or equivalent standards.<sup>3</sup>

In addition, the MLA has established a set of best practices which include, among others, practices related to fair and responsible credit risk assessment. One of those best practices states members should ensure "all loans offered

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<sup>2</sup> Marketplace Lending Association, *Members* (2017), <http://marketplacelendingassociation.org/members/>

<sup>3</sup> Marketplace Lending Association, *About Us* (2017), <http://www.marketplacelendingassociation.org/about-us>.

through the marketplace are made with high confidence that the borrower can repay their entire debt burden without defaulting or re-borrowing.”<sup>4</sup>

Although much of our members’ operations are regulated by state and federal lending laws, their position as facilitators matching investor demand for efficient and high quality investments with borrowers seeking capital requires members to explore novel models of raising and/or directing capital. Investment products governed by the Securities Act of 1933 (the “**Securities Act**”) include, among others, asset backed securitizations, pooled loan funds, and fractional marketplaces offering borrower payment dependent notes backed by fractional interests in loans.

The MLA offers its comments on the Concept Release with certainty that our proposals will allow facilitation of more affordable credit products for all borrowers, including borrowers who have been underserved by the traditional credit market, and concurrently expand safe investment opportunities in diverse asset classes to a greater range of investors.

## **B. Constraints in the Exempt Offering Framework**

The MLA notes that while many marketplace lending platforms in the U.S. issue exempt offerings, most do not provide a retail product, such as a registered fund or a peer-to-peer (or “**P2P**”) program because of the costs, time and complexity required to register each offering with the SEC. Further, the SEC’s disclosure guidelines were largely developed long before internet-based investing developed and accordingly do not allow marketplace lending platforms to maximize their reach and effect. The regulatory costs and limitations, imposing significant barriers to entry and ongoing expense, are in turn imposed on prospective investors, who are unable to access alternative, diverse investment opportunities.

### **a. Inapplicability or Limitations in Current Registration and Exemption Requirements**

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<sup>4</sup> Marketplace Lending Association, *The Marketplace Lending Best Practices* (2017), <http://www.marketplacelendingassociation.org/industry-practices>.

## *Crowdfunding Exemption*

In 2012, Congress recognized that federal securities laws were unduly impeding small business capital formation and directed the SEC to implement a “Crowdfunding Exemption” from Securities Act registration for the investment and sale of equity and debt securities. Regulation Crowdfunding, which was implemented by the SEC in November 2015, included certain restrictions that make the exemption unusable by marketplace lenders:

1. section 4(a)(6) and the Rules<sup>5</sup> can only be used to provide financing to companies and not to individuals, and, therefore, cannot be used to provide credit directly to consumers. While this still allows incorporated small businesses to access credit, it eliminates consumer loans and small business loans to sole proprietors;
2. the Rules prohibit platforms from evaluating the merits of the offering which, in practice, prevents platforms from credit underwriting and subsequently pricing the risk of the loan (by setting interest rates); and
3. aggregate amount of securities sold by the issuer may not exceed \$1.07 million in any 12-month period. The SEC considers platforms as “co-issuers” of the securities and applies the same limit to the platform as it does the borrower whose loan backs the security making the Section 4(a)(6) exemption unviable for marketplace lending platforms. This is evidenced by the fact that most Regulation Crowdfunding offerings are non-debt securities.

In light of the above, it seems that the implementation of the Crowdfunding Exemption failed to fully achieve its objective of allowing businesses to offer and sell securities, particularly debt. We respectfully request the SEC to reconsider its approach to the application of the Crowdfunding Exemption to better enable support for the funding of small businesses whilst maintaining appropriate investor protection.

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<sup>5</sup> eCFR Title 17, Chapter II, Part 227

## *Regulation A*

The SEC adopted and amended Regulation A to provide an exemption from registration for certain relatively small offerings. However, an issuer (or co-issuer) cannot use Regulation A to sell more than \$50 million of securities in any 12 month period. This cap remains the principal difficulty posed by Regulation A for platforms engaged in a continuous offering of Platform Notes in addition to the particularly burdensome filing, disclosure, and reporting requirements in Tier 2 offerings.

We see these requirements as impacting the ability of marketplace lenders to operate at scale, and the downsides this brings. Operating at scale allows firms to better invest in robust and scalable solutions for servicing the needs of investors (more so than individual issuers) and a rolling programme of Platform Notes is a more typical model deployed in the sector. It better supports the model of scaling businesses and growing bank alternatives. We see no evidence of investor detriment in practice and, further, see no reason how the present threshold actually provides investor protection when assessed from a marketplace lending platform perspective.

## *Regulation D*

Platforms can only offer securities without registration in a private placement under Rule 506(b) of Regulation D which allows general solicitation of accredited investors only. The accredited investor definition is a central component of Regulation D and it is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act’s registration process unnecessary.”<sup>6</sup>

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<sup>6</sup> Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan 16, 1987) [52 FR 3015] (the “Regulation D Revisions Proposing Release”).

The MLA does not contend whether wealth correlates with sophistication as noted in the studies cited in the “2015 SEC Accredited Investor Staff Report” but we do believe that the annual income requirement excludes financially sophisticated investors that make less than \$200,000 a year. Additionally, the net worth requirement does not take into account a financially sophisticated investor’s net worth relative to the loss they can absorb as a percentage of their assets. In other words, sophisticated investors with less than \$1 million in assets should still be able to invest up to a certain percentage of their net worth in non-registered securities.

### **b. Lessons from Foreign Frameworks and Regulators**

Faced with similar concerns around the lack of funding for small businesses whilst wishing to maintain a good level of investor protection, the UK Government and regulator created bespoke regimes for loan-based<sup>7</sup> crowdfunding platforms to:

1. ensure the balance of fairness between investors of all types, borrowers and platform operators, is maintained;
2. ensure platforms implement sensible operational controls to mitigate potential day-to-day business risks and business interruption risks;
3. allow platforms to develop a straightforward user experience whilst giving investors choice in how they execute and manage their investments (such as tools to ensure easy diversification across many different loans and a secondary market to provide the option for liquidity);
4. ensure a high degree of transparency so that small businesses understand the total cost of credit at an early stage and investors have a clear view of estimated net yields, default rates and likely performance during stressed scenarios – as well as the performance of their own loan portfolio in granular detail; and

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<sup>7</sup> Also known in the UK as ‘peer-to-peer lending’, this is where investors lend money in return for interest payments and a repayment of capital over time.



5. help play an important role in rebalancing and insulating the economy from future economic shocks or credit constraining events. On the investor side, platforms have effectively developed a new credit asset class.

By recognizing the innovation, value and transparency that these platform marketplaces have created, the UK implemented a regulatory framework that created a large, well-functioning retail market for loan platform products. In fact, Funding Circle, a marketplace lending platform and member of MLA, has been in several recent quarters the largest net small business lender in the UK with 83,000 retail investors having lent £5.4 billion through their platform, earning investors £290 million in interest<sup>8</sup>.

Additionally, the European Union (so applicable through the 28 member states of the Union) has implemented rules that sought to achieve the same outcomes for investment-based<sup>9</sup> crowdfunding platforms; balancing the ability for young and growing privately-held companies to seek shareholder capital whilst applying standards of disclosures and other investor protections.

In both cases - the UK lending regime and the European-wide equity regime - the concept of participation has successfully broadened beyond simple investor wealth considerations. There has, and continues to be, a real focus on risk awareness and understanding of investors and in addition to a “high net worth” qualifier, investors are free to lend to (or invest in) small businesses if they are “sophisticated” (for example, have relevant financial experience including that gained professionally or by prior investment history or can otherwise demonstrate knowledge and understanding) or agree to limit the amount invested via such platforms. The current regimes are based on self-declaration and self-certification.

Similar principles are currently also being implemented in Germany.

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<sup>8</sup> <https://www.fundingcircle.com/uk/investors/>

<sup>9</sup> Investors directly or indirectly fund new or established businesses by purchasing equity investments such as shares or debentures.

## **C. MLA Proposals to Increase Access to Capital and Expand Investment Opportunities**

Marketplace lending platforms offered diverse, alternative investments totaling more than \$20 billion in 2018, representing significant year over year growth. The vast majority of this investment was accessible only to qualified institutional buyers, largely due to the difficulties in navigating and complying with securities regulations.

Marketplace lenders provide numerous advantages to less sophisticated investors that the current offering framework fails to leverage, including, among others, standardization of informational disclosures, ease of investor onboarding, and expanded access to alternative asset classes. The MLA suggests the following reforms to enable marketplace lenders to maximize the benefits they provide to borrowers and investors.

This model is shown to work in other countries, and we see no reason why the U.S. should be any different.

### **a. Create an Exemption from Registration for Marketplace Lending Platforms**

MLA asks the SEC to create a safe harbor exemption for marketplace lending platforms as co-issuers and to not place a cap on the aggregate amount of securities they help facilitate for borrowers/issuers and to allow the disclosure requirements to be tailored to the lending platform itself – its approach to credit assessment, collection of late or defaulted loans, historic lending performance and its operational robustness.

In our experience, providing investors with the means to assess historic performance and operational stability are important; we believe that informed decision-making is more powerful than relatively arbitrary rules which artificially constrain investor choice.

### **b. Amend the Crowdfunding Exemption to Allow Utilization by Marketplace Lending Platforms**

Alternatively, the SEC should consider amending the Crowdfunding Exemption to:

1. create a safe harbor exemption for marketplace lending platforms as co-issuers and to not place a cap on the aggregate amount of securities they help facilitate for borrowers/issuers while maintaining the cap on primary issuers;
2. allow platforms to evaluate the merits of the offering through underwriting, interest rate pricing and investor yield; and
3. eliminate the restriction on financing for individuals.

Considering that Congress created and the SEC successfully implemented an exemption framework for equity crowdfunding which is inherently riskier than loan-based debt securities, it seems there is sufficient evidence to support and a clear need for the inclusion of marketplace lending in the Crowdfunding Exemption.

We think it is important that the differences between loan-based and equity-based funding are considered relative to regulatory and risk management frameworks – all with a view to ensuring appropriate protection for the end users of such services whilst allowing innovation in each category. There is a significant distinction between the two in terms of the nature, purpose and risk profile of these funding methods. We believe these differences should compel regulatory regimes that are reflective of the different models. Some key differences are highlighted in the table below:

	<b>Loan Funding</b>	<b>Equity Funding</b>
<b>Ranking</b>	Ranks ahead of shareholders and, in the case of secured lending, ahead of most other creditors; often with ancillary recovery rights (such as through shareholder or director personal guarantees)	Typically subordinated rights to other pre-existing shareholders (and always to trading creditors and lenders)

<b>Duration and Liquidity</b>	Fixed term position (limited term loans) known at the outset of the lending relationship	Long term capital with shareholders taking the ultimate risk position in a business
	Potential for liquidity through an operational secondary market, giving investors the opportunity to realise and withdraw funds at a time of their choosing	Illiquid, with any opportunity to realise an upside outside the investors' control
	Loans are amortising and so interest and principal are repaid on a monthly basis, which reduces exposure to borrowers on an ongoing basis and allows investors to re-invest returns on an ongoing basis	Typically waiting for an exit event (a one-time transaction)
<b>Credit assessment</b>	Using advanced statistical techniques to build risk scores, which are focused on borrower's ability to repay a fixed amount of debt in light of business as usual cash-flows	Relies on due diligence of the business and an assessment of its future prospects and specific future projects, including based on business plans
<b>Investor value</b>	Investor value derived from the borrower's ability to repay from business as usual cash-flows, backed up by shareholder / director guarantees and security	Whether investor value is derived depends on the success of the business as a whole and, often, some future undetermined "exit" event
<b>Risk profile</b>	Typically lower risk, for example to fund growth and expansion in relation to established existing businesses, products or markets	Typically higher risk since the purpose of the equity raise is typically to focus on new and innovative – but unproven – ideas, products or markets or early stage start-up financing
<b>Nature of underlying asset and regulatory environment</b>	A direct loan contract between lender and borrower on standard pre-approved terms that are consistently applied	The issue of equity securities, the terms attached to which vary project to project

Focusing in particular on the applicable disclosure regimes, although a certain level of disclosure is critical for each type of funding, any framework regime should correlate to the relative risks of the nature of the funding. In our view, equity funding and loan funding should merit different investor entry and disclosure requirements for the reasons stated above.

Lending platforms are specialists in providing loans by arranging unsecured term loans to fund growth and expansion. This means that applications for funding are not necessarily made with specific projects or investments in mind (although they may be) or with specific business cases or plans to be reviewed. It is important to understand this because it impacts on the nature of the disclosures that are appropriate to be made to investors, in that lending platforms rely to a greater extent on the actual historic performance of a business to build advanced statistical assessment models than on business plans or project specific disclosures.

In the context of loan-based funding, individual issuers/borrowers matter less than the performance of each investor's loan portfolio overall. This is why lending platforms focus on ensuring investors are sufficiently diversified to limit their credit risk exposure, combined with a high degree of transparency on performance – both on an overall platform level and on an individual investor portfolio level.

For these reasons, investors will focus less on specific information about a certain loan or borrower and be inclined to manage their investment risk by diversifying, i.e. spreading smaller investment amounts over a higher number of investments. As such, investors need to be informed about the lending platform itself – its approach to credit assessment, collection of late or defaulted loans, historic lending performance and its operational robustness.

Diversification is key and is a proven strategy for ensuring positive customer outcomes. For example, since 2010, every investor who has lent to at least 100 businesses equally through Funding Circle's UK platform (no more than 1% of their portfolio to a single business) for at least a year has made a positive return, with 91% earning at least 5% a year after fees and bad debt. The Crowdfunding Exemption framework is an important step toward the "democratization" of

finance and there is an opportunity for the SEC to further help facilitate small business capital formation by taking this information into consideration when examining its framework.

**c. Expand the Definition of Accredited Investor to Include a Sophistication/Knowledge Qualification**

Lastly, MLA asks the SEC to keep the current income and net worth requirements in place but to amend the definition of accredited investor to allow individuals to qualify as accredited investors based on other measures of sophistication and to implement a sliding scale to determine investment limits for investors that make less than the current income and net worth requirements. MLA believes that the following recommendations for evaluating sophistication referenced in the SEC's 2015 staff report are worth serious consideration because they accurately assess sophistication and sufficiently safeguard investors from risk:

- 1. Permit employees of private funds to qualify as accredited investors for investments in their employers funds.** A private fund's employees likely have sufficient access to the information necessary to make informed decisions about investments in their employer's funds. The Commission should consider adding a new category of the definition to include "knowledgeable employees" of "covered companies" as those terms are defined in Rule 3c-5 of the Investment Company Act.
- 2. Permit Individuals Who Pass an Accredited Investor Examination to Qualify as Accredited Investors.** For investors that do not meet the current income and assets requirement, the Commission should develop and administer online an accredited investor examination for individuals to objectively demonstrate they are financially sophisticated and understand the nature and risks of unregistered offerings.
- 3. Institute a sliding scale to determine investment limits for investors that earn less than \$200,000 a year or have less than \$1 million in assets and meet the sophistication requirements.** The Commission should consider adopting the sliding scale (or similar but not less than) of

investor limits instituted in the Crowdfunding Rule provided they meet the sophistication requirements I.e. greater of \$2,200 or 5 percent of the lesser of the investor's annual income or net worth if either the investor's annual income is less than \$200k or net worth is less than \$1 million; in a 12-month period. This would allow for sophisticated investors that are not necessarily wealthy, to invest in alternative assets with investment limits as guardrails to sufficiently ensure investors can absorb any losses. This chart illustrates a few examples of the investment limits:

Investor Annual Income	Investor Net Worth	Calculation	Investment Limit
\$30,000	\$105,000	Greater of \$2,200 or 5% of \$30,000 (\$1,500)	\$2,200
\$150,000	\$80,000	Greater of \$2,200 or 5% of \$80,000 (\$4,000)	\$4,000
\$150,000	\$107,000	10% of \$107,000 (\$10,700)	\$10,700
\$199,999	\$900,000	10% of \$199,999 (\$19,999)	\$19,999

Please do not hesitate to contact me at [nat.hoopes@marketplacelendingassociation.org](mailto:nat.hoopes@marketplacelendingassociation.org) or (202) 662-1825 should you have any questions.

Sincerely,  
 Nathaniel L. Hoopes  
 Executive Director  
 Marketplace Lending Association