April 14, 2017

The Honorable Senator Mike Crapo
Chairman

The Honorable Senator Sherrod Brown
Ranking Member

Committee on Banking, Housing, & Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510
(By email to: submissions@banking.senate.gov)

Re: Request for Proposals to Foster Economic Growth

Dear Chairman Crapo, Ranking Member Brown and Members of the Committee:

Lending Club is pleased to have the opportunity to participate in the discussion you have opened requesting proposals to foster economic growth in the U.S. economy. We appreciate the chance to share our perspective on marketplace lending, its impact on consumers and businesses, and how marketplace lenders can address credit gaps that limit economic opportunity for important sectors of the economy.

Lending Club is the world's largest online credit marketplace, facilitating personal loans, auto loans, and small business loans. Borrowers access lower interest rate loans through a fast and easy online or mobile interface. Investors provide the capital to enable many of the loans in exchange for earning interest. We operate fully online with no branch infrastructure, and use technology to lower cost and deliver an amazing experience. We pass the cost savings to borrowers in the form of lower rates and to investors in the form of attractive returns, helping people achieve their financial goals every day.

Our mission is to transform the financial system to make borrowing more affordable and investing more rewarding. We have facilitated nearly $25 billion in loans to more than 1.8 million individual and small business borrowers since our founding in 2006. These loans have saved consumers over $1 billion

dollars[1] by helping them refinance expensive credit card debt into lower-rate term loans.

Executive Summary

New technologies are making financial services more accessible, affordable, and easier to use. We are encouraged by the efforts we have seen by federal agencies seeking to encourage responsible innovation in financial technology solutions.[2] However, despite some promising recent bills that have been introduced, opportunities remain for Congress to help realize the potential that financial technology innovation offers for economic growth in the U.S. We believe there is a clear need for action in the face of persistent credit gaps across sectors of the economy restraining growth potential.

We thank the Chairman and the Ranking Member for convening this request for proposals and allowing us to offer our view on a few measures that, we believe, would allow marketplace lenders such as Lending Club to more easily make credit available to borrowers and thus unlock the broader benefits that accompany these loans. In particular, we urge the Committee to support legislation in three specific areas. First, we urge support for legislation that would lower the cost of credit to consumers and small businesses by returning certainty to secondary markets for bank loans. Second, we urge support for legislation that would facilitate "point and click" access to consumer-owned taxpayer data for loan applications, which would make the process of applying for a loan more efficient and provide lenders more data on the basis of which to approve loans. Finally, we also call on the Committee to convene a legislative process to study measures to incentivize investment and savings, particularly in underserved communities, which would form the basis for draft legislation. While we recognize that some of these proposals might reach beyond the Committee's jurisdiction or fall within the jurisdiction of multiple committees, we believe that the proposals squarely address the Committee's goal to solicit proposals to increase economic growth through the banking system.

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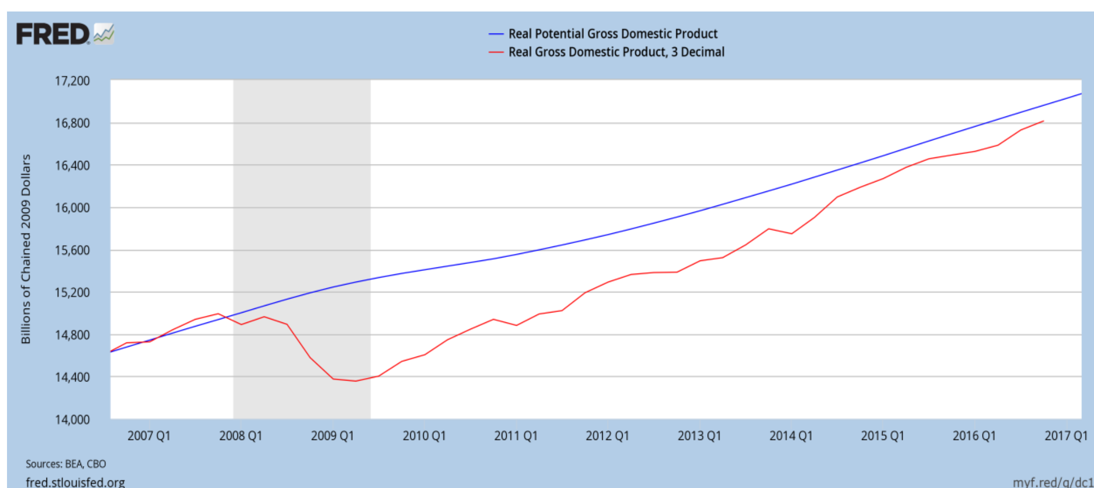
[1] Based on responses from 14,986 borrowers in a survey of 70,150 randomly selected borrowers conducted from July 1, 2014—July 1, 2015, borrowers who received a loan to consolidate existing debt or pay off their credit card balance reported that the average interest rate on outstanding debt or credit cards was 21.8% and average interest rate on loans through Lending Club is 14.8%. Lending Club determined a total payment the borrower would have made if they had paid off their credit card or debt in the same term as would correspond to the loan through Lending Club. Lending Club then compared that to what borrowers would pay in interest and origination fee on a loan through Lending Club repaid on schedule [*Hereinafter LC Borrower Survey*].

[2] For example, Lending Club applauds the U.S. Treasury for convening a request for proposals on financial technology (Public Input on Expanding Access to Credit Through Online Marketplace Lending, 80 Fed. Reg. 42,866 (July 20, 2015)) and the OCC for issuing a draft supplement to its Comptroller's Licensing Manual Draft Supplement. *Evaluating Charter Applications From Financial Technology Companies*, [*hereinafter Draft Supplement*], Office of the Comptroller of the Currency, Washington, D.C. (March 2017), *available at*: https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf.

While these proposals certainly do not exhaust the field of measures that could be taken to encourage responsible innovation in financial products and services, they are of critical importance from the perspective of encouraging financial technology's contribution to increased growth of the U.S. economy.

<u>The Impact of Credit Gaps on U.S. Economic Growth</u>

The Chairman and Ranking Member's request comes at a critical time. A wide and diverse range of economic commentators have recognized that, by some (and sometimes differing) historical measures, the recovery of the U.S. economy since the financial crisis has been lukewarm at best.[3] While the U.S. economic output has made up much of the lost ground caused by the financial crisis, to this day the economy lags behind its potential. The Federal Reserve Bank of St. Louis has estimated that we are still below our pre-recession economic trend by more than $100 billion annually:



The financial sector clearly plays a role in this story. An extensive body of economic research has examined the ways that bank lending impacts economic growth,[4] with studies drawing the link between

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[3] *Compare* Larry Summers, *Reflections on the 'New Secular Stagnation Hypothesis,' in* S*ECULAR* S*TAGNATION*: F*ACTS*, C*AUSES AND* C*URES*, ed. Coen Teulings and Richard Baldwin (Center for Economic and Policy Research, 2014) at 27-28, figure 1a (depicting the gap between actual and potential output for the U.S.), *available at*: http://scholar.harvard.edu/files/farhi/files/book_chapter_secular_stagnation_nov_2014_0.pdf; *and* Dimitri B. Papadimitriou, Michalis Nikiforos and Gennaro Zezza, *Strategic Analysis: Destabilizing an Unstable Economy* (Levy Economics Institute of Bard College, March 2016), at 1 ("This has been by far the slowest recovery in the postwar history of the United States."), *available at*: http://www.levyinstitute.org/pubs/sa_mar_16.pdf; *and* Robert Barro, *The Job-Filled Nonrecovery*, *AEI Economics Working Paper 2016-13* (American Enterprise Institute, October 2016), at 2 ("The recovery from the recent Great Recession in the United States (and many other places) has been nonexistent."), *available at*: https://www.aei.org/wp-content/uploads/2016/10/Job-Filled-Nonrecovery.pdf.
[4] One classic study looking at the impact of bank branch reform in the U.S. starting in the 1970s concluded that

higher lending volumes and higher rates of growth.[5] Following in this vein, some commentators have suggested that a key driver of our tepid recovery has been underwhelming lending volume causing difficulties for individuals and small businesses to have access to necessary credit.[6] For example, while there are significant gaps in data availability, by some measures small business credit origination is still down 18% against its 2008 peak (based on FDIC Call Report data),[7] with originations by the four largest banks—Bank of America, N.A., Citibank, N.A., JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A.—still down 50% from their pre-crisis levels through 2014.[8]

A recent study found that while the small business lending gap that followed the financial crisis has been largely (though far from fully) filled by non-bank financial companies, a credit *rate* gap still persists, which the authors conclude has contributed to a persistent negative impact on wages.[9] Such a rate gap is beginning to be addressed by responsible new lending by fintech lenders and marketplaces offering responsible, lower-cost credit. Similarly, a Harvard Business School whitepaper explains how the post-crisis shortfall in small business credit has impacted economic growth by holding back small business

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these reforms boosted lending quality and accelerated real per capital growth rates and found that bank lending quality was the main channel through which the financial sector reform affected economic growth. Jith Jayaratne and Philip E. Strahan, *The Finance-Growth Nexus: Evidence from Bank Branch Deregulation*, *Quarterly Journal of Economics*, 111, 639-70 (1996). *See also* Joseph Schumpeter, *THE THEORY OF ECONOMIC DEVELOPMENT* (1969).

[5] Another classic study analyzing the link between bank credit and real economic activity in forty-two countries from 1976 through 1993 found a strong correlation between the overall level of bank lending in an economy and increases in real per capita income growth. Ross Levine and Sara Zervos, *Stock Markets, Banks, and Economic Growth*, *American Economic Review*, 88, 537-58 (1998). *See also* Robert Heller, Testimony before the Committee on Banking, Housing and Urban Affairs United States Senate, *Fostering Economic Growth: The Role of Financial Companies* (United States Senate, March 28, 2017), *available at*: https://www.banking.senate.gov/public/_cache/files/5d24d73e-812a-4ad1-99f7-8349a0b996d9/3C7386F1B0F9230025C2832B9580F202.heller-testimony-3-28-17.pdf.

[6] Chen, Brian S., Samuel G. Hanson and Jeremy C. Stein, *The Decline of Big-Bank Lending to Small Business: Dynamic Impacts on Local Credit and Labor Markets*, Working Paper [*hereinafter Decline of Big-Bank Lending*] (Harvard Business School, March 2017) at 5 ("an extrapolation of our results suggests that the resulting small business credit gap may have contributed significantly to the severity of the Great Recession and the sluggish pace of the subsequent recovery"), *available at*: http://www.people.hbs.edu/shanson/BigBankSmallBiz_paper_20170317_FINAL.pdf.

[7] *See* Karen Gordon Mills and Brayden McCarthy, *The State of Small Business Lending: Innovation and Technology and the Implications for Regulation* [*hereinafter State of Small Business Lending*] (Harvard Business School, December 2016), at 29-30, *available at*: http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf.

[8] Decline of Big-Bank Lending at 1.

[9] *Id*. at 3-5 (documenting how small business borrowers have substituted tight bank credit with credit from non-bank lenders, a phenomenon that coincides with the payment of higher interests rates and loans with shorter maturities, forcing businesses at first to lay off workers and then to substitute labor for capital resulting in a drag on productivity and wages).

from pursuing business expansions and new opportunities,[10] in turn contributing to the dramatic drop off in startup formation in the years following the financial crisis.[11] These trends have meant that the number of jobs generated by startups remains well below pre-recession levels,[12] contributing to the overall reduction in dynamism in the U.S. economy.[13]

Financial technology lenders can play a greater role in addressing the financing gaps faced by consumers and small businesses. Technology has enabled marketplace and online lenders to reduce cost through the ability to operate without a branch network and the automation of tasks that remain highly manual at most traditional banks. Compare Lending Club's operating cost ratio of 2-3% to a traditional lender's expense ratio of 5-7%.[14] This greater efficiency contributes to the ability of online credit marketplaces to offer a lower cost of credit. The benefits to customers of our low-cost technology-based model are furthered by the use of excellent credit risk technology. Some of the credit models we work with are able to evaluate credit risk twice as effectively as generic scores provided by major consumer reporting agencies.[15]

Low costs and effective risk modeling enable Lending Club to provide lower rates, and sometimes to reach borrowers that traditional lending approaches do not. This can include borrowers that a traditional bank may deem to be unprofitable, such as smaller sized loans that underserved borrowers more often require. The minimum loan through the Lending Club platform is $1,000 for consumer loans and $5,000 for business loans. Small business loans originated through our platform have nearly double representation of minority-owned businesses.[16] At times, banks or CDFIs have partnered with Lending Club to leverage this ability to deliver affordable credit to underserved, low- to moderate income

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[10] State of Small Business Lending at 38.

[11] In both absolute terms and as a percentage of total firms in the economy. *Id*. at 19-20.

[12] *Id*. at 21.

[13] *See id*. at figure 8, 22. *See also* Decline of Big-Bank Lending at 6.

[14] Lending Club's operating cost ratio of 2-3% is estimated on a run rate basis on operating expenses for the quarter that ended on June 30, 2016 (annualized), assuming no growth in monthly rate of origination volume. Traditional lenders' operating expense ratio of 5-7% is operating expenses expressed as a percentage of outstanding loan balance. The analysis used Q2 2016 data and included Wells Fargo & Company, Citigroup, Inc., Capital One Financial Corporation, Discover Financial Services, Bank of America Corporation, and JPMorgan Chase & Company.

[15] Based on a comparison of the currently deployed model on the platform to industry generic scores such as FICO utilizing the Kolmogorov–Smirnov test, an industry standard measure of the effectiveness of a risk model.

[16] Based on Bayesian Improved Surname Geocoding analysis of Lending Club business loan borrowers, benchmarked to 14.6% representation of minority-owned businesses in traditional retail bank loans, as per Jules Lichtenstein, *Demographic Characteristics of Business Owners*, Issue Brief Number 2 (Small Business Administration Office of Advocacy, January 16, 2014), *available at*: https://www.sba.gov/sites/default/files/Issue%20Brief%202,%20Business%20Owner%20Demographics.pdf.

borrowers.[17]

While marketplace lending can play a critical role in spurring economic growth by removing barriers to credit access for underserved consumers and small businesses, more could be done to facilitate responsible innovation and competition in credit markets. The next section discusses some measures we believe would achieve those goals.

Proposals to Magnify the Impact of Financial Technology Innovation on U.S. Economic Growth

1. Return Certainty to Secondary Markets for Bank Loans

First, we call on the Committee to address the uncertainty that was created by the *Madden v. Midland Funding, LLC*,[18] decision of the U.S. Court of Appeals for the Second Circuit. That case was wrongly decided and caused significant adverse impacts to marketplace platforms such as Lending Club that facilitate loans in the three states impacted by that decision (New York, Connecticut, and Vermont). In essence, the court in *Madden* ignored a long-standing doctrine, known as "valid when made," which ensures that a loan will remain valid and enforceable if the loan complied with law when it was originated, regardless of whether the loan is sold or transferred and regardless of the identity of any subsequent owner of that loan.[19] This principle is important because any restrictions on the validity of a loan that reduces the liquidity of that loan in turn decreases the value of the loan and could increase the price that lenders charge borrowers to compensate for the reduced liquidity. Many marketplace platforms, Lending Club included, rely on loan sales, assignments and transfers as part of our funding models, and the ability to sell a loan into the secondary markets broadly is essential to maintaining liquidity in credit markets more generally. The uncertainty created by *Madden* is not limited to marketplace lending but rather reaches to all bank lending. If other jurisdictions follow the *Madden* holding, access to credit would be reduced apace, likely resulting in a drag on economic growth.

Proposal

We call upon the Committee to support legislation that addresses the uncertainty created by *Madden* by clarifying that the "valid when made" doctrine continues to be the law of the land. We support the Marketplace Lending Association's proposal on this matter, and refer the Committee to its comment letter for detail on specific language to include in legislation.

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[17] Defined as borrowers whose reported adjusted household income is less than 80% of the median income of their zip code and live in majority or greater low to moderate income census tracts as of June 30, 2015.
[18] 786 F.3d 246 (2nd Cir. 2015).
[19] The *Madden* court holding results in a situation where, while the rate of interest on a loan would be valid if collected by a bank, it may not be valid or enforceable when interest payments are collected by a non-bank entity.

2. "Point and Click" Access to Taxpayer Data

Next, we propose that Congress direct the Internal Revenue Service (IRS) to update its data sharing systems to ensure that taxpayers can provide lenders instant access to taxpayer data when taxpayers apply for credit. This would entail a simple revision to the IRS's "4506-T" data sharing systems that are currently in place, automating these systems and creating an application programming interface (API) to facilitate their instant transferability.

Lenders often review a taxpayer's 4506-T data as part of credit underwriting procedures, which the IRS provides to such third-parties upon the taxpayer's request.[20] However, the system is currently based on manual processing and the physical mailing of paper forms. This means that the 4506-T data is not available for lenders that provide instant credit decisions and quotes, which is a highly valued experience for consumers and small business owners. This is unfortunate because the data provided under the 4506-T process is typically more detailed and covers a longer period than the self-reported values provided by loan applicants.[21] The availability of additional data therefore can enable lenders to originate loans in cases where doing so might not have been otherwise possible. Thus, by making access to such taxpayer-owned data available on a "point and click" basis, Congress could significantly increase the flow of credit to consumers and small business borrowers.

Proposal

We call upon the Committee to support legislation that would direct the IRS to upgrade its 4506-T data sharing system and ensure that it is available to support responsible innovation in lending. Again, we support the Marketplace Lending Association's proposal on this matter and refer the Committee to its comment letter for specific language and more detail on specific principles to incorporate in any legislative proposal: free or low-cost access; ease of use and integration into online applications; availability for all types of loan products; and inclusion of more fields from tax returns than are currently available pursuant to the 4506-T process.

3. Incentivize Investment and Savings in Underserved Consumers and Communities

Our final proposal would be for Congress to study legislative initiatives to directly incentivize credit access and broader financial opportunities within underserved communities. Financial technology holds great promise for transforming financial services as a result of lower operating costs, better

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[20] *See* https://www.irs.gov/pub/irs-pdf/f4506-T.pdf.

[21] For example, Lending Club requires small business borrowers to self-report revenues and profits looking back one year, but summary data available through the 4506-T would give us verified data on three years of data, including business balance sheets and cost ratios.

utilization of information and technology, and avoidance of business model conflicts that may hinder the ability of incumbent financial institutions from taking advantage of these historic opportunities.[22] But in order to ensure that the benefits from financial technology are widely felt, efforts need to be taken to ensure that financial inclusion is encouraged and that fintech lending is responsible. Congress should study, design, and pass legislation that specifically targets inclusive economic growth.

Lending Club's experience is that financial technology can unlock opportunity for consumers, small businesses and communities that are currently underserved by the existing financial infrastructure, particularly through our partnerships with financial institutions (including traditional financial institutions and community development financial institutions (CDFIs) such as the Opportunity Fund) that are designed to deliver affordable credit to underserved, low- to moderate-income borrowers.[23] Congressional action could unlock further opportunities for such partnerships. One successful model that the Committee could look to in thinking about incentives for inclusive growth is the example of New Markets Tax Credits (NMTCs).[24]

NMTCs incentivize equity investments in financial intermediaries that provide a variety of critical financial services in underserved, low-income communities, including lending activities, by offering tax credits to such investors equaling 39% of capital invested in such entities, claimable over a fixed, seven-year investment schedule.[25] According to one study produced for the Partnership for Job Creation, investments made pursuant to the program were highly successful in directly and indirectly incentivizing

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[22] For example, about two-thirds of personal loan borrowers on Lending Club's platform report using their personal loan to pay off an existing loan or credit card balance and report that the interest rate on their Lending Club loan was an average of 7 percentage points lower than they were paying on their outstanding debt or credit cards (based on the LC Borrower Survey). Incumbent lenders, such as credit card issuing banks, do not widely offer these borrowers personal loans; a business model conflict prevents them from reducing the rates on their own portfolios, since the offering of personal loans could compete with their credit card business, eating into their own profits.

[23] The Opportunity Fund is one of the leading nonprofit small business lenders in the United States. Our partnership combines the strengths of the marketplace lending and CDFI models in order to expand access to capital to small businesses that neither organization would be able to serve on its own. Lending Club contributes our technology, enabling loans to be underwritten at lower operating cost, our focus on customer experience to provide applicants a simple and fast experience, and the broad reach of our applicant base and marketing activities. Opportunity Fund provides a CDFI's expertise with "high-touch" service to help borrowers who do not qualify for the core Lending Club program to prove themselves to be creditworthy. This program began as a pilot in California, and is moving towards expansion into other states to serve more underserved small businesses.

[24] The NMTC Program was enacted by Congress as part of the Community Renewal Tax Relief Act of 2000 and is incorporated as section 45D of the Internal Revenue Code (IRC).

[25] The IRC defines which census tracts qualify for such treatment, including at least a 20% poverty rate or a median family income below 80% of the greater surrounding area's median family income (with consideration given to whether this area is urban or rural). In addition, other low-income communities may qualify under Internal Revenue Bulletin 2006-29, Notice 2006-60 (July 17, 2006) , *available at*: https://www.irs.gov/irb/2006-29_IRB/ar07.html.

job creation.[26] The study found that revenues directly and indirectly attributable to NMTC investments in operating businesses and commercial developments substantially exceeded revenues foregone by the tax credit, resulting in a net return to U.S. taxpayers ranging from 2.2 to 14.8 times the value of tax credits awarded under the program.[27]

While improvements to the NMTC program could certainly be made and the seven-year time horizon might not be appropriate for certain lending facilitated through fintech platforms, the return to taxpayers from such targeted investments in our economy speaks to the ability of targeted tax breaks to direct productive resources through the financial system to the communities that need it most. We should build on these successes by applying them to the promise that financial technology holds for unlocking growth and potential.

Proposal

We call upon the appropriate committees to convene a process to explore the ability of targeted tax incentive measures to catalyze investments in underserved U.S. consumers, small businesses and communities, and the contribution that such measures would add to economic growth. We urge the appropriate committees to consider targeted tax incentives to directly induce capital formation in underserved communities and small business borrowers. Congress should relieve the tax burden on investors who invest in loans originated by marketplace lending platforms (or pursuant to clearly-defined partnership programs with such platforms) whose origination programs are restricted to underserved borrowers or low-to-moderate income small businesses borrowers.[28] Modeled after the NMTC program, investments in qualified census tracts or to qualified borrowers could be granted a corresponding tax credit, or could simply be tax-exempt. Further, we reiterate the tax incentive and tax reporting proposals we made in our response to the Department of the Treasury's Request for Information concerning Marketplace Lending and refer the appropriate committees to that letter for more detail on specific proposals to consider.[29]

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[26] *See* Ellen D. Harpel, *Return on Investment: Fiscal and Economic Impacts of the New Markets Tax Credit Program* (Business Development Advisors, December 2012), *available at*: https://www.akingump.com/images/content/2/0/v4/20213/Fiscal-and-Economic-Impacts-of-the-New-Markets-Tax-Credit-103839.pdf.

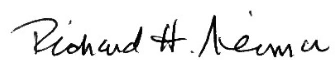
[27] *Id*.

[28] The definition of underserved borrowers could be based on location in qualifying census tracts following the definitions in the NMTC rules. *See supra* note 25.

[29] *See Lending Club's Response to Marketplace Lending RFI*, Comment Letter (Lending Club, September 2015), at 28-30, *available at*: http://ir.lendingclub.com/interactive/lookandfeel/4213397/LendingClubResponseToTreasuryRFI.pdf.

Thank you for the opportunity to comment on this important initiative. We remain available to provide additional input or answer any questions regarding our comment letter. Please do not hesitate to reach out to me directly at 202-772-3170 or by email at rneiman@lendingclub.com. We look forward to continued engagement with the Committee in supporting the economic growth of the U.S. economy.

Sincerely,



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