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LENDINGCLUB

PUBLIC COMMENT ON THE FEDERAL TRADE COMMISSION'S HEARINGS ON COMPETITION AND CONSUMER PROTECTION IN THE 21ST CENTURY:

Protecting Consumers and Promoting Responsible Innovation in Lending

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LendingClub commends the Federal Trade Commission (the "FTC"), its staff, and its Commissioners for their commitment to protecting consumers and promoting competition in a rapidly evolving global economy.[1] We believe the planned series of hearings will be a valuable tool in aligning the Commission's policy and enforcement priorities to meet the challenges of the 21st-century economy. In this comment, we offer input regarding consumer welfare implications of innovations in predictive analytics, with a focus on how innovations can reduce the cost of credit, increase financial inclusion, and prevent discrimination. We also urge the Commission to use its upcoming hearings to consider opportunities for the FTC to address irresponsible lending to small businesses.

LendingClub is America's largest online credit marketplace, facilitating personal loans, auto loans, and small business loans. Investors provide capital to enable most loans, while borrowers access lower-interest-rate loans through a fast and easy online or mobile interface. We operate fully online with no branch infrastructure, and we use technology to lower costs, to assess credit risk in innovative ways, and to deliver an improved customer experience. We pass the cost savings generated by our business model and technology on to borrowers in the form of lower rates and expanded access to credit, helping people achieve their financial goals every day.

Since our launch in 2007, LendingClub has facilitated over $36 billion in loans to more than 1.9 million individual and small-business borrowers and has saved borrowers as much as $2.4 billion.[2] However, credit marketplaces and other fintech companies offering lower prices are not the only participants in the marketplace. The decline in traditional bank lending to consumers and small businesses has also led to an increase in lenders offering predatory products to borrowers with coercive repayment obligations and high annual interest rates ("APRs") that sometimes exceed 300%.[3]

LendingClub strives to be a leader in this new and rapidly expanding segment of the financial services industry, and has proactively sought to promote borrower-friendly standards and business practices. We see it as in our interest—and in the interest of borrowers—to create a virtuous cycle of positive competition within the industry rather than a race to the bottom. The FTC is well positioned to contribute to an environment of healthy competition in this industry. In particular, we urge the FTC to promote the development and use of innovative technologies to reduce borrowing costs and improve access to credit among underserved communities, and to protect small business borrowers from predatory lending practices.

I. Reducing Borrowing Costs

The FTC should support innovations in algorithmic decision tools, artificial intelligence, and predictive analytics that can help accurately assess creditworthiness, reduce costs to borrowers, and improve access to credit. While the FTC must carefully consider how companies use and protect customers' data, the responsible use of data in new and innovative ways delivers real benefits to consumers and small businesses seeking credit.

Consumers benefit when they are able to access credit on a faster, more convenient, and lower-cost basis than is available through traditional lenders. For example, about two-thirds of LendingClub borrowers report using their loan to refinance higher-cost credit cards into lower-rate loans. By accessing lower rates, and moving from the cycle of revolving credit card debt to a more responsible term-loan structure, we have provided borrowers up to $2.4 billion in savings. To a family of four at or below the U.S. median household income, about $57,000 annually in 2016, these savings can be significant.[4]

Among other forms of savings to consumer borrowers, LendingClub's auto-loan program reduces costs for borrowers who are often being overcharged through sometimes discriminatory dealer markups.[5] By helping borrowers refinance into a lower-cost loan through LendingClub, we eliminate these markups and save typical borrowers approximately three percentage points and $1,500 over the life of the loan, or more.

LendingClub's ability to save money for consumers is due in part to innovations in credit analytics. Researchers at the Federal Reserve Banks of Philadelphia and Chicago used LendingClub data to analyze the role of alternative data and machine learning in fintech lending. The researchers specifically noted that fintech companies are offering consumers reduced-cost products, stating that "consumers pay smaller interest rate spreads on loans from LendingClub than from traditional lending channels, indicating that fintech lending can provide credit to consumers at a lower cost."[6] The Fed researchers further found that, "given the same credit risk (i.e., for borrowers with the same expected delinquency rate), consumers would be able to obtain credit at a lower rate through the LendingClub than through traditional credit card loans offered by banks."[7]

This research also addressed the ways innovation in credit analytics is helping fintech lenders better serve borrowers whom traditional lenders may overlook or overprice. The researchers found that, over time, the correlation between LendingClub's proprietary credit rating grades and FICO scores fell from over 80% correlation in 2007, when the company launched, to approximately 35% for loans originated in 2014 and 2015.[8] Particularly in later years, this means that consumers with lower FICO scores could receive the highest "A" rating in LendingClub's credit model, "providing evidence that the use of additional information sources could allow some borrowers with lower FICO scores, who are nevertheless creditworthy, to get access to credit and potentially get a lower price than if FICO scores were the only criteria."[9] The Fed researchers also found that among LendingClub borrowers with lower FICO credit scores, borrowers who received "A" and "B" ratings from LendingClub were significantly less likely to default on their loans than the average low-credit-score borrower, despite having similar FICO scores. This finding illustrates how innovations in credit analytics by companies like LendingClub are already helping to provide lower-cost credit to people who may be overlooked or overpriced by more traditional lenders.

While big data and predictive analytics raise real policy questions about consumer privacy and data security, innovative applications of these technologies can deliver clear benefits to consumers seeking credit. The FTC should encourage productive and responsible uses of new technology while pursuing bad actors seeking to misuse consumer data, and should acknowledge the demonstrated benefits of the use of big data in the lending sector when assessing data privacy and security issues.

II. Improving Access to Credit and Preventing Discrimination

We believe that technology has the power to increase financial inclusion, and we encourage the FTC to support innovation in algorithmic decision tools and predictive analytics by non-bank lending companies to broaden access to credit and provide economic opportunity in historically underserved communities.

Access to Credit

According to an estimate by Oliver Wyman, 45 to 60 million people do not have sufficient information in their credit file to have a credit score, which is essential for any traditional lending decision.[10] Minority groups are disproportionately represented within this group.[11]

Like many fintech lenders, LendingClub seeks to provide access to credit to a broad spectrum of Americans, including those in communities that are underserved by traditional lenders. The same researchers at the Federal Reserve Banks of Philadelphia and Chicago published a second working paper analyzing whether fintech lenders provide services in areas underserved by traditional banks.[12] They found that "LendingClub's consumer lending activities have penetrated areas that may be underserved by traditional banks, such as in highly concentrated markets and in areas that have fewer bank branches per capita."[13] The Fed researchers also found that "the portion of LendingClub loans increases in areas where the local economy is not performing well,"[14] suggesting that LendingClub and other fintech lending companies are satisfying demand for credit that would otherwise be unmet.[15]

LendingClub's efforts to increase access to credit also extend to small businesses. Seven out of ten LendingClub small-business borrowers reported that they were not otherwise accessing affordable capital.[16] Representation of minority-owned firms among LendingClub borrowers is five times higher than in traditional bank lending, and representation of women-owned firms is four times higher.[17]

Preventing Discrimination

While creditworthiness models have long been criticized for their negative impact on minority communities, LendingClub's experience demonstrates that data analytics can be used to help reverse these trends.

There are undoubtedly questions for policymakers and regulators about how best to ensure that innovations in alternative data, machine learning, and artificial intelligence used in credit underwriting do not result in discrimination. Particularly if credit decisions are made by models that are incomprehensibly complex to humans, some fear that such models could include proxies for race or other protected classes, or could inadvertently disadvantage protected classes in credit decisions.

Our views about the potential for technology to address these questions and combat discrimination recently led us to submit a comment letter to the Consumer Financial Protection Bureau in support of maintaining disparate impact fair lending regulation, which prohibits creditors from employing facially neutral policies or practices "that have an adverse effect or impact on a member of a protected class unless it meets a legitimate business need that cannot reasonably be achieved by means that are less disparate in their impact."[18] We urged the Bureau to maintain the policy because it addresses the widely held concern about discriminatory effects in lending without imposing proscriptive requirements that could prevent innovations in data, machine learning, and artificial intelligence capable of improving access to credit and reduce costs for members of historically underserved communities.

For our part, in addition to maintaining our own fair lending program through which we assess and revise our processes to ensure they do not have a disparate impact on protected classes, we have sought to encourage others in the industry to adopt responsible fair lending programs. The Marketplace Lending Industry Best Practices, which we abide by and helped create, include a section titled “Non-Discrimination” that calls for fair lending assessment when dealing with novel sorts of data.[19]

In considering the benefits and risks of new technologies in this space, we urge the FTC to recognize that, when used responsibly, algorithmic decision tools and predictive analytics not only can reduce borrowing costs for consumers, but also can improve access to credit for historically underserved communities.

III. Protecting Small Business Borrowers

LendingClub urges the FTC to continue to support meaningful policy and legislative reform to ensure small-business borrowers can obtain access to credit on fair and transparent terms, and to consider the Bipartisan Policy Center’s recent call for the FTC to engage on this issue.[20]

When we launched our small business lending program, we soon became aware of the rise of lending practices with the potential to harm small businesses. Many businesses applying for loans came to us with more debt than they could really afford, often at rates that were irresponsible at best and unconscionable at worst. In many cases, borrowers did not know how high their interest rate was because it had never been disclosed to them.

Many small-business owners may turn to these products because they are unable to access the capital they need to grow and hire due to the market gap in traditional bank lending that developed following the financial crisis. A 2016 study by the Federal Reserve concluded that 60% of employer small businesses have unmet funding needs.[21] This lack of capital in turn prevents significant small-business-driven job creation and economic growth. Notably, the gap in lending disproportionately affects women- and minority-owned small businesses. These businesses often operate with less financial capital than their peers, and owners of such businesses, when surveyed, disproportionately report that they are discouraged from applying for credit for fear of denial.[22]

Small businesses have increasingly been targeted by lenders engaging in irresponsible lending practices. Research by the Opportunity Fund, a California-based non-profit micro-lender, found that, among small businesses who had applied to Opportunity Fund for refinancing, the average APR was 93.9% while the single highest APR was 358%.[23]

A number of responsible actors in the fintech industry (including LendingClub) and leading non-profit organizations formed the Responsible Business Lending Coalition (“RBLC”) to develop an industry-backed response to these problems. The RBLC is a diverse coalition of leading non-profit and for-profit organizations committed to expanding access to capital to small businesses and combatting irresponsible lending practices affecting small businesses. Other members include the two leading non-profit lenders to small businesses, Accion and Opportunity Fund; small business advocacy organization Small Business Majority; fintech lender Funding Circle; impact investor Community Investment Management; and the Aspen Institute.

Within a few months of its formation, the RBLC launched the *Small Business Borrowers’ Bill of Rights,* which reflects a cross-sector consensus of the rights of small-business borrowers, and defines detailed standards for transparency, non-abusive products, responsible underwriting, non-discrimination, fair treatment from brokers, and fair collection practices. The RBLC *Small Business Borrowers' Bill of Rights* has now been signed by over 90 non-profit and for-profit lenders, fintech companies, advocacy and community groups, brokers, community banks, and CDFIs.[24]

Together with the RBLC, we have also called for the creation of new federal and state small-business borrower protection laws, including Truth in Lending Act-like protections for small businesses;[25] and implementation of Section 1071 of the Dodd-Frank Act to require lenders to create transparency and to encourage competition and lending in underserved communities.[26]

Yet the fact remains that not all firms abide by the standards of responsible lending proposed by the RBLC. The FTC, by establishing standards that apply to all non-bank financing providers, can protect borrowers and create healthy competition within the industry. Indeed, just this month the Bipartisan Policy Center called for Congress to direct the FTC to create small-business lending disclosure standards, as the RBLC has been advocating for since 2015. LendingClub supports the BPC's recommendation. Moreover, the FTC should use its existing authority to stop predatory practices in the non-bank lending market that harm small businesses. Critically, the FTC can use this authority to reach business-to-business conduct, like small-business lending, that harms or is likely to harm consumers.[27] The Commission can also engage with other state and federal agencies like the CFPB, OCC, and State AGs to ensure tough oversight of marketplace lenders and to protect consumers while at the same time allowing the benefits of innovation in the industry to accrue to borrowers—including historically underserved borrowers.

IV. Conclusion

Providing consumers and small businesses access to credit at fair rates and with responsible products not only benefits borrowers, but also the local communities that they serve and the broader economy. We thank the Commission for considering our perspectives on small business and consumer lending and hope the Commission takes steps to support borrowers in these markets.

We believe that panels addressing these issues could help identify policy solutions to support lower prices and increased financial inclusion, while preventing discrimination and addressing irresponsible small-business lending. These panels could be part of the Commission's planned hearing on the consumer welfare implications associated with the use of algorithmic decision tools, artificial intelligence, and predictive analytics and/or the hearing on state and federal regulations that prohibit unfair or deceptive acts or practices.

Thank you again for the opportunity to comment on this important initiative. We remain available to provide additional input or answer any questions. 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 continuing to engage with the FTC on these critical policy issues in the course of the hearings this fall.

Copies To:

The Hon. Joseph Simons, Chairman
The Hon. Maureen Ohlhausen, Commissioner
The Hon. Rohit Chopra, Commissioner
The Hon. Noah Joshua Phillips, Commissioner
The Hon. Rebecca Kelly Slaughter, Commissioner

Bilal Sayyed, Director, Office of Policy Planning
Andrew Smith, Director, Bureau of Consumer Protection
Maneesha Mithal, Associate Director, Division of Privacy and Identity Protection
Malini Mithal, Acting Director, Division of Financial Practices

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[1] LendingClub is currently engaged in litigation with the FTC; this comment letter does not address issues relevant to that litigation.

[2] This estimate covers borrower savings on loans for credit card payoff and debt consolidation purposes. Interest rates of credit card and other debt not through LendingClub are based on responses from a survey of 7,331 randomly selected borrowers conducted between Feb. 15, 2016 and Sept. 30, 2017. We assumed 3% annual fees for credit cards and other debt instruments as a percentage of cycle-ending balances, based on the CFPB publication, "The Consumer Credit Card Market," (Dec. 2015). Paydown rates for debt not issued through LendingClub were assumed to be minimum payments for 40% of borrowers, and a three-year paydown period for 60% of borrowers, based on consumer behavior findings in Sumit Agarwal, Souphala Chomsisengphet, Neale Mahoney, & Johannes Stroebel, *Regulating Consumer Financial Products: Evidence from Credit Cards*, 130 Quarterly Journal of Economics 111, (2015). For minimum monthly payments, we assumed interest payment on existing balance in the period plus 1% of outstanding balance plus fees.

[3] Opportunity Fund Report, *Unaffordable and Unsustainable: The New Business Lending On Main Street,* 3, 6 (May 2016).

[4] United States Census Bureau, *American Community Survey Briefs: Household Income: 2016*, 3 (Sept. 2017) https://www.census.gov/content/dam/Census/library/publications/2017/acs/acsbr16-02.pdf.

[5] Ending these markups also helps combat discriminatory pricing practices: Evidence shows that auto dealers are twice as likely to add markups to African-American borrowers than white borrowers, and that auto dealers routinely charge African-American borrowers two to four times more in markups than their white counterparts. *See* Stuart Rossman, *The Data is Clear: Auto Lenders Discriminate*, U.S. News & World Report (Nov. 17, 2015) (citing research from the National Consumer Law Center).

[6] Julapa Jagtiani & Catharine Lemieux, *The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform*, 11 (April 2018) (confirming the results of an earlier Federal Reserve Bank of Philadelphia working paper, Julapa Jagtiani & Catharine Lemieux, *Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information*, (July 2017)).

[7] *Id*.

[8] *Id.* at 10.

[9] *Id*. at 11.

[10] Peter Carroll & Saba Rehmani, Oliver Wyman, *Alternative Data and the Unbanked*, 5 (2017).

[11] For example, according to estimates from the Financial Industry Regulatory Authority cited in the Oliver Wyman report, only 51% of African-Americans and 58% of Latinos (as opposed to 75% of American adults as a whole) have credit scores. *Id.* at 3.

[12] Julapa Jagtiani & Catharine Lemieux, *Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?*, 1 (March 2018).

[13] *Id*. at 1.

[14] *Id*.

[15] *Id.* at 11.

[16] These figures are based on a LendingClub survey of 242 business loan borrowers that took out a loan between March 2014 and March 2016. This includes borrowers who applied for other financing but were not approved, did not apply for other financing, or considered financing offers from other online lenders or merchant cash advance. It does not include borrowers who considered financing offers from banks or "other" types of lenders.

[17] Figures are from LendingClub's small business program from 2015 to 2017: demographics are estimated using BISG analysis, compared by dollar with bank conventional loan programs cited in *21st Century Barriers to Women's Entrepreneurship* by the U.S. Senate Committee on Small Business and Entrepreneurship (July 2014) and *Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs* by Kenneth Temkin of the Urban Institute (Jan. 2008).

[18] LendingClub comment to the Consumer Financial Protection Bureau, "Request for Information Regarding the Bureau's Inherited Regulations and Inherited Rulemaking Authorities; Maintain Disparate Impact Policy," (June 23, 2018), https://www.regulations.gov/document?D=CFPB-2018-0012-0080.

[19] The full text of the Marketplace Lending Best Practices is available at http://marketplacelendingassociation.org/industry-practices/.

[20] Bipartisan Policy Center, *Main Street Matters: Ideas for Improving Small Business Financing*, (Aug. 2018), https://bipartisanpolicy.org/wp-content/uploads/2018/07/Main-Street-Matters-Ideas-for-Improving-Small-Business-Financing.pdf.

[21] Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis & San Francisco, *2016 Small Business Credit Survey*, 18 (April 2017).

[22] Alicia Robb, *Access to Capital among Young Firms, Minority-Owned Firms, Women-Owned Firms, and High-Tech Firms*, 31 (April 2013) (study commissioned by the U.S. Small Business Administration Office of Advocacy).

[23] Opportunity Fund, *Unaffordable and Unsustainable: The New Business Lending On Main Street*, 6 (May 2016), https://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf.

[24] The full text of the *Small Business Borrowers' Bill of Rights* is available at http://www.borrowersbillofrights.org/.

[25] The RBLC's federal and state policy positions are available at http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_federal_state_policy_recommendations_4-5-18.pdf.

[26] *See* RBLC comment to the Consumer Financial Protection Bureau, "Section 1071 and the Small Business Lending Market," (Sept 14, 2017), http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/final_rblc_letter_to_cfpb_on_1071.pdf.

[27] In *FTC v. Certified Merchant Services, Ltd.*, No. 4:02cv44 (E.D. Tex. 2003), the FTC brought suit against a transaction processing company for scamming merchants through unilateral modification of contracts, unauthorized charges, misrepresentations, and undisclosed fees, and in *FTC v. Liberty Supply Co.*, No. 4:15-cv-829 (E.D. Tex. 2017), the FTC was granted a preliminary injunction based on the likely harm to small businesses and organizations from unfair and deceptive marketing and sale of office supplies.