Marketplace lending 2.0
Bringing on the next stage in lending
The story is more than marketplace lending and banks

The first report that the Deloitte Center for Financial Services released on marketplace lending in March of 2016 asked essentially one question: Is the convergence between marketplace lenders (MPLs) and banks inevitable? And our response was that not only were they already converging, but that there would likely be much more bank-MPL convergence to come in the way of partnerships, joint ventures, mergers and acquisitions (M&A), and lending as a service (LaaS) (in both a branded and white labeling capacity), making disintermediation a moot point.

But 12 months later, we see a picture that is much bigger in scope than just MPL-bank convergence. Marketplace lending is an integral piece of a larger fintech puzzle that is transforming the financial services industry. At its core, what we are calling marketplace lending is simply lending that is enabled through digital platforms that mine data that are increasingly nontraditional, and streamline the loan acquisition, origination and servicing processes. We expect that asset classes such as small business, student, and unsecured consumer will move almost completely to digital platforms in the medium term, while other asset classes, such as residential mortgages and auto lending will get there more slowly. The lenders and originators will likely continue to sometimes be separate entities, sometimes the same entity, and will include a variety of types, from banks to online nonbanks to other types of fintechs to traditional technology firms, as well as various types of retail organizations and service providers, in a range of cooperative scenarios including partnering, merging, and LaaS.

Further out, we see a technology platform-enabled lending environment moving from a predictive to a prescriptive analytics stage. In developing their precision for mining, refining and using data effectively to originate loans, lenders should be able to use these data sets to offer tailored financial solutions to customers through a rich ecosystem. Lastly, to comply with any possible future regulation coming from multiple agencies and jurisdictions, MPLs are forming alliances and associations seeming to promote and establish standardization and transparency in order to get ahead of, and work with, regulators.

Figure 1. Examples of how the ecosystem continues to deepen and expand
We cannot ignore the ever-present credit cycle question

A common observation, often repeated, is that marketplace lending, in its current scale, has not yet been tested by a full credit cycle. We did see some headline-grabbing industry events in 2016, but they do not seem to have negatively impacted the industry. Instead, demand remains high with a lot of capital looking for high yield in a still low-interest rate environment. The S&P/LSTA US Leveraged Loan 100 Index showed a healthy 11.8 percent return from end-January 2016 to end-January 2017, so the credit market continues to grow. In short, a sharp downturn in the credit cycle appears unlikely in 2017, unless geopolitical or other events take an unexpected turn. That said, recent spikes in long-term US treasuries yields (the three-year pierced three percent in January), while not holding long enough to indicate where the industry is in a credit cycle, is a trend to watch. And with the Federal Reserve System (the Fed) expected to increase interest rates further, it is only natural to assume that we have possibly moved off the height of the credit cycle toward an environment of tighter margins. The macro credit data volumes and performance are not showing much to indicate this downward trend just yet.

According to the Fed, residential mortgage delinquency rates are relatively high, but they reflect a steady quarterly decline since 2010 when they exceeded 11 percent (Figure 2), and charge-offs have been negligible for some time (Figure 3). Also, unsecured consumer loan delinquencies, although inching up since 2014, are in the two percent range as are charge-offs, both moderate rates for a financial system. But while the data at this point are not showing a precipitous fall in the credit cycle in 2017, there are other signs that point to perhaps the beginning of a downward trajectory on the not-too-distant horizon.

**Figure 2: Delinquency rates (%) in the USA**

![Delinquency rates (%) in the USA](image)
The most recent annual Office of the Comptroller of the Currency (OCC) study on lending in the United States is one such sign. The survey reports banks relaxing standards for a fourth consecutive year. Predictably, the nature of looser standards has depended on the asset class. For commercial loans, relaxed standards are in pricing, guarantor requirements, and loan covenants, while in retail, lenders are reducing collateral requirements and accepting higher loan-to-value ratios along with higher debt-to-income ratios.

A loosening of underwriting standards has in turn increased the number of subprime borrowers in one asset class in particular: auto lending. Delinquencies have steadily risen in this asset class, with the securitization market driving its growth. According to the Fed, motor vehicle loans grew 7 percent year-on-year to over $1.1 trillion in third quarter 2016. While not even close to the scale of the financial crisis meltdown of nine years ago fueled by residential mortgage-backed securities (the auto lending market is substantially smaller and less systemic), large banks are involved as managers, trustees, and servicers in securitizations of subprime auto loans, so repercussions of a crash will have some degree of scale.

With regard to the residential mortgage market, a recent analysis by Deloitte’s US economics team noted that a generational rethinking of ownership in a sharing economy has homeownership on the decline. This finding supports a Federal Reserve study that looked for a student debt-homeownership correlation from 1997 to 2010 and found that a “10 percent increase in student loan debt causes a one to two percentage point drop in the homeownership rate for student loan borrowers during the first five years after exiting school.” Considering that student debt has increased by 35 percent since 2011 (through November 2016), there is reason to believe that homeownership will indeed continue to fall. While this in itself is not a harbinger of a credit-cycle downturn, the combination of that with rising home prices and housing starts, and a recent increase lately in companies entering the market, are signs that the market may be in for a type of bubble as competition increases, supply increases, and demand decreases.

Figure 3: Charge-off rates (%) in the USA
Quantifying marketplace lending

We would be remiss not to put the size of marketplace lending into perspective with the US credit market on a whole. From its beginnings in 2007, MPLs have originated about $40 billion in loans.\textsuperscript{13} Considering that the average marketplace loan is three to four years old, current outstanding credit is considerably less. Meanwhile, total outstanding unsecured consumer credit alone in the United States is $3.7 trillion.\textsuperscript{14}

That said, given its rapid growth, convergence, and expansion into different asset classes, we believe marketplace lending is worth analyzing as another credit cycle indicator. But perhaps the first hurdle to clear in putting a magnifying glass to volume and performance in marketplace lending is that the standard data aggregators upon which credit market statistics trackers depend do not identify marketplace lending as a separate category. But along with marketplace lending’s growth, companies have emerged in its ecosystem that, due to their business models as platforms for connecting MPLs and investors, have access to marketplace lending data that make a good proxy for the performance and volume of the industry as a whole.

One such company, Orchard, is fully engaged in the complex task of collecting, scrubbing, and synthesizing marketplace lending data that are far from uniformly reported across MPLs. As Figure 4 depicts, originations from a group of MPLs that account for approximately 90 percent (by Orchard’s estimation) of the MPL-originated unsecured consumer lending market have declined for three consecutive quarters, which follow years of constant, and robust, quarter-on-quarter growth.\textsuperscript{15}

Given its rapid growth, convergence, and expansion into different asset classes, marketplace lending is worth analyzing as another credit cycle indicator.

Figure 4: Marketplace lending originations by quarter ($ billions)
(Cumulative total in the USA since 2007 is $35.7 billion)
Lower originations in the second and third quarters of 2016 are likely a result of a temporary decline in funding after events in early 2016, reflecting a stronger discipline among some MPLs to deliberately manage origination and recalibrate the underwriting process. After this adjustment, we expect to see originations grow in subsequent quarters, at least in the short term.

As for charge-offs (Figure 6), at least part of the spike could possibly be explained by a lag mismatch. Since it takes a minimum of four months for a loan to charge off, the charge-off numerator is likely in this case to be mismatched to a smaller origination denominator that is not the actual vintages from which the numerator (charge-offs) came.

As noted earlier in the paper, underwriting standards in the US credit market overall appear to be loosening, and at least some MPLs may also be following this natural cycle. Admittedly, at least for now, we do not see this phenomenon happening much among the players from which the data was collected for Figures 4, 5, and 6 as they are mostly the established players that undertook the aforementioned underwriting recalibration.

But we do know that the number of MPLs in the marketplace lending space overall have increased tremendously over just the past 12 months and that underwriting rigor is being sacrificed by some players in this more competitive, crowded market. Anecdotally, we know that non-prime borrowers are being targeted more often; there are now a number of MPLs (again, not reflected in the data collected here) chasing borrowers who had been rejected by other MPLs, especially for personal unsecured installment loans aimed at consolidating credit card debt. So, yes, these market facts and the evidence of data collected showing the market is susceptible to volatility could be interpreted as a credit market that is prone to a softening like any other and could indicate that we are potentially at the cusp, albeit early, of a downward turn.

In summation, marketplace lending will most likely see performance downturn as it experiences its unique market reconciliation in the credit landscape, which we expect to include the convergence we discussed earlier, and some players falling out of the market as the macro credit cycle goes its inevitable natural route on the downward, tighter-margin, less-demand trend of a cycle. But we remain convinced that marketplace lending itself will survive and thrive as a model as the success cases continue to execute with rigor, and become ever more entwined into the lending market as a whole.
Changes in the last 12 months that hint at a maturing market

The big names in marketplace lending have raised rates in line with the Federal Funds rate while allowing tighter spreads as their costs of funding rise due to their own credit tightening policies along with an increasingly competitive market. We argue that this behavior is a sign that the industry is maturing. And we posit that the lenders who survive this trend of higher rates and tighter spreads will need some kind of combination of the following attributes: origination scale, reputation, access to balance sheets, access to hybrid investment funding, and technology that can gain efficiencies (for example, doing more with fewer employees and less capital, including, the outsourcing of servicing that is not otherwise important for the expansion of services).

Another sign of maturity is in the MPL funding model. Like large lending institutions, MPLs seem to be moving in the direction of funding that maximizes retention and lowers risk. At its inception, marketplace lending was funded predominantly through selling fractional loans to retail investors. To gain scale, the funding pendulum swung all the way to the other side and MPLs predominantly sold whole loans to private equity, hedge funds and other institutional investors, including banks. Now, the trend is to focus on a balanced hybrid funding model that includes a healthy mix of retail (which can be more “sticky”) and wholesale funding, as well as long- and short-term capital sources, including balance sheet funding and securitization. We believe that MPLs with multiple, tested, vintage portfolios will be at an advantage, especially in a less favorable credit environment, to secure this type of hybrid funding.

On the other side of the funding equation, a more conservative investor with specialization in MPL-originated loans may be becoming the norm—investors who know how and where to kick the tires. In short, the digital financing space may be becoming less of a risk play and more of a viable business model that is being taken seriously by multiple facets of the finance industry. The hedge fund investors who jumped in for the short-term high-yield portfolios including some who leveraged for more yield, have diminished. There are now more investors that have developed expertise in assessing the operations of MPLs and the performance of their loans. At a recent conference, a panel of investors that specialize in online lending platforms agreed that in addition to analyzing operations and controls remotely, it was important to go onsite to meet the staff and look at the actual facilities in which they operate. In particular, the panelists agreed that they were looking at the general operating environment and staff enthusiasm as well as for humility; that staff members know what they don’t know and respect the money they are receiving from investors and giving to customers. They also emphasized assessing an MPL’s technology prowess as much for reporting and cybersecurity capabilities as for acquisition and originations capabilities.
Not only are many investors physically meeting with lenders and evaluating them with measured, layered diligence, but they are also not shy about outsourcing some crucial due diligence to an ever-expanding marketplace ecosystem, such as market intelligence, legal and tax services. Another sign of maturity in the digital lending space is that more investors are preferring passive (buying portfolios wholesale) versus active (hand picking loans for tailored portfolios) investing in marketplace lending-originated portfolios. We believe this behavior further emphasizes the importance they place on the due diligence regarding the operations of the lenders and not just what is being originated—another trend that may facilitate more institutional investing. Meanwhile, the signs are everywhere that banks have become an integral ecosystem player in marketplace lending. Let’s remember that whether intentional or not, marketplace lending fits into a years-in-the-making effort by many banks to transform their online presence from just a service to a sales channel. As Figure 7 shows, the average MPL-originated loan size has grown, and one of the reasons for this is that banks are often becoming much more involved in putting their balance sheets into the space. Banks—such as Cross River Bank, a vocal proponent for “skin in the game” as a necessity for the future health of marketplace lending—have begun to specialize in partnerships with MPLs. Furthermore, the scenario we explored last year of a bank potentially building an MPL-like lender (online platforms leveraging technology to originate and process loans) has organically become a reality. Examples include Wells Fargo’s FastFlex for small business lending, and Marcus by Goldman Sachs for unsecured consumer lending (Figure 1).

Figure 7: Average marketplace lending loan size ($)

Source: Orchard
Expanding asset classes also portend the future

In terms of sheer volume, unsecured consumer lending (which increasingly includes student loans) still often rules the marketplace lending landscape by a wide margin, with small business an up-and-coming second, yet other asset classes are also beginning to benefit in meaningful ways.

**Small business**

On the small business front, the Fed estimates there is still unsatisfied demand to the tune of hundreds of billions of dollars and that marketplace lending has begun to make a dent by bringing renewed attention to the market that includes increased bank involvement in the sector either through their own efforts or through MPL relationships. Big banks are approving more loans, albeit still only in the 20 percent range of applications according to a monthly survey by Biz2Credit (Figure 8), but the four percent growth rate is quite significant considering they are still the largest lenders to small businesses. The uptick in bank lending is also filling demand for installment loans that enable some small businesses to move away from merchant cash advances (MCAs). Although the MCA market is not going away, the growing trend of bank incumbents becoming more engaged in tech-enabled efforts is proving that there was an unfulfilled demand for lower cost installment products.

**Residential mortgage**

Currently, only four of the top 10 mortgage lenders are banks, credit unions, or other depository institutions, compared to six in 2015 and eight in 2011. In fact, the three banks that accounted for half of all mortgage originations in 2011 now only account for 21 percent. And as one of the two largest nonbanks involved in residential mortgage originations, Quicken Loans also recently introduced an online lending channel, RocketLoans, offering personal installment loans.

---

**Figure 8: Approval rates of small business lenders (% of applications)**

<table>
<thead>
<tr>
<th></th>
<th>November 2015</th>
<th>November 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big banks</td>
<td>22.8</td>
<td>23.7</td>
</tr>
<tr>
<td>Institutional</td>
<td>62.4</td>
<td>63.3</td>
</tr>
<tr>
<td>Small banks</td>
<td>48.9</td>
<td>48.8</td>
</tr>
<tr>
<td>Credit unions</td>
<td>42.4</td>
<td>41.1</td>
</tr>
<tr>
<td>Alternative</td>
<td>60.7</td>
<td>59.2</td>
</tr>
</tbody>
</table>

Source: Biz2Credit
However, the residential mortgage process still often requires reams of antiquated legal documentation and procedures in most states, so MPLs involved directly with residential mortgages have for the most part used their digital platforms to source customers and sell the loans to the large mortgage players. But even in doing this, they have made the market more dynamic and competitive. LendingTree, for example, has heightened competition among banks and MPLs by collecting enough data for assessing a prospects’ credit worthiness to enable more competition among lenders to offer customers pre-approved mortgages that lead eventually to acquisition and origination. Most importantly, though, MPLs have begun the process of bringing digitization into an often cumbersome, multi-party business.

**Commercial real estate**
Nonbanks have been investing in the CRE market for a while. Private equity, hedge funds, REITs, and institutional lenders have created and developed a deep nonbank market, so it is only natural that marketplace lending proliferates to make processes even easier for institutional investors. They are doing this, in particular, to invest in projects on central platforms, which has come in the form of “crowdfunding models” that serve to aggregate capital to invest in real estate.

**Auto lending**
Although auto lending is an asset class that may see a rocky patch in the near future, MPLs are nonetheless focusing on aspects of it that are easily disintermediated. Namely, auto financing is still typically unnecessarily paper-based. Where retail mortgages have multiple parties (for example, bank, attorneys, inspectors, appraisers) that make documentation complex, auto financing does not—often, instead, financed through just the dealer from which the car was purchased. Given the technology-fueled disruptive innovations that have been transforming the automotive industry, such as driverless cars, ridesharing, and connected cars, financing autos through marketplace lending seems a natural step in the innovation evolution, including a dealer building its own online lending platform. These types of lending platforms, for example, could become available with a developed software or hosted service programs that dealers or dealer networks could join.
Securitization is a powerful indicator of marketplace lending’s maturation and future

A burgeoning online-originated, loan-backed securities market may be a telling indicator that marketplace lending is fast becoming a more permanent aspect of the financial services industry. Analysts who pontificated that the end of the Prosper-Citi securitization relationship was a sign that the market for marketplace lending-backed securitization was faltering have been proved wrong. The pace and depth of securitizations in the online lending space has not abated. The first securitization happened as recently as October 2013 and the first major credit agency-rated tranches as recently as January 2015. Since then, the number of securitizations and cumulative value have grown by double- and triple-digit rates of growth. As of year-end 2016, the total cumulative value was 80 percent higher than 12 months prior (Figure 9).

Figure 9: Cumulative securitizations of marketplace lending asset-backed securities ($ billions)

Source: PeerIQ: Quarterly Securitization Trackers
But more than just growing, securitization has become a viable source for further funding for marketplace lending and a catalyst for its maturing and standardizing. Regarding the latter, the percentage of marketplace-originated loans that were funded through asset-based securities (ABS) was 70 percent in 2016 versus less than 10 percent in 2014. Regarding the former, there are multiple indicators.²³

For one, although market interest rates have increased, the loans being securitized often reflect more rigorous underwriting and tighter spreads than in previous years, debunking theories that investors are only interested in online lending as a high-yield play in a low-rate market; in 2016, spreads tightened 50 percent, yet new issuance was oversubscribed.²⁴ That the securitization market already has ecosystem players, such as PeerIQ, that specialize in risk management solutions, portfolio monitoring, and loan surveillance of securitized MPL-originated loans is itself a sign that the market is expanding and maturing. As PeerIQ reports, standardized securitization issues are already becoming a norm as Marlette issued a deal from its mutual fund trust-branded shelf, Lending Club on its LCIT shelf. Upstart and Prosper are initiating their own programs, and SoFi is well along the road of successful repeat issuances, which has reduced its funding costs considerably. Lastly, in terms of market credibility, there are currently 120 marketplace lending-originated ABS.²⁵

None of this is surprising to us, as is evident in the predictions we made in the securitization discussion in our previous paper. We still expect the number of securitizations to exceed 100 in the next couple of years and to continue growing in value by double-digit percentages annually for at least the next two years after that. We continue to expect an increase in the range of investors and sponsors, and there will also likely be more bank partnerships in the loans that are securitized to meet the five-percent risk retention requirements. Lastly, we expect more third-party servicing to raise the level of investor confidence.²⁶

A secondary market in marketplace lending is quite a different story. Although a small one has grown out of the ABS market, the secondary market for online lending otherwise is still very much in its infancy, comprising a few listed funds. However, while the US Securities and Exchange Commission (SEC) is considering whether a debt instrument can be treated as a tradable security, aforementioned platform ecosystem players are busy building the connector/facilitator platforms and obtaining broker-dealer licenses that are the necessary ingredients for secondary market trading of marketplace lending loans or loan portfolios.
An industry seeking advocacy and standardization

MPLs seem to have astutely grasped that establishing a position in a sector that has historically been rife with economy-breaking transgressions requires proactive measures.

Generally, a sector or industry that self-polices and organizes advocacy mouthpieces is one that is developing for durability. MPLs seem to have astutely grasped that establishing a position in a sector that has historically been rife with economy-breaking transgressions requires proactive measures.

The marketplace lending industry’s Small Business Borrowers’ Bill of Rights was recognized for accomplishing its intent by the US Treasury in collaboration with the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Fed, the OCC, the Small Business Administration, and the SEC. They acknowledged that the Small Business Borrowers’ Bill of Rights was being appropriately proactive to “organize support from online marketplace lenders for transparent pricing and terms, non-abusive products, responsible underwriting, fair treatment from brokers, inclusive credit access, and fair collection practices …”

The two associations created after publishing our last paper are an extension of this effort: the Marketplace Lending Association (MLA) and the Innovative Lending Platform Association (ILPA). Both seem to be carefully controlling their membership, a sign that they are striving for uniformity in message regarding regulations and promoting standards and protocols, although the MLA added 12 new members recently to capture representation of more asset classes. Their challenges are to address governance, funding stability (for example, a healthy mix of institutional, retail, securitization, and long-term), economic downturn readiness (for example, well-run operations will survive, and should be able to pivot seamlessly from origination to servicing), and to promote uniform standards, protocol, and transparency. We believe that one way online lenders will likely tackle transparency issues will be to continue in the vein of using groundbreaking technology, such as blockchain, to create immutable records to minimize problems such as “stacking” [see Sidebar: Blockchain may go a long way to solving several growing marketplace lending problems].
Blockchain may go a long way to solving several growing marketplace lending problems

Marketplace lending is a natural to join the pioneer use cases for blockchain in that it: 1) is a small and focused enough market with transaction volume for a shared network; 2) comprises tech-savvy companies open to integrating new technology; and 3) comprises nimble players without the size and baggage of complex legacy systems that inhibit integrating blockchain into their core operations.

Blockchain enables near real-time transactions in a “trustless” environment on a distributed ledger that guarantees immutability and irreversibility (if you are unfamiliar with the basic tenets of blockchain, please refer to Deloitte’s thought leadership white paper on the topic). Hence, in adopting blockchain: MPLs would not have to sacrifice their competitive advantage of fast and efficient digital loan processing as the near-real-time, digital-based feature of recording blockchain transactions would mesh perfectly; the MPL would gain efficiencies and both the customer and MPL would be assured secure and tamper-proof transactions with the immutability and irreversibility features; and the distributed ledger in a trustless environment would gain efficiencies for the company by eliminating third-party operations.

One particular problem blockchain can address is “stacking,” where borrowers are approved and receive funding from an MPL and immediately afterward or simultaneously apply, are approved and receive funding from another MPL, increasing the probability of default. If a marketplace lending-originated approval to release funds were conducted on a blockchain, transactions would be recorded on a trustless, distributed ledger that prevents duplication and guarantees immutability. Yet, though the transaction in a blockchain is protected and immutable, one might argue that there could possibly be the issue that a borrower could conduct transactions under a different alias. But blockchain can also solve this problem by extending the scope of the distributed ledger to include smart contracts that point to databases with customer data. In the course of an application, a lender would have access to these data on a permissioned basis by a customer, which comes with it the knowledge of whether the customer data has been accessed by another lender.

The biggest hurdle to clear to make distributed ledger technology in lending an effective tool for marketplace lending would be cooperation—that is buy-in from enough players in the industry to participate on a networked, trustless, blockchain. It seems only natural that a technology-driven, innovative industry would be one to embrace a new, ground-breaking technology to speed transactions, reduce operational complexity, and enhance security.

A constantly evolving ecosystem seems critical to this equation of standardization, protocols, and transparency. Banks are ideal compliance providers. Shrewd investors with expertise are likely to want to use platforms and intelligence providers to perform due diligence, and third-party loan servicing is also key; while many MPLs have taken pride in using their technology know-how to service their own originations, organizations with significant scale and expertise are better adapted to service delinquent loans, and the market (that is, investors) is demanding this expertise. A third-party servicing mandate for certain securitization contracts most certainly set the precedent, but third-party servicers are becoming a commonplace factor in marketplace lending of all stripes in line with independent reviews, “hot” backup servicing arrangements, and data validation standards.
Same regulatory issues, but an OCC federal fintech charter would be a game changer

The premise of the decision *Madden v. Midland Funding, LLC*, that a lender cannot increase the interest rate of a loan that exceeds the usury cap in the borrower’s state of residence applies only in the three states that the Second Circuit Court of Appeals serves: Vermont, New York, and Connecticut.30 Hence, MPLs and banks still have the option to avoid these states or have national bank involvement include balance sheet risk.31 But MPLs are also on alert regarding loans being inhibited for importing even when made by nationally chartered banks in states without usury caps; the Maryland Court of Special Appeals ruled that a payday lender could not market loans online to Maryland residents if those loans had been generated at interest rates above Maryland’s usury caps to Maryland residents by nationally chartered banks. However, the specifics of this case are not a clear-cut worry for MPLs just yet. The payday lender, a nonbank credit servicer, did buy the loans from these banks, and Maryland had a law requiring credit servicers to be licensed in Maryland to service Maryland residents, and the case is also currently on appeal to a higher court.32

That aside, though, bank lending regulations still apply equally to any type of lender, regulations that include the Unfair, Deceptive, or Abusive Acts or Practices, Truth in Lending Act, the Fair Credit Reporting Act, Servicemembers Civil Relief Act, and Anti-Money Laundering and Know Your Customer, to name a few. Also, MPLs must comply with the same collection procedures as any other type of lender.33

The good news is that the assessment by the US Treasury, following its request for information on marketplace lending, acknowledged, with the affirmation of the Federal Reserve, the SEC, and the OCC, that marketplace lending is a welcome and legitimate means to meet both consumer and small-business credit demand that traditional banks had not been serving in the past decade and a half. Other positive developments on the regulatory horizon include the Financial Services Innovation Act, which would create fintech innovation offices in 12 different government agencies and a protection period from regulation while new products are created and tested, and the IRS Data Verification Modernization Act, which would require the IRS to reduce paperwork requirements for borrowers.34

Possibly the most positive development on the regulatory front, the OCC fintech charter, has unfortunately been put into question due to the uncertainty around how it aligns with policymakers on both sides of the aisle in Congress and with a new Republican White House. In theory, the new administration and legislative bodies are deprioritizing federal regulations in favor of state regulations, which would put the OCC charter on shaky ground. The MPL is a prime, and eager, candidate for the OCC’s proposed special-purpose federal charter, which would grant a national bank charter to a fintech that either engages either in fiduciary activities, lending, paying checks, or receiving deposits.35 With a federal charter, MPLs would have the flexibility to import interest rates from the state in which they originate their loan. In fact, without the movement to a national charter, marketplace lending stands the chance of seeing its growth as an industry seriously limited given the complexity that state-by-state regulation adds to an MPL’s operations and geographic scope. Even without the uncertainty on the policy front, the OCC is waiting on the continuing public comment period on its white paper and then further analysis, following these comments, which will result in a policy statement announcement.36

Thinking optimistically that it does come to pass, we believe that the prime qualifying MPL candidates for this charter would have scale and/or unique and solid technology platforms matched with conservative, reliable, hybrid pools of capital and the ability to operate with fairly tight spreads. Also, compliance with the Community Reinvestment Act (CRA) would favor the more established MPLs as banks have already been engaging with them to meet their CRA requirements, the Lending Club-Citi partnership being a high-profile example.37
Marketplace lending has expanded well beyond a question of MPLs converging with traditional banking. Rather, it has taken many shapes to become an integral and expanding part of the lending landscape. Marketplace lending is a prime example of how digitization is becoming integral to financial services’ meaningful market share and operating efficiencies, while meeting rising expectations for customer experience in a digital world.

Yet, as marketplace lending evolves, it is also on the cusp of transformation, again. That there was unmet consumer small loan demand is now not in question, but the “low-hanging fruit” that drove MPL growth is well understood and being served by an increasingly diverse group of MPLs and other lenders. Convergence means that banks, MPLs, other organizations, and the marketplace lending ecosystem have likely become more efficient at using technology platforms to originate loans. So now it is up to MPLs who want to retain some degree of autonomy to continue to develop and evolve within the financial services industry with a disciplined approach, including underwriting with rigor, having hybrid funding access (which can include balance sheets), and finding customer scale through tactical partnerships. But let us not forget that there is also ample market opportunity for marketplace lending that does not require scale—providing online lending as a service (LaaS) in either a branded or white labeling capacity. LaaS seems to be a sure ticket to survival, especially with a lending market that includes both small and mid-size traditional banks and credit unions that do not have the operational and/or capital capacity to develop in-house marketplace lending as well as financing arms of parent companies with core operations out of the realm of lending. Imagine the potential, for example, of linking auto-dealer financing to digital lending platforms.

So what about the downturn in the credit cycle that we predict will have an impact on marketplace lending, and won’t this affect the securitization market? Sure, a little and maybe more, for a time. But we believe that marketplace lending is not only here to stay, but will be difficult to identify as its own class as it converges and integrates and becomes a common aspect of lending. So, yes, a credit cycle would change the landscape, but its sturdier aspects, which have already changed lending for good, are expected to remain. Its players and ecosystem could deepen and expand, and securitization and secondary markets that come of it may only grow and strengthen, fueled by the successful market players.

Lastly, there seems to be tremendous opportunity for MPLs in the United States to grow exponentially by going global. Once MPLs work out data integrity kinks and obtain more clarity on regulations to which they may be subjected, it may be only natural that the success stories expand abroad and join markets that are already flowering in Europe and Australia, and growing exponentially in China.
Endnotes


2 Marketplace lending and MPL: Not too long ago, a technology platform to connect borrowers and investors was referred to as peer-to-peer lending, but this term was considered too narrow once institutional investors and other investing scenarios entered the equation. The same has now been said of the terms marketplace lending and marketplace lenders (MPLs) as online lenders that fund through balance sheets are technically not tapping a “marketplace” for funding. There is considerable debate on the subject, but in this paper, marketplace lending and marketplace lenders refer also to lenders employing an online (or other digital) lending platform while funding with their own balance sheet.


5 “Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks,” Board of Governors of the Federal Reserve System, November 18, 2016.


13 This $40 billion figure is an estimate based on rounding up the data supplied by Orchard in the last quarter depicted in figure 4 to include asset classes that are not represented in the data in figure 4.


15 “Consumer unsecured Q3 2016,” Orchard Quarterly Industry Report, December 9, 2016. Note: For the purpose of protecting the privacy of Orchard’s clients, we do cannot list the names of the MPLs from which this data was collected.


24 Ibid.

25 Ibid.

26 Ibid.


28 MLA members are Lending Club, Prosper Marketplace, Funding Circle, Able, Affirm, Avant, Commonbond, Marlette Funding, PeerStreet, Sharestates, StreetShares, and Upstart. Associate members are dv01, LendIt, and eOriginal. ILPA members are OnDeck, CAN Capital, and Kabbage.


31 Ibid.

32 Ibid.

33 Ibid.


36 Lalita Clozel, “Does the OCC really have the power to charter fintech firms?” American Banker, January 18, 2017.

37 Lalita Clozel, “How does the OCC plans to apply CRA-Like requirements to fintech firms?” American Banker, December 9, 2016.

Contacts

Industry leadership

Kenny M. Smith
Vice Chairman
US Financial Services Leader
Deloitte Consulting LLP
+1 415 783 6148
kesmith@deloitte.com

Sandeep Gupta
Partner
Deloitte & Touche LLP
New York
+1 212 436 5614
sandgupta@deloitte.com

Chris Herrmann
Partner
Deloitte & Touche LLP
San Francisco
+1 415 783 4303
cherrmann@deloitte.com

Author

Stephen Fromhart
Research Manager, Banking & Securities
Deloitte Center for Financial Services
Deloitte Services LP

Deloitte Center for Financial Services

Jim Eckenrode
Executive Director
Deloitte Center for Financial Services
Deloitte Services LP
+1 617 585 4877
jeckenrode@deloitte.com

Val Srinivas, Ph.D.
Research Leader, Banking & Securities
Deloitte Center for Financial Services
Deloitte Services LP
+1 212 436 3384
vsrinivas@deloitte.com

The Center wishes to thank the following Deloitte client service professionals for their insights and contributions to this report:

Kirby Rattenbury, Partner, Deloitte & Touche LLP
Greg Sobreiro, Director, Deloitte Consulting LLP
Douglas Zercoe, Partner, Deloitte & Touche LLP

The Center wishes to thank the following Deloitte professionals for their support and contributions to the report:

Michelle Dahl, Senior Marketing Manager, Banking & Securities, Deloitte Services LP
Lisa DeGreif Lauterbach, Financial Services Industry marketing leader, Deloitte Services LP
Erin Loucks, Lead Marketing Specialist, Deloitte Center for Financial Services, Deloitte Services LP
Seth Raskin, Manager, Deloitte Services LP
About the Center for Financial Services
The Deloitte Center for Financial Services, which supports the firm's US Financial Services practice, provides insight and research to assist senior-level decision makers within banks, capital markets firms, investment managers, insurance carriers, and real estate organizations.

The Center is staffed by a group of professionals with a wide array of in-depth industry experiences as well as cutting-edge research and analytical skills. Through our research, roundtables, and other forms of engagement, we seek to be a trusted source for relevant, timely, and reliable insights. Read recent publications and learn more about the center on Deloitte.com. For weekly actionable insights on key issues for the financial services industry, check out the Deloitte Center for Financial Services' Quick Look Blog.