

# Crowdfunding and Peer-to-Peer Lending: Legal Framework and Risks

## Peer-to-Peer Lending Meetup New York



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December 18, 2013

# Agenda

- Crowdfunding - SEC Rules are Out- now what?
- Peer-to-Peer Lending
- Your Questions Answered



# Crowdfunding After the SEC Rules Proposal



# JOBS Act Overview

*“To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.”*

- **Crowdfunding – online fundraising...but there’s a catch**
- Regulation A+ - from \$5mm to \$50 mm
- Private Placement Reforms
  - General Solicitation relaxed – effective Sept. 23
  - Enhanced verification of Accredited Investors if Soliciting
- “Go Public” Shareholder Thresholds Increased
- IPO On-Ramp and Emerging Growth Companies
- Relaxation on Research Restrictions
- Decimalization – move to \$.09 tick increments?
- Prospective Issuer Outreach
- *Signed into law April 5, 2012*

# Crowdfunding background



- **Capital**
- **Raising**
- **Online**
- **While**
- **Deterring**
- **Fraud and**
- **Unethical**
- **Non-**
- **Disclosure**
- Comprises Title III of the JOBS Act
- Originated from two perceived needs:
  - that smaller retail investors did not have access to early stage investment opportunities
  - that start-up companies did not have adequate access to available capital, particularly online capital raising
- Adds exemption from SEC registration for crowdfunding transactions in the form of new Section 4(6) of the Securities Act

# Backdrop: Current Crowdfunding Landscape – Five\* Varieties



Type	Rewards/ Donation- Based	Equity to Accredited Investors	Equity to the Public	Peer-to-Peer Lending	*Advertised Private Placements/Title II
Examples	Kickstarter, Indiegogo, RocketHub, YouCaring	FundersClub, AngelList, Ourcrowd	???	Lending Club, Prosper, Zopa (UK)	Private Placements using advertising and general solicitation
Securities Reg Status	Not sales of “securities”	Sales of securities to accredited investors	Sales of securities to the general public	Registered borrower-payment dependent notes	Exempt private placements under Rule 506(c)
Regulation	State-level antifraud only; not SEC- regulated	SEC-regulated, no- action letters protect website solicitations from being public offerings	Extensive SEC regulation; currently illegal until SEC rules are finalized	SEC-registered securities, not really crowdfunding; banking regulations, not legal in several states to borrow or invest	Extensive SEC regulation and proposed regulation; enhanced investor verification
Bad Actor Disqualification	Not applicable	Applies for all issuers and for the crowdfunding sites themselves	Not applicable under JOBS Act, but SEC has said it will apply	Not applicable	Yes

# Public Equity Crowdfunding



## Information Regarding the Use of the Crowdfunding Exemption in the JOBS Act

On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act was signed into law. The Act requires the Commission to adopt rules to implement a new exemption that will allow crowdfunding. Until then, we are reminding issuers that any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws.

- Deadline for SEC rulemaking was due December 31, 2012

# Public Crowdfunding vs. Other Exemptions



Feature	Public Crowdfunding	Regulation A+	Regulation D Rule 506 (4(a)(2))
Maximum Total Raised	\$1 million per 12 month period	\$50 million per 12 month period	Unlimited p
Number of Investors	Unlimited but subject to maximum total raised	Unrestricted p	Unlimited accredited investors; up to 35 non-accredited investors unless soliciting p
Investment Per Investor	Restricted by income/net worth	Unrestricted p	Unrestricted p
Investor Disclosure	Required, must be filed with SEC	Required, must be filed with SEC	Not required if all accredited investors; Form D filing proposed p
Intermediary Required	Yes – broker/dealer or funding portal	No p	No p
Subject to ongoing SEC reporting following raise	Yes, at least annually, possibly more frequently	Yes; at least audited financials filed annually	No p



# Public Crowdfunding vs. Other Exemptions (cont.)



Feature	Crowdfunding	Regulation A+	Regulation D Rule 506 (4(a)(2))
Disclosure Liability	Yes, full disclosure liability with a knowledge exception	Yes, full disclosure liability with a knowledge exception	Only anti-fraud liability p
Shares restricted	Yes, for one year	No p	Yes, for public companies most can sell under Rule 144 after six months
State Filing	Possibly, depends on future rules by state	No, if securities sold are listed on a national securities exchange or if sold only to “qualified investors”	Usually no if only offering to accredited investors p
Advertising and general solicitation	Not allowed	Allowed p	Allowed if sales are made only to accredited investors and issuer takes reasonable steps to verify accredited status
Can public cos., foreign issuers, investment companies and exempt inv. companies issue	No	Yes p	Yes p

# Peer-to-Peer Lending



# Peer-to-Peer Lending

- What is Peer-to-Peer Lending?
- Is it legal?
- What are the risks for borrowers, lenders?
- What is the legal status of the loans?
- Can the loans be resold?
- Is this a form of crowdfunding?
- Why aren't big banks intervening?
- Institutional vs. Retail Investors





Investors earn better returns, borrowers pay lower rates.

### Invest & Earn Solid Returns

Thousands of investors each month join Lending Club for solid returns.

Investments in Lending Club Notes can provide:

- Low volatility
- Monthly cash flow
- Solid returns

401(k) Rollovers and IRAs Available >

Projected Returns by Grade A-C of 5.11% to 9.29%\*

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### Borrow up to \$35,000\*

Fast and free to check your rate.

How much do you need?

What is it for?

How is your credit?

Respond to mail >

[Check Your Rate](#)

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**LATEST STATS:** Lending Club investors have earned **\$255,090,092** in interest since inception. | [see more >](#)

**Forbes**  
America's Most Promising Companies  
— 2011 & 2012 —

[Read more >](#)

... earned its place on an income investor's menu.



[See what others are saying about us >](#)

#### Featured Borrower

Alex  
Mountain View, CA  
Debt Consolidation  
\$11,100 at 15.99% APR

"Getting engaged forced me to make some important financial decisions, so I consolidated several sources of debt with a single loan from Lending Club."

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**2,030,000 MEMBERS.**  
**\$707,000,000 IN PERSONAL LOANS FUNDED.**

**6.73 %**  
Starting APR for best borrowers\*

- Low fixed rates
- Fast and easy online application
- No teaser rates or hidden fees
- Rates from 6.73% to 35.36% APR

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Invest money. Earn great returns. [Learn about investing](#)

### IN THE NEWS

# In Philadelphia, it's worth 50 bucks...





# What's Going On Here?

## Laptop Lending | How peer-to-peer loans work

### BORROWER

1. A would-be borrower applies online for unsecured loan of up to \$35,000.

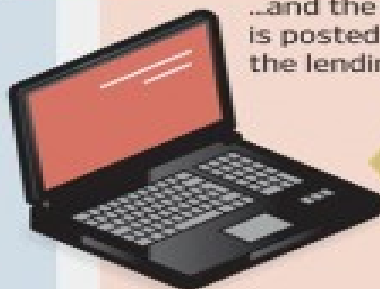


### PEER-TO-PEER PLATFORM

2. The peer-to-peer platform vets the potential borrower by checking on his or her credit history, outstanding debt, employment and bank account.

3. The approved customer is quoted an interest rate based on credit risk...

...and the loan request is posted online by the lending platform.



### INVESTORS



4. Investors can review vitals for a would-be borrower: income, credit history, size of desired loan, personal statement about reason for loan, but not borrower's name.

5. The investors can fund pieces of the loan, generally in increments of \$25.

6. The loan is issued by a bank, in an arrangement with the lending platform, and the slices sold to investors are technically securities issued by the platform.

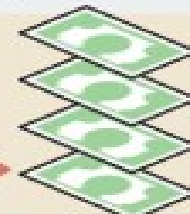


7. The lending platform charges the borrower an origination fee, calibrated according to credit risk...

...and collects a servicing fee from the lenders.



8. Loan payments from the borrower are distributed in slices to investors.



Source: Peer-to-peer lenders

Reporting by Ianthe Jeanne Dugan, graphic by Joe Shoulak/The Wall Street Journal

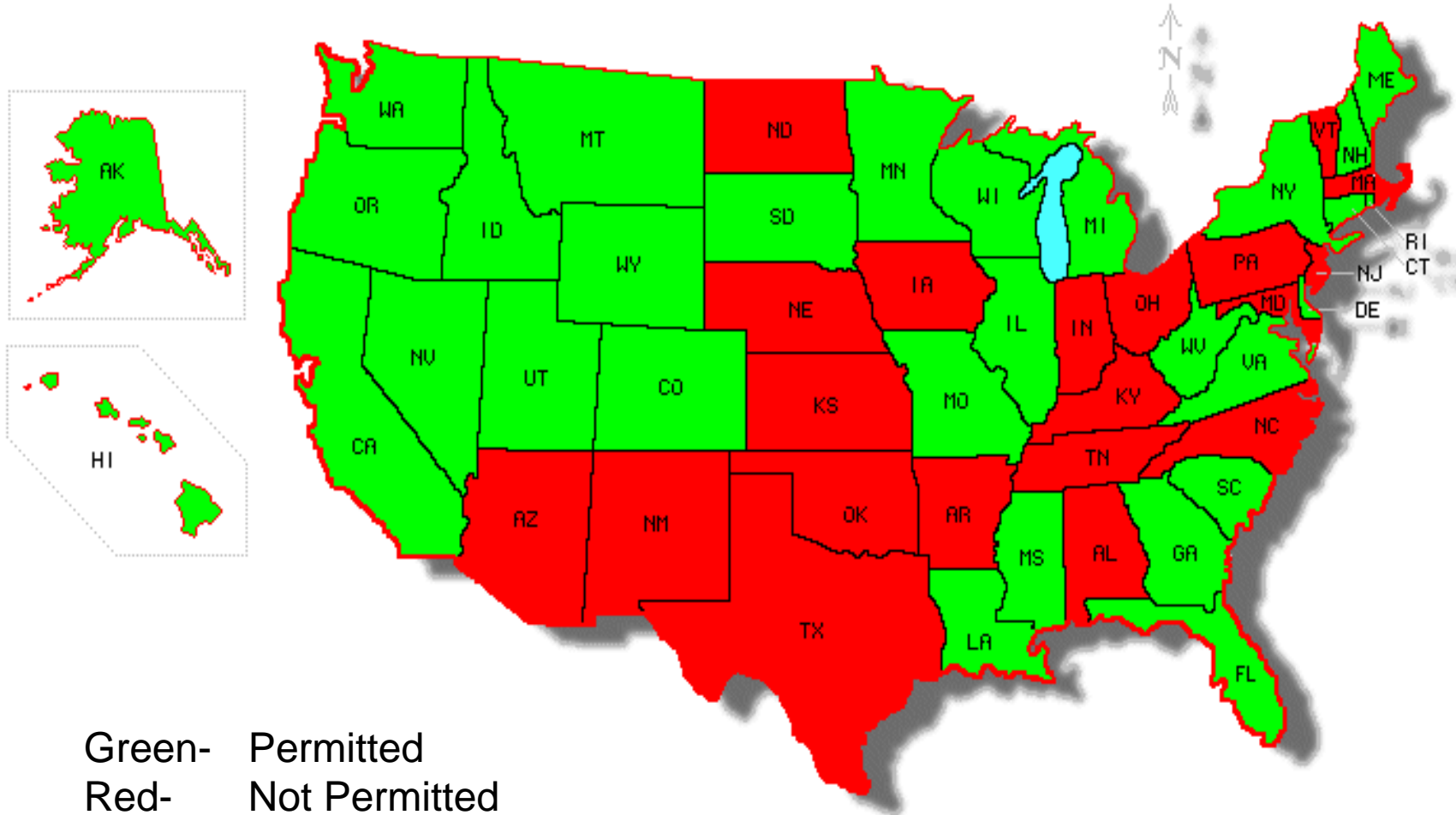
# Top Legal issues in Peer-to-Peer



- Neither LendingClub nor Prosper are banks
  - Peer-to-peer lending sites facilitate loans to consumers from WebBank, a Utah-chartered state industrial bank
  - WebBank allows interest rate to be “portable”
  - WebBank sets credit terms, extends credit and holds loan for 1 day
  - Both LC and Prosper have been in business over 5 years
    - Battles have been waged in each state to arrive at this point
  - Platforms retain servicing rights and service loan
  - \$\$ is not FDIC or SIPC insured
- Bank regulatory “lite” applies – Platforms must comply with consumer finance credit, privacy and auto-deduction laws, but.....
  - Exempt from 23A and 23B affiliate rules\*
  - Exempt from regulatory capital rules\*
  - Exempt from too big to fail, living wills, Volcker
  - Will big banks start to care at some point, and then what happens?
- Borrower may not pay and Lender cannot sue Borrower
  - Lender has limited ability compared to traditional lending
  - Limited recourse to enforce loan
  - Collection fees will exceed recovery



# States Cannot Agree on Legality



Green- Permitted  
Red- Not Permitted

# State Consequences

- Big states currently out: Texas, Ohio, Pennsylvania, New Jersey, Massachusetts
- Subject to:
  - historic positions
  - political shifts
  - bureaucratic malaise
  - idiosyncratic state banking laws
- Since platforms are not national banks, not subject to federal preemption
- New states may allow or current states may disallow
- Risk of being lumped in with payday lenders

# Securities Law Issues

- Securities regulation- Platforms issue borrower payment dependent notes through daily SEC-registered offerings
  - SEC registered offering preempts state blue sky laws
- *Reminder: SEC registered offerings are not subject to the private placement or Title III crowdfunding rules*
  - Peer-to-peer is a form of crowdsourcing but not crowdfunding
- Not Private Placements
- Not traded on an exchange
  - Limited liquidity – “lend and hold” model
  - Limited valuation authority
- Base shelf must be refreshed every 3 years, SEC registration fees paid
- Issuer bankruptcy risk (platforms), not borrowers
  - Reliant on issuer for current public information

# Example: SEC Prospectus Filed 3-4 Times Per Day

424B3 1 listing\_20131107-1650.htm

**Listing Report: Supplement No. 43 dated Nov 07, 2013 to Prospectus dated Oct 14, 2013**

File pursuant to Rule 424(b)(3)  
Registration Statement Nos. 333-179941 and 333-179941-01

**Prosper Funding LLC**  
Borrower Payment Dependent Notes

**Prosper Marketplace, Inc.**  
PMI Management Rights

This Listing Report supplements the prospectus dated Oct 14, 2013 and provides information about each loan request (referred to as a "listing") and series of Borrower Payment Dependent Notes (the "Notes") Prosper Funding LLC is currently offering. Prospective investors should read this Listing Report supplement together with the prospectus dated Oct 14, 2013 to understand the terms and conditions of the Notes and how they are offered, as well as the risks of investing in Notes. As described in the prospectus dated Oct 14, 2013, each Note will come attached with a PMI Management Right issued by Prosper Marketplace, Inc.

The following series of Notes are currently being offered:

**Borrower Payment Dependent Notes Series 990689**

The following information pertains to the borrower loan being requested, that corresponds to the series of Notes to be issued upon the funding of the borrower loan, in the event the listing receives commitments to purchase Notes in an amount that equals or exceeds the minimum amount required for the loan to fund.

Amount:	\$3,000.00	Prosper Rating:	AA	Listing Duration:	14 days
Minimum Amount to Fund:	\$2,100	Estimated loss*:	0.74%		
Term:	36 months				
Lender yield:	5.05%	Borrower rate/APR:	6.05% / 6.73%	Monthly payment:	\$91.33
Lender servicing fee:	1.00%	Effective Yield*:	5.00%		
		Estimated return*:	4.26%		

\* Estimated loss is the estimated principal loss on charge-offs. Effective yield is equal to the borrower interest rate: (a) minus the servicing fee rate, (b) minus estimated uncollected interest on charge-offs, (c) plus estimated collected late fees. Effective yield, Estimated loss and Estimated return are intended to represent the estimated average effective yield, loss and return, respectively, on a basket of loans with the same characteristics as this listing. All estimates are based on the historical performance of Prosper loans for borrowers with similar characteristics. The calculations of Effective yield, Estimated loss and Estimated return require significant assumptions about the repayment of loans, and lenders should make their own judgments with respect to the accuracy of these assumptions. Actual performance may differ from estimated performance.

**Borrower's Credit Profile**

Prosper score (1-11):	11	First credit line:	Dec-1993	Debt:Income ratio:	Self-employed (DTI Not Calculated)
FICO08 score:	760-779 (Nov-2013)	Inquiries last 6m:	1	Employment status:	Self-employed
Now delinquent:	0	Current / open credit lines:	8 / 6	Length of status:	2y 0m
Amount delinquent:	\$0	Total credit lines:	23	Occupation:	Sales - Commission
Public records last 12m / 10y:	0 / 0	Revolving credit balance:	\$3,424	Stated income:	\$25,000-\$49,999
Delinquencies in last 7y:	0	Bankcard utilization:	17%		
		Homeownership:	Yes		
Screen name:	wise-fairness-treaty	Borrower's state:	Virginia	Borrower's group:	N/A

Credit and homeownership information was obtained from borrower's credit report and reported without having been verified. Employment and income was provided by borrower and reported without having been verified.

Prosper Activity  
[Loan history](#)      [Payment history](#)      [Credit score history](#)

# Peer-to-Peer: On the horizon...



- Platforms spending big \$\$\$ to maintain and increase borrower pool
  - How long can upward trends last
  - Will big banks start to care, and if so, what happens then?
- Business loan platforms based on cash flow multiples
  - But, hard to standardize and value
- More Focus on:
  - repeat borrowers
  - whole loans
  - institutional investors using big data
  - packaging agreements (“institution will take \$x per year or pro rata amount of program”)
- Secondary market allowing liquidity and valuation marks

# Questions & Answers



# Speaker Biographies



# Brian Korn



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- Corporate and Securities practice group, based in New York
- Hands-on transaction execution and market expertise across product categories, including equity capital markets, debt capital markets, leveraged finance and private equity
- Former in-house counsel at Barclays and Citigroup investment banks
- Specialist in IPOs, the JOBS Act and SEC compliance, as well as early-stage fundraising, high yield debt and swaps/derivatives
- Media Appearances: Fox Business Television, Bloomberg, NPR, CCTV America
- Published or Quoted: *Forbes*, *CNBC*, *MSNBC*, *New York Law Journal*, *Law360*, *Philadelphia Inquirer*, *Pittsburgh Post-Gazette*, *The Financier*, *Review of Securities & Commodities Regulation*
- Seasoned 16 year securities expert and frequent speaker: PLI, NYC Bar faculty member; Speaker at national securities and crowdfunding conferences
- J.D. Northwestern University School of Law
  - Northwestern Journal of International Law & Business
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Concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940, and broker dealers and commodity futures traders and pool operators

Represents many hedge funds and other alternative investment funds in fund formation, investment and compliance matters, including compliance audits and preparation work

Writes and speaks frequently on issues involving investment management, health care and other matters and is the author of four books on hedge funds

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