

# REQUEST FOR PUBLIC COMMENT ON PROPOSED STATEMENT OF POLICY REGARDING PEER-TO-PEER LENDING

March 23, 2022

**Deadline for Public Comment: April 22, 2022**

The Corporation Finance Section (“Section”) and the Corporation Finance Policy Project Group (“Project Group”) of the North American Securities Administrators Association, Inc. (“NASAA”) seek public comment on a proposed *Statement of Policy Regarding Peer-to-Peer Lending* (the “Statement of Policy”), attached hereto as Exhibit A.

Comments on the proposed Statement of Policy should be submitted on or before the deadline above. We are only accepting comments by electronic mail. Comments should be emailed to [NASAAComments@nasaa.org](mailto:NASAAComments@nasaa.org), with a cc: to the Section Chair, Andrea Seidt ([Andrea.Seidt@com.ohio.gov](mailto:Andrea.Seidt@com.ohio.gov)), and the Project Group Chair, Jeff Soderstedt ([jsodersted@pa.gov](mailto:jsodersted@pa.gov)). All comments received in response to this request will be posted to NASAA’s website ([www.nasaa.org](http://www.nasaa.org)) without edit or redaction, though inappropriate comments will not be posted. Accordingly, please do not include any information in your comment letter that you do not wish to become publicly available. After the close of the comment period, the Section and Project Group will review all comments and consider whether to present the Statement of Policy, in its current or revised form, for potential adoption by vote of the NASAA membership.

## Background

In the early 2000s, several online platforms began to offer loans (“Lending Platforms”) through which investors could match with borrowers seeking loans and lend them money as an investment. Unlike loans to friends and relatives, Lending Platforms connected people without preexisting relationships. These online financial services are commonly known as “social lending,” “person-to-person lending,” or “peer-to-peer lending.” Peer-to-peer Lending Platforms thus allow individuals or businesses to obtain loans funded by others on the platform.

For a loan to be offered on a Lending Platform, generally the borrower must meet certain minimum credit requirements set by the platform, which may include a minimum FICO score, satisfactory debt-to-income ratios, 36 months of credit history, a limited number of credit inquiries in the previous six months, or other sureties of creditworthiness. Lending Platforms may obtain borrowers’ credit profiles from consumer reporting agencies.

If a borrower’s loan application is accepted, the Lending Platform will generally assign a risk ranking corresponding to a specific interest rate and list the loan for investment on its platform. The Lending Platform will provide information regarding the terms of the loan, including the amount, maturity date, and limited information about the borrower. Potential peer-to-peer lenders can access the Lending Platform and decide whether to invest in a loan, whether singularly or as part of a pool of investors, on the terms outlined by the platform.

As an example, some early Lending Platforms allowed several investors to invest in a single loan and used a bank to facilitate the lending. Investors could view loans on the Lending Platforms and choose to invest a portion of the money requested by the borrower. Once enough

investors with enough money, as determined by the policies set out by the Lending Platform, subscribed to invest in a loan, the facilitating bank issued a promissory note to sell to the Lending Platform. The Lending Platform took money from investors and gave the bank a security interest in those proceeds in exchange for the promissory note from the bank. The money or security interests were then placed with a trustee through a trust indenture. Acting with power of attorney for the borrowing members, the Lending Platforms executed a promissory note representing the terms of the borrower's loan with the bank and the bank sent the money for the loan to the borrowing member. If the borrower defaulted, the investors were at risk of losing their investments. Through this process, the Lending Platforms created and issued securities to the investors in the loans.<sup>1</sup>

Borrowers generally obtain loans ranging from \$1,000 to \$25,000. Such modest securities offerings may otherwise be difficult to obtain through traditional capital markets. However, these peer-to-peer investments contain significant risks and may be potentially harmful to investors. For example, without any preexisting relationship, obtaining knowledge about the borrower and his/her/its financial condition may be almost impossible and thus prevent any prospective investor from being able to make an informed investment decision. Investors are reliant on the Lending Platform to vet borrowers, facilitate loans, enforce repayment, and otherwise set and enforce the terms of the notes. Investors may be limited in their ability to seek recourse from a borrower if a loan defaults and information presented to investors may ultimately be false.

The proposed Statement of Policy seeks to address these concerns and provide a framework for registering securities issued by Lending Platforms under state securities laws.

### **Request for Comment**

The Section and the Project Group request public comment on the proposed Statement of Policy attached hereto.

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<sup>1</sup> See *In re Prosper Marketplace*, SEC Rel. No. 33-8984 (Nov. 24, 2008), available at <https://www.sec.gov/litigation/admin/2008/33-8984.pdf>.

# **EXHIBIT A**

# [PROPOSED] STATEMENT OF POLICY REGARDING PEER-TO-PEER LENDING

## I. APPLICATION AND BACKGROUND INFORMATION

This statement of policy applies to the registration and qualification of securities offerings involving peer-to-peer lending. In peer-to-peer lending, individuals or entities (borrowers) seeking loans receive their loan proceeds from other individuals (investors) in an arrangement involving a Lending Platform. A Lending Platform is an entity that utilizes an online auction type of marketplace to identify borrowers seeking loans and to facilitate the purchase of debt securities by investors. In these offerings, investors purchase debt securities which are issued in the name of the Lending Platform but depend upon the proceeds of a specific borrower loan for repayment. For the purpose of registering these securities, this statement of policy deems the Lending Platform to be the issuer of the debt securities in offerings that use the above-described structure.

While applications not conforming to the standards contained herein will be looked upon with disfavor, where sufficient justification is provided, certain guidelines may be modified or waived by the Administrator.

## II. DEFINITIONS

This statement of policy uses the following terms defined in the NASAA *Statement of Policy Regarding Corporate Securities Definitions*.

Administrator  
Affiliate  
Disclosure Document  
Independent Director  
Person  
Unsound Financial Condition

## III. REQUIREMENTS FOR LENDING PLATFORMS

- A. **Net worth.** The Lending Platform must demonstrate that it is solvent and has a tangible net worth equal to at least five percent of the face value of the outstanding loans originated on the Lending Platform; however, the Lending Platform's tangible net worth may not be less than \$250,000. The Administrator may require audited financial statements for its most recent fiscal year and, if necessary, unaudited financial statements prepared within 120 days after the date that the application is made.
- B. The Lending Platform must not be in Unsound Financial Condition.
- C. **Regulatory compliance.** The Lending Platform and/or any third-party operator subcontracting with the Lending Platform must:

1. Comply with FINRA and state registration requirements;
2. Provide a copy of articles of incorporation or other documents which indicate formation of an entity, certified by a state or jurisdiction;
3. Provide financial statements of the entity; and
4. Provide a copy of any executed agreement between the Lending Platform and the third-party operator.

**D. Annual Reports.** The Lending Platform must deliver to the investors an annual report at least annually. The annual report must include a balance sheet of the Lending Platform, a statement of income, a statement of cash flow, and material information regarding the Lending Platform's portfolio of debt securities, including cash flows, delinquency rates, and gross and net loss rates. These financial statements must be audited in accordance with generally accepted accounting principles.

**E. Experience and Knowledge.** The officers and directors of the Lending Platform must demonstrate the knowledge and experience necessary to supervise the origination, bundling, and servicing of the loans. The Lending Platform must have at least one officer and one director with at least three years of relevant banking, lending, and investment experience demonstrating the knowledge required to enforce the Lending Platform's policies and to manage its operations. In addition, at least one officer must have relevant cybersecurity, e-commerce, and technology experience required to carry out the Lending Platform's services.

**F. Independent Directors.** The Lending Platform must have a majority of Independent Directors, and at a minimum have at least two Independent Directors. The Independent Directors must review and resolve any conflicts of interest. Independent Directors shall monitor the Lending Platform's net worth, assuring reporting of loan default rates and charge-offs in accordance with Paragraph I, investigate possible conflicts of interest between the Lending Platform and investors, review affiliated transactions, and assure information required by this policy is available to investors.

**G. Indemnification.** The Lending Platform must not indemnify its officers or affiliates for any liability or loss to investors or borrowers participating on the Lending Platform due to their negligence or misconduct. Indemnification of the officers, affiliates or directors will not be allowed for any liability imposed by judgment, and costs associated therewith, including attorney's fees, arising from or out of a violation of state or federal securities laws. Indemnification will be allowed for settlements and related expenses of lawsuits alleging securities law violations, and for expenses incurred in successfully defending such lawsuits, provided that a court either: a. approves the settlement and finds that indemnification of the settlement and related costs should be made, or b. approves indemnification of litigation costs if a successful defense is made.

**H. Income Tax Information.** The platform must deliver to investors, no later than January 31 of each year, all information necessary for preparation of their federal

income tax returns, including, but not limited to, information enabling investors to report taxable income or loss from their investments or write off their investment.

- I. Verification of Material Information.** The Lending Platform must verify material information regarding borrowers. The Lending Platform must disclose in the Disclosure Document how often the platform verifies material information obtained from borrowers. This material information may include, but is not limited to, employment, stated income, other debt incurred, and debt-to-net income ratios. These procedures must be submitted to the Administrator upon request. The Lending Platform may not attempt to disclaim the accuracy of the information it presents to investors. The Lending Platform must deliver information at least annually about borrowers to investors, including any changes to previously provided information such as employment, income, and debt, and it must update that information as it changes.
- J. Delinquencies, Charge-Offs and Defaults.** The Lending Platform must report delinquencies, charge-offs, and defaults to credit reporting agencies in accordance with state, provincial, and federal laws.
- K. Collection Efforts.** The Lending Platform must engage in reasonable, good-faith efforts to collect any unpaid debt on behalf of the investor and must make every effort to recover unpaid debts and apply payments pro-rata toward borrower's, unpaid debt securities. All payments received from a borrower will be dedicated, allocated, and used solely to service the applicable debt securities until payment in full. The Lending Platform must adopt procedures to identify bankrupt borrowers.
- L. Full Recourse.** The Lending Platform must retain full recourse on the debt securities issued through its platform, in the event of default.
- M. Borrower's Credit Profile.** The Lending Platform must secure an undertaking from borrowers to provide their individual credit reports. The Lending Platform must distribute material changes to the borrower's credit information to applicable holders of the debt securities annually. The Lending Platform must also distribute changes in the borrower's individual credit score.
- N. Educational Materials.** In addition to the prospectus, the Lending Platform must provide borrowers and investors with educational materials, which may not be misleading, take measures to reduce the risk of fraud, make available information about the Lending Platform and the offering, provide communication channels to permit discussions about offerings on the platform, and facilitate the offer and sale of the debt securities. Educational materials must be submitted to the Administrator and reviewed prior to dissemination.
- O. Commingling of Funds.** The Lending Platform must not commingle funds of any investor with its own funds.
- P. Credit Enhancements.** The Lending Platform's use of credit enhancements, or the lack thereof, must be prominently disclosed in the summary section of the Disclosure

Document. These enhancements may take the form of insurance, letters of credit, lines of credit, over-collateralization, reserve accounts, guarantees, and other arrangements intended to decrease the likelihood of default.

Examiners may apply the provisions of the *NASAA Registration of Asset-Backed Securities* statement of policy regarding credit enhancements by analogy.

**Q. Secondary Markets.** If the Lending Platform provides a secondary market for resale of the debt securities, the Administrator may require the Lending Platform to disclose information about its compliance with the Securities Exchange Act of 1934, as well as demonstrate compliance with applicable state laws and regulations.

#### **IV. PUBLIC OFFERINGS OF PEER-TO-PEER LENDING DEBT SECURITIES**

**A. Trust Indenture.** Unless the Administrator permits otherwise, public offerings of debt securities covered by this statement of policy must be secured by a Trust Indenture which adequately protects the rights of the investors. At a minimum, the Trust Indenture must satisfy the following requirements:

1. The Trust Indenture must comply with the provisions of the Trust Indenture Act of 1939;
2. There must be one or more trustees under the Trust Indenture at all times;
3. The Trustee must have at least three years' relevant experience acting as a trustee for a Trust Indenture;
4. The Trust Indenture must be filed with the Administrator; and
5. The Trust Indenture must address what is deemed a default under the terms of the investor agreement.

#### **B. Disclosure Document.**

1. **Information about Peer-to-Peer Lending Arrangements.** In addition to general disclosure requirements, the Disclosure Document must disclose all material information about the following topics unique and specific to peer-to-peer lending and the Lending Platform:
  - a. Descriptive information about how the Lending Platform operates (i.e. verification procedures that will be utilized, the extent to which the loans are secured, any obligation of the Lending Platform to make payments to the investors, and any recourse by investors in the event of a defaulted loan);
  - b. Descriptive information about all material parties involved in the operation of the Lending Platform (such as the servicer and financial institutions);

- c. Descriptive information about any material events, affiliated transactions or circumstances that might be a material conflict of interest among the interests of the platform, its officers, directors or trustees, and investors;
- d. Compensation received by the Lending Platform and any other Person involved in loan administration and debt collection;
- e. Descriptive details about any material limitations on the obligations of the Lending Platform;
- f. The duties and obligations of the Lending Platform and a description of all transaction fees, servicing fees, and other charges, such as late fee charges, insufficient funds charges, check processing fees, and collection fees, and the impact on investors of the fees and charges;
- g. Descriptive information about the Trust Indenture and a statement that the Trust Indenture complies with the Trust Indenture Act of 1939;
- h. Financial suitability requirements applicable to investors funding a loan through the purchase of a debt security;
- i. Historical information regarding outstanding loans, default rates, and loan performance of the borrowers;
- j. The verification procedures, including the frequency and percentage of transactions in which transactions have been verified, used to verify the identity and financial condition of borrowers (such as the individual's credit information, income, and any bankruptcy records) and claimed use of loan proceeds with a discussion of the extent to which such information will be available to individuals bidding and committing to purchase the debt securities;
- k. A description of loan-collection procedures and methods, a description of any collection agent, and an explanation that the Lending Platform has no liability for the default of any of the loans funded through the Lending Platform;
- l. Terms of the indebtedness, including interest rates, repayment time periods, and consequences of default;
- m. The extent to which holders of the debt securities will have the ability to pursue borrowers to collect payments under the loan agreements;
- n. The extent to which holders of the debt securities will receive payments if borrowers default;
- o. A description of what constitutes a default;
- p. The extent to which the loans are secured;



- q. The extent to which the servicer can retain payments received from a borrower after the final maturity date of the debt security;
- r. The extent to which, and the methods by which, an investor may transfer debt securities;
- s. If using a third-party servicer, that the servicer is the assignee of the promissory note and the extent to which the promissory notes are obligations of the platform to the holders of the debt securities; and
- t. All servicing or origination fees and costs charged to the borrower and the investor, and how those fees and costs are calculated.

2. **Risk Disclosure and Material Information.** The Disclosure Document must describe risks and material information specific to investing in peer-to-peer debt securities, which must include but is not limited to the following:
  - a. The high-risk nature of peer-to-peer lending, including the statement that a person should not invest unless they can afford to lose their entire investment;
  - b. The lack of any guarantee that a note issued by the Lending Platform will be paid if unsecured or undersecured;
  - c. The risk that a loan payment may be refunded due to a charge-back by the borrower's financial institution and result in a negative cash balance in the account of the investor; and
  - d. Any risks and material information regarding the possible dissipation of funds prior to the issuance of loans, time limits under which funds may be held by the Lending Platform without investing them in debt securities, and whether funds may be returned to investors because loans were not fully funded.

**C. Online Disclosure.** If a Lending Platform offers securities online, the platform must disclose, at a minimum, all material information about the following topics on its website prior to the sale of investor notes related to borrower loans:

1. If the borrower is not an individual, a description of the entity, its legal status, and its corporate history;
2. If the borrower is an individual, information about the borrower; including, but not limited to, occupation and employment history for the past five years, and information about the borrower's income and monthly expenses;
3. Terms for the borrower loan, including the target amount of the loan;
4. Terms for the investor notes;

5. The borrower's required minimum monthly payment and whether early payments are permitted;
6. A description of the material terms of any indebtedness of the Lending Platform, including the amount, interest rate, maturity date, and any other material terms;
7. Disclosure of any loan and payment history of the borrower through the Lending Platform within the past three years;
8. The Lending Platform must prominently display on its website the extent to which it acts as a rating organization by scoring or grading the ability of the borrower to pay the loan and interest on the debt security;
9. The Lending Platform shall disclose what investor information is verified; and
10. Administrators may require the Lending Platform to provide additional information regarding borrowers.

**D. Subscription Agreements.** The Lending Platform and each person selling the debt securities on behalf of the Lending Platform must require the investors to complete a subscription agreement, minimally satisfying the following:

1. The Lending Platform, and each person selling the debt securities, must make reasonable efforts to determine that the purchase of the debt securities is a suitable and appropriate investment for each investor on the basis of information obtained from the prospective investor. Relevant information for determining suitability and appropriateness includes the investor's age, investment objectives, investment experience, income, net worth, financial situation, other investments of the prospective purchaser, and any other material factors;
2. The Lending Platform must maintain subscription agreements for at least six years from full repayment. The suitability standards in this policy do not relieve a broker-dealer or Lending Platform from the responsibility to make an independent determination of suitability under industry standards; and
3. The subscription agreement cannot require investors to state any of the following:
  - a. That the investor understands or comprehends the risk factors associated with the investment;
  - b. That the investment is suitable for the investor;
  - c. That the investor has read the Disclosure Document; and
  - d. That the investor has read or relied solely on the Disclosure Document or online material.

**E. Investor Agreements.** Investor agreements must describe the terms and provisions of the service agreement between the Lending Platform and the investors. The investor agreement must:

1. State the information about the borrower that the Lending Platform provides to investors and state whether that information is verified or unverified;
2. Require delivery of the borrower's financial information required in III H and L to the investor at least annually;
3. Require the Lending Platform to deliver notice of, and all material information regarding, any relevant bankruptcy filing by the borrower to the investor;
4. Require the Lending Platform to deliver notice and all material information regarding debt securities deemed worthless for tax reporting purposes under section 165 of the Internal Revenue Code;
5. Require the Lending Platform to deliver to investors an annual report at least annually. The annual report must include a balance sheet for the Lending Platform, a statement of income, a statement of cash flow, and material information regarding the Lending Platform's portfolio of debt securities, including cash flows, delinquency rates, and gross and net loss rates. These financial statements must be prepared in accordance with generally accepted accounting principles and audited in accordance with generally accepted auditing standards;
6. Require the Lending Platform to deliver to the investor, no later than January 31 of each year, all information necessary for preparation of their federal income tax returns, including, but not limited to, information enabling investors to report taxable income from their investments, or write off their investment when repayment of the note is no longer anticipated because of a bankruptcy, and information regarding original discount rules in order to allow investors to determine whether continued accrual of the original issue discount as income is applicable; and
7. Require the Lending Platform to disclose all servicing or origination fees or costs charged to the borrower and the investor, and how those fees or costs are calculated.

**F. Investor Qualifications.**

1. Total sales to an investor in a Lending Platform shall not exceed:
  - a. The greater of \$2,200 or 5 percent of the lesser of the investor's annual income or net worth if either the investor's annual income or net worth is less than \$110,000; or

- b. 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of \$110,000, if both the investor's annual income and net worth are equal to or more than \$110,000.
2. The risks to individual investors of non-pooled investments are greater than the risk of pooled investments. In most current peer-to-peer lending offerings, lending members pick specific loan investments from specific investors unknown to them. Their investment risk is tied specifically to the loans selected. In addition to the above, Administrators may require Lending Platforms establish a minimum number of loans per investor or pooling/bundling to spread the risk of delinquencies, charge-offs and loan defaults among all investors in the offering. In that event, the Administrator may apply the provisions of the NASAA Registration of Asset-Backed Securities statement of policy regarding portfolio characteristics by analogy.

**G. Disclosure and Marketing.** Sales material, including without limitation internet and social media advertisements, as well as any mobile applications, used in the offer and sales of notes, must conform to filing, disclosure, and adequacy requirements under applicable state regulations. Statements made in sales material may not conflict with, or modify, risk factors or other statements made in the Disclosure Document.