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Highlights

Highlights of GAO-11-613, a report to congressional committees

July 2011

PERSON-TO-PERSON LENDING

New Regulatory Challenges Could Emerge as the Industry Grows

Why GAO Did This Study

Over the last decade, Internet-based platforms have emerged that allow individuals to lend money to other individuals in what has become known as person-to-person lending. These online platforms present a new source of credit for borrowers and a potential investment opportunity for those with capital to lend. Both for-profit and nonprofit options exist, allowing for income-generating and philanthropic lending to a variety of people and groups around the world. The Dodd-Frank Wall Street Reform and Consumer Protection Act directed GAO to conduct a study of person-to-person lending. This report addresses (1) how the major person-to-person lending platforms operate and how lenders and borrowers use them; (2) the key benefits and risks to borrowers and lenders and the current system for overseeing these risks; and (3) the advantages and disadvantages of the current and alternative regulatory approaches.

To do this work, GAO reviewed relevant literature, analyzed regulatory proceedings and filings, and interviewed federal and state officials and representatives of the three major person-to-person lending platforms currently operating in the United States. GAO assessed options for regulating person-to-person lending using a framework previously developed for evaluating proposals for financial regulatory reform.

The Bureau of Consumer Financial Protection, Federal Deposit Insurance Corporation, and Securities and Exchange Commission provided written comments on the report, and they all noted the need to continue to monitor the development of the industry.

View GAO-11-613 or key components.
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What GAO Found

The three major U.S. person-to-person lending platforms facilitate lending by allowing individuals acting as lenders to invest in loans to individual borrowers. Prosper Marketplace, Inc. (Prosper) and LendingClub Corporation (LendingClub), the two major for-profit platforms, screen and rate the creditworthiness of potential borrowers. Individual lenders (and a growing number of institutional investors) browse the approved loan requests on the companies' Web sites and purchase notes issued by the company that correspond to their selections. Kiva Microfunds (Kiva), the major nonprofit platform, allows individual lenders to indirectly fund loans to entrepreneurs around the world by funding interest-free loans to microfinance institutions. The three platforms have grown rapidly and, as of March 2011, Prosper and LendingClub had made about 63,000 loans totaling approximately $475 million, and Kiva about 273,000 loans totaling about $200 million. The for-profit companies said that borrowers were often consolidating or paying off debts or were seeking alternate sources of credit, while lenders were seeking attractive returns. Kiva said that its lenders were not seeking to generate income and were motivated mostly by charitable interests.

Person-to-person lending platforms offer lenders the potential to earn higher returns than traditional savings vehicles and may offer borrowers broader access to credit. Individual lenders and borrowers face risks that are currently overseen by a complex regulatory structure. For example, lenders risk losing their principal and, on the for-profit platforms, the interest on their investments. Borrowers face risks typical of consumer lending, such as unfair lending and collection practices. Currently, the Securities and Exchange Commission and state securities regulators enforce lender protections, mostly through required disclosures. The Federal Deposit Insurance Corporation and state regulators enforce protections for borrowers on the major for-profit platforms, and the newly formed Bureau of Consumer Financial Protection will also play a role in borrower protection as it becomes operational. The Internal Revenue Service and the California attorney general enforce reporting and other requirements for Kiva as a charitable organization. Kiva's microfinance institution partners are subject to varying consumer financial protection requirements that apply where they lend.

The two options that GAO identified for regulating person-to-person lending—maintaining the status quo or consolidating borrower and lender protections under a single federal regulator—both offer advantages and disadvantages. The current system offers protections that are consistent with those for traditional borrowers and investors. Some industry observers suggested that protecting lenders through securities regulation under this system lacked flexibility and imposed inefficient burdens on firms. Under a consolidated regulatory approach, current protections for borrowers would likely continue and, depending on how implemented, lender protections could be expanded. But uncertainty exists about shifting to a new regulatory regime and about the potential benefits. Finally, regardless of the option selected, new regulatory challenges could emerge as the industry continues to evolve or if it were to grow dramatically, particularly if that growth was primarily due to the increased participation of institutional versus individual investors.