

Securities Regulators warn investors about peer-to-peer internet lending

State securities regulators are warning investors to be careful about peer-to-peer lending over the Internet, a trend that they say is on the rise as conventional loans have become scarcer and more costly.

Online loan “matchmaking,” also called social lending or P2P, makes loans available to individuals and small businesses, and offers investors above-average returns on their money. By 2013, \$5 billion will have been loaned through P2P sources around the world, according to research firm Gartner Inc. That's a 260% jump from about \$1.5 billion through January 2010 and an enormous advance from \$500 million in 2007.

Still, the process doesn't always work the way it is supposed to, said **David Massey, president of the North American Securities Administrators Association Inc.**, which has issued an alert to investors about P2P lending. In Nevada, regulators have found instances in which a peer-to-peer lender didn't register its products, and also had cases in which some lending schemes were “criminal scams,” **Nevada securities administrator Carolyn Ellsworth** said.

Investors should get the background and licensing information about P2P intermediaries from securities, banking and insurance regulators in their state, said Mr. Massey, who is the deputy securities administrator in North Carolina. “If the enterprise is soliciting capital from the public, it's probably going to go into the investment in some form of a security,” he said. “It's a good practice to see whether the securities were registered or whether the firm has a record with somebody — although they could still be stealing from you,” Ms. Ellsworth said.

These loans are expensive, with the borrower paying more according to how risky the loan is, Ms. Ellsworth said. Even the lender usually pays a 1% service fee, she said. Much of the information in NASAA's alert is "good, sensible advice" that can help investors make sure that they understand the risks associated with peer-to-peer lending, said Lending Club's founder and chief executive, Renaud Laplanche.

The biggest risk is that borrowers will default on their loans. ... The reward of peer-to-peer lending is that investors "invest directly in the loans made to consumers, so they get the opportunity to gain the spread that the banks typically make," Mr. Laplanche said. ... When problems arise with P2P loans, it is often due to the fact that an intermediary handles the transactions, Mr. Massey said. "With these cases, the borrower and the lender never have direct contact," he said. The lender doesn't even know the identity of the borrower. Therefore, it may be impossible to verify independently any financial or business information that the borrower may have provided. ...

Regulation of "this emerging business model" is murky, Mr. Massey said. In fact, the Dodd-Frank Act mandated a one-year study of the regulatory framework for peer-to-peer lending by the General Accounting Office. That study is due in July, GAO spokesman Charles Young said. Mr. Laplanche said that any additional regulation that leads to more consumer protection and transparency "would be welcome."

(Investment News, 10 January 2011)