

Are you an informed investor?

PEER-TO-PEER LENDING

What is Peer-to-Peer (P2P) Lending?

Peer-to-peer lending is an emerging online financial service also known as social lending, person-to-person lending or P2P. Peer-to-peer lending allows individuals and small businesses to obtain unsecured loans that are funded by other persons. A fundamental component of peer-to-peer lending is the use of the Internet as a marketplace. In other words, peer-to-peer lending involves loan “matchmaking” on the Internet.

The current economic downturn has caused financial institutions to become increasingly cautious about making loans. Through the online borrowing and lending practice of peer-to-peer lending, borrowers generally obtain loans ranging from \$1,000 to \$25,000 that would otherwise be difficult or costly to obtain from traditional banks, while lenders fund such loans based on the promise of a capital return.

Who is the borrower? The borrower typically is an individual or small business that posts a loan request with a brief narrative describing the anticipated use of the loaned funds. Monthly payments are taken from the borrower’s bank account and, directly or indirectly, transferred to the lenders’ accounts. Borrowers may request loans for both business and personal use.

Who is the lender? The lender is an investor who seeks out a peer-to-peer lending business or “platform.” Lenders review loan listings and choose specific borrower postings to bid on and fund. The lender receives a note evidencing his/her investment. Several lenders may fund one loan, resulting in several promissory notes.

Who is the “loan matchmaker”? Peer-to-peer lending websites, also called platforms, connect borrowers with lenders. Typically, platforms issue notes, directly or indirectly, to the lenders, often making the platform the conduit, lender and issuer of the note. Many of these notes are securities, subject to federal and state registration requirements.

Is Peer-to-Peer Lending the Right Investment for You?

It is difficult to generalize the risks, since each transaction structure differs significantly from platform to platform. However, here are some of the potential risks and factors to think about before becoming a peer-to-peer investor:

1. The peer-to-peer lending business model is still in its infancy and some platform operators may be unseasoned businesses. Some peer-to-peer platforms issue securities to investors, and therefore may be subject to federal and state registration requirements. Some peer-to-peer platforms are not authorized to conduct business in certain jurisdictions. It is always a good idea to check with your state securities regulator. To find your state’s securities regulator, visit the website of the North American Securities Administrators Association at www.nasaa.org.

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2. Loans are unsecured. Investors are dependent on the borrower to repay the loan. Investors may have no legal ability to pursue the borrower in the event the borrower fails to pay. Furthermore, the identity of the borrower is often not available to the lender. If collection efforts are pursued by the website provider or some other third party, payments after maturity may be retained by the website platform. Collection expenses may reduce the entire amount available to the lender. A borrower may also seek bankruptcy protection, which may result in the discharge of any or all amounts owed.
3. Limited verification of borrower financial data is performed. The platform may not do a thorough check of the borrower's credit information, income, bankruptcy records or claimed plans for the loaned funds. Borrower expenses may be misrepresented or intentionally omitted by the borrower. Borrowers may incur additional secured and unsecured debts without any restriction. Borrowers may lose income, become unemployed or incur additional expenses. The health and life expectancy of borrowers is uncertain.
4. Notes are not FDIC-insured, nor are they guaranteed by any federal or state agency.
5. Default rates on peer-to-peer loans may be unusually high, exceeding 25 percent on some platforms. In some instances, there may well be very good reasons why a bank would not fund a given loan or portfolios of loans.

Who Regulates Peer-to-Peer Lending?

Peer-to-peer lenders make consumer loans and often issue securities. Accordingly, peer-to-peer operators may be regulated by:

- The U.S. Securities and Exchange Commission (SEC)
- State securities regulators
- State banking regulators

Protect Yourself

Be skeptical of investment opportunities you learn about through the Internet. When you see an offering on the Internet - whether it is on a company's website, in an online newsletter, on a message board or in a chat room - you should assume it is a scam until you've done your homework and proven otherwise.

- Get the facts and verify any information provided to you.
- Only invest money you can afford to lose.

When considering any investment, protect yourself from fraud by contacting your state securities regulator. State securities regulators can provide background and licensing information on investment promoters and tell you if the investment is registered for sale in your state. One simple phone call to your state securities regulator could help you spot the red flags of fraud and avoid losing your money on a scam.

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