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Lending Club

Lending Club CEO Renaud Laplanche and his team ended the conference call with their securities lawyers. It was January of 2008 and Laplanche and COO John Donovan had been engaged in conversations with their lawyers for several months, exploring whether or not the lending model they were using involved an offer of securities. Based in Sunnyvale, CA, Lending Club was a relatively new entrant in the nascent peer-to-peer (P2P) lending industry, where people would borrow and lend money to each other online. Individuals who wished to borrow money would apply for what was essentially a personal loan and be matched up with individuals willing to lend money to them, in what was sometimes referred to as the "eBay of loans".[a]

While the SEC had yet to take a position regarding whether or not the loans were to be considered securities, there was a real chance that the lending was about to get more complex. Until now, Lending Club had relied on *promissory notes* as the instruments through which their lender members would lend money, in fractional shares, to borrowers.[1] These notes were the legal embodiment of the promises by the borrower. But without a secondary market in which to trade the promissory notes, lender members had to hold them until the three-year loan period ended or until the loans were paid off. According to Director of Product Strategy, Rob Garcia, this lack of liquidity was one of the top three reasons why lender members refrained from committing larger sums of money on existing P2P Lending platforms, and kept potential lenders from signing up in the first place. Indeed, it was Lending Club's hope that they could improve on this model by establishing a secondary trading market for the notes that had brought about their discussions with the SEC. A larger issue soon emerged: if the SEC determined that Lending Club was not just facilitating and servicing loans (via promissory notes) but was issuing *securities*, Lending Club would be required to adjust their business model and undergo a lengthy S-1 registration process with the SEC in order to continue lending.[2] Laplanche, who also was a lawyer, was skeptical that the promissory notes were

[1] Promissory notes are unconditional promises to repay borrowed funds and define the terms under which repayment happens. The payee (i.e., lending entity) holds the note, signed by the borrower, as proof of the money owed and repayment terms.

[2] The securities registration process requires submission of the SEC S-1 form for "registration under the Securities Act of 1933 ("Securities Act") of securities of all registrants for which no other form is authorized or prescribed." http://www.sec.gov/about/forms/forms-1.pdf (accessed January 2010)

Professor Peter Tufano, Harvard Law Professor Howell Jackson, and Research Associate Andrea Ryan prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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indeed securities in the first place. Ultimately, however, it would be the SEC's judgment that would matter, not only to Lending Club, but to the entire peer lending industry going forward.

While there had yet to be a clear indication of how the SEC would ultimately rule, there was reason to suspect that things would not go smoothly. Their main competitor in the growing P2P lending space, Prosper Marketplace, Inc., made a preliminary S-1 filing on October 30, 2007. In Prosper's attempt to establish a secondary market for their notes, Prosper's filing included no reference to whether or not the original notes were securities. They positioned the notes as securities only when traded on the secondary market.[3]

Since Prosper hadn't completed their initial filing with the SEC, Laplanche and Donovan believed that "something wasn't going well" with the filing. Furthermore, they believed that Prosper would likely take the position that the promissory notes were not securities and therefore did not require SEC approval. But Laplanche thought that the probability of the SEC determining that Lending Club's promissory notes would need to be registered was about 50/50. The Lending Club team had two choices: propose a new lending model that treated the loans as securities or wait and see what would happen. If they were to file, they anticipated it would cost them roughly $5 million in legal and other costs, with no guarantee of SEC approval. (**See Exhibit 1 for Lending Club financials**). If they were to wait and see, they might ultimately be forced to either register or shut down. In doing so, they could face fines, which could be in the millions of dollars, on top of their registration costs.[b] But there was one other angle to consider. If they decided to file, and were the first P2P lenders to be seriously considered by the SEC, they would be better positioned to help shape the registration process itself (and therefore the development of a newly regulated peer lending space). Were they the first approved, they would no longer be a second mover in the space, giving them ample advantage to shape and evolve their product strategy and overall growth.

Laplanche turned and looked intently at his team. In the past six months they had received a lot of advice—from their lawyers and from friends in the securities industry. The team already had crafted a plan that he thought might work should they decide to register, but it offered no guarantee of either SEC approval or a successful repositioning of their new business. While the decision wasn't an easy one as there were myriad regulatory, strategic, and financial angles to consider, it was nonetheless time to make it.

Early Stages of Lending Club

French-born Laplanche was used to taking calculated risks. A French sailing champion, Laplanche earned an MBA from Paris-based HEC and London Business School and JD from Montpellier University. He practiced law, and had been a Senior Associate at New York law firm Cleary Gottlieb Steen & Hamilton. In 1999, Laplanche founded TripleHop Technologies, a developer of context-search, retrieval, and classification software solutions, most notably its flagship product, MatchPoint. He sold TripleHop to Oracle in 2005 where he served as VP until 2006, when he left to start Lending Club.

[3] As competitors in the new P2P lending space, Lending Club and Prosper had consulted with one another on fraud, risk and ID theft related issues, but not on regulatory and legal matters.

It was his early experience with TripleHop that had informed his idea for Lending Club. To get TripleHop going, Laplanche had spent $20,000 in three months by borrowing from credit cards. He soon realized that although his credit was good, he was paying an 18% annual percentage rate (APR)—a rate far higher than he thought appropriate. Sharing his frustration with his friends, he found that they would loan him the money for only 10%. This experience suggested that direct peer lending could benefit both borrowers (paying lower interest rates than through traditional lending channels) and lenders (earning higher interest rates than through traditional savings or investment products).

His emerging ideas of peer lending become Lending Club's two founding principles. First, he thought that people pay high interest rates on loans because they don't have time to shop around for better rates. Second, technology can be used to match borrowers and lenders, leveraging social networks and online communities to foster trust on the lender side and responsibility on the borrower side.[c] Laplanche saw the potential for growing the idea into a profitable business, and started putting a team together in the fall of 2006.

The Lending Club concept was evolving when he hired his first four employees in January 2007. First was Sidney Chen, an experienced banker with 13 years of experience in credit and risk management at GE Capital and other major firms. He would help Laplanche shape the lending platform and later become Director of Platform Management. Laplanche then connected with John Donovan. Donovan had spent 15 years managing product development for MasterCard International, working on projects such as building a platform for global marketing and bringing debit cards online. Donovan was living in Connecticut after a number of years overseas. Laplanche was determined to bring him on board, surprising Donovan by flying from California to Connecticut just to make his pitch over breakfast. Soon after, Donovan became the second employee and COO of Lending Club, and began his routine red-eye flights between his Connecticut home and Lending Club's Sunnyvale, CA headquarters.

Laplanche then brought on Soul Htite to build the Lending Club platform. Soon to become the VP of Technology, Htite had a wealth of experience building scalable and robust systems at Oracle. Lastly, Laplanche hired Garcia, an experienced web-product consultant and user-experience expert, who had built innovative e-commerce and web-based product experiences for more than 10 years at Razorfish. It was up to Laplanche, Chen, Donovan, Htite, and Garcia, to build and implement a new lending model in the $13 trillion consumer lending industry.

By May, the core team of five men not only had fleshed out the initial concept for their online P2P business, where people would sign on to request loans and others would lend it to them, but also had the platform running and handling loans. Lending Club closed on its first loan on June 6, 2007 and passed the $250,000 only one month later.[d] In August, they raised $10.3 million in Series A financing and opened its website to the general public. . By December 2007, they had finalized their partnership arrangement with WebBank, a Utah-chartered FDIC insured, Industrial Bank which would serve as

the lender and assign the loans (without recourse) to Lending Club at closing. [4] This arrangement would allow Lending Club to expand nationwide under the WebBank charter.

Personal Lending

As of December 2006, consumer liabilities outstanding in the U.S. were over $13 trillion, with $2.4 trillion in consumer credit and $9.9 trillion in home mortgages.[5] Personal or "signature" loans—loans which are "unsecured" or require no collateral—comprised roughly 3% of consumer credit outstanding, or $720 million.[6] These fixed-amount installment or "closed end" loans with amortized monthly payments were most commonly originated through credit unions (non-profit, member-focused financial institutions that commonly offered lower-rate and moderate-income consumer targeted products), community banks (with specific community-serving charters), and consumer lending divisions of larger banks and finance companies. Loans typically were available in amounts of between $1,000 and $20,000, although some institutions offered personal loans up to $50,000 and some credit unions made them for as little as $500. [e]

However, since the 1980s, personal loans had comprised an increasingly small share of the consumer credit market, as consumers relied more heavily on credit cards.[f] In 2006, the average credit card APR was15.09%.[g] Unlike personal loans, credit cards provided nearly instant access to credit and allowed consumers either to charge a purchase directly or to take cash advances from an automated teller. Furthermore, fewer institutions offered personal loans. According to *The American Banker*, "Most banks [left] small personal loans to pawnshops and payday lenders...."[7] institutions sometimes called "alternative financial services." The standard borrowing rate for payday lenders was $15-$20 per $100 borrowed for a two week loan, or a minimum of 390% on an annualized APR basis, depending on whether or not the borrower took the entire two weeks to repay.[8]

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[4] An industrial bank, or industrial loan company (ILC) was unlike other banks in that it could be owned and controlled by non-financial institutions. As such, industrial banks were exempt from the Bank Holding Company Act of 1956, which allowed them to operate under fewer regulatory restrictions. These state-charted institutions were insured by the Federal Deposit Insurance Corporation (FDIC), and had the ability to establish branches nationwide. http://www.bricker.com/Publications/articles/1054.asp (accessed January 2010). See also Ergungor, O. Emre and James B. Thomson, "Industrial Loan Companies", Economic Commentary, Federal Reserve Bank of Cleveland, October 1, 2006. http://www.clevelandfed.org/research/Commentary/2006/1001.pdf (accessed January 2010).

[5] The total figure represents all financial liabilities of households and nonprofits as of December 2006. Consumer credit includes credit cards as well as other consumer loans (auto, personal). Federal Reserve Flow of Funds, z.1 release, 3/12/09, Table L.100, http://www.federalreserve.gov/releases/z1/Current/z1r-4.pdf (accessed December 2009).

[6] In 2004, personal loans comprised approximately 2.7% of all consumer debt. Bucks, Brian K., Arthur B. Kennickell, and Kevin B. Moore. 2006. "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances."*Federal Reserve Bulletin* 92, pp. A1-A38.

[7] Ben Jackson, "Short-term Lending: Promise, Peril, and Politics," *American Banker* (March 2003): 42. Pawn shops and payday lenders are considered "alternative financial services" and are usually concentrated in low-income communities.

[8] If a borrower paid the loan off before the end of the two week period, the effective APR could climb to over 1000%. Edward C. Lawrence and Gregory Elliehousen, "A Comparative Analysis of Payday Loan Customers," *Contemporary Economic Policy* (April 2008): 26:2.

An Emerging Credit Market: Peer-to-Peer Lending

Banks, credit unions, and alternative financial service providers weren't the only ones lending money to consumers. A 2006 report by the Federal Reserve found that more than 8% of households had outstanding loans with family and friends.[h] Leveraging this long-standing practice, two categories of lending models emerged. The first was CircleLending, which launched in 2001 and became Virgin Money U.S. in 2007. The founders' business concept was based on the belief that informal transactions between family and friends often were difficult in a variety of ways—financially, administratively, and personally.[i] To facilitate smoother transactions among family members and friends, Virgin Money managed the loan and repayment process for borrower/lender pairs who came to them ready to prepare and close on a loan.[j] As of January 2008, Virgin Money had serviced over $200 million in loans and had a default rate of 5%.[k]

Other models, instead of building on existing relationships between people, harnessed the internet to create an online community connecting individuals who were seeking loans with individuals who were willing to lend money. This social lending model was called peer-to-peer (P2P), person-to-person, or simply peer lending.

The first online P2P lender was Zopa, which launched in the UK in 2005.[9] In 2006, Prosper launched the first P2P site in the U.S., followed by Lending Club in early 2007.[l] Zopa also launched its U.S. site (Zopa USA) in December of 2007.[m] Each company operated under a slightly different model. In the Prosper model, prospective borrowers would post how much they wished to borrow along with the highest interest rate they were willing to accept. Lenders would review borrowers' profiles and bid on the loans by reducing the interest rate until it hit the lowest point the lender could accept.[n] This "auction-style" model was very different from the Zopa USA "depository" model. Zopa USA worked with partner credit unions that would take in lenders' capital to fund federally-insured certificates of deposits (CDs). In turn, the credit unions would provide low-rate personal loans to Zopa USA borrowers.

In some ways, Lending Club's model reflected elements of both Prosper's and Zopa's. Like Prosper's model, lenders funded specific borrower loans. However, like Zopa, interest rates on loans were determined centrally, not by an auction between borrowers and lenders. As described below, Lending Club set rates based on a review of borrowers' credit histories.

P2P lenders made their money from either flat or percentage-based fees that the borrower and/or lender would pay for the service. Virgin Money, operating under a slightly different model, charged a flat rate of $150 per loan. Zopa, Prosper, and Lending Club fees were percentage-based. (**See Exhibit 2 for details on fees**). According to Celent, a research firm, in 2007 the P2P and social lending was estimated to have made roughly $600 million in loans and was projected to total as much as $5.8 billion by 2010.[o] Prosper was the leader in the space. As of December 2007, Prosper had

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[9] http://uk.zopa.com/ZopaWeb/public/help/help-faqs-interested.html#around (accessed January 2010). Also, in October of 2005, Kiva, a nonprofit organization that enabled "individuals to make personal loans to microenterprises in developing countries" launched its website. The model, however, was different from other peer lenders in that it merged philanthropy and microlending. http://www.kiva.org/about/release_20051012 (accessed January 2010).

530,000 members (i.e., individuals who had registered on the website and agreed to the Terms of Use).[p] Lending Club had 20,000 members.[q] Between their inception in May of 2005 and December 2007, Prosper originated a total of 17,385 loans, in the amount of $109 million, and as of December had nearly 13,000 loans in active repayment.[10] (**See Exhibit 3 for Prosper default rates**). Between the time of their first loan in June 2007 and December 2007, Lending Club originated 603 loans, totaling $4.79 million, nearly all of which were in active repayment.[11] During that same time period, Prosper originated 6,104 loans, totaling $43.6 million.

Although projections painted P2P lending as a rapidly growing niche in the consumer credit market, the financial industry as a whole had been facing rather serious difficulty as a result of the mortgage market. First, homeowners had been taking the opportunity to leverage the equity in their homes as a result of rising home prices by taking out increasing numbers of home equity credit lines and home equity loans. As of December 2007, there were $1.13 trillion in home equity lines and loans outstanding, a compound annual growth rate (CAGR) of 12% since 2000. [r]

Second, subprime lending, or lending to higher-risk borrowers with weaker credit histories, had become increasingly common in the 1990s.[12] Newer, more flexible terms became available as well, including adjustable rate mortgages, which had interest rates that would start out low and increase over time, "resetting" typically after two or three years. Many of these loans were bundled into investment products (i.e., securitized) and then divided into pieces (i.e., tranches). In late 2007, major corporations such as Citigroup, Merrill Lynch, and Morgan Stanley announced losses and write downs in the billions on their subprime-related investments.[s] The federal government began to put plans together to ameliorate some of the difficulties homeowners were having. In December of 2007, President Bush and Treasury Secretary Paulson announced a foreclosure relief plan targeted to the approximately 1.2 million Americans who would be unable to make mortgage payments when the interest rates on their adjustable-rate mortgages reset.[t] (**Exhibit 4 provides more details on the state of the credit markets.**)

Lending Club's Approach

LC's business model was intentionally different from Prosper's and Zopa's schemes. According to Laplanche, Prosper's auction model was built on the idea of a somewhat "utopian marketplace"

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[10] www.prosper.com (accessed December 2009). Prosper also was named one of the top 50 best websites for 2007 http://www.time.com/time/specials/2007/article/0,28804,1633488_1633594_1633570,00.html, (accessed December 2009).

[11] One loan was 16-30 days late, and three loans were 31-120 days late. Lending Club default rates varied according to the assigned loan grade. The median default rate was 2.21%.

[12] According to Souphala Chomsisengphet and Anthony Pennington-Cross, "The Evolution of the Subprime Mortgage Market," Federal Reserve Bank of St. Louis, January/February 2006, p. 1, "Subprime lending introduced a substantial amount of risk-based pricing into the mortgage market by creating a myriad of prices and product choices largely determined by borrower credit history (mortgage and rental payments, foreclosures and bankruptcies, and overall credit scores) and down payment requirements." While it offered benefits in terms of increasing access to homeownership for less qualified borrowers, the risks were higher because those with poor credit histories are more likely to default. Subprime interest rates were higher to reflect this increased risk. http://research.stlouisfed.org/publications/review/06/01/ChomPennCross.pdf (accessed December 2009).

where prospective lenders would know how to price a loan given the risk the borrower presented, and prospective borrowers would still receive a fair rate. They anticipated, however, that potential lenders would be uncomfortable assessing credit risk. He saw Zopa's model as essentially a "sign-up sheet" for anyone who wanted to put money into CDs that would eventually end up funding low-cost loans to borrowers, but the link between borrower and lender was less direct. In contrast, Lending Club established a pricing model instead of an auction model, setting interest rates, and thereby "bridging the knowledge and experience gap for lenders." Furthermore, they kept the feeling of a direct relationship between the lender and the borrower, even though behind the scenes the loan would be processing through a bank.

As they were shaping their model in the spring of 2007, Laplanche and the team also made a decision about the segment they would target. Lending Club would require borrowers to have a minimum credit score of 640 on the FICO scale. They would rely on borrowers' credit scores reported by a credit reporting agency (e.g. TransUnion) based on models created by the Fair Isaac Company to predict a consumer's credit behavior. FICO scores were calculated on the amount of debt a consumer held, history of payment, length of credit relationship, type of credit, and applications for new credit. FICO scores were generated on a scale of 300 to 850. The national average as of October 2007 was 692 and the median in 2007 was 723.[u] (**See Exhibit 5 for a national breakdown of FICO scores and borrowing options**). Any borrower with a score below 640 was typically considered high-risk or subprime.[v] While Zopa had a similar cutoff, Prosper's required minimum credit score was 300.[13] Prosper assigned one of seven letter credit grades (AA, A, B, C, D, E and HR (High Risk)), based on the borrower's credit score, to each registered borrower who posted a listing.[w] For example, scores of 760 or higher were rated AA, and between 300 and 539 were rated HR.[x] Between November 2005 and December 2007, 52% of loans originated through Prosper were for borrowers with scores below 640.[14]

Eschewing the subprime market would reduce Lending Club's growth opportunities and position it against other traditional lenders who advanced funds to low-risk, creditworthy borrowers. By setting the credit score higher, however, they would be better positioned to gain the trust of lenders who would be less likely to experience defaults. Gaining trust was an important component of their plan and of their brand. For example, according to Donovan, "We were told we would need at least $100 million to build a brand. We didn't have that kind of money, so we focused on the trust piece. Plus, while common sentiment was that the credit space was incredibly competitive, we knew better. The credit industry had walked away from what consumers really wanted—trust and community. We decided we were going to operate in a community—one with standards of membership."

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[13] When Prosper first launched, borrowers were not required to have a credit history and there was no minimum credit score required. In February of 2007, they set the minimum of 300 and no longer accepted borrowers with no credit history. http://www.lazymanandmoney.com/in-defense-of-prospercom-a-look-at-the-investment/ (accessed December 2009).

[14] Between March and December of 2007, 61% of borrowers had scores below 640. See statistics at www.prosper.com (accessed December 2009).

With this in mind, the team initially reached out to *offline* communities such as university employees and advocacy-group members in the hopes of creating an *online* community from people with existing connections. But this approach failed to generate substantial borrower and lender interest. Lending Club decided to go straight to online communities. In May of 2007, they launched as an application on Facebook, an online "social utility."[y] In August of 2007, they had their first round of venture capital financing, raised $10.26 million and launched their own website, www.Lending Club.com.

Applying for a Loan through Lending Club

Lending Club hoped to attract borrowers who were young professionals living in big cities and enjoying above-average income and credit quality. Borrowers were acquired in a variety of ways: internet search engine marketing, social media reach, word of mouth and public relations efforts. The total acquisition cost averaged between $40 and $60 per borrower, approximately $25 of which was attributed to marketing. Use of social media and public relations efforts were very low cost. Display ads as part of search engine marketing were on the higher end.

Given the type of borrowers they were targeting, the team expected that Lending Club loans would be a way for borrowers to pay off high-interest credit card debt by taking a lower interest Lending Club loan and paying it back over time. With the target borrower population being fairly young, they typically were not homeowners and did not have access to low-cost borrowing through home equity lines of credit (**See Exhibit 4 for rates on other borrowing options**.)

Interested borrowers started by completing a loan request online. They were asked how much they wished to borrow (minimum of $1,000, maximum of $25,000) and what the loan would be used for (e.g., home improvement, debt consolidation, automobile or other major purchase). Most borrowers also took the opportunity to describe what they needed and why they needed it in more detail, along with making the case for why a lender should help to fund the loan. The following three paragraphs offer a sample of borrower requests:

> **Borrower 1**: "The rate of interest and fees incurred by carrying a balance on my credit card are so outrageous at this point that continuing to pay them is patently bad financial thinking. I wish to redirect my efforts at retiring my debt via another more-reasonable means. I have sufficient funds to direct to this end on a monthly basis, and have simply gotten tired of their being gobbled up by interest and fees." (Requested $8500 and received $8,500 at a rate of 10.28%)
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> **Borrower 2**: "This loan would purchase a small pickup truck to use for my small but growing home repair business. I believe the pickup would allow me to bid on larger jobs, be more productive and thus provide me a better opportunity at a greater monthly income. I've never been late or missed a payment on a credit card or personal/auto loan in my life." (Requested $8,000 and received $8,000 at a rate of 11.86%)
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> **Borrower 3**: "Dartmouth Gilmore Girls - My daughter is a freshman at Dartmouth college, and we have a Gilmore Girl relationship. She recently received a named scholarship for academic and personal promise, but it does not cover the full tuition. She is doing phenomenally, taking an extra class and is very involved, with quite a few leadership roles

on campus. She works over each of her breaks (including Christmas and New Years!), and I want to be as supportive as possible. We're consolidating some debts to simplify our lives." (Requested $10,000 and received $10,000 at a rate of 13.43%)

The Approval and Pricing Model

Chen's extensive banking experience gave him a banking, credit and risk management perspective on loan pricing. He and the team reviewed how banks priced loans and graded risk, including how they factored in the classic "5 c's of credit": collateral, credit/character (credit and payment history typically captured by a FICO score), capacity (debt-to-income ratio), capital (how much the borrower is contributing to the deal), and conditions (the purpose of the loan). The Lending Club model relied on three of these factors: credit (in the form of the FICO score), capacity to pay, and the conditions under which the loan would be made, including current economic conditions.

There were a few steps involved in approving a borrower and setting the interest rate. After the borrower completed an application, each would be reviewed to determine if they met the following pre-conditions:

- U.S. citizen or permanent resident
- At least 18 years old
- Have a valid email account
- Have a U.S. social security number
- Have an account at a financial institution with a routing transit number

Assuming all the preconditions were met, the computer did an initial screening of the applicant based on the following criteria:

- Minimum FICO score of 640
- 25% debt-to-income ratio, including all debt service except mortgage debt[15]
- Minimum of 1 year of credit history
- Minimum of at least four credit accounts ever opened (e.g., ever had a loan or credit card)
- Minimum of three currently open credit accounts (i.e., lines of credit available to access and/or loans in active repayment)
- No more than 10 credit inquiries (i.e., lender requests for borrower credit information as a result of borrower application for credit) in the past six months
- No current delinquencies, recent bankruptcies, collections, or open tax liens (i.e., unpaid taxes, the balance of which is secured against a property)
- Balance on lines of credit not exceeding the maximum amount permitted.

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[15] Calculated based on all non-mortgage debt reported by a consumer reporting agency and the income reported by the borrower member.

Borrowers completed a form with personal information including name, address, phone numbers, date of birth, social security number, income, and employer information. This information was used for verification purposes, but was not shared in the borrower's online profiles.

The review process required a number of cross-checks and related expenses: identity verification (i.e., verifying that the borrowers are who they say they are, costing Lending Club $.30) and authentication (i.e., verifying not only identities but verifying personal information that only the borrowers would know, costing $1), FICO report (i.e., credit history, costing $1), credit score (costing $.20), and fraud score (i.e., reflecting the risk that a transaction may be fraudulent, costing $.30). Borrowers learned in real time whether they were pre-approved or not. Approximately 87% of applicants were screened out at this preliminary stage.

Pre-approved borrowers were then told the terms of their loans, should they be fully approved and funded. (**See Exhibit 6 for borrower and loan characteristics for issued loans.)** Borrowers chose either to accept the rate Lending Club established based on the loan amount they requested, or to get a lower rate if they were willing to accept a smaller loan.

Interest rates were set based on the borrower's characteristics and FICO score according to a specific formula. They were assigned to borrower loan grades in three steps. First, Lending Club determined the base rate by considering (1) the spread between the cost of credit for borrower members and the return on bank deposits; (2) the general economic environment; and (3) competition from other social lending platforms and rates set by major financial institutions. Second, they determined an assumed default rate that attempted to project loan default rates. Third, they used the assumed default rate to calculate an upward adjustment to the base rates, which they called "Adjustment for Risk and Volatility." Lending Club had a fairly fine-grained set of credit categories, with seven grades (letters A through G), each with five sub-grades representing different risk categories and rates. (**See Exhibit 7 for details on interest rates and how they were set.)** As of December 2007, interest rates ranged from 7.12% to 17.86%. Expected default on personal loans for the FICO bands selected by Lending Club ranged from 0.45% to 3.16%.[16]

Borrowers who accepted the terms of the loan also agreed to pay Lending Club an origination fee of between .75% and 2% of the loan amount, depending on their risk profile.[17] They would then have their profiles posted on the website as "pending". Sometimes loans were fully funded within two days. If a loan were not fully funded at the end of the two-week period, the borrower could choose to cancel the loan (paying no fee or penalty) and have the option to relist it on the site, or accept a loan for whatever portion of their total request had been funded, with an adjusted monthly payment. The fixed-rate three-year unsecured loan could be paid off at any time without penalty.

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[16] Lending Club's loan grades are calibrated to reflect progressive default risk based on validation data from the classic FICO score model by Fair-Isaac Company and TransUnion.

[17] A low-risk "A" level borrower paid .75%, "B" level paid 1.0%, "C" level paid 1.5%. Any borrower determined higher risk than "C" paid 2.0%. The origination fee was included in the APR calculation and was subtracted from the gross proceeds prior to the borrower receiving the loan fund.

While the loan request was pending, allowing lenders to commit funds, the borrower underwent the next stage in the approval process—"manual review." Manual review took as few as two days or as many as five days, and ensured what Chen called "responsible underwriting." Lending Club staff relied on the reports generated by the preliminary analysis to provide guidance. "Red" or "yellow" flags indicated potential inconsistencies, the need for more detailed information, or potential fraud. These commonly would appear if the borrower had moved numerous times in recent years, or if the borrower's stated occupation did not seem aligned with the stated income. If income and/or employment verification were required, as it was for approximately 30% of pre-approved borrowers, Lending Club staff would require the borrower to submit paystubs, IRS Forms W-2 or other tax records. Lending Club sometimes used a verification service as well, which, for $13 per report, would confirm the borrower's income and employment through public and credit records. Considering staff time and the cost of verification services, each verification process cost Lending Club around $25.

Approximately 50% of pre-approved borrowers either didn't respond to the verification request or provided insufficient information. These borrowers were then delisted from the site, and any pending lender commitments would be returned to the lenders' accounts. Of those pre-approved borrowers who successfully completed the verification process, roughly 40% chose to cancel their loan requests. In total, it cost between $40 and $60 to acquire a funded borrower. Approximately 75% of borrowers who received pre-approval ended up with fully funded loans (representing roughly 10% of all borrowers who applied).

The Lender Experience

In the early stages, Lending Club attracted lenders with rather distinctive profiles. They were between 35 and 55 years old, and the strong majority resided on either the East or West Coast. They were technology-savvy, "self-directed" investors who liked to closely manage their investment portfolios, and who had experience investing in stocks and bonds through an online brokerage account. Indeed, many reported being driven to the Lending Club platform as it provided them with an opportunity to earn predictable returns, investing in instruments that were not correlated with the stock market.

It cost Lending Club between $25 and $30 to acquire a lender (attributed mostly to marketing costs) but virtually nothing once they signed on to fund loans. Lenders got started first by providing a completed tax withholding statement and undergoing identity verification. Then, before they could fund any loans, lenders needed to set up a Lending Club account—an "in trust for" account through Wells Fargo Bank. Lenders linked their existing bank account to the ITF account, from which designated withdrawals were made to fund loans, and into which borrower payments were deposited. The ITF account paid no interest either to the lender or to Lending Club.

Lenders could invest in a single loan or tens or hundreds of loans. A single loan might have one lender, or could be funded by numerous lenders. While Lending Club was still in a start-up phase, they anticipated steady state figures. On average, a lender had roughly $4,500 invested in 25 loans, or about $180 per loan. Loans typically were for amounts between$6,000 and $7,000 and each were

funded by roughly 34 lenders.[18] Lenders paid Lending Club a 1.00% service fee throughout the life of the loan. The service charge was deducted from any payments on a loan immediately after the payments were allocated to the lender members' Lending Club accounts.

There were two main ways that lenders could choose which loan/loans to fund: individually or as a Lending Club-selected portfolio. (**See Exhibit 8 for a summary of loan performance as of December 31, 2007**). In the first method, a lender would browse or sort loan requests. They could see how much borrowers were requesting, how much was already funded, and how many days were left on the posting. They could review specific criteria including interest rate, FICO score, debt-to-income ratio, and delinquencies in last two years, but they could also search for general terms (e.g., city, hometown, profession, employer, and educational and institutional affiliations) and review comments posted by the borrowers themselves. Second, they could rely on Lending Club's proprietary search engine, "LendingMatch." Approximately 30% of lenders used this service.

LendingMatch created a sample listing of promissory notes responsive to search criteria based on the lender member's target weighted average interest rate for the lender member's profile. First, the lender would indicate how much he wished to invest and at what weighted rate. LendingMatch would assign a risk level to these criteria, which the lender could modify by changing either the principal investment or the targeted interest rate. Once the lender member was satisfied with the risk level, he could view the loans that comprised the sample portfolio, and make adjustments at the loan level if he wished. Finally, the lender would agree to fund the portfolio.[19] **(See Exhibit 4 for comparable interest rates for investment and savings products.)**

Funding the Loans: The Legal-Regulatory Challenge

The Promissory Note Model

In the original model, lenders were assigned anonymized, individual promissory notes corresponding in principal amount to their purchase price, subject to Lending Club's right to service the loan. (**See Exhibit 9 for a copy of the Promissory Note**.) Lenders could choose to put as little as $25 toward a borrower's loan or as much as they wished up to the maximum requested (or available to fund at the time of investing). Once the loan was funded, accepted, and in active repayment, the lender would begin to receive payments of principal and interest into their lender accounts, which they could then use to lend again or choose to withdraw or transfer the funds elsewhere.

Lending Club facilitated the initial funding of the loans by drawing upon lender members' funds and depositing them to borrower members. Under this model, Lending Club was the lender of record: it was lending funds to borrowers and immediately assigning the rights of payments to "lenders", who were in fact "notes purchasers". As such, Lending Club needed to meet each state's

[18] These were Lending Club early steady state projections. As of January 2008, they were still in the start up phase. At the time, the average lender investment was $940. Lenders invested in an average of 17 loans with a fraction per loan of approximately $55. The average loan amount was $7221 and the average number of lenders per loan was 131.

[19] Should any of the loans included in the portfolio be cancelled, the lender would have the option to replace the cancelled loan request with another loan request of the same or higher risk grade.

lending guidelines, often unique to each state, including varying licensing requirements and usury thresholds (i.e., interest rate maximums).[20] Doing so was costly and time consuming, and it was difficult to manage the various interest rate caps. Furthermore, some states had thresholds that were so low as to make lending to residents there essentially impossible.[21] Lending Club sought a way to be able to make its service available nationally, which its relationship with WebBank would accomplish.

The WebBank Partnership Model

Utah allowed its state-chartered industrial banks to issue loans nationally under one set of regulations. It was for this reason that Laplanche and the team were pleased to have finalized their arrangement with WebBank, a FDIC-insured, state-chartered industrial bank organized under the laws of the State of Utah.[22] This partnership would allow Lending Club to originate the loans in a consistent manner across all 50 states. At the time, Lending Club had been doing business only in California, Michigan, Illinois, Pennsylvania, Oregon and Nevada, and was only partially available in Texas and Ohio. Limited to these states, their market comprised less than 40% of the US adult population. According to Laplanche, partnering with WebBank allowed Lending Club to expand their market to include "about 108 million more Americans who [could] borrow and lend directly among each other and get better rates."[z]

Under the WebBank arrangement, borrowers entered into a *borrower membership agreement* with Lending Club and a *loan agreement* with WebBank. WebBank managed the money coming from lenders to fund the loan and dispersed the loan proceeds to the borrower. Each loan first was screened by Lending Club to ensure that the borrower met WebBank's credit criteria. Once approved, the loan was divided into separate promissory notes in amounts that matched the purchase commitments from lender members for the particular member loan. At closing, WebBank indorsed the promissory notes to Lending Club and assigned each to the applicable lender member, subject to the loan sale and servicing agreement.[23]

Lending Club continued to service the loans (i.e., collecting payments, monitoring loans, reporting to credit agencies, managing delinquencies) and charged each lender member a fee of 1.00% of all payments of interest, principal, late fees and recoveries received in respect of the member loans. Borrower bank accounts would be debited electronically through Automated Clearing House (ACH) transfer (payment by check would only be allowed in exchange for a 5% increase in the

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[20] Many states set interest rate caps as a consumer protection. However, lenders in some states, particularly those who targeted lower-income or poorer-credit borrowers often found ways to tack on extra fees while keeping the actual interest rates under the state cap.

[21] For example, in 2007 Pennsylvania had a 6% cap and Alabama had an 8% cap, while Rhode Island capped at 21% and some states imposed no cap. http://web.archive.org/web/20071015042928/www.usurylaw.com/state/ (accessed December 2009)

[22] An industrial bank, or industrial loan company (ILC) was unlike other banks in that it could be owned by non-financial institutions. These banks are regulated and insured by the FDIC.

[23] Lending Club had an annual contract with WebBank in which they paid a flat monthly fee up to a maximum number of originations. If they went over the maximum allowance, they were required to pay a percentage of the origination amount.

interest rate.)[aa] The funds were transferred to a clearing account where they remained for four days or until the amounts cleared, whichever was shorter. Thereafter, Lending Club made payments on the promissory notes by allocating amounts received on specific member loans to the appropriate lender member's account.

The Bank Lender Model Versus the Security Model

The original model and the WebBank variant both treated the promissory notes as loans. The discussions with the SEC would treat the obligations that lenders accepted as securities. If Lending Club were to file with the SEC, they would need to do so with a very well thought out plan. Originally, Lending Club had structured the arrangement so that lenders would be assigned the rights to be paid on the promissory notes and Lending Club would act as the servicer. However, in a securities framework--and particularly as there had been no precedent for such an arrangement--Laplanche knew that the SEC might characterize the bank or perhaps even individuals as "co-issuers" of securities, rather than accepting Lending Club as the exclusive issuer. It was essential that individual borrowers not be deemed issuers.

Laplanche's strategy was to analogize the arrangement to a municipality's issuance of special purpose bonds to support infrastructure projects like bridges or toll roads. While the municipality was considered the issuer of such securities, returns to investors depend solely on the economics of the underlying projects and such bonds were not considered general obligations of the municipalities. Drawing on this analogy, Laplanche could argue that individual borrowers would be the "projects" that would make payments and investors would gain returns from the performance of each project/borrower without having the SEC deem each borrower to be a "co-issuer." Of course, even if the SEC were to accept the argument, it was not clear how much information the Commission's staff would require of each borrower or whether the disclosure requirements would interfere with Lending Club's business model.

To effect this transaction, borrowers would still submit promissory notes. However, instead of issuing them *through* Lending Club to lender members, they would be submitted *to* Lending Club. Lending Club would hold the promissory notes. In turn, Lending Club would issue "Member Payment Dependent Notes" ("Notes") to lenders (or "lender members"). These latter Notes gave lender members the returns dependent on the repayment of specific promissory notes that backed the Notes. If the member didn't pay, lender members had no recourse to either Lending Club or WebBank.

Under the proposed securities model, borrowers' loans would be publically offered as Notes pursuant to a prospectus. (**See Exhibit 10 for a diagram of the proposed platform**.) The offering would be a continuous offering pursuant to Rule 415 under the Securities Act of 1933, as amended, which would allow Lending Club to register the securities and then "shelve" them for up to two years.[24] Laplanche and his team expected that they would sell Notes on a daily basis.

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[24] According to the SEC, "securities that are registered on a shelf registration statement pursuant to Rule 415 may be sold concurrently in any of the transactions for which they were registered." http://www.sec.gov/interps/telephone/cftelinterps_rule415.pdf (accessed January 2010).

The Proposed Lender Member Eligibility and Process

From the beginning, virtually anyone with a tax id number whose identity could be verified could become a lender with Lending Club. However, some state regulators had started requiring more stringent suitability standards related to income and net worth of potential investors, The team was unsure about whether or not to adopt such a standard uniformly. One the one hand, establishing a higher minimum standard would limit their market, and effectively exclude small-dollar (i.e., $500-$1000) retail investors. But the dollar value of lending wouldn't change dramatically—that they might simply have a smaller number or "larger value" investors. They decided that, should they file with the SEC, they would propose that lender members be required to meet one of two criteria to satisfy minimum financial suitability standards and maximum investment limits.

1. An annual gross income of at least $70,000 and a net worth (exclusive of home, home furnishings, and automobile) of at least $70,000 or

2. A net worth (exclusive of home, home furnishings, and automobile) of at least $250,000.

Furthermore, lender members would not be permitted to purchase Notes in an amount excess of 10% of their net worth.

As with any security, lender members would be instructed to carefully read the prospectus. So that lender members would be able to review the prospectus and each individual loan, Lending Club would post a loan request on the website, in essence offering a series of Notes corresponding to that loan. The loan request would serve as a supplement to the prospectus, or a "posting report." Posting reports would be filed within two business days of the initial posting. In addition, pursuant to Rule 424(b) under the Securities Act, Lending Club would file supplements ("sales reports") to the prospectus at least weekly. These sales reports would include detailed information about the Note: principal amount, loan grade of the corresponding member loan, maturity and interest rate of each series of Notes sold. Lending Club also would post the sales reports to their website.

Lending Club would not guarantee payment of the Notes, nor would the Notes be obligations of the borrowers. While the returns on the Notes would be "dependent on" underlying member loans, the Notes would be technically unsecured and holders of the Notes (i.e., lender members) would not have a direct security interest in the corresponding member loans or the proceeds of those loans. Lending Club's obligation would be to make payments on a Note corresponding to the pro-rata share of borrower payments on their loan, less a 1.00% service charge and to do so within four business days of receiving loan payments. Lender members also would receive late fees and prepayments (there no prepayment penalties assessed to borrowers) less the same 1.00% fee.[25] Notes would give a stated, fixed interest rate, be fully amortizing, payable monthly, and have an initial maturity of three years and four business days from issuance, which is four business days longer than the term of the corresponding member loan to allow for the finality of ACH transfer of funds. Interest rates would be assigned as they had been under the previous model.

[25] In the case where borrowers default (i.e., become 120 days late and are charged off) Lending Club would not pay lenders any unsuccessful payment fees or collection fees.

When deciding which loans to funds, lender members would still be able to either browse or search for specific loan and/or borrower criteria. Under this new model, however, lender members also would be able to invest in a portfolio of loans balanced around returns and volatility according to the requirements they set. They also would have the option of reinvesting their interest and principal payments or withdrawing them.

A lender member would need to have sufficient funds in his Lending Club account to make a commitment to purchase a Note. To ensure that this happened, lender members would be required to authorize an ACH debit from their individual bank account to a non-interest bearing "in trust for" (ITF) account maintained by Lending Club at Wells Fargo Bank, N.A. Lending Club would maintain sub-accounts for each lender member to track and report lender member commitments and borrower payments. At closing, the Note would be registered, the funds transferred from the ITF account to WebBank, and WebBank would disburse the loan proceeds to the borrower by ACH transfer.

If Lending Club were able to establish a secondary market, lender members would be able to buy and sell their Notes. Laplanche and the team had preliminary discussions with broker-dealers discussing how this might work. While setting up a secondary market would allow Lending Club to ensure liquidity to lenders, it also would give Lending Club the opportunity to monitor how the loans sold on the secondary market where both borrower profiles and payment history on the Lending Club loan would be available.

Once invested in a loan or loans, lender members would face not only the risk that the loans might default, but also that Lending Club itself might become subject to a bankruptcy or similar proceeding. While the holder of a Note would then have a general unsecured claim against Lending Club there would still be many risks. These included that they might face delays in payments on the Notes, uncertainty as to whether Lending Club or the lender member (i.e., holder of a Note) would have a priority right to payment from the corresponding member loan, and questions as to whether the lender member would have a right to payment from any Lending Club assets or any related accounts. Lending Club would mitigate these risks through an agreement with an independent back-up servicer which would ensure that borrowers would continue to make payments. While the back-up service contract would be a bit complex given that payments would have to be made to a large number of small investors, by the beginning of 2008, Lending Club was in discussions with two or three potential servicers.

Designing the Offering Scale

Lending Club also had to decide how much in the principal amount of Notes they would request. It would be a balancing act, requiring that the number not be either too large, in that it would cause concern within the SEC, nor too small, in that it wouldn't allow Lending Club to grow without returning with a new offering shortly or would suggest that they were engaging in something less than a "serious asset class." Considering their five-year growth projections and these related factors, Laplanche preliminarily settled on $600 million.[26] The Notes would be issued in series to lender members, where each series would correspond to a single consumer loan originated

[26] Prosper had requested $500 million in their October 2007 filing. Note that the filing fee is a function of the amount of securities registered.

through the platform to a borrower member. The Notes would not be contractually senior or subordinated to any other of Lending Club. They would be unsecured, special, limited obligations of Lending Club. Lending Club would have no obligation to make any payments on the Notes unless, and then only to the extent that Lending Club would receive payments on the corresponding member loan.

Making the Decision

Laplanche and the team had to weigh the opportunities and risks involved with moving to a securities model. Indeed, it was somewhat uncommon to seek out additional regulation and paperwork. Inviting additional SEC regulation (assuming they were even approved) would require dramatically new ways of doing business, in the backend, with their partners and with their borrowers and lenders. The legal cost of filing alone would be roughly $3.5 million. Furthermore, Lending Club would have to temporarily stop allowing lenders to fund loans while undergoing SEC review (i.e., enter a "quiet period") as well as gear up for a new marketing campaign once the period ended. They expected that these adjustments would cost them another $1.5 million and also require them to fund any new borrowers with internal resources.

Laplanche knew that the SEC's position would shape P2P lending. And assuming that the SEC continued to scrutinize P2P lending practices, Laplanche knew that the longer they waited, the likelier it would be that they would lose whatever influence they might have in the process. In short, it was time to decide if they would (1) keep their current model, continue to assert that they were not offering securities, and risk later SEC enforcement action, or (2) make a proactive filing to the SEC in hopes of gaining approval under a new securities-based lending model and earning the right to establish a secondary market trading platform, which might not be possible otherwise.

There were a variety of issues and risks to consider. Would registering with the SEC be worth the money, extensive legal paperwork, and the inevitable headaches? If they held the position that they were not trading securities, what were the chances that the SEC would ultimately allow them to continue under their current model? On the other hand, if the lending process did constitute the issuance of securities, which party or parties would be the issuers? Any issuer would need to disclose full financials to the SEC for approval. Would Lending Club be the sole issuer? Would their new partner WebBank, who originated the loans, be considered an issuer? Or would each prospective borrower seeking a loan through their site be construed an issuer as well, making each small borrower an SEC registrant? Furthermore, if they were not able to establish a secondary market, how would the limited liquidity affect their ability to attract lenders and grow their business? In short, would Lending Club be better off by filing, or would they be putting themselves at more risk? And apart from these legal issues, was Lending Club well positioned to succeed in the new P2P segment?

Exhibit 1 Lending Club Financials, Condensed Statement of Operations (unaudited)

Nine months ended December 2007		
Revenues	$000 (except per share)	
Loans held for investment[1]		
Interest income, net	$	230.8
interest expense	$	(12.1)
Net interest income (expense), loans held for investment	$	218.7
Provision for loan losses[2]	---	
Net interest income (loss) after provision for loan losses	$	218.7
Borrower Loans and Lender Notes held for investment at fair value		
Interest income/(expense), Borrower Loans, net	---	
Interest (expense)/income, Lender Notes, net	---	
Net interest income/(expense), Lender Notes and Borrower Loans held for investment at fair value	---	
Amortization of loan servicing rights[2]	$	2.4
Other revenue	---	
Total (losses) revenues	$	221.1
	$	-
Operating expenses	$	-
Sales, marketing and customer service	$	1,339.0
Engineering	$	1,300.0
General and administrative	$	1,903.7
Total operating expenses	$	4,542.8
Loss before provision for income taxes	$	(4,321.7)
Provision for income taxes	---	
Net loss	$	(4,321.7)
Basic and diluted net loss per share	$	(0.55)
Weighted-average shares of common stock used in computing basic and diluted net loss per share	$	7,842.2

[1] Represents loans in which Lending Club was the direct lender. The interest portion paid by borrowers on the loans funded by Lending Club and the amortization of the origination fees

[2] While loan losses were $0 as of the end of December 2007, Lending Club expected that their loan losses would increase due to an expected increase in the amount of loans held for investment.

[3]This service charge is equal to 1.00% of all amounts paid by LendingClub to a lender with respect to a loan. The service charge is deducted from any payments on a loan before the net amounts of those payments are allocated to the lender member's account.

Source: Compiled by case writer from company documents

Exhibit 2 P2P Lender Comparison as of December 2007

Selected Loan Statistics, June 2007 through December 2007		
	LendingClub[1]	Prosper[2]
Number of Loans originated	603	6,104
Amount of Loans originated	$4,791,550	$43,607,858
Net charge offs (dollars)	0	25.80%
Default rate	No defaults as of December 2007. Assumed default rate varied by credit grade: range from .16% to 5.53%. Median assumed default rate is 2.84%	3% (actual)[3]
Delinquencies*	0.39%	10.33%

* reported figure varys slightly from data available by download

Fees and Charges as of December 2007			
	Lending Club	Prosper	Zopa
borrower fee	.75% to 2%	1% or 2%, minimum of $25	0.5%[3]
lender service charge	1%	1%	0.5%[3]
failed payment/non-sufficient fund (NSF) fee[4]	$15	1%	$15
late fees[4]	greater of 5% of installment amount or $15	$15	$15
collection fees	between 7% and 30% of amount received	15% of amount recovered	not stated
minimum interest rate	7.12%	n/a[4]	8.75%[5]
maximum interest rate	17.86%	n/a[4]	16.99%[5]
minimum loan[4]	$1,000	$1,000	not stated
maximum loan[4]	$25,000	$25,000	$25,000
loan term[4]	3 years	3 years	5 years

[1] Lending Club data from company documents or www.lendingclub.com unless otherwise noted

[2] Prosper data from www.prosper.com unless otherwise noted

[3] http://www.techcrunch.com/2007/12/13/p2p-loans-gainingtraction-lending-club-goes-nationwide/

[4] http://www.p2plendingreview.com/for_brwrs.html. Note that Prosper loan rates are set auction-style by borrowers and lenders. There are no minimums or maximums.

[5] http://www.techcrunch.com/2007/11/30/zopa-gearing-up-for-us-launch/

Exhibit 3 Prosper Delinquencies and Charge Offs, Number of Loans, May 2005 through December 2007

	520-559	560-599	600-639	640-679	680-719	720-759	760+	No Credit*
Late (16-30 days)	2.87%	2.57%	1.75%	2.02%	1.07%	0.53%	0.66%	-
1 month late	4.36%	2.81%	2.24%	2.18%	2.37%	0.91%	0.83%	1.37%
2 months late	3.84%	3.98%	1.51%	1.74%	1.19%	0.98%	0.25%	4.11%
3 months late	5.28%	2.98%	2.16%	1.39%	0.85%	0.83%	0.41%	6.85%
Net charge offs	24.13%	16.41%	8.13%	5.37%	3.22%	2.18%	1.36%	42.85%

* Prosper stopped accepting borrowers with no credit history in February of 2007

Source: compiled by casewriter from data on www.prosper.com (accessed January 2010).

Exhibit 4 Interest Rates and Indicators as of December 2007

Annual averages unless otherwise noted[1]	2000	2001	2002	2003	2004	2005	2006	2007
Interest Rates								
Federal Funds Daily Rate	6.24	3.88	1.67	1.13	1.35	3.22	4.97	5.02
Prime Rate	9.23	6.91	4.67	4.12	4.34	6.19	7.96	8.05
3 Year Treasury Bonds	6.22	4.09	3.1	2.1	2.78	3.93	4.77	4.35
6 Month LIBOR[2]	6.20	1.98	1.38	1.22	8.78	4.70	5.37	4.60
Investing/Savings Rates								
Interest Bearing Checking Account (last price end of year)[3]	2.69	1.15	0.86	0.55	0.62	0.73	1.43	2.29
Money Market Account (last price end of year)[3]	4.38	1.94	1.59	1.7	1.91	2.8	3.64	3.5
3 Year Certificate of Deposit (CD)[4]	5.56	4.02	2.13	2.48	3.36	4.53	4.72	3.53
Money Market Mutual Fund (taxable)[5]	5.76	3.60	1.22	0.60	0.78	2.59	4.42	4.63
Bond Fund Total Returns (short-term)[5]	7.59	7.27	5.47	2.54	1.63	1.45	4.05	4.29
Bond Fund Total Returns (intermediate-term)[5]	9.44	7.64	8.04	5.10	3.91	1.80	4.15	4.70
Bond Fund Total Returns (long-term)[5]	9.36	7.85	8.36	8.79	6.47	2.23	4.43	3.10
Average Borrowing Rates								
Credit Card	15.99	14.21	13.11	12.35	12.51	12.58	13.31	12.75
2-Year Personal Loan	14.10	12.62	12.24	11.97	11.84	11.95	12.49	12.16
Home Equity Loan[6]	9.56	7.99	7.32	6.83	7.01	7.45	7.53	8.10
Home Equity Line of Credit[6]	8.83	5.40	4.32	3.85	3.95	6.74	7.50	7.41
Auto Installment Loan (4 year)	9.64	7.86	7.34	6.82	6.71	7.43	7.92	7.59
New Car Finance Rate (Finance Companies)	7.54	3.49	3.80	4.04	5.46	6.64	5.81	4.33
Per Capita Consumer Debt ($2008)	$ 7,850	$ 8,206	$ 8,453	$ 8,617	$ 8,766	$ 8,754	$ 8,778	$ 8,949
Delinquency Rates								
Single Family Mortgages	2.45	2.41	2.13	1.93	1.51	1.78	2.11	3.31
Consumer Loans	3.85	3.86	3.65	3.46	3.19	2.82	3.07	3.56
Charge-off Rates								
Single Family Mortgages	0.16	0.21	0.16	0.35	0.10	0.09	0.15	0.47
Consumer Loans	2.95	3.33	3.01	3.06	2.82	3.20	2.41	2.79

Sources: compiled by casewriter from the sources listed below. All databases accessed as of January 2010.

[1] Data are from the Federal Reserve Bank H.19 report (interest rates) or G.19 report (consumer credit) unless otherwise noted. All consumer credit data are based on commercial banks unless otherwise noted.

[2] Thomson DataStream, for the month of December

[3] Bankrate US national average rates, Bloomberg

[4] Global Financial Data

[5] Morningstar

[6] Bankrate (Bloomberg and Bankrate). Home equity loans are installment loans which typically have a fixed rate of interest. Home equity lines of credit are open credit lines which typically have variable interest rates.

Exhibit 5 Distribution of Population by FICO Score

National FICO Score Distribution, All Adults in U.S. in 2007 (unless noted)		Millions
Adult population[1]	---	227.4
Adults with no credit history (estimate)[2]	18%	40.0
Adults with credit scores[3]		187.4
0-499	2%	3.7
500-549	5%	9.4
550-599	8%	15.0
600-649	12%	22.5
650-699	15%	28.1
700-749	18%	33.7
750-799	27%	50.6
800+	13%	24.4
Household population[1]	---	112.9
Households with credit cards[4]	73%	82.4
Homeowners[5]	68%	154.9
Homeowners with home equity line of credit[6]	18%	28.5
Homeowners with home equity loan [6]	6%	9.9

Sources: Compiled by casewriter from the following sources, all accessed January 2010

[1] U.S. Census,2006-2008 American Community Survey, http://www.census.gov

[2] http://cfsinnovation.com/system/files/imported/managed_documents/cfsi_amerbkr_primthinfiles_13nov.pdf; http://perc.net/right25.htm

[3] www.myfico.com

[4] Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances; http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf

[5] Homeownership rate, http://www.census.gov/hhes/www/housing/hvs/annual07/ann07t12.html

[6] Survey of Consumer Finances, 2007

Exhibit 6 Lending Club Borrower and Loan Characteristics

Borrower and Loan Characteristics on All Loans Issued June 2007 through December 31, 2007	
Loan Characteristics	
Number of loans issued	603
Average size of loan request	$ 8,255
Median size of loan request	$ 6,000
Average amount borrowed	$ 7,946
Median amount borrowed	$ 6,000
Average interest rate	11.8%
Median interest rate	11.5%
Median Lending Club credit grade	C4
Borrower Characteristics	
Average monthly income	$ 5,374
Average debt-to-income ratio	10.7%
Percentage of borrowers who rent	58.9%
Credit History*	
Average number of open credit lines	8.6
Percentage with revolving credit balances	93%
Average balance on revolving credit (those with balances)	$ 17,179
Average percentage of revolving credit line in use	50.3%
Average number of credit inquiries in previous six months	2.9
Percentage of borrowers with delinquencies in past two years	17.4%
Average number of delinquencies in past two years (those with delinquencies)	0.3
Average months since last delinquency (those with delinquencies)	11.8
FICO Score Ranges	
640-659	25.4%
660-678	18.1%
679-713	32.4%
714-749	12.5%
750-779	8.5%
780+	5.2%
unknown/unrecorded	2.8%

* Twenty nine records are missing credit history data and are not included in these figures

Source: compiled by case writer from company data at www.lendingclub.com (accessed January 2010).

Exhibit 7 Lending Club Interest Rate Model

Step 1: Determine borrower interest rate and lender base rate of return.

Example: Borrower has a FICO score of 693. His risk grade is B-3 and his rank is 8. His base interest rate is 9.33%.

Floor Rate (Alternative Investment Rate)	5.28%	(Scheduled H15 Federal Reserve)
Ceiling Rate (Alternative Borrowing Rate)	15.09%	(Schedule G19 Federal Reserve)
Lender Bonus Spread	1.52%	
LC Base Rate	6.80%	
Default Basis Points	300.049505	
Risk Reward	200%	

Rank[1]	FICO Score	Base Risk Grade	Sub-Grade	Est. Pop Distribution	Expected Charge-Off Rate	Lending Club Base Rate	Risk Reward[2]	Interest Rate[3]
1	770		1		0.16%	6.80%	0.3178%	7.12%
2	747		2		0.32%	6.80%	0.6336%	7.43%
3	734	A	3	49.9%	0.47%	6.80%	0.9494%	7.75%
4	723		4		0.63%	6.80%	1.2653%	8.07%
5	714		5		0.79%	6.80%	1.5811%	8.38%
6	707		1		0.95%	6.80%	1.8970%	8.70%
7	700		2		1.11%	6.80%	2.2128%	9.01%
8	693	B	3	13.7%	1.26%	6.80%	2.5287%	9.33%
9	686		4		1.42%	6.80%	2.8445%	9.64%
10	679		5		1.58%	6.80%	3.1603%	9.96%
11	675		1		1.74%	6.80%	3.4762%	10.28%
12	671		2		1.90%	6.80%	3.7920%	10.59%
13	668	C	3	6.46%	2.05%	6.80%	4.1079%	10.91%
14	664		4		2.21%	6.80%	4.4237%	11.22%
15	660		5		2.37%	6.80%	4.7395%	11.54%
16	656		1		2.53%	6.80%	5.0554%	11.86%
17	652		2		2.69%	6.80%	5.3712%	12.17%
18	648	D	3	6.46%	2.84%	6.80%	5.6871%	12.49%
19	644		4		3.00%	6.80%	6.0029%	12.80%
20	640		5		3.16%	6.80%	6.3188%	13.12%
21	638		1		3.32%	6.80%	6.63%	13.43%
22	635		2		3.48%	6.80%	6.95%	13.75%
23	632	E	3	3.44%	3.63%	6.80%	7.27%	14.07%
24	629		4		3.79%	6.80%	7.58%	14.38%
25	627		5		3.95%	6.80%	7.90%	14.70%
26	624		1		4.11%	6.80%	8.21%	15.01%
27	621		2		4.26%	6.80%	8.53%	15.33%
28	619	F	3	2.92%	4.42%	6.80%	8.85%	15.65%
29	617		4		4.58%	6.80%	9.16%	15.96%
30	615		5		4.74%	6.80%	9.48%	16.28%
31	614		1		4.90%	6.80%	9.79%	16.59%
32	612		2		5.05%	6.80%	10.11%	16.91%
33	610	G	3	1.91%	5.21%	6.80%	10.42%	17.22%
34	608		4		5.37%	6.80%	10.74%	17.54%
35	606		5		5.53%	6.80%	11.06%	17.86%

[1] Rank ordered loan grades to allow for modifications. For example, if a borrower had a 693 FICO score (B3), his initial rank was 8. However, when modifications were made based on DTI and loan amount requested, the effective rank may have dropped.

[2] Risk reward is two times the expected charge-off rate

[3] Borrower base interest rate is the Lending Club base rate plus the risk reward

Note: All grades and ranks with FICO scores below the required minimum of 640 are used only for reference in determining the final modified rate. The grades extend through K, each with five sub-grades but are not shown here due to space limitations.

Step 2: Determine modified rate

a. Determine guidance limit for borrower's risk grade

Example: The borrower requests a $15,000 loan.

Base Risk Grade	Guidance Limit
A	15,000
B	12,500
C	10,000
D	7,000
E	4,000
F	3,000
G	2,000
H	Decline
I	Decline
J	Decline
K	Decline

b. Determine utilization modifier (ratio of borrower's requested loan amount to guidance limit)

Example: The $15,000 loan request is 120% higher than the guidance limit for a B-grade loan. ($15,000 / $12,500 = 120%. This utilization ratio requires a modifier of -4.

Base Risk Grade A~D	Utilization Modifier													
	Utilization Ratio	0%	25%	50%	75%	100%	125%	150%	175%	200%	225%	250%	275%	300%
	Modifier	0	-1	-2	-3	-4	-5	-6	-8	-10	-12	-14	-16	-18

c. Determine risk modifier based on debt to income ratio (DTI)

Example: The borrower has a debt to income ratio of 18%, which requires a modifier of -2.

Base Risk Grade A~D	Debt to Income Ratio Modifier											
	DTI	0%	7%	13%	18%	20%	23%	25%	28%	30%	33%	36%
	Modifier	0	0	-1	-2	-4	-8	-12	-16	Decline	Decline	Decline

d. Total modifier values ***Example: -4 + -2 = -6***

e. Subtract modifier from initial rank to get new rank ***Example: 8 - - 6 = 14***

f. Determine modified interest rate

Example: The initial risk grade for this borrower was B-3 (rank 8). The new risk grade is C-4 (rank 14). The borrower's interest rate is 11.22%.

Note: Borrowers also paid origination fees according to the following risk categories: "A".75%, "B" 1.0%, "C" 1.5%, "D" through "G" 2.0%. The origination fee was included in the APR calculation and was subtracted from the gross proceeds prior to the borrower receiving the loan fund.

Source: Created by case writer using company documents

Exhibit 8 Loan Performance June 1, 2007 through December 31, 2007

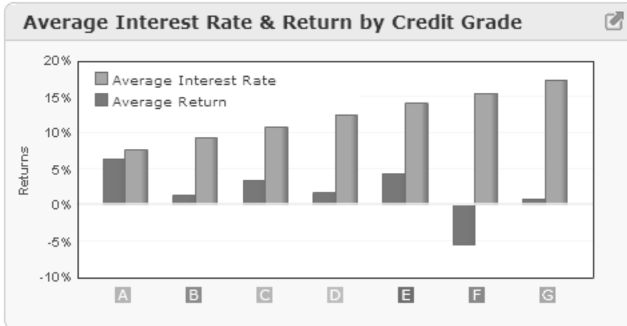
Lending Club Statistics

Feedback

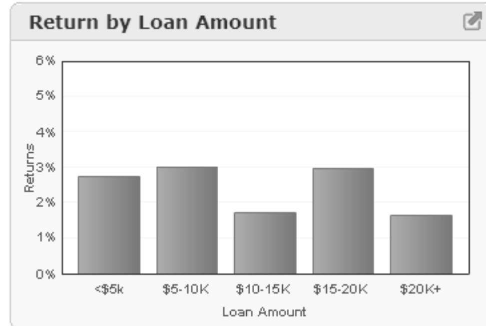
Highlights | **Performance** | Loan Details | Download Data

Show: Custom dates From: June 1, 2007 To: December 31, 2007 Refresh

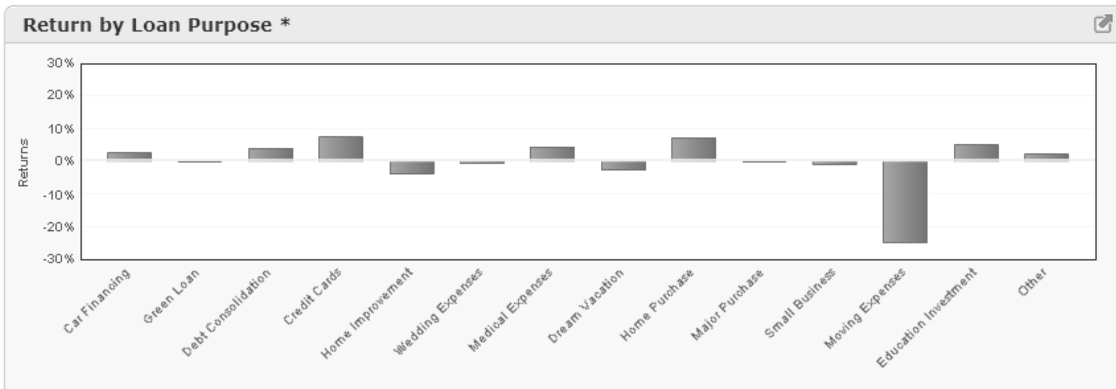
Average Interest Rate & Return by Credit Grade



Return by Loan Amount



Return by Loan Purpose *



* Loan purpose describes the reported intent of borrowers and may not reflect actual usage. Investors should rely on loan grades rather than loan purpose.
Net annualized returns are calculated using the formula described here. Past Performance is no guarantee of future results. Lending Club Notes are not guaranteed or insured, and investors may have negative returns.

Note: Net annualized return is based on funds actually received each month, net of the 1.0% service charge. Lending Club made deductions to account for any defaulting loans (equal to the outstanding principal amount of any note for which the corresponding loan is 120 days or more delinquent).

Source: Web site screenshot from https://www.lendingclub.com/info/statistics-performance.action (accessed February 2010).

Exhibit 9 Lending Club Promissory Note

PROMISSORY NOTE

$25 Loan **(ID# 010203)** issued on **August 24, 2007**

You (the "Borrower") promise to pay to the order of LendingClub Corporation (the "Lender") the principal sum of **$25** with interest set forth below. The Borrower will make payments by automatic debit from the Borrower's bank account previously provided to the Lender.

This Promissory Note ("Note") bears interest during each calendar month from the date hereof until paid, at a fixed rate of **11.41%** annual percentage rate. In no event is the interest rate to be higher than the maximum lawful rate. Interest is calculated on a monthly basis upon the unpaid balance with each date representing 1/12th of a year. The last payment might be of a slightly different amount to adjust for rounding.

Principal and interest is to be paid during and throughout the period of thirty-six (36) months in the following manner:

> Payments of principal and interest in the amount of **$0.81** are to be made by the Borrower to Lender commencing **September 25, 2007**, and on the same day of each successive month thereafter until **August, 2010**, when the full amount of unpaid principal, together with unpaid accrued interest is due and payable. If the monthly anniversary is on the 29th, 30th, or 31st of the month, and the following month does not have a 29th, 30th, or 31st day, the monthly payment will be due on the last day of the month in which the payment was due.

All payments on this Note are to be made in immediately available lawful money of the United States. To ensure timely payment under this Note, Lender has given Borrower a choice of making monthly payments by automated withdrawal from an account designated by the Borrower using an automated clearing house or electronic funds transfer or by bank drafts drawn by Lender on Borrower's behalf on Borrower's designated account each month. This authorization does not affect the Borrower's obligations to pay when due all amounts payable under this Note, whether or not there are sufficient funds therefore in such accounts. The foregoing authorization is in addition to, and not in limitation of, any rights of setoff. With regard to payments made by automatic withdrawal, the Borrower has the right to stop payment of automatic withdrawals or revoke the Borrower's prior authorization for automatic withdrawals by notifying their financial institution at least three (3) banking days before the scheduled date of transfer. The Borrower will notify Lender of the exercise of the Borrower's right to stop a payment or revoke the Borrower's authorization for automatic withdrawals at least three (3) banking days before the scheduled date of transfer. All payments are to be applied first to the payment of all fees, expenses and other amounts due to Lender (excluding principal and interest), then to accrued interest, and the balance on account of outstanding principal; provided, however, that after Default, payments will be applied to the obligation of Borrower to Lender as Lender determines in its sole discretion.

In the event any payment is received by Lender more than fifteen (15) days after the date due, the Borrower is to pay, to the extent permitted by law, Lender a late payment fee of **5.00% of the installment amount**. Any such late charge assessed is immediately due and payable. Any payment received after 3:00 P.M. on a banking day is deemed received on the next succeeding banking day.

When an automatic debit from the Borrower's account fails and is rejected by the Borrower's bank, or when a bank draft drawn on Borrower's account is rejected by the Borrower's bank, an unsuccessful payment fee is charged to the Borrower. Each attempt to collect a payment is considered a separate transaction, so an unsuccessful payment fee will be assessed for each failed attempt. The amount of each unsuccessful payment fee is **$0.10**. The Borrower can make any payment early, in whole or in part, without penalty or premium at any

time after the expiration of a 6-month period starting on the date of this Note. Any partial prepayment is to be applied against the principal amount outstanding and does not postpone the due date of any subsequent monthly installments, unless Lender otherwise agrees in writing.

The Borrower will use the proceeds of the loan from Lender primarily for personal or household use and not for commercial purposes.

The Borrower will be deemed in Default if the Borrower: fails to pay any amount due under this Note; files or has instituted against it any bankruptcy or insolvency proceedings or any assignment for the benefit of creditors; dies or becomes disabled or makes any material misrepresentation in this Note or any other documents, applications or related materials delivered to Lender with respect to this Note.

Upon Default, the Lender may exercise all remedies available to Lender under applicable law, including demand upon the Borrower to immediately pay all amounts owed under this Note. The Lender may assign this Note without notice to the Borrower under applicable law. The Borrower may not assign this Note without the prior written consent of the Lender. This Note inures to the successors, assigns, heirs and representatives of the Borrower and Lender.

The Borrower hereby waives demand, notice of non-payment, protest, and all other notices or demands whatsoever, and hereby consents that without notice to and without releasing the liability of any party, the obligations evidenced by this Note may from time to time, in whole or part, be renewed, extended, modified, accelerated, compromised, settled or released by Lender.

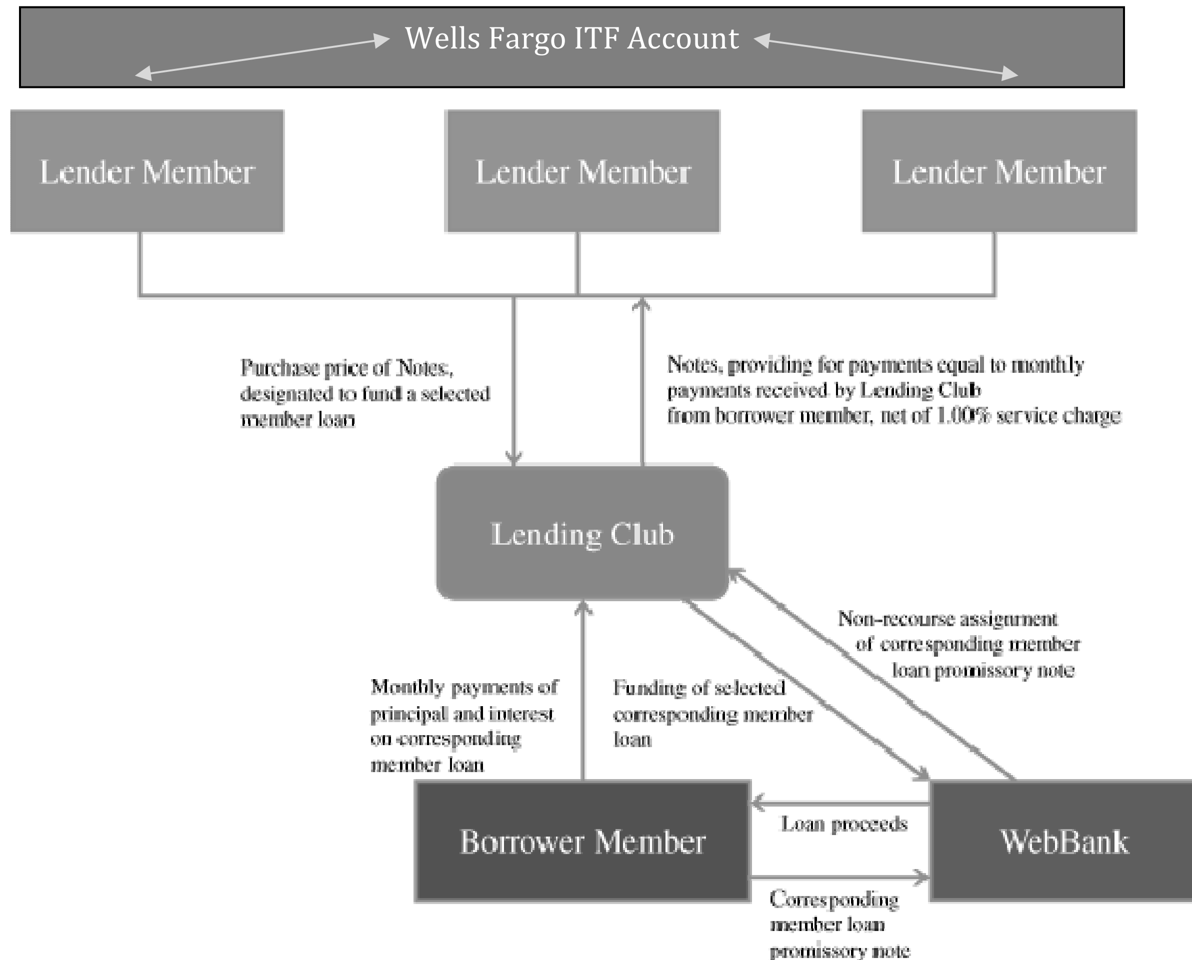
Any changes to this Note must be in writing signed by the Borrower and Lender. Notices will be mailed electronically to the addresses provided.

Lender is hereby authorized to fill in any blank spaces in this Note and to date this Note as of the applicable date and to correct patent errors herein.

This Note has been executed and delivered in the state of the Borrower's residence and is deemed a contract made under such state's law. The unenforceability of any provision of this Note shall not affect the enforceability or validity of any other provision of this Note.

Source: Company Documents

Exhibit 10 Proposed Securities Model



Source: Company documents

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