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Brage Humphries

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Funding the Future: Marketplace Lending, Equity Crowdfunding, and Bank Lending

I. INTRODUCTION

In October 2017, Arthur Moye, CEO of Full Circle Brewing Co., needed a $1 million loan to upgrade and expand his brewery in Fresno, California.\(^1\) His expansion plan included purchasing larger brewing tanks to quadruple the brewery’s capacity, renovating the brewery’s building, and going beyond brewing kegs of beer to producing cans of beer to sell in stores such as Safeway and Costco.\(^2\) Initially, Moye sought a traditional bank loan.\(^3\) However, instead of providing Full Circle with a $1 million loan, Fresno First Bank suggested that the company work with crowdfunding firm Breakaway Funding LLC to raise enough capital to reduce the bank’s risks of lending.\(^4\) The crowdfunding campaign allowed the average person to purchase a stake in the brewery with a minimum investment of only $500.\(^5\) As of January 2018, Full Circle raised $124,000 through equity crowdfunding, which then allowed the company to obtain a $685,000 traditional loan from Fresno First Bank.\(^6\) In October 2019, Full Circle estimated that over the past two years, its production capacity increased fifteen-fold, and its revenues increased by 335%.\(^7\)

Small businesses and startups such as Full Circle traditionally face great difficulty in raising money from customary sources of business finance, such as bank lending and venture capital.\(^8\) Although bank

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2. Id.
3. Id.
4. Id.
5. Id.
6. Id.
lending remains a major source of funds for entrepreneurial ventures, banks are commonly concerned about businesses’ creditworthiness. This concern makes banks hesitant to provide loans to businesses before they have a proven track record, consistent cash flows, and an adequate amount of tangible assets they can use as collateral. The 2008 financial crisis only increased these concerns. Although venture capital and angel investors address a portion of this need for funding, these investors are extremely selective and often only invest in companies with the potential for explosive growth. From 1981 to 2005, an average of only 0.1% of startups per year in the United States received venture capital funding. In response to this gap, crowdfunding developed as a method of alternative finance for these small businesses and startups.

Through the use of online platforms, crowdfunding projects are able to largely bypass bank intermediaries. The recent growth of crowdfunding—particularly lending-based and equity-based crowdfunding platforms—calls into question traditional lending models used by banks. The rising crowdfunding industry has replaced some

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10. Id.
12. See Walthoff-Borm et al., supra note 9, at 515 (explaining the rise of crowdfunding as an alternative to traditional bank finance following the 2008 financial crisis).
13. Id.
15. See Walthoff-Borm et al., supra note 9, at 516 (explaining how crowdfunding provides entrepreneurs with an alternative to traditional forms of equity financing and bank financing).
17. See id. (“As a consequence of this explosive growth, crowdfunding has been asking several pertinent questions of the traditional lending models used by banks.”).
conventional banking functions. Banks must decide whether to compete against or collaborate with this new and growing practice.

This Note examines current forms of crowdfunding and explores competition between crowdfunding and bank lending. This Note proceeds in four parts. Part II explains crowdfunding and various methods of crowdfunding. Part III examines the current impact of crowdfunding on traditional bank lending. Part IV explores existing partnerships between banks and crowdfunding platforms. Part V offers recommendations for how banks should adapt to the crowdfunding industry.

II. CROWDFUNDING

Crowdfunding is a method of raising money for projects or ventures from a large number of people. Today, this is typically performed via the Internet. Crowdfunding is a mode of crowdsourcing. While many believe crowdfunding to be a new phenomenon, forms of crowdfunding were used throughout history. For example, in 1885, New York City was short on funds for a pedestal

18. See id. (providing examples of banks being bypassed for by small businesses seeking financing).
19. See id. ("Banks have been deciding whether this revolutionary industry should be regarded as friend or foe, and as a result, have had to choose between collaborating or competing with [online crowdfunding platforms].").
20. See infra Part II.
21. See infra Part III.
22. See infra Part IV.
23. See infra Part V.
24. Crowdfunding, OXFORD UNIV. PRESS: OXFORD ENG. DICTIONARY ONLINE (3d ed. 2015), https://www-oed-com.libproxy.lib.unc.edu/view/Entry/429943?rskey=hxdLYt&result=2&isAdvanced=false#eid [https://perma.cc/H475-R76F] (defining crowdfunding as “the practice of funding a project or venture by raising money from a large number of people, each of whom contributes a relatively small amount, typically via the Internet.”).
25. Id.
for the Statue of Liberty, recently gifted from France. In response, Joseph Pulitzer led a successful rewards-based crowdfunding campaign to secure funding for the pedestal, rewarding gifts of one dollar or more with twelve-inch replicas of the Statue of Liberty. Today, crowdfunding sites such as Kickstarter.com, GoFundMe.com, and Indiegogo.com receive considerable attention as methods for entrepreneurs to fund their ideas.

Crowdfunding intermediaries represent platforms that “act as matchmakers between capital-seeking agents and capital-giving agents, funneling the funding from the investors to the capital-seeking enterprises.” Unlike traditional financial intermediaries, crowdfunding platforms merely facilitate funding instead of borrowing or lending on their own account. Crowdfunding platforms are examples of financial technology (“fintech”) companies. Crowdfunding is generally split into five categories: (1) donation-based crowdfunding, (2) rewards-based crowdfunding, (3) pre-purchase-based crowdfunding, (4) marketplace lending, and (5) equity-based crowdfunding. Although donation-
based, rewards-based, and pre-purchase-based crowdfunding are popular forms of crowdfunding, this Note focuses on the for-profit crowdfunding methods of equity crowdfunding and marketplace lending.

38. Donations-based crowdfunding allows individuals to contribute donations to a crowdfunding effort without receiving anything in return. See id. (describing various types of crowdfunding, including donations-based crowdfunding). If a crowdfunding campaign includes no potential for return in exchange for a contribution, then there is no offering of securities. Thomas Lee Hazen, Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure, 90 N.C. L. REV. 1735, 1739 (2012) (explaining that if there is no “express or implied possibility of a return to the donor, there is no offering of securities.”). Because donors have no possibility of return, this model of crowdfunding does not meet the definition of “investment contract” outlined in SEC v. W.J. Howey Co. and therefore does not implicate securities laws. S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946) (defining “investment contract” as “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .”). Donations may fund for-profit enterprises, but most donation sites focus on non-profit organizations. Bradford, supra note 8, at 15–16. Popular donations-based crowdfunding sites include globalgiving.org, GLOBALGIVING, globalgiving.org [https://perma.cc/2QPM-E22G] (last visited Sept. 21, 2019), and donorschoose.org. DONORSCHOOSE.ORG, donorschoose.org [https://perma.cc/M765-B7V8] (last visited Sept. 21, 2019). Pure donations-based crowdfunding sites are rare. Id. at 15.

39. Rewards-based crowdfunding provides contributors to a crowdfunding effort with a “tangible benefit in exchange for their donation.” Nazir, supra note 37, at 81–82. Pre-purchase-based crowdfunding is similar to rewards-based crowdfunding and is where contributors receive the product that the business or entrepreneur creates. Bradford, supra note 8, at 16. In order to avoid implicating securities laws, the benefit for both forms of crowdfunding cannot involve a financial return such as “interest, dividends, or part of the earnings of the business.” Id. Rewards and pre-purchase-based crowdfunding are the most common forms of crowdfunding. Nazir, supra note 37, at 81. Popular platforms that use these forms of crowdfunding include Kickstarter, GoFundMe, and Indiegogo. Jackie Zimmermann, Rewards-Based Crowdfunding: What it is, When it Works, NERDWALLET (Dec. 6, 2017), https://www.nerdwallet.com/blog/small-business/reward-crowdfunding/ [https://perma.cc/887R-2FFM]. Examples of rewards given to backers include t-shirts, digital downloads of albums, and “thank you” calls. Bradford, supra note 8, at 18. In its first case involving crowdfunding, the Federal Trade Commission (“FTC”) took legal action in 2015 against a project creator who raised funds through Kickstarter for a board game but spent most of the funds on himself. Press Release, Fed. Trade Comm’n, Crowdfunding Project Creator Sets Agrees FTC Charges of Deception (June 11, 2015) https://www.ftc.gov/news-events/press-releases/2015/06/crowdfunding-project-creator-sets-ftc-charges-deception [https://perma.cc/QSN4-D6Q] (describing the first crowdfunding case the FTC became involved in). In the campaign, the defendant raised over $122,000 from 1,246 backers, promising them rewards of a copy of the game or a figurine. Id. The case settled and represents an ongoing effort by the FTC to protect consumers involved in fintech and the potential for the FTC to become involved in this form of crowdfunding in the future. Id.

40. See Nazir, supra note 37, at 81–82 (describing that the pre-purchase-based crowdfunding is the most common form of crowdfunding, while providing examples of successful donations-based crowdfunding platforms and rewards-based crowdfunding campaigns).

41. See infra Part II.A.

42. See infra Part II.B.
A. Equity Crowdfunding

Equity crowdfunding is a process that allows investors to purchase ownership interests in companies.43 Because this form of crowdfunding involves the sale of a security,44 it implicates federal securities laws and is subject to regulation by the Securities and Exchange Commission (“SEC”).45 In general, any sale or offering of securities must qualify for an exemption in order to avoid registration under the Securities Act of 1933 (“1933 Act”).46 Prior to 2012, equity crowdfunding platforms were primarily governed by the Regulation D (“Reg D”) and Regulation A (“Reg A”) 1933 Act exemptions.47 These exemptions decrease regulatory obligations for issuers, reducing their costs and time to raise capital.48

On March 27, 2012, Congress enacted the Jumpstart Our Business Startups Act (“JOBS Act”) in order to expand access to public capital markets for emerging growth companies.49 Congress designated Title III of the JOBS Act as the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (“CROWDFUND Act”).50 The CROWDFUND Act served as the foundation for equity crowdfunding in the United States.51 This Act provided an exemption from registration with the SEC for the offer and sale of up to $1 million of securities in a twelve-month period to non-accredited investors.52

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45. Bradford, supra note 8, at 33.
48. Id. at 3.
50. Id.
52. A non-accredited investor is any investor who does not meet the income or net worth requirements to be an accredited investor as defined by the SEC. 17 C.F.R. § 230.501(a) (2019). For natural persons to be considered accredited investors, the current standard is an individual net worth or joint net worth with that person’s spouse of over $1,000,000 excluding the value of the primary residence, id. at § 230.501(a)(5), or an individual income of $200,000
On October 15, 2015, the SEC adopted a rule called Regulation Crowdfunding (“Reg CF”) that became effective on May 16, 2016 and implemented the requirements of the CROWDFUND Act.\(^\text{53}\) Under the rule as updated in 2017, issuers can raise up to an aggregate of $1.07 million over a twelve-month period without registering their offering with the SEC.\(^\text{54}\) The aggregate amount individuals may invest in offerings shall not exceed the greater of $2200 or five percent of the investor’s annual income if the investor’s annual income is less than $107,000.\(^\text{55}\) If the investor’s annual income and net worth are equal to or greater than $107,000, then the individual can invest up to the lesser of either ten percent of his or her annual income, or ten percent of his or her net worth, up to a maximum of $107,000.\(^\text{56}\) Reg CF also introduced the funding portal, a new kind of entity that acts as an intermediary in transactions involving the offer or sale of securities on behalf of others.\(^\text{57}\) This regulation allows ordinary retail investors to invest in private businesses as a crowd through these funding portals.\(^\text{58}\)

Companies relying on Reg D are exempt from registering their offerings but must file “Form D”, which includes information about the issuer’s identity, principal place of business, related persons, industry group, and other basic information.\(^\text{59}\) Currently, Reg D consists of three
rules: Rule 504, Rule 506(b), and Rule 506(c). Between 2009 and 2017, almost all of the reported offerings through Reg D used Rules 506(b) and 506(c). Rule 506(b) prohibits general solicitation and advertising and limits investors to accredited investors and up to thirty-five sophisticated, non-accredited investors. Rule 506(c), as amended by the SEC pursuant to Title II of the JOBS Act, permits general solicitation and advertising if the offering is limited to accredited investors. In 2017, $1.8 trillion of capital was raised using Rules 506(b) or 506(c), with an overwhelming majority raised pursuant to Rule 506(b).

Reg A was amended in 2015 pursuant to Title IV of the JOBS Act. The amended regulation (“Reg A”) increased the exemption for registration requirements for private offerings from up to $5 million to up to $50 million over a twelve-month period. Reg A splits offerings into two tiers. Each tier is subject to certain reporting requirements and regulatory compliance. Tier 1 requires only exit reports, while Tier 2 requires annual reports, semiannual reports, current event reports, audited

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61. 17 C.F.R. § 230.506(b).
62. 17 C.F.R. § 230.506(c); BAUGUESS ET AL., supra note 47, at 4.
63. Between 2009 and 2017, 99.9% of the reported offerings through Reg D used Rules 506(b) and 506(c). BAUGUESS ET AL., supra note 47 at 2.
64. 17 C.F.R. § 230.506(b)(2)(i).
66. 17 C.F.R. § 230.506(c).
68. From September 23, 2013, to December 31, 2017, only 4.4% of Rule 506 offerings have raised capital pursuant to Rule 506(c), with 95.6% of offerings having raised capital pursuant to Rule 506(b). Id. at 15.
71. Isaacson, supra note 51, at 448.
72. 17 C.F.R. § 230.251. Tier 1 allows issuers to offer up to $20 million over a 12-month period and Tier 2 allowing issuers to offer up to $50 million over a 12-month period. Id. Tier 1 does not put a limit on non-accredited investors investing in a Tier 1 offering, while Tier 2 limits the amount that non-accreditors can invest to no more than 10% of the purchaser’s net worth or annual income, whichever is greater. Id. at § 230.251(d)(2)(i)C).
73. Isaacson, supra note 51, at 448.
financial statements, and exit reports.\textsuperscript{74} Reg A+ acts as an alternative to a small Initial Public Offering or other securities offering methods under the 1933 Act.\textsuperscript{75} However, the cost of regulatory compliance creates a high barrier for Reg A+ offerings, making this exemption unlikely to trump Reg D for raising capital.\textsuperscript{76} Compared to Reg CF and Reg A offerings, Reg D offerings raise more capital and occur more frequently.\textsuperscript{77}

B. Marketplace Lending

Marketplace lending\textsuperscript{78} involves contributors who loan money and expect their loans to be returned in the future, normally with interest.\textsuperscript{79} This form of crowdfunding involves the “crowd” lending to borrowers through unsecured loans.\textsuperscript{80} These loans are typically made to individuals or small businesses.\textsuperscript{81} The most common form of marketplace loans are unsecured consumer loans, while small business loans are a growing second.\textsuperscript{82} The two most popular marketplace lenders are LendingClub\textsuperscript{83} and Prosper.\textsuperscript{84} As of June 30, 2019, LendingClub issued over $50 billion in loans\textsuperscript{85} while Prosper facilitated more than $16 billion in loans as of

\begin{footnotesize}
\begin{enumerate}
\item 17 C.F.R. § 230.257 (2019).
\item Isaacson, supra note 51, at 449.
\item BAUGUESS ET AL., supra note 47, at 9.
\item Marketplace lending is also known as peer-to-peer lending. John L. Douglas, New Wine into Old Bottles: Fintech Meets the Bank Regulatory World, 20 N.C. BANKING INST. 17, 27 (2016). This practice is also referred to as debt crowdfunding, person-to-person lending, P2P lending, or lending-based crowdfunding. Wroldsen, supra note 43, at 588–89.
\item Wroldsen, supra note 43, at 588–89.
\item LENDINGCLUB, supra note 83.
\end{enumerate}
\end{footnotesize}
To provide a loan, the marketplace lending platform must approve the borrower. Once approved, the borrower receives a credit risk score and an interest rate determined by the platform. Because most of the platform’s services are automated, getting a loan can be easier, faster, and more cost effective than borrowing from a bank.

In 2008, the SEC issued a cease and desist order against Prosper. The SEC declared that Prosper, and by extension other marketplace lending platforms, were offering securities. Following the SEC’s cease and desist order, marketplace lending platforms had to shelf register each loan before a lender’s investment. Details of each funded loan are now recorded on EDGAR.

The cease and desist order also changed how marketplace lending platforms conduct their transactions. Before the SEC’s order, platforms such as Prosper and LendingClub originated loans to borrowers, and WebBank, a Utah-chartered industrial bank funded the loans. WebBank then assigned the note to the lender through the platform. After the order, notes issued by Prosper and similar marketplace lending

86. PROSPER, supra note 84.
87. Freeman & Nutting, supra note 80, at 3–4.
88. Id. at 4.
89. Id.
91. Id. at *4.
92. Shelf registration is a method for issuers to register new offerings on a delayed basis without having to issue them immediately. See 17 C.F.R. § 230.415 (2019) (describing the process of shelf registration). Shelf registration allows an issuer to register a group of securities and then issue them in parts. See Andrew Verstein, The Misregulation of Person-to-Person Lending, 45 U.C. Davis L. Rev. 445, 489 (2011) (explaining the advantages of shelf registration for peer-to-peer lending platforms). Shelf registration is essential for peer-to-peer lending platforms because it allows issuers “economies of scale in registration.” Id.
94. EDGAR is the SEC’s publicly accessible disclosure database. Id.
96. An industrial bank is “a financial institution deriving funds from the sale of investment certificates and from deposits made by individual savers and investing such funds in personal loans often secured by a comaker note or chattel mortgage.” Industrial Bank, MERRIAM-WEBSTER ONLINE DICTIONARY, https://www.merriam-webster.com/dictionary/industrial%20bank [https://perma.cc/AFJ2-ZB2U] (last visited Oct. 25, 2019).
97. Verstein, supra note 92, at 476.
98. Id.
platforms continue to remain the platform’s obligation. These notes, also known as “borrower payment dependent notes,” are debt instruments sold to lenders who then receive money contingent on borrower repayment. After the SEC’s cease and desist order, all marketplace lending platforms either registered with the SEC or failed. While the marketplace lending platform now formally retains loans that are funded and selected by investors, in practice investors bear the credit risk because the notes offered by the platforms are only payable once borrowers make payments on their loans. Despite these changes in regulation and transactions following the SEC’s order in 2008, marketplace lending remains popular.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) tasked the U.S. Government Accountability Office (“GAO”) with studying marketplace lending in order to develop an “optimal federal regulatory structure.” The GAO study was completed in 2011 and found two primary regulatory options for marketplace lending, which offered different approaches to lender protection. The two options recommended by the GAO included: “(1) continuing with the current bifurcated federal system—that is, protecting lenders through securities regulators and borrowers primarily through financial services regulators . . . or (2) consolidating borrower and lender protection under a single federal regulator, such as CFPB.” However, the report was inconclusive on which option Congress should select, so marketplace lending platforms remain regulated by the SEC.

99. Id. at 476–77.
100. Id. at 477.
101. Id. at 476–77.
103. Id. at 1084.
104. Lo, supra note 93, at 90. For example, LendingClub has issued over $50 billion in loans as of June 30, 2019, LENDINGCLUB, supra note 83, while Prosper has facilitated more than $16 billion in loans as of September 15, 2019. PROSPER, supra note 84.
107. Id.
108. Id.
The proper regulation of marketplace lending and other fintech companies remains open to debate. In 2016, the Office of the Comptroller of the Currency (“the OCC”) offered guidance on the possibility of creating a special purpose national bank charter for fintech companies, including marketplace lending platforms. The OCC declared that a fintech company must, at minimum, receive deposits, pay checks, or lend money to receive a special purpose bank charter. However, in May 2019, the U.S. District Court for the Southern District of New York held that the OCC could not issue a special purpose bank charter to a fintech company that does not receive deposits. The court held that the National Bank Act was unambiguous that the “business of banking” requires receiving deposits. While this decision calls into question the OCC’s ability to issue a special purpose bank charter for a fintech company, it remains unclear whether marketplace lending platforms are included in the OCC’s definition of a fintech company.

III. THE IMPACT OF CROWDFUNDING ON BANK LENDING

While bank lending continues to be a major source of capital for businesses, banks remain concerned about firm creditworthiness and are hesitant to provide loans to businesses without proven track records, consistent cash flows, or sufficient assets to pledge as collateral. This reluctance increased as a result of the 2008 financial crisis, as banks became more “risk-averse” and faced tightened regulations in its...
Growing demand for alternative funding established crowdfunding methods like marketplace lending and equity crowdfunding as popular sources of funding for startups and small-to-medium sized businesses.  

Under traditional “pecking order theory,” information asymmetries typically drive entrepreneurs to use internal funds whenever available. However, when these funds are lacking, entrepreneurs turn to debt financing, which includes marketplace lending. Entrepreneurs usually prefer debt financing to equity financing because equity financing normally involves a dilution of their ownership share. If debt financing is neither available nor a practical option, entrepreneurs turn to external equity financing. Equity crowdfunding, a form of external equity financing, is therefore employed as a last resort under traditional pecking order theory.

A. The Impact of Marketplace Lending on Bank Lending

Marketplace lending represents a developing non-bank activity that competes with the traditional financial intermediation conducted by commercial banks. In 2015, the two largest marketplace lending platforms originated $12 billion in personal unsecured loans, compared to $241 billion of outstanding personal loans in the United States. A
2016 report found that the global marketplace lending market was $26.6 billion in 2015, but it anticipates that this market will be worth $897.85 billion by 2024.\textsuperscript{131} This projected growth is attributed to the after-effects of the 2008 financial crisis, including low interest rates and lack of sufficient funding for businesses.\textsuperscript{132} Technological advances, improved online interfaces, and numerous partnerships between crowdfunding platforms are also expected to contribute to this industry’s growth.\textsuperscript{133}

For borrowers, loans from marketplace lenders generally charge lower interest rates than similar bank loans because a majority of marketplace lending services are automated, resulting in lower overhead for the platforms.\textsuperscript{134} Because marketplace lending represents an alternative to bank lending, marketplace lenders compete with banks.\textsuperscript{135} These lenders are able to provide loans to high-risk borrowers who cannot obtain credit from traditional financial intermediaries.\textsuperscript{136} This facilitates credit expansion for borrowers who are deemed too risky by commercial banks.\textsuperscript{137} Marketplace lending also affects small commercial banks through these banks’ losses in loan volume and acceptance of riskier borrowers.\textsuperscript{138} Most of these losses in loan volume come from high-risk loans, as low credit borrowers seek marketplace loans in place of commercial bank loans.\textsuperscript{139} Large commercial banks do not currently appear to be losing loan volume to marketplace lenders.\textsuperscript{140} Marketplace lending is likely to progressively affect bank lending in the future as the

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\textsuperscript{132} \textit{Id.}

\textsuperscript{133} \textit{Id.}

\textsuperscript{134} Freeman & Nutting, supra note 80, at 4.

\textsuperscript{135} See Wolfe & Yoo, supra note 128 (showing that “peer-to-peer lending represents an emerging competitor to traditional depository lenders such as commercial banks.”).

\textsuperscript{136} \textit{Id.} at 1.

\textsuperscript{137} \textit{Id.}

\textsuperscript{138} \textit{Id.} at 4 (defining small commercial banks as banks with assets less than $300 million).


\textsuperscript{140} \textit{Id.} at 3.
\end{flushleft}
global marketplace lending industry increases in size and more borrowers choose marketplace loans.141

B. The Impact of Equity Crowdfunding on Bank Lending

While marketplace lending directly competes with bank lending,142 equity crowdfunding is in less direct competition with bank lending because entrepreneurs traditionally choose debt financing over equity financing.143 Although still in its infancy, equity crowdfunding is becoming an increasingly popular source of external finance for early stage companies,144 as banks restricted lending after the 2008 financial crisis.145 Following the implementation of Reg CF and Reg A+, the “crowd” became more involved in equity crowdfunding campaigns.146 However, Reg D offerings continue to raise significantly more capital and occur more frequently compared to Reg CF and Reg A+ offerings.147

141. See Transparency Mkt. Research, supra note 131 (providing statistics that display the growth of marketplace lending).
142. See Wolfe & Yoo, supra note 128 (explaining that marketplace lending is a form of a “non-bank activity competing with traditional deposit-taking lenders.”).
143. See Walthoff-Borm et al., supra note 9, at 515 (explaining the rise of crowdfunding as an alternative to traditional bank finance following the 2008 financial crisis and the pecking order theory in corporate finance).
144. Id.
145. Id. at 516.
146. See Isaacson, supra note 51, at 463–64 (arguing that Regulation D, Regulation A+, and Title III of the JOBS Act have failed to accomplish the JOBS Act’s goal of increasing investment opportunities for the average investor).
147. Between September 23, 2013, and December 31, 2017, there were 7,110 Rule 506(c) filings initiated, raising almost $183.3 billion in initial Form D filings. Bauguess et al., supra note 47, at 15. During the same period, there were 87,890 Rule 506(c) filings initiated, raising almost $1.8 trillion in initial Form D filings. Id. Under Reg A+, securities offerings outpaced the rate of those under Reg A in the period from June 19, 2015, to October 31, 2016. Knyazeva, supra note 75, at 1. During that time period, issuers filed 147 offerings under Reg A+ seeking a total of $2.6 billion. Id. Although issuers only reported earning an approximate total of $190 million during this time period, this is likely understated due to the limit on the reporting timeframes. Id. The SEC estimates that there were 1,351 equity offerings under Reg CF between its implementation on May 16, 2016, and December 31, 2018. Staff of U.S. Sec. and Exch. Comm’n, Report to the Commission, Regulation Crowdfunding 4 (2019) (providing a detailed report on crowdfunding for the first three years following the implementation of Regulation Crowdfunding). The approximate number of offerings increased each year, with 292 initiated in the first 12 months, 557 in the second 12 months, and 502 from May 16, 2018 through December 31, 2018. Id. During this entire period, 105 issuers also returned to crowdfunding for follow-on offerings. Id. The median amount reported raised for completed offerings was $107,367. Id. As of the end of 2018, there were 45 funding portals registered with the Financial Industry Regulatory Authority (“FINRA”). Id. at 27. Since Reg CF’s implementation, the total proceeds from crowdfunding campaigns and the number of successful campaigns utilizing this regulation grew significantly. Crowdfund Capital Advisors, The 2018 State of Regulation Crowdfunding
D offerings under 506(b) and 506(c) only apply narrowly in scope to accredited investors\textsuperscript{148} and a limited number of non-accredited investors.\textsuperscript{149} Because Reg CF and Reg A+ do not limit the number of non-accredited investors who can invest in an equity crowdfunding campaign, they are viewed as a step in the right direction towards allowing the “crowd” to engage in investment opportunities.\textsuperscript{150}

Entrepreneurs usually prefer debt financing to equity financing because equity financing usually involves a dilution of their ownership share.\textsuperscript{151} If debt financing is neither available nor a practical option, entrepreneurs turn to external equity financing.\textsuperscript{152} A 2018 study examined data from 277 firms that searched for equity crowdfunding on Crowdcube, a UK crowdfunding platform, to determine how equity crowdfunding fits into traditional pecking order theory.\textsuperscript{153} The study found that firms which are less profitable, lack internal funding, have excessive debt levels, and have high levels of intangible assets are more likely to search for crowdfunding.\textsuperscript{154} This indicates that firms tend to choose equity crowdfunding as a last resort.\textsuperscript{155} Therefore, the study suggests that equity crowdfunding does not directly compete with bank lending because entrepreneurs typically choose debt over equity financing.\textsuperscript{156} However, equity crowdfunding can help banks close the gap on informational asymmetries that typically cause banks to avoid lending to startup companies without a proven track record.\textsuperscript{157} A successful equity crowdfunding campaign signals to banks that the

\textsuperscript{148} 17 C.F.R. § 230.506(c) (2019).
\textsuperscript{149} 17 C.F.R. § 230.506(b)(2)(i) (2019).
\textsuperscript{150} See Isaacson, supra note 51, at 463–64.
\textsuperscript{151} Cosh et al., supra note 125, at 1498.
\textsuperscript{152} Walthoff-Borm et al., supra note 9.
\textsuperscript{153} Id.
\textsuperscript{154} Id. at 513.
\textsuperscript{155} Id. at 514.
\textsuperscript{156} Id.
\textsuperscript{157} See id. (“Because of information asymmetries, entrepreneurs prefer to use internal financing whenever possible; next they will raise external debt financing; and, finally, when their debt capacity is exhausted, they will raise external equity financing, but only as a last resort.”).
startup company will be profitable in the future and less likely to default on a loan.\textsuperscript{158}

IV. PARTNERSHIPS BETWEEN BANKS AND CROWDFUNDING PLATFORMS

A. Bank Partnerships with Marketplace Lending Platforms

Although marketplace lending platforms primarily affect banks through losses in loan volume and the acceptance of riskier borrowers by small commercial banks,\textsuperscript{159} there are opportunities for partnerships and collaboration between marketplace lenders and banks of all sizes.\textsuperscript{160} As the global marketplace lending market exhibits a high potential for growth,\textsuperscript{161} some banks have noticed marketplace lending and become involved in the industry.\textsuperscript{162} Banks commonly partner with marketplace lenders to facilitate loan transactions.\textsuperscript{163} Banks and marketplace lenders have also formed partnerships through acquisitions, joint ventures, and hybrid lending practices.\textsuperscript{164}

While many marketplace lenders lend directly to borrowers, some partner with banks to facilitate loan transactions.\textsuperscript{165} In this partnership, the marketplace lender collects borrower applications, provides credit grades, and then refers the application to its partner bank.\textsuperscript{166} Once the partner bank receives the application, the bank makes the loan to the

\begin{itemize}
\item \textsuperscript{158} See John Reosti, \textit{Ex-Banker’s Crowdfunding Firm Finds Its Missing Link: A Bank}, AM. BANKER (Sept. 29, 2016) (explaining how Fresno First Bank’s partnership with Breakaway Funding helps close the “information gap” between the bank and its prospective borrowers).
\item \textsuperscript{159} Wolfe & Yoo, supra note 128, at 1.
\item \textsuperscript{160} Julapa Jagtiani & Kose John, \textit{Fintech: The Impact on the Consumer and Regulatory Responses}, 100 J. OF ECON. AND BUS. 1, 2 (2018).
\item \textsuperscript{161} TRANSPARENCY MKT. RESEARCH, supra note 131 (describing the growth of marketplace lending).
\item \textsuperscript{163} Angela Herrboldt, \textit{Marketplace Lending} 13 (2015), https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/si_winter2015-article02.pdf [https://perma.cc/434C-5AKK].
\item \textsuperscript{164} Jagtiani & John, supra note 160, at 2.
\item \textsuperscript{165} Herrboldt, supra note 163, at 13.
\item \textsuperscript{166} Id. at 14.
\end{itemize}
borrower and then sells the loan back to the marketplace lender. The marketplace lender issues securities notes to the investors who pledged to provide funding for the loan. The borrower then makes monthly payments to the marketplace lender, who issues payments to the investors and charges a fee.

Acquisitions and joint ventures between banks and marketplace lenders reduce banks’ lending costs through the implementation of technology that provides banks with automated services and makes lending easier, faster, and more cost effective. As of 2019, PNC Bank’s partnership with digital lender OnDeck Capital allows U.S. businesses to apply for lines of credit up to $100,000 on PNC’s website and receive an answer almost immediately through the use of OnDeck’s technology. PNC’s goal is to make credit access easier and faster for small businesses. Similarly, JP Morgan and OnDeck Capital began a partnership in 2016, wherein OnDeck provided its technology to JP Morgan for the bank to offer online loans to small businesses. When the partnership ended in 2019, JP Morgan developed its own platform to continue to offer these online loans to small businesses.

Banks and marketplace lending platforms also partner at the community banking level. The BancAlliance network, a national group of community banks ranging from $200 million to $10 billion in assets, and LendingClub formed a partnership in 2015. This partnership offers BancAlliance members access to co-branded personal loans through the LendingClub platform and the ability purchase some of

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167. Id.  
168. Id.  
169. Id.  
170. See Freeman & Nutting, supra note 80, at 4 (describing the history and development of crowdfunding).  
172. See id. (describing PNC Bank’s partnership with OnDeck Capital).  
174. Id.  
175. Id.  
the loans for their own portfolios. The partnership pairs LendingClub’s low cost of operations with the community banks’ low cost of capital to decrease the cost of credit for consumers.

Another potential partnership between banks and marketplace lending platforms involves a practice called “hybrid lending.” Hybrid lending combines normal balance sheet lending with off-balance sheet lending through marketplace lending platforms. Normal balance sheet lending refers to the traditional financial intermediation of loans by banks through withdrawable deposits, where banks lend to a borrower and hold the loan on their balance sheet to maturity. Off-balance sheet lending refers to loans that have been moved off of a bank’s balance sheet through pooling and securitization. The combination of balance sheet and off-balance sheet lending allows businesses to finance part of a loan through a marketplace lending platform and the rest through traditional bank lending. Rabobank, a Dutch bank, is one of the first banks in the world to adopt a hybrid model through its own hybrid platform called Rabo & Co. The bank offers businesses the ability to finance part of their loan on the bank’s balance sheet, while providing the remaining funding through co-financing from institutional investors and banking clients. Currently, this hybrid model is used by many of the leading marketplace lending platforms.

Hybrid lending is advantageous for banks involved in lending to riskier businesses such as startups and small businesses because it

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177. Id.
178. Id.
180. Id.
182. See id. at 3 (describing off-balance sheet lending).
183. See Veenstra, supra note 179 (explaining the advantages and potential of hybrid lending).
184. Id.
185. See id. ("[W]ith its own hybrid lending marketplace, the bank could take a portion of that loan as part of its standard balance sheet lending (the amount that fits its balance sheet risk model), and put the remainder in its marketplace for investors to fund.").
mitigates the lender’s risk.\textsuperscript{187} This model is also advantageous for investors.\textsuperscript{188} When the originator of a loan retains some risk on their balance sheet, investors have more confidence in the loans because their incentives are aligned with the originator’s.\textsuperscript{189} Additionally, the model helps lenders survive periods of capital scarcity in the marketplace lending market.\textsuperscript{190} As small commercial banks have been affected the most by marketplace lending through losses in loan volume and the acceptance of riskier borrowers, they stand to gain the most from hybrid lending.\textsuperscript{191}

B. Bank Partnerships with Equity Crowdfunding Platforms

While equity crowdfunding may be a last resort for firms in search of capital,\textsuperscript{192} some banks such as Fresno First Bank have formed partnerships with equity crowdfunding platforms.\textsuperscript{193} In general, banks are hesitant to provide loans to unproven startups and small businesses that do not have significant assets.\textsuperscript{194} Therefore, the primary advantages of bank partnering with equity crowdfunding sites are reducing information asymmetries that cause banks to avoid lending to startups and small businesses, and providing startups and small businesses with collateral.\textsuperscript{195} The popularity of an equity crowdfunding campaign signals to the bank that a venture can be successful,\textsuperscript{196} while the campaign can

\textsuperscript{187} See Veenstra, supra note 179 (explaining the advantages and potential of hybrid lending).
\textsuperscript{189} Id.
\textsuperscript{190} Id.
\textsuperscript{191} See generally Wolfe & Yoo, supra note 128 (explaining the effect of peer-to-peer lending on bank credit).
\textsuperscript{192} Walthoff-Born et al., supra note 9, at 514.
\textsuperscript{193} See Reosti, supra note 158 (explaining the partnership between Fresno First Bank and Breakaway Funding).
\textsuperscript{194} Berger & Udell, supra note 11, at 623–624.
\textsuperscript{195} See id. (stating that banks will generally not lend to small businesses until “they reach a level of production where their balance sheets reflect substantial tangible business assets that might be pledged as collateral.”).
\textsuperscript{196} See Reosti, supra note 158 (explaining the partnership between Fresno First Bank and Breakaway Funding).
also provide the business with sufficient capital to pledge as collateral for a loan.197

In 2016, Fresno First Bank formed a partnership with equity crowdfunding platform Breakaway Funding.198 This partnership was designed to allow the bank to evaluate prospective clients earlier in the capital cycle than it could otherwise.199 First, Breakaway Funding receives important business information such as business plans, financial projections, and financial statements.200 Then, Breakaway Funding packages the information for review by the bank.201 This information, along with the support that a crowdfunding project receives from backers, helps close the information gap that normally causes banks to avoid lending to these businesses.202 Full Circle Brewing Co. utilized this partnership to receive a traditional bank loan from Fresno First Bank after its successful equity crowdfunding campaign.203

V. CONCLUSION AND RECOMMENDATIONS

Although crowdfunding does not yet rival traditional bank lending, there is clear demand for alternative funding that poses a threat to the banking industry.204 Banks now realize the business potential for crowdfunding and are becoming involved in the industry through their own platforms or through partnerships with existing platforms.205

197. See Berger & Udell, supra note 11, at 624 (stating that banks will generally not lend to small businesses until “they reach a level of production where their balance sheets reflect substantial business assets that might be pledged as collateral.”).
198. Reosti, supra note 158.
199. Id.
200. Id.
201. Id.
202. Id.
203. Castellon, supra note 1. A similar partnership formed in 2013 between BNP Paribas, a French international bank, and Ulule, Europe’s first crowdfunding platform. BNP Paribas, Banking and Crowdfunding: a Complementary Relationship (Apr. 4, 2018), https://group.bnpparibas/en/news/banking-crowdfunding-complementary-relationship [https://perma.cc/S2AT-RJGM]. The bank similarly uses information from a crowdfunding campaign to make loans to the business, believing that a “successful crowdfunding campaign provides a strong guarantee: it demonstrates the existence of a market, the entrepreneur’s professionalism and their capacity to mobilize future customers.” Id. In 2017, BNP Paribas and Ulule created a financing system where successful crowdfunding campaigns on Ulule obtain a bank loan from BNP Paribas for an amount equal or greater to the total amount raised by their campaign. Id.
204. See Setälä, supra note 34 (describing the rise of crowdfunding and its competition with the banking industry).
205. See id. (exploring the potential use of crowdfunding in the banking industry).
Although banks face less direct competition from equity crowdfunding than from marketplace lending, \footnote{206. See Walthoff-Borm et al., supra note 9 (explaining how business first choose debt finance over equity finance under traditional pecking order theory).} banks have the opportunity to benefit through partnerships with equity crowdfunding platforms. \footnote{207. See Reosti, supra note 158 (explaining the advantages of the partnership between Fresno First Bank and Breakaway Funding).} These partnerships expand bank lending to startups and small businesses through campaigns that provide ventures with capital that can be used as collateral \footnote{208. See Berger & Udell, supra note 11, at 624 (stating that banks will generally not lend to small businesses until “they reach a level of production where their balance sheets reflect substantial business assets that might be pledged as collateral.”).} and help close the information asymmetry gap between these borrowers and banks. \footnote{209. See Reosti, supra note 158 (explaining how the partnership between Fresno First Bank and Breakaway Funding allows Fresno First Bank to decrease the information gap between it and its borrowers).}

Marketplace lending, on the other hand, directly competes with bank lending. \footnote{210. Wolfe & Yoo, supra note 128.} Nevertheless, partnerships between banks and marketplace lending platforms can position banks to benefit from the rise of the marketplace lending industry. \footnote{211. See Jagtiani & John, supra note 160.} Banks should choose to partner with marketplace lending platforms directly through facilitating loan transactions, acquisitions, or joint ventures, \footnote{212. See generally Freeman & Nutting, supra note 80, at 4 (describing the history and development of crowdfunding).} or adopt hybrid lending practices which allow banks to lend to riskier borrowers such as startups and small businesses. \footnote{213. See Veenstra, supra note 179 (explaining the advantages and potential of hybrid lending).} As marketplace lending increases, \footnote{214. TRANSPARENCY MKT. RESEARCH, supra note 131.} these partnerships will provide a growing source of revenue for banks and allow them to play a central role in this emerging industry. \footnote{215. See Herrboldt, supra note 163, at 18 (describing bank participation in marketplace lending as an attractive source of revenue for banks).}