

Regulatory Circumvention: Underpricing and Flipping in Marketplace Lending

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- ▶ How does this regulation affect the pricing strategy of MPLs?
- ▶ Since MLPs make money by charging fee on loan originations, MLPs want to increase origination volume
- ▶ Main predictions and findings
 1. If secondary markets exist, MLPs offer higher interest rates (lower prices) to attract investors who flip securities in the secondary market so that excluded investors can participate.
 2. When market segmentation ends, the interest rate should go down (prices go up)

Overview of Comments

- ▶ Very important question given the increasing share of FinTech lenders
- ▶ Novel contribution by studying the pricing mechanism of loans offered by MLPs
- ▶ Unique regulatory setting to answer the research question

Scope for improvement:

1. Conceptual clarity
2. Identification
3. Interpretation of results

Comment 1: Conceptual Framework

- ▶ Borrow from Wei and Lin (2016)

$$E\pi_p = a.Q.Pr(W^{N:Q} < \gamma(p))$$

- ▶ Argue that $E\pi_p$ is increasing in Q
- ▶ $E\pi_p$ is increasing in Q , *ceteris paribus*. Not sure how an increase in $\gamma(p)$ would increase Q
- ▶ Supply of funds increasing in $\gamma(p)$ while demand for funds decreasing in $\gamma(p)$
- ▶ Increasing $\gamma(p)$ because of market segmentation will attract more investors but might drive away borrowers
- ▶ How does it affect the probability of the loan being repaid (which would also affect expected profit)?
- ▶ Can you provide direct evidence on whether the loan amount increases after the regulatory change?
- ▶ Can you also test if the origination fee changes post registration?

Comment 2(i): Empirical Strategy

$$\text{InterestRate}_{i,t} = \beta_t + \beta_s + \beta_1 \text{PostRegistration}_t + x'_{\text{borrower}} \beta_c + x'_{\text{loan}} \beta_l + \epsilon_{i,t}$$

Concern 1:

- ▶ Has the nature of contracts changed? Since these MLPs are now regulated, do they originate safer contracts which provide a lower return to investors.

Suggestions:

- ▶ Show summary stats table with loan characteristics before and after the regulatory change
- ▶ Matched control group in robustness tests (only for the IPO event) but that should be the baseline
- ▶ Implement Khwaja and Mian (2008) strategy. **Look at repeat transactions by the same borrower** before and after the registration.
- ▶ Half of all transactions for Lending Club are repeat transactions. Within borrower change in interest rate will alleviate any concerns arising from composition changes driving the results.

Comment 2(ii): Empirical Strategy

Concern 2:

- ▶ What if the fall in interest rate is not a strategic response of the underwriters to the regulation but rather reflects a change in demand of investors?
- ▶ Since securities are now regulated, perhaps the investors demand a lower risk premium for funding these contracts compared to the case when these MLPs were not regulated?

Suggestion:

- ▶ Can you exploit any variation across states in terms of benefits enjoyed by investors after the registration?

Comment 2(iii): Empirical Strategy

Concern 3:

- ▶ Need more evidence to rule out the credit supply story
- ▶ Could the null results for auction pricing be driven by small sample size?

	InterestRate			
	Fixed Pricing		Auction Pricing	
	(1)	(2)	(3)	(4)
PostRegistration	-0.24172*** (-25.653)	-0.23455*** (-24.863)	0.45412 (0.507)	0.50642 (0.564)
LnAmount	0.00844 (0.784)	0.02246* (1.942)	1.30943*** (8.371)	1.27923*** (7.972)
	(54.694)	(41.936)	(-2.742)	(-1.116)
Borrower State FE	Yes	Yes	Yes	Yes
Employment Status	Yes	Yes	Yes	Yes
Credit Grade FE	BRM	BRM × Credit Grade	BRM	BRM × Credit Grade
Time FE	None	None	None	None
SE clustered	Borrower state	Borrower state	Borrower state	Borrower state
R-squared	0.931	0.933	0.843	0.844
Adj. R-squared	0.931	0.933	0.829	0.829
Obs.	83,086	83,086	879	879

- ▶ Suggestion: Add investor fixed effects

Comment 3: Interpretation of Results

- ▶ Do higher interest rates during the market segmentation period reflect underpricing? Important to think about the right benchmark
- ▶ It's possible that before the regulation, the higher interest rate are an optimal response to frictions arising from asymmetric information between the borrowers and investors.
- ▶ Investors will invest in risky loans only if they are offered a high enough compensation for bearing this risk

Conclusion

- ▶ Interesting paper and important question
- ▶ More work needed to claim that the reduction in interest rates post regulation reflects **strategic pricing** by underwriters
- ▶ Implementing a Kwaja and Mian (2008) style estimation will lend immense support to the identification strategy
- ▶ Many avenues for future research