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June 3, 2008

Via DHL

Edward A. Giedgowd, Esq.
Chief Compliance Officer and General Counsel
PROSPER MARKETPLACE, INC.
111 Sutter St., 22nd Floor
San Francisco, CA 94104-4540
Phone: (415) 593-5418
Fax: (415) 362-7233
e-mail: ed@prosper.com

RE: INCREASED RISKS OF LOSS AND ACTUAL LOSSES CAUSED BY PROSPER'S FAILURES

Dear Mr. Giedgowd:

I represent a group of Prosper lenders who are frustrated about the platform and its nonresponsiveness to lender concerns. This letter summarizes these lenders' major concerns, and proposals for addressing them. This letter is sent with the hope that these issues will be resolved quickly and informally.

I. Failure to Provide Accurate Information About Risks Presented By Certain Locations or Types of Loans

It has become apparent to lenders that Prosper has permitted loans to originate in states where it cannot or will not make meaningful efforts to collect on late loans. Prosper has not informed lenders of the difference in debt collection laws of the various states, nor how Prosper permits these different laws to impact its performance of its fiduciary duties to lenders. Prosper apparently is also more interested in pursuing collections on larger loans than on smaller loans. Prosper has not informed lenders that the difference in state laws, or in Prosper's own collection practices, may impact Prosper's fiduciary duty to collect lenders' funds in the event of delinquency, or that sales of those loans upon default may result in lower prices.

This information, and any other information Prosper has collected about trends from various states or types of loans or that is otherwise material to a lender's decision to bid on a listing, must be provided to lenders.

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II. Poor Collections Results

Lenders have been expressing concern about the extremely poor collection performance for more than a year. (See, for example, <http://www.prospers.org/blogs/media/blogs/Fred93/open-letter-number-2.pdf>.) Adding to that concern is the lack of any information – specific or general – about the status of collections on particular loans. My clients have not been furnished with any information about efforts to collect on their late loans, including whether the collection agency has even successfully contacted the delinquent borrowers. This is unacceptable. Prosper, as my clients' loan servicer, must immediately amend its policies and procedures to provide lenders with specific information about the efforts made to collect on the loans, including the borrowers' stated intent with respect to repayment. That information must be provided along with all other data about loan payments.

If a borrower has sent a "cease and desist" letter to the collection agency, Prosper must assume responsibility for collections, and for informing lenders of the status of those efforts.

In addition, lenders have repeatedly raised concerns about "blenders," borrowers who are also lenders, with late loans. The LRA, and all other appropriate legal documents, must be amended immediately to provide Prosper with the right to withhold payments due to blenders whose loans are more than fifteen days late, and apply those payments to the blenders' overdue loan balances. Prosper already promised lenders in writing on March 2, 2007 that "If one of them defaults, we'll find a way to take the gains from the borrower's lending portfolio and give it to lenders on their loan." Demand is hereby made that Prosper rectify its breach of this promise by paying the lenders on every such loan their pro rata portion of the blender's own lending account that should have been, but wasn't, given to them when the blender defaulted.

III. Failure to Sell Defaulted Loans

My clients are dismayed by the increasingly large portfolio of non-performing loans on the platform, and Prosper's refusal to sell them. The LRA currently states:

Except in the case of borrower bankruptcy, Notes that become over 120 days past due are charged off and offered for sale to an unaffiliated debt buyer authorized and willing to purchase consumer loans. You authorize Prosper to offer for sale and sell your Notes that become over 120 days past due to a debt buyer in accordance with this Section. Because debt purchasers buy many past-due Notes at once, Notes that are in default might not be offered for sale at the point at which they are exactly 120

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days past due, but may remain unsold for some period after they are 120 days past due.

Many lenders have loans that are eight or nine months past due, or more. The older these loans become, the less they are worth – and the more likely the borrowers are to file for bankruptcy. Prosper controls the timing of the debt sales, and does not appear to be abiding by the terms of the LRA.

It is particularly troubling that one offer to purchase a delinquent loan at twice what the junk debt buyer ultimately paid was unjustifiably rejected by Prosper. That demonstrates that Prosper may not be putting its lenders' interests first, as Prosper's fiduciary duties to its lenders require it to do. Demand is hereby made that Prosper immediately sell all loans that are delinquent by more than 120 days, unless the borrower has made a payment of at least one month's principal and interest in the prior thirty days, or there is some other individualized reason that Prosper reasonably believes that holding that loan out of the debt sale is in the lenders' best interests. That reason must be disclosed to lenders. In addition, demand is hereby made that Prosper reimburse each and every lender on loan 4018 the money that Prosper's improper rejection of the high bid for that defaulting loan cost them. If Prosper wishes to accept a low bid, rather than a higher bid, then Prosper, not the lenders, should suffer the loss caused by that decision.

Prosper's failure to hold quarterly debt sales has resulted in clear harm to lenders. Prosper last sold defaulted loans in December, 2007, and the sales price was substantially less than at the prior sale. Prosper apparently attempted another debt sale in late April, 2008 (a month later than it should have), where the bids were substantially lower than in December. Instead of selling the loans for the best price Prosper could get (as its fiduciary duty and the LRA obligated it to do), Prosper permitted the loans to age even longer, devaluing the older debt even more, and in late May, 2008 was apparently offered less than half of what it had been offered a month earlier. Demand is hereby made that Prosper treat all loans that were 121+ days late as of the date of the December debt sale as having been sold in March, 2008. To that end, Prosper must provide very specific detail about the debt sale proceeds received in December, 2007 and the bids made in April and May, 2008 so lenders can determine a fair price.

Prosper has recently notified lenders that the bids it received to buy defaulted loans in May were either very low or attached conditions that Prosper deemed unacceptable. Prosper must specify, in detail, the "conditions" that made the May, 2008 bids unacceptable to it, and explain why it rejected those bids. With respect to all debt sale negotiations in 2008, Prosper must disclose the identity of the debt bidders and buyers to the lenders, as well as the terms of each offer so that the lenders can

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verify that Prosper did, indeed, make a commercially reasonable effort to obtain the best possible price for the loans. Further, for each effort to sell the debt, Prosper must disclose to lenders the identity of each bidder and the winning bidder on past sales, and every potential debt buyer that Prosper notified of the upcoming sale in an effort to solicit bids.

In another express violation of the LRA, Prosper apparently no longer intends to hold debt sales, instead planning to have some unspecified person "apply" unspecified "charge off collection techniques" to debt that is 121+ days old. Prosper cannot unilaterally decide that it is in the lenders' best interests despite the terms of the LRA for these loans to be subjected to "charge off collection techniques." Instead, should Prosper wish to deviate from the terms of the LRA, Prosper must provide lenders with detail about these proposed "techniques," including, at a minimum, what they consist of, who will "apply" them and what the cost to lenders will be. Then, Prosper must permit lenders to opt in or out of this experiment. And, in the future, Prosper must hold debt sales at least quarterly. If the current method of conducting debt sales does not provide Prosper with a mechanism to dispose of non-performing loans, Prosper should investigate alternative means of debt sales, perhaps even in the form of a secondary auction on its platform, open to all qualified buyers.

IV. Failure to Prosecute "New Agency Test" Lawsuits

Last year, Prosper invited lenders to opt in or out of a series of planned lawsuits against 66 borrowers whose loans were more than four months late. The lenders who opted in to these suits have not been told whether suit has actually been filed on each of the loans. It appears that where suits have been filed, they most likely have not been served, since very few proofs of service have been filed with the courts. It therefore appears that the cases have not been litigated aggressively – or, in most cases, at all. The LRA instructs lenders not to contact Prosper's collection law firm, yet very little information about the prosecution of these cases has been provided. Any unserved lawsuit must be served immediately, and, if service is unsuccessful, Prosper's counsel must take prompt steps to obtain leave of court to serve the complaints via publication. If an answer is filed, Prosper should promptly evaluate the action for summary judgment.

Further, information about the status of these actions must be provided to all lenders, and updated at least monthly. With respect to Prosper Marketplace, Inc. v. Holly Brown, Los Angeles Superior Court Case No. 08C00921, Prosper must immediately notify the lenders why the action was dismissed without prejudice

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V. **Failure to Protect Lenders' Interests After A Borrower Claims to Have Declared Bankruptcy**

Prosper's fiduciary duty towards its lenders requires that Prosper act in a manner that is most likely to protect the interests of lenders on loans where the borrower has filed or states their intention of filing for bankruptcy.

Prosper has admitted, in writing, to treating loan 2139 (listing number 23444) as being in bankruptcy for more than a year based solely on the borrower's claim that she was "going to" file. Prosper did nothing to verify the borrower's claim, and has not yet sold that loan. The loan continues to show that it is both in collections and in bankruptcy, and the lenders do not know whether it truly is. Whether or not this borrower ultimately filed a bankruptcy petition, the lenders on this loan suffered monetary damage as a result of this loan not being sold timely, both in terms of lost interest and in terms of the diminishing amount debt buyers are willing to pay for Prosper loans. Demand is hereby made that Prosper reimburse all lenders on that loan in at least the amount they would have received had the loan been sold timely, together with interest thereon.

Similarly, loans 1323 and 7107, likely among many others, show they are simultaneously in collections and in bankruptcy, suggesting that Prosper has relied solely on the borrower's stated future intent to file. A recent PACER search did not turn up any bankruptcy filing by the borrower on loan 7107.

These loans highlight the harm caused to lenders by Prosper taking the unsubstantiated word of borrowers. While lenders are aware that Prosper intends at some unspecified future date to provide information to lenders about the petition filing date and chapter, that is inadequate. Prosper must verify that the petition has been filed, and must file all documents needed to protect the interests of the lenders. Prosper must also file appropriate documents to perfect the lenders' claims, must challenge the dischargeability of any loan obtained fraudulently or too close in time to the bankruptcy filing, and must verify that the bankruptcy actually results in a discharge of the Prosper loan. If the bankruptcy petition is dismissed, Prosper must notify lenders of that, and promptly recommence collection activity, or sell the loan as defaulted.

Prosper must provide the following documentation of any loan in bankruptcy on the loan information pages on its website: (1) the date and chapter of the petition; (2) the steps Prosper has taken to protect the lenders' interests; (3) the status of the bankruptcy; and (4) whether the bankruptcy has been discharged. Prosper must also provide lenders with a detailed summation of the adversary proceedings or other challenges it has made, and the outcome of those filings.

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If no bankruptcy petition has been filed, of course, Prosper and its agents must continue collection efforts on the lenders' behalf. Borrowers should not be permitted to avoid collection efforts and their repayment obligations while they consider how best to address their financial situation, as this is to the lenders' clear detriment. Prosper must treat all loans as being delinquent until it is furnished with paperwork from the Court establishing that a bankruptcy petition has truly been filed.

VI. Failure to Honor Repurchase Guarantee

Lenders have identified cases of apparent identity theft after loans go late. One example is Listing No. 102017, where the borrower represented himself to be a woman who had a credit history extending back 12 years and a six-figure income. In reality, the borrower was a 22 year old man. Prosper inexplicably refused to honor its identity theft guarantee on this loan. Please honor that guarantee immediately.

Additionally, there are many loans where the borrower never made even one payment, or where a borrower made two or fewer payments. Prosper must diligently investigate potential identity theft with respect to those loans (which include, without limitation, the loans resulting from listings 102580, 137658, 140191, 179350 and 208191) and advise the lenders on those loans, with specificity, about the outcome of the investigations. If identity theft is found, Prosper must promptly honor its repurchase guarantee.

Lenders are also concerned by the fact that Prosper has essentially stopped repurchasing loans under its identity theft guarantee. To date, Prosper has repurchased 122 loans. These include the 66 New Agency Test loans and a handful of loans Prosper repurchased due to credit data issues. Thus, roughly fifty loans were repurchased by Prosper for other reasons (which we presume include the identity theft guarantee). Prosper has repurchased only one loan that originated after August 1, 2007 -- despite the fact that more than 40% of all Prosper's loans originated after that date. It is extremely unlikely that there has only been one identity theft loan in all that time; it is far more likely that the near complete absence of repurchases is due to the "success" of Prosper's strenuous efforts since last summer to deprive lenders of the information they formerly used to discover numerous fraudulent and identity theft loans on their own. As you know, many of the loans Prosper repurchased were identified by lenders through discussions on Prosper's own forums, before Prosper eliminated those forums and stripped basic information from the listings. Because Prosper knows that its conduct has severely impaired the ability of lenders to ferret out fraud, it has a fiduciary duty to increase its own efforts to determine whether the listing was fraudulent in any manner. Instead of fulfilling that duty, it appears that Prosper may have used this as an opportunity to cease having to spend its own capital repurchasing fraudulent loans. Please be aware that we intend to vigorously pursue discovery on this

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and other topics should further action be required to protect lenders' interests.

VII. Failure to Protect Lenders From Other Instances of Borrower Fraud

Prosper's fiduciary duty requires Prosper to protect lenders from garden variety fraud, as well. That includes borrowers who take out loans with no intention of repaying them, such as the loan resulting from Listing 71273, which funded after lenders warned Prosper that the borrower had posted his lack of intent to repay the loan as well as admitting that he lied about the purpose of the loan. Not surprisingly, after Prosper permitted this loan to fund, the borrower defaulted.

Prosper must investigate all listings reported as fraudulent. Prosper must investigate all reports of suspected fraud before permitting loans to fund. Listings 18121 and 71273 provide but two examples of loans that originated despite many well-supported reports of suspected fraud, then subsequently defaulted. Demand is hereby made for a full explanation of Prosper's investigation (or lack thereof) of these reports of fraud on these listings, and why Prosper believes (if it does) that its investigation was "commercially reasonable" as required by the Lender Registration Agreement ("LRA"). Needless to say, if Prosper's investigation was not commercially reasonable, Prosper must reimburse all lenders on these loans (and any other loans that were permitted to fund despite reports of fraud) for their losses.

VIII. Failure to Provide Accurate Performance Information

Prosper misrepresents the value of lenders' portfolios, both on each lender's individual overview page and on its Marketplace Performance page. On the lending overview page, the interest rate is artificially inflated since it does not take into account the lack of interest actually paid on late loans. Prosper could easily correct this misleading information, since at least two third party sites (www.lendingstats.com and www.ericccc.com) provide more accurate – and significantly lower – estimated rates of return than does Prosper.

With collections remaining at less than 20%, Prosper must adjust the manner in which it reports account values to lenders. A loan that is four months late is worth significantly less to a lender than one that is two days late. Loans in bankruptcy likely have no value. Despite this, Prosper portrays all loans, regardless of their status, at full face value, including accrued interest and late fees, which substantially overstates the portfolio's real value. Prosper must provide lenders with more accurate loan valuation.

Prosper must immediately cease providing lenders with inflated interest rate data and inflated loan

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valuations. Prosper must disclose the number of bankruptcies on the lender overview page, and must value them accordingly. Once a loan goes more than thirty days late, it must be valued in the lenders' portfolios at the discounted value that represents the probability of curing. Loans that are subject to a debt sale (+4 month loans) should be valued in lenders' portfolios at no more than the proceeds obtained for a loan of that nature in the previous debt sale. If a loan is charged off it must be treated as having no value.

Similarly, Prosper must provide accurate information on its Marketplace Performance page, which it invites lenders to use "to figure out what kinds of borrowers will yield the highest return for your portfolio." The data there is inaccurate, due, at least in part, to matters noted above. The failure to hold timely debt sales distorts that data, since loans that should be counted as defaults are instead counted as 4+ month lates. In addition, the New Agency Test loans are erroneously treated by Prosper as if they had never originated. Since these loans are by definition "defaults" in everything but name (indeed, for the lenders opting out of the New Agency Test, these loans are defaults, since these lenders were paid the pennies on the dollar that these loans would have received had they been sold at the last junk debt sale), they should be treated as defaults for all reporting purposes. Loans that Prosper charges off must be clearly identified on the Marketplace Performance page, as well, and must be treated as having no value for purposes of ROI calculations and lender bidding guidance. Under no circumstances shall "charged off" loans be treated like the New Agency Test loans are currently treated (i.e., as if they had never originated). Not surprisingly, Prosper's actual results are substantially worse than reported. These misrepresentations must be corrected, and only correct data posted in the future.

IX. Retroactive Changes to Terms of Service, to the Detriment of Lenders

Prosper has repeatedly amended the LRA and terms of service, until recently not even notifying lenders of such changes (much less obtaining lenders' consent). Needless to say, Prosper has no authority to unilaterally amend any agreement governing the relationship between the parties, particularly in a retroactive fashion.

One change that resulted in significant lender concern was Prosper's unilateral decision to permit borrowers to obtain second loans without having paid off their first loans. Several lenders advised Prosper that the terms of service permitted only one loan at a time, and this change presented real increased risk. Prosper was urged to permit second loans only on first loans that originated after this change, and notification to lenders, so lenders could decide for themselves whether they wanted to assume this much greater risk. Prosper ignored the likely risk to lenders, and declined to permit second loans only on first loans that were listed after the amendments. Thus, lenders who bid with

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the certain knowledge that Prosper would only allow one loan at a time were suddenly faced with additional risk. Many lenders would not have made loans in the first instance had they known that Prosper might later permit second loans because of the additional risk.

This additional risk is evident with borrower "dbfunding," who first borrowed \$15,000 (listing 29537), then, after second loans were permitted, borrowed another \$14,650 (listing 228201). The loans now show they are in bankruptcy. At least with respect to those lenders who have not implicitly acquiesced to the new terms of service by continuing to lend, Prosper must immediately repurchase the first loan. When any similar situation arises in the future, whether the first loan defaults or files for bankruptcy, Prosper must immediately reimburse all lenders who have not loaned since the changes in the terms of service.

Prosper unilaterally decided to move collections away from Penncroto AmSher, which charges lenders a higher fee. At the time of this switch, Prosper promised that lenders would not be charged more than they would have been had the loans remained at Penncro. After it was pointed out to Prosper that notwithstanding its promise, lenders were actually being charged the higher AmSher fees, Prosper stated that this was due to a "coding error," and that Prosper would reimburse lenders the over-charges. Apparently, no such reimbursement has yet occurred, despite months having passed. Demand is hereby made that Prosper immediately provide that reimbursement to lenders.

Prosper unquestionably has a fiduciary duty to lenders, which it has breached in many respects. The foregoing are areas where breaches have clearly and repeatedly occurred, and which must promptly be addressed to avoid litigation. I look forward to your written response, with the specific steps with which Prosper will address these concerns, by June 24, 2008.

cc: John B. Witchel, CTO and Co-Founder of Prosper Marketplace, Inc.
Christian A. Larsen, CEO and Co-Founder of Prosper Marketplace, Inc.
Kirk T. Inglis, CFO of Prosper Marketplace, Inc.
James W. Breyer
Lawrence W. Cheng
Paul M. Hazen
Clients