thirdpartylending@fdic.gov
Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
5500 17th Street, NW
Washington, DC 20429

Re: Comments on Proposed Financial Institutions Letter (FIL) 50-2106: Third-Party Lending

Dear Chairman Gruenberg:

The undersigned national and state consumer, legal services and civil rights groups submit these comments on the FDIC's proposed Third-Party Lending Guidance (Third-Party Guidance).[1] We appreciate the FDIC's effort to ensure safety, soundness and consumer compliance when banks conduct aspects of lending through a business relationship with a third party.

However, we strongly oppose any suggestion in the guidance that it is ever appropriate for a bank to rent out its charter in a way that will allow the third party to evade state laws. While the proposed guidance emphasizes that banks must take full responsibility to ensure that all aspects of the lending process comply with consumer protection laws and do not pose undue risks, that is not enough.

Instead, the guidance must clearly and unequivocally prevent banks from entering into rent-a-bank relationships that avoid state consumer protection laws, in particular interest rate and fee caps, or state oversight through licensing regimes. Among the third-party lending arrangements identified in the guidance are those where the nonbank originator lacks the necessary licenses to lend on its own behalf and seeks to take advantage of the institution's ability to export interest rates. By identifying these arrangements without criticizing them—and by setting up the framework to manage the risks of these arrangements—the Third-Party Guidance could legitimize and lead to the spread of rent-a-bank arrangements that enable high-cost, predatory payday or installment loans, as well as other forms of high-rate lending.

<u>The FDIC's Third-Party Guidance should include an unequivocal declaration that it is inappropriate for a bank to rent out its charter to enable lending by a third party that could not make the loans directly</u>. The OCC made clear in 2001 that enabling an entity to make loans that it cannot make directly can be an abuse of a bank charter,[2] and that message was sufficient to stop national banks from engaging in these practices. The FDIC should do no less in 2016.

While rent-a-bank relationships are never appropriate, they are especially harmful to consumers and risky to banks when they enable lending above the Military Lending Act's (MLA) fee-inclusive 36% interest rate cap. Lending above those rates violates the laws of a significant

[1] Federal Deposit Insurance Corporation, Examination Guidance for Third-Party Lending (July 29, 2016), *available at* https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf.

[2] OCC Bulletin 2001-47, Third-Party Relationships, Risk Management Principles 4 (Nov. 1, 2001), *available at* http://www.ffiec.gov/ffiecinfobase/resources/outsourcing/occbul_2001_47_third_party_relationships.pdf.

number of states and poses a number of other risks, including compliance risks of violating the MLA itself, the forthcoming Consumer Financial Protection Bureau's (CFPB) payday loan rules, rules against unfair, deceptive or abusive practices, and abusive debt collection practices.

The Third-Party Guidance must explicitly prohibit rent-a-bank partnerships that allow third parties to avoid state laws, even when the bank has taken measures to protect itself from the economic risk traditionally inherent in these relationships. Indeed, given the current state of the case law on challenging the real lender status, the more the bank insulates itself from the risk of these relationships, the greater the likelihood that the arrangement will be found to be a sham and expose the bank and the third-party lender to litigation risk, potentially including actions under the Racketeer Influenced and Corrupt Organizations Act for facilitating usurious lending. The Third-Party Guidance should also do more to highlight and forestall the risks posed by high interest rates.

Banks Should Not Enable Third Parties to Make High-Rate Loans that Would Be Illegal Absent the Bank Partnership.

We recognize that third-party lending relationships take many different forms. The expertise, technology and other capacities provided by third parties may enable banks to enhance their lending services and lower costs, thereby benefiting both banks and consumers. In some of these relationships, the bank has the predominant economic interest and the partnerships do not avoid the laws that protect consumers or result in dangerous loans. At the same time, third-party partnerships are also being used to enable the third party to avoid state licensing, interest rate caps or other state consumer protection laws and to make loans that would be otherwise illegal. The core of our concerns with rent-a-bank transactions is that they facilitate predatory, unaffordable credit.

As the FDIC is aware, in the 1990s and early 2000s payday lenders partnered with banks in rent-a-bank relationships in order to avoid state interest rate caps. Interest rates over 300% were not uncommon.[3] The FDIC and other bank regulators issued guidances on these partnerships, and all banks ultimately exited the partnerships. Unfortunately, rent-a-bank has returned, but only, apparently, through FDIC-supervised banks.

The payday lender Elevate—a spin-off of Think Finance, which had a partnership with First Bank of Delaware—now uses Republic Bank & Trust Co. to originate high-cost, open-end lines of credit in order to circumvent state usury caps.[4] Through its Elastic brand, Elevate offers purportedly

---

[3] *See, e.g.,* Flowers v. EZPawn Okla., Inc., 307 F. Supp. 2d 1191. 1204 (N.D. Okla. 2004); BankWest Inc. v. Baker, 324 F. Supp. 2d 1333 (N.D. Ga. 2004), *aff'd*, 411 F.3d 1289 (2005), *reh'g granted, opinion vacated*, 433 F.3d 1344 (11th Cir. 2005), *opinion vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006); State *ex rel.* Salazar v. Ace Cash Express, Inc., 188 F. Supp. 2d 1282 (D. Colo. 2002); Long v. Ace Cash Express, Inc. (M.D. Fla. June 18, 2001) (order), *available at* www.consumerlaw.org/unreported; New York *ex rel.* Spitzer v. County Bank of Rehoboth Beach, Index No. 6046-03; RJ1 No. 01-04-080549 (N.Y. Sup. Ct. Jan. 2, 2007).

[4] *See* Elevate Credit, Inc., Securities and Exchange Commission Form S-1, Registration Statement 27 (Nov. 9, 2015) [hereinafter Elevate SEC Form S-1], *available at* https://www.sec.gov/Archives/edgar/data/1651094/000119312515371673/d83122ds1.htm. *See also* Jeff John Roberts, *Bad credit is a bonanza for online lender, but critics cry foul*, Fortune, July 9, 2015, *available at* http://fortune.com/2015/07/09/elevate-online-loans/.

open-end loans[5] in 40 states.[6] As just one example, Elevate is available in Oregon, which caps open-end credit at an annual percentage rate (APR) of 36%.[7] Elevate does not disclose an APR, but a $380 advance repaid with monthly minimum payments would cost $480 to repay over four months.[8] The fee-inclusive APR for this extension of credit is about 120%,[9] which is over three times the legal interest rate for this credit in Oregon.[10] (Elevate also offers, through its Rise brand, closed-end credit at rates up to 365% in states where those rates are permitted under state licenses.[11] However Elevate's open-end line—which enables built-in rollovers—is growing as a share of its business.)

Elevate depends on Republic Bank to be able to make these usurious loans.[12] Elevate targets subprime borrowers and has a very high default rate, which it has no intention of lowering.[13] The CFPB has calculated that Elevate charges off 50% of its average balances.[14] Elevate recently announced that it is planning to expand its market and lend through more bank partnerships in 2017.[15]

---

5 While the loans purport to be open-end, they really function more like a series of closed-end loans. A $400 advance has minimum payments that pay the loan off in four months. The main difference between Elastic and Rise is that, with Elastic, the consumer has a line of credit and can take additional advances. With Rise, the consumer technically would need to apply for a new loan, although it seems likely that the process would be fairly automatic for a returning customer.

6 *See* https://www.elastic.com/FAQs/ (answer to "What states are currently served by Elastic?").

7 Or. Rev. Stat. §§ 725.340, 725.345(2).

8 *See* https://www.elastic.com/what-it-costs/ (Fees and Charges).

9 We have calculated the APR including all of the fees. The Truth in Lending Act rules for calculating APRs on open-end credit are full of loopholes and might result in an APR of 0% for the Elastic loan because there is no periodic interest rate.

10 *See also* Carolyn Carter et al., NCLC, Installment Loans: Will States Protect Borrowers From A New Wave Of Predatory Lending? 45 (July 2015) [hereinafter NCLC Installment Loans], *available at* http://www.nclc.org/images/pdf/pr-reports/report-installment-loans.pdf.

11 *See* http://www.risecredit.com; Elevate SEC Form S-1, at 140, *available at* https://www.sec.gov/Archives/edgar/data/1651094/000119312515371673/d83122ds1.htm.

12 *See* Elevate SEC Form S-1 at 27 ("The structure of the Elastic product exposes us to risks associated with being reliant on Republic Bank as the originating lender…. Because line of credit products are relatively more difficult to establish under state law, any inability to find another originating lender would adversely affect our ability to continue to offer Elastic, which in turn could have a material adverse effect on our business, prospects, results of operations, financial condition or cash flows.").

13 Elevate's net charge-offs were 51% of revenues in 2014. Elevate SEC Form S-1, at 22. While Elevate noted that this charge-off ratio could go down with a more seasoned portfolio, the company stated that "we do not intend to drive down this ratio significantly below our historical ratios and would instead seek to offer our existing products to a broader new customer base to drive additional revenues." *Id.* at 78.

14 81 Fed. Reg. 47863, 47886 n.246 (July 22, 2016).

15 Ari Levi, *Online subprime lender Elevate looks to expand as it awaits IPO window*, CNBC, Oct. 26, 2017, *available at* http://www.cnbc.com/2016/10/26/online-subprime-lender-elevate-looks-to-expand-as-it-awaits-ipo-window.html.

Another high-cost lender, CashCall, attempted to use a rent-a-bank relationship with First Bank and Trust of Millbank, South Dakota to make loans of $1000 or more to borrowers in West Virginia at rates of 59% to 96%, well above West Virginia's interest rate caps. A court ultimately held that this bank's role in the transactions was a sham: CashCall was the true lender and was required to comply with state interest rate caps.[16] However, lenders are making adjustments to their partnerships to survive these challenges, and we fear an increase of these inappropriate rent-a-bank schemes. (We discuss below the implications of the "true lender" decisions.)

While rent-a-bank relationships are most alarming when they enable high-rate lending, the FDIC should not permit rent-a-bank arrangements even if the rates are not in the triple digits. Although marketplace lenders that use bank partnerships generally keep their rates under 36%, 36% is nevertheless a very high rate, especially if charged on consumer loans that can potentially reach as high as $40,000.[17] New York's usury rate, for example, is 25%. The FDIC should not permit the use of a bank charter to be rented out to a lender to enable the lender to make loans to borrowers in New York or any other state that the lender could not legally make directly.

The Proposed Guidance Will Not Stop Unaffordable High-rate Lending, Exposing Both Consumers and Banks to Risks.

Bank partnerships formed to enable high lending are a completely inappropriate use of a bank charter and should not be allowed. The Elevate-Republic Bank partnership is the only one of which we are aware at the present time that involves rates above 36%. Nonetheless, we fear that the proposed Third-Party Guidance could have the effect of legitimizing third-party lending relationships that circumvent state consumer protection laws. These partnerships could result in the expansion of high-rate lending that causes considerable consumer injury, leads to unfair, deceptive or abusive practices, and ultimately poses risks to both consumers and banks alike.

The proposed Third-Party Guidance makes it clear that the bank is responsible for the third party's compliance with federal laws, and that the FDIC will evaluate the bank's relationship with the third party in its examinations. But the Third-Party Guidance focuses on ensuring that both the bank and the third party comply with federal law, not state law. In the lending area, various federal laws and regulations require disclosures, prohibit discrimination, protect consumers from certain damaging debt collection practices when conducted through third parties, and generally prohibit unfair and deceptive practices. Those laws are helpful, but they are not enough to protect consumers.

Federal laws do not generally cap interest rates,[18] which are the most effective way of protecting consumers from unfair, abusive and unaffordable loans; only state laws do that. State

---

[16] State of West Virginia *ex rel.* Darrell V. McGraw v. CashCall, Inc., No. 12-1274 (W.V. Sup. Ct. May 30, 2014), *available* at http://www.courtswv.gov/supreme-court/memo-decisions/spring2014/12-1274memo.pdf. *See also* CashCall, Inc. v. Morrisey, 2014 WL 2404300 (W. Va. May 30, 2014) (unpublished).

[17] *See* U.S. Dep't of the Treasury, Opportunities and Challenges in Online Marketplace Lending 10 (May 10, 2016). Note the repayment of a $40,000 loan over ten years at a 36% rate will require a total of payments of $562,706.43.

[18] However, the Military Lending Act and the Servicemembers Civil Relief Act cap interest rates charged on credit provided to servicemembers and their dependents.

usury laws give consumers essential protection from predatory loans that strip them of assets and essential cash, and diminish their hopes of accumulating even a modest degree of economic security and wealth.

While the CFPB has proposed rules to require lenders making loans above 36% to consider the borrower's ability to repay the loan, the proposed rules would not stop unaffordable high-rate loans. There are numerous exceptions and loopholes in the CFPB's proposal, and the proposed rules' attempt to preserve access to high-cost credit secured by payment devices or vehicle titles would still permit far too much unaffordable and predatory lending to continue.

Additionally, the state laws being evaded in these rent-a-bank arrangements are enforceable by the consumers involved, as well as by state regulators and enforcement authorities. The requirements of the FDIC's Third-Party Guidance will not be privately enforceable, and there is no private right of action to enforce the CFPB's payday loan regulations.

As a result, even after the payday loan rules are finalized, ensuring compliance with federal law will not be enough to protect consumers from harmful, damaging credit. State interest rate caps will continue to play a vital role in protecting consumers from predatory lending. The CFPB itself has recognized that "the fee and interest rate caps in these States [that cap rates below payday loan rates] would provide greater consumer protections than … the requirements of the proposed [payday loan] rule."[19] Indeed, state interest rate caps are especially critical as payday lenders move into longer and larger loans that can result in a deeper debt trap and more consumer harm than even the short-term payday loans of today.

In the past, regulators were able to use violations of federal laws—such as deceptive marketing, and violations of the Equal Credit Opportunity Act and the Fair Credit Reporting Act—to shut down inappropriate rent-a-bank relationships.[20] And that marriage of high-cost loans with violations of federal law allowed federal regulators to end these relationships that were so harmful to consumers. But today, high-cost lenders have become more sophisticated. They may purport to be in compliance with federal law and still make high-cost, unaffordable loans that cause consumer harm through their rent-a-bank relationships.

We appreciate the FDIC's admonition that consumers must demonstrate the capacity to repay a loan.[21] But as the CFPB's payday loan proposal demonstrates, capacity to repay is a vague standard that is difficult to evaluate and enforce. The lender's ability to secure repayment and the borrower's ability to afford the loan while meeting other expenses are completely different things. The divergence is particularly apparent when a lender is able to collect despite a loan's

---

19 81 Fed. Reg. 47903 (July 22, 2016).

20 *See, e.g.,* In the Matter of First Bank of Delaware and CompuCredit Corporation, Notice of Charges for an Order to Cease and Desist and For Restitution, Federal Deposit Insurance Corporation, FDIC-07-256b, FDIC-07-257k, *available at* http://www.fdic.gov/news/news/press/2008/FBD_Notice_of_Charges.pdf.

21 The FDIC Expanded Guidance for Subprime Lending includes this warning: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent." But ensuring a capacity to repay only ensures that the bank will get its money back. It does not ensure that the loan is affordable and fair.

unaffordability due to the use of a preauthorized payment method, auto title security, or other coercive payment mechanisms. Thus lenders may claim that their borrowers have demonstrated the capacity to repay loans that are, in fact, quite unaffordable.

Unaffordable high-rate loans may ultimately be unfair, deceptive or abusive under federal law. But drawing clear lines between legal and illegal lending programs is much more difficult without interest rate caps, exposing both consumers and banks to risks.

High-Rate Loans Pose Safety and Soundness Risks Because They Cause Considerable Consumer Harm Even if, and Indeed Because, Lenders Can Profit Despite Consumers' Inability to Repay.

Interest rate caps are especially important to protect consumers because in much of the high-rate installment loan market, the normal incentive to make affordable loans does not work. When loans have high interest rates, lenders can seek out and profit from borrowers who will default in significant numbers. The gap between lender and borrower success is likely to encourage business models that harm numerous consumers. High-rate lending leads to asymmetrical incentives between borrowers and lenders.

- As long as the borrower pays long enough before defaulting, a high-rate installment loan will be profitable. If the borrower makes even one third of the payments on a longer term high-rate installment loan, the lender will receive sufficient cash flow to recover the amount loaned and another 50% or more, likely more than enough to turn a profit.
- A borrower who defaults later is a much more profitable customer than one who prepays the loan in full too early. A high-rate lender has an incentive to avoid tighter underwriting because it can lead to borrowers who are able to repay early, thereby generating less revenue, and to screen out the more profitable consumers who struggle for months or years to make payments and then ultimately default.

While the lender has a successful, profitable experience, default causes a cascade of devastating consequences that are likely to plague the consumer for a lifetime.[22] High-rate lending supports these high default rates—indeed, the defaults are the excuse and justification for the high rates themselves, under the guise of risk-based pricing.

Lenders that have used rent-a-bank models to avoid state interest rate caps can be profitable despite high default rates that cause considerable consumer harm. CashCall has been profitable despite a planned default rate of 35% to 40%.[23] As discussed above, CashCall had a rent-a-bank partnership with an FDIC-insured bank that was shut down by a court, but the partnership could

[22] For more information on this analysis, see National Consumer Law Center, *Misaligned Incentives: Why High-rate Installment Lenders Want Borrowers Who Will Default* (July 2016) [hereinafter NCLC, Misaligned Incentives], *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.

[23] NCLC, Misaligned Incentives at 8.

reemerge in a different form. Elevate continues to use a rent-a-bank model to make high-rate loans and is meeting its profit targets[24] despite charge-offs of 50% of its outstanding balances.[25]

Simply warning banks about the risks of these partnerships—which may be quite profitable for a bank—is not enough to protect consumers from the abusive credit these partnerships facilitate. Rent-a-bank arrangements allowing credit that evades state law limits and permits high-cost lending must be clearly prohibited by the FDIC.

The FDIC Should Explicitly Prohibit Banks from Using Rent-a-Bank Relationships to Avoid State Licensing and Oversight

In addition to evading state interest rate caps, rent-a-bank arrangements also enable the lender to avoid state licensing and, often, state oversight.[26] When the third party and not the bank has the predominant economic interest in the lending program, it is inappropriate for the bank to let itself be used to prevent state oversight of that entity. While bank regulators have some authority to scrutinize the activities of banks' third-party vendors, that is not the same thing as the oversight that comes with state licensing, state examinations, and state oversight.

Moreover, neither bank regulators nor the Consumer Financial Protection Bureau are likely to be looking at potential violations of state law. For example, in the recent case against LendUp, the CFPB brought an enforcement action focused solely on deceptive conduct. [27] But the State of California, through its examination process, found that LendUp was also violating state laws, including laws that prevent interest rates from being disguised through "expedited" fees and that prohibit a lender from requiring a consumer to take out a payday loan as a condition of an installment loan.[28]

States play an essential role in supervising nonbank entities. The FDIC should not permit its guidance to be used as an excuse to displace states from their role in protecting consumers.

---

24 Philip Ryan, *Loan Volume at Elevate, Alt-Subprime Startup, Hits $442 Million*, Bank Innovation, Feb. 10, 2015, *available at* http://bankinnovation.net/2015/02/loan-volume-at-elevate-alt-subprime-lending-startup-hits-442-million/.

25 81 Fed. Reg. 47886 n.246 (July 22, 2016).

26 State licenses may still be needed if the entity engages in marketing, servicing or collecting activities that require a state license. But it is not clear if the state would have examination or oversight authority over underwriting or other lending activities without a state license.

27 In the Matter of Flurish, Inc., dba LendUp, Consent Order, September 27, 2016, *available at:* http://files.consumerfinance.gov/f/documents/092016_cfpb_LendUpConsentOrder.pdf.

28 The state enforcement agency found that LendUp had committed a total of 385,050 individual violations of state laws protecting consumers. The Commissioner Of Business Oversight v. Flurish, Inc. (dba LendUp), Settlement Agreement signed September 23, 2016, *available at:* http://www.dbo.ca.gov/Press/press_releases/2016/LendUp-Settlement%20Agreement.pdf.

The More the Bank Protects Itself From the Risks of the Lending Program, the Greater the Risk that the Arrangement will be Found to be a Sham and Result in Litigation Risk.

The proposed Third-Party Guidance requires that banks fully protect themselves from the many different risks (including litigation and reputational risk) and actual financial losses that might result from partnerships with third parties. These risks are especially great with high-cost lending. However, as long as the bank addresses the risks to the bank, the Third-Party Guidance appears to allow partnerships with high-rate lenders.

But the more the bank protects itself from the risks of a lending program, the greater the likelihood that a court will find that the partnership is a sham, that the nonbank entity is the "true lender," and that the loans are illegal under state law. The test used by the courts to determine the "true lender" in a rent-a-bank relationship traditionally has been an analysis of which party bears the primary economic risk from the loan. The economic risk analysis tests whether the bank could suffer losses (not charge-offs, but actual losses) as the result of the transactions. If the third party carries the predominant risk of those losses, then the bank is not considered the true lender.[29]

Moreover, even if the FDIC were to use another test to determine whether the bank is the real lender, such as "which party makes the credit decision" that would not rescue the transaction from being a damaging one to consumers, which the FDIC should not be facilitating. And, the notion that it is the banks, rather than the third parties, which are actually making the credit decision in these transactions is simply not logical. The entire point of the third parties' involvement in these transactions is to bring their supposedly superior big data analysis to the underwriting analysis. As Elevate recently pointed out when explaining its plans for expansion to more bank partners:

> [Elevate CEO] Rees is investing heavily in research and development as he aims to distribute Elevate's software-driven underwriting system into more U.S. banks.[30]

While it may be an employee of the bank that actually presses the button disbursing the loan funds to the borrower, the decision to extend that credit is always made pursuant to the algorithms developed by the third party.

A bank's minimal role in the underwriting process for the loans may be another reason that courts are persuaded to find that the partnerships are a sham and that the lenders must be licensed

---

[29] *See, e.g.,* CashCall, Inc. v. Morrisey, 2014 WL 2404300, at *14 (W.D. Va. May 30, 2014) (unpublished); BankWest Inc. v. Baker, 324 F. Supp. 2d 1333 (N.D. Ga. 2004), *aff'd*, 411 F.3d 1289 (2005), *reh'g granted, opinion vacated*, 433 F.3d 1344 (11th Cir. 2005), *opinion vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006); Flowers v. EZPawn Okla., Inc. 307 F. Supp. 2d 1191, 1204 (N.D. Okla. 2004); Goleta Nat'l Bank v. Lingerfelt, 211 F. Supp. 2d 711 (E.D.N.C. 2002); State *ex rel.* Salazar v. Ace Cash Express, Inc., 188 F. Supp. 2d 1282 (D. Colo. 2002); *In re* Ace Cash Express, Inc. (Fla. Dep't of Banking & Fin. Dec. 30, 2002) (final administrative order), *available at* www.consumerlaw.org/unreported; People *ex rel.* Spitzer v. Cty. Bank of Rehoboth Beach, Del., 846 N.Y.S.2d 436, 439 (N.Y. App. Div. 2007). *See also* Commonwealth of Pennsylvania v. Think Finance, Inc., 2016 WL 183289 (E.D. Pa. Jan. 14, 2016); Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012).

[30] Ari Levi, *Online subprime lender Elevate looks to expand as it awaits IPO window*, CNBC, Oct. 26, 2017, *available at* http://www.cnbc.com/2016/10/26/online-subprime-lender-elevate-looks-to-expand-as-it-awaits-ipo-window.html.

and comply with state interest rate caps. Generally, if a lender is unlicensed, its loans will be considered usurious in almost any state, including those that permit licensed lenders to charge high rates. States typically extend the authority to charge higher rates only to those lenders who agree to comply with their licensing and oversight requirements.

When loans are ultimately found to be usurious, consumers may be entitled to substantial damages, posing litigation risk to the bank. For example, the FTC recently obtained a $1.3 billion order against Scott Tucker, who attempted to evade state laws through rent-a-tribe relationships. The court employed the same "true lender" analysis that would have applied in a rent-a-bank scheme.[31] While the third-party lender may be the most exposed if a lending arrangement is found to be a sham, banks could also be exposed to several significant risks. Courts have applied the Racketeer Influenced and Corrupt Organizations Act to banks that collude to facilitate usurious lending.[32] The banks could also be exposed to risks if their lending partners collapse and are unable to fulfill their obligations.

Current lenders engaged in third-party relationships with banks are reacting to the "true lender" analysis in these cases by adjusting their relationships to give the bank more "skin in the game," which also exposes them to more risk from losses.[33] But the more the rates exceed state law, the greater the risk of litigation and reputation risk to the bank, as well as potential financial risk.

We urge the FDIC to avoid the risks to both the consumers and the banks by simply prohibiting rent-a-bank relationships.

Small Banks May be Particularly Susceptible to Inappropriate Rent-a-Bank Relationships, Which Pose Special Safety and Soundness Risks to Those Banks.

Smaller community banks may be especially susceptible to entreaties from companies whose primary interest is to evade consumer protection laws and engage in abusive lending. Those banks may not have the sophistication to spot potential abuses or the compliance systems to monitor their nonbank partners. Some smaller banks are also starved for fee income and may be eager to enter into arrangements with third parties that promise lucrative new revenue sources. It is likely no coincidence that the banks that have enabled elder abuse scams and other payment fraud targeted by Operation Choke Point have all been, to date, small banks.[34]

---

31 Consumer Fin. Prot. Bureau v. CashCall, Inc., 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016).

32 *See, e.g.,* Dillon v. BMO Harris Bank, 16 F. Supp. 3d 605 (M.D.N.C. 2014) (denying motion to dismiss RICO claims against banks that enabled payday lenders to collect loans from North Carolina residents that would be illegal under state law and against state-chartered bank for aiding and abetting unlicensed lending in violation of anti-evasion provision of the state lending law).

33 *See, e.g.,* Pepper Hamilton, *Lending Club Makes Big Changes in Response to Madden v. Midland*, Feb. 29, 2016, *available at* http://www.pepperlaw.com/publications/lending-club-makes-big-changes-in-response-to-madden-v-midland-2016-02-29/.

34 *See* NCLC, Issue Brief, *What is Operation Choke Point?: Stopping Banks from Helping Scammers Raid Your Bank Account* (Sept. 2015), *available at* http://www.nclc.org/images/pdf/banking_and_payment_systems/payment-fraud/ib_what_is_operation_choke_point52815.pdf.

Similarly, the recent rent-a-bank relationships that have enabled high-rate lending all have involved small banks. As the payday lender Elevate reaches out to more bank partners, it is likely that it will target smaller banks looking to lend "outside of their branch footprint."[35]

Third-party lending relationships pose a much greater risk to smaller banks. With a smaller base of other business, smaller banks could face serious safety and soundness problems if they suddenly find their third-party lending subject to enforcement actions or if they lose a significant part of their revenue when the arrangement ends. Ironically, larger banks have more capacity to handle the risk of these relationships, but are also appropriately wary of the reputation hit they would take from partnering with predatory lenders. Rent-a-bank arrangements pose a much greater risk to the smaller banks that are most likely to enter into these partnerships.

The FDIC Should Directly Prohibit Banks from Renting out Their Charters.

In the early 2000s, both the OCC and, later, the FDIC issued guidances aimed at the banks that were partnering with payday lenders to evade state interest rate caps. The OCC's guidance, however, was much more direct about the inappropriateness of rent-a-bank arrangements. It declared:

> National banks should be extremely cautious before entering into any third-party relationship in which the third party offers products or services through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly. *Such arrangements may constitute an abuse of the national bank charter.*[36]

John D. Hawke, the OCC's Comptroller at the time, called rent-a-bank payday lending "an abuse of the national charter," noting: "It is a matter of great concern to [the OCC] when a national bank essentially rents out its charter to a third-party vendor who originates loans in the bank's name and then relinquishes responsibility for how those loans are made….We are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws that would otherwise apply to it."[37]

The FDIC's previous guidance was much less specific about the general risks of bank lending partnerships.[38] It also took the FDIC much longer to end the rent-a-bank payday lending

---

[35] Ari Levi, *Online subprime lender Elevate looks to expand as it awaits IPO window*, CNBC, Oct. 26, 2017, *available at* http://www.cnbc.com/2016/10/26/online-subprime-lender-elevate-looks-to-expand-as-it-awaits-ipo-window.html.

[36] OCC Bulletin 2001-47, Third-Party Relationships, Risk Management Principles 4 (Nov. 1, 2001) (emphasis added), *available at* http://www.ffiec.gov/ffiecinfobase/resources/outsourcing/occbul_2001_47_third_party_relationships.pdf.

[37] News Release, Comptroller of the Currency, OCC Concludes Case Against First National Bank in Brookings Involving Payday Lending, Unsafe Merchant Processing, and Deceptive Marketing of Credit Cards (Jan. 21, 2003), *available at*

https://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-3.pdf.

[38] *See* Federal Deposit Insurance Corporation, Guidance for Managing Third-Party Risk, Financial Institution Letter (FIL) 44-2008 (June 6, 2008), *available at* https://www.fdic.gov/news/news/financial/2008/fil08044a.html.

relationships of the early 2000s. While the agency ultimately shut them down, today's more sophisticated high-cost lenders will prove more elusive targets if federal law violations are the only tools, as discussed above. The disparity between the admonitions of the OCC's guidance in 2001 and the FDIC's may be the reason that the recent problematic rent-a-bank relationships have involved FDIC-supervised banks and not OCC-supervised banks.

The FDIC must declare directly that it is an abuse of a bank charter and an unsafe and unsound practice for a bank to enter into a partnership with a third party that permits the third party to offer products or services with fees, interest rates, or other terms that cannot be offered by the third party directly. While there are many legitimate purposes of bank partnerships with third parties, allowing a third party to avoid state licensing, interest rate caps or other consumer protection laws is not one of them. Banks expose both consumers and themselves to risks when they permit themselves to be used as pawns by predatory lenders.

Rent-a-Bank Arrangements are Never Appropriate, and They are Especially Risky to Consumers and Banks When They Involve Lending Above the Military Lending Act.

Rent-a-bank arrangements are never an appropriate use of a bank charter. These arrangements pose especially severe risks to both consumers and banks when they enable lending over the rates permitted by the Military Lending Act (MLA) and its regulations. Lending above the MLA cap poses special risks for several reasons.

First, banks and their third-party partners are directly subject to MLA caps when they lend to servicemembers and their dependents. The possibility that a consumer could be covered by the MLA results in greater compliance risks when a lender is making loans above MLA limits.

Second, the MLA is a useful measuring stick to assess whether a lender's rates would violate the laws in a substantial number of states. For example, a $2000, two-year loan that has an APR above 36%, including all fees,[39] would violate the law in 30 states and the District of Columbia.[40] The loan would violate the law in 12 additional states if the fee-inclusive rate is only slightly higher, 38% to 41%.[41] For a smaller $500 six-month loan, a rate over 36% would violate the law in 18 states plus DC, and a rate above 40% would violate the law in 30 states.[42] Thus, a partnership that enables loans above the MLA rate should be deemed to be *per se* hazardous and thus inappropriate, because it would be for the purpose of evading state laws, thus exposing the bank to risks.

Third, the MLA rate is likely to be the dividing line between loans that are exempt from the CFPB's payday installment loan rules and those that are covered.[43] Banks will be exposed to much

---

[39] The actual Truth in Lending Act APR might be lower with fees excluded. Our methodology tracks the requirements of the Military Lending Act.

[40] *See* NCLC Installment Loans 46. (New Hampshire amended its law after the publication of the NCLC report.)

[41] *Id.*

[42] *Id.*

[43] The CFPB has defined the term "total cost of credit" in a way that largely tracks the MLA's military APR. *See* 81 Fed. Reg. 47909-10 (July 22, 2016).

greater compliance risks if the loans are covered by the payday rules, as the bank will have greater obligations to assess the borrower's ability to repay. Banks cannot simply look at a lender's procedural up-front underwriting processes to assess compliance. The bank may also be in violation of the ability-to-repay rule if default, delinquency or reborrowing rates are excessive.[44]

Fourth, the higher default rates that tend to correlate with rates above 36% also lead to more substantial debt collection efforts and greater risk of unlawful, abusive debt collection efforts. While the Fair Debt Collection Practices Act does not apply to banks or other first-party lenders, abusive debt collection efforts by a creditor can violate the ban on unfair, deceptive or abusive practices and lead to CFPB enforcement action.[45] The CFPB is also in the process of drafting more extensive rules to govern debt collection practices by creditors. The bank or its lending partner will be at greater risk of violating these rules for high-rate subprime loans that lead to substantial debt collection programs. The bank can even be at risk if the loans are sold to debt buyers.[46]

Finally, the 36% rate reflected in the MLA is a widely accepted dividing line between high-cost, predatory loans that pose risk of consumer harm and lower-cost loans that are more likely to be affordable.[47] With higher rate loans, the consumer injury is higher, but the lender's incentive to make affordable loans and avoid unfair, deceptive or abusive practices is lower.[48] Higher rates lead to misaligned incentives between the lender and the borrower, which ultimately expose the bank to risks of predatory lending programs.

Conclusion

The proposed Third-Party Guidance appears to permit, rather than prohibit, rent-a-bank relationships. We strongly urge the FDIC to revise the Guidance to prevent bank partnerships from being used to permit a third party to engage in activity that it could not legally engage in directly.

If you have any questions or would like to discuss this, please contact us at (202) 452 6252, or by email at LSaunders@nclc.org and MSaunders@nclc.org.

Thank you for the opportunity to submit these comments.

---

44 81 Fed. Reg. 48010 (explaining that rates of delinquency, default or reborrowing are evidence of whether the lender has made a reasonable ability to repay determination as required by the proposed rule).

45 *See* Press Release, Consumer Fin. Prot. Bureau, CFPB Takes Action Against ACE Cash Express for Pushing Payday Borrowers Into Cycle of Debt (July 10, 2014), *available at* http://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-ace-cash-express-for-pushing-payday-borrowers-into-cycle-of-debt/.

46 *See* Press Release, Consumer Fin. Prot. Bureau, 47 States and D.C. Take Action Against JPMorgan Chase for Selling Bad Credit Card Debt and Robo-Signing Court Documents (July 8, 2015), *available at* http://www.consumerfinance.gov/about-us/newsroom/cfpb-47-states-and-d-c-take-action-against-jpmorgan-chase-for-selling-bad-credit-card-debt-and-robo-signing-court-documents/.

47 Lauren K. Saunders, NCLC, Why 36%? The History, Use, and Purpose of the 36% Interest Rate Cap (Apr. 2013), *available at* https://www.nclc.org/images/pdf/pr-reports/why36pct.pdf.

48 *See* NCLC, Misaligned incentives.

Yours very truly,

National Groups
National Consumer Law Center (on behalf of its low-income clients)
Consumer Action
Consumers Union
Consumer Federation of America
National Association of Consumer Advocates
National Council of LaRaza
Public Citizen
U.S. PIRG

State and Local Groups
Arkansans Against Abusive Payday Lending
Community Legal Services of Philadelphia
Florida Alliance for Consumer Protection
Housing and Economic Rights Advocates of California
Jacksonville Legal Aid
LAFChicago
MFY Legal Services of New York
Michigan Poverty Law Program
Mountain State Justice
Legal Aid of Southwest Ohio on behalf of its low-income clients
Legal Services NYC
New Economy Project of New York
North Carolina Justice Center
Public Good Law Center of California
South Carolina Appleseed Legal Justice Center
Texas Appleseed
Virginia Poverty Law Center
West Virginia Center on Budget and Policy