October 18, 2020

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C 20551

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street S.W., Suite 3E-218
Washington, D.C. 20219

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments-RIN 3064-ZA26, Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429

Re: Proposed Interagency Guidance on Third-Party Relationships: Risk Management (Docket No. OP-1752; FDIC RIN 3064-ZA26; Docket ID OCC-2021-0011)

Dear Ms. Misback, Mr. Sheesley, and the Chief Counsel's Office:

The Student Borrower Protection Center ("SBPC") offers the following comments to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency ("the Agencies") in response to their proposed interagency guidance ("Proposed Guidance" or "Guidance") for banking organizations on managing risks associated with third-party relationships.[1]

While it is certainly true that most student loans are made by the federal government,[2] the role of private banking organizations in providing financial services to college students—including through third parties—is substantial. College attendees rely on banks and associated partners for a wide array of products including private student loans,[3] checking accounts,[4] credit cards,[5] and more.

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[1] https://www.regulations.gov/document/OCC-2021-0011-0001
[2] Of more than $1.7 trillion outstanding in student loan debt, more than $1.5 trillion consists of federal student loans. See https://www.federalreserve.gov/releases/g19/HIST/cc_hist_memo_levels.html, https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/PortfolioSummary.xls.
[3] See, e.g., https://protectborrowers.org/mentorworks/
[4] See, e.g., https://www.gao.gov/assets/gao-14-91.pdf
[5] See, e.g., https://www.nytimes.com/2008/10/18/opinion/18sat2.html

Unfortunately, the marketing of financial products to college students has too often proven to be a vehicle for harm, abuse, and profiteering at those students' expense,[6] with third-party partnerships appearing at the center of many of the most notorious bank-involved scandals that have ripped off students over the last several decades.[7] Moreover, industry attention to college students as possible financial consumers both in the context of banking[8] and beyond it[9] appears to be surging, underscoring the need for strong borrower safeguards. The Agencies addressed here are prudential regulators, but the legal and reputational risks that poorly managed third-party relationships can expose banks to through resultant consumer harm, and the more general distrust they can breed along the way in the banking system, create a clear need for consideration of consumer protection in the context of the Agencies' Proposed Guidance.

Accordingly, we offer the following specific comments on the Agencies' Proposed Guidance:

- **Consumer outcomes and the extent to which third-party relationships put consumers at risk should be central to the Agencies' final guidance.** The Agencies' Proposed Guidance generally concerns the principal-agent problems posed by partnerships between banks and third parties, with the central risk the Guidance contemplates being, in simple terms, that a bank's partner might do something embarrassing or illegal that could put the bank at risk.[10] The Proposed Guidance also contemplates various operational dangers that third-party partnerships may impose on banks themselves,[11] some of which rise to touching indirectly on consumer protection,[12] but passingly little attention is paid to borrower safeguards per se.[13]

  This is a mistake. Throughout history and particularly (though certainly not exclusively) as it relates to college students, consumer protection risks have been a key mechanism through which banks' partnership with third parties have ultimately posed a risk to those institutions themselves, not to mention to borrowers.[14] This pattern is particularly evident as it relates to instances in which third-party partnerships that have created misaligned

[6] See, e.g., https://www.newamerica.org/weekly/remembering-student-loan-scandal/; https://www.marketwatch.com/story/after-controversy-trump-administration-releases-report-showing-deals-between-bankscolleges-cost-students-27-million-2018-12-10

[7] See, e.g., https://www.wsj.com/articles/SB119690691390915331; see also *supra* note 5.

[8] See, e.g., *supra* note 3.

[9] https://www.nytimes.com/2021/09/25/your-money/robinhood-colleges.html; https://www.cnbc.com/2021/09/21/jpmorgan-chase-is-buying-college-financial-aid-platform-frank.html

[10] See, e.g., part C of the Proposed Guidance included as Section IV of the request for comment.

[11] Id. (e.g. "Evaluating how the third-party relationship could affect banking organization employees, including dual employees, and what transition steps are needed for the banking organization to manage the impacts when the activities currently conducted internally are outsourced")

[12] Id (e.g. "Understanding potential information security implications including access to the banking organization's systems and to its confidential information")

[13] To the Agencies' credit, it would be wrong to say that *no* attention is paid to consumer outcomes. For example, the proposed guidance states that banking organizations should "[e]valuate the third party's fee structure and incentives to determine if the fee structure and incentives would . . . result in inappropriate risk taking by the third party or the banking organization" which in the context of historical examples discussed below can be read as reflecting consumer concerns. The Proposed Guidance also states that "a banking organization's use of third parties does not diminish its responsibility to perform an activity in a safe and sound manner and in compliance with applicable laws and regulations." One can reasonably presume those include consumer protection statutes and regulations.

[14] See, e.g., *supra* notes 5-6.

incentives that have catalyzed predatory lending. Consider the example of the First Marblehead Corporation (FMC), a consulting firm that in the 2000s arranged for bank partners to extend private loans used for higher education expenses that it would ultimately securitize.[15] Because FMC offered banks an opportunity to issue these loans under an originate-to-distribute model, the company's partner banks issued increasingly risky but lucrative credit generally to students at for-profit colleges, often with little consideration of whether these loans would ultimately be repaid.[16] Meanwhile, the nature of these banks' relationship to FMC meant that this deterioration in underwriting standards did not necessarily pose a clear risk to these institutions *along the lines that the Proposed Guidance contemplates risk.* Indeed, even as borrowers ultimately defaulted in droves, ruining innumerable financial lives, and even as FMC went bankrupt,[17] banks did not face clear, immediate danger to their franchise such as changes in the nature of their credit exposure stemming from partnerships with FMC. Nevertheless, the legacy of banks' involvement in FMC's scheme continues to pose extensive reputational risk, as market observers will often go to great lengths to specifically enumerate the various banks that partnered with FMC to generate its doomed loans.[18]

Had banks examined partnerships with FMC from the perspective of the risks that those partnerships might generate for *consumers*, banks may well have avoided being associated with a decades-long history of defaults on poorly underwritten debt and efforts by the firms managing FMC's securitized loans to recuperate losses by targeting communities of color.[19] More broadly, had banks taken a more holistic view of risk, they may have realized that banking is a relationship-based industry, and that risks to consumers in the context of financial services are all but certain to generate legal and reputational risks to the companies they patronize—even when those dangers arise with the help of third parties. The Proposed Guidance being considered here should be revised to reflect this reality.

- **Partnerships between banks and institutions of higher education should be given specific attention in the Proposed Guidance, as these arrangements have historically proven extremely risky for both banks and consumers.** As drafted, the Proposed Guidance generally contemplates that the range of third parties that banks might partner with could include firms engaged in "core bank processing, information technology services, accounting, compliance, human resources, and loan servicing."[20] Notably absent

[15] See *supra* note 7.
[16] https://protectborrowers.org/wp-content/uploads/2021/01/Maryland-NCSLT.pdf
[17] See *supra* note 7.
[18] See, e.g., https://www.championyourrights.com/post/ncslt-loses-lawsuit-and-appeal-can-t-prove-it-owns-student-loans-in-case-where-consumer-represente
[19] See https://protectborrowers.org/wp-content/uploads/2021/03/Dubious-Debts_2021.pdf; https://protectborrowers.org/wp-content/uploads/2021/08/Co-Opting-CA-Courts.pdf; *see also supra* note 16.
[20] Section I of the Proposed Guidance.

from this list and from the Proposed Guidance as a whole are institutions of higher education. This omission overlooks the tens of millions of dollars that banks pay schools each year for the exclusive right to market financial products on campus,[21] the windfall profits that partnerships with colleges generate for banking organizations,[22] and the extensive history of abuse and consumer harm arising from such arrangements.[23] Schools have been caught partnering with banks to deliver substandard but lucrative products in the credit card market,[24] the prepaid card market,[25] the private student loan market,[26] all generating lasting consumer harm and, in some cases, action by state law enforcement officials against banking organizations.[27]

In response to each of these successive scandals, Congress and federal policymakers have introduced a variety of compliance standards, disclosure requirements, and conduct restrictions governing banks' relationships with schools across various consumer financial markets.[28] However, available evidence indicates that many of these new regulations have so far been lightly enforced, especially as it relates to so-called "preferred lender arrangements" between colleges and organizations offering private student loans.[29] In light of the recent change in presidential administrations and extensive associated staffing changes at the Department of Education and the Consumer Financial Protection Bureau, that may soon change. If it does, prior laxity by banks in their oversight of partnerships with schools could produce immediate legal and reputational risk.

Banks' partnerships with schools are simply different from their relationships with other varieties of third parties in terms of the history of harm they involve and the related compliance obligations they now trigger. Accordingly, we recommend that the Agencies incorporate into their final guidance specific references to and recommendations surrounding the unique risks that third-party partnerships with institutions of higher education pose—and the unique considerations they should generate—for banks.

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21 https://www.wsj.com/articles/banks-pay-big-bucks-for-top-billing-on-college-campuses-1517148001
22 See, e.g., *supra* note 6.
23 Id.
24 https://uspirg.org/sites/pirg/files/reports/Campus_Credit_Card_Trap_2008_USPIRG.pdf
25 https://www.marketwatch.com/story/advocates-say-theres-an-unholy-alliance-between-banks-and-colleges-and-the-feds-should-break-it-up-11620420200
26 https://www.nytimes.com/2007/07/29/education/edlife/pappano.html
27 https://abcnews.go.com/Blotter/story?id=6418904&page=1 ("Lenders who have reached settlements include many of the names familiar from the meltdown of the banking sector: JP Morgan Chase, Citibank, Bank of America, Wachovia, Wells Fargo, National City, Sallie Mae CIT/Student Loan Xpress among them.")
28 See, e.g., Pub. L. No. 111-24, 123 Stat. 1734 (2009) (placing restrictions on the targeting of college students and other young people by credit card companies); 34 C.F.R. § 668.164(e)(2)(ix), (f)(4)(viii) (regulating the prepaid campus card market); Higher Education Opportunity Act, Pub. L. No. 110-315 (restricting "preferred lender arrangements" between private education loan companies and institutions of higher education)
29 See, e.g., https://protectborrowers.org/pushing-predatory-products-how-public-universities-are-partnering-with-unaccountable-contractors-to-drive-students-toward-risky-private-debt-and-credit/; https://protectborrowers.org/wp-content/uploads/2021/09/SBPC_ISA_PLA.pdf

- **The Proposed Guidance should deal more frankly with the prevailing notion that third-party partnerships are frequently or even usually an effort at regulatory arbitrage, which could put ultimately consumers and banking institutions at risk.** The Proposed Guidance states that "[t]he use of third parties can offer banking organizations significant advantages, such as quicker and more efficient access to new technologies, human capital, delivery channels, products, services, and markets."[30] The elephant in the room—but not in the Agencies' Proposed Guidance— is the notion shared by academics,[31] advocates,[32] journalists,[33] and even industry participants[34] that banks' partnerships with third parties can also serve as a pathway to regulatory arbitrage. This should be a startling accusation, as it raises the specter of banking organizations publicly profiting by facilitating or engaging in the evasions of the law. That this activity could put banks at substantial legal and reputational risk while leading to extensive consumer harm hardly bears explanation, but it clearly merits inclusion in the Agencies' final guidance.

  Students are certainly not the only group for whom the risks associated with regulatory arbitrage are salient, but they are particularly frequent targets for those who may try to avoid the law through bank partnerships. As a result, students' experiences illustrate the risks that regulatory arbitrage poses for consumers and financial institutions alike. Consider the example of income share agreements (ISAs), an emerging but extremely risky form of financing product that requires students to pledge a portion of their future income in exchange for an advance of money used to pay for college or vocational training.[35] To avoid regulatory scrutiny and in a move that senior financial regulators have identified as an effort at "regulatory arbitrage,"[36] companies offering ISAs have traditionally and spuriously argued that their product is not a form of credit or a loan, and that it therefore does not fall within the ambit of existing state and federal consumer protections or regulatory scrutiny.[37] Under this dubious cover, companies offering ISAs have gone on to deploy a wide range of predatory and harmful practices including the outright misrepresentation of facts surrounding their products,[38] the omission of legally required contract language meant to protect consumers from fraud,[39] and the use of

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[30] Section I of the Proposed Guidance.
[31] https://ilr.law.uiowa.edu/print/volume-106-issue-4/predatory-fintech-and-the-politics-of-banking/, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3684244
[32] https://consumerfed.org/elements/www.consumerfed.org/file/Testimony_of_CFA_USPIRG_et_al_Regulatory_Restructuring_HFSC_6_24_09.pdf
[33] https://www.axios.com/coinbase-proves-crypto-still-hasnt-grown-up-0300064a-a4aa-4a84-b1bd-2b715b0f52e3.html
[34] https://www.mckinsey.com/~/media/McKinsey/Industries/Financial%20Services/Our%20Insights/A%20vision%20for%20the%20future%20of%20cross%20border%20payments%20final/A-vision-for-the-future-of-cross-border-payments-web-final.ashx#page=13 ("On the other hand, smaller or less involved banks are increasingly finding options to reduce regulatory pressure, for example by working with fintechs to tap into regulatory arbitrage. . . .")
[35] See generally, https://protectborrowers.org/income-share-agreements-2/
[36] https://youtu.be/6J7l2eVcg4s?t=374
[37] https://protectborrowers.org/wp-content/uploads/2020/07/Pearl.Shearer_Credit-By-Any-Other-Name.pdf
[38] https://protectborrowers.org/wp-content/uploads/2020/05/Vemo-Complaint.pdf
[39] https://protectborrowers.org/wp-content/uploads/2021/05/SBPC_Holder_Rule_Final.pdf

pricing schema that produce apparent racial disparities among consumers.[40] Further, as the ongoing partnership between the ISA company MentorWorks and the nationally chartered bank Blue Ridge Bank[41] exemplifies, ISA providers are increasingly turning to banks to provide the capital necessary to conduct their business. Arrangements between banks and ISA providers ostensibly offer both sides an opportunity for regulatory arbitrage: for the banks, these partnerships are a chance to originate a product that they would likely otherwise fear to touch, and for the ISA companies, these arrangements are a convenient way to attempt to uphold their lie of not being regulated financial services companies.

This house of cards is already collapsing, and the consequences for banks and consumers are only starting to become clear. Since August of this year, state[42] and federal[43] law enforcement has taken action against ISA providers to affirm that ISAs are clearly "loans" and "credit" for the purposes of relevant consumer protection statutes, and that companies operating in the ISA market will be expected to comply with them. The specific ISA providers that were the targets of these actions did not operate through bank partnerships, but those that do and the banks they work with may soon find that what they previously viewed as a lucrative opportunity at regulatory arbitrage could have been a costly and damaging mistake. It stands to reason, for example, that law enforcement may be interested in investigating banks' roles in facilitating the origination of ISAs that, like those described above,[44] appear to violate fair lending law.

Partnerships between ISA providers and banks are an isolated example, but they point to a broader truth: when banks' third-party relationships are predicated on regulatory arbitrage, they put banks and consumers at risk. Moreover, given the common understanding that financial regulation in the U.S. arises mostly in response to crises[45] and scandals,[46] the Agencies should enshrine in their final guidance that regulatory arbitrage—even when nominally legal—is likely to give rise to the same harms that led to in the first place to the rules now being evaded.

As discussed above, it can hardly be described any longer as an open secret that banks' third-party partnerships are often driven by a desire to evade laws and regulations. It is not tenable for the Agencies or their final guidance to remain silent to this fact.

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[40] https://protectborrowers.org/wp-content/uploads/2021/03/SBPC_Inequitable-Student-Aid.pdf
[41] https://protectborrowers.org/wp-content/uploads/2021/04/Letter_MentorWorks_OCC.pdf
[42] https://protectborrowers.org/sbpc-statement-on-california-dfpi-consent-order-with-income-share-agreements-servicer-meratas/
[43] https://protectborrowers.org/statement-on-cfpb-enforcement-action-against-income-share-agreement-provider-better-future-forward-inc/
[44] Note that the specific ISAs referenced above were not originated through a bank partner. See *supra* note 40.
[45] https://sgp.fas.org/crs/misc/R44918.pdf ("The system evolved piecemeal, punctuated by major changes in response to various historical financial crises."
[46] See, e.g., *supra* notes 24-28.

In closing, we reiterate that college students and graduates have historically been at heightened risk of targeting by predatory financial institutions, and that partnerships between banks and third parties have proven to be a cornerstone of many schemes that have allowed bad actors to profit at these consumers' expense. We urge you to consider the unique risks that third-party bank partnerships pose in the context of higher education, to resist calls to narrow the scope of the Proposed Guidance,[47] and to acknowledge the key role of consumer protection in risk management.

Sincerely,

Ben Kaufman
Head of Investigations & Senior Policy Advisor
Student Borrower Protection Center

[47] https://www.regulations.gov/comment/OCC-2021-0011-0011 (requesting that the agencies narrow the definition of "business arrangement," among other changes)