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Via Electronic Mail

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
(thirdpartylending@fdic.gov)

RE: Financial Institutions Letter (FIL) 50-2016: Request for Comment on Proposed Guidance for Third-Party Lending

Ladies and Gentlemen:

On behalf of Oportun, Inc. ("**Oportun**"), we are submitting this comment letter in response to the Federal Deposit Insurance Corporation's ("**FDIC**") proposed guidance for third party lending (the "**Proposal**"). Specifically, Oportun encourages the FDIC to make certain enhancements to the Proposal that may benefit the broader public, particularly in light of the FDIC's commitment to increase participation in the banking system by households defined as "unbanked" and "underbanked," both of which represent significant proportions of Oportun's customer base.[1]

In particular, Oportun has identified two potential clarifications to the Proposal worthy of the FDIC's consideration: (1) the Proposal should clarify that banks may originate small-dollar installment loans with APRs in excess of 36% in third party lending arrangements (especially in light of the tendency for APR calculations to have an exaggerated impact on short-term, small-dollar installment loans); and (2) the meaning of "subprime credit characteristics" should be clarified to avoid automatic application of subprime capital adequacy standards to third-party lending programs that responsibly serve borrowers with no or low credit scores if other risk mitigating factors are present.

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[1] FDIC, *Bank Efforts to Serve Unbanked and Underbanked Consumers – Qualitative Research*, p. 1, (May 25, 2016) [hereinafter, "**FDIC Research**"] (defining "unbanked" as U.S. households that did not have a checking or savings account, and "underbanked" as U.S. households that used nonbank financial services in addition to having a bank account to meet their financial needs); *see also* Affordable Small-Dollar Guidelines, (Attachment to FIL-50-2007, June 19, 2007) [hereinafter, "**Small-Dollar Loan Guidelines**"] (noting "affordable short-term loan programs, particularly those offered to [low-to-moderate income] individuals and in [low-to-moderate income] areas, may be used as a marketing vehicle to tap into the underbanked market. This strategy has been pursued by some financial institutions as one important part of a profitable, long-term, multiple-account relationship for these individuals.").

Introduction

Oportun is a financial technology company founded in 2005 with headquarters in Redwood City, California. Oportun's mission is simple: to provide affordable loans to Latinos and others with little or no credit history so they can establish credit and build a better future. In recognition of Oportun's primary mission of providing responsible, affordable loans to underserved consumers, promoting community development, and predominantly serving low-to-moderate income communities, Oportun has been certified by the United States Department of Treasury as a Community Development Financial Institution ("**CDFI**") since November 2009.

People with little or no credit history have limited options should they need to borrow money to fix a car, pay a deposit on a new rental apartment, take care of an emergency, or make a large purchase. The credit bureaus consider them "unscorable" and mainstream financial institutions consider lending to them to be both risky and unprofitable. That leaves many of these "credit invisibles" with no alternative but to turn to high-cost products.

By using advanced data analytics and technology to score people others consider "unscorable," Oportun is able to lend money to individuals left out of the financial mainstream. Because most of Oportun's new customers do not have a credit report or score when they first apply for a loan, the business model for new customers is based partially upon a *"get-to-know-you"* approach. Many first-time applicants with no credit history are initially approved for a relatively small loan (e.g., $500) at a short duration (generally 7 months).

Oportun helps these "credit invisible" customers establish credit history by reporting their payments to two of the three nationwide credit reporting agencies ("**CRAs**"). Also, if at a later date these customers need additional loans and meet Oportun's credit and ability-to-repay requirements, the subsequent loans are often larger with a much lower APR. These loans are also reported to the nationwide bureaus, further establishing credit for the "credit invisibles."

From the regulatory perspective, Oportun operates as a balance sheet, state-licensed lender. Oportun has thus far been able to scale its operations relying on a state-licensing regulatory framework. Between May 2006 and September 30, 2016, Oportun made 1.6 million loans and disbursed $2.9 billion dollars to more than 800,000 customers, the vast majority of whom live in low-to-moderate income ("**LMI**") communities. Oportun currently operates in six states, and plans to expand further over the next few years. However, for Oportun to be able to offer its responsible loans, which are a healthy alternative to payday and other high-cost loans, on a uniform nationwide basis, Oportun is considering various options, including partnering with one or more banks that would be governed by the Proposal. It is from this perspective, of an operator in the responsible small-dollar lending space, that we respectfully submit this comment to the Proposal on Oportun's behalf.

Comment

1. **The Proposal should clarify that banks may originate small-dollar installment loans with APRs in excess of 36% in third party arrangements (especially in light of the tendency for APR calculations to have an exaggerated impact on short-term, small-dollar installment loans).**

Question number 4 posed by the FDIC in FIL 50-2016 states the following:

The Proposed Guidance outlines three categories of third-party lending arrangements: originating loans for third parties; originating loans through third parties or jointly with third parties; and originating loans using platforms developed by third parties. Do those examples appropriately capture the various types of arrangements? Are the respective descriptions of those arrangements appropriate?

In reference to the first category described in this question (i.e., originating loans for third parties), Oportun notes that the FDIC -- in Footnote 3 of the Proposal -- reaffirms as it has in prior guidance that "[f]ederal law authorizes state-chartered depository institutions to charge interest on loans to out of state borrowers at rates authorized by the state where the financial institution is located, regardless of usury limitations imposed by the state laws of the borrower's residence."[2] However, in the Small-Dollar Loan Guidelines, the FDIC has stated "a number of institutions have developed affordable small-dollar credit programs with APRs that range between 12 percent and 32 percent with no or low fees. As permitted by state law, we encourage lenders to offer small-dollar credit with APRs no greater than 36 percent."[3]

The unfortunate effect of the foregoing statement in the Small-Dollar Loan Guidelines is that supervised banks may choose to treat 36% APR as an absolute rate cap on small-dollar loans, potentially limiting the ability of Oportun to partner with a bank to offer its responsible loans on a nationwide basis. By way of example, below we have set forth a comparison of loans which illustrates (1) that for small loans with shorter repayment periods, a small, state-approved origination fee greatly impacts the APR, and (2) the significant distortion created by the Truth in Lending Act's APR formula despite, in many cases, a nominal real-dollar effect.

Disbursed Amount	Origination Fee	Interest Rate	Term	APR	Finance Charge	Payment Amount	# of Pymts	Total Pymts
$500	$35	36%	7 mos	56.76%	$103	$40	16	$603
$500	$0	36%	7 mos	36%	$64	$37	16	$564

The top loan, which is representative of the $500 loan offered to new Oportun customers in California under the Pilot Program for Increased Access to Responsible Small Dollar

[2] *See* Proposal at p. 2 (citing the Federal Deposit Insurance Act, 12 U.S.C. § 1831d).

[3] *See* Small-Dollar Loan Guidelines (Attachment to FIL-50-2007), *supra at Footnote 1.*

Loans ("**California Pilot Program**"),[4] has bi-weekly payments of $40, just $3.00 more than the bottom loan. However, because of the $35 origination fee charged to offset Oportun's costs to process the loan, the APR between the two loans differs by more than 20 percentage points. The APR of 56.76% is many times lower than the rate that would be charged for payday, auto-title, and pawn loans, which are the most widely-used alternatives among individuals with little or no credit history.[5]

Therefore, to avoid the potential for exclusion of responsible small-dollar lending, Oportun respectfully requests that the FDIC clarify in the Proposal that there is no automatic 36% APR limitation on small-dollar bank loans (including those made through third-party lending arrangements). To curb any potential abuses with such loans, the FDIC could look to the Consumer Financial Protection Bureau's ("**CFPB**") proposed rule for Payday, Vehicle Title, and Certain High-Cost Installment or look to state laws such as the California Pilot Program, both of which introduce the concept of limiting interest rate to 36% but allowing for a small origination fee to offset some of the costs to originate responsible loans.[6]

In the same vein, we note that the Small-Dollar Loan Guidelines, if not clarified in the context of third party arrangements, could further cause lenders to not partner with organizations that offer APRs more than 36% by suggesting supervised banks making small-dollar loans under the Small-Dollar Loan Guidelines may receive favorable consideration for Community Reinvestment Act ("**CRA**") purposes. If the Small-Dollar Loan Guidelines are not clarified in the context of third party relationships in the Proposal, such an approach could effectively set a federal usury rate for small-dollar loans since supervised banks may choose to abstain from small-dollar loan programs that would not result in CRA credit – and, in fact, could potentially result in CRA criticism.

As a practical matter, supervised institutions are unlikely to enter into third-party lending arrangements for small-dollar loans exceeding an APR of 36% for fear that a negative

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[4] Cal. Fin. Code §§ 22365 *et seq.* (operative as of Jan. 1, 2014 and applicable to loans between $300-$2,500 made by California Finance Lenders Law licensees specifically approved for participation in the California Pilot Program).

[5] Compared to the alternatives typically available to people with limited credit history — including payday, auto-title, and pawn loans — Oportun loans are affordable. Those alternatives are on average more than three times more expensive than Oportun loans but can be up to seven times more expensive, according to a study conducted in California, Texas, and Illinois on Oportun's behalf by the Center for Financial Services Innovation (CFSI), a leading authority on consumer financial health. CFSI developed a product cost model that took into account the size of a loan, the monthly cash-flow borrowers have available to service a loan, and the rates and terms offered at Oportun and at alternative small-dollar credit providers that are generally used to fulfill similar borrowing needs in some of the geographic areas served by Oportun (California, Illinois, and Texas). Data was collected in March 2015 [hereinafter, "**CFSI Study**"].

[6] *See* CFPB Proposed Rule for Payday, Vehicle Title, and Certain High-Cost (June 2, 2016), p. 1294 (providing text of proposed 12 C.F.R. §1026.12(b)(5)(i) to determine modified total cost of credit calculation exclusive of lender's costs of underwriting loans, which includes safe harbor of up to $50 for a single origination fee); *see also* Cal. Fin. Code §22370(c)(1) (permitting approved licensees to charge an administrative fee of up to 7% of the loan amount not to exceed $90 for the first loan, and 6% of the loan amount not to exceed $75 for subsequent loans).

CRA evaluation made available to the public will have damaging financial ramifications. In fact, the FDIC's stated commitment to the unbanked and underbanked appears to be unintentionally undermined despite the origination of responsible loans lawfully permitted under federal law that have been proven to benefit LMI communities and borrowers.[7]

In addition to Oportun's certification as a CDFI, the vast majority of Oportun's customers live in LMI communities and, should Oportun partner with a bank to originate loans, the bank may greatly benefit from a CRA perspective. As such, Oportun encourages the FDIC to include a statement in the Proposal affirming that institutions offering products through third-party lending programs with APRs above 36% will not be viewed *per se* as violating the CRA and will not be criticized in CRA evaluations if their products are offered in a compliant, responsible and lawful manner.

2. The meaning of "subprime credit characteristics" should be clarified to avoid automatic application of subprime capital adequacy standards to third-party lending programs that responsibly serve borrowers with no or low credit scores if other risk mitigating factors are present.

Question number 7 of the 10 questions posed by the FDIC in FIL 50-2016 states the following:

"The Proposed Guidance outlines some of the risk management areas examiners will consider when reviewing third-party lending relationships. These considerations include credit underwriting and administration, loss recognition practices, ***the applicability of subprime lending guidance, capital adequacy****, liquidity and funding, profitability and budgeting, accounting and allowance for loan and lease losses maintenance, consumer compliance, programs for safeguarding customer information, and information technology. Are the considerations appropriate? Should additional considerations be addressed?"(Emphasis added).*

As noted in the FDIC's prefatory statements to Question 7, a portion of the Proposal focuses on a supervisory assessment of the applicability of existing subprime and payday lending guidance (collectively, the "**Subprime Guidance**") to third-party lending arrangements.[8] Respectfully, however, the Proposal falls short of providing detailed guideposts to bank examiners and supervised institutions in making an accurate assessment as to the conditions under which the Subprime Guidance should be applied to third-party lending arrangements. If not clarified, the specific language in both the Proposal and the Subprime Guidance could cause bank examiners and supervised institutions to misapply the Subprime Guidance automatically to third-party lending arrangements when loans are made to those with little or no credit history. The FDIC should therefore clarify the supervisory considerations set forth in the Proposal in relation

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[7] *See* CFSI Study, *supra at Footnote 5.*

[8] *See* Expanded Guidance for Subprime Lending Programs (FIL-9-2001, January 31, 2001) and the Guidelines for Payday Lending (FIL-14-2005, March 1, 2005 (revised November 2015)).

to subprime programs and capital adequacy standards to ensure that heightened capital requirements are not deemed to be automatically applicable to third-party lending arrangements designed to benefit borrowers with no or low credit scores if other differentiating factors are present.

The Subprime Guidance states that "[t]he term 'subprime' refers to the credit characteristics of individual borrowers. . .[who] will display a range of credit risk characteristics that may include one or more of the following:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;
- Bankruptcy in the last 5 years;
- Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or
- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income."[9]

In addition, the Proposal refers back to the Subprime Guidance as follows: "Because of the challenges in overseeing risks related to third-party lending, . . .the Subprime Guidance will be applied to all subprime programs in third-party lending arrangements."[10]

Notably absent in the foregoing analysis in the Proposal is any consideration or examples of mitigating factors such as a lender's historical loan performance and other efforts the lender may have undertaken to develop a more informed underwriting analysis that belies the default risk implicit for borrowers with low or no credit scores. Oportun has been lending to the "credit invisibles" for over ten years, and has developed extremely predictive modeling using both self-reported and non-traditional "big data." In addition, Oportun performs an "Ability to Repay" analysis using verified income and debt on all applicants. The result is that Oportun's net losses have been in the mid-single digits ever since the financial crisis.

Furthermore, the "discretion" afforded examiners in classifying loans as "subprime" serves to undermine the principles undergirding specific "exclusions" from subprime status identified in the Subprime Guidance: "This guidance will generally not apply to. . . community development loans as defined in the [Community Reinvestment Act] regulations that may have some higher risk characteristics, but are otherwise mitigated by

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[9] *See* Subprime Guidance (FIL-9-2001) at p. 2-3.

[10] *See* Proposal at p. 10.

guarantees from government programs, private credit enhancements, or other appropriate risk mitigation techniques."[11]

Based on the foregoing, the Proposal as currently formulated could lead to the over-classification of subprime loans originated through third-party lending arrangements, when the borrowers have little or no credit history with national credit bureaus. This classification, in turn, would almost certainly lead to a requirement for supervised banks to maintain higher cash reserves based on the capital adequacy standards set forth in the Subprime Guidance.[12] Specifically, the Subprime Guidance states that "examiners should reasonably expect, as a starting point, that an institution would hold capital against such portfolios in an amount that is **one and one half to three times greater than what is appropriate for non-subprime assets** of a similar type."[13] (Emphasis added). Banks may therefore be hesitant to do business with a third party that serves those with little or no credit or alternatively will charge more due to the bank's higher costs to maintain the higher capital amounts.

Thus, the implicit bias in the FDIC's current definition of "subprime" threatens to further intensify the unintentional consequence of making even fewer lending dollars available for responsible, innovative, and well-underwritten lending programs such as Oportun's that meet the needs of the unbanked and underbanked on the path to financial stability.[14] As such, Oportun encourages the FDIC to be mindful of one of the major findings of the report it issued in May of this year in connection with its research on the unbanked and underbanked: "Bank partnerships with nonprofit organizations and local government agencies are key components in [the Banks'] efforts to serve unbanked, underbanked, and LMI consumers. This is a 'tried and true' strategy that, when executed well, is mutually beneficial to banks, their community partners, and consumers. To be most effective, however, these partnerships require significant commitments from banks and their partners. **In particular, better communication about shared goals and metrics is likely to lead to greater successes for all participants**." (Emphasis added).[15]

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[11] *See* Subprime Guidance (FIL-9-2001) at p. 2; *see also Interagency Questions and Answers on the Community Reinvestment Act*, 66 Fed. Reg. 36619, 36631, Sec. 345.22(a)-1 (July 12, 2001) (providing confirmation from the federal banking agencies that establishing loan programs that provide small, unsecured consumer loans in a safe and sound manner (i.e., based on the borrower's ability to repay) and with reasonable terms may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment area(s)).

[12] *See* Subprime Guidance (FIL-9-2001) at p. 6; *see also* Small-Dollar Loan Guidelines (Attachment to FIL-50-2007), *supra at Footnote 1* (stating "the [Subprime Guidance] limits the definition of subprime lending as a program with an aggregate credit exposure greater than or equal to 25 percent of Tier 1 capital. Accordingly, affordable small-dollar loan programs that fall under the 25 percent of Tier 1 capital threshold would not be expected to provide the additional capital.").

[13] *Id.*

[14] *See* Jim Campen, *Small-Dollar Lending: Is There A Responsible Path Forward?*, Center for Economic and Policy Research, p. 12 (2012), *available at http://cepr.net/publications/reports/small-dollar-lending-is-there-a-responsible-path-forward (*last visited September 28, 2016).

[15] *See* FDIC Research, *supra at Footnote 1*, p. 2.

At the moment, unfortunately, there is an absence of actionable guidance to support bank partnerships with for-profit CDFIs like Oportun to enable realization of the aforementioned shared goals.[16] To that end, the FDIC may wish to include in the Proposal examples of additional characteristics that may avoid over-classification of loans made to borrowers with no or low credit scores as subprime. These additional characteristics should include: lender's historic loan performance on loans made to those applicants with little or no traditional credit; borrower's historic loan performance on prior loans which may not be reflected on nationwide credit bureaus; borrowers' evidence of ability to repay the loan; and classification of a for-profit lender as a CDFI.

In light of the foregoing, Oportun respectfully requests the FDIC to augment the Proposal to provide more detailed guidance for bank examiners and supervised institutions to follow in performing a thorough analysis to determine whether the Subprime Guidance is applicable to third-party lending arrangements to those with little or no credit. Specifically, examples of additional factors to be considered when evaluating loans to borrowers with no or low credit scores would help distinguish and disassociate subprime lending from lending to those with little or no credit. In so doing, Oportun believes the FDIC will advance its goal of increasing banking participation by unbanked and underbanked populations without limiting its enhanced oversight of third-party lending arrangements.

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Once you have had a chance to review this information, please do not hesitate to contact me at (310) 424-3901, or by email at crockwell@buckleysandler.com, if you would like to discuss any matters addressed in this letter. Oportun welcomes the opportunity to share further information and insights with the FDIC in its efforts to better understand the current landscape of third party lending arrangements.

Sincerely,

Clinton R. Rockwell
Partner

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[16] *See, e.g.,* FDIC Press Release, *Affordable Small-Dollar Loan Guidelines* (Nov. 4, 2006) (noting "[c]ollaboration with other financial institutions or organizations, both for-profit and not-for-profit, may assist a financial institution to develop and implement a small-dollar loan program for its community. . . . Some have developed alliances with alternative financial service providers in an effort to reach out to the unbanked and underbanked, with the aim of transitioning these individuals to asset-building products and more mainstream banking services.").