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<u>Via Email: Comments@fdic.gov</u>
Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

Re: Docket No. RIN 3064-ZA04
Request for Information on Small-Dollar Lending

Dear Secretary Feldman:

We, the undersigned attorneys general, submit this comment in response to the Federal Deposit Insurance Corporation's ("FDIC") request for information on small-dollar lending.[1]

We welcome the FDIC's interest in encouraging FDIC-supervised financial institutions such as state-chartered banks to offer prudently structured and responsibly underwritten small-dollar credit products to consumers. As the FDIC's recent data shows, approximately 8.4 million U.S. households were "unbanked" and approximately 24.2 million U.S. households were underbanked in 2017.[2] The short-term credit needs of these households are largely met by the fringe financial sector: non-bank entities such as payday lenders and high-cost installment lenders that "are often usurious, sometimes predatory, and almost always worse for low-income individuals than the services offered by traditional banks to their customers."[3] Most borrowers are unable to repay these loans when they become due and are instead forced to take out new loans – and pay additional fees – to cover the prior loans, which can trap them in an endless cycle of debt.[4] The high cost of fringe

[1] *See* Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58,566 (Nov. 20, 2018).
[2] *See* "2017 FDIC National Survey of Unbanked and Underbanked Households," Federal Deposit Insurance Corporation, October 2018 [hereinafter "FDIC Survey"].
[3] Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. 165, 166-67 (2014); *see* FDIC Survey, *supra* note 2, at 8 (discussing alternative financial services for unbanked and underbanked households).
[4] According to a 2016 study by the Consumer Financial Protection Bureau, an astonishing 80% of payday loans are rolled over. *See* Consumer Fin. Prot. Bureau, *Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products* at 115-16 (June 2016), *available at* https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf. The fees payday lenders reap from such borrowers – estimated to be $3.8 billion annually – are one of the industry's largest sources of revenue. *See* Ctr. for Responsible Lending, *Shark-Free Waters: States Are Better Off Without Payday Lending* at 1 (Aug.

financial products are, in part, a function of the administrative costs such institutions face in originating and servicing credit extended to unbanked and underbanked households.[5] State-chartered banks face lower administrative costs and can leverage economies of scale to offer small-dollar credit to unbanked and underbanked consumers at lower costs than fringe financial institutions.[6] There are, however, important legal risks for state-chartered banks that seek to enter this sector.

I. Evasion of State Laws

Many states have enacted laws to protect consumers from abuses associated with high-cost small-dollar credit offered by fringe lenders. These laws reflect the will of the citizens in each state to restrict the ability of fringe lenders to engage in predatory practices. Although the details of these laws vary from state to state, there are features common to most state small-dollar lending laws. Many state laws cap the annual percentage rate ("APR") licensed lenders can charge for small, unsecured loans, and prohibit unlicensed lending.[7] In addition to rate caps on installment loans, many state laws substantially circumscribe fringe lenders' ability to offer extremely predatory products such as high-cost payday loans. These limitations include outright prohibitions, structural

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2016), *available* at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-shark-free-waters-aug2016.pdf.

[5] *See* Baradaran, *supra* note 3 at 167; *but see* Mark Flanney & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* (FDIC Ct. for Fin. Research, Working Paper No. 2005-09, 2005).

[6] *See* Baradaran, *supra* note 3 (explaining how similar economies of scale, infrastructure, and clientele can help the Post Office offer affordable small-dollar loans).

[7] CA: licensed lenders limited to monthly interest charges ranging from 1% to 2.5% for loans of various amounts less than $2,500. *See* Cal. Fin. Code § 22303; CT: 36% for small loans less than $5,000 and 25% for small loans between $5,000 and $15,000. *See* Ch. 668, Part III, Conn. Gen. Stat.; CO: *See* C.R.S. §§ 5-2-201, 5-2-214; DC: licensed lenders prohibited from charging rates in excess of 24%. *See* D.C. Code § 28–3301; IL: 99% on consumer installment loans less than $1,500 and 36% on consumer installment loans between $1,500 and $40,000. *See* 250 Ill. Comp. Stat. §§ 670/15 & 17.2; MA: 12% civil usury rate on small dollar loans of less than $6,000 and licensed lenders permitted to charge no more than 23%. *See* Mass. Gen. L. c. 140, § 96; 209 CMR 26.01 (Small Loan Rate Order); MD: licensed lenders prohibited from charging rates in excess of 24% or 33% for consumer loans less than $6,000, depending on the original and unpaid principal balance of the loans. *See* Md. Code Ann., Com. Law §§ 12-301-12-303, 12-306; NC: licensed lenders prohibited from charging interest in excess of blended rate of 30% on loans not exceeding $15,000. *See* N.C. Gen. Stat. § 53-176; NJ: Criminal usury law prohibits lenders from charging more than 30% to individuals. *See* N.J.S.A. 2C:21-19. Civil usury law prohibits unlicensed lenders from charging more than 16%. *See* N.J.A.C. 3:1-1.1; NY: Criminal usury law prohibits licensed lenders from charging more than 25%. *See* N.Y. Penal L. § 190.40. Civil usury law prohibits unlicensed lenders from charging more than 16%. *See* N.Y. Gen. Oblig. § 5-501; N.Y. Banking L. § 14-a; NC: licensed lenders prohibited from charging interest in excess of blended rate of 30% on loans not exceeding $15,000. *See* N.C. Gen. Stat. § 53-176; OR: licensed lenders prohibited from charging in excess of 36% on consumer finance loans of $50,000 or less. *See* Or. Rev. Stat. § 725.340(a); PA: licensed lenders limited to 24% APR under the Consumer Discount Company Act, 7 P.S. §§ 6217.1, and unlicensed lenders limited to 6% APR under Section 201 of the Loan Interest and Protection Law, 41 P.S. § 201; VA: 36% for small loans less than $2,500. Va. Code Ann. §§ 6.2-1501 and 6.2-1520.

limits,[8] and restrictions on the ability to take out multiple loans or rollover credit.[9]

Laws restricting small-dollar lending are not particularly new. State usury laws date back to the late nineteenth century, and efforts to restrict small-sum lending began over a century ago.[10] Since the enactment of these laws, states have struggled with efforts by fringe lenders to evade state restrictions. Evasion schemes include structuring loans to fall outside the scope of state lending laws[11] or characterizing interest as fees.[12] In recent decades, fringe lenders have attempted to leverage relationships with third parties to overcome state restrictions. In the early 2000s, fringe lenders began to associate with traditional banks to take advantage of the fact that traditional banks are generally not subject to state interest rate caps.[13] This method became known as "rent-a-bank" lending because the bank participated only by lending its name and charter to the transaction. Payday lenders would claim the bank was the lender, allowing it to take advantage of the bank's ability to export its home state's interest rate and evade the usury and other interest rate caps in the state where the borrower resides.[14]

By the late 2000s, "rent-a-bank" lending declined as many traditional banks severed their relationships with payday lenders. The financial crisis of 2008 along with increased regulatory scrutiny may have precipitated this decline. When rent-a-bank schemes began to falter, payday lenders turned to Native American tribes in an attempt to take advantage of tribal sovereign

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[8] CA: limits traditional personal-check-based payday loans to $300. *See* Cal. Fin. Code sec. 23035(a); CO: effective February 1, 2019, limits rates on payday loans to 36%. *See* C.R.S. 5-3.1-105; DC: prohibiting all lenders from charging rates in excess of 24%. *See* D.C. Code § 28–3301; IL: limits payday loans to the lesser of 25% of consumer's gross monthly income (22.5% for installment payday loans) or $1,000. *See* 815 Ill. Comp. Stat. § 122/2-5(e); MA: *See* Mass. Gen. L. c. 140, § 96; 209 CMR 26.01 (Small Loan Rate Order); NJ: N.J.A.C. 3:1-1.1 and N.J.S.A. 31:1-1(a); OR: requires minimum 31-day term and prohibits certain terms and waivers of rights. *See* Or. Rev. Stat. § 725A.064; PA: limits interest rate to 24% APR, caps late fees, prohibits compound interest. *See* 7 P.S. §§ 6217.1; VA: limits payday loans to $500. Va. Code Ann. § 6.2-1816(5); WA: lesser of 30 percent of the consumer's gross monthly income or $700. *See* Wash. Rev. Code sec. 31.45.073(2).

[9] CA: Cal. Fin. Code sec. 23037(a); CO: C.R.S. § 5-3.1-106 IL: 815 Ill. Comp. Stat. 122/2-30; IA: Iowa Code sec. 533D.10(1)(e); MA: 209 CMR 26.01 (Small Loan Rate Order); Or. Rev. Stat. § 725A.064(6); VA: Va. Code Ann. sec. 6.2-1816(6); WA: Wash. Rev. Code sec. 31.45.073(2).

[10] *See* F. B. Hubachek, *The Development of Regulatory Small Loan Laws*, 8 L. & Contemp. Probs. 108, 113 (1941) (detailing the history and the adoption of uniform small loan laws by states in the early twentieth century).

[11] *See De La Torre v. CashCall, Inc*., 422 P.3d 1004 (Cal. 2018) (holding that loans structured to fall outside California's small-loan rate cap can be unconscionable if the interest rate is too high); *State, ex rel King v. B&B Inv. Group, Inc. et al.*, 329 P.3d 658 (N.M. 2014) (holding that lender's year-long signature loans structured to evade New Mexico payday lending laws were structurally and procedurally unconscionable).

[12] *See, e.g., Livingston v. Fast Cash USA, Inc.*, 753 N.E. 2d 572 (Ind. 2001) (rejecting lender's argument that interest charges were simply check cashing fees); *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997) (same); *see also Illinois v. CMK Inv., Inc. d/b/a All Credit Lenders*, No. 14 C 2783 (N.D. Ill. Judgment entered June 17, 2016) (alleging installment lender's mandatory account protection fee that was charged on a sliding scale based on the amount financed was undisclosed interest in violation of the applicable 36% rate cap imposed by Illinois law).

[13] *See* Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections. Consumer Federation of America and the U.S. Public Interest Research Group, Washington, DC, Nov. 13, 2001, *available at* https://uspirg.org/reports/usp/rent-bank-payday-lending (describing the then emerging trend of "rent-a-bank" schemes among payday lenders).

[14] *See Pennsylvania v. Think Finance, Inc.*, No. 14-7139, 2016 WL 183289, at *1 (E.D. Pa. 2016) (describing rent-a-bank scheme, where payday lender partners with "an out-of-state bank" to act "as the nominal lender while the non-bank entity was the de facto lender" in a partnership that sought to take "advantage of federal bank preemption doctrines to insulate the [payday lending entities] from state regulation").

immunity. Under these tribal lending schemes, "a non-tribal payday lender makes an arrangement with a tribe under which the tribe receives a percentage of the profits, or simply a monthly fee, so that otherwise forbidden practices of the lender are presumably shielded by tribal immunity."[15]

A number of recent decisions have cast doubt on the legality of tribal lending schemes.[16] As a result, payday lenders are once again turning to "rent-a-bank" schemes in order to evade state law. Recent court decisions, however, suggest that "rent-a-bank" schemes are just as legally flawed as tribal lending schemes.[17] State-chartered banks should be wary of entering into relationships with fringe lenders that are structured to evade state rate caps. **We recommend that the FDIC discourage banks from entering into these relationships in any guidance it issues on small-dollar lending.**

II. Ability to Repay

Although state-chartered banks are generally not subject to state usury laws, other than applicable rate caps in a state-chartered bank's "home" state[18], state-chartered banks are still subject to laws of general applicability such as state unfair and deceptive acts or practices ("UDAP") laws and the law of unconscionability embedded in state common law and statutes. A state-chartered bank that directly or indirectly extends credit that is structured to fail,[19] that lacks economic substance,[20] or where there is no reasonable probability of repayment may violate state UDAP or state-law unconscionability.[21] **As such, we recommend that the FDIC discourage banks from extending small-dollar loans without considering the consumer's ability to repay.**

In order to ensure that these small-dollar loans are prudently made, we recommend the FDIC

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[15] Kyra Taylor et al., Pub. Justice Found., *Stretching the Envelope of Tribal Sovereign Immunity? An Investigation of the Relationships Between Online Payday Lenders and Native American Tribes* 6 (2017) (internal quotation marks omitted), *available at* https://www.publicjustice.net/wp-content/uploads/2018/01/SVCF-Report-FINAL-Dec-4.pdf.

[16] *See, e.g., CFPB v. CashCall, Inc., 2016 WL 4820635*, at *6 (C.D. Cal., Aug. 31, 2016) (holding that defendant payday lender was the "true lender" and real party in interest in tribal lending scheme); *MacDonald v. CashCall, Inc.*, 2017 WL 1536427, at *3 (D.N.J. Apr. 28, 2017), *aff'd*, 883 F.3d 220 (3d Cir. 2018) (detailing recent trend of cases in favor of parties challenging tribal lending arrangements across the country).

[17] *See, e.g., Think Finance*, *supra* note 14 (denying motion to dismiss and finding that state's allegations that non-banks were utilizing a "rent-a-bank" scheme to circumvent state usury laws were sufficient to state a plausible claim for relief and not preempted); *CashCall, Inc. v. Morrisey*, 2014 WL 2404300 (W. Va. May 30, 2014) (not published), *cert. denied*, __ U.S. __, 135 S.Ct. 2050 (2015) (holding that substance governs over form in evaluating "true lender" in a "rent-a-bank" scheme); *Meade v. Marlette Funding*, No. 2017CV30377 (Colo. Dist. Ct. Aug. 13, 2018) (order denying non-bank defendant's motion to dismiss on preemption of applicable Colorado rate caps).

[18] *See* 12 U.S.C. § 1831d(a).

[19] *See Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548 (Mass. 2008) (holding that mortgage loans structured to fail unless the borrower's income will increase during the loan's term were unfair under Mass. UDAP law).

[20] *See CFPB v. ITT Educ. Servs., Inc.*, 219 F. Supp. 3d 878 (S.D. Ind. 2015) (denying defendant's motion to dismiss and finding that the CFPB's allegation that for-profit college took unreasonable advantage of its students by steering them into institutional loans with a known default rate in excess of 60 percent in order to achieve objectives beyond the return on the loan was sufficient to state a claim); *See also De La Torre* & *B&B*, *supra* note 11.

[21] As an example, the D.C. Code provides that it is an unlawful trade practice to "make or enforce unconscionable terms or provisions of sales or leases" and that "in applying this [standard], consideration shall be given to," among other factors, "knowledge by the person at the time credit sales are consummated that there was no reasonable probability of payment in full of the obligation by the consumer." D.C. Code § 28-3904(r).

include in any guidance on small-dollar lending factors banks should consider in evaluating a consumer's ability to repay. Specifically, we recommend that the FDIC suggest that banks consider a consumer's monthly expenses such as recurring debt obligations and necessary living expenses in evaluating ability to repay and take into account a consumer's ability to repay the entire balance of the proposed loan at the end of the term without re-borrowing. We also recommend that the FDIC suggest that banks at least consider the consumer's capacity to absorb an unanticipated financial event – for instance, in the unexpected event of a loss of income or the added expense of a medical emergency – and, nonetheless, still be able to meet the payments as they become due.

III. Conclusion

We appreciate the opportunity to submit this this comment. Please contact our offices if you have any questions or need additional information.

Sincerely,

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