Office of the Treasurer & Tax Collector
City & County of San Francisco

José Cisneros, Treasurer

February 4, 2020

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Delivered electronically to comments@fdic.gov

Re: Comments on FDIC Notice of Proposed Rulemaking, Federal Interest Rate Authority, 12 CFR Part 331, RIN-3064-AF21

Dear Chairman McWilliams,

On behalf of the City and County of San Francisco ("San Francisco" or "City"), I am writing to express strong opposition to the Federal Deposit Insurance Corporation (FDIC)'s proposed rule for "Federal Interest Rate Authority" ("Proposed Rule"). This Proposed Rule would broadly and unnecessarily preempt state interest rate caps on consumer loans whenever the lender partners with a bank—allowing harmful predatory lending to proliferate in California and across the United States.

As San Francisco's Treasurer, I believe that my responsibility to safeguard our city's money extends to the financial wellbeing of our residents, and I have worked hard to develop programs and policies that help build financial security for low-income San Franciscans. My Office of Financial Empowerment, and our network of nonprofit partners, have seen the devastating impacts that predatory lending can have on our residents. We have worked with local and state leaders to combat harmful consumer loans, for example by enacting fringe finance zoning ordinances and supporting state legislation to cap interest rates on payday and installment loans and provide consumer protections against predatory lending generally.

The City has also taken other steps to curb and remedy these abuses. For example, City Attorney Dennis Herrera sued storefront lending institutions Check 'n Go and Money Mart, together with their online affiliates and an associated out-of-state bank, for unlawful, unfair and fraudulent business practices stemming from their marketing of short-term installment loans at unlawful interest rates to low-income borrowers. Ultimately, that lawsuit secured nearly $8 million in restitution for more than 10,000 eligible borrowers throughout California.

My comments are primary related to the following arguments against the Proposed Rule:

1. The rule would encourage the spread of high-cost, predatory lending, which traps borrowers in spiraling debt and strips wealth from low-income families and communities.
2. The FDIC's authority to govern the interest rates charged by state banks does not extend

to interest rates nonbank entities can charge after they purchase a loan.

3. Payday lenders in California have explicitly stated plans to broadly expand rent-a-bank schemes; the proposal would embolden these and other new schemes.
4. The FDIC's statement that the rule would not address the "true lender" doctrine provides little comfort, since the proposal effectively encourages evasion of state law and places an intolerable and impractical burden on state regulators and consumers alike.

The rule would encourage the spread of high-cost, predatory lending, which traps borrowers in spiraling debt and strips wealth from low-income families and communities.

We see firsthand the devastating impacts that predatory high-cost lending can have on our residents. Many families in San Francisco, and millions more across the country, are living paycheck to paycheck. Stagnant wages, high cost housing, childcare costs, and other financial strains are contributing to this problem. Unfortunately, some lenders see this despair as an opportunity to trap borrowers into high cost loans, with exorbitant interest rates that far too often lead them into financial ruin.

This type of abuse leads to damaged credit, repossession of car, closure of bank accounts, lawsuits, wage garnishment, and even bankruptcy. Over time, the damage to individuals becomes a community problem, as significant spillover effects deplete the wealth of entire neighborhoods and communities.[1] Further, predatory nonbank lenders deliberately target Latino and African American borrowers, both through concentration of storefronts in minority and low-income neighborhoods and through online targeting. Even after controlling for income, research has shown that African American and Latinx consumers are disproportionately likely to take out predatory high-cost loans.[2]

The FDIC's authority to govern the interest rates charged by state banks does not extend to interest rates nonbank entities can charge after they purchase a loan.

At least 43 states and the District of Columbia (DC) impose interest rate caps on some consumer loans. Among those that cap rates, the median annual rate including all fees is 36.5% for a $500, six-year loan, 31% for a $2000, two-year loan, and 25% for a $10,000, five-year loan.[3] While payday lenders are pushing hard at the state level to make high-cost long-term payday loans legal

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[1] Sarah D. Wolff, "The Cumulative Costs of Predatory Practices," Center for Responsible Lending, June 2015: https://www.responsiblelending.org/state-of-lending/reports/13-Cumulative-Impact.pdf.

[2] *See* Pew Charitable Trusts, "Who Borrows, Where They Borrow, and Why," July 2012 (https://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why); Pew Charitable Trusts, "Fraud and Abuse Online: Harmful Practices in Internet Payday Lending," Oct. 2014 (https://www.pewtrusts.org/en/research-and-analysis/reports/2014/10/fraud-and-abuse-online-harmful-practices-in-internet-payday-lending).

[3] *See* Carolyn Carter et al., "Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans," National Consumer Law Center (Aug. 2017), https://www.nclc.org/issues/predatory-installment-lending-2017.html; Carolyn Carter et al., "A Larger and Longer Debt Trap? Analysis Of States' APR Caps For A $10,000 5-year Installment Loan," National Consumer Law Center (Oct. 2018), https://www.nclc.org/images/pdf/pr-reports/installment-loans/installment-loans-report-2018.pdf.

in more states, the large majority of state legislatures have rejected these efforts. In addition, sixteen states plus DC have interest rate caps that prevent short-term payday loans, a number that has grown by several over the last decade.

The Proposed Rule, however, would permit nonbank assignees of loans from banks—including unregulated payday lenders—to charge whatever interest rate the bank may charge without regard to state usury laws.

The FDIC's purported authority to preempt state usury laws is anemic, at best. The FDIC relies on section 27 of the Federal Deposit Insurance Act (FDIA), which governs the interest rate that state banks may charge.[4] But the FDIA does not address and does not apply to the rate nonbank entities can charge after they purchase a loan. The FDIC also relies on section 24(j) of the FDIA, which provides that state consumer protection laws apply to branches of out-of-state banks to the same extent that they apply to national banks. But that section, again, says nothing about state laws that apply to nonbank entities after a bank sells a loan.

The FDIC does not have any broader preemption power except to the extent there is a conflict with another federal law the FDIC administers. The FDIC's proposal has not pointed to any federal laws that conflict with state usury laws that apply after a bank sells a loan.

Payday lenders in California have explicitly stated plans to broadly expand rent-a-bank schemes; the Proposed Rule would embolden these and other new schemes.

California recently passed AB 539 (Limon), which imposes an interest rate cap of roughly 38% on certain installment loans. As the likelihood of this historic and hard-fought legislation becoming law became clear, nonbank lenders began to openly discuss evasion of the new law through "rent-a-bank" arrangements. For example, the CEO of Elevate Credit Inc. (Elevate) stated during a July 29, 2019 earnings call with investors:

> "As you know, in California a piece of legislation . . . would limit the amount of interest that can be charged loans from \$2,500 to \$10,000. So what does this mean for Elevate? As you know, . . . similar to our recent experience in Ohio, we expect to be able to continue to serve California consumers **via bank sponsors that are not subject to the same proposed state level rate limitations."**[5]

Several other online payday lenders have also informed investors that they would be pursuing a rent-a-bank strategy to evade the new California law.[6]

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[4] 12 U.S.C. § 1831d.

[5] *See* https://seekingalpha.com/article/4278838-elevate-credit-inc-elvt-ceo-ken-rees-q2-2019-results-earnings-calltranscript (emphasis added).

[6] *See* National Consumer Law Center, "Issue Brief: Payday Lenders Plan to Evade California's New Interest Rate Cap through Rent-a-Bank Partnership," (Oct. 2019) (providing transcripts of earnings calls in which the CEOs of Curo Holdings Corp. (d/b/a Speedy Cash), Elevate Credit Inc., and Enova (d/b/a NetCredit, CashNetUSA) discuss plans to evade California's state law interest rate caps through rent-a-bank arrangements), *available at* https://www.nclc.org/issues/ib-rent-a-bank.html.

In the early 2000s, both the FDIC and the Office of the Comptroller of the Currency (OCC) cracked down on rent-a-bank schemes; the FDIC issued guidelines in 2005[7] and brought enforcement actions to end payday lenders' rent-a-bank arrangements with banks.[8]

It has been disconcerting to see a recent comeback in these schemes. Opploans, for example, is an online non-bank lender that makes loans with a 160 percent annual percentage rate (APR), which are illegal in 22 states and the District of Columbia, through a rent-a-bank arrangement with FinWise Bank, regulated by the FDIC.[9] Elevate makes loans (branded as Rise loans) with a 99 to 149 percent APR that are illegal in at least 15 states, also through a rent-a-bank arrangement with FinWise Bank.[10] Elevate also offers another loan product (branded as Elastic lines of credit) in 40 states at rates that can reach 109 percent APR through a rent-a-bank arrangement with Republic Bank, also regulated by the FDIC.[11]

It would be even more disconcerting to see the FDIC enact regulations that would sanction these sham arrangements.

The FDIC's statement that the Proposed Rule would not address the "true lender" doctrine provides little comfort, since the proposal effectively encourages evasion of state law and places an intolerable and impractical burden on state regulators and consumers alike.

The FDIC's discussion of the Proposed Rule notes that the agency is not addressing the question whether the bank is the real party in interest or the "true lender" on a loan.[12] This statement does little to mitigate the dangers of the Proposed Rule. In fact, the agency's proposal has the effect of inviting, rather than guarding against, evasion of state law through rent-a-bank schemes.

The proposed rule would eliminate the clean line established in *Madden v. Midland Funding*[13] that federal law generally only preempts state usury laws on interest that the bank charges, not

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[7] FDIC Guidelines for Payday Lending (Nov. 2015), available at https://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[8] *In re CompaCredit Corp.*, Case Nos. FDIC-08-139b, FDIC-08-140k, FDIC-07-256b, FDIC-07-257k, FDIC-07-228b, FDIC-07-260k (Dec. 19, 2018), *available at* https://www.fdic.gov/news/news/press/2008/pr08142a.pdf.

[9] *See* https://www.opploans.com/licenses/ (listing Alaska, Arizona, California, District of Columbia, Florida, Hawaii, Indiana, Kansas, Kentucky, Louisiana, Maine, Michigan, Minnesota, Montana, Nebraska, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Virginia, Washington, and Wyoming). *See also,* National Consumer Law Center, Issue Brief: Stop Payday Lenders' Rent-a-Bank Schemes (Nov. 2019), https://www.nclc.org/issues/issue-brief-stop-payday-lenders-rent-a-bank-schemes-november-2019.html. The 160 percent APR on loans exceeds the interest rate caps in these states.

[10] Elevate 2018 10-K at 15-16. Elevate also appears to be evading interest rate caps in Ohio and Texas by brokering the loan as a credit service organization (CSO). *Id.* at 7, 15-16. Under this scheme, a third-party lender finances the loan at the legal interest rate but has no relationship with the borrower. Elevate, as the CSO, charges fees to arrange, collect, and guarantee the loan, which result in an effective APR of 60 percent to 299 percent.

[11] Elevate Form 10-Q at 46 (for period ending June 20, 2019).

[12] Proposed Rule, 84 FR 66845, at 66846.

[13] 786 F.3d 246 (2d. Cir. 2015).

interest charged by a non-bank assignee. It is simple for state regulators, enforcement officials, and consumers to see what interest rate a non-bank is charging.

The true lender doctrine, on the other hand, requires review of the totality of the circumstances and can require years of litigation and facts that are not immediately publicly available—such as what relative share of the economic interest the non-bank has or whether the non-bank is immunizing the bank for the risk. Forced arbitration clauses will block consumers from bringing true lender cases on a classwide basis. And consumers cannot count on states to bring these cases, as enforcement and regulator resources are limited and in some parts of the country the state officials do not have a strong track record on consumer protection. Thus, the true lender doctrine alone cannot be expected to provide adequate defense against evasion of state law through rent-a-bank schemes.

In conclusion, by allowing lenders to evade state lending rate caps through so-called "rent-a-bank" arrangements, the Proposed Rule would encourage the spread of high-cost, predatory lending. The FDIC's authority to broadly preempt state interest rate limits that apply to state-regulated non-hank lenders is questionable, and I disagree with any suggestion that this proposal may be needed to enable lenders to meet the credit needs of the financially vulnerable. To the contrary, it would likely deepen financial vulnerability by facilitating the spread of high-cost loans, and jeopardizing the most effective tool states have to stop predatory lending.

I urge you to withdraw this unjustified and potentially harmful proposal.

Sincerely,

José Cisneros
Treasurer, City and County of San Francisco