February 4, 2020

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: *Cross River Bank's Comments on FDIC Notice of Proposed Rulemaking Entitled "Federal Interest Rate Authority"*

Dear Mr. Feldman:

On behalf of Cross River Bank ("Cross River" or the "Bank"), I would like to thank you for the opportunity to provide comments on the Federal Deposit Insurance Corporation's ("FDIC") Notice of Proposed Rulemaking ("NPRM") on Federal Interest Rate Authority, issued December 6, 2019. Cross River supports the FDIC's efforts to reaffirm longstanding legal precedents, restore stability to the lending markets and mitigate further reductions in the availability of credit.

Consistent with the common law doctrine of "valid-when-made," the FDIC's NPRM would codify two fundamental aspects of federal banking law: (1) the right to lend nationwide by exporting rates and fees permitted by the State where the bank is located and; (2) a loan which is valid when made remains valid even if it is later sold, transferred or assigned to a third party. The Second Circuit's holding in *Madden v. Midland Funding* has called these fundamental principles into question, having adverse effects on both consumers and the market. The FDIC's NPRM will ensure that affordable access to credit will be provided, in a responsible manner, to consumers, some of whom would otherwise not qualify. The FDIC's proposed rule is consistent with safe and sound banking practices and restores decades of preceding banking principles.

Comments

FDIC's Legal Authority to Codify the Proposed 12 CFR § 331

In a report to the President of the United States, published in July 2018, the Secretary of Treasury recommended that the Federal banking regulators "use their available authorities to address challenges posed by *Madden*."[1] In codifying 12 C.F.R. Part 331, *Federal Interest Rate Authority*, the FDIC is acting within the Agency's full statutory authority as prescribed under the Federal Deposit Insurance Act ("FDI Act").[2]

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[1] *See* "A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation" July 31, 2018 at pg. 93
[2] *See* 12 U.S.C. §§ 1811

Specifically, the FDI Act authorizes the FDIC to prescribe rules and regulations that the Agency deems necessary to carry out the provisions for the laws which it has the responsibility of administering.[3]

As the FDIC noted in the current NPRM, the legal ambiguity created by Madden has called into question the enforceability of the terms of interest rates.[4] The FDIC correctly states, that this uncertainty "may hinder or frustrate loan sales, which are crucial to the safety and soundness of State banks' operations".[5] The continued risks posed by the Second Circuit's misguided decision requires the intervention of Federal prudential regulators to restore consistency and stability to the markets.

The FDIC acknowledges that although *Madden* was a case concerning loans assigned by a national bank under 12 U.S.C. § 85, the federal statutory framework governing a State banks' authority regarding interest rates has been interpreted and patterned in the same manner as Section 85.[6] This position is consistent with the FDIC longstanding interpretation of the statute.[7] Creating parity in the application of the applicable federal statutes in this regard is critical to ensuring the adverse effects of *Madden* are reversed.

For the reasons stated above, Cross River believes that the FDIC is operating within its statutory authority.

Cross River's Market Participation

Cross River is a New Jersey state chartered FDIC-insured financial institution. From inception, Cross River has combined the innovative approach and solutions of a technology company with the security, reliability and trust of a regulated financial institution. In the wake of the 2008 financial crisis, when the credit markets had all but evaporated, Cross River used its clean balance sheet and strong capital to provide access to affordable credit for consumers most in need.

As Cross River continued to evolve and partner with fintech companies, the Bank expanded access to credit beyond its single branch location, reaching consumer's nationally, who may otherwise not have access. Today, Cross River partners with more than a dozen marketplace lenders to originate loans and safely provide access to credit across the country. Since inception, the Bank has originated more than 14 million loans and in 2019, Cross River originated more than 500,000 loans on average per month.

As a regulated financial institution, consumer protection and regulatory compliance remain a top priority. Cross River works with various fintech partners to greatly expand its reach nationally and to allow it to compete with other banks on a nationwide basis. Since the Bank actually originates all loans, its regulators (including the FDIC) properly hold it accountable and responsible for every aspect of the loan origination

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[3] *See* 12 U.S.C. § 1819(a)(Tenth). "[T]he Corporation… shall have power… To prescribe by its Board of Directors such rules and regulations as it may deem necessary to carry out the Provisions of this Act or of any other law which it has the responsibility of administering or enforcing (except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to any other regulatory agency)."

[4] *See* 84 Fed. Reg. at 66845 (Dec. 6, 2019)

[5] *See Id.*

[6] *See Id.*

[7] *See* FDIC General Counsel's Opinion No.10, *Interest Charged Under Section 27 of the Federal Deposit Insurance Act*, 63 FR 19258 (Apr. 17,1998) and FDIC General Counsel's Opinion No. 11, *Interest Charges by Interstate Banks,* 63 FR 27282 (May 18, 1998).

process, from initial solicitation to processing, to underwriting, to approving and ultimately funding. This also makes logical sense, as the need to ensure strong consumer protection, as well as safe and sound operation of the Bank is critical.

The Bank owns the end to end process throughout the life cycle of the loan; every part of the cycle is performed according to Bank standards, Bank policy and under the strong and active oversight by the Bank. In fact, the Bank voluntarily determined to effectively operate under the FDIC's FIL-50-2016 proposed guidance ("FIL-50"), which it believed presented a fair and balanced view of how banks should work with third-parties in the lending process. Cross River fully embraces its responsibility to ensure the Bank's internal processes provide thorough and extensive diligence. The credit and protection provisions guaranteed to consumers do not change through the cycle of the loan. Cross River strongly believes that it should not be penalized simply because it has chosen to work with third-parties in the lending process and engage in loan sales after origination. These are real loans made by a state-chartered, federally-regulated Bank whose interest rate complies with the requirements of its home state. Therefore, the interest rate at the time the loan is originated should carry, even when the loans are sold, assigned or transferred to third parties. While the Bank retains a percentage of these loans on its balance sheet, consistent with banking practices, Cross River sells loans on the secondary market, freeing capital and enabling the Bank to expand access to credit.

As a result of the *Madden* decision, Cross River has utilized its balance sheet to retain additional loans to mitigate the negative implications of the misguided decision. Utilizing the Bank's balance sheet in this manner has restricted Cross River's opportunity to work with partners in expanding access to affordable credit. Retaining additional loans requires increased capital levels, which in turn prevents Cross River from making use of the Bank's liquidity to maximize the number of loans for more families in need.

Ultimately, as a direct result of the *Madden* decision, many consumers have been left on their own to bear the burden of this limited access to credit; they have fewer, more expensive, and potentially riskier options, including predatory type loans. In addition, the Bank has witnessed firsthand the impact noted by one commentator in the FDIC's NPRM on the ability of depository institutions to sell or securitize loans originated in the Second Circuit. Since the *Madden* decision, the Bank has clearly witnessed a reduction in its ability to sell and securitize loans originated in the Second Circuit and the Bank expects this chilling effect in the secondary markets not only to continue, but to increase should the *Madden* decision be left unchecked. By explicitly verifying Section 27 of the Federal Deposit Insurance Act, the FDIC will solidify that permissibility of a given interest rate must be determined at the time the loan is made and not when a particular interest payment is taken or received, bringing much needed certainty to the secondary markets, which as noted in the NPRM is crucial in preventing the injection of risk to the safety and soundness of our nation's banking system. The Bank wholeheartedly supports the FDIC's NPRM in this regard.

Rent-a-Bank vs Partnership Model

Cross River values the FDIC's opposition to entities who partner with state banks with the *sole goal* of evading state usury law to engage in predatory lending practices. Fundamental to economic resiliency is the availability of credit at rational interest rates. Excessively high-interest, predatory loans trap

consumers in a cycle of debt causing unnecessary economic hardship. It is critical to distinguish the responsible market participants that are empowering consumers to take control of their financial well-being.

As noted earlier, consumer protection and compliance are at the heart of everything Cross River does. As the regulated institution, responsible for compliance, we are required to ensure our partners adhere to all relevant lending requirements. Cross River and our partners make a conscious decision to work with one another to advance responsible innovation and expand affordable access to credit, not to violate state laws.

The Bank strives to democratize the financial services industry in order to create a more inclusive system. Our strategic partnerships have played a role in helping to achieve this goal, leading to a more resilient financial system. Cross River fully understands and appreciates the regulatory responsibility that is associated with being the bank, originating each loan and onboarding these partners.

In furtherance of the above, the Bank in 2016 made the conscious decision to operate in accordance with FIL-50, which sets forth the FDIC's July 29, 2016 proposed "Examination Guidance for Third-Party Lending." Cross River believes that by formalizing FIL-50, in addition to finalizing the current NPRM, the FDIC will achieve its goal of preventing predatory lending practices and abuses to the bank-partnership model. Institutions who adopt these principles clearly demonstrate their continued commitment to actively engage with their partners, ensuring their practices comply with relevant laws. Adopting FIL-50 is another measure that exemplifies Cross River's continued involvement through the life cycle of the loan process.

Formally establishing these policies will eliminate any form of passive arrangements between banks and third parties, resulting in true partnership agreements. Cross River fully comprehends the consequences of passively allowing third parties to exploit the Bank's charter and has implemented robust onboarding standards to avoid this outcome. Continued oversight and strict compliance standards are pertinent to ensuring consumer protection. Solidifying the expansive set of principles prescribed in FIL-50 would curtail abusive practices and encourage responsible, safe lending practices. Regulating third party lending to avoid further exploitation of "rent-a-bank" schemes is well within the authority and capabilities of the FDIC.

Effects on Consumers

While the FDIC's NPRM stated that the agency was unaware of any widespread negative effects on credit availability as a result of *Madden*, several studies have demonstrated the adverse repercussions faced by consumers. These studies provide evidence that as a result of the *Madden* holding in the Second Circuit, (1) access to affordable credit has decreased for consumers and (2) personal bankruptcy filings have increased for consumers.

Specifically, a joint study by Stanford, Columbia and Fordham Law Schools, *What Happens When Loans Become Legally Void? Evidence from a Natural Experiment* (Honigsberg, Jackson and Squire), combined proprietary data from three marketplace lenders, finding that, in the Second Circuit, *Madden* reduced credit availability for borrowers who would likely borrow at rates above state usury limits, or otherwise

not qualifying for credit. The study also found that the volume of marketplace loans originated above state usury limits had decreased since the *Madden* decision.

The study stated that, "outside the Second Circuit, loan volume for borrowers in all FICO buckets increased substantially after Madden—and that a significant portion of the growth was driven by borrowers with lower credit scores. In New York and Connecticut, however, growth after Madden appears comparable to other circuits only for borrowers with FICO scores over 700." The study goes on to say that, after *Madden*, loans to borrowers with FICO scores below 644 "virtually disappeared," clearly demonstrating that individuals with lower scores have been disproportionately affected by *Madden.* The result of this is a less inclusive financial system limiting access to credit to families who need it most.

A joint study from the University of Bristol and Shanghai University titled, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* (Danisewicz and Elard)*,* further demonstrated the negative effects *Madden* has had on consumers in the Second Circuit. Similar to the previously referenced study, the sample group in this paper demonstrated that the number of marketplace loans declined 13.4% for an average state and the volume of these loans declined by 10% per month for the average state.

Using data from the U.S. Courts Administrative office, the report found that there was an 8% increase in personal bankruptcy filing in Connecticut and New York, in comparison to other states, following the *Madden* decision. The bankruptcy data further indicated that low-income households had been disproportionately affected. Specifically, the study states, "low-income households experience the most severe rationing of marketplace credit (64%) and the largest rise in personal bankruptcy (8.5%) following the verdict." This estimate is more conservative side than statistics sighted by similarly issued studies.

Additional Consequences of the Madden Decision

Cross River commends the FDIC's current efforts to rectify the adverse consequences that have resulted from the *Madden* decision. The FDIC's NPRM takes concrete steps forward in restoring stability and certainty to the markets. However, more than one longstanding legal principle has been called into question resulting in ripples throughout the industry as related to the lending markets. Despite the progress made by the FDIC's current NPRM, the remaining inconsistencies in applicable standards will continue to plague market participants and consumers alike, injecting unnecessary risk into the safety and soundness of the banking system at the national level.

Although the FDIC has elected to omit the "true lender" issue from the current NPRM proposal, Cross River would like to emphasize that without addressing this other longstanding legal precedent, continued uncertainty may further discourage banks and fintechs from entering into responsible partnerships, ultimately stifling innovation and further constricting credit availability.

The FDIC has ample tools at its disposal to address this "true lender" issue and would be acting well within the Agency's statutory authority in doing so. Cross River believes the FDIC should use its regulatory authority to formally codify FIL-50, clarifying that institutions demonstrating active and continuous oversight, risk management, and responsibility throughout the cycle of a loan should, at a minimum, be presumed to be the true lender, absent any clear and convincing evidence to the contrary.

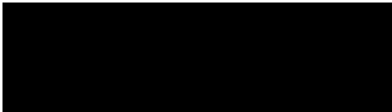
Conclusion

It is clear that the *Madden* decision has adversely impacted consumers' ability to obtain affordable credit from responsible lenders and caused uncertainty in secondary markets. As a result, consumers have been locked out of the financial services industry or been forced to seek riskier and/or higher cost forms of credit to meet their needs. This credit gap has inadvertently empowered predatory lenders and prevented consumers from taking control of their financial well-being.

By codifying a rule consistent with the valid-when-made doctrine, the FDIC would be ensuring a more stable and resilient financial system. Reaffirming the long-standing legal precedent will provide credit worthy consumers, many of whom have been overlooked by traditional lending models, with the access to credit they need. The FDIC's efforts will create a more inclusive financial system that expands options for consumers.

Cross River supports the Agency's efforts to rectify the consequences of the *Madden* ruling. As discussed above, these efforts will resolve many of the burdens consumers have faced as a result of limited credit options. We thank you again for the opportunity to provide comments on the current proposal and look forward to being a resource for the Agency in the future. If you have any questions, please feel free to contact me at agelbard@crossriver.com or 201-808-7189.

Sincerely,



ARLEN W. GELBARD
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