RE: Request for Information on Small-Dollar Lending - FIL-71-2018

The MLA represents the marketplace lending industry, and our goal is to promote a transparent, efficient, and customer-friendly financial system by supporting the responsible growth of digital marketplace lending, fostering innovation in financial technology (fintech), and encouraging sound public policy. MLA limits its membership to marketplace lending platforms (MPLs) that meet specific standards of safety and responsibility toward consumers and the overall marketplace. Among the protections offered, MLA members must (i) be transparent with consumers about APR / annualized interest rates, penalties, and fees, by disclosing them up front and in plain English; (ii) Not offer so-called “payday” or “high-cost installment loans” as defined by the CFPB -- those that are above the 36% APR threshold laid out in the Military Lending Act. This 36% APR standard has also previously been utilized by both the OCC and the FDIC in guiding banks on safe, sound, and pro-consumer small dollar lending.

Executive Summary

1. “Small dollar lending” encompasses a potentially wide range of products, some of which are high risk for both the consumer and the bank (very small dollar amount, very short term with high APRs and single-payment structures). Other products are much lower risk for both the customer and the lender, for instance: closed end installment, lower APRs, multi-payment loans that can be made available for sale into the broader credit market. To the extent that MLA members directly, or in partnership with banks, offer small dollar amount loans, they are the low-risk loans of the latter variety, and the MLA considers such loans that are under $5,000 at origination, to be the digital version of “responsible small dollar products.”

2. Today, the consumer lending market (including these small dollar loans) continues to be underserved by traditional banks using traditional customer interaction -- ie banks that make loans via bank branches and hold all loans to maturity. Evidence from a range of sources, including Transunion, dv01, Federal Reserve researchers and academic researchers indicate that innovative banks, working in various ways with technology providers, such as MLA members, are helping to fill these critical gaps and providing responsible “smaller dollar” credit options to millions of Americans who need them. These partnerships are well-regulated and clearly bring benefits to consumers, banks, and our economy.
3. The FDIC (and other regulators) can do more to support banks and foster closer working relationships with fintech providers. This includes establishing clarity by regulation on the valid-when-made principle that was undermined by the 2015 Madden decision, and finalizing the proposed FIL-50 Third Party Lending Guidance to help guide how banks can, and should, manage a bona-fide third-party lending arrangement. As the FDIC reviews finalizing FIL-50, it can also address unnecessary “true lender” uncertainty arising from certain older abusive payday lender-bank partnerships.

Digital Lending Impact

It is important to first note that today, there is already a large, fast-growing market of bank-originated digital consumer loan offerings that includes loans with smaller dollar sizes. Often working in partnership with bank originators at the “front end” of the loan process and bank loan purchasers who provide funding and portfolio loans on balance sheet, MPLs are delivering more affordable products to consumers, in locations that many banks no longer adequately serve, providing healthy competition in key product categories.

Digital lending, therefore, is no longer just an idea or a possibility, it is now a proven solution to a long-standing problem – the lack of convenient access to a wide range of affordable credit options for tens of millions of working Americans. Nearly 60 percent of Americans don’t have the funds to cover an unexpected $1,000 emergency, according to a recent Bankrate.com survey. The same survey also found that more than one-third of households have endured a major unexpected expense over the past year. Consumers who are “credit invisible,” “thin-file” or who have low credit scores often have the most difficulty obtaining fairly-priced loans. MLA members offer simple installment products with unsecured loans in sizes as low as $50 and as high as $100,000. Using fintech analysis from TransUnion / PeerIQ, dv01, as well as data provided directly by MLA members, MLA estimates that over the past 5 years, there have been approximately five million <36% APR unsecured non-payday digital marketplace loans originated in the U.S. that were issued with an original balance of $5,000 or less.

It’s important to note that the average originated unsecured personal loan balance for MLA members is somewhat higher – approximately $10,000 with terms of between 1 and 5 years. MPLs offering these consumer loans do so at an average of just under 15% APR with 100% of the loans falling below the 36% APR threshold set forth in the Military Lending Act. There is approximately $30 billion of such loan volume currently outstanding in the market. According to TransUnion, these fintech loans now account more than 35% of all US personal loans.

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3. Data provided from TransUnion’s Prama environment, which allows financial institutions to quickly analyze customer performance and benchmark it against the industry and their peers. Also relies on MLA member estimate with additional data provided by dv01. https://dv01.co
4. https://dv01.co
Finally, these are well regulated loans, subject to the same consumer lending standards as any other consumer loan, with significant oversight from a wide array of federal and state prudential and consumer protection regulators.

**Typical Use Cases**

Online unsecured personal loans from marketplace lending platforms have become a critical alternative option for these borrowers looking for credit to deal with an unforeseen emergency, such as a non-discretionary major unforeseen home or auto repair. Borrowers can also use a personal digital installment loan to access credit to make a large purchase and pay it off in simple installments. These “use cases” are serving consumers who want, need, and deserve the opportunity to get a better financial product.

Loans for MPLs also help those looking for an affordable transparent path out of higher cost (often credit card) debt. By consolidating debt with a loan from an MPL, borrowers can avoid carrying revolving credit card debt at a higher APR. For the sake of a quick comparison of rates, a review of all the credit card offers on bankrate.com reveals that APRs on such products consistently range from 14.75% - 27% APR.6 The CFPB has found that when typical annual and late fees are included, there is a significant increase in credit card APR.7 With well over a $1 trillion in consumer credit card debt now outstanding, many borrowers need lower APR options to refinance and pay down their balances. The availability of MPL products has yielded billions in savings for these borrowers who are unable to pay off their full balance. One marketplace lender working alongside a bank partner alone estimates that it has provided borrowers with more than $2 billion in total savings via lower interest rates. That is money that is available for investment in a stronger Main Street economy.

In questions 16-19 of the RFI, the FDIC asks how innovative technology can help address the small dollar market and support banks. The below highlights digital products reaching underserved.

To sum up the challenge that many MLA member firms are working hard to solve with bank partners: the vast majority of American consumers reliably pay their debt obligations, yet less than half of Americans consistently qualify for prime credit.8 We believe that MLA members are making progress on this problem by using machine learning and richer data sources, and improved user experience, better serving these customers. In 2017, the CFPB awarded the first ever no-action letter to Upstart Network, an MLA member company that uses alternative credit data and modeling in credit decisions. Similarly, researchers from the Federal Reserve

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6 [www.bankrate.com](http://www.bankrate.com)
Bank of Philadelphia (FRBP) released a report that relied on data from Lending Club, one of the largest MPLs, and concluded in part that “lending activities by [F]intech lenders seem to have filled the credit gap”; and that the use of alternative data “has enhanced financial inclusion and allowed some borrowers to be assigned better loan ratings and receive lower priced credit.”

As the FRBP study highlights, marketplace lending is well-positioned to help address the problem of access to responsible credit for several reasons. First, loan decisions by marketplace lenders are typically based on a more comprehensive picture of a potential borrower’s credit profile than just a FICO score. As a result, MPLs are often able to offer more affordable financial products to a population of borrowers who are often not being offered choices by traditional brick and mortar institutions, including borrowers with little credit history and low FICO scores. Increased availability of such simple digital products in underserved urban and rural markets also helps to address the decline in “brick and mortar” bank branches as customer interaction increasingly moves online. Second, marketplace lending platforms are also able to make decisions much faster than traditional lenders and do so with much greater transparency and ease for the borrower, providing convenience.

Contrasting digital installment loans with other widely available small dollar credit products

Increased competition serves to lower costs to consumers and help the economy – and so all market participants – traditional banks and the latest FinTech firms – should be encouraged to innovate and promote transparent, efficient, and customer friendly financial products. With internet access and smartphone adoption becoming nearly universal, even for unbanked and underbanked communities, there is an opportunity for borrowers to secure access to financial products offered at APRs that are orders-of-magnitude lower than traditional products such as storefront payday or installment loans, rent-to-own schemes, pawn shops, or other products. ⁹

For instance, in New York, a state impacted by the Madden decision with a state licensed lender interest rate cap of 25%, the APRs on New York “rent-to-own” products operate well above 100% APR. Borrower hardship can lead to repossession of the product by the rent-to-own operator, even after many (very expensive) payments. ¹⁰ Contrast such a product to the unsecured loans made through an MLA member offering digital loans at the point-of-sale in partnership with a New Jersey bank. The digital marketplace loan has simple, daily accruing interest, all-in APRs between 0-30%; there are has no prepayment penalties; there is never any additional interest charged such as deferred or compounding interest, and the consumer does not risk having the product re-possessed if they fall behind on payment.

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⁹ [https://ag.ny.gov/consumer-frauds/rent-own](https://ag.ny.gov/consumer-frauds/rent-own)

Similarly, the Pew Charitable Trusts recently did a comparison between installment loans and payday loans. Their findings heavily favored simple installment loans over payday structures for the following reasons:

- Monthly payments on installment loans are more manageable. According to Pew, installment loan payments typically take up 5 percent or less of a borrower’s monthly income.
- Second, according to Pew, it is less expensive to borrow through an installment loan than payday loan. A 2013 study from the Consumer Financial Protection Bureau found that the median fee on a typical 14-day loan was $15 per $100 borrowed, a much higher APR. Interest on long-term payday loans can reach as high as 400 percent.
- Unfortunately, without a viable alternative, consumers living “paycheck-to-paycheck” can easily fall into a cycle of multiple payday loans. For example, a woman in Texas paid a total of $1,700 on a $490 loan from a payday lender; it was her third loan taken out in a year.
- Often, original payday loans are rolled over into new, larger loans under the same fee schedule. Pew finds that 76 percent of payday loans are used to pay off old payday loans.\(^\text{11}\)

The Pew study is careful to point out that small dollar installment loans can also carry high rates and that potentially abusive add-on products such as credit insurance can add significantly to installment loan APRs without adequate disclosure. MLA members, however, voluntarily cap interest rates on simple closed-end installment loans at an all-in 36% APR and must clearly disclose all fees and features to remain in good standing with the MLA’s terms of membership.

**Existing Regulatory Frameworks**

Currently, MPLs have two options for engaging in business nationwide: (1) direct lending, which requires state-by-state licensing, and/or (2) working as a third party service provider and facilitator for nationally-chartered or state-chartered bank (Bank Partnership). Under the direct lending model, if a MPL would like to engage in the lending business in a certain state, it must obtain a license in that state. While this option may be feasible for companies that engage in business with a regional footprint, this option is more burdensome if a MPL wants to engage in business in many or all jurisdictions.

To do so, the MPL would be required to obtain 51 (exclusive of the territories) different licenses/registrations, as applicable, and comply with 51 different regulatory schemes to offer products online (where state lines are significantly blurred). This means that even for an MPL intending to lend with standardized, <36% APR consumer installment loan on a nationwide basis would have to build a regulatory compliance framework for numerous and differing rules.

that apply to various business practices, usury laws, fee restrictions, and other requirements. Many of these laws are dependent upon the amount of loan principal, and borrower location, location of the collateral, and other factors, such as physical location requirements, as set forth in state law. This lack of standardization makes it far more difficult to tap the liquidity of the capital markets to support lending for the middle class, driving up costs at the front end for borrowers. Under this model, platforms are regulated at the federal level by the CFPB and FTC.

Under the bank partnership option, MPLs do not originate loans to borrowers. Rather, they purchase and/or service loans originated by a bank, and they may provide marketing, processing, credit modeling and/or underwriting technology, loan administration, and loan servicing and other support services to assist bank partners. Under the home-host framework, all banks are exempt from state-by-state lender licensing and usury requirements (or the requirements are preempted), among others, because such banks are subject to other state and/or Federal regulatory laws and oversight (as applicable). By extension, MPLs partnering with such banks may not need licensure (depending on the activity) but must comply with the same regulatory laws prescribed for banks. For example, MPL partners are subject to the supervisory and enforcement jurisdiction of the bank’s relevant prudential regulator and are seen as vendors, or service providers, and still are subject to additional bank third-party compliance requirements. Notwithstanding, we note that there are state licenses that a MPL may still need to obtain depending on the activities performed (e.g., servicing license, collection agency license, etc.) regardless of a bank partnership.

In a bank partnership, MPLs also must comply with the requirements for robust compliance risk management programs, including compliance with Federal/state consumer and/or commercial finance laws and best practices. Banks oversee and supervise all aspects of compliance with respect to loan origination (e.g., develop marketing materials, set the credit underwriting criteria, issue all policies and procedures, etc.) and will not partner with entities that are unable to uphold and/or comply with these bank requirements including anti-money laundering compliance and cybersecurity requirements. Essentially, banks and their regulators require MPLs to perform at the same standards as if the bank performed the activities. This is set forth under law by the Bank Service Company Act, which gives federal banking regulators the ability to regulate and examine MPLs in connection with their activities in partnerships with banks. Here, CFPB and FTC consumer protection regulations still fully apply.

Policy Considerations: In questions 10-12, the FDIC asks about legal, regulatory and other challenges that impede banks from being able to do more responsible small dollar lending. The FDIC can make progress by approving FIL-50, and addressing Madden and True Lender uncertainty.

To ensure that banks are positioned to offer more responsible loans in smaller denominations to the widest range of creditworthy borrowers, a couple of key factors are important to consider. First, over the past decade, the growth of online lending demonstrates that borrowers have mostly transitioned to a digital user experience and will have expectations for a digital loan offering. To satisfy this expectation, the bank must have the capabilities to verify
identity, assess creditworthiness, make a credit decisions and to fund small dollar loans digitally.

Second, to ensure diversification, banks need to be able to offer a uniform loan product to similarly situated customers across the United States. To serve these customers, banks are likely to rely on the exportation of interest rates from a favorable state jurisdiction that falls within the bank’s branch network. For instance, in launching its online consumer lending capability, Goldman Sachs Bank which holds a New York banking charter, has elected to operate its online lending arm known as Marcus out of the Salt Lake City, Utah branch.¹²

Finally, to ensure safety and soundness, it is crucial that small loans can be sold into the broad credit market with loan contracts remaining enforceable on their original terms. The FDIC and OCC should consider using existing authority to address the fallout from the 2015 decision by the U.S. Court of Appeals for the Second Circuit in Madden v. Midland Funding, LLC that ignored a well-established principle of banking law—the “valid-when-made doctrine” – that a loan whose interest complies with applicable state law at the time of origination remains valid when sold, transferred, or assigned to third-parties.

While this is clearly key for digital models that rely on bank origination partners, as economic conditions change, all banks that make responsible small dollar loans must have flexibility to manage their portfolio of loans, cash needs, and regulatory considerations. To that end, in its July 2018 Executive Order report titled “A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation,” Treasury stated that “regulators should use their available authorities to address challenges posed by Madden.”¹³ The law firm Davis Polk & Wardwell followed up shortly after the Treasury report with a public legal memoranda that laid out the available authorities for addressing the problems caused by Madden.¹⁴

Indeed, the valid-when-made doctrine is critical to a healthy financial system, small businesses, and consumers because it ensures liquidity in the credit markets, thereby reducing the cost of credit to borrowers. Both the OCC and President Obama’s Solicitor General are on record as opposing the Madden decision, suggesting that the decision rests on a misunderstanding of Section 85 of the National Bank Act and existing Supreme Court precedent.¹⁵ Unfortunately,

¹² [https://www.marcus.com](https://www.marcus.com) language: Marcus by Goldman Sachs° is a brand of Goldman Sachs Bank USA. All loans and deposit products are provided by Goldman Sachs Bank USA, Salt Lake City Branch
the Second Circuit’s unprecedented decision in Madden created uncertainty and illiquidity in the credit markets, negatively impairing the availability and price of credit to consumers and small businesses in the three states that comprise the Second Circuit – New York, Connecticut, and Vermont. Specifically, because of the risk that loan contracts will not be enforceable, the decision has frustrated a bank’s ability to sell, assign, or transfer credit receivables (except to other banks) in the three impacted states, which then reduces the liquidity and value of those assets. This reduction in liquidity and asset value leads lenders to charge borrowers higher rates to compensate for the reduced liquidity and value of the loan assets. A recent study from researchers from Columbia, Fordham, and Stanford showed a post-Madden 52% decline in credit availability for borrowers in those 2nd Circuit states with credit scores under 625.\textsuperscript{16}

As Senator Patrick Toomey (R-PA) put it at a recent Senate Banking Committee hearing statement about Madden risk to Comptroller of the Currency Joseph Otting:

“Quite predictably, if banks can’t be confident that they can sell these loans, they’re just not going to originate them in the first place.”\textsuperscript{17}

For most community and regional banks, offering small dollar loans will often require partnerships and “white label” arrangements with fintech platforms. For those partnerships to bear fruit, the fallout from Madden must be addressed. To maintain safety and soundness of a small dollar lending program, a top priority for the FDIC should be to ensure that bank small dollar loans can be freely sold, assigned and transferred to both other banks and to non-banks. The Madden decision has severely curtailed this power in the Second Circuit.

Another independent academic study from co-authors at the University of Bristol, and the School of Finance at Shanghai University highlights another negative impact of the Madden decision: higher personal bankruptcy rates in 2nd Circuit. They analyzed how a decline in the availability of marketplace loans affects the incidence of personal bankruptcy. The paper relies on publicly available data from the courts and bank / marketplace lending partnerships. By using the 2nd Circuit U.S. Court of Appeals verdict as an exogenous source of variation in marketplace lending, they show that the court decision precipitated a persistent rise in personal bankruptcy, particularly among low-income households.\textsuperscript{18} In fact, it is just these types of situations of financial hardship where access to transparent, simple emergency loans can often be most impactful.\textsuperscript{19} Related “true lender” cases that had been brought to block payday
lending - bank partnerships but have recently turned against responsible, low rate MPLs raised
the accusation that the originating bank is somehow not the actual lender, even where the
bank clearly meets the standards laid out by OCC Interpretive Letter 822 and FDIC GC Opinion
11. A reaffirmation from the FDIC of the powers of FDIC supervised banks to sell loans under
Section 521 of the Depository Institutions Deregulation Act of 1980 (DIDA) would provide
market certainty, increase liquidity, and make credit more affordable for borrowers	nationwide.\textsuperscript{20}

Finalizing FIL-50 Guidance

people in the U.S. filed for bankruptcy in 2016, wiping out $118 billion in debt and making
bankruptcy more costly in per capita terms than health insurance. Credit losses impose costs both on
taxpayers, given that bankruptcy-related losses are tax-deductible, and on future borrowers, given
that risk-adjusted interest rates rise.” Sources:

- Han, S., and Li, G., “Household Borrowing after Personal Bankruptcy,” \textit{Journal of Money, Credit, and
- Dobbie, Will, and Jae Song, “Debt Relief and Debtor Outcomes: Measuring the Effects of Consumer
  710-746.
- Fisher, Jonathan, Who Files for Personal Bankruptcy in the United States?, U.S. Census Bureau,
- Gropp, Reint, John Karl Scholz, and Michelle J. White, “Personal Bankruptcy and Credit Supply and
- Berkowitz, Jeremy and Michelle J. White, “Bankruptcy and Small Firms' Access to Credit,” \textit{RAND

\textsuperscript{20} In a recent American Banker article, \url{https://www.americanbanker.com/opinion/a-remedy-for-true-
lender-lawsuits-already-exists} Former OCC attorney Mark Dabertin points out that: “FDIC can look
to interpretations of the National Bank Act set forth in the Office of the Comptroller of the
Currency's Interpretative Letter 822 or the Federal Deposit Insurance Act in the Federal Deposit
Insurance Corp.'s General Counsel Opinion No. 11. The OCC issued Interpretative Letter 822 on
February 17, 1998, in response to the Neal-Riegle Interstate Banking Act of 1994, which both
brought about interstate branch banking and created the possibility that a national bank could be
subject to the usury laws of more than its home state. The OCC opined in Interpretative Letter 822
that it would be would be “nonsensical” for a national bank to be expected to engage in a nationwide
lending business “without a reference point for determining appropriate state interest rate law.” As a
result, it created a three-part test in the letter for conclusively determining where a national bank is
“located” when it makes a loan. This same test was adopted by the FDIC several months later in its
opinion. Under the three-part test, the activity of making a loan is boiled down to just three primary
activities: the decision to approve the loan, the communication of the approval decision and the
physical disbursement of the proceeds, \textit{and if any one of these activities takes place in the bank’s home
state}, the loan is considered to have been made in that state and the bank may choose to charge its
home state’s interest rates to all borrowers, irrespective of state of residence. By conclusively
determining where a loan is made in an easy-to-apply manner, the three-part test brought interest-
rate certainty to bank lending conducted through branches. As a general rule, the fact that a bank
subcontracts marketing, loan servicing or other “ministerial,” or nonessential, lending activities to
third-party service providers has no effect on the bank’s ability to export its home state’s interest
rate under federal law.”
Finally, with respect to the role digital lending partners may play as banks expand responsible small dollar lending and other product offerings, we urge the FDIC to finalize its Guidance for Third Party Lending, discussed in FIL-50-2016. 21 We offer three recommendations regarding this Guidance:

1) Consider that some banks may be unable to deliver a particular lending service other than through a third-party lending arrangement. We suggest adding, in the “Purpose” section of the Guidance, that one possible strategic objective of constructive third-party lending arrangements is to “enable lending services for the bank’s customers that may otherwise not be sustainable for the bank in the absence of a third-party lending arrangement.” Similarly, we would suggest modifying the language in the Strategic Risk section to reflect the important perspectives of community banks to clarify that third-party lending arrangements may be essential to a bank’s strategy in that it may be unable to deliver a particular lending service in the absence of such an arrangement.

2) Consider how the nature and quality of the loan products themselves should be highlighted in the Guidance for their implications to reputational and safety-and-soundness risks. Lending products with APRs greater than 36% can at times result in expensive “debt-trap” cycles of re-borrowing and may pose longer-term but nevertheless important risks to the banks, including risks of reputational harm and customer attrition. In a risk-based vendor management framework, such longer-term risks are important considerations. We suggest they be discussed in the Guidance. Providing this clarity would be valuable to encouraging appropriate Third-Party Lending, by providing clearer differentiation between responsible and irresponsible use of the “issuing bank model” of third-party lending arrangements.

3) Seek to standardize this examination guidance across agencies, perhaps through the FFIEC. Standardized guidance and examination modules would be valued by banks who may be subject to different expectations from the FDIC, OCC, FRB, and state regulators. This topic of technology partnerships is consistent with the FFIEC’s previous guidance on technology related topics.

Closing

Small dollar lending can be an important source of credit for many Americans. Digital marketplace lending has the potential to better serve Americans who may still rely on other more risky or abusive credit products to meet their everyday credit needs. The FDIC has the opportunity to support responsible small dollar lending through policy and oversight approaches that appropriately recognize the digital revolution in lending. These approaches should support bank-fintech partnership models, which are a proven way to provide simple and

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responsible access to affordable credit options. The MLA greatly appreciates the opportunity to comment on the FDIC's efforts to increase small dollar lending and looks forward to an ongoing dialogue on how banks and fintech partners can best serve the financial needs of our nation.