



October 27, 2016

Ms. Rae-Ann Miller
Associate Director
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
thirdparty lending@fdic.gov

Re: Proposed Guidance for Third-Party Lending, FIL-50-2016

Dear Ms. Miller:

Americans for Financial Reform (“AFR”) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation’s (“FDIC”) proposed Examination Guidance for Third-Party Lending (“Proposed Guidance”).¹ AFR is a coalition of over 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups. Several of these organizations are submitting separate comments making important suggestions regarding this Proposed Guidance, and AFR requests that the FDIC give those comments full consideration.²

Our comments below focus on four specific issues related to FDIC supervision of third-party lending relationships and the Proposed Guidance: (i) rent-a-bank arrangements; (ii) certain prudential risks of third-party lending; (iii) third-party compliance programs; and (iv) Community Reinvestment Act coverage. Each issue is addressed in turn. As the Proposed Guidance notes,³ there are a wide variety of business models that rely on a third party to perform a significant function in bank lending. Accordingly, all types of relationships are not addressed by each section.

Rent-A-Bank Arrangements Should Be Prohibited

AFR agrees with comments submitted by the Center for Responsible Lending, National Consumer Law Center, and others which argue that the FDIC should prohibit banks from engaging in rent-a-charter arrangements that facilitate high-cost lending, and we concur with them on the great importance of this point. The FDIC should tighten its guidance to ensure it is not more permissive

¹ Examination Guidance for Third-Party Lending, in FDIC Financial Institution Letter – FDIC Seeking Comment on Proposed Guidance for Third-Party Lending (FIL-50-2016) (Jul. 29, 2016) (“Proposed Guidance”).

² As noted below, AFR’s member organizations support AFR’s overall principles and are working for an accountable, fair, and secure financial system. However, these organizations have not specifically joined this comment.

³ Proposed Guidance at 2.

than the Office of the Comptroller of the Currency's supervision of national banks' third-party relationships. FDIC-regulated depository institutions should not be permitted to originate loans on behalf of third parties in an attempt to circumvent state interest-rate caps and other protections.⁴ These arrangements are transparent regulatory arbitrage that lead to grave consumer harm and are an abuse of the unique rights afforded to insured institutions.⁵

Third-Party Relationships Should Not Facilitate Circumvention of Bank Regulation

Third-party lending relationships were central to the 2008 financial crisis, as bank participation in "originate to distribute" lending chains both facilitated origination of substandard and exploitative credit and involved pipeline and liquidity risks that later proved a grave threat to bank safety and soundness. We welcome the statement in this Examination Guidance that bank management and boards will be held responsible for creating and monitoring a strong and comprehensive set of policies governing third-party lending risks, including both underwriting and credit exposure and compliance with all consumer protection laws and regulation "to the same extent as if the activities were handled within the [banking] institution itself."⁶ It is critical that banks do not use third-party relationships as a mechanism for avoiding regulatory safeguards that would otherwise apply to their activities. The Proposed Guidance recognizes this principle in stating that "[t]he FDIC will evaluate lending activities conducted through third-party relationships as though the activities were performed by the institution itself."⁷ This principle must continue to be enforced through supervisory practice.

Prudential Risks of Third-Party Lending Relationships

We support elements of the Proposed Guidance which require banks to establish specific limits on each third-party lending arrangement, and on such arrangements overall (as a percentage of total capital), as well as specific limitations on total credit exposures, liquidity risks, and risks related to loan types. Related due diligence and model oversight requirements for bank management are also important.⁸ We also strongly support the statement in the Proposed Guidance that "[i]nstitutions engaging in significant third-party lending activities are expected to maintain capital

⁴ See generally 12 U.S.C. § 1831d(a). However, recent judicial decisions that have called into question whether state law is preempted when a loan is nominally originated by a bank but in fact the origination is dominated by a non-bank lender. See *West Virginia v. Cashcall Inc.*, No. 08-C-1964 (Kanawha Cty., W.V. Cir. Ct. Sept. 10, 2012), available at <https://www.nclc.org/images/pdf/unreported/wv-v-cashcall-phase-II-usury.pdf> (holding that an online lender had the predominate economic interest in a loan nominally originated by a national bank; accordingly, the state usury law was not preempted).

⁵ Cf. Comptroller John D. Hawke, Jr., *Remarks Before the Women in Housing and Finance* (Feb. 12, 2002) ("rent out the preemption privileges of a national bank . . . constitute[s] an abuse of the national charter . . ."), available at <https://occ.gov/static/news-issuances/speeches/2002/pub-speech-2002-10.pdf>.

⁶ Proposed Guidance at 12.

⁷ *Id.* at 1.

⁸ *Id.* at 6-8.

well above regulatory minimums.”⁹ Requiring such institutions to be particularly well capitalized provides an important regulatory backstop to protect against the potential failure of internal policies and procedures

We also offer the following additional considerations:

Off-balance sheet liabilities of third-party lending relationships are significant. As the Proposed Guidance rightly notes, “[c]redit risk should not be disregarded if loans are sold, particularly if the institution is subject to repurchase requirements.”¹⁰ Typically, a bank that sells or participates loans to a non-bank third party makes representations and warranties regarding the underwriting of those loans, including the credit characteristics of the borrower and the value of any collateral. If the representations and warranties are false, the debt buyer has the right to rescind the transaction, in effect requiring the debt seller to buy back the asset (even after a borrower defaults).¹¹ In aggregate, these liabilities can be enormous.¹² The FDIC should therefore examine the credit quality of all loans originated by the banks it regulates, and require appropriate loss reserves for those loans, regardless of whether the bank continues to own the loans.

Third-party collection and servicing relationships should be scrutinized. Banks’ engagement of third-party servicers and debt collectors, especially when the bank retains the credit risk of the debt, should be scrutinized for misaligned incentives and potential harm to both the bank and its customers.¹³ As the recent history of the residential mortgage industry vividly illustrates, servicers’ incentives may be severely misaligned from both the borrower and the bearer of the credit risk of the loan.¹⁴ For example, a servicer may be compensated for certain high-cost collection tactics on a fee-for-service basis, while other less severe actions would not entitle the servicer to additional compensation. Similarly, thinly-capitalized holders and buyers of distressed debt may seek quick but severe collection actions to garner whatever borrower assets they can in the short-term, rather than restructuring the debt to the long-term financial benefit of both borrower and lender. In

⁹ *Id.* at 11.

¹⁰ *Id.* at 4.

¹¹ For an explanation of these claims, see *ACE SEC Corp. v. DB Structured Products, Inc.*, 36 N.E.3d 623 (N.Y. 2015).

¹² See, e.g., Philip R. Stein & Sacha A. Boegem, *Bank of America and Freddie Mac Settle Mortgage Loan Claims*, BILZIN SUMBERG’S MORTGAGE CRISIS & FINANCIAL SERVICES WATCH (Dec. 5, 2013), available at <http://www.financialserviceswatchblog.com/2013/12/bank-of-america-and-freddie-mac-settle-mortgage-loan-claims/> (noting that Bank of America paid \$45 billion in mortgage-industry settlements from 2010 to 2013).

¹³ U.S. DEP’T OF THE TREASURY, OPPORTUNITIES AND CHALLENGES IN ONLINE MARKETPLACE LENDING 5-8 (May 10, 2016).

¹⁴ See generally Diane Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 WASH. L. REV. 755 (2011).

addition, under some circumstances, sellers of debt can be held liable for violations of the Fair Debt Collection Practices Act, creating a legal risk for transfers of debt to third-parties.¹⁵

Indemnification agreements or warranties may not protect banks. The Proposed Guidance rightly states that “[e]ven where an insured institution properly seeks to mitigate the risks of third-party lending arrangements through contracts that provide indemnifications . . . such agreements do not insulate the institution from its ultimate responsibility to conduct lending activities in a safe and sound manner and in compliance with laws and regulations.”¹⁶ It should be underscored that indemnification against legal claims by small or thinly-capitalized firms carries considerable counter-party risk, because any firm that has systematic failures in its operations (for example, faulty automated underwriting software) would likely face massive legal liabilities that would exceed its assets, leading to insolvency and bankruptcy. Effective risk management requires strong, independent due diligence rather than reliance on indemnification agreements or warranties.

Third-Party Compliance Programs

The Proposed Guidance correctly notes that “institutions should establish a third-party lending risk management program and policies prior to entering into any significant third-party lending relationship.”¹⁷ However, the Proposed Guidance does not detail the compliance standards to which third-party institutions should be held. Since the insured institution is effectively outsourcing core, high-risk functions to a third party, the FDIC should require that the bank insist the third-party have a sound compliance program in-line with the standards that are demanded of the bank. The FDIC should also require that banks ensure that any employee of the third-party institution is afforded (contractually, if not by statute) whistleblower protections for providing information to the bank or Federal or state regulators about the third-party’s relationship to the bank or about the bank itself.¹⁸

In order to satisfy the FDIC’s safety and soundness requirements, an institution is required to have “internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities[.]”¹⁹ Specifically, “the FDIC expects the Board of Directors and management of each institution to have a system in place to effectively manage its compliance risk, consistent with its size and products, services and markets.”²⁰ This includes an effective

¹⁵ *In the Matter of: Chase Bank, USA N.A. and Chase Bankcard Services, Inc.*, No. 2015-CFPB-0013 (consent order entered Jul. 8, 2015).

¹⁶ Proposed Guidance at 4.

¹⁷ *Id.* at 5.

¹⁸ *Cf.* 31 U.S.C. § 5328 (2001).

¹⁹ FDIC Standards for Safety and Soundness, 12 C.F.R. § 364 ApxA (2016).

²⁰ FDIC COMPLIANCE EXAMINATION MANUAL, COMPLIANCE EXAMINATIONS § II-1.2 (2015) (“FDIC COMPLIANCE EXAMINATION MANUAL”).

compliance management system (CMS) that is “comprised of three interdependent elements: [b]oard and senior management oversight; [c]ompliance program; and [c]ompliance audit.”²¹

The design of a compliance management system is complicated by the involvement of a third party. Though “the responsibility for ensuring that an institution and its third-party providers are in compliance appropriately rests with the Board and senior management of the institution,”²² the nature of third-party lending is such that – absent specific steps to address this – management has little direct control. The FDIC is clear that “the success of an institution’s CMS is founded on the actions taken by its Board and senior management.”²³ But without an appropriately designed compliance program and contractual guarantees of operational control and/or audit rights, the degree of control that the Board and management of the insured institution can exercise over the third-party uninsured lender is limited.

The FDIC can mitigate this risk by providing clear and authoritative guidance to ensure proper accountability and effective oversight at all levels of a third party. The FDIC has already provided a specific set of tools to design and implement an effective compliance management system. Insured institutions must satisfy the following requirements:

- Adopt clear policy statement and procedures;
- Appoint a compliance officer with authority and accountability;
- Allocate resources to compliance functions commensurate with the level and complexity of the institution’s operations;²⁴
- Conduct periodic compliance audits;
- Provide recurrent reports by the compliance officer to the Board;
- Conduct regular and comprehensive training for the third-party’s Directors, management, and staff;
- Design and implement an effective monitoring system;²⁵
- Implement procedures for promptly addressing consumer complaints; and
- Conduct regular and thorough independent compliance audits.²⁶

²¹ *Id.*

²² *Id.* at § II-3.1

²³ *Id.*

²⁴ Factors to consider include: institution’s size, number of branches, and organizational structure; business strategy; types of products; staff experience and training; type and extent of third-party relationships’ location of the institution; and other influences. *Id.* at § II-3.4.

²⁵ “An effective monitoring systems includes regularly scheduled reviews of: disclosures and calculations for various product offerings; document filing and retention procedures; posted notices, marketing literature, and advertising; various state usury and consumer protection laws and regulations; third-party service provider operations; and internal compliance communication systems[.]” *Id.* at § II-3.3-3.4.

²⁶ “The scope and frequency of an audit should consider: expertise and experience of various institution personnel; organization and staffing of the compliance function; volume of transactions; complexity of

Third-party institutions should be held to standards that closely mirror these requirements for insured institutions to mitigate the risk of compliance failure. This step would prevent the misuse third-party lending relationships as a means to gain the rights and reputation of an insured bank without the attendant responsibility for ensuring compliance.

Community Reinvestment Act Consideration

As the comment of the National Community Reinvestment Coalition explains in more detail, any lending conducted under a third-party partnership arrangement should be examined as part of the banks' Community Reinvestment Act ("CRA") Performance Evaluation. Including all lending is essential to achieving the statutory purpose of the CRA, namely to establish that banks have a "continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."²⁷

* * *

Your consideration of these comments is appreciated. For questions, please contact Marcus Stanley, Policy Director at Americans for Financial Reform, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

products offered; number and type of consumer complaints received; number and type of branches; acquisition or opening of additional branch(es); size of institution; organizational structure of the institution; outsourcing of functions to third-party service providers [...]; degree to which policies and procedures are defined and detailed in writing; and magnitude / frequency of changes to any of the above." *Id.* at § II-3.4.

²⁷ 12 U.S.C. § 2901.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc.
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute

Americans for Financial Reform
Comment on Guidance for Third-Party Lending
October 27, 2016

- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good

Americans for Financial Reform
Comment on Guidance for Third-Party Lending
October 27, 2016

- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)

Americans for Financial Reform
Comment on Guidance for Third-Party Lending
October 27, 2016

- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY

Americans for Financial Reform
Comment on Guidance for Third-Party Lending
October 27, 2016

- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development

Americans for Financial Reform
Comment on Guidance for Third-Party Lending
October 27, 2016

- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Phoenix AZ
- UNET