October 27, 2016

Via e-mail to thirdpartylending@fdic.gov

Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
5500 17th St NW
Washington, DC 20429

Re: Financial Institution Letter 50-2016

To Chairman Gruenberg:

I. Introduction

The Center for Responsible Lending (CRL)[1], along with Americans for Financial Reform[2], the Consumer Federation of America[3], the Leadership Conference on Civil and Human Rights[4], and the NAACP[5] submit this comment in response FIL-50-2016, "FDIC Seeking Comment on Proposed Guidance for Third-Party Lending," issued on July 29, 2016. This Federal Deposit Insurance Corporation (FDIC) proposed guidance would set forth additional safety, soundness, and consumer compliance measures that FDIC-supervised institutions should follow when lending through a business relationship with a third party. We thank the FDIC for recognizing that there is a need for greater oversight within third party banking relationships, especially over entities whose operations are only tangentially related to a bank's everyday operations.

---

[1] The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Over 30 years, Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits. It serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

[2] The Consumer Federation of America is a national organization of more than 250 nonprofit consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education.

[3] Americans for Financial Reform is a nonpartisan and nonprofit coalition of more than 200 civil rights, consumer, labor, business, investor, faith-based, and civic and community groups. Formed in the wake of the 2008 crisis, we are working to lay the foundation for a strong, stable, and ethical financial system – one that serves the economy and the nation as a whole.

[4] The Leadership Conference on Civil and Human Rights is the nation's oldest and most diverse coalition of civil and human rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, The Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. The Leadership Conference consists of more than 200 national organizations representing persons of color, women, children, organized labor, persons with disabilities, the elderly, gays and lesbians, and major religious groups.

[5] Founded in 1909, the National Association for the Advancement of Colored People (hereinafter NAACP) is our nation's oldest, largest and most widely known grassroots civil rights organization. The principal objectives of NAACP are to ensure the political, educational, social and economic equality of all citizens; to achieve equality of rights and eliminate racial prejudice among the citizens of the United States; to remove all barriers of racial discrimination through democratic processes; to seek enactment and enforcement of federal, state and local laws securing civil rights; to inform the public of the adverse effects of racial discrimination and to seek its elimination; to educate persons as to their constitutional rights and to take all lawful action to secure the exercise thereof.

The FDIC's proposed guidance provides a framework that will require banks to place more stringent requirements on the institutions that they conduct business with. However, as written, the proposed guidance will still enable consumer harm and allow FDIC-supervised institutions to engage in risky relationships with third parties via rent-a-bank lending. We are deeply concerned about the risk this could create for the Federal Deposit Insurance fund, the reputation of FDIC-insured banks, and the FDIC itself, as well as the adverse impact on consumers.

The FDIC must completely eliminate rent-a-bank lending. Rent-a-bank transactions facilitate predatory, unaffordable credit. The FDIC's proposed guidance ensures that many high interest rate loans will be made to consumers throughout the United States, which would otherwise be illegal under the laws of the state in which the consumers reside. The FDIC can, and should, take a stronger stand. It is clear that third parties operating under the rent-a-bank model are attempting to avail themselves of more predatory rates. Solely requiring more stringent third party oversight will not prevent bad actors from taking advantage of the gaping loophole in the field caused by the FDIC's permissive regulatory approach. In summary, we offer the following recommendations to strengthen the proposal:

- **A) The FDIC should not allow its member institutions to rent their charters;**
- **B) The FDIC's definition of significant risk activity should mirror that of the Office of the Comptroller of the Currency (OCC) Third-Party Relationship Guidance; and**
- **C) The FDIC should propose guidance with stronger limits on third-party relationships and bring its regulation in line with the OCC.**

In addition to these comments, CRL concurs with the comments submitted by the National Consumer Law Center that include specific caution against allowing banks to rent out their charters for the purpose of avoiding state law or facilitating lending in excess of state interest rate caps.

The FDIC should not allow its insured institutions to rent their charters.

Federal laws and regulations require disclosures, prohibit discrimination, protect consumers from certain damaging debt collection practices when conducted through third parties, and generally prohibit unfair and deceptive practices. But federal laws do not generally keep interest rates sufficiently low that they help ensure that only affordable, non-predatory loans are made; only state laws do that. The FDIC's Third Party Guidance, if followed, only requires compliance with federal laws. The actual effect of this guidance facilitates the avoidance of state interest rate caps—and that is the primary problem with the FDIC's proposed guidance.

The proposed FDIC's proposed Third-Party Lending Guidance regulates, and thus will unequivocally authorize, rent-a-bank relationships between FDIC regulated banks and non-bank lending partners. We object to rent-a-bank relationships because their primary effect is avoidance of state law consumer protections, almost always to the detriment of the consumer-borrowers in the rent-a-bank transactions. The core of our concerns with rent-a-bank transactions is that they facilitate predatory, unaffordable credit. The FDIC's proposed Third Party Guidance will not prohibit banks from enabling non-banks to make high-cost loans they could not make but for the bank partnership. Indeed, with this guidance, many high interest rate loans will be made to consumers throughout the United States, which would otherwise be illegal under the laws of the state in which the consumers reside.

Per FDIC guidance, "Federal law authorizes federal and state-chartered insured depository institutions making loans to out of state borrowers to 'export' favorable interest rates provided under the laws of

the state where the bank is located. In other words, a state-chartered bank is allowed to charge interest on loans to out of state borrowers at rates authorized by the state where the bank is located, regardless of usury limitations imposed by the state laws of the borrower's residence."[6] Using this guidance, influenced by interpretations of state parity laws[7], the FDI Act[8], principles derived from the National Bank Act[9], and case law[10], the FDIC has seemingly resigned itself to the notion that non-bank, third party lenders should be able to take advantage of this benefit as though they are depository institutions through the doctrine of federal preemption. We implore the FDIC to rethink this approach. While FDIC institutions participate in many legitimate, scrupulous third party banking relationships, rent-a-bank lending is not one of them. The FDIC should completely bar its member banks from renting out their charters to third party lenders. The FDIC should acknowledge that lenders have spurious (at best) relationships with FDIC insured banks in these arrangements, then move forward and bar its banks from renting their charters to these lenders.

There is current conflicting legal authority on whether third parties taking advantage of rent-a-bank arrangements can charge interest on loans to out of state borrowers at rates authorized by the state where the financial institution is located, regardless of usury limitations imposed by the state laws of the borrower's residence. Some courts have held that the true lender in these transactions is the entity which actually set the terms for the loan and then extended credit to the consumer.[11] However, many more courts have determined that the "true lender" in rent-a-bank transactions is the one with the predominate economic interest in the lending transactions.[12] In rent-a-bank lending, lenders fund and service the loans in question, perform other lender functions, and receive most of the economic benefit of the lending program. As such, courts have held that the banks are not the "true lender" for regulatory

[6] FDIC, *Guidelines for Payday Lending* (Revised November 2015), *available at* https://www.fdic.gov/news/news/financial/2005/fil1405a.html.
[7] Riegle-Neal Interstate Banking and Branching Efficiency Act, 12 U.S.C. § 1811 (1994).
[8] FDIC*, Gen. Couns. Opinion No. 11, Interest Charges By Interstate State Banks*, 63 Fed. Reg. 27282 (May 18, 1998), *available at* https://www.fdic.gov/regulations/laws/rules/5500-800.html.
[9] 12 U.S.C § 38 (1864).
[10] *Marquette Nat'l Bank v. First Omaha Serv. Corp.*, 439 U.S. 299 (1978) (Held that per 12 U.S.C. § 85, national banks are allowed to charge interest on loans at the rate "allowed by the laws of the State in which the bank is "located").
[11] *Sawyer v. Bill Me Later, Inc.*, No. 2:11-cv-00988, 2014 U.S. Dist. LEXIS 71261 (D. Utah May 23, 2014) (In finding the bank to be the true lender, the court noted that the plaintiff failed to sufficiently allege facts that would indicate that Bill Me Later acted as the true lender. Specifically, the court pointed to the following facts as determinative in its "true lender" analysis: (1) the bank was a party to the consumer loan agreements; (2) the bank funded the consumer loans and owned the credit accounts; (3) the bank held the credit receivables for two days; and (4) the bank owned the consumer accounts and profited from the financial gain based on interest collected on the consumer loans).
[12] *CFPB v. CashCall Inc., et al.*, Case No. CV 15-7522-JFW (RAOx), 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) (Finding that the entire monetary burden and risk of the loan program was placed on CashCall, such that CashCall, and not Western Sky, had the predominant economic interest in the loans and was the "true lender" and real party in interest, thus subjecting CashCall to state law); *CashCall Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 20, 2014) (Found CashCall to be the "true lender" because CashCall: (1) bore the economic burden and risk associated with the loan program; (2) acquired the loans from FB&T for more than the amount financed by FB&T; (3) had its owner and only stockholder personally guarantee all financial obligations to FB&T; (4) agreed to indemnify FB&T for any losses, including claims asserted by borrowers; (5) agreed only to purchase loans originating from FB&T if they complied with CashCall's underwriting policies; and (6) treated the loans, for financial reporting purposes, as if CashCall funded them. Because the court characterized CashCall as the "true lender," Section 27 did not preempt the state law claims for violations of the WVCCPA).

purposes. We agree with this interpretation of the law, and do not believe that the issue needs to continue to play out in our nation's court systems. We ask the FDIC to end the conflict by issuing guidance that clearly prevents its banks from participating in third party rent-a-bank transactions. This would bring the FDIC in line with the OCC and show that the FDIC has a vested interest in consumer protection and values the integrity of bank charters.

II. Potential Risks

In the FDIC's comment request, the Agency asks whether the proposed guidance "reasonably identif[ies] and describe[s] the risks that warrant emphasis for third-party lending arrangements." We believe that the proposed guidance understates the risks related to third-party lending, particularly with insured institutions partnering with third parties in making higher-cost lending transactions. These "rent-a-bank" arrangements pose great harm to borrowers, and they also pose a serious threat to the value and integrity of bank charters.

The current proposal will still enable consumer harm because it permits evasion of consumer protections at the state and federal level.

For decades, high-cost non-bank lenders have continually sought out bank partnerships in order to make loans without complying with state usury and small loan rate caps and other restrictions included in some payday and installment loan laws. This deliberate circumvention of state law harms borrowers and enables non-bank lenders to skirt consumer protection regulations. As currently written, the FDIC Proposed Guidance will enable consumer harm by implicitly allowing rent-a-charter lending. These Guidances will inadvertently exacerbate issues in the current landscape by sanctioning dubious arrangements.

States enacted small loan laws in the early 20th Century in order to curb abusive "salary-buying" and other extremely high-cost lending focused on vulnerable consumers while facilitating viable unsecured lending. States that enacted the model law capped rates at around 36 percent annual interest for small loans to be repaid in installments.[13] While the *Marquette*[14] court decision in the late 1970's authorized federally chartered or insured banks to export their home-state interest rate caps, and state chartered banks subsequently followed suit by using parity laws to similarly evade interest rate caps, non-bank lenders such as small loan companies, payday and title lenders, remained subject to state authorizing legislation, limits on loan terms, and interest rate and fee caps.[15]

In more recent years, the rent-a-bank model has been attempted in the multi-payment payday loan space as well. Again, it has been met with state opposition and rejected in many courts on grounds that the arrangement is a ruse where the non-depository is the de facto lender.[16] Furthermore, online rent-a-

---

[13] Lauren Saunders, *Why 36%? The History, Use and Purpose of the 36% Interest Rate Cap*, National Consumer Law Center (Apr. 2013), https://www.nclc.org/images/pdf/pr-reports/why36pct.pdf.

[14] *Marquette, supra* note 5.

[15] Jean Ann Fox, *Safe Harbor for Usury: Recent Developments in Payday Lending*, Consumer Federation of America (Sep. 1999), http://www.consumerfed.org/pdfs/safeharbor.pdf.

[16] Final Order On Phase II Of Trial: The State's Usury And Lending Claims, *State of West Virginia, ex rel. v. CashCall, Inc and J. Paul Reddam, Kanawha County Circuit Court*, Civil Action No.: 08-C-1964 (Sept. 10, 2012) (upholding the state's claim that CashCall was the de facto lender in violation of the state's usury limit, while finding that CashCall

bank lending by nonbank entities has increased. While some of these lenders are offering loans in compliance with state usury caps, others are charging rates that appear to exceed state law. In addition, payday lenders are morphing into installment loans in anticipation of tougher CFPB rules addressing balloon-payment payday loans and in order to evade state usury laws. These high-cost installment lenders are dependent on the lender obtaining direct access to the borrower's bank account, ensuring the lender is repaid even when the borrower cannot afford the loan. With exorbitant fees, borrowers again are left in long-term, high-cost debt traps that they cannot escape. The National Consumer Law Center's comment outlines two such examples: Elevate, which partners with Republic Bank and Trust Company to originate high-cost open-end lines of credit in order to circumvent state usury caps, and CashCall, which attempted to use a rent-a-bank relationship with First Bank and Trust of Millbank, South Dakota to make loans of $1000 or more at rates above West Virginia's interest rate caps.[17] Finally, widespread presence of arbitration clauses that prevent private individual or class actions to challenge these lenders' preemption claims (though the CFPB arbitration rule promises to limit these) has essentially left it to regulators to monitor their supervised banks for these arrangements.

It appears that the FDIC hopes that by increasing pressure on the banks, the banks will put contractual or audit pressure on third parties to behave ethically. Past experience makes it clear that this will not be enough to stop usurious lenders. Although other federal agencies have soundly rejected multiple iterations of rent-a-bank arrangements, high-cost lenders continue to evolve their products in attempts to evade state usury laws by utilizing gaps in regulation. The FDIC must prohibit its member institutions from renting their charters to ensure that these third party relationships do not provide a conduit for evading consumer protections.

III. Supervisory Conditions

The proposed guidance does not adequately capture all significant lending arrangements.

Under the FDIC's proposed guidance, institutions that engage in "significant" lending activities through third parties will be subject to "increased supervisory attention." Third party lending arrangements will be considered significant if they "have a material impact on revenues, expenses, or capital; involve large lending volumes in relation to the bank's balance sheet; involve multiple third parties; or present material risk of consumer harm."[18] The proposed guidance then goes on to outline standards for third party lending risk management programs.

We appreciate the Agency's expanded definition of "significant" lending activity, and agree that it is appropriate to expect insured institutions to conduct ongoing monitoring in these arrangements. However, ongoing monitoring of these relationships should be a floor, not a ceiling, when it comes to insured institutions originating loans for third parties. We also believe that the FDIC's definition of

---

purchased all loans made under the arrangement from First Bank of Delaware three days later and clearly bore the economic risk of the loans), *available at* http://bit.ly/16lOhAe.

[17] National Consumer Law Center, Comment, *Comments on Proposed Financial Institutions Letter (FIL) 50-2106: Third Party Lending* (forthcoming October 27, 2016).

[18] Payday lending schemes that operate through rent-a-bank arrangements can involve large lending volumes in relation to the bank's balance sheet. *Mother Jones*, a nonprofit investigative news organization, found that one-quarter of Eagle National Bank of Pennsylvania's 2001 earnings came from Dollar Financial Group payday loans. Similarly, Goleta National Bank of California contracted with Ace Cash Express, whose loans provided 20 percent of Goleta's profits in the same year. Brendan I. Koerner, *Preying on Payday*, Mother Jones (May 2001), http://www.motherjones.com/politics/2001/05/preying-payday.

significant risk activity should mirror that of the Office of the Comptroller of the Currency (OCC) Third-Party Relationship Guidance. The OCC expects its banks to have more comprehensive and rigorous oversight and management of third-party relationships that involve "critical activities"—significant bank functions (e.g., payments, clearing, settlements, custody) or significant shared services (e.g., information technology), or other activities that: (1) could cause a bank to face significant risk if the third party fails to meet expectations; (2) could have significant customer impacts; (3) require significant investment in resources to implement the third-party relationship and manage the risk; and/or (4) could have a major impact on bank operations if the bank has to find an alternate third party or if the outsourced activity has to be brought in-house.

We believe that the OCC's definition is more comprehensive in capturing "significant" arrangements. It is possible for a bank to conduct a large volume of consumer lending that dwarfs its high-cost lending volume by a third-party contract with a single lender, but the high-cost business could still be facilitating a number of abusive loans. In turn, the damage from those loans could harm the bank's reputation. Under the FDIC's current proposed definition of a significant third-party relationship, while this scenario could be construed to "present material risk of consumer harm," there is also a chance that it would not be captured.

The FDIC should propose guidance with stronger limits on third-party relationships and bring its regulation in line with the OCC.

The FDIC should align its guidance with that of the OCC. The OCC has comparable third party oversight requirements[19], but went further than the FDIC in addressing the undeniable risk of harm that arises from third party lending arrangements that benefit high-cost lenders. A prior OCC bulletin on third party relationships explicitly states that "National banks should be extremely cautious before entering into any third-party relationship in which the third party offers products or services through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly. *Such arrangements may constitute an abuse of the national bank charter* (emphasis added)."[20]

In 2003, the OCC took a series of enforcement actions that eliminated rent-a-bank payday lending relationships from the national banking system after finding a number of abuses. Like the FDIC, the OCC was concerned with oversight and "the inability of small banks to properly oversee the third parties who were making loans in their names." The OCC named the inherent risks of potential TILA and ECOA violations, as well as UDAP violations, as its primary motivators for rejecting rent-a-bank payday lending.[21] The agency has also cited "deceptive marketing practices, failure to secure confidential customer files, and unsafe and unsound lending" as an impetus for barring rent-a-bank arrangements.[22] Last year, when issuing the new CIF Handbook on CIFs, the OCC made it clear that the banks may not "rent their charters" to *any* third parties. This was in accord with longstanding policy. John D. Hawke, the OCC's previous Comptroller, called rent-a-bank lending "an abuse of the national charter," noting "It

---

[19] OCC, Bull. No. 2013-29, Third-Party Relationships (Oct. 30, 2012), *available at* https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html.
[20] OCC Bull. No. 2001-47, Third Party Relationships, Risk Management Principles at 4 (Nov. 1, 2001*), available at* http://ithandbook.ffiec.gov/media/27914/occ-bul_2001_47_third_party_relationships.pdf.
[21] Press Release, OCC, *Peoples Nat'l Bank to Pay $175,000 Civil Money Penalty* (Jan. 31, 2003), *available at* https://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-6.pdf.
[22] *Payday Lending*, OCC, https://www.occ.gov/topics/consumer-protection/payday-lending/index-payday-lending.html (last visited Oct. 26, 2016).

is a matter of great concern to [the OCC] when a national bank essentially rents out its charter to a third party vendor who originates loans in the bank's name and then relinquishes responsibility for how those loans are made… [w]e are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws that would otherwise apply to it."[23] Furthermore, more than a decade ago, Comptroller Hawke declared, "The preemption privileges of national banks derive from the Constitution and are not a commodity that can be transferred for a fee to nonbank lenders."

The FDIC has already acknowledged the potential for consumer harm in small dollar lending. In 2013, the FDIC, along with the OCC, issued guidance for direct deposit advance products. In doing so, the Agency recognized that these type of loans "…[t]ypically have high fees, are repaid in a lump sum in advance of the customer's other bills, and often are not subject to fundamental and prudent banking practices through which a bank can determine the customer's ability to repay the loan and meet other necessary financial obligations." The FDIC also stated that these products "pose a variety of credit, reputation, operational, compliance, and other risks."[24] Furthermore, in 2012, Chairman Gruenberg sent a letter to over 200 coalition members (including CRL) stating he was "deeply concerned about… continued reports of banks engaging in payday lending and the expansion of payday lending activities under third-party arrangements."[25] These recent efforts follow guidance issued by the FDIC over a decade ago raising safety and soundness and compliance concerns around payday lending programs.[26] After issuing the aforementioned statements, we hoped that the FDIC would take the logical next step of preventing its member institutions from offering high-cost loans by proxy via rent-a-bank arrangements, particularly where the arrangements are designed to evade state law. This has not been the case.

IV. Conclusion

These Guidances as drafted pose a serious threat to the value and integrity of bank charters and the Federal Deposit Insurance Fund. Furthermore, they put borrowers at greater risk of harm, under the imprimatur of the banking system. So long as the bank's investment and risks are protected in the credit made through the third party, there are no requirements that ensure consumers are protected from harmful high-cost loans.[27] Federal regulators should not give approval to relationships that evade state law in order to facilitate nonbank lenders charging consumers exorbitant interest rates. Interest rates

---

[23] Press Release, OCC, *OCC Concludes Case Against First Nat'l Bank in Brookings Involving Payday Lending, Unsafe Merchant Processing, and Deceptive Marketing of Credit Cards* (Jan. 21, 2003), *available at* https://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-3.pdf

[24] FDIC, *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products* (Nov. 21, 2013), *available at* https://www.fdic.gov/news/news/press/2013/pr13105a.pdf.

[25] Letter from Martin J. Gruenberg, Chairman, FDIC, to Lisa Donner, Executive Director, AFR (May 29, 2012), *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/Bank-DDA-FDIC-OC12-65R-1.pdf

[26] FDIC Financial Institution Letter 14-2005, *Guidelines for Payday Lending* (Revised November 2015) *available at* https://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[27] The FDIC Expanded Guidance for Subprime Lending does include this warning: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent." But ensuring a capacity to repay only ensures that the bank will get its money back. It does not ensure that the loan is affordable and fair.

above 100% are not atypical in these relationships;[28] indeed interest rates over 300% have historically been used in rent-a-bank arrangements. Our fear is that once the legality and propriety of banks renting out their charter has been enshrined in formal guidance—as would occur if the FDIC's Third Party Guidance is made operative—these third party arrangements will mushroom into even higher interest rates than are now common. It is up to policymakers to protect consumers from predatory lending. The FDIC must ban rent-a-bank relationships.

Sincerely,

Center for Responsible Lending (CRL)
Americans for Financial Reform (AFR)
Consumer Federation of America (CFA)
Leadership Conference on Civil and Human Rights (LCCHR)
NAACP

[28] Philip Ryan, *Loan Volume at Elevate, Alt-Subprime Startup, Hits $442 Million* (Feb. 10, 2015), *available at* http://bankinnovation.net/2015/02/loan-volume-at-elevate-alt-subprime-lending-startup-hits-442-million/; *CashCall, supra* note 10; National Consumer Law Center, *Comment*, *supra* note 11.