



Reinvestment
PARTNERS
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January 20th, 2020

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th St. SW
Suite 3E-218
Washington, DC 20219

RE: Docket ID OCC 2019-0027

Dear Sirs:

Please accept this comment made by Reinvestment Partners regarding the notice of proposed rulemaking on clarifying the law that governs interest rates that state-chartered banks and insured branches of foreign banks (collectively, "state banks") may charge.

Reinvestment Partners is a 501 © 3 non-profit group from Durham, North Carolina. We work locally, across North Carolina, and nationally to represent the needs of under-served consumers.

We have concerns about an intention to apply the "valid-when-made" principle. We know that the results of this decision would lead to harm for consumers, as the same practice fostered a widespread system of high-cost lending until 2001. Before then, a set of banks headquartered in "usury-friendly" states assigned recently-originated loans to payday lenders under the regulatory cover of pre-emption.

Now, the Office of the Comptroller of the Currency proposes a new rule which would reinstate that environment, authorizing banks to facilitate high-cost loans. In doing so, the OCC ignores the lessons from the past at the peril of consumers. Doing so would represent a dangerous usurpation by the federal government of state power in North Carolina, as the North Carolina General Assembly has clearly expressed its preference to set interest rate caps at thirty percent – far below any of the rates offered through the rent-a-bank model.

Payday lenders have tried to sidestep state rate caps for many years. Under this proposal, they would have the support of the OCC to do so.

Discussion

Courts have already found that the "rent-a-bank" practice violates established legal precedent.

In 2003, the New York Attorney General sued County Bank (Rehoboth, Delaware) and two of its associated entities for violating the state's anti-usury laws. The violations alleged in the suit addressed the exact practices contemplated in the OCC's proposal. In 2016, a lawsuit in the Eastern District of Pennsylvania indicted a payday lender and his attorney for violating Pennsylvania's usury cap through the rent-a-bank evasion.

"Companies that made payday loans to Pennsylvania residents over the internet tried to circumvent Pennsylvania's prohibition against payday lending by conditioning their loans on the borrowers' execution of contracts stating that Pennsylvania law does not apply to those loans. The Pennsylvania Supreme Court, however, invalidated such contractual provisions in 2008 and 2010....the practice of a payday lender paying a bank to act as a front for the payday lending enterprise in order to evade state anti-usury laws were referred to by payday lending industry insiders as 'rent-a-bank.' From approximately 1997 to 2003, the Hallinan Payday Loan Companies effectively rented County Bank."

Using the cloak of County Bank's charter, Hallinan Payday Loan Companies made payday loans across all fifty states, even though those loans exceeded usury caps on personal loans in many of those states. County Bank was not the "true lender," as it did not supply the capital, nor did it manage the underwriting of applications, nor did it service the loans, and it was not the ultimate beneficiary of the interest payments generated from the loans. County Bank's participation stemmed solely from its location in a "usury-friendly" state, as described by the attorney representing the defendants in the case. (United States District Court for the Eastern District of Pennsylvania, 2016).

With the enablement of national regulators, other banks followed suit. Notably, the rent-a-bank model allowed banks to facilitate lending at many times the rates permitted by state law. ACE Cash Express used Goleta National Bank while simultaneously Dollar Financial Group used Eagle National Bank to make small-dollar loans with interest rates of as much as 520 percent. History shows that the reinstatement of laws supporting these business practices will not result in modest changes to lending, but will instead empower banks to become a part of an industry that traps consumers in high-cost debt.

Indeed, were it to be that the OCC permitted the return of rent-a-bank, it would introduce practices that contradict currently-state policies related to reliance on debt. The OCC has established guidelines that limit the number of overdraft fees that a member bank can apply to an account within a specific time frame. The OCC's determination regarding the appropriate reliance on overdraft goes against the empirical evidence of known patterns in payday lending. In North Carolina, for example, payday lenders typically rolled loans over at least four times.

If the proposed rule change became effective, it would once again mean that a federal regulator used the cloak of federal pre-emption to undermine the legislatively expressed will of the North Carolina General Assembly.

The proposed rule replaces a simple regulatory regime with one that is far more difficult to apply.

Once established, it will be difficult to distinguish between evasive partnerships and genuine attempts by banks to sell loans to meet their liquidity needs or to sell delinquent assets to third-party debt collectors. At the moment, regulators can apply judgment. With this change, regulators will have to set aside their discernment. In the Duke Law Journal, John Hannon that “courts applying the true lender test disregard the form of lending configuration in favor of a searching examination of its substance, considering a variety of factors designed to determine which entity is the actual lender... the true lender doctrine represents a judicial mechanism capable of imposing a sensible limit on the heretofore endless scope of the exportation doctrine, while avoiding the uncertain market conditions sown by Madden’s approach (Hannon, 2018)”

The use of a true lender doctrine creates regulatory certainty. Under a rent-a-bank relationship, the bank is not the underwriter, the servicer, or the ultimate recipient of future loan repayments. We do not believe that it is appropriate to conflate liquidity concerns with the need to flip loans in a matter of twenty-four hours to a nonbank lender.

By adding so much ambiguity, regulators who do attempt to apply reason to their actions will invite representatives of rent-a-bank agreements to litigate their disagreements. The new approach requires a regulator to make a judgment whose contention would undoubtedly face legal challenges. It might require a regulator to invest in years of litigation to prove that a nonbank is the “true lender” in a “rent-a-bank” scheme.

While rules exist to thwart evasive rent-a-bank schemes, several FDIC-regulated banks have already deployed partnerships that utilize this model. We believe that the OCC should consider these relationships as evidence of how their banks might use pre-emption to facilitate high-cost lending.

To establish its right to pre-empt the types of loans made under the rent-a-bank model, a federal banking regulator would have to demonstrate that the nonbank is not the “true lender.” We strongly object to that conclusion. In the rent-a-bank model, a nonbank may perform all or some of the following functions: a) provide a true source of the capital, b) act as the advertiser, c) conduct the servicing of the loan, d) perform the underwriting and e) receive most or all of the subsequent loan repayments. In some cases, the nonbank takes a stake in an investment vehicle whereby it can indirectly participate in the benefits of the contract. For example, Elevate Credit’s relationship with FinWise Bank gives responsibility to Elevate for b) customer acquisition and d) underwriting. A) Elastic holds a direct ownership interest in EF SPV (Elastic Special Purpose Vehicle), whose capital is utilized to purchase 96 percent of originated loan balances. Under terms of the relationship between Elastic and EF SPV, Elastic is the e) “primary beneficiary.” (Elevate Credit, 2019)

Current loan terms and loan performance should underscore the unsafe nature of the lending that pre-emption would enable.

Rent-a-bank relationships are designed to facilitate high-cost lending, but in doing so, they put credit in the hands of borrowers who frequently cannot afford to repay their debts.

Rent-a-bank fosters interest rates that are not just slightly above state usury caps, but instead, at rates that are dramatically greater than the limits states would prefer to apply. For example, Elevate Credit reports that the effective APR for a Rise loan (described above) made through its partner relationship with Finwise is 180 percent.

Rent-a-bank lending does not rely on an ability-to-repay underwriting standard. It results in the origination of high-cost loans to borrowers who are frequently unable to afford the cost of the debt. Consider once more the business model of Elevate Credit. Elevate indicates that borrowers default on thirteen percent of Rise loans. The company has a practice of setting aside an additional fourteen percent of outstanding loans in loan loss reserves. Take together, their “cumulative principal loan charge-offs through September 2019 for each annual vintage since 2013 vintage is generally under thirty percent and continue to generally trend at or slightly below our twenty-five to thirty percent targeted range. (Elevate Credit, 2019)”

The practice creates debt traps. While the company’s SEC filings do not show how frequently borrowers renew their loans, we suspect that the total number is very high, as the company says that approximately three of every seven loans it makes are to a borrower who was a previous customer (Elevate Credit, 2019).

These results underscore our concerns over the quality of lending, and while it may not impact the safety of a bank’s balance sheet, it does describe a harmful business model that may undermine the reputation of the bank and the regulatory standards under which the bank operates.

Countering the OCC’s Basis for the Proposed Rule:

In its notice of proposed rulemaking, the FDIC makes the following points to support the proposed regulation:

Loan sales enable state banks to increase their liquidity in a crisis: While we agree that banks can make use of liquidity to avert threats to their soundness, we disagree that this concept contributes to any support for this proposed rule. Generally speaking, a bank holds these loans for no more than two days. There is no virtually no risk to the bank to make these loans, as the credit risk associated with those assets does not deteriorate when the bank holds them on its balance sheet. Indeed, a bank sells the loan before a borrower is due to make the first payment on the debt.

Is it defensible to contend that a bank would have a bad debt concern, when the business model explicitly requires a bank to surrender the loan before the first payment is due?

If the OCC insists on holding the unreasonable belief that the bank is the “true lender,” then the OCC should apply a correspondingly conservative standard for how retained loans are categorized in the formula for determining the bank’s Tier 1 capital ratio. A bank should have to set aside a significant amount of capital to guard against losses associated with holding loans made through a process where, as in the case of Elastic, as much as thirty percent of capital is lost because of poor loan performance.

We disagree with the idea that pre-emption will serve consumers who need more access to credit

We disagree with the idea that consumers will benefit from the “improved availability of credit from State banks...in the absence of the proposed rule, these consumers might be unable to obtain credit from State banks and might instead borrower at higher interest rates from less-regulated lenders.”

North Carolina consumers currently have access to credit. That statement holds not just for prime borrowers but also consumers with poor credit. While many banks may hesitate to provide loans to non-prime consumers, state-regulated non-bank lenders compete to give credit to non-prime consumers. In 2017, 479 North Carolina-licensed consumer finance lenders originated 463,888 loans with a combined

value of \$1.684 trillion. At the end of the year, those lenders had \$1.019 trillion in consumer installment loans outstanding. Borrowers received loans of all sizes; almost six thousand consumers received a loan of an amount of less than \$600. Nearly ten thousand applicants received a loan of between \$12,500 and \$15,000 (North Carolina Commissioner of Banks, 2018). These loans were all originated at rates below our state’s usury cap. These results underscore our belief that consumers already have access to credit, regardless of their credit profile.

Concluding Thoughts

We believe that the proposed rule would create a race-to-the-bottom effect, where a group of lenders relocates to “usury-friendly” states. In the first iteration of rent-a-bank, payday lenders found willing partners in a small group of states, most often in Delaware, where they could use a charter to hurdle over state anti-usury laws. We fear that a new era of rent-a-bank could be worse, given the opportunities for banks to make loans over the internet. Indeed, the proposed rule could portend a future where banks use technology to take usury to scale. That outcome would represent a lost opportunity, as internet banking should allow financial institutions to pass along the benefits of their reduced operating costs to consumers in the form of cheaper products – and to do so at scale. Rent-a-bank would expand given the opportunities it offers for frictionless scaling of service, but it will never reduce borrowing costs, as it only exists as a means of evading usury caps.

We request that the OCC not amend CFR 7.4001 and 12 CFR 160.110 to implement the “valid-when-made” standard. “Valid-when-made” may fit for the assignment of charged-off debt; it is not the right lens for assessing the nature of rent-a-bank loans. Those differences are easily discernible: in the rent-a-bank model, the non-bank is the “true lender.” The non-bank performs all or most of the essential functions of lending: customer acquisition, underwriting, and servicing. For the most part, non-banks or their related entities are also the ultimate beneficiaries of the loan repayments.

In the end, the important standard for the OCC is to make sure it prevents its banks from using third-party relationships as a means of evading state laws.

We assert our own set of principles: A charter is not a service for hire. A consumer should not be the victim of an arbitrary legal theory. A regulator should use its judgment to see an evasion for what it is and then act to prevent it. A bank should not trade on the malleability of its charter to facilitate evasive practices. The pre-emption should not be utilized as a means to undermine consumers.

We appreciate the opportunity to comment on this proposed rule. If we can answer any questions or provide any further input, please reach out to either myself or our Executive Director.

Sincerely,

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