RE: 6714-01-P

OFFICIAL TESTIMONY OF YOLANDA D. MCGILL, CENTER FOR RESPONSIBLE LENDING, ON PETITION FOR RULE-MAKING TO PERMIT PREEMPTION OF STATE LAWS WITH RESPECT TO THE INTERSTATE ACTIVITIES OF STATE BANKS

May 24, 2005

Thank you to the Hearing Officers and the FDIC for allowing me to come before you and testify today and to the Petitioners for raising these important issues.

My name is Yolanda D. McGill and I am here speaking on behalf of the Center for Responsible Lending. The Center for Responsible Lending is a non-profit organization engaged in policy research and advocacy with the goal of ending predatory lending practices. CRL is an affiliate of Self-Help Credit Union, a state-chartered, federally insured financial institution. Self-Help and affiliates form one of the nation's largest nonprofit community development lenders, whose mission is to create and protect ownership opportunities for low-wealth families through home and small business ownership.

Self-Help has provided $3.8 billion in financing to help over 40,000 low-wealth borrowers buy homes, build businesses and strengthen community resources. Our organization was instrumental in helping to pass North Carolina's comprehensive state statute against predatory mortgage lending, the country's first, and has been a leader on legislative and regulatory efforts to address predatory lending issues nationally.

I am an attorney, but not a banking lawyer per se – I began my career as a business bankruptcy attorney. At CRL I have focused on addressing the legal, political and market circumstances that give rise to problematic, abusive and predatory consumer (non-mortgage) loan credit products, such as payday loans and tax refund anticipation loans.

Given the dramatic impact this Petition would have on the dual banking system and fundamental principles of comity among states — for good or for ill — the FDIC should not engage in a rulemaking process absent a clear directive from Congress. Neither the history of our dual banking system nor recent Congressional actions support a broad preemption of state banking law by state-chartered financial institutions.

The arguments presented by Petitioners, with due respect, consist of a selective and out-of-context reading of recent Congressional actions. The FDIC should reject the cobbled-together argument advanced by the Petitioners, especially given the current policy debate as to whether even recent OCC preemptive rules reflect Congressional intent.

The best entities to protect families from the abusive loan products that are proliferating in the alternative financial services market offered by state banks and their affiliates and contractual partners are state banking commissioners and attorneys general, given the multiplicity of actors all across the country involved in these activities. Without the institutional authority and capacity to effectively protect consumers from abusive loan products proliferating in the alternative financial services market, the FDIC should resist the temptation to displace state-level enforcement mechanisms, thereby transforming itself into the primary regulator for all insured state banks and their affiliates and contractual partners. Pursuant to the Federal Deposit Insurance Act, the FDIC must rely on the states to regulate the activities of state banks and their business associates, and to protect consumers from unfair or abusive lending practices. Its authority to authorize banking activities is limited. Unlike the OCC, the FDIC's primary role is to protect the deposit insurance fund from insolvency, chiefly through the promotion and enforcement of sound banking practices. The FDIC should hew to this role and decline the Petitioners' request for rulemaking.

I will touch on three general themes that I feel are important to raise, based on the Petition and also on what I have heard at the hearing so far:

I. The breadth of Petitioner's request – the problem of agents.
II. FDIC lacks authority to promulgate rules applicable to the breadth of players and activities covered by Petition.
III. In addition to potential abuses, there are real abuses in the credit marketplace that would be increased by adoption of Petition.

I. <u>The breadth of Petitioners' request – the problem of agents.</u>

I note first off that those so far who have supported the Petition are in favor of parity for banks, or for banks and their branches, or for banks and their operating subsidiaries. However no one has spoken to the concern that was foremost in my mind when I read the Petition, namely that the Petitioners would extend preemptive privilege <u>beyond</u> the bank or its branch to any other person with whom the bank does business, based on the Petitioners' interpretation of Riegle-Neal and Gramm-Leach-Bliley. This is express in the Petition and also implicit in the request for parity with national banks, given the OCC's recent preemption determinations with respect to bank activities conducted through out-of-state subsidiaries and non-bank agents.

My primary concern is about bank partnerships with non-bank vendors and alternative financial service providers, such as those who offer payday loans and refund anticipation loans, and the problem of effective regulation of those products that have been shown to have adverse effects on American families. I'll discuss this issue later.

II. <u>FDIC lacks authority to promulgate rules applicable to the breadth of players and activities covered by Petition.</u>

Petitioners suggest that Congress has approved of FDIC granting preemptive privileges to state banks, but a full examination of recent action in Congress on this issue indicates a reluctance to accept OCC preemptive rules, and in no way leads to the conclusion that Congress would support the FDIC in bestowing similar preemptive privileges on state-chartered banks. Everyone here so far has expressed concern with OCC's overreaching preemption determinations – CRL is included in that number. The concerns relate to the extension of NBA preemption to operating subsidiaries, to licensing requirements, to non-traditional banking activities and the like. Quarrel as we may with the OCC's aggressive approach, they can at least point to some legal support in their favor – their creation and role as charterer and overseer of federal banks and the exclusive visitorial power they enjoy over those banks, the broad set of enumerated powers for national banks expressly set forth in the NBA, especially 24 (Seventh) and the supremacy of federal law over state law.

The FDIC on the other hand is in a very different situation. It was created as an insurance fund to safeguard the vitality of the banking system, granted concurrent visitorial authority of the banks it insures, and lacks the statutory authority to supplant state law applicable to those banks unless expressly provided for. This supplementary authority has been granted by Congress in a few areas, namely in Section 27 limited to bank exportation of interest rates and Riegle-Neal to facilitate branching.

The issue for me is, where is there authority for the FDIC to promulgate rules to expand application of federal law, or home state law vis-a-vis federal law, to entities besides insured state banks and their branches (and possibly operating subsidiaries)? And even if the FDIC had the authority to issue such rules, where does it get authority to cover anything outside of the rate of interest the bank can collect? Elizabeth Renuart went over the lack of statutory authority – to that I would emphasize that Section 27 of the FDIA does not do the job. OCC relies on Section 85, which is substantively the same as Section 27 of the FDIA, <u>plus</u> Section 24 (Seventh) in order to promulgate regulations outlining permissible national bank activities.

III. <u>In addition to potential abuses, there are real abuses in the credit marketplace that would be increased by adoption of Petition.</u>

In addition, I have to talk about payday lending here because there are payday lenders in the courts right now claiming to be agents of insured state banks and asserting in their briefs that the state in which they do business is powerless to regulate them because of Section 27. Georgia passed a law to curb payday lending and was promptly sued. The State of Georgia feels they do have the power to regulate these non-banks, and we agree. Ninety-one percent of payday loans are made to borrowers caught in debt trap of five or more loans per year, and while the FDIC's revised guidance is helpful as an acknowledgement of the debt trap, the lack of clarity around regulatory authority is a big problem for states seeking to control this abuse. The FDIC should do nothing that will further these payday lenders' argument that states have no authority over these non-banks operating within their borders.

Earlier testimony glossed over the Petitioners' inclusion of entities and any persons that are not banks or branches – but that is an area where the FDIC should pay careful attention, for that is the area that is most ripe for abuse and where, we fear, the FDIC is in the least effective position to address these abuses. I will leave the theoretical 'race to the bottom' discussion to the side and talk about the real abuses I see every day. Through CRL's website and various list serves, and a very wide coalition made up of industry analysts, financial professionals, private and public attorneys, as well as contact with media and with industry representatives seeking something akin to a good housekeeping seal, we see all manner of innovative credit options, many of which are not offered by banks, most of which are not beneficial for consumers or even as they are marketed to be. Debt consolidation products, Internet catalog sales, opportunities to pay down your mortgage in half the time by paying through a 'trust', cash advances against post-dated checks (fee-free for the first advance or 50% off if you bring in a friend), contracts for deed (instead of a mortgage, you enter into a long-term contract; you breach, you lose the property without the benefit of a foreclosure process) and on and on.

Elizabeth covered much of this, the disarray in the credit marketplace, so I won't belabor it except to say that it is not theoretical – the bottom is real, some of us see it every day and we do not think it is in line with the FDIC's role as insurer and promoter of safety and soundness to attempt to expand preemption for state banks in a manner that encourages the banks to engage in practices and in partnerships that might be lucrative in the short term – fast profits, avoidance of pesky regulatory issues around branching – but are detrimental to families and by extension to the economic vitality of communities in the mid and long term. Instead, we would hope that the FDIC would support state efforts as they continue in their primary roles as cauldrons for innovation and effective regulation and enforcement. This can only occur when it is clear to whom state banks and 'any other person' with whom they do business are accountable when they do business with the consumers in a given state. And the answer should be – the given state.

Conclusion

Petitioners and their supporters assert that the Petition as written is not about preemption but deals only with the narrow issue of parity. They maintain that the FDIC should move quickly to save state banking charters and the dual banking system, and that consumer protection issues should be dealt with after parity is established. We strongly disagree. We believe that authorizing state banks to disregard the banking laws of sister-states is a problem of constitutional magnitude that would deprive our state assemblies of an essential regulatory role. The importance of accountability at the state level is highlighted every time a credit consumer suffers at the hands of a service provider who has found a new, creative way to circumvent effective protections. Furthermore, we believe that the FDIC has no authority to issue a rule of this nature absent a clear directive from Congress. In sum, states simply should not be allowed to void each other's regulatory authority.

Affording state-chartered banks the preemptive privileges enjoyed by national banks is inappropriate, as it denies regulatory authority of one state in favor of its sister-state. The

FDIC should recognize this fundamental distinction and avoid conflating the role of preemptive privileges as applied to national banks with that of the limited access to these same privileges that has been made available to state-chartered banks. Even a rule that purports to simply codify the language of Riegle-Neal as applicable to state banks could be beyond the FDIC's authority if it bars the application of state law to entities beyond the bank branch or to activities beyond interest rate exportation. In addition, such a rule would certainly have no basis in Congressional action to date if it applied to activities in states where the bank had no branch at all, as is also sought in the Petition. We do not believe the FDIC should make it possible for the Delaware legislature, for example, to deprive the Iowa legislature of their ability to deal with problems in their state brought about by Delaware banks, their subsidiaries and their partners. That is indeed a bridge too far.