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Subcommittee on Financial Institutions and Consumer Credit

Examining Opportunities for Financial Markets in the Digital Era

September 28, 2018

Good afternoon Chairman Luetkemeyer, Ranking Member Clay, and Members of the House Committee on Financial Services' Subcommittee on Financial Institutions and Consumer Credit. Thank you for inviting me to testify today about opportunities and challenges posed by financial technology (fintech) in the financial services marketplace, the current regulatory and consumer protection landscape, and the need to ensure that emerging products and players best serve consumers rather than trapping them in unaffordable or abusive debt.

I am the Director of Federal Advocacy at the Center for Responsible Lending (CRL), 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, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income, rural, women-headed, and minority families. In total, Self-Help has provided over $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and currently serves more than 80,000 mostly low and moderate-income families through 30 retail credit union branches in North Carolina, California, and Illinois.

This important hearing addresses how technological innovation has resulted in the development of new services and delivery platforms by both traditional financial institutions and non-bank fintech companies. The rapid expansion of market participants and their products has brought new opportunities, as well as significant consumer protection concerns, to the financial marketplace. In my written testimony I will discuss in detail the essential legal questions and consumer protection issues that must be at the center of the broader fintech dialogues occurring between consumer groups, lenders, regulators, and Congress. My testimony will address two main topics. In Section I, I will broadly identify some of the key consumer protection concerns that have emerged with the rise of fintech marketplace lending (one of the fastest growing components of fintech). In Section II, I will focus on the United States Department of the Treasury's report released on July 31, 2018, titled *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation*.[1] Referencing the report, I will discuss areas where CRL, along with numerous civil rights groups and state attorneys general, have expressed significant concerns about the impact that the Treasury Report's recommendations would have on

[1] U.S. Department of the Treasury, Report to President Trump: A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation (July 2018), [hereinafter, Treasury Report] available at https://home.treasury.gov/sites/default/files/2018-07/A-Financial-Systemthat-Creates-Economic-Opportunities---Nonbank-Financi....pdf.

consumers. *Our central priorities are (1) preserving the progress made by state and federal stakeholders to guard consumers from predatory debt trap loan products*, *(2) ensuring fintech lending evolves in cadence with existing and developing consumer protection laws, and (3) the preservation of state usury laws.*

I. **Consumer protection concerns with an emerging policy space**

The term fintech, admittedly overly broad in the context of specific policy recommendations, warrants a more specific definition for the scope of my testimony. Rather than referring to a specific platform or product, fintech is best considered, as Professor Adam Levitan describes it, as a rubric that covers a broad range of companies and products: "[s]ome of these companies offer consumer credit, some payments, some insurance, some investment services, and some financial advice. Some of these companies compete directly with banks, while others partner with banks. Additionally, some fintechs deal directly with consumers, while some provide support services for other financial institutions."[2] Given the topic of this hearing and the jurisdiction of the Committee, I will use the term fintech in a narrowed definition to address consumer lending products and services (including secondary market securitization) of banks and non-bank financial institutions, as well as the relevant current and evolving consumer protection laws and guardrails.

CRL is wary of unscrupulous actors and payday lenders adopting the banner of "fintech" with the purpose of evading consumer protection laws, particularly state-level rate caps for consumer loans, while using the term "innovation" as a justification for exemption from basic, long-standing consumer protection laws and regulations. Ultimately, there is no getting around the fact that a predatory loan is a bad loan, regardless of whether it is delivered through a technically advanced medium or a storefront. However, we are well aware, and are encouraged by, the potential benefits of fintech, especially as it relates to affordability and financial inclusion. CRL is dedicated to ensuring consumer lending marketplaces are fair, transparent, and equitable, and we are appreciative of the opportunity to contribute to this discussion. We are also very concerned about specific Treasury Report recommendations that robustly address the benefits of fintech for

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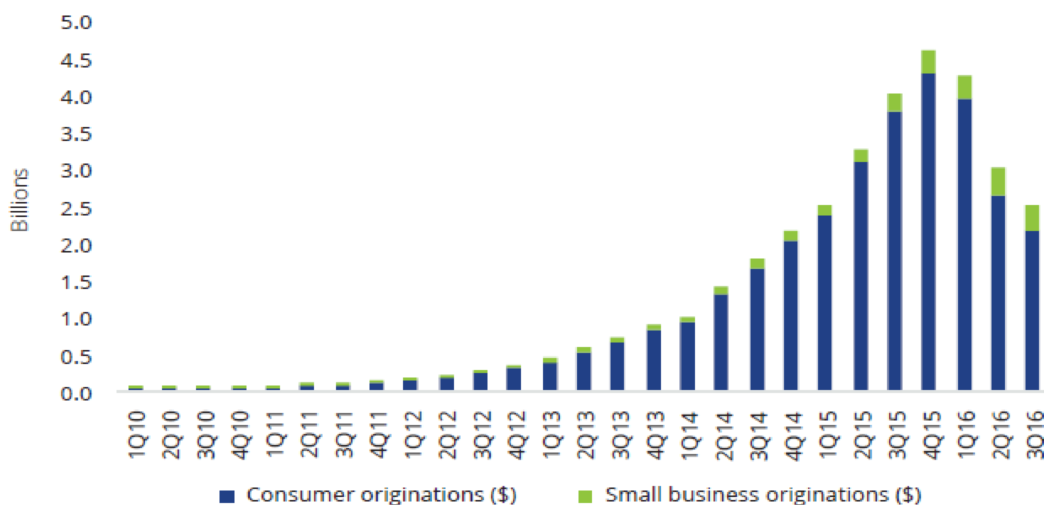
[2] Adam J. Levitin, written testimony delivered to the United States House of Representatives Committee on the Financial Services Subcommittee on Financial Institutions and Consumer Credit "Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace" January 30, 2018. Available at https://financialservices.house.gov/uploadedfiles/hhrg-115-ba15-wstate-alevitin-20180130.pdf

investors and professional traders, but sometimes excessively relies on an untested, and oftentimes invalidated, policy narrative about how consumers will benefit from innovation.

The Growth of Marketplace Lending

As one of the fastest areas of growth in fintech, marketplace lending, is a quickly growing market at the center of research and data modeling. As defined by the Consumer Protection Bureau, "[m]arketplace lending uses online "platforms" to connect consumers or businesses who seek to borrow money with investors willing to buy or invest in the loan. In most cases, once a loan is made, the platform collects principal and interest payments from borrowers and sends the payments, less certain fees that the platform keeps, to investors."[3] Marketplace lending is growing (see figures below), but still represents a small fraction of the overall consumer lending market, with marketplace loans "representing a small portion of the $3.5 trillion U.S. consumer lending market, the largest online marketplace platforms originated over $5.0 billion of unsecured consumer credit in 2014, and over $10.0 billion in 2015."[4]

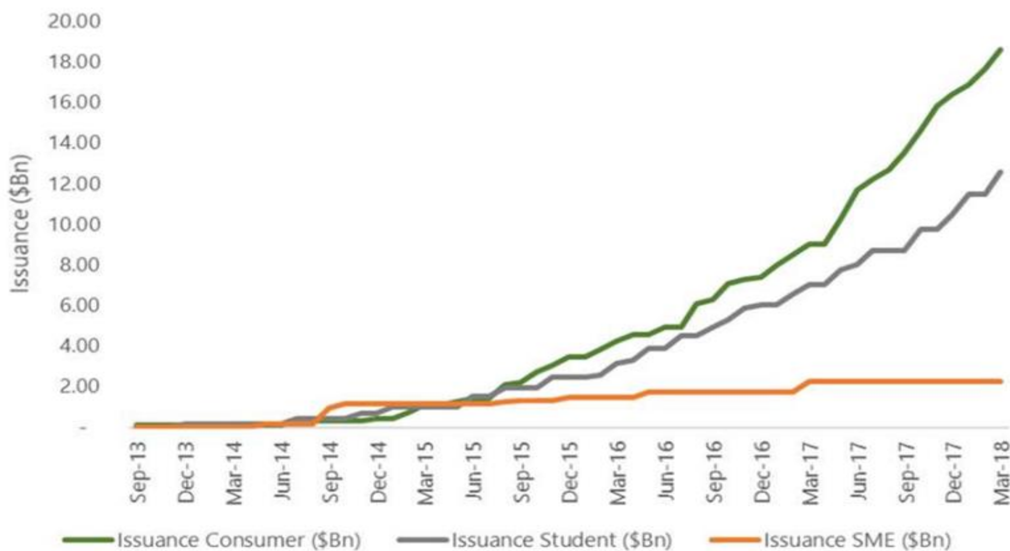
Marketplace lending originations by quarter ($ billions, cumulative total in the US 2007 to 3Q 2016 is $35.7 billion)



Source: Orchard

[3] https://files.consumerfinance.gov/f/201603_cfpb_understanding-online-marketplace-lending.pdf; See also "Online marketplace lending refers to the segment of the financial services industry that uses investment capital and data-driven online platforms to lend either directly or indirectly to consumers and small businesses."
https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf
[4] https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf page 14

Cumulative total issuance 2013 to 2018



Source: Bloomberg, PeerIQ

Marketplace lending is oftentimes touted as providing new access to credit, potentially at lower rates with streamlined underwriting. However, many questions remain — are originations truly new, or is this piled on debt that will not pay off the original loan? Who is accountable for risk and consumer harm, the online platform or the investors making the loans? Who has oversight over the investor/lenders and the platform?

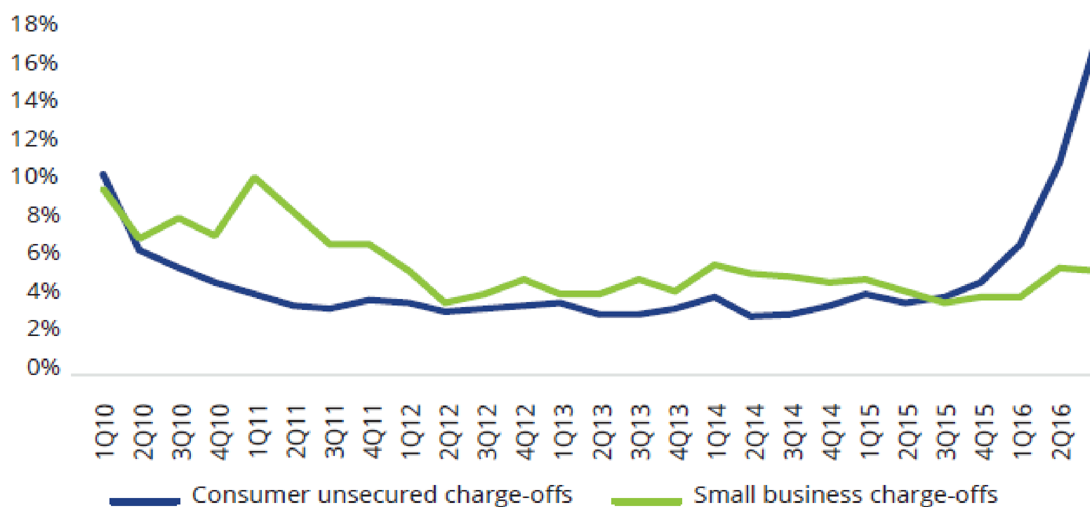
The Treasury Report cites a study by the Federal Reserve Bank of Philadelphia to support the claim that fintech is a driver of financial inclusion, pointing to specific examples such as marketplace lenders serving communities where physical bank branches have closed.[5] However, the preliminary conclusions that the report draws from examples such as these, in terms of capturing underserved populations, is that the primary purpose of many marketplace loans is to refinance higher rate debt into less expensive debt.[6] The Treasury Report's claim does not logically follow from examples of financial inclusion outside of debt refinancing, which is not "new" capital to start a business, buy a home, or build a path to a higher income through education, but is instead a service for consumers with existing debt. While cost savings are a benefit for consumers, the assertion that marketplace lending is a main driver of financial inclusion for productive uses of

[5] Treasury Report, at 89, *citing* Julapa Jagtiani and Catharine Lemieux, Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information, Federal Reserve Bank of Philadelphia Working Paper 17-17 (2017), at 9-12, available at: https:// www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-17.pdf.
[6] *Id*, at 90

loan funds, rather than a driver for cost savings, warrants a distinction when we consider the reforms proposed the Treasury Report, especially when it relies on such overgeneralizations about consumer benefits from innovation to justify recommendations that would jeopardize consumer safety.

Furthermore, it is too early to tell whether marketplace lending can be productive in different economic environments, or if it is providing only a temporary service. Looking at market trends, one concerning data point is that alongside this initial explosion of growth, there are also growing signs of stress and potential market failures as evidenced by a growing number of defaults and charge offs (See figure 6 below).

Figure 6: Marketplace lending charge-offs by quarter (%)



Source: Orchard

The securitization of marketplace loans quickly increases systemic risk and expands the stakeholders of marketplace loans to include traders and asset speculators. This is where a distinction must be made between regulatory efficiency for asset speculation in the secondary markets, from innovation with the aim of financial inclusion. Fintech companies must be accountable for claims that automatically correlate regulatory flexibility with consumer benefit. While these two priorities are not mutually exclusive, they are distinct, and should not be conflated under a broad call to minimize the presence of federal regulators who are in a position to ensure consumer protection laws are enforced and effective. Securitization is not a new innovation, and 10 years out from the mortgage lending crisis we know all too well the damage done by Wall

Street-driven demand for loans with generous interest payments and poor underwriting practices. Cumulative issuance for marketplace lending securitization now totals $38.4 billion across 126 deals since 2013. Since September 2013, 80 consumer, 36 student, 10 SME, and one mortgage deals have been issued. The total issuance of securitized consumer loans is $21.2 billion, for student loans it's $14.8 billion and for small business loans $2.5 billion.[7] Delinquencies on these securitized loans are happening more frequently and earlier in the life of the loan than they did on the older loans. As we have seen in the past, securitization amplifies the risk and uncertainty in the system when the underlying assets are not sound financial products. One particularly striking example is when one lender had experienced such high net losses in three of its securitized pools that it trigged the provision to buy back the loans from its investors. These were for loans that carried APRs of 30 to 50%. The rapid growth of originations in marketplace lending, and a corresponding growth in delinquency rates, evidenced in securitized marketplace loans, is a cause for concern.

As the Treasury Report acknowledges, "with only a few years of credit performance, these credit models have yet to be tested in various macroeconomic environments that would include either higher interest rates or a general economic downturn."[8] This insight should again be a caution against ignoring consumer protections surrounding bank partnerships, the call for regulatory sandboxes, or compromising state consumer protection laws. In fact, CRL points to this very premise as to why consumer protection laws should remain intact and evolve alongside innovation. While we are all admittedly unsure of what fintech can deliver, in terms of financial inclusion, we do know for a fact what happens when consumers are left in the crosshairs of predatory lenders. Short-term payday loans and car title loans cost borrowers over $8 billion per year in fees and often lead to financial challenges, such as delinquency on other bills, overdraft fees, loss of a checking account, debt collection costs, and bankruptcy.[9] Regulators should refocus the discussion of marketplace lending around streamlined underwriting and ability-to-repay and underwriting requirements in order to ensure these products are sound, and reasonably priced in accordance with state laws.

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[7] Ahluwalia, Ram, Kevin Walsh, and Sam Hu. "Marketplace Lending Securitization Tracker." PeerIQ, 2Q2018. https://www.peeriq.com/research/peeriq-mpl-securitization-tracker-2018-q2/.

[8] *Id,* at 90

[9] See Center for Responsible Lending policy brief, *Neglect and Inaction An Analysis of Federal Banking Regulators' Failure to Enforce Consumer Protections* (2009). Available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/neglect-and-inaction-7-10-09-final.pdf

Who Bears the Cost of Failed Loans?

A recent report from Bloomberg uncovered that two of the largest online lenders do not verify income and employment in a significant percentage of the loans they make.[10] Another marketplace lender did not verify income or employment for about 25% of their loans. Yet another didn't verify income or employment for about 2/3 of its loans. [11] What does this mean for borrowers? Often borrowers are burdened with the failure of the loan, not lenders or investors. Unaffordable loans can have devastating consequences for anybody, but particularly for low-income consumers.[12] Often these loans take a super lien by gaining direct access to a borrower's bank account, which means a domino effect could cause delinquency on other bills, increased likelihood of overdraft fees, and even bank account closures. This is the start of a vicious cycle whereby damaged credit scores increase the barriers to a borrowers' ability to access more affordable products in the future, as well as jobs, housing, and insurance. Further, in an economic downturn, if many borrowers are forced to default at once, this could leave lenders or investors with significant losses and lead to larger systemic harms.

What is the Role of State Law in a "National" Fintech Marketplace?

Another central concern in is fintech's facilitation of the evasion and preemption of state consumer protections. State usury caps play an important role in protecting consumers from predatory and wealth stripping credit products. In addition, States are actively working to assert their long-held authority over regulation of non-banking lending, particularly as it regards to price and other concerns.[13] This is particularly of concern when federal law does not cover the costs of

[10] Matt Scully, "Biggest Online Lenders Don't Always Check Key Borrower Data", BLOOMBERG (June 14, 2017), *available at* https://www.bloomberg.com/news/articles/2017-06-14/biggest-online-lenders-don-t-always-check-key-borrower-details.

[11] *Id.*

[12] See for example, *Power Steering: Payday Lenders Targeting Vulnerable Michigan Communities*, Center for Responsible Lending (2018). Available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-michigan-paydaylending-aug2018.pdf

[13] See for example; **New Hampshire** actions against many online lenders: Prosper (2016): https://www.nh.gov/banking/orders/enforcement/documents/16-035-co-20161123.pdf Upstart Network (2016): https://www.nh.gov/banking/orders/enforcement/documents/16-034-co020161220.pdf Klarna Credit (2017): https://www.nh.gov/banking/orders/enforcement/documents/17-052-co-20171108.pdf ;RockLoans Marketplace (RocketLoans) (2017): **New York Department of Financial Services** investigations into online lenders (2016) - http://fortune.com/2016/06/03/new-york-inquiry-online-lenders/ and https://www.reuters.com/article/us-new-york-regulator-internet-exclusive/new-york-state-launches-inquiry-of-online-lenders-idUSKCN0YP27N; New York Department of Financial Services report on online lending (2018): https://www.dfs.ny.gov/reportpub/online_lending_survey_rpt_07112018.pdf ; **California** action against LendUp (2016) - http://www.dbo.ca.gov/Press/press_releases/2016/LendUp%20Settlement%20Release%2009-26-16.pdf and http://www.dbo.ca.gov/Press/press_releases/2016/LendUp-Settlement%20Agreement.pdf; California investigation into high-cost lenders' online lead generation activity (just announced today!) - http://www.dbo.ca.gov/Press/press_releases/2018/Triple Digit%20APR%20Special%20Report%20Release%2009-26-18.asp; **Virginia** (2018) - Enova: https://www.oag.state.va.us/media-center/news-releases/1185-may-4-2018-herring-alleges-illegal-predatory-loans-in-suit-against-one-of-virginia-s-largest-online-lenders

loans like those considered in marketplace lending, and there is not a robust federal oversight system in place. One effort to preempt state law comes in the form of the OCC charter. Another is in the form of rent-a-bank schemes, which, as discussed below, "valid when made" or "true lender" would enable. A third is direct high-cost payday or installment lending by banks. These questions are central to the discussion below when considering some of the recommendations of the Treasury report.

II. Building a Financial System that Protects Consumers

In accordance with Executive Order 13772,[14] the United States Department of Treasury released a report on July 31, 2018 titled, "*A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation [Hereinafter "Treasury Report, or "Report"]*."[15] Recognizing that the Report covers a very expansive topic area, the remainder of this discussion will be centered around consumer lending products and services. The following Treasury Report recommendations raise particular concerns that should be addressed by financial regulators and Congress as they consider the evolving financial marketplace. In response to the financial crisis, the Report starts with the position that the impact of consumer protection law are "[…] policy changes [that] made certain product segments unprofitable for banks, thereby driving activity outside the banking sector and creating opportunities for emerging non-bank financial firms to address unmet market demands."[16] This statement mischaracterizes the impact of consumer protections that save borrowers billions in inappropriate charges and prevent long-term debt traps that do not provide any benefit to the borrower. In some cases, these products and abusive practices contributed to, and prolonged, the financial crisis and put the safety and soundness as well as the reputations of banks at risk. The reemergence of payday type loans or rent-a-bank charter agreements with non-banks is at the expense of consumers and is not a market response to demand for high cost, poorly underwritten loans.

MoneyLion: https://www.oag.state.va.us/media-center/news-releases/1122-february-7-2018-virginia-consumers-to-receive-2-7-million-in-relief-from-settlement-with-internet-lender; **Colorado** actions against Marlette Funding, Avant (2017) ; **Pennsylvania** action against Think Finance (2014) - Commonwealth of Pennsylvania v. Think Finance, Inc., et al., Civil Action No. 14-cv-7139 (E.D. Pa); **Vermont** (2014): Campaign against online lending - http://ago.vermont.gov/wp-content/uploads/2018/01/Illegal-Lending-Report-April-2014.pdf; **Florida:** http://www.myfloridalegal.com/newsrel.nsf/newsreleases/2F836464563D0EB5852580A600709370

[14] Executive Order 13772, *Core Principles for Regulating the United States Financial System*, issued February 3, 2017.

[15] Treasury Report, supra n. 1

[16] *Id*, at 4-5

- <u>The danger of preemption: The OCC charter and the preemption of State law</u>

The Treasury Report recommends that the OCC move forward with its special purpose national charter.[17] The OCC released a proposal for a special purpose national bank charter for financial technology companies and solicited comments on that proposal in December 2016.[18] Very soon after the report was published the OCC announced it would begin considering applications for special purpose charters. CRL is deeply concerned that an OCC special purpose charter would be used to preempt or circumvent state law. We also strongly disagree with the Report's conclusion that the OCC has addressed the preemption issue, along with other consumer protections, because "it would encourage special purpose national bank charter applicants to meet an ongoing financial inclusion standard of "provid[ing] fair access to financial services by helping to meet the credit needs of its entire community" through setting supervisory expectations and making such a commitment a condition for charter approval."[19] This is far from an adequate resolution to the preemption of state usury limits, which have served as effective protections against predatory lenders. A special purpose non-bank charter will enable preemption of state oversight and authority and would allow almost any entity to readily serve as vehicle for unaffordable loans.

Research from the Center for Responsible Lending and other organizations shows that the OCC's aggressive preemption of state laws has historically been a significant factor in contributing to consumer harm, particularly with regard to mortgage lending. For example, in 2006, in the lead up to the financial crisis, national banks, federal thrifts, and their subsidiaries made almost a third of subprime loans, 40% of Alt-A loans, and 51% of interest-only and option ARM loans. In total over $700 billion in hazardous loans were made by banks and nonbanks that states were unable to regulate because of OCC preemption. We understand that the OCC seeks to expand financial

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[17] "Treasury recommends that the OCC move forward with prudent and carefully considered applications for special purpose national bank charters. OCC special purpose national banks should not be permitted to accept FDIC-insured deposits, to reduce risks to taxpayers. The OCC should consider whether it is appropriate to apply financial inclusion requirements to special purpose national banks. The Federal Reserve should assess whether OCC special purpose national banks should receive access to federal payment services."[17]

[18] See Treasury Report pp. 71-73 for full discussion of charter: See p 71, note 196 for further discussion on the OCC announcement ("The OCC special purpose national bank charter was proposed through a series of OCC announcements. See Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (Dec. 2016), available at: https://www.occ.gov/topics/responsible-innovation/comments/special- purpose-national-bank-charters-for- ntech.pdf; ("OCC Fintech Paper"); Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016), available at: https://www.occ.gov/ publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ- perspective.pdf; Summary of Comments and Explanatory Statement: Special Purpose National Bank Charters for Financial Technology Companies (Mar. 2017), available at: https://www.occ.gov/topics/responsible-innovation/summary-explanatory-statement- ntech-charters.pdf ("OCC Comment Summary"); Draft Licensing Manual Supplement (Mar. 2017), available at: https://www.occ.gov/publications/publications-by-type/licensing- manuals/ le-pub-lm- ntech-licensing-manual-supplement.pdf."

[19] Treasury at 72

inclusion and lead innovation through issuing non-bank charters to fintech institutions. However, there is insufficient evidence that the OCC puts the needs and best interests of consumers ahead of the interests of the banks it supervises. We believe that if the OCC proceeds with granting a federal charter to fintech companies, the OCC will ultimately undermine the consumer protection regulatory framework that has been called for by the general public. We concur with the National Consumer Law Center (NCLC) in their remarks stating that safety and soundness supervision and enforcement of federal laws do not replace substantive state laws that do not have a federal counterpart.[20] For example, the Consumer Bureau recently brought enforcement action against LendUp, a fintech non-bank lender, for deceptive conduct.[21] LendUp charged rates as high as 300% APR on some of its loans,[22] even though it marketed itself as a "financial innovator" that was expanding access to credit, LendUp was determined to be in violation of state law by the California Department of Business Oversight, because it was charging impermissible fees on their loans.[23] CRL has thoroughly documented state enforcement actions related to lenders originating gaps illegal loans.[24] Given the destructive and devastating consequences of predatory loan products, the OCC should not take any action that will compromise a states' ability to prosecute usurious practices.

- <u>The federal government should not preempt critical state usury limits by sanctioning rent-a-bank schemes in the name of "valid when made" or "true lender" policies.</u>

Another attack on state consumer protection laws has come in the form of efforts to codify so-called "valid when made" and "true lender" doctrines, which would enable rent-a-bank schemes that could gut state interest rate caps. Treasury recommends Congress codify both doctrines;[25] that

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[20] National Consumer Law Center, Comment, Comments to the Comptroller of the Currency on "Exploring Special Purpose National Bank Charters for Fintech Companies" available at http://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/comments-fintech-jan2017.pdf

[21] In the Matter of Flurish, Inc., dba LendUp, Consent Order (Sep. 27, 2016), available at http://files.consumerfinance.gov/f/documents/092016_cfpb_LendUpConsentOrder.pdf.

[22] The Commissioner of Business Oversight v. Flurish, Inc. (dba LendUp), Settlement Agreement signed Sept. 23, 2016 (the state enforcement agency found that LendUp had committed a total of 385,050 individual violations of state laws protecting consumers), available at http://www.dbo.ca.gov/Press/press_releases/2016/LendUp-Settlement%20Agreement.pdf.

[23] Press Release, Consumer Fin. Prot. Bureau, CFPB Orders LendUp to Pay $3.63 Million for Failing to Deliver Promised Benefits: Online Lender Did Not Help Consumers Build Credit or Access Cheaper Loans, As It Claimed (Sept. 27, 2016), available at http://www.consumerfinance.gov/about-us/newsroom/lendup-enforcement-action/.

[24] Diane Standaert & Brandon Coleman, Ending the Cycle of Evasion: Effective State and Federal Payday Lending Enforcement, Center for Responsible Lending (Nov. 2015), available at http://www.responsiblelending.org/payday-lending/research-analysis/crl_payday_enforcement_brief_nov2015.pdf.

[25] Treasury Report at 203, "Treasury recommends that Congress codify the "valid when made" doctrine to preserve the functioning of U.S. credit markets and the long- standing ability of banks and other financial institutions, including marketplace lenders, to buy and sell validly made loans

banking regulators use their authorities to reinforce the same; and even that states revise their laws to essentially exempt entities partnering with banks. But such steps would gravely undermine the strongest protection we have against predatory lending—state usury limits—and, contrary to claims from those pushing the legislation, they are not necessary to ensure access to affordable credit.

Decades ago, a few banks – which are generally not subject to state interest rate limits – began renting out their charters to enable payday lenders to make high-cost loans in states where high rates are prohibited. Those schemes were ultimately shut down, and since the mid-2000s, federal regulators have generally kept rent-a-bank arrangements for short-term payday loans at bay. At that time, OCC Comptroller Hawke called rent-a-bank schemes "an abuse of the national charter"[26] and cautioned that "[t]he benefit that national banks enjoy by reason of [preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank."[27] But these schemes have continued to spring up for high-cost installment loans. Elevate makes loans at 100% interest using Republic Bank & Trust in Kentucky, ignoring the voter-approved 36% or lower rate caps in Arkansas, Montana, South Dakota and other states. CashCall made loans up to 99% in Maryland and West Virginia using First Bank of Delaware and First Bank & Trust, though courts later shut them down. On Deck Capital makes small business loans with rates up to 99.7% APR, originating loans through Celtic Bank in states where it cannot make the loans directly.

Marketplace lenders are also using banks to charge rates up to 36% that are not permitted in many states for large loans of $30,000 to $40,000; the State of Colorado has sued two marketplace lenders, Avant and Marlette, for using rent-a-bank arrangements to hide the fact that these state-regulated lenders are the true lender. In rent-a-bank operations—both old and new—the non-bank lender is in the driver's seat. The bank is a façade, originating the loan and perhaps

without the risk of coming into conflict with state interest rate limits. Additionally, the federal banking regulators should use their available authorities to address challenges posed by Madden."; "Treasury recommends that Congress codify that the existence of a service or economic relationship between a bank and a third party (including financial technology companies) does not affect the role of the bank as the true lender of loans it makes. Further, federal banking regulators should also reaffirm (through additional clarification of applicable compliance and risk-management requirements, for example) that the bank remains the true lender under such partnership arrangements."; "Treasury recognizes the role of state laws and oversight in protecting consumers, but such state regulation should not occur in a manner that hinders bank partnership models already operating in a safe and sound manner with appropriate consumer protections. Treasury recommends that states revise credit services laws to exclude businesses that solicit, market, or originate loans on behalf of a federal depository institution pursuant to a partnership agreement."

[26] The Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Reserve Board, and FDIC all shut down rent-a-bank in the early-to-mid 2000s.

[27] https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.

having a minor additional role that merely serves as cover for the fact that the main value the bank adds is its interest rate preemption rights. Typically, virtually all aspects of the loan program other than origination are handled by the non-bank lender, which may include setting the loan terms, designing the underwriting criteria, handling the website, marketing the loans, taking and processing applications, servicing the loans, handling customer service, and, for securitized loans, packaging the loans for investors. While the bank may approve aspects of these operations, the vast majority of the work and the vast majority of the profits go to the non-bank lender.[28]

The Treasury Report correctly identifies the concerns expressed by consumer advocates when they state "[…] consumer groups have expressed concern that the bank partnership model can harm consumers by allowing partnering firms to bypass state-based usury limits and other state requirements. Advocates note that some lenders operate with high-APR business models and offer loans whose APRs can exceed 100%, when fees are included. Beyond enabling high-APR products, advocates note that in the past, such third-party partnerships have enabled some deceptive practices." [29] The Report however, does not address these concerns specifically, and instead goes on to state after some discussion: "Treasury recognizes that these existing bank partnership arrangements have generally enhanced the provision of credit to consumers and small businesses."[30] Again we see a recognition of key consumer protection issues immediately swept under the rug, and replaced with a claim about financial access equaling consumer benefit without convincing data.

The so-called "true lender" rent-a-bank bill, H.R. 4439, or the sanctioning of this rouse by a federal banking agency, would place a blanket stamp of approval on bank partnerships that evade state law. We note that the OCC's recent installment loan guidelines advised against rent-a-bank

[28] These undisputed facts recited by the court are virtually identical to the payday lender rent-a-bank arrangements of 20 years ago:

> For example, Avant, Inc. paid the implementation fee to initiate the lending program, paid all of WebBank's legal fees in the program, bears all of the expenses incurred in marketing the lending program to consumers, determines which loan applicants will receive Avant Loans and bears all costs of making these determinations, ensures the program complies with federal and state law, assumes responsibility for all servicing and administration of the Avant Loans "even during the period before WebBank sells the loans to Avant, Inc. or its affiliates," and assumes responsibility for all communications with loan applicants and consumers who receive Avant Loans. [Id. at 34(a)-(j)] Additionally, Avant, Inc. bears all risk of default, and indemnifies WebBank against all claims arising from WebBank's participation in the lending program. [Id. at 34(l)] Avant, Inc., along with the other non-bank entities, collects 99% of the profits on the loans while "WebBank's share in the profit is only approximately one percent.

Meade v. Avant of Colorado, LLC, 2018 WL 1101672 (D. Colo. Mar. 1, 2018). Avant attempted to distinguish itself from the rent-a-bank arrangements 20 years ago on the grounds that payday lenders claimed to be agents of the bank whereas Avant was an assignee of the loans. That is not only a distinction without a difference, it is not even a distinction. Payday lenders in the past were also assignees of the loans, and Avant also claims to be a bank "service provider" (i.e., an agent).

[29] *Id,* at 91, n 247, n 248

[30] *Id,* at 92

schemes. The bills currently introduced[31] to override the Second Circuit's Madden v. Midland decision, would also severely undermine the effectiveness of state interest rate caps. which held that a debt buyer purchasing debts originated by a national bank could not take advantage of the National Bank Act's preemption of state interest rate caps. Because there are no federal usury caps,[32] chartered institutions would have no actual limit on the interest rates and fees they could charge to borrowers, federal preemption for non-bank entities would have the functional effect of abolishing established state interest rate caps that protect consumers and, by extension, many small businesses from predatory and unaffordable loans. Currently, over 90 million people live in the 15 states plus the District of Columbia that enforce interest rate caps to prevent abusive high cost short term loans and debt trap products.[33] Collectively, these states save over $5 billion in fees that would otherwise be paid toward unaffordable loans.[34] Many of these states have always prohibited predatory loans in their state, aggressively enforcing their strict usury limits. Many more states have interest rate caps on installment loans that are much lower than rates offered by marketplace or higher-cost lenders. States have adamantly worked, over many years, to enact, enforce, and protect against the abuses of high-cost loans and resisted numerous attempts by predatory lenders to evade these protections. The *Madde*n decision did not limit the interest rates that banks may charge on credit cards and other forms of credit, but what it does prevent is the evasion of state interest rate caps by a rent-a-charter agreement. Reversing the Second Circuit's decision would open a huge loop hole for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use "rent-a-bank" arrangements to charge high usurious and predatory rates on loans. The rent-a-bank bills provide that "a loan that is valid when made as to its maximum rate of interest ... shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any State law to the contrary."

For example, CashCall has attempted to partner with banks to make usurious loans in numerous states. Courts have struck down those arrangements, finding that CashCall had to

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[31] H.R. 3299 and S.1642
[32]. The Military Lending Act establishes a 36% rate cap for service members and their families.
[33] Center for Responsible Lending, U.S. Payday Interest Rates Calculated on a Typical Loan (May 2016), available at http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_rate_cap_map_2016.pdf.
[34] Delvin Davis & Susan Lupton, States without Payday and Car-title Lending Save Over $5 Billion in Fees Annually, Center for Responsible Lending (Updated Jan. 2017), available at http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_fee_savings_jun2016.pdf.

comply with state interest rate caps.[35] Legislation that pre-empts state usury laws could undermine decisions like these, by stating that a loan's interest rate remains valid even if a loan is transferred or assigned to a third party and "may be enforced by such third party notwithstanding any State law to the contrary." This would enable high-rate lenders to use banks to originate and then immediately transfer usurious loans, in essence loan laundering usurious loans through their bank charter. Importantly, efforts to extend preemption to nonbank entities run counter to the Wall Street Reform Act. While reaffirming the principle of bank preemption of some state laws, Dodd-Frank reversed a Supreme Court decision that extended preemption to operating subsidiaries of national banks, limiting preemption to the bank itself. Rent-a-bank schemes are even less connected to actions of the bank itself than activities of bank subsidiaries are.

States have weighed in on this already. In a letter by 20 State Attorneys General opposing provisions in another similar bill that would have overturned the Madden decision, the state law enforcement officers warned that the bill "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps."[36] In fact, the Colorado Attorney General is in the midst of challenging online lenders' use of a rent-a-bank scheme to make loans in violation of the state's usury limits.[37]

On a policy level, these bills are not a necessary "fix" to ensure access to affordable credit. Supporters of the bills claim that the *Madden* decision has had an adverse impact on access to credit, citing a study that showed a decrease in marketplace lending by three lenders in the Second Circuit to subprime borrowers after the Madden decision, especially for borrowers with FICO scores below 644. However, the study showed that even before the Madden decision these lenders offered a very small amount of credit in the low FICO range.[38] Thus, the impact on access to credit was inconsequential. Moreover, it is likely that the credit extended before the decision at the lower end of the FICO spectrum was made to borrowers who had trouble repaying, and that lenders were

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[35] See, e.g., CashCall, Inc. v. Maryland Com'r of Financial Regulation, 139 A.3d 990 (Md,. Ct. App. 2016); CashCall, Inc. v. Morrisey, 2014 WL 2404300 (W. Va. May 30, 2014).

[36] Letter from Eric T. Schneiderman, New York Attorney General, to Paul Ryan, Speaker, U.S. House of Representatives, et. al. (June 7, 2017), available at https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.

[37] Colorado Moves to Dismiss Lawsuits by Banks Seeking Judgment in Online Lending Cases", LENDIT NEWS (May 1, 2017), available at http://www.lendit.com/news/2017/05/01/colorado-moves-dismiss-lawsuits-banksseeking-judgement-online-lending-cases.

[38] Colleen Honigsberg et al., The Effects of Usury Laws on Higher-Risk Borrowers, Columbia Business School Research Paper No. 16-38 (Dec. 2 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215 (see Before Madden and After Madden chart on page 44).

relying on high interest rates on large loans to offset for high default rates. Contrary to what lenders often claim, robust state loan laws do not drive people to find loans online. In fact, illegal online lending is more prevalent in states that do not effectively regulate predatory lending than it is in states that enforce state interest rate caps.

- Exposing Consumers to debt traps by repealing the Payday Rule

The Treasury paper recommends changes to the regulation of small dollar loans that would both leave consumers vulnerable to debt trap payday loans from non-bank lenders and expose them to new risks of the same from depositories.[39] The Consumer Bureau's final payday rule, with a compliance date of August 2019, reins in payday and car title lending abuses by preventing these lenders from trapping consumers in an endless cycle of unaffordable 300% interest debt. At its core, the Consumer Bureau's payday rule is based on the common-sense principle that lenders have a responsibility to determine whether a borrower can afford to repay the loan without getting stuck in a cycle of unaffordable debt. This principle is particularly important for high-cost loans where lenders can seize funds from the borrower's bank account or repossess their car if they default. An ability-to-repay requirement is a sensible and sound approach and a principle that, according to a recent poll of likely voters, is supported by Republicans, Independents, and Democrats by a 20-point margin.[40]

This rule is the culmination of over five years of stakeholder input and extensive research by the Consumer Bureau demonstrating the harm caused by making loans without considering a borrower's ability-to-repay. A large body of research has demonstrated that payday and car title loans are structured to create a long-term debt trap that drains consumers' bank accounts and causes significant financial harm, including delinquency and default; fees for overdraft and

[39] Treasury Report, 2017. *"Treasury recognizes and supports the broad authority of states that have established comprehensive product restrictions and licensing requirements on nonbank short-term, small-dollar installment lenders and their products. As a result, Treasury believes additional federal regulation is unnecessary and recommends the Bureau rescind its Payday Rule." "Treasury recommends the federal and state financial regulators take steps to encourage sustainable and responsible short-term, small dollar installment lending by banks. Specifically, Treasury recommends that the FDIC reconsider its guidance on direct deposit advance services and issue new guidance similar to the OCC's core lending principles for short-term, small-dollar installment lending."*

[40] "AFR/CRL Poll of 1000 Likely Voters Nationwide by Telephone," July 28, 2018. https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-afr-pollmemo-fullresults-jul2018.pdf. Q: Currently, mortgage lenders are always required to verify a borrower's ability to repay before issuing the mortgage. Some people have suggested flexibility and adding exceptions to this requirement, so that lenders can issue some mortgages without having to determine a borrower's ability to repay. Which would you favor: FLEXIBLE requirements, so some mortgages can be issued without verifying ability to repay, or TIGHTER requirements that lenders must fully verify the ability to repay for ALL mortgages? Do you favor flexible/tighter requirements strongly or just somewhat?

insufficient funds; increased difficulty paying mortgages, rent, and other bills; loss of checking accounts; and bankruptcy. A large portion of borrowers eventually default, but many times only after borrowers have paid hundreds or even thousands of dollars in fees.

Contrary to the Treasury Report's suggestion that the Consumer Bureau rule does not leave room for state regulation, the rule serves as a regulatory floor, without preempting existing or future state laws that go further than the federal rule to protect consumers from debt-trap loans.[41] Thus, in the 15 states plus D.C. with rate caps on short-term loans, those caps remain in place, and in the remaining 35 states, the rule provides critical protection.[42] In fact, Congress charged the Consumer Bureau with addressing unfair and abusive practices, which is what this rule does—with the reasonable requirement that lenders determine whether borrowers can afford the loans. Additionally, the rule provides additional enforcement tools to the states, as state Attorneys General and regulators will be able to enforce the rule against actors making unfair and abusive payday loans in their state.[43] And contrary to payday lender industry claims, the payday lending rule will not hamper access to needed credit. The rule takes aim only at unaffordable credit that leads to a debt trap, by requiring only that lenders determine whether a borrower has the ability-to-repay the loan before making it. The payday lender business model is not about providing credit; it's about creating a debt trap. Over four out of five payday loans—more than 80%—are taken out within a month of the borrower's prior loan. In essence, payday lenders generate their own demand by making unaffordable loans.

Finally, the Consumer Bureau rule addresses unfair and abusive practices that the Bureau found could not be adequately addressed through disclosure. The Consumer Bureau studied whether disclosure alone could address the core harms from cycles of repeat loans that the rule aims to prevent. Evidence from a field trial of disclosures aimed specifically at reborrowing showed only a marginal effect on repeat loans. Analysis of actual disclosures implemented in Texas showed that the likelihood of a repeat loan decreased by only 2% following implementation.[44] The Consumer Bureau concluded that the impact of disclosures on the core harm caused by repeat loans was "nearly negligible."[45] It attributed the inadequacy of disclosure

[41] See, Payday Lending Rule: Myths & Facts, Center for Responsible Lending (2018). Available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-payday-cra-myths-apr2018_0.pdf
[42] *Id.*
[43] *Id*
[44] *Id.*
[45] *Id*

in part to the strong incentives payday lenders have to ensure borrowers stay in long cycles of repeat loans. Meanwhile, the Treasury report includes recommendations for banking regulators that could lead to proliferation of high-cost payday and installment loans by banks.

- Short-term payday loans by banks. The FDIC should retain, and OCC should re-institute, their guidance addressing "deposit advance" loans.

The Treasury paper recommends that the FDIC reconsider its 2013 guidance addressing "deposit advance" bank payday loans. In 2013, a handful of banks were making high-cost payday "deposit advance" loans, structured just like loans made by non-bank payday lenders. The bank repaid itself the loan in full directly from the borrower's next incoming direct deposit, typically wages or Social Security, along with annual interest averaging 225% to 300%. Among their many victims was Annette Smith, a widow who relied on Social Security for her income. Annette testified before Congress about a Wells Fargo "direct deposit advance" for $500 that cost her nearly $3,000.[46] Annette's experience was hardly an aberration.[47] Over half of deposit advance borrowers had more than ten loans annually,[48] despite so-called protections like installment plans. Additionally, deposit-advance borrowers were seven times more likely to have their accounts charged off than their counterparts who did not take out these loans.[49] But the banks setting these debt traps dug in, defending them staunchly. At their peak, bank payday loans—even with only six banks making them—drained roughly half a billion dollars from bank customers annually. This cost does not include the severe broader harm that the payday loan debt trap has been shown to cause, including overdraft and non-sufficient funds fees, increased difficulty paying mortgages, rent, and other bills, loss of checking accounts, and bankruptcy. Payday lending has a particularly adverse impact on African-Americans and Latinos. A disproportionate share of payday borrowers come from communities of color, and bank payday loans that jeopardize their bank accounts can leave these communities even more disproportionately underserved by the banking mainstream.

Payday lending by banks was met by fierce opposition from virtually every sphere—the military community, community organizations, civil rights leaders, faith leaders, socially

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[46] Testimony of Annette Smith Before the Senate Special Committee on Aging, "Payday Loans: Short-term Solution or Long-term Problem?", July 24, 2013, *available at* https://www.youtube.com/watch?time_continue=50&v=UG7B3L3oDN8.
[47] Rebecca Borné and Peter Smith, *The State of Lending in America and Its Impact on U.S. Households: Bank Payday Lending*, Center for Responsible Lending (Sept. 2013), https://www.responsiblelending.org/state-lending/bank-payday-loans.
[48] Rebecca Borné, *Been There, Done That: Banks Should Stay Out of Payday Lending*, Center for Responsible Lending (July 2017), http://www.responsiblelending.org/research-publication/been-there-done-banks-should-stay-out-payday-lending.
[49] CFPB, Supplemental Findings on payday, payday installment, and vehicle title loans, and deposit advance products (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf

responsible investors, state legislators, and members of Congress. The FDIC and OCC's 2013 guidances requiring an income-and-expense-based ability-to-repay determination, and the Federal Reserve's supervisory statement emphasizing the "significant consumer risks" bank payday lending poses. As a result of these actions, most bank payday lending programs were suspended (Fifth Third is the notable exemption, as it continues to make short-term payday loans) and bank customers were generally protected from a devastating debt traps at the hands of their bank.

We were deeply discouraged by the OCC's rescission of its deposit advance guidance in October 2017. In response, more than 230 groups signed an open letter to banks urging them to stay out of payday lending. The OCC rationalized this rescission in part by noting that the Consumer Financial Protection Bureau's finalization of its payday lending rule earlier that day subjected banks to potentially inconsistent regulation.[50] But the CFPB's rule and the deposit advance guidance are both necessary and are complimentary. Moreover, the CFPB has since publicly announced that it is reconsidering its rule, and rescission of the deposit advance guidance could leave borrowers entirely unprotected from debt-trap lending by our nation's banks.

The OCC also noted that banks should offer more short-term credit because banks are more regulated than non-bank lenders and thus can do so at less risk to the consumer. The Treasury Department expressed the same notion in its fintech paper. But again, the data on bank payday loans left no question that bank payday loans were the same as those made by non-bank lenders—high-cost, unaffordable, debt-traps.[51]

- High-cost installment loans by banks — Banks should keep loans at no more than 36% APR and should determine ability-to-repay based on income and expenses.

The Treasury paper also recommended that the FDIC issue installment loan principles similar to the OCC's May installment loans bulletin. But the OCC's guidelines lack sufficient guardrails around ability-to-repay and price. Meanwhile, the National Credit Union Administration (NCUA)

[50] The OCC's rescission following finalization of the CFPB rule was immediate, even as the CFPB rule's compliance date is not until August 2019.
[51] Deposit advance borrowers were seven times more likely to have their accounts charged off than their counterparts who did not take deposit advance loans. Further, following discontinuation of deposit advance, former borrowers, compared to non-borrowers, did not incur an increase in overdraft or NSF fees. CFPB, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* at 39 (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

is also considering a dangerous new program, opposed by many groups,[52] that could facilitate unlimited flipping of short-term high-cost loans,[53] as well as unaffordable longer-term loans.

The FDIC already has installment loans guidelines advising a cap of 36% — and it should reinforce them. Other regulators should join. And NCUA should not expand its program in unsound ways. In addition, all regulators should emphasize that loans should be made based on an ability-to-repay determination based on income and expenses. Civil rights, consumer and faith groups have continually voiced strong opposition to bank lending in excess of 36% APR, and urged consideration of both income and expenses, registering these concerns with regulators and banks alike.[54]

U.S. Bank recently stepped through the door opened by the OCC's installment loan bulletin. The bank introduced "Simple Loan," a three-month installment loan of up to $1,000 at a typical APR of 70% (and up to 88%) that would be illegally high in approximately 31 states plus D.C. if made by a nonbank lender.[55] This product will be unaffordable for many borrowers and ultimately erode protections from predatory lending across the board. A supposed safeguard of the U.S. Bank product, and one floated as a "safeguard" in a variety of other high-cost loan contexts, is limiting payments to 5% of gross income. But data simply do not support that this metric—which disregards the expenses of financially distressed consumers—is a meaningful affordability standard for high-cost loans. In fact, federal government research on more than one million loans found default rates of more than 38% at payment-to-income ratio of 5% or less.[56]

Common sense doesn't support this notion either. Payday borrowers have very low incomes, are typically already overburdened by credit, and have average credit scores in the low 500s. Consider a family of four at the federal poverty level of $24,300 annually, $2,025 monthly. Consider also that 55% of renters who earn less than $30,000 pay more than 50% of gross income

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[52] Comments of 100+ community, consumer, civil rights, faith, and legal services groups to NCUA on Proposed Payday Alternative Loan (PAL) Rule (Aug. 3, 2018), http://stopthedebttrap.org/blog/proposed-rule-credit-union-payday-alternative-loans-shouldnt-permit-cycle-high-cost-debt/.

[53] Comments of the Center for Responsible Lending, Self-Help Federal Credit Union, Self-Help Credit Union, and the National Consumer Law Center (on behalf of its low income clients) to NCUA on Proposed PAL Rule (Aug. 3, 2018), https://www.responsiblelending.org/research-publication/comments-response-national-credit-union-administration-proposal-expand-its.

[54] Letter from national civil rights, faith, and consumer groups to federal banking regulators (May 4, 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-bank-usury-joint-regulators-4may2018.pdf; Letter from community, civil rights, faith, and consumer groups to FDIC Chair McWilliams (Aug. 21, 2018), https://www.responsiblelending.org/media/fdic-should-not-allow-banks-make-payday-loans-says-coalition-letter; Open Letter to Banks: Don't Make Debt Trap Payday Loans, signed by over 200 groups (Nov. 3, 2017), https://www.responsiblelending.org/research-publication/open-letter-banks-dont-make-debt-trap-payday-loans.

[55] Even a lower rate of 60% is deemed too high by 93% of North Carolina voters. Poll by Public Opinion Strategies and released by CRL (Apr. 8, 2015), https://www.responsiblelending.org/media/poll-what-unites-93-tar-heels-opposition-predatory-lending-and-bill-pushing-interest-rates.

[56] Stop the Debt Trap, *Assessing Both Income and Expenses Is Necessary in Test of Borrower's Ability to Afford a Consumer Loan* (Nov. 9, 2017), http://stopthedebttrap.org/wp-content/uploads/2017/11/stdt-5percent-nov2017.pdf

for rent alone.[57] A 5% PTI standard assumes that this borrower has an extra $101 each month, or $1,215 annually, to spare toward high-cost debt. For most borrowers, this assumption doesn't match reality. And history has shown us that, rather than substitute for other high-cost products, additional high-cost loans push already constrained borrowers further into unsustainable debt. Payday loans, including deposit advance loans, have not been shown to reduce overdraft fees.[58] In fact, software consultants for bank payday loans, and for proposed new NCUA "payday alternative loans" (PALs), tout "[l]ittle to no cannibalization of NSF/OD [overdraft] income."[59] Yet payday loans are consistently shown to trigger overdraft fees.[60]

Similarly, when banks were making deposit advance loans at price points of half or two-thirds that of storefront lenders, with annual volume of $6.5 billion (most of it, like storefront payday loan volume, generated by the previous unaffordable payday loan),[61] there was no evidence that they put a dent in nonbank payday lending. High-cost installment loans also often add to already unsustainable debt burdens. In Colorado, where installment loans average 129% APR, a default or delinquency occurred in 23% of all 2016 loans.[62] Even when the loans are repaid, focus group participants there describe how these loans often compounded their already unmanageable debt burdens.[63]

Thus, we know of no evidence suggesting that high-cost bank installment loans will drive down nonbank payday lending. They do, however, threaten a race to the bottom as nonbank lenders will seek to loosen state usury laws to "compete" with banks, threatening the most meaningful protection against predatory lending: state usury limits. Moreover, banks and credit unions do not need special passes to make reasonably priced loans. Many depositories make affordable

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[57] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2018* (2018), http://www.jchs.harvard.edu/sites/default/files/Harvard_JCHS_State_of_the_Nations_Housing_2018.pdf.

[58] CFPB, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* at 39 (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

[59] https://www.cashplease.com/financial-institution-benefits/.

[60] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 33-34 (2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf; CFPB, *Online Payday Loan Payments* (2016), https://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf; Susanna Montezemolo & Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, Center for Responsible Lending (March 2015), https://www.responsiblelending.org/research-publication/payday-mayday-visible-and.

[61] Leslie Parrish & Uriah King, *Phantom Demand*, Center for Responsible Lending (2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

[62] Ellen Harnick & Delvin Davis, *Payday Lenders Continue to Put Coloradoans Into High-Cost Debt*, Center for Responsible Lending (Feb. 2018), https://www.responsiblelending.org/media/new-report-coloradans-pay-119-borrow-392-through-payday-lending.

[63] Tom Feltner, Diane Standaert, & Ellen Harnick, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans*, Center for Responsible Lending (July 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf.

installment loans,[64] and around 650 credit unions lend under the current rules of the NCUA payday alternative loan program. There are also 76 million open subprime credit cards, up steadily since it was 59 million in 2012.[65]

Extremely high interest rates on loans to financially vulnerable consumers cannot be justified as everyday risk-based pricing. The rates, instead, are a red flag signaling a business model not based on ability-to-repay. Banks making loans through checking accounts have the added leverage of holding the customer's bank account. This can ease their ability to profit off loans, even if they leave borrowers without enough money to meet basic needs. The most efficient and effective way to ensure affordability is through interest rate caps of no higher than 36%. This idea is strongly supported by Americans across the political spectrum, as seen in Arizona, Ohio, Montana, and South Dakota, where voters in recent years have voted overwhelmingly in favor of this rate limit. Fifteen states and D.C. have these caps on short-term loans, many more have them on installment loans, and federal law establishes the cap for military service members.

- **Consumers are not test subjects: Regulatory Sandboxes**

The Treasury Report states that the impact of regulatory sandboxes[66] "… help foster economic growth. New ideas can facilitate market efficiency, spurring improvements to services and products. Not all innovations will succeed; some might even cause harm. Regulation should address and potentially mitigate negative externalities."[67] Here again the Treasury Report acknowledges the potential harms to consumers, and glosses over the extensive, and many times permanent, damage that consumers face with predatory loan products by designating them as simply "negative externalities." This approach unequivocally deprioritizes consumer protection and seems to reject the clear research data that concludes predatory loans are toxic. The notion that certain laws, especially civil rights, need to be suspended or scaled back to provide a clearing for innovation is very troubling. For example, the permeance of the impact on consumers, should not be tossed aside, and the generational wealth that can be at risk by foreclosures, damaged credit, or

[64] Stop the Debt Trap, *Assessing Both Income and Expenses Is Necessary in Test of Borrower's Ability to Afford a Consumer Loan* (Nov. 9, 2017), http://stopthedebttrap.org/wp-content/uploads/2017/11/stdt-5percent-nov2017.pdf.
[65] American Bankers Association, Credit Card Market Monitor (July 2018), https://www.aba.com/Press/Documents/2018Q1CreditCardMonitor.pdf.
[66] *"Treasury recommends that federal and state financial regulators establish a unified solution that coordinates and expedites regulatory relief under applicable laws and regulations to permit meaningful experimentation for innovative products, services, and processes. Such efforts would form, in essence, a "regulatory sandbox" that can enhance and promote innovation. If financial regulators are unable to full those objectives, however, Treasury recommends that Congress consider legislation to provide for a single process consistent with the principles detailed in the report, including preemption of state laws if necessary."*
[67] *Id, 167*

loss of bank accounts, are all protected by state and federal laws that were enacted to specifically remedy market failures and inequities. Secondly, the controlled results of a specific sandbox agreement provide an incongruous comparison with what would happen with the same model that had to account for a marketplace with consumer protections. There is no sound policy justification as to why innovation should not evolve in lock step with current consumer credit and civil rights laws, to ensure that the data and results of sandbox models can reliably be used for predictive products and innovations in a safe, sound and legally permissible manner. When the Report states "[t]he regulatory environment should instead be flexible so that firms can experiment without the threat of enforcement actions that would imperil the existence of a firm",[68] it is clear that, for the Treasury, consumer protection is not only an afterthought, but is in fact an obstacle. This is an unacceptable position when the entirety of consumer well-being is at stake, and there is not sound equitable policy reason to prevent innovation from evolving alongside critical consumer protection and civil rights laws.

- Controlling for Bias: algorithms and systemic prejudice. Treasury Recommendation on Consumer Data: A.I & Machine Learning[69]

The integration and use of algorithms and data into risk models has clear benefits when it comes to cost efficiency and streamlined underwriting. Algorithms significantly improve the time it takes to process the data that fintech companies use to determine risk, however, our concern is that the opaqueness of proprietary models, with little to no scrutiny, leave unanswered questions of consumer remedies, model discrimination, and disparate impact issues. In fact, at a certain scale, models based on discriminatory data can exacerbate market inequities. Consumer advocates are deeply concerned about the potential threat that biased data and the implementation of algorithms in fintech can have in intensifying discriminatory practices instead of limiting them.[70] It is imperative that banks and fintech companies take a proactive and comprehensive approach in analyzing the potential consumer threats that could arise from the adoption of algorithmic systems to facilitate and expedite their processes, as well as provide access to data sets and algorithms to ensure compliance with anti-discrimination laws. There needs to be strong practices in place to

[68] *Id,* at 167

[69] *Treasury Report, "Regulators should not impose unnecessary burdens or obstacles to the use of AI and machine learning and should provide greater regulatory clarity that would enable further testing and responsible deployment of these technologies by regulated financial services companies as the technologies develop."*

[70] See Andrew Waxman, *AI can help banks make better decisions, but it doesn't remove bias*, American Banker (June 5, 2018). Available at https://www.americanbanker.com/opinion/ai-can-help-banks-make-better-decisions-but-it-doesnt-remove-bias

ensure that the data used to create these algorithms is thoroughly analyzed to the highest standard to reduce the impact of bias, as well as contain systemic preventive safeguards to make sure these institutions are prepared with efficient control mechanisms that would remedy any discrimination. issues that arise.

Conclusion

As financial products and services that were once in the form of brick and mortar branches, salesmen, and desktops move online and to mobile devices it is important to remember that these products and services are not new. The products that are being utilized and offered as expanding access to credit and financial growth through financial technology are still the same products and services we've always known – they are still loans and mortgages. As this conversation moves towards questions of regulation I would urge Congress to be diligent about remembering this and ask the question "is this a traditional product or service in new packaging?" and use that as a baseline in determining how ensure that appropriate consumer protections are applied. Innovation of product delivery is very distinct from innovation of product. The former readily fits into the current consumer protection legal framework that has been instrumental to protect consumers. The latter warrants a very serious consideration of consumer impact.

Consumers will be the ones that will be hurt the most if we get this wrong.

This is why the CRL's central priorities are *(1) preserving the progress made by state and federal stakeholders to guard consumers from predatory debt trap loan products*, *(2) ensuring fintech lending evolves in cadence with existing and developing consumer protection laws, and (3) the preservation of state usury laws.*

Thank you again, for allowing me to share CRL's perspective today with the committee and I hope that you will consider my words and the perspective of consumers as Congress and Federal and State regulators approach the evolving fintech marketplace.