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Attention: Marketplace Lending RFI
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW, Room 1325
Washington, DC 20220

Re: *Marketplace Lending RFI ("Public Input on Expanding Access to Credit Through Online Marketplace Lending"), Docket No. 2015-17644*

I. Introduction

The **Center for Responsible Lending** (CRL) files this comment in response to the Department of the Treasury (the Department)'s request for information (RFI) on marketplace lending. We thank the Department for the opportunity to comment.

CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting family wealth by working to eliminate abusive lending practices. Since our founding in 2001, we have studied financial practices across a range of loan products, including mortgages, payday loans, and depository overdraft, and urged responsible policy at the state and federal level.

CRL is an affiliate of Self-Help, one of the nation's largest Community Development Financial Institutions (CDFI), whose collective mission is to create and protect ownership and economic opportunity for all. Self-Help's experiences as a responsible lender, including its experiences with borrowers whose financial conditions have been significantly harmed by abusive lending practices, prompted CRL's founding and inform our work.

Self-Help consists of a state-chartered credit union (Self-Help Credit Union (SHFU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund. SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. While Self-Help's work benefits communities of all kinds, its focus is on those who may be underserved by conventional lenders, including people of color and low-wealth families and communities. Over more than 30 years, it has provided $6.6 billion in financing to help over 99,000 low-wealth borrowers buy homes, start and build businesses, and strengthen community resources.

In 2008, Self-Help founded SHFCU to expand Self-Help's mission; in 2010, SHFCU launched a pilot credit union concept, Community Trust Prospera, which is designed specifically around the needs of families living paycheck-to-paycheck. A hybrid of a check casher and a credit union branch, CT Prospera aims to meet unbanked customers where they are by providing check cashing, remittance and other services in a convenient and comfortable environment with extended hours. At the same time, its tellers are trained to deliver "in-line financial education" at the point of service, nudging customers toward mainstream financial products such as savings and checking accounts, and a broad range of responsible loan products, including personal loans, credit cards and mortgage loans.

The Department's RFI raises a number of important questions about the growing online lending marketplace both in the consumer and small business lending space. Our history of advocacy for fair lending practices, and against unfair ones, is the lens through which we focus these comments, where we emphasize:

- Online marketplace loans must comply with applicable state law.
- Underwriting for ability-to-repay, based on income and expenses, should be required for every loan.
- Small business loan protections, including prohibition of broker steering, are critical.
- Mandatory arbitration clauses should be prohibited.

II. Online marketplace loans must comply with applicable state law.

The law is clear that online loans made by non-depositories are subject to the law of the state in which the borrower resides.[1] This is true regardless of whether the non-depository partners with a depository institution to make the loan, so long as, as typically has been the case, the non-depository bears the predominant economic risk in the transaction.

The so-called "rent-a-bank" model – whereby non-depositories make loans at rates prohibited by state usury laws under the pretext that their partnership with a depository permits them to charge the depository's home state rate, pursuant to national bank preemption and related law[2] – has been squarely rejected by federal and state regulators and the courts. In the early-

[1] For examples of successful enforcement actions against online loans made in violation of state law, *see* Center for Responsible Lending, "Effective State and Federal Payday Lending Enforcement: Paving the Way for Broader, Stronger Protections (Oct. 4, 2013) (describing several state enforcement actions against tribal-affiliated lenders), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/State-Enforcement-Issue-Brief-10-4-FINAL-fix.pdf.

[2] As the FDIC explains it, "Federal law authorizes federal and state-chartered insured depository institutions making loans to out of state borrowers to 'export' favorable interest rates provided under the laws of the state where the bank is located. That is, a state-chartered bank is allowed to charge interest on loans to out of state borrowers at rates authorized by the state where the bank is located, regardless of usury limitations imposed by the state laws of the borrower's residence." FIL FDIC: FIL-14-2005: Guidelines for Payday Lending. However, as described here, this doctrine has not been used to permit evasion of state law through non-depository/depository relationships.

to-mid 2000s, federal banking regulators, through a combination of guidance and enforcement actions, shut down rent-a-bank schemes with payday lenders.[3] While the scheme rested on the payday lender's claim that it was a mere agent for the out-of-state bank, the payday lender was the de facto lender, with the bank's economic interest typically limited to the fee it received from the lender for the use of its charter. State regulators also had success forcing lenders with rent-a-bank schemes out of their states.[4] Where similar payday lending rent-a-bank arrangements have occasionally popped up in the years since, regulators have continued to quash them.[5]

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[3] 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.

The OCC issued an advisory as well as enforcement actions and then-Comptroller John D. Hawke called the schemes "an abuse of the national charter," noting "It is a matter of great concern to us when a national bank essentially rents out its charter to a third-party vendor who originates loans in the bank's name and then relinquishes responsibility for how these loans are made . . . . [w]e are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws that would otherwise apply to it." http://www.occ.gov/static/news-issuances/news-releases/2002/nr-occ-2002-10.pdf; http://www.occ.gov/topics/consumer-protection/payday-lending/index-payday-lending.html; http://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-3.pdf.

The Office of Thrift Supervision also issued an advisory, noting "Associations should not 'lease' their charter out to nonthrift entities through an agreement that allows the nonthrift entity to circumvent state and local law." Thrift Bulletin 82, Aug. 18, 2003, at 8.

The Federal Reserve Board stopped the First Bank of Delaware from renting its charter to storefront payday lenders; the relationship is described here: http://www.consumerfed.org/financial-services/166.

The FDIC also issued an advisory addressing payday lending through non-bank partners (FIL FDIC: FIL-14-2005: Guidelines for Payday Lending) and later shut down a straggling rent-a-bank arrangement with an enforcement action (*In the Matter of First Bank of Delaware, and CompuCredit Corporation, Notice of Charges for an Order to Cease and Desist and for Restitution, Federal Deposit Insurance Corporation,* FDIC-07-256b, June 15, 2008, *available at* http://www.FDIC.gov/news/perss/2008/FDBNoticeofCharges.pdf; *See also In the Matter of First Bank of Delaware, Stipulation and Consent to the Issuance of an Order to Cease and Desist, Order for Restitution, and Order to Pay*, Oct. 3, 2008, *available at* http://www.FDIC.gov/bank/individual/enforcement/2008-10-20.pdf.

[4] After North Carolina law stopped permitting payday lending in the state in 2001, Advance America asserted it was permitted to continue making payday loans there through a partnership with an out-of-state bank. In 2005, the state banking commissioner ruled that Advance America loans indeed were in violation of state law, and the lender ceased its operations in the state. I*n re Advance America: Order, N.C. Comm'r of Banks*, 05:008 (Dec. 22, 2005).

[5] For example, in 2010, the Office of Thrift Supervision shut down a payday loan line of credit, iAdvance, being offered through the non-depository prepaid card issuer Netspend's cards, through partnership with one of the OTS's supervisee banks. Form 8-K filed by Meta Financial Group, Inc. with the Securities and Exchange Commission, October 6, 2010, *available at* http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm (noting the OTS cited unfair and deceptive acts or practices). *See also http://www.getdebit.com/debit-news/netspend-ipo-buzz-good-and-bad/ (*industry commentary noting, on the eve of Netspend initial public offering:

In more recent years, the rent-a-bank model has been attempted in the multi-payment payday loan space as well. Again, it has been met with state opposition, upheld in court, on grounds that the arrangement is a ruse where the non-depository is the de facto lender.[6]

Following regulatory crackdown on rent-a-bank in the payday space, a similar scheme arose whereby predominantly online lenders of both single-payment and multi-payment payday loans have claimed that affiliation with Indian tribes grants them tribal sovereign immunity from state law. State and federal regulators have vigorously disputed this claim with considerable success.[7]

Underscoring the limitations of bank preemption doctrine in the context of non-depositories, a recent Second Circuit federal court decision held that debt buyers, as assignees of bank loans, are not entitled to preemption. The court reasoned that the buyers are acting on their own behalf as the owner of the debt, and that there was no reason to believe that applying state usury laws to non-bank assignees would significantly interfere with a national bank's ability to exercise its power under the National Bank Act.[8]

Finally, underscoring the extent to which states have worked to defend their usury limits from online loans that exceed them, in recent years state regulators have pursued lead generators[9] and payment processors[10] and sought the assistance of banks,[11] payment networks,[12] and even

[6] Final Order On Phase II Of Trial: The State's Usury And Lending Claims, State of West Virginia, ex rel. v. CashCall, Inc and J. Paul Reddam, Kanawha County Circuit Court, Civil Action No.: 08-C-1964, Sept. 10, 2012. http://bit.ly/16lOhAe (upholding the state's claim that CashCall was the de facto lender in violation of the state's usury limit, while finding that CashCall purchased all loans made under the arrangement from First Bank of Delaware three days later and clearly bore the economic risk of the loans).

[7] *See* Center for Responsible Lending, "Effective State and Federal Payday Lending Enforcement: Paving the Way for Broader, Stronger Protections (Oct. 4, 2013) (describing several state enforcement actions against tribal-affiliated lenders), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/State-Enforcement-Issue-Brief-10-4-FINAL-fix.pdf; Press Release, *CFPB Sues CashCall for Illegal Online Loan Servicing*, Dec. 16, 2013 ("Western Sky Financial asserted state laws did not apply to its business because it was based on an Indian reservation and owned by a member of the Cheyenne River Sioux. But this relationship with a tribe does not exempt Western Sky from having to comply with the state laws when it makes a loan over the Internet to consumers in various states.")

[8] *Madden v. Midland Funding, LLC, --- F.3d ---, 2015 WL 2435657 at *1 (2d Cir. May 22, 2015).* On August 12, 2015, the Second Circuit denied Midland's request for rehearing *en banc*.

[9] *See*, *e.g.*, http://www.dfs.ny.gov/about/press/pr1503101.htm.

[10] *See*, *e.g.*,http://www.dfs.ny.gov/about/letters/pr130806-link1.pdf.

[11] *Id.*

online search engines[13] and national cable networks[14] to prevent illegal online loans from being made to their residents.

III. Underwriting for ability-to-repay, based on income and expenses, should be required for every loan.

Ability to repay is a cornerstone principle of responsible lending. Where systemic problems have arisen in lending markets, lending without regard to ability to repay has been a key culprit – in the mortgage market leading up to the financial crisis, for example, and in the payday lending market where repeat, serial loans are typical and half of borrowers ultimately default because lenders ignore ability to repay at the outset.[15]

Underwriting for ability to repay – which, by regulatory consensus, means ability to repay a loan on its original terms without refinancing or reborrowing while meeting other obligations and expenses – is always necessary.[16] It has even pronounced importance for any loan where the lender takes access to the borrower's checking account, as with many online loans. Lenders can repay themselves, often first in line before other creditors or merchants, directly from

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[12] *See*, *e.g.*, *Id.* (urging assistance from ACH processor NACHA); *see also* https://www.governor.ny.gov/news/cuomo-administration-takes-action-halt-illegal-online-payday-lending-through-debit-card.

[13] *See*, *e.g.*, http://www.dbo.ca.gov/Press/press_releases/2015/Search_Engine_initiative_04-07-15.pdf.

[14] http://ago.vermont.gov/focus/news/attorney-general-announces-$1000000-crackdown-on-illegal-lending.php.

[15] Susanna Montezemolo, *The State of Lending in America & its Impact on U.S. Households: Payday Lending Abuses and Predatory Practices* (Sept. 2013) (finding that over three-fourths of all payday loan volume is from loans made within two weeks of the borrower's previous loan, indicating that the borrower lacked the ability to repay the previous loan); Susanna Montezemolo and Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, Center for Responsible Lending (Mar. 2015), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-mayday-visible-and.html (finding nearly half of all payday loans ; the Consumer Financial Protection Bureau (CFPB), in the most comprehensive data set on payday lending ever compiled and analyzed, found that the median borrower took out ten payday loans from a single storefront lender during one year, and spent 199 days of the year in payday debt. Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings,* April 24, 2013, *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[16] See comments of AARP, CRL, Consumer Federation of America, Leadership Conference on Civil and Human Rights, NAACP, National Consumer Law Center (on behalf of its low income clients), and National Council of La Raza, to the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) on their *Proposed Guidance on Deposit Advance Products,* dated May 30, 2013, at 6-8, *available at* http://www.responsiblelending.org/paydaylending/policylegislation/regulators/advocates-support-proposed.html

borrowers' next deposit; in this way, lender account access reduces the lender's inherent incentive to ensure the borrower has ability to repay, so long as the lender has the ability to collect. Indeed, even "successful repayment" of loans with account access is far from evidence of affordability; often, the lender is repaid because the funds are there on payday while the borrower is subsequently unable to meet other obligations during the pay period. A cycle of reborrowing ensues – one that may not be evidenced by default on that loan so much as by serial refinancings of that loan and/or delinquencies or defaults on other obligations.

Thus, ability to repay is essential, and particularly for account-access loans. So though emerging lending channels may reduce underwriting costs, they must not threaten underwriting quality or replace underwriting for affordability.

IV. Protections for small business loans are essential.

Many concerns with consumer loans apply to small business loans as well. These loans, too, must comply with applicable state law and be made only subject to the borrower's ability to repay. Though a need for greater transparency in this space has been noted,[17] improved disclosure will not diminish the importance of cornerstone principles like these.

Of particular concern in the small business space is the practice whereby a broker steers a borrower into a certain loan not because it is the best deal for the borrower but because it generates the largest lender-to-broker kickback, or yield-spread premium. Yield-spread premiums, as they did in the subprime mortgage space before the financial crisis, often result in borrowers receiving more expensive, riskier loans than they qualify for, and frequently with a racially disparate impact. To address steering in the mortgage market, Dodd-Frank prohibited compensation that varies based on loan term (other than principal amount) and prohibited steering borrowers into loans that they lack the ability to repay or that have predatory characteristics or effects. Similar broker duties should apply to brokered non-mortgage loans. While lack of transparency around broker compensation in the small business marketplace lending space has been noted, improved transparency alone will not provide sufficient protection. Indeed, in the mortgage context, regulators determined that a disclosure approach would not adequately address the perverse incentives that yield-spread premiums created, and that substantive regulation was needed. The same is true in this context.

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[17] A recent study found that while online loans hold appeal for some small business owners, information about the loans online can be confusing and difficult to compare across products. Barbara J. Lipman and Ann Marie Wiersch, AlternAtive lending through the eyes of "Mom & Pop" Small-Business Owners: Findings from Online Focus Groups, A Special Report From the Federal Reserve Bank of Cleveland (Aut. 25, 2015), https://www.clevelandfed.org/Newsroom%20and%20Events/Publications/Special%20Reports/sr%2020150825%20alternative%20lending%20through%20the%20eyes%20of%20mom%20and%20pop%20small%20business%20owners.aspx.

V. Mandatory arbitration clauses should be prohibited in all consumer and small business loan contracts.

Mandatory arbitration clauses bar injured borrowers from bringing claims to court, leaving a secret, systematically biased arbitration proceeding as their only option to seek redress. These clauses are fundamentally unfair because they leave borrowers with no real avenue for remediation; they also facilitate unfair and abusive financial practices by leaving irresponsible lenders unaccountable. They should be prohibited in all consumer and small business loan contracts.[18]

VI. Conclusion

Thank you for consideration of our comments; we would be happy to discuss them further.

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[18] For an extensive study of mandatory arbitration clauses, *see* CFPB's recent study at http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf; *also see* recent letter from 50 Senators to CFPB, May 21, 2015, urging it to prohibit mandatory arbitration clauses in all consumer financial contracts, http://www.franken.senate.gov/files/documents/150521CFPBarbitrationLetter.pdf.