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January 20th, 2020

Robert E. Feldman
Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: RIN 3064-AF21 Federal Interest Rate Authority

Dear Sirs:

Please accept this comment made by Reinvestment Partners regarding the notice of proposed rulemaking on clarifying the law that governs interest rates that state-chartered banks (collectively, “state banks”) may charge, whether the permissibility of an interest rate would be determined at the time the lender makes the loan, how it would be impacted by changes in State law, or changed due to the loan’s sale, assignment or transfer.

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

- We are the largest administrator of VITA sites in North Carolina.
- In the last two years, we have purchased and rehabbed 95 apartments for very low-income households, including units with supportive services for the formerly homeless and for veterans.
- We provide nutrition assistance to SNAP beneficiaries.
- We engage directly with industry. We have challenged several bank mergers, sit on national advisory boards for two banks, and participate in an advisory board made up of Fintechs and non-profits. We represent consumers in the Faster Payments Council.
- Our policy team regularly publishes unique research on consumer finance issues and comments on current rulemakings.

We believe our variety of programming gives our organization the grounding to speak with authority on the impact that the FDIC's proposed rule would have on vulnerable consumers.

We know that the results of this decision if applied beyond the specific scope of that case, would lead to harm for consumers, as the same practice fostered a widespread system of high-cost lending until 2001. Before then, a set of banks headquartered in "usury-friendly" states (a term utilized in a recent case in the US District Court for the Eastern District of Pennsylvania) assigned recently-originated loans to payday lenders under the regulatory cover of pre-emption. North Carolina was among a long list of states where payday lenders operated using the space created by pre-emption.

Now, the Federal Deposit Insurance Corporations proposes a new rule which would reinstate that environment, authorizing banks to facilitate high-cost loans. The new rule would walk back the expressed will of North Carolina (and many other states), opening the door for a revival of a legal loophole that allowed banks to bypass state anti-usury law. Doing so would represent a dangerous usurpation by the federal government of state power in North Carolina, as the North Carolina General Assembly has clearly expressed its preference to set interest rate caps at thirty percent – far below any of the rates offered through the rent-a-bank model.

In doing so, the FDIC ignores the lessons from the past at the peril of consumers. Payday lenders have tried to sidestep state rate caps for many years. Under this proposal, they would have the support of the FDIC to do so. Before 2001, payday lenders partners with several FDIC-regulated financial institutions to make loans at rates that were four to twenty times greater than our state's usury cap. Pre-emption did not improve the market for consumers, but instead, it dramatically worsened the nature of short-term credit.

We have concerns about an intention to apply the "valid-when-made" principle as recently decided in Madden v. Midland Funding. We believe that the application of the decision in Madden overstates its purpose. The assignment of debt differs in clearly-definable ways from the issuance of loans, even in the "rent-a-bank" model. The FDIC should see that distinction and therein utilize the "true lender" standard. It should use its supervisory powers to guarantee that banks deploy safe and sound business practices; indeed, it should never apply policies that enable financial institutions to utilize FDIC-insured deposits to distribute predatory capital.

Discussion

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

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

> *"Companies that made payday loans to Pennsylvania residents over the internet tried to circumvent Pennsylvania's prohibition against payday lending by conditioning their loans on the borrowers' execution of contracts stating that Pennsylvania law does not apply to those loans. The Pennsylvania Supreme Court, however, invalidated such contractual provisions in 2008 and 2010….the practice of a payday lender paying a bank to act as a*

> *front for the payday lending enterprise to evade state anti-usury laws were referred to by payday lending industry insiders as 'rent-a-bank.' From approximately 1997 to 2003, the Hallinan Payday Loan Companies effectively rented County Bank."* (United States District Court for the Eastern District of Pennsylvania, 2016)

It will be ironic if the defendants in that case (Wheeler Neff and Charles Hallinan) remain under custody in federal prison because they were found guilty for creating the legal argument for rent-a-bank (as well as tribal lending) while at the same banking regulators saw to make their deception the standard for federal law.

In the late 1990s, under the cloak of County Bank's charter, Hallinan Payday Loan Companies made payday loans across all fifty states, even though those loans exceeded usury caps on personal loans in many of those states. County Bank was not the "true lender," as it did not supply the capital, nor did it manage the underwriting of applications, nor did it service the loans, and it was not the ultimate beneficiary of the interest payments generated from the loans.

County Bank's participation stemmed solely from its location in a "usury-friendly" state, as described by the attorney representing the defendants in the case. (United States District Court for the Eastern District of Pennsylvania, 2016):

> *"Defendant Wheeler Neff advised Adrian Rubin to relocate his payday lending operations overseas or to one of three states that defendant Neff described as "usury friendly," which meant that they permitted payday lenders registered in those states to issue loans to customers across the county. Defendant Neff identified the "usury friendly" states as Delaware, Utah, and New Mexico. On or about January 29, 2003, Rubin incorporated a payday lending company in Utah, which he called Global Pay Day Loan ("Global"), and opened offices in Salt Lake City, Utah, and Philadelphia, Pennsylvania."*

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

Indeed, were it to be that the FDIC permitted the return of rent-a-bank, it would introduce practices that contradict currently-state policies related to consumer reliance on the repeated use of debt that is perceived to be inappropriate. In its 2010 guidance on overdraft programs, the FDIC established guidelines on how its supervised financial institutions should monitor "excessive or chronic customer use" of overdraft services (Federal Deposit Insurance Corporation, 2010). The FDIC's determination regarding the appropriate reliance on overdraft goes against the empirical evidence of known patterns in payday lending. In North Carolina, for example, payday lenders typically rolled loans over at least four times.

While County Bank might not become the gateway for exportation of lending, other FDIC-regulated banks stand ready to play the part. The FDIC is the primary regulator for Cross River Bank (New Jersey), FinWise Bank (Utah), Republic Bank of Kentucky (Kentucky), and Bank of Lake Mills (Wisconsin).

We know that these financial institutions will export high rates because these companies already make loans in usury-friendly states bearing rates of as much as three hundred percent. Indeed, in its most recent annual report, online lender Enova indicates that the only thing holding the company back from moving into other states are interest rate ceilings:

> *We currently do not offer consumer loans in the remaining states or in the District of Columbia because we do not believe it is economically feasible to operate in those jurisdictions due to specific statutory or regulatory restrictions, such as interest rate ceilings, caps on the fees that may be charged, or costly operational requirements. However, we may later offer our consumer products or services in any of these states or the District of Columbia if we believe doing so may become economically viable.* (Enova International Inc., 2019)*"*

Elevate and Enova rent Republic Bank of Kentucky. Enova's installment loans bear interest rates of as high as 99.9 percent. Its Ca$hNetUSA payday lending division charges rates of as high as 325 percent. Elevate's Elastic Line of Credit is an "online line of credit" bearing an origination fee of $5 per $100 advanced against the line plus a monthly charge of 5 percent of all open balances (Elevate Credit, 2019). Elevate claims that the effective rate is 97 percent, although some consumers may pay more depending on the length of the utilization of the credit line. In each case, Republic Bank of Kentucky plays an essential role in the provision of very high-cost credit.

Elevate rents FinWise Bank to operate its Rise installment loan, bearing rates of between 99 and 149 percent in sixteen states (Elevate Credit, 2019).

Before a 2017 consent order from the FDIC, the Bank of Lake Mills (Wisconsin) partnered with Military Credit Services and Freedom Stores Incorporated to facilitate loans targeted largely at service members. Ironically, in a span of fewer than three years, the proposed rule reflects a complete reversal in how the FDIC interprets the Federal Deposit Insurance Act (12 U.S.C. 1831d(a). (Rosenblum, 2019) *Loans sold by Bank of Lake Mills to those lenders, along with others made to Word Business Lenders and others, bore interest rates of approximately 120 percent; at the time, the FDIC forced the Bank of Lake Mills to cease these activities. Now, just three years later, it seems to have lost its way.*

Again, there would be irony, for although it is the Office of the Comptroller of the Currency charged with applying the pre-emptive powers of the National Bank Act to its member national banks, the current array of bank-partner lenders broadly fall within the supervision of the FDIC. The National Bank Act articulates the logic behind pre-emption, but here we see its implementation occurring through a regulator of state banks. We have to ask for clarity – how is pre-emption enacted by a banking regulator who has no legal justification for pre-empting?

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

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

scope of the exportation doctrine while avoiding the uncertain market conditions sown by Madden's approach (Hannon, 2018)"

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

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

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

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

Rent-a-bank relationships put credit in the hands of borrowers who frequently cannot afford to repay their debts.

The model's only purpose for existence is to enable lenders to charge interest rates that are not just slightly above state usury caps, but instead, at interest rates that are dramatically greater than the limits states would prefer to apply. For example, Elevate Credit reports that the effective APR for a Rise loan (described above) made through its partner relationship with FinWise is 180 percent. Elevate rents Republic Bank of Kentucky, an FDIC-supervised financial institution, and FinWise, another FDIC-regulated institution.

Rent-a-bank lending does not rely on an ability-to-repay underwriting standard. It results in the origination of high-cost loans to borrowers who are frequently unable to afford the cost of the debt. Consider once more the business model of Elevate Credit. Elevate indicates that borrowers default on thirteen percent of Rise loans. The company has a practice of setting aside an additional fourteen percent of outstanding loans in loan loss reserves. In its description of how those two sets of loans combine to reflect on their total loan performance, Elevate reports that "cumulative principal loan charge-offs through September 2019 for each annual vintage since 2013 vintage is generally under thirty

percent and continue to generally trend at or slightly below our twenty-five to thirty percent targeted range. (Elevate Credit, 2019)"

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

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

Countering the FDIC's Basis for the Proposed Rule:
In its notice of proposed rulemaking, the FDIC makes the following points to support the proposed regulation:

Proposed rule opinion; The assignability of debt, without a corresponding drop in yields, enables financial institutions to increase their liquidity in a crisis:

While we agree that banks can make use of liquidity to avert threats to their soundness, we disagree that this concept contributes to any support for this proposed rule, nor does it apply a sensible lens to the question of how regulators should enforce relationships between banks and payday lenders.

To the point of liquidity: rent-a-bank contracts do not put pressure on the liquidity of banks. Generally speaking, banks hold at least 90 percent of these loans for no more than twenty days – and often for only two days. There is no virtually no liquidity risk to the bank for loans held in the short run, as the credit risk associated with those assets does not deteriorate when the bank holds them on its balance sheet. Indeed, a bank sells the loan before a borrower is due to make the first payment on the debt.

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

Proposed rule opinion: If a usury cap exists, then regulations will disadvantage state banks who compete with national banks.

In its 2019 amicus brief (Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, 2019), the FDIC and the OCC jointly contend that interest rate caps can threaten the safety and soundness of a bank's balance sheet. The brief points to the situation in the 1970s, when interest rates on medium and long-term debt reached 18 percent. Rate caps held state banks to originate loans at a ceiling of five percent, and as a result, they could only make loans at rates that were far lower than their cost of capital.

Right now, It is not the case that rates are ten or even fifteen percentage points higher than prevailing capital costs. Instead, in the rent-a-bank model, pre-emption facilitates lending at interest rates that are often 300 percentage points about the cost of capital.

The threat does not exist – and experts on Wall Street believe it will not be real – for at least the next thirty years. Currently-prevailing interest rates create no urgency, as banks can currently acquire funds at less than two percent; rates on deposits are usually less than 25/100ths of one percent, and ten-year

treasuries sell at less than 1.5 percent. The yield curve is almost inverted, meaning that Wall Street believes that interest rates may be historically low for the next thirty years. Regulators are arguing to use a legal theory to solve a problem that does not exist. Moreover, the "smartest people in the room" have made trillions of dollars in investments with the belief that the problem will not exist for the next three decades. Indeed, given that very few regulatory careers expand beyond thirty years, only a handful of staff may ever experience a moment when this problem needs to be solved.

Proposed rule opinion: applying Madden is the best way to address safety and soundness concerns.

The FDIC could remedy the actual problem with other approaches.

When the bank holds back a portion of the nonbank's loan, then the FDIC could respond in several ways to meaningfully address its concerns about safety and soundness.

First, the FDIC could apply a correspondingly conservative standard in how it categorizes retained loans in the formula for determining the bank's Tier 1 capital ratio. A bank should have to set aside a significant amount of capital to guard against losses associated with holding loans made through a process where, as in the case of Elastic, as much as thirty percent of funds are lost because of poor loan performance.

Republic Bank of Kentucky states that in its Republic Credit Solutions segment, where it holds 10 percent of loans associated with Elevate, "loss rates are for this product has consistently been higher than Traditional Bank loss rates for unsecured consumer loans." Republic set aside $16.9 million for loan losses on a portfolio with a fair value of just $34 million, underscoring the exploitative nature of these loans (Republic Bancorp, 2019).

Secondly, it could extend the time that a bank must hold the loan. The proposed rule indicates that it might condition the cost of loans on the 90-day commercial paper rate. To impose a standard requiring a holding period for 100 percent of the debt, even for a term of as little as 90 days, would immediately increase a bank's sensitivity to the high risk of these loans. Indeed, its entirely plausible that if a bank had to bear such risk, it would make the prudent decision to cease this lending model entirely. The FDIC could define these loans in ways that distinguish the debt from other types of debt (credit card, auto, MBS) in ways that protect liquidity and add clarity. For example, it could dictate that debt secured by property or debt issued through an EFTA-covered credit product would not have a 90-day holding period requirement. We will leave it to the FDIC to divine the right principle.

Alternatively, if the FDIC believes that these loans present a risk to the bank's safety and soundness, then it could prohibit the practice of allowing banks to participate in the model.

Proposed rule opinion: pre-emption helps consumers by giving them needed access to credit.

The FDIC opines that "improved availability of credit from State banks…in the absence of the proposed rule, these consumers might be unable to obtain credit from State banks and might instead borrower at higher interest rates from less-regulated lenders."

Not true. Again, the FDIC is applying legal theory to solve a problem that does not exist.

North Carolina consumers from all points on the credit spectrum currently have plenty of access to credit. That statement holds not just for prime borrowers but also consumers with poor credit. While

many banks may hesitate to provide loans to non-prime consumers, state-regulated non-bank lenders compete to give credit to non-prime consumers. In 2017, 479 North Carolina-licensed consumer finance lenders originated 463,888 loans with a combined value of $1.684 trillion. At the end of the year, those lenders had $1.019 trillion in consumer installment loans outstanding. Borrowers received loans of all sizes; almost six thousand consumers received a loan of an amount of less than $600. Nearly ten thousand applicants received a loan of between $12,500 and $15,000 (North Carolina Commissioner of Banks, 2018). These loans were all originated at rates below our state's usury cap. These results underscore our belief that consumers already have access to credit, regardless of their credit profile.

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

Concluding Thoughts

We believe that the proposed rule would create a race-to-the-bottom effect, where a group of lenders relocates to "usury-friendly" states. In the first iteration of rent-a-bank, payday lenders found willing partners in a small group of states, most often in Delaware, where they could use a charter to hurdle over state anti-usury laws.

We fear that a new era of rent-a-bank could be worse, given the opportunities for banks to make loans over the internet. Indeed, the proposed rule could portend a future where banks use technology to take usury to scale. That outcome would represent a lost opportunity, as internet banking should allow financial institutions to pass along the benefits of their reduced operating costs to consumers in the form of cheaper products – and to do so at scale. Rent-a-bank would expand given the opportunities it offers for frictionless scaling of service, but it will never reduce borrowing costs, as it only exists as a means of evading usury caps.

When the FDIC comments that it "supports the position that it will view unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State (s)," we are heartened.

Yet we cannot square that statement with the points made in the proposed rule, nor does it seem consistent with the amicus brief that FDIC files in support of Madden's "valid-when-made" rule.

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

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

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

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

Sincerely,

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Director of Research
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