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January 15, 2017

Comptroller Thomas J. Curry

Office of the Comptroller of the Currency

400 7th Street SW, #3e

Washington, DC 20024

Via electronic submission

Re: Comments on Exploring Special Purpose National Bank Charters for Fintech Companies

Dear Comptroller Curry,

The Pew Charitable Trusts is a non-profit, research-based organization that provides data and analysis to help ensure a safe and transparent marketplace for consumer financial services. Pew's consumer finance team includes two projects. The consumer banking project has published research on deposit fees and overdraft policies; bank use of arbitration clauses; consumer use and awareness of mobile payments; the prepaid debit card market; and the U.S. regulatory framework surrounding mobile payments financial services. The small-dollar loan project has released the "Payday Lending in America" series of reports and other research about the small-dollar credit market as well as extensive policy recommendations for serving these borrowers with safer, lower-cost loans.

As the Office of the Comptroller of the Currency (OCC) assesses the benefits and risks of a special purpose charter for nonbank financial services firms, Pew is pleased to offer comments on the implications of our research on small-dollar loans and consumer banking, particularly as there are significant parallels between the online small-dollar loan marketplace and small business loans.

While Pew has no specific recommendation on the question of whether the OCC should create a new charter, we note that there are serious risks associated with doing so. Further, as discussed below, it is possible that the OCC could more effectively accomplish goals with respect to consumer protection, financial inclusion, and access to safer and lower-cost financial services by simplifying and improving the guidelines that govern existing national banks. In these comments, Pew will address questions one (1), three (3), four (4), six (6), and eight (8) as set forth by the OCC.

Questions for comment:

1. What are the public policy benefits of approving fintech companies to operate under a national bank charter? What are the risks?

Pew has not conducted research sufficient to answer this question. However, while the OCC is contemplating a charter for nonbank companies in order to promote useful innovation, it is worth noting that banks have advantages that could be better leveraged to benefit consumers, and the OCC can do more to foster innovation within the existing banking system. A large and diverse customer base, sophisticated technology and operations within a mature legal framework, and a track record of operating profitably in a safe and sound manner all indicate banks can safely provide many services at low cost. It is difficult to predict if a new charter would provide a value-add to consumers in a way that the current chartered system does not or cannot.

New policies could stimulate better options for consumers *within the existing national banking system*

To the extent that the OCC intends to spur the development of better opportunities and outcomes for consumers, it would do well to focus on simplifying and improving existing regulations for the deposit-taking banks that it charters. In this light, Pew continues to advocate for sensible reforms within the banking system. In short, banks can be the best source for low-cost, small-dollar credit alternatives if regulators encourage two things: 1) a simplified process for originating safe small-dollar loans, such as the 5 percent payment-to-income alternative outlined in the CFPB's 2015 small-dollar loan proposal[1] and the National Credit Union Administration's "Payday Alternative Loan" guidelines,[2] and 2) financial inclusion through the elimination of harmful practices like high-to-low transaction reordering, which increases overdraft costs, a factor that drives many consumers out of the banking system.[3]

Making small-dollar loans that adhere to the 5 percent payment-to-income alternative would allow for affordable payments, reasonable terms, and low costs. Further, it would enable banks to serve customers who do not qualify for prime products without imposing costly overdraft penalty fees, which are a primary source of bank credit for these customers today. Small-dollar loans could also enhance access to the banking system by encouraging migration away from unaffordable online payday loans and excessive use of overdraft, both of which put customers at risk of losing their checking accounts. The public supports these policies, as more than 70 percent of all Americans favor stronger regulation of the payday loan market and support allowing banks to offer lower-cost small loans.[4] Pew has advocated that the CFPB finalize the 5 percent payment-to-income alternative. We urge the OCC to allow it, too, because it meets two crucial objectives: clear, strong consumer protections, and a streamlined and

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[1] Consumer Financial Protection Bureau, *Small Business Advisory Review Panel For Potential Rulemakings For Payday, Vehicle Title, and Similar Loans: Outline Of Proposals Under Consideration and Alternatives Considered*, March 25, 2015, 27, http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf#page=27. See Section 3(b) for a description of the Bureau's proposal for "loans with periodic payments below a specified payment-to-income ratio."

[2] Short-Term, Small Amount Loans, 75 Fed. Reg. 58285 (Sept. 24, 2010).

[3] The Pew Charitable Trusts, "Overdrawn," (June 2014), 10, http://www.pewtrusts.org/~/media/assets/2014/06/26/safe_checking_overdraft_survey_report.pdf#page=13.

[4] In August 2016, Pew surveyed the general public to gauge their opinions on some of the possible outcomes of the CFPB's proposed small-loan rule and the types of loans that might result from it. The survey found that 70 percent of American adults believe that payday loans should be more regulated. Similar results were reported in Pew's 2015 survey, available here: http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=5.

simple compliance process. (See Pew's comment letter on the CFPB draft rule for further discussion of this proposal.)

Consumers are also eager for this change. They overwhelmingly favor stronger regulation of the market, and surveys show that most borrowers who have turned to payday lenders want reforms that will result in smaller payments and lower prices. Further, borrowers indicate that they would use such credit instead of payday loans,[5] and the experiences of credit unions and other lenders offering lower-cost small installment loans is that borrowers see their credit scores increase, improving their trajectory to qualify for still lower-cost credit. (For specific guidelines on small-dollar loans, please see Pew's response to Question 8.) More affordable options with these elements could thrive under rules outlined in the longer-term 5 percent payment-to-income alternative section of the CFPB's 2015 proposal. For example, regulators could require less underwriting and documentation if the lender agrees to limit loan cost or durations and cap monthly payments at an affordable 5 percent of monthly income, or $125 for the average borrower who earns about $30,000 per year. Payments above that amount are unaffordable for most borrowers. These two crucial safeguards would lead to much lower-cost credit than loans that merely verify income and some expenses.[6]

A new charter would create substantial new risks without necessarily stimulating better consumer options

One notable risk of allowing consumer finance companies to obtain special purpose banking charters is that, to the extent that obtaining a charter from the OCC would enable a company to claim exemption from state usury and consumer protection requirements, it would place borrowers at serious risk of harm. While a special purpose charter could offer nonbank lenders an opportunity to expand and compete with costly payday and payday installment loans, it would likely raise risks for borrowers in states with strong usury rate caps and consumer protection laws. In the payday loan market, lenders have previously used the "rent-a-bank" model that allowed them to export the interest rates of a state with high or no interest rate limits via the National Bank Act in order to circumvent usury laws of states with lower rate caps and lend to those residents. Prudential regulators eventually issued guidance that ended this model, but high-cost lending in violation of state rate caps continues to be prevalent in the online market. Many unscrupulous lenders have been targets of judicial[7] and regulatory[8] actions because of the propensity for abusive practices via the ACH system, which is atypical of depository institutions that are subject to prudential regulatory oversight, have long-term relationships with their customers, and would like to offer lower-cost loans.[9] If lenders are treated as "national banks" under

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[5] The Pew Charitable Trusts, comment letter on CFPB's Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 7, 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-142716. See Section 3(d) for discussion and Appendix A for full survey results.

[6] The CFPB's pending payday and small-dollar loan rule focuses on requiring lenders to assess a loan applicant's income and certain expenses, but the lack of clear safeguards regarding payment size, loan duration, and other factors would leave borrowers vulnerable and consumers generally would be better off if regulations provided clear product safety guidelines and a simplified origination process that encouraged banks and credit unions to introduce safer, lower-cost small-credit options. See The Pew Charitable Trusts, comment letter on CFPB's Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 7, 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-142716.

[7] Nick Bourke, Fintech Law Report, *Online Lending and the Integrity of the Banking System: Behind the Heated Rhetoric Over "Operation Choke Point,"* Mar/Apr 2015, Volume 18, Issue 2, pp. 5-6, http://www.pewtrusts.org/~/media/assets/2015/05/fintech1802_aa_bourke_proofed.pdf?la=en#page=5.

[8] NACHA, "ACH Network Risk and Enforcement Topics," Aug. 26, 2014, https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics.

[9] The Pew Charitable Trusts, comment letter on CFPB's Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 7, 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-142716.

the special purpose charter, it is likely that high-cost lenders would once again attempt to use the charter to expand into states with lower rates and stronger consumer protections. Preempting usury limits can be harmful for consumers, because once a company can avoid a state's usury law, there is no countervailing protection scheme in place to replace it.

Further, to the extent that a new special purpose charter would allow lending, it would create significant risk of normalizing or even stimulating the expansion of harmful practices associated with payday and subprime lending. As research from Pew and elsewhere has shown, existing state payday and high-cost installment loan laws have failed to address these problems. Absent a comprehensive and well-vetted policy to contain these risks, the OCC should not proceed with any plan for a new charter that would allow lending.

3. What information should a special purpose national bank provide to the OCC to demonstrate its commitment to financial inclusion to individuals, businesses and communities? For instance, what new or alternative means (e.g., products, services) might a special purpose national bank establish in furtherance of its support for financial inclusion? How could an uninsured special purpose bank that uses innovative methods to develop or deliver financial products or services in a virtual or physical community demonstrate its commitment to financial inclusion?

Pew research demonstrates that innovations like mobile payments can potentially solve part of the financial inclusion puzzle in the U.S. Nearly 7 in 10 adults now own a smartphone in the U.S.; and 46 percent of the U.S. population has used a smartphone to make a mobile payment, meaning a financial transaction via a website, by sending a text message, or through an app. However, for the most financially vulnerable, structural obstacles exist to the adoption of some financial services innovations. A Pew survey shows that over half of unbanked consumers receive their income by check, money order, or cash; 74 percent of unbanked consumers cited the use of cash as a barrier to using mobile payments (the most cited reason among the unbanked).[10] Additionally, 18 percent of the unbanked reported canceling or suspending cellphone service in the last year.[11] This research strongly suggests that a key challenge to increasing financial inclusion through the use of mobile payments for the most vulnerable consumers is ensuring that service providers are able to adequately serve consumers who may have intermittent access to a mobile device (for example, by ensuring that consumers are able to make needed transactions offline as well as online). To the extent a newly chartered institution might attempt to improve financial inclusion for its customers, it is important for the OCC to consider the challenges noted above. Pew research shows that age is the most important demographic predictor of mobile payments use: As of late 2015, only 30 percent of the silent generation (70-87 years old) and only 56 percent of baby boomers (51-69 years old) owned a smartphone–a significant portion of this demographic is rendered unable to use mobile payments technology.[12]

[10] The Pew Charitable Trusts, "What do Consumers Without Bank Accounts Think About Mobile Payments?" (June 2016), http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/06/what-do-consumers-without-bank-accounts-think-about-mobile-payments. See Figure 15.
[11] Ibid.
[12] The Pew Charitable Trusts, "Who Uses Mobile Payments?" (May 2016), 4, http://www.pewtrusts.org/~/media/assets/2016/05/who_uses_mobile_payments.pdf#page=6.

4. Should the OCC seek a financial inclusion commitment from an uninsured special purpose national bank that would not engage in lending, and if so, how could such a bank demonstrate a commitment to financial inclusion?

Charter holders should not engage in fee-based overdraft. Punitive overdraft programs force consumers out of the traditional banking system and cause financial strain on consumers that cannot afford them. The OCC should ensure the harmful overdraft practices of the checking account market do not spread. Rather, funds held in accounts under any such charter should be subject to regulations substantially like the CFPB's prepaid account rules regarding overdraft and the provision of credit (including requirements to comply with the Truth in Lending Act [TILA]).[13] Overdraft fees contribute to customers losing their transaction accounts and leaving the banking system: Data show that 28 percent of overdrafters closed a checking account in response to overdraft fees.[14] A new charter should not exacerbate the problems created by overdraft fees; it is important to prevent overdraft penalty fees and other automated credit from taking hold. More than three-quarters of the people who paid an overdraft penalty fee express concern about specific overdraft policies, including the high cost of a penalty and the practices of charging "extended" overdraft fees—additional charges for failing to repay a negative balance on time—and of reordering withdrawals from highest to lowest dollar amount, which have the effect of increasing overdraft fees.[15] Results from Pew's 2014 survey of prepaid card users found that most unbanked cardholders use prepaid cards to avoid check-cashing and overdraft fees and debt.[16] Further, most prepaid card users generally would prefer to have a transaction declined than pay an overdraft fee.[17]

6. Should the OCC use its chartering authority as an opportunity to address the gaps in protections afforded individuals versus small business borrowers, and if so, how?

Online lending has become an increasingly attractive option for borrowers who cannot access traditional financing from depository institutions, as smaller and newer companies in particular have difficulty securing funds due to low credit scores or an insufficient number of years in operation.[18] Further, commercial banks–the main source of funding for small business credit–have significantly decreased lending post-recession, disproportionately impacting small businesses.[19]

The "marketplace" originally referred to peer-to-peer loans such as those offered by Lending Club and Prosper, but as providers have expanded their loan options, the definition has also expanded to include

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[13] Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z), 81 Fed. Reg. 83935 (Nov. 22, 2016).
[14] The Pew Charitable Trusts, "Overdrawn," (June 2014), 10, http://www.pewtrusts.org/~/media/assets/2014/06/26/safe_checking_overdraft_survey_report.pdf#page=13.
[15] Ibid.
[16] The Pew Charitable Trusts, *Banking on Prepaid* (June 2015), 6, http://www.pewtrusts.org/~/media/assets/2015/06/bankingonprepaidreport.pdf#page=9.
[17] Ibid, 6-7.
[18] Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, "Joint Small Business Credit Survey Report," Feb. 2015, 9, https://www.newyorkfed.org/medialibrary/media/smallbusiness/SBCS-2014-Report.pdf#page=9.
[19] Federal Financial Institutions Examination Council, "Reports - Findings from Analysis of Nationwide Summary Statistics for 2015 Community Reinvestment Act Data Fact Sheet," Aug. 2016, https://www.ffiec.gov/hmcrpr/cra_fs16.htm. See link to Table 1. Though small business lending has begun trending upward since 2014, data for 2015 show only about 6.1 million small business loans were originated or purchased for a total of $228 billion compared with a peak of 13.5 million loans in 2007 totaling $329 billion.

business loans, cash or capital advances, and lines of credit.[20] However, the online market–and small business lending specifically–remains fairly fragmented, which makes it difficult to estimate its volume and capture the breadth of available products. Rates for these products are typically higher than traditional financial products offered by depository institutions such as signature loans and small business loans, can either be higher or lower than rates for credit cards, and are far lower than those offered by conventional payday and installment lenders.

Pew has identified certain practices in the online payday loan market that could also become an issue for online small business borrowers. For example, sharing personal and financial information online can be risky for applicants, as lenders often partner with lead generation sites–which sell personal information to lenders in the network–to acquire new customers.[21] Online payday loan borrowers in Pew's survey experienced more fraud and abuse than their storefront counterparts: 30 percent reported being threatened by a lender or debt collector and 39 percent reported that their personal information was sold to a third party without their knowledge. Often borrowers did not know the name of their lender; were threatened with arrest; and they or their family members were harassed by a lender or debt collector.[22]

Small business borrowers are also generally not afforded the same protections as individual borrowers, who are covered by a network of state and federal laws and regulations. For example, marketplace lenders typically require small business loan applicants to personally guarantee the loans, meaning lenders can use personal credit scores, reports, and assets. This may be in addition to a lien on business assets.[23] As a result, these loans can function like a consumer loan if borrowers are personally liable. The OCC should take note of small business lending practices that could place the borrower and the business in undue jeopardy.

Pew's research on credit cards found similar problems regarding the demarcation between consumer and business credit cards. While harmful practices were outlawed for consumer credit cards with the passage of the Credit CARD Act, it did not cover business credit cards. Subsequently, an analysis of disclosures and direct mail data revealed more than 10 million offers each month for business credit cards that included potentially harmful practices, such as requiring personal liability for all charges. Pew called for the extension of consumer protections on business credit cards whenever an individual may be held personally liable.[24] In the context of small business loans, the OCC should consider requiring consumer protections to apply whenever an individual may be held personally liable for the loan.

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[20] Providers include merchant cash advance (MCA) companies, lending platforms (peer-to-peer lenders), direct lenders, and payment processors.

[21] The Pew Charitable Trusts, *Fraud and Abuse Online: Harmful Practices in Internet Payday Lending* (October 2014), 5, http://www.pewtrusts.org/~/media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf#page=9.

[22] Ibid, 10.

[23] OnDeck, "Frequently Asked Questions," accessed Dec. 19, 2016, https://www.ondeck.com/faqs/. OnDeck loans are secured by a lien on business assets and a personal guarantee, but they do not take personal assets; Funding Circle, "Frequently Asked Questions," accessed Dec. 15, 2016, https://www.fundingcircle.com/us/support/?&mkwid=sqUmX9C7Q_dc&pcrid=67713505977&pkw=funding%20circle&pmt=e. Funding Circle requires a lien on business assets and personal guarantees from the primary business owners, and many personal items can be used as collateral, including home equity and vehicles.

[24] The Pew Charitable Trusts, "U.S. Households At Risk From Business Credit Cards" (May 2011), 6, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/phg/content_level_pages/reports/pewbusinesscreditcardsreportpdf.pdf#page=7.

8. What actions should the OCC take to ensure special purpose national banks operate in a safe and sound manner and in the public interest?

As discussed elsewhere in this letter, any credit provided by an institution in association with the new charter should be covered by TILA; however, further safeguards are also needed including a comprehensive policy to prevent the replication of problems currently found in state-licensed payday and high-cost installment loan markets, and a prohibition of fee-based overdraft.

Additionally, any funds held by a nonbank that holds a special purpose charter should be protected by deposit insurance. Deposit insurance is a major consumer protection for bank customers. Outside of the banking system, some stored funds may not qualify as deposits, and would not be protected in the event of an institutional failure.

To the extent a charter holder would seek to provide alternative subprime small-loan products, it is the OCC's responsibility to ensure that such loans would be subject to comprehensive rules not just about pricing, but also about other factors that matter to the borrower's success: affordable payments, reasonable time to repay, and protections from hidden or upfront fees. This is because such loans are strongly associated with problems throughout the country that no other set of state or federal policies have effectively addressed. Even a new proposed federal rule by the CFPB for small-dollar loans would not signify that all small-dollar loans are safe, as high prices, large payments, and front-loaded fees will persist.[25]

Rather than creating a new type of charter, it may be easier and more effective for the OCC to encourage lower-cost innovation in the small-loan market by providing affirmative guidelines to traditional banks. With respect to high-cost credit, Pew has made recommendations that the OCC may also wish to consider when regulating traditional banks interested in offering small-dollar loans:

- Limit payments to an affordable percentage of a borrower's periodic income, such as 5 percent
- Spread costs evenly over the life of the loan
- Guard against harmful repayment or collection practices
- Require concise disclosures that reflect both periodic and total costs
- Set maximum allowable charges on loans for those with poor credit

More specifically, the OCC should enact new guidelines allowing existing nationally chartered banks to make loans or lines of credit based on the 5 percent payment-to-income alternative under consideration by the CFPB, with certain modifications. This would establish a clear regulatory road map for producing better small-credit options profitably and at a fair price, within the existing robust system of prudential bank regulation. This alternative, which the CFPB outlined in 2015 and requested comments about in its

[25] See footnote 6, above, for discussion of the CFPB proposal. In Pew's analysis, high-cost covered loans will thrive in at least 27 states under the CFPB proposal because it allows high-cost installment lending with few consumer protection guidelines. Payday and auto title lenders are already issuing high-cost installment loans or lines of credit in 27 of the 40 states where they operate today.[25] In these states, lenders will continue making loans that have no federal restrictions on cost, payment size, or the length of time they can access a bank account or car title as long as they document a borrower's income, credit report obligations, and estimate similar people's expenses.

2016 proposed rule,[26] would provide for small installment loans or lines of credit with monthly payments up to 5 percent of the borrower's monthly income, and repayment terms between 46 days and six months (or possibly longer terms with cost limits). Available evidence suggests that a 5 percent payment-to-income ratio is suitable from the borrower's and the lender's perspectives, but these are new products and experience may suggest that a different percentage is appropriate over time.[27] In this way, the OCC can boost lower-cost innovation in the small-loan market without undermining state-level consumer protections that could be threatened by a nonbank charter.

We thank the OCC for the opportunity to comment on the exploration for special purpose national bank charters for fintech companies and we look forward to continuing the discussion.

Sincerely,

Nick Bourke

[26] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 FR 48039, July 22, 2016.

[27] For more detailed information on Pew's policy recommendations for small-dollar loans, see The Pew Charitable Trusts comment letter on the CFPB's Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 7, 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-142716. See also, *Payday Lending in America: Policy Solutions* (October 2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.