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RE: Proposed Interagency Guidance on Third-Party Relationships: Risk Management
Federal Reserve Board Docket No. OP-1752

Federal Deposit Insurance Corporation RIN 3064-ZA26

Department of the Treasury, Office of the Comptroller of the Currency Docket OCC-2021-0011

On behalf of Pew's consumer finance team, I am pleased to provide comments on the proposed guidance noted above. Pew is a global, non-governmental research and public policy organization dedicated to serving the public. Consumer finance—and in particular, the small-dollar credit market—is an area in which Pew has dedicated significant research and analysis resources for more than a decade.

A small number of third-party, small-dollar lenders are misusing bank partnerships in ways that pose harm to consumers, put bank reputations at risk, and generally threaten the integrity of federal and state regulatory systems. The agencies should work urgently and decisively to stop this risk—which now exists primarily through a handful of FDIC-supervised bank partnerships—from spreading. Not all small-dollar lending programs are risky; indeed, bank small-dollar loan programs can provide substantial net benefits to consumers and the banking system overall, if they are structured with affordable installment payments, pricing that is sustainable for both the bank and its customers, and other reasonable safeguards.[1] In many cases, third parties provide essential services that let banks lend to their deposit account holders quickly and at low cost.[2] Therefore, the agencies will need to draw and enforce guidelines that stop harmful partnerships without discouraging beneficial ones.

In our view, based on Pew's extensive research, it is critical to stop harmful small-dollar credit partnerships immediately, before they take root in our banking system, and to do so in a way that fosters more beneficial partnerships between banks and non-banks. This letter focuses on this need and offers suggestions for how the agencies could address third-party, small-dollar credit partnerships in the proposed guidance.

(Continued on next page.)

[1] The Pew Charitable Trusts, "Standards Needed for Safe Small Installment Loans from Banks, Credit Unions" (2018), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions.
[2] The Pew Charitable Trusts, "RIN 3064-ZA04 (FDIC Request for Information on Small-Dollar Lending)" (2019), 12, https://www.pewtrusts.org/en/research-and-analysis/speeches-and-testimony/2019/01/18/pew-provides-input-to-fdic-on-promoting-affordable-small-loans.

Background: Most banks are underperforming in the small-dollar installment loan space, while a handful of non-banks fill the gap by misusing partnerships with small banks

In recent years, thanks to clear joint guidance from regulators, a number of larger banks have launched well-designed small-dollar credit products that meet the needs of their customers directly.[3] Some large banks have started investing in product development and systems innovation to make such small installment loans or lines of credit available to their customers. However, the majority of banks are not yet offering their customers small-dollar installment loans and lines of credit even though they are well-positioned to do so. If even a few more of the country's largest banks began making reasonable small installment loan alternatives available to their deposit account customers who currently rely on payday loans or frequent overdrafts, financially fragile consumers would save billions of dollars per year.[4]

Some smaller banks have also expanded their small installment loan offerings; but for smaller banks, the cost of developing systems to originate and service small installment loans is usually prohibitive and this necessitates partnering with third-party service providers. In many cases, these third-party relationships are comprehensively managed and produce clear benefits for banks and their customers. Potentially beneficial partnerships between banks and non-banks occur when a non-bank service provider joins with a bank to help the bank serve its own customers without exposing the bank or its customers to unacceptable or unmanageable third-party risk. Often, the non-bank partner provides technological platforms that increase the speed and reduce the cost of underwriting, originating, or servicing loans to the bank's checking account customers. While the loans may in some cases carry rates that exceed what a non-bank lender could charge under the laws of the state where the customer resides, the principles of preemption apply because the bank is serving its own customers across state lines, holding the risk of loss, considering and managing all potential risk from third parties involved in the lending transactions, and generally operating within the established and well-contained framework of federal regulation and supervision.

But in other cases, absent clear guidance and effective supervision by federal regulators, third parties act in potentially disreputable or illegal ways and use bank partnerships to make small-dollar loans to consumers who have no relationship with the bank other than the loan itself.[5] These third parties rely on bank partnerships as a shield from state consumer protection laws or state regulatory oversight.[6] As demonstrated below, this can also occur in cases where the third parties hold related state licenses such as payday loan or check-cashing licenses, and lenders usually charge fee-inclusive rates above 100% or create elaborate business structures, sometimes involving high add-on fees via additional third-party relationships that may or may not be known to the partner bank. These arrangements have the potential to create risk that their bank partners may be unable to assess or manage, while at the same

[3] The Pew Charitable Trusts, "Bank Regulators' Guidance A Move in the Right Direction, but Carries Risks" (2020), https://www.pewtrusts.org/en/about/news-room/press-releases-and-statements/2020/05/20/pew-bank-regulators-guidance-a-move-in-the-right-direction-but-carries-risks.

[4] Underbanked consumers spend several hundred billion dollars each decade on fees and interest on products like payday, auto title, rent-to-own, pawn, and other subprime loans. For example, see: Center for Financial Services Innovation, "Financially Underserved Market Size Study" (2019), https://finhealthnetwork.org/research/2019-financially-underserved-market-size-study/.

[5] This is not to say that rent-a-bank customers are unbanked. The FDIC has found only about 5.4% of American households are unbanked, and every payday loan customer has a checking account because that is a precondition of getting the loan. Instead, rent-a-bank partnerships often target customers who have checking accounts at other banks.

[6] For example, see "AG Racine Sues Online Lender for Making Predatory and Deceptive Loans to 4,000+ District Consumers" (2021), https://oag.dc.gov/release/ag-racine-sues-online-lender-making-predatory-and.

time removing customers from the protection of otherwise applicable state consumer protection laws.[7] Such partnerships are commonly referred to as "rent-a-bank" arrangements.

In short, third-party small-dollar credit arrangements can put customers, the bank, and the banking system at risk, warranting heightened scrutiny for rent-a-bank concerns, while true partnerships between banks and non-banks can help improve service to the bank's own customers at fair rates and terms that are subject to federal oversight.[8]

"Rent-a-bank" snapshot

A "rent-a-bank" arrangement occurs when a bank partners with a non-bank lender to target customers who have little or no other relationship with the bank. The bank typically does not hold the loans on its books or carry the risk associated with the loans, though in some cases the bank may act as lender but outsource origination and servicing in ways that expose customers to various interactions with (and charges from) third-party companies that may or may not be under contract with or even known by the bank.

The non-bank typically arranges loans at an annual percentage rate (or total cost inclusive of fees) that is substantially higher than the bank otherwise charges to its customers or what the law of the borrower's state of residence allows. These arrangements are fairly characterized as a way for a non-bank to form contracts that give it the benefits of national bank preemption even when all of the businesses or customers involved in the loan transaction are not subject to the same policies or oversight as the bank's own activities and customers, which is why the arrangements are known as "rent-a-bank" or "rent-a-charter" arrangements.[9]

[7] For purposes of this comment letter, we presume that some bank partnerships will confer federal preemption of state laws to third-party lending arrangements and some will not. Further, we note that the validity of preemption claims turns on facts and though there is some gray area in the legal interpretations, a recent federal law change made it harder for companies to succeed in these claims. See, e.g., https://www.davispolk.com/insights/client-update/occs-true-lender-rule-has-been-repealed. Regardless of whether preemption principles apply to any given third-party arrangement, we ask the agencies to take note of the critical risk that could develop if third parties are enabled to claim exemption from state-level oversight because of a bank partnership while simultaneously engaging in activities and additional third-party relationships that may be outside the view or control of banks and federal regulators. Examples of this behavior, such as blending state-licensed check cashing activities with bank-enabled lending activities, are noted in the following sections of this letter. Accordingly, regulators may wish to require banks and their non-bank partners that rely on preemption claims to justify their positions and show how they have managed the relevant litigation and other risks that may be associated.

[8] Indeed, leveraging technology and expertise from non-bank service providers who can improve the speed and cost of small-dollar lending may be the key to ensuring access to safe and affordable small installment loans within the banking system. For example, Pew recently encouraged the CDFI Fund to concentrate its efforts on supporting these types of partnerships when they are focused on serving the bank's own customers. See: https://www.pewtrusts.org/en/research-and-analysis/speeches-and-testimony/2020/09/10/pew-encourages-efficiency-in-treasury-departments-small-dollar-loan-program-investments.

[9] As explained below, a number of businesses may be involved in a loan program, including businesses that charge fees for distributing loan proceeds / cashing loan proceeds checks and businesses that charge fees for arranging electronic loan repayment. These businesses may or may not be contracted with—or known by—the bank that serves as the lender of record. This can put customers at great risk and associated charges can be extreme, for example a 10% surcharge on loan disbursements and/or loan repayments.

Though rent-a-bank partnerships remain uncommon, they have grown in recent years and may, if unchecked, expand rapidly. According to National Consumer Law Center (NCLC), at least five banks currently engage in third-party relationships that appear to raise rent-a-bank concerns.[10] Each identified bank is regulated by the FDIC. A summary of these relationships is provided in Appendix A.

Despite the small number of banks engaging in this practice, rent-a-bank arrangements have expanded into more than a dozen states, including states where payday or other high-rate loans are otherwise prohibited.[11]

Further, rent-a-bank arrangements are being used to allow banks and their partners to charge more than what state-licensed payday lenders charge: Pew is aware of at least seven states where unlicensed payday lenders use bank partnerships to charge *more than state-licensed payday lenders charge in those states*. These states are: Colorado, Maine, New Mexico, Ohio, Oregon, Virginia, and Washington.

For example, a non-bank company is currently offering bank-enabled small-dollar loans in several states including Ohio, where it charges more than a comparable loan from a state-licensed payday lender. The non-bank states that it partners with "FDIC-insured, state chartered banks."[12] As of October 9, 2021, a $1,000, 9-month loan from this company that is originated by one of these banks carried charges resulting in 160% APR, while the same loan from the country's largest payday lender, which operates under an Ohio non-bank lender license pursuant to the state's payday loan law as revised in 2018, has an APR of 88%.[13] The bank-enabled loan in this example has an APR that is 72 percentage points higher than the equivalent loan from the state-licensed payday lender and costs nearly double in dollar terms. This example is consistent with others shown in NCLC's rent-a-bank watchlist (see Appendix A).

In general, rent-a-bank partnerships entail consumer credit arrangements that have costs, repayment terms, or other characteristics that would violate otherwise applicable state laws. Though high costs or rates are often a concern, other concerns apply as well including otherwise appliable state licensing rules or laws governing consumer protection or business practices.[14] Third parties that contract with the bank may resist any effort of state regulators to examine their role in the lending activity—even where state law may reasonably be interpreted to require the nonbank entity to obtain a license for brokering, arranging, or servicing loans or where state law prohibits blending consumer credit activities with the entity's core state-licensed business (e.g. check cashing).

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[10] National Consumer Law Center, "High-Cost Rent-a-Bank Loan Watch List" (2020), https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html, accessed on October 9, 2021.

[11] National Consumer Law Center, "Consumer Rent-a-Bank Watch List – Public.xlsx," 2021, https://docs.google.com/spreadsheets/d/1XJxKzS6e9hgkRFYAr3idNkLVUcHZmuAm/edit#gid=1917677263, accessed on October 9, 2021.

[12] The company lists the following bank partners on its website: FinWise Bank, First Electronic Bank, and Capital Community Bank (CCBank). https://www.opploans.com/bank-servicing/ (accessed October 9, 2021). All are Utah-chartered banks supervised by the FDIC.

[13] See: https://www.opploans.com/rates-and-terms/ohio/; https://www.advanceamerica.net/store-locations/ohio#rates. (Each site accessed October 9, 2021.)

[14] Conference of State Bank Supervisors, "Statement for the Record: "Rent-a-Bank Schemes and New Debt Traps"' (2020), https://www.csbs.org/policy/statements-comments/statement-record-rent-bank-schemes-and-new-debt-traps

Two additional examples of small-dollar credit arrangements from bank-nonbank partnerships on the market in 2021 follow, based on a review of consumer complaints, borrower loan agreements, and various publicly available advertisements and disclosures.[15]

Example 1: **NONBANK-1**, a state-licensed check cashing store, advertises and arranges loans, stating that "the lender of [the loans] is" **BANK-1**, located in another state, "Member FDIC."

- Terms of loans are not publicly disclosed but customer loan agreements describe a "line of credit agreement" for loans up to $1,000 with an annual percentage rate for cash advances of 35.99% and a monthly participation fee of $4.99.
- The customer agreement states that "[f]ees may be charged by third-parties to access loan proceeds" and describes both charges for accessing loan proceeds (up to 10% or more) and charges for making required loan payments (up to 10% or more).
- An addendum to the customer loan agreement identifies **NONBANK-2** terms and conditions leading the customer to "agree" to enroll in services and be subject to certain fees. The addendum states: "By way of example, if the payment due is $100, the fee is $10.00 and your debit card will be charged a total of $110.00. If you request $300 to be funded in real time directly to your bank or debit card, you will be charged a $30.00 fee and $270.00, which represents the net proceeds after the 10% fee is deducted for the cost of the Service, will be deposited into your bank account or debit card…. You will be charged a fee each time you use the Service." The addendum to the customer loan agreement is signed **BANK-2** "by and through its agent, **NONBANK-3**, dba **NONBANK-2**."
- It is not clear if **NONBANK-2** or **NONBANK-3** has any contractual relationship with **BANK-1** or whether **BANK-1** and **BANK-2** have agreements between themselves.
- Though offered as a "line of credit," the loan agreement stipulates that any amount borrowed is due in full within one month. The payment due includes all advanced amounts plus all applicable fees and charges. The customer loan agreement includes an incentive for repeat borrowing. Customers have reported that agents in the store have encouraged them to reborrow if they could not afford the required payment in a single lump sum.
    - The loan agreement discloses an APR of 35.99%, apparently calculated according to disclosure requirements for open-end credit. However, if the cash advance and the shown transaction charges were calculated as part of a one-month, closed-end credit transaction—which is arguably more appropriate given the required repayment terms—then the effective APR on a $500 advance under these terms repaid in one month would be approximately 48% APR (minimum) to 288% APR or more (maximum).[16]

[15] Example customer loan agreement and related materials on file with author.

[16] Under relevant law including federal Regulation Z (12 C.F.R. Part 1026), the calculation of the finance charge on loans that are not open-end credit includes service and transaction fees. For example, the "finance charge" includes any "charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." 12 C.F.R. 1026.4(a). Examples of charges included in the finance charge in federal regulation include "[s]ervice, transaction, activity, and carrying charges" and "(p)oints, loan fees, assumption fees, finder's fees, and similar charges." 12 C.F.R. 1026.4(b). An exception applies for certain "[f]ees charged for participation in a credit plan," but the exception does "does not apply to fees imposed separately on individual closed-end transactions" or on certain prepaid debit card transactions. 12 C.F.R. 1026.4(c)(4) and Official interpretation of Paragraph 4(c)(4), https://www.consumerfinance.gov/rules-

    - Minimum APR calculation includes charges of $19.99 (approximately $15 in interest at 35.99% annual rate and $4.99 monthly service fee).[17]
    - Maximum APR calculation assumes additional fees of $100 or more (allowable $50 charge for accessing loan proceeds / cashing loan check plus allowable charge of $50 or more for making the loan payment).[18]
    - The repayment after one month would be approximately $520 (minimum) to $620 or more (maximum). For a borrower making $15 an hour and working full time (earning about $2,500 per month), this payment would consume approximately 20% (minimum) to 24% (maximum) of their monthly pre-tax income.
    - These costs exceed otherwise applicable limits in the loan customer's state, including limits which state-licensed payday lenders abide by. The repayment terms and other aspects of the loan arrangements do not comply with otherwise applicable laws in the state.
- The loan agreement allows the lender to use remotely created checks or other means to debit borrower checking accounts.
- It is possible, but not clear, that NONBANK-1 is violating the terms of its state check-cashing license by offering this type of credit at its licensed store locations.

<u>Example 2</u>: **NONBANK-1**, a state-licensed check cashing store, offers vehicle title loans at its stores in partnership with out-of-state lender **NONBANK-2** and **BANK-1**.

- On its website, **NONBANK-2** explains it "can often help [financial services businesses] by providing a new product to expand their business" and that "partners offering title loans [can] earn commission on funded loans…."
- **NONBANK-1** solicits loan customers at its stores and directs them to the **NONBANK-2** website, which redirects customers to a second website, branded **NONBANK-2a**, which states: "The **NONBANK-2a** loan is made by **BANK-1**, a Utah charted [sic] bank… Member FDIC. All loans will be serviced by **NONBANK-2**."
- The NONBANK-2 website further states: "Loans in Arkansas, California, Delaware, District of Columbia, Florida, Indiana, Kansas, Kentucky, Maine, Michigan, Minnesota, Mississippi, Montana, Nebraska, Oklahoma, Ohio, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Virginia, Washington, and Wisconsin are made by **BANK-1**, member FDIC. **NONBANK-2** is a service agent for **BANK-1.**"

Among other things, these examples demonstrate that small-dollar credit arrangements can introduce critical third-party risk, including through the actions of parties that may not be in a direct contractual relationship with or even known by the partner bank—such as the nonbank entity charging fees to process loan disbursements or payments. Presumably, the partners in these arrangements would claim

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policy/regulations/1026/interp-4/#4-c-3-Interp-1. Regulation Z treats any credit that does not meet the definition of open-end credit as closed-end credit. 12 C.F.R. 1026.2(a)(10).

[17] The Excel formula for calculating this APR is: =RATE(1,-519.99,500)*12

[18] The Excel formula for calculating this APR is: =RATE(1,-619.99,500)*12

that the terms of the loans themselves are not subject to state regulation based on federal preemption analysis. This would be a debatable claim that is likely subject to litigation risk.[19] Yet despite the outcome of that debate, it is apparent that either the contracting third-party and/or non-contracting third parties may be engaging in activity that violates the terms of their state licenses or other applicable state laws, such as prohibitions on engaging in certain lending activity within licensed check-cashing stores—or could be found to be in violation unless the arrangements were carefully designed and monitored for compliance. All of this shows how third-party lending arrangements can create critical risk of customer harm, reputational risk to the bank, and risk to the integrity of federal and state regulatory regimes. These potential harms will go undetected or unmanaged if banks and their federal regulators do not address them decisively.

<u>Recommendations: The agencies should specifically address small-dollar credit arrangements</u>

Our high-level recommendations are that the agencies should:

1. Act decisively to stop harmful small-dollar credit partnerships immediately, before they take root in our banking system, and to do so in a way that fosters more beneficial partnerships between banks and non-banks.

2. Add more specific guidance addressing rent-a-bank and other third-party risk concerns related to small-dollar credit arrangements with non-bank partners. In their guidance, the agencies should focus on, and where warranted establish prohibitions or substantially heightened levels of risk management requirements and scrutiny about, small-dollar credit programs. This is especially true for any program with characteristics indicative of abuse of the bank charter or the banking system, such as:

    a. The bank is not lending to its own customers or it is lending to customers who have no relationship with the bank other than the third-party credit arrangement.
    b. The bank has no long-term role or stake in the customer relationships, such as when the bank is indemnified by non-bank partners or otherwise disposes of all or most of the risk.
    c. The non-bank partner or its affiliates are payday or vehicle title loan lenders.
    d. The credit products feature terms that mimic payday loans, such as effective APRs (inclusive of any potential transaction surcharges) of 100% or more, balloon-payment features, or repayment terms of less than 45 days.

3. Confirm the agencies' support for banks to expand their offerings of safe small-dollar installment loan programs to their deposit account customers, directly or in conjunction with third-party service providers, as reflected in the agencies' joint guidance from May 2020.[20] The

[19] See note 7.
[20] The FDIC, Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA), "Interagency Guidance for Responsible Small-Dollar Loans (May 2020), https://www.fdic.gov/news/financial-institution-letters/2020/fil20058.html. Pew provided comment on the guidance at https://www.pewtrusts.org/en/about/news-room/press-releases-and-statements/2020/05/20/pew-bank-regulators-guidance-a-move-in-the-right-direction-but-carries-risks.

agencies should refine this guidance to strongly discourage balloon payments and repayment terms shorter than 45 days while encouraging adoption of simple, fast, low-cost automated underwriting technologies similar to those described in the OCC's 2018 bulletin.[21]

Responses to specific questions posed by the agencies follow. Again, our comments focus on third-party, small-dollar credit arrangements.

1. to what extent does the guidance provide sufficient utility…? In what areas should the level of detail be increased or decreased…?

a. We recommend including specific guidance and examples about small-dollar credit arrangements. It should encourage banks to provide safe small installment loans to their deposit account customers while adding numerous examples and guidance designed to avoid rent-a-bank problems as further explained below.

2. What other aspects of third-party relationships, if any, should the guidance consider?

a. The guidance should encourage or require banks to obtain certification from third parties of their compliance with any and all relevant laws and regulations of the states in which they operate.
    - This may include requiring that the bank and its partners document their findings about preemption of state lending laws.
    - Further, even in cases where federal preemption principles may apply to the terms of the loans themselves, third parties should be required to certify compliance with (or document how they are exempted from) other laws that could be relevant to the business of the partnership. This is particularly true for third parties that hold licenses as check cashers or that engage in loan brokering, because state laws often govern how licensees or other persons may blend these types of businesses with the business of making or arranging consumer credit.

b. Banks should be required to review and approve the entirety of the fees and charges that may apply to a loan customer in the course of applying for, receiving, or repaying credit, including any fees and charges from third parties that are not in direct contractual relationship with the bank.

3. In what ways, if any, could the proposed description of third-party relationships be clearer?

a. The proposed guidance defines a third-party relationship as "any business arrangement… by contract or otherwise." We recommend adding explicit examples and guidance about third parties that are not under contract with the bank but may charge loan customers fees or charges on distribution of loan proceeds or making of loan payments (see Examples 1 and 2 in the previous section of this letter).

[21] OCC Bulletin 2018-14, "Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending," issued on May 23, 2018 (rescinded upon issuance of the 2020 joint statement). Pew's recommendations are further elaborated in our comment on the 2020 joint statement (see note) and in "Standards Needed for Safe Small Installment Loan Programs From Banks, Credit Unions" (2018), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions.

- At a minimum, the agencies should define any such entity as a "third party" for purposes of this guidance.
- Ideally, we recommend that the agencies act to prohibit or strongly discourage this practice altogether (the agencies should prohibit or strongly discourage any small-dollar lending arrangement in which any third party not under contract with the bank may impose fees or charges in connection with the loans, including fees for cashing loan proceeds checks, electronically receiving loan proceeds, or making loan payments). The bank could ensure this by requiring any third party it contracts with to abide by these restrictions.

6. How could the proposed guidance better help a banking organization appropriately scale its third-party risk management practices?

a. The agencies have noted that the proposed guidance "is intended to provide principles that are useful for a banking organization of any size…." Because rent-a-bank concerns are thus far concentrated at small banks, and because small banks may lack the resources to fully assess and control the complex risks associated with third-party small-dollar credit arrangements, the agencies should consider developing guidance for small-dollar credit arrangements that is clearer or more specific than other forms of guidance.
    - For example, the agencies could develop specific examples of prohibited or highly discouraged activities, such as making small-dollar loans to customers that do not hold a deposit account with the bank before taking the loan or in connection with any company that holds any state license to conduct payday or vehicle title lending, or making small-dollar loans with rates that exceed 100% or where customers pay more in fees than they received in credit.
    - Or the agencies could develop a checklist of specific risks to consumers and reputation that it expects senior bank officials (including potentially board members at smaller banks) to review and monitor on an ongoing basis.
    - *See also Question 9*.

7. In what ways, if any, could the proposed guidance be revised to better address challenges a banking organization may face in negotiating some third-party contracts?

a. As suggested under question #3 above, the agencies should require or strongly encourage banks to include provisions in contracts with third-party, small-dollar credit partners to control for rent-a-bank concerns and other risks outlined in this letter.
b. The agencies may wish to consider developing a list of standard or favored contractual terms that protect consumers and avoid reputational or other risks including terms that would avoid rent-a-bank concerns. Such a list may prove especially useful for small banks and examiners of small banks, with respect to managing the complex risks associated with third-party small-dollar credit arrangements. This list might include provisions to:
    - Require the third party to keep written records sufficient to ensure compliance with the contract and applicable laws
    - Require the third party to submit to auditing or review by the bank and its federal regulator(s)

- Prohibit the third-party from charging or accepting any fees in connection with a loan from any person other than the partner bank, and from facilitating any other third party from doing so
- Prohibit the third-party from engaging in any services other than those specific services related to originating, underwriting, or servicing the loan on behalf of the bank.[22]

8. In what ways could the proposed description of critical activities be clarified or improved?

a. The agencies should define third-party, small-dollar credit arrangements as critical activities or designate them as activities that will be presumed to be critical unless circumstances clearly warrant otherwise. This should establish a presumption for heightened risk management and supervision requirements and result in elimination of rent-a-bank concerns.

9. What additional information, if any, could the proposed guidance provide for banking organizations to consider when managing risks related to different types of business arrangements with third parties?

a. We recommend that the agencies explicitly prohibit, strongly discourage, or establish heightened expectations of risk management and supervisory review (such as deeming the activity a “critical activity”) for any small-dollar credit program where:
   - The bank is not lending to its own customers
   - The bank is lending to customers who have no pre-existing / no other relationship with the bank
   - The bank does not maintain an ongoing relationship with the customer (e.g. sells the loans/risk) or is indemnified by a third party
   - The partner is a payday or vehicle title lender (e.g. maintains state licenses *in any state* for making such loans directly to consumers)
   - Loans will be originated or serviced, or third parties will have the opportunity to act with a customer, anywhere other than at the bank’s branches or electronic properties under control of the bank
   - Loans are due in less than 45 to 90 days or in fewer than three or four installments
   - Loans or lines of credit may include (directly or indirectly from other third parties) any fees or charges that would not be reflected in the APR
   - Usage demonstrates customer complaints or legal or regulatory enforcement actions directed against a third party involved in the partnership.

b. The agencies should give examples of beneficial or encouraged small-dollar credit programs that would be presumed to pose minimal third-party risk. These examples should include the following prerequisites:
   - The bank is lending to its own deposit account customers
   - Loans meet standards for safety and affordability, such as being repayable in at least three or four installments and in no less than 45 to 90 days or more.[23]

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[22] For relevant examples from state law, see Va. Code Ann. § 6.2-1523.1(A)(4) through (6), https://law.lis.virginia.gov/vacode/title6.2/chapter15/section6.2-1523.1/.

[23] See: The Pew Charitable Trusts, “Standards Needed for Safe Small Installment Loans from Banks, Credit Unions” (2018), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions; Bank Policy Institute, “Banks Receive ‘Go-Ahead’ to Meet

- Loan customers interact only with the bank through all stages of origination and loan servicing (e.g. the bank's branch, website, telephone, or other electronic servicing channels).
- The non-bank partner is providing services for the bank related to originating or servicing loans in a manner that is generally invisible to the loan customer.
- The non-bank partner is acting under a contract with the bank that prohibits the third party from charging additional fees or facilitating any other entity to interact with customers or charge fees in connection with the loan.

c. We caution the agencies against establishing unnecessarily restrictive guidelines related to the following:
   - APR. As Former FDIC Chair Sheila Bair has explained[24] about the agency's prior small-dollar loan pilot project, attempting to limit bank small-dollar loan programs to a fixed APR cap that prevents even efficient banks from covering their costs for smaller loans may do more harm than good. Banks that price transparently will often find it too difficult to sustain such programs and will thus avoid servicing customers in this market, while other lenders will act to circumvent APR caps by adding fees that are not included in the calculation of the APR.[25] Instead, the agencies should focus on ensuring that the APR and all costs are completely and transparently disclosed, while tolerating a variety of reasonable pricing on small-dollar loan programs. Pew recommends tolerating double-digit APRs that scale down for larger amounts within a safe and well-regulated bank small-dollar installment loan program (triple-digit APRs are never justified on such programs and the agencies could justifiably prohibit or discourage them).[26] Other than a modest monthly account maintenance fee, the agencies should strongly discourage the addition of any fees and in particular those that would not be reflected in the APR calculation.
   - Cooling off periods or usage limits. While limited research shows that capping the number of allowable loans or establishing cooling-off periods between loans can reduce usage of harmful short-term payday loans,[27] there is no research-based justification for such caps in the context of safe and transparent installment loans or lines of credit. Further, some research indicates that enforcing cooling-off periods or frequency limits can discourage consumers from repaying installment loans or lines of credit early when

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Consumer Small-Dollar Lending Needs"(2020), https://bpi.com/banks-receive-go-ahead-to-meet-consumer-small-dollar-lending-needs/; Consumer Financial Protection Bureau, "No Action Letter Template" (2020), https://www.consumerfinance.gov/documents/8851/cfpb_bpi_no-action-letter.pdf.

[24] Sheila Bair, "FDIC Comment Letter RIN 3064-ZA04" (January, 2019), https://www.fdic.gov/regulations/laws/federal/2018/2018-small-dollar-lending-3064-za04-c-049.pdf.

[25] Ibid. See also, Bank Policy Institute, "What is the Break-Even Cost of Small-Dollar Loans" (2021), https://bpi.com/what-is-the-break-even-cost-of-small-dollar-loans/.

[26] See also note 23.

[27] See, Consumer Financial Protection Bureau, "Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products" (June, 2016), Chapter 4, https://files.consumerfinance.gov/f/documents/Payday_Loans_Highlights_From_CFPB_Research.pdf.

they are able to do so—perhaps out of fear of being cut off from accessing credit in the future if they want or need it.[28]

10. What revisions to the proposed guidance, if any, would better assist banking organizations in assessing third-party risk as technologies evolve?

a. The agencies will be successful if they foster automation technology while maintaining a high degree of scrutiny on the quality and substance of small-dollar credit programs. Automation is essential to the success of any bank small-dollar installment loan alternative to payday and similar loans, because banks must drive operating costs down low enough to sustain the programs even while charging a fair price to borrowers.[29] In most cases, banks will turn to non-bank partners for technology and innovative business practices to help streamline, automate, expedite, and generally reduce the cost of originating and servicing small-dollar loans to the bank's customers. This type of technology is a necessary component of any safe, affordable, and sustainable small-dollar credit program, and for this reason the agencies should promote such partnerships whenever they are associated with safe and sound lending. But innovative technology alone is not sufficient to ensure safety and soundness, and for this reason the agencies must scrutinize the nature of partnerships, loan terms, customer experience, and origination and servicing arrangements closely as discussed elsewhere in this letter.

11. What additional information, if any, could the proposed guidance provide to banking organizations in managing the risk associated with third-party platforms that directly engage with end customers?

a. The agencies have highlighted the general risks that can occur with respect to uncontracted third parties; any additions to the guidance that specifically directs banks and their supervisors to consider how customers may be affected by the actions of uncontracted third parties in the course of a small-dollar credit arrangement would be welcome. Banks should be required to assess and eliminate or tightly control these risks. In particular, the bank should consider ways in which small-dollar credit customers could be exposed to charges, solicitations, or potential fraudulent activity wherever the entirety of the customer's experience is not conducted at the bank's own branch or electronic channel. An example of a potentially intolerable risk, as described in the "Rent-a-bank snapshot" section above, is where a bank partners with a third party that helps originate or service loans at its check-cashing stores while other entities (possibly not in contractual relationship with the bank) obtain the right to charge customers transaction fees in connection with the loans as high as 10% or more for disbursing loan proceeds and/or processing loan payments.

16. What other factors should a banking organization consider in determining the types of subcontracting it is comfortable accepting in a third-party relationship? What additional factors are relevant when the relationship involves a critical activity?

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[28] The Pew Charitable Trusts, "Payday Lending in America: Policy Solutions" (October 2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.

[29] The Pew Charitable Trusts, "Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks" (2017), https://www.pewtrusts.org/~/media/assets/2017/04/payday-loan-customers-want-moreprotections.

a. As explained elsewhere in this letter, we recommend treating any third-party small-dollar credit program as a critical activity for purposes of this guidance and/or establishing heightened expectations for risk management and supervision with respect to small-dollar credit arrangements.
b. In this context, the bank and its supervisors should consider the entirety of the entities that are or could possibly be involved in the consumer credit transactions. This would include not just the third-party contractee's subcontractors but also any other third party that is affiliated in any way with the contractee or the customer's experience with the credit offering, such as a company that charges transaction fees for receiving loan proceeds or making loan payments. *See also Questions 3 and 7, above*.
c. Such scrutiny is not warranted when a bank makes small loans to its deposit account customers with assistance of a technology provider and through branches or electronic channels exclusively controlled by the bank, because of the much lower customer risk involved and because there is already sufficient supervision of such lending.

18. To what extent should the concepts discussed in the OCC's 2020 FAQs be incorporated into the guidance? What would be the best way to incorporate the concepts?

a. Note: We comment here on the OCC's 2020 FAQs, in response to Section V of the proposed guidance. We refer to numbered items within the FAQ reproduced in Section V of the proposed guidance using the following format: [OCC-1], [OCC-2], and so on. As with the rest of this comment letter, we focus here specifically on third-party, small-dollar credit programs.
b. In general, the guidance should include specific provisions about small-dollar credit programs, as noted throughout this letter (*see e.g. Questions 6 and 9*). Because of the uniquely complex risks involved, guidance about third-party small-dollar credit arrangements should be unusually clear about discouraging programs that raise rent-a-bank concerns. Additionally, we encourage the agencies to be unusually clear about what small-dollar credit program features are strongly discouraged or prohibited, as well the expected features of acceptable small-dollar credit arrangements. Such clarity will prevent the spread of rent-a-bank concerns (as seen in the handful of such programs discussed above) while also encouraging the development of safe and affordable installment loan alternatives to payday and similar high-rate loans. Smaller banks that lack the resources to investigate potential customer harms or develop their own technology solutions will especially benefit from such uniquely clear guidelines.
c. [OCC-8] asks *What third-party relationships involve critical activities?* The agencies should clearly state that they will treat any third-party, small-dollar credit program as a critical activity subject to heightened scrutiny because of the significant customer impacts and reputational risks that could materialize in any such small-dollar credit program. For smaller banks, this may include holding senior executives or board members accountable for reviewing and approving any third-party, small-dollar loan program at the bank. Alternatively, the agencies could allow banks to treat third-party, small-dollar loan programs as non-critical activities only if they meet certain clear thresholds and standards set by the agencies. *See also Questions 6 and 9 above*.
d. [OCC-9] *regarding how bank management should determine the risks associated with third-party relationships.* The agencies should consider publishing a list of common or potential risks associated with third-party, small-dollar credit programs. *See also Questions 6 and 9 above.*

e. [OCC-10] states that the "OCC expects banks to have more comprehensive and rigorous management of third-party relationships that involve critical activities." The agencies should retain this expectation and set clearer expectations that third-party, small-dollar credit arrangements will generally be considered critical activities.
f. [OCC-19] covers *what should a bank consider when entering a marketplace lending arrangement with nonbank entities*. The agencies should draw clear distinctions between credit arrangements that serve a bank's own deposit account customers within branches or electronic channels fully controlled by the bank and other types of programs.

In conclusion, we strongly encourage the agencies to act urgently to prevent the spread of risky third-party small-dollar credit arrangements and to do so in a way that encourages banks to expand safe and affordable small-dollar installment loan offerings to their own deposit account customers, either directly or in well-managed partnerships with non-bank service providers.

Sincerely,

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APPENDIX A: Rent-a-Bank Loan Watch List - National Consumer Law Center (NCLC)

Non-Bank Partner	Product Name	Bank Partner(s)	Regulator	Installment Loans	APRs
Enova (CashNetUSA)	NetCredit	Republic Bank & Trust (Kentucky)	FDIC	$2,500-$10,000	up to 99.99%
OppLoans (aka OppFi)		Finwise Bank (Utah), Capital Community Bank (CC Bank) (Utah), and First Electronic Bank (a Utah industrial bank)	FDIC	$500-$4,000	up to 160%
Duvera Billing Services dba EasyPay Finance		Transportation Alliance Bank dba TAB Bank (Utah)	FDIC	*Not disclosed*	*Not disclosed*
Elevate	Rise	FinWiseBank (Utah) and Capital Community Bank (Utah)	FDIC	$500-$5,000	99%-149%
Elevate	Elastic	Republic Bank & Trust (Kentucky)	FDIC	$500-$4,500	up to 109%
Applied Data Finance dba Personify Financial		First Electronic Bank	FDIC	$500-$10,000	up to 179.99%
Wheels Financial Group, LLC dba LoanMart (under the ChoiceCash brand)		Capital Community Bank	FDIC	$500-$4,500	80% - 204%*
Axcess Financial (Check n' Go)	Xact	Capital Community Bank	FDIC	$1,000-5,000	145% - 225%
Check Into Cash	CC Connect	Capital Community Bank	FDIC	up to $2,400	up to 224.99%
American First Finance		FinWise Bank	FDIC	*Not disclosed*	*Not disclosed*

* Data incomplete. Utah loan example taken from the LoanMart website: Utah Loan Information | 1 800 LoanMart (accessed October 11, 2021).

Source: NCLC, https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html