



By electronic submission to Comments@fdic.gov

Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Request for Information on Small-Dollar Lending, Docket ID FDIC-2018-25257; RIN 3064-ZA04

Dear Sirs and Madams:

The Online Lenders Alliance (“OLA”) welcomes the opportunity to respond to the request for information (“RFI”) issued by the Federal Deposit Insurance Corporation (“FDIC”) to solicit comments and information on small-dollar lending, including steps that can be taken to encourage FDIC-supervised banks to offer small-dollar credit products that are responsive to customers’ needs and that are underwritten and structured prudently and responsibly.¹ In particular, OLA applauds the FDIC for issuing the RFI as part of its commitment to support innovation and with recognition of the potential for small-dollar lending to play a critical role in satisfying the convenience and needs of underbanked communities. We believe that there are many opportunities for FDIC-supervised banks to leverage innovative technologies to make small-dollar loans in a safe and sound manner and to expand financial inclusion in the United States.

OLA represents the growing industry of innovative companies that develop and deploy financial technology, including proprietary and innovative underwriting methods, big data analytics, and non-traditional delivery channels, to offer online consumer loans and related products and services. OLA’s members include online lenders, vendors and service providers to lenders, consumer reporting agencies, payment processors, and online marketing firms.

Many OLA members provide technology services to FDIC-supervised banks to facilitate the banks’ extension of credit – generally unsecured, small-dollar loans in amounts less than \$5,000 – to consumers. Many of these consumers are non-prime individuals (those with credit scores ranging from 680-700). By partnering with fintech companies such as OLA members to provide small-dollar loans, banks are able to serve the financial needs of these populations who may not have other options to pay for unexpected or emergency expenses.

This letter provides information regarding the benefits of bank-fintech partnerships in the context of small-dollar credit and recommendations for the FDIC to best encourage FDIC-supervised

¹ Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58,566 (Nov. 20, 2018).

banks to offer responsible small-dollar credit products that are responsive to consumer credit needs.

I. Bank-Fintech Partnerships Produce Substantial Benefits and are Subject to Robust Regulation and Oversight

Banks increasingly are partnering with fintech companies and relying on fintech companies' services to deliver financial products and services using innovative technologies. These partnerships enable banks to deliver products and services to a broader customer base, with greater efficiency, and with less risk to consumers and the banks themselves.

The benefits to consumers from bank-fintech partnerships are substantial. Fintech companies offer customers simple and convenient features, including easy to use web and mobile interfaces to apply for credit and make payments.

Financial services innovation has been spurred through bank-fintech partnerships. Banks that collaborate with fintech companies are able to develop innovative technologies that better address the needs of customers. As just one example, many fintech companies provide banks with technological tools to improve their data and data management techniques in credit underwriting, as well as marketing, sourcing, and ability to fulfil consumer's credit demands.² Fintech companies also leverage artificial intelligence and machine learning and use their proprietary algorithms to help banks evaluate, offer and track loans to those consumers.

The Center for Financial Services Innovation, in a recent comment letter to the FDIC, characterized these partnerships as a "win-win-win" for all involved, especially consumers. The bank wins because it can serve a broader and deeper segment of the consumer market than it otherwise could.³ The fintech company wins by creating an opportunity to facilitate the offering of products to consumers at rates that are economical and permissible, given the bank's involvement as the lender. Consumers win because they get access to high-quality credit that they otherwise would not. All of this equates to greater competition among providers and lower costs of credit, resulting in more options and access to credit for consumers.⁴

² See U.S. Dep't of Treasury, A Financial System That Creates Economic Opportunities, Nonbank Institutions, Fintech, and Innovation, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System [hereinafter "Treasury Fintech Report"], July 2018, at 86, available at: <https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf>.

³ Bank-fintech partnerships also allow "smaller and more rural banks to broaden the set of products and services they can offer to consumers and small businesses in their communities." Center for Financial Services Innovation, Comment Letter on FIL-50-2016 Proposed Guidance for Third-Party Lending (Oct. 27, 2016), available at: <https://cfsinnovation.org/research/cfsi-comment-letter-on-proposed-guidance-for-third-party-lending/>.

⁴ The FDIC, in proposed examination guidance for third-party lending programs, echoed these sentiments: "Third-party lending arrangements may provide institutions with the ability to supplement, enhance, or expedite lending services for their customers. Engaging in third-party lending arrangements may also enable institutions to lower costs of delivering credit products and to achieve strategic or profitability goals." FDIC, Examination (continued...)

Bank-fintech partnerships also are subject to extensive oversight by federal and state banking agencies. Bank-sponsored lending programs with fintech companies are subject to robust supervision by the federal banking agencies, and the FDIC has published detailed guidance for banks to follow in managing these relationships and the agency supervisory staff to follow in exercising oversight with respect to the relationships. This guidance states that any loans issued by a bank – including those that benefit from the technology of a fintech partner – are subject to the same high level of scrutiny and regulation as any other loan issued by the bank. This oversight protects consumers and the financial system. In addition, many fintech companies are subject to federal and state lending and consumer protection regulations, including, for example, the Truth in Lending Act and Equal Credit Opportunity Act. Many fintech companies are also subject to the Electronic Funds Transfer Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and the Bank Secrecy Act, among other laws.

In sum, bank-fintech partnerships facilitate the delivery of safe, lower cost, compliance-focused, and more convenient financial products and services to consumers and are subject to substantial regulatory oversight. These characteristics make bank-fintech partnerships particularly suitable for the extension of prudent small-dollar credit.

II. Bank-Fintech Partnerships Are Critical to Facilitate Small-Dollar Lending

Many banks do not have the technical expertise to market, underwrite, originate, service, and collect small-dollar loans and bridge these gaps by partnering with a fintech company. Fintech companies have spent years developing innovative technology and analytics for these specific credit processes. A bank that partners with a fintech company is able to use these technologies to reach consumers who otherwise may not be able to access credit, including borrowers, that live in so-called “banking deserts” where there are not many bricks and mortar bank branches.⁵ In addition, a borrower of lesser credit quality, whether a consumer with a thin credit history or no credit history, can benefit from the greater use of non-traditional credit information employed by fintech companies to underwrite small-dollar credit more effectively for these borrowers.

It often is not economically viable for large U.S. banking organizations to engage directly in small-dollar lending. Recent attempts by banks to enter into the small-dollar lending market historically served by innovative marketplace lenders have been largely unsuccessful. For example, in 2008 the FDIC launched its Small-Dollar Loan Pilot Program, which was a case study designed to illustrate how banks can profitably offer affordable small-dollar loans. The program’s low participation rates only highlighted the banking industry’s challenges with this market. Loans were capped at \$1,000, and origination and other upfront fees plus interest

Guidance for Third-Party Lending, July 29, 2016, *available at*: <https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf>.

⁵ See Julapa Jagtiani and Catharine Lemieux, Working Paper No. 17-17, Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information, Federal Reserve Bank of Philadelphia, July 6, 2017, at 34-37, *available at*: <https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-17.pdf>.

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charges were capped at a 36 percent APR. A year into the program, the FDIC increased the maximum loan amount to \$2,500 following requests from the participating banks. 18,163 of the 34,400 loans made during the two-year pilot program were under the original cap of \$1,000, and the average loan amount was roughly \$700.⁶ The program proved to be largely unprofitable for banks, as most used the program to drive consumers into fee-based checking accounts where they could be subject to overdraft and insufficient fund fees. The program also demonstrated that a 36 percent APR cap on small-dollar loans was unworkable for most banks.

Accordingly, the bank-fintech partnership model is often the most readily available way to reach consumers in need of small-dollar loans. Partnering with a fintech company allows a bank to deploy its own capital to make small-dollar loans that it would not have otherwise made, thereby expanding the bank's customer base and providing broader access to small-dollar credit for consumers. Banks benefit from the technical expertise of the fintech company as well as funding from the fintech company to share the banks' credit risk.

III. The FDIC Should Address Existing Legal Impediments to the Bank-Fintech Partnership Model in Order to Facilitate Small-Dollar Lending

Recent judicial decisions and regulatory uncertainty have impeded the bank-fintech partnership model that is critical to small-dollar lending. Specifically, a handful of court decisions have called into question whether the bank in a bank-fintech partnership is the "true lender" even if the bank extends the credit according to underwriting criteria it has approved, is named in the loan agreement as the lender, and holds the loan for some time after the loan is made. These court decisions are based on a "predominant economic interest" test that is subjective and has been cited to conclude that the fintech company, and not the bank, is the true lender in these circumstances.⁷ The decisions are at odds with established judicial precedent interpreting the Federal Deposit Insurance Act ("FDIA").

The split in courts' analysis of "true lender" litigation and whether the bank or fintech company is the lender for purposes of federal banking laws, including provisions in the FDIA that authorize a bank to export the maximum interest rate permitted in the bank's home state,⁸ is having a chilling effect on innovation in the United States. Whether the bank or fintech company is the true lender may be the difference in determining whether the loan is void or uncollectible, meaning that the lender may not be able to recover its principal, much less its costs and profit, depending on the court's "true lender" analysis. These differing outcomes have

⁶ FDIC Quarterly, A Template for Success: The FDIC's Small-Dollar Loan Pilot Program, 2010, Vol. 4, No. 2, available at: <https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf>.

⁷ See Treasury Fintech Report at 93 ("...compliance with such a standard on an ex-ante basis could be difficult because of nuances in how a court might determine the predominant economic interest. Firms enter into partnership arrangements in which they negotiate a range of terms and conditions based upon a variety of market, economic, and other considerations.")

⁸ See *id.* at 88 ("...federal law allows the bank, and federal jurisprudence allow the marketplace lender servicing the loan, to charge interest at the rate allowed by the laws of the state where the bank is located....")

(continued...)

highlighted the continued uncertainty in the marketplace and created challenges for banks, fintech companies, and investors. Without certainty, these market participants may no longer be willing to make loans if their loans may be invalidated after the fact by a court.⁹ This lingering uncertainty has a particularly detrimental impact on small-dollar lending, which may be subject to a number of state laws that have different effects depending on whether the bank or the fintech company is the true lender.

We note that the “true lender” argument is different from the “valid when made” issue raised by *Madden v. Midland*.¹⁰ In a true lender challenge, it is the validity of the underlying loan that is called into question, with the plaintiff typically alleging that the loan was originated by a nonbank with terms and conditions that violate state law. “Valid when made” refers to the longstanding legal principle that a loan that is valid and non-usurious at its inception cannot subsequently become usurious, including, for instance, when that loan is subsequently sold. This doctrine has been embraced by the Supreme Court since at least 1833 (*Nichols v. Fearson*). However, it was recently called into question by the Second Circuit’s opinion in *Madden v. Midland Funding*, which has created uncertainty for investors in bank loans.

In *Madden*, the court held, in part, that the National Bank Act, which preempts state usury laws with respect to the interest a national bank may charge on a loan, did not preempt state-law usury claims against a third-party debt collector that had purchased the loan from a national bank. The court declined to apply the “valid when made” doctrine and held that state usury laws may validly prohibit a national bank’s assignee from enforcing the interest rate term of a debt agreement that was valid when made under applicable state law. This uncertainty reduces consumers’ access to credit as marketplace lenders “may be discouraged from purchasing and attempting to collect on, sell, or securitize loans made in these states because of the risk of litigation asserting violations of state usury laws.”¹¹

The U.S. Department of Treasury (“Treasury”) has recognized the value of the bank-fintech partnership model and has recommended “eliminating constraints brought about by recent court cases that would unnecessarily limit the functioning of U.S. credit markets.”¹² Treasury, in its report on fintech from July 2018, called upon Congress to take action to codify the “valid when made” doctrine and the legal status of a bank as the “true lender” of loans it originates but then

⁹ See *id.* at 93 (“The uncertainties created by these court cases create pressure to alter these partnership arrangements based upon nonmarket factors. Some marketplace lenders, for example, have already restructured their economic relationships with partnering banks to better account for the risks presented by these court cases. A fragmented legal structure creates an inefficient regulatory framework and significant compliance challenges for the bank partnership model.”)

¹⁰ See *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. U.S. 2505 (2016).

¹¹ Treasury Fintech Report at 92. (“In response to *Madden*, some lenders are changing their lending and securitization activities by, for example, excluding loans from Second Circuit states in their pools altogether.”) *Id.*

¹² Treasury Fintech Report at 11.

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places with a nonbank partner, and calls upon federal banking regulators to use their available authorities to address these issues.¹³

Without regulatory and legal certainty for the “true lender” and “valid when made” issues, banks will be unwilling to engage in partnerships with fintech companies that are fundamental to providing small-dollar loans. The FDIC should take immediate action to clarify the circumstances in which the bank in a bank-fintech partnership is the “true lender” and to codify the “valid when made” doctrine in order to encourage small-dollar lending. On the “true lender” issue, the FDIC should issue guidance that clarifies that a bank is the true lender on any loan agreement that the bank executes. A bank thus may export its location-state’s interest rate on any loan to which the bank is a party.¹⁴ On the “valid when made” issue, the FDIC should issue guidance clarifying that an interest rate on a loan made by an FDIC-insured bank that is lawful at origination remains lawful and collectible after any sale of the loan. This would confirm the doctrine, stabilize expectations of consumers, banks, and investors, and articulate to courts adjudicating lawsuits against fintech companies or banks that “valid when made” is valid law and policy favored by the FDIC.

¹³ See *id.* at 93 (“Treasury recommends that Congress codify the “valid when made” doctrine to preserve the functioning of U.S. credit markets and the longstanding ability of banks and other financial institutions, including marketplace lenders, to buy and sell validly made loans without the risk of coming into conflict with state interest-rate limits.”) See also *id.* at 94 (“Treasury recommends that Congress codify that the existence of a service or economic relationship between a bank and a third party (including financial technology companies) does not affect the role of the bank as the true lender of loans it makes. Further, federal banking regulators should also reaffirm (through additional clarification of applicable compliance and risk-management requirements, for example) that the bank remains the true lender under such partnership arrangements.”)

¹⁴ Online Lenders Alliance, Letter to FDIC and Office of the Comptroller of the Currency regarding “true lender” litigation (July 23, 2018). [**CONFIRM**: Please confirm the date that the letter was submitted.]

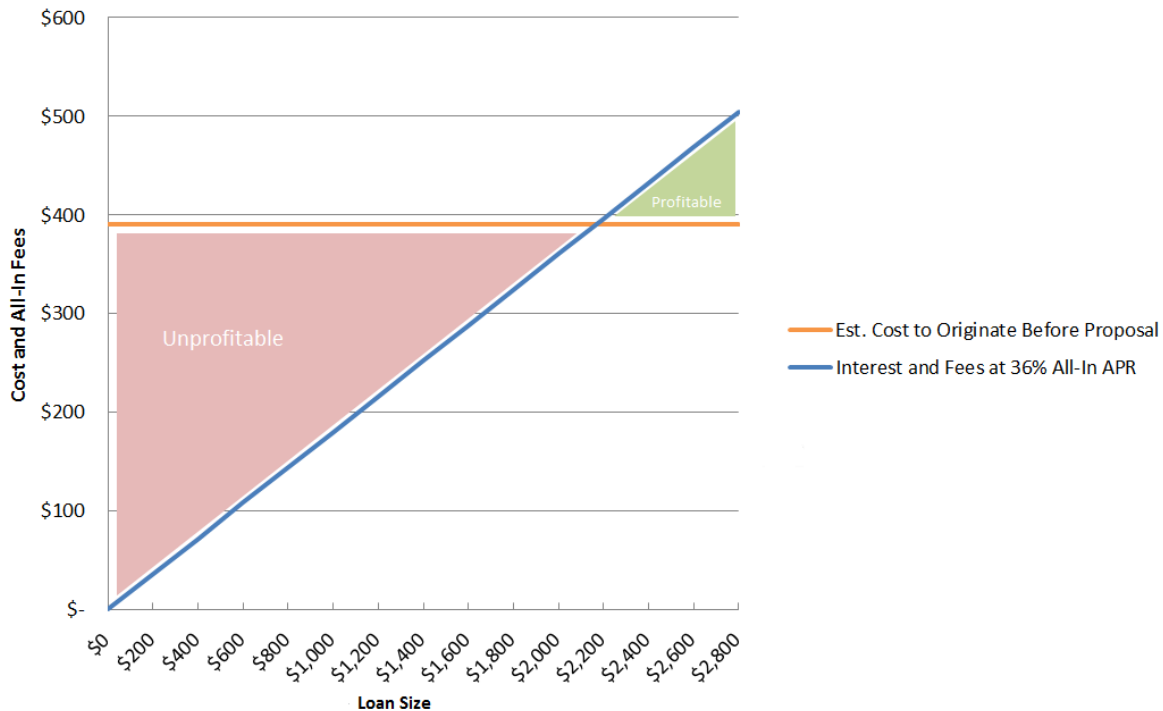
IV. The FDIC Should Not Institutionalize or Favor in Anyway a 36 Percent APR Cap, Which Obliterates Banks' Ability to Offer Responsible Small-Dollar Loans

A. *A 36 Percent APR Standard Reduces Access to Credit by Consumers*

Small-dollar loans often have interest rates in excess of a 36 percent “all-in” APR due to the short time periods, small loan sizes, and underwriting costs involved. Small-dollar loans offered through the internet generally have higher rates of credit loss and borrower fraud than other forms of consumer credit. Moreover, relative to the size of the loan, the cost of acquiring a customer and underwriting an unsecured small-dollar loan is much greater than the cost for a larger loan. Credit decisions and credit pricing are based on risk, and the customer segment for small-dollar loans generally consists of risky borrowers who cannot qualify for other forms of credit. Lenders would lose money and the ability to continue to lend if they made loans in small-dollar amounts at a rate below a 36 percent total cost of credit.

It is unrealistic for the FDIC to expect banks to make small-dollar loans with an annualized total cost of credit at or below 36 percent. The graph below demonstrates this point. One OLA member has estimated that the current cost to originate a small-dollar installment loan is \$390 per loan. The graph shows that limiting interest and fees to a 36 percent interest rate would make it unprofitable to make any six-month loan smaller than \$2,166.67. Consumers who require smaller loans simply cannot be served profitably at or below the 36 percent interest rate at today’s cost structure.

**Origination Costs and Interest and Fees Based on Loan Size
Six Month Loans at 36% All-In APR**



B. *The 36 Percent APR Standard Is Not Supported by Empirical Evidence*

The 36 percent interest rate cap on small-dollar loans is arbitrary and is not supported by empirical data.

Arbitrary interest rate caps negatively affect consumers and undermine the FDIC’s stated purpose of providing consumers access to credit. For example, after interest rate caps were imposed and certain short-term loans were banned in Georgia and North Carolina, consumers “bounced more checks, complained more about lenders and debt collectors, and filed for Chapter 7 bankruptcy at a higher rate,” according to the Federal Reserve.¹⁵ A rate cap of 36 percent for small-dollar personal loans would amount to a de facto redlining of 109 million individuals in the U.S. who are not able to access credit from traditional banks because they are considered too big a risk.

The FDIC should undertake a robust empirical analysis to better understand the negative impact that a 36 percent APR standard would have on consumers’ ability to access small-dollar credit products. Prior empirical analyses have demonstrated that a 36 percent APR standard is ineffective in creating a robust supply of small-dollar loans to consumers in need of this form of credit.

C. *The 36 Percent APR Standard Needs to be Revisited in Light of Operation Choke Point*

In a letter to the House Judiciary Committee, the Department of Justice (“DOJ”) admitted that Operation Choke Point – an initiative in which federal agencies devised and relied upon a list of politically disfavored merchants with the intent of “choking-off” these merchants’ access to payment systems and banking services – was misguided, is no longer in effect, and will not be undertaken again.¹⁶ According to the DOJ, “law abiding businesses should not be targeted simply for operating in an industry that a particular administration might disfavor.”¹⁷

Members of the Senate Banking Committee sent a letter to the FDIC in November 2018 stating that “[r]ecently released internal [FDIC] documents regarding Operation Choke Point highlight the need for the FDIC to send a clear message that the old culture of Operation Choke Point is over and the need to review how policy has been communicated from the FDIC to regulated

¹⁵ Morgan, Donald P., Strain, Michael R., Federal Reserve Bank of New York Staff Reports, Payday Holiday: How Households Fare after Payday Credit Bans, Staff Report no. 309, Nov. 2007, Revised Feb. 2008 at 3, *available at*: https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr309.pdf.

¹⁶ See Boyle, Stephen E., Asst. Att’y Gen., Letter to Hon. Bob Goodlatte, Chairman, Committee on the Judiciary, U.S. House of Representatives (Aug. 16, 2017), *available at*: <http://alliedprogress.org/wp-content/uploads/2017/08/2017-8-16-Operation-Chokepoint-Goodlatte.pdf>.

¹⁷ Id.

(continued...)

institutions.”¹⁸ The Senators requested that the FDIC “review all options available to ensure lawful businesses are able to continue to operate without fear of significant financial consequences.”¹⁹ As noted above, a 36 percent APR standard is a major impediment for small-dollar lenders, many of whom were the targets of Operation Choke Point. The FDIC should revisit all of its policies to ensure that these law-abiding businesses are able to operate effectively without being held to unfair and unworkable standards.

In addition, the FDIC needs to eliminate the disparate regulatory treatment of small-dollar lenders and their large bank counterparts. For example, U.S. Bank recently launched a fee-based small-dollar loan product that allows customers to borrow between \$100 and \$1,000 for a fee of \$12 for every \$100 borrowed with autopay from a U.S. Bank checking account, or \$15 for every \$100 if paid manually.²⁰ This means that if a customer uses autopay, he or she would be paying an annualized APR of greater than 70 percent.

D. *The FDIC Should Revise its Small-Dollar Loan Guidelines*

In its 2007 Affordable Small-Dollar Loan Guidelines (“2007 Guidelines”), the FDIC encouraged lenders to “offer credit products with interest rates and fees that reflect associated risks,” noting that “[p]ricing may vary depending on the risk profile of the target group.”²¹ However, the 2007 Guidelines contradict this recommendation for a flexible risk-based approach, by “encourag[ing] lenders to offer small-dollar credit with APRs no greater than 36 percent.” This guidance has been interpreted by the industry to favor a cap on the interest rate a small-dollar lender can charge as a safety and soundness requirement. We are not aware of any empirical evidence to explain how the FDIC arrived at 36 percent, nor has the FDIC updated the percentage to reflect changes to interest rates, consumer needs, and small-dollar lending practices since 2007.

A 36 percent APR standard is unworkable for small-dollar lending and increases the cost of credit to consumers. Accordingly, the FDIC should revise its 2007 Guidelines to remove the reference to a 36 percent APR standard and at the same time revise the FDIC Small-Dollar Loan Pilot Program to remove the reference to the 36 percent APR requirement. The FDIC should instead encourage a fee-based model for small-dollar loans (e.g., \$15-\$20 for every \$100 borrowed). Consumers often need very small loans to address cash-flow balances, unexpected expenses, or income volatility. As noted in the RFI, “if faced with a hypothetical \$400 expense,

¹⁸ Crapo, Senator Mike et al., Letter to Hon. Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation (Nov. 7, 2018), *available at*: <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2018/11/Choke-Point-Letter-11.7.18.pdf>.

¹⁹ Id.

²⁰ U.S. Bank, News Release, U.S. Bank launches Simple Loan to meet customers’ short-term cash needs, Sept. 10, 2018, *available at*: <https://www.usbank.com/newsroom/news/us-bank-launches-simple-loan-to-meet-customers-short-term-cash-needs.html>.

²¹ FDIC, Press Release, “Affordable Small-Dollar Loan Guidelines,” June 19, 2007, *available at*: <http://www.fdic.gov/news/news/press/2007/pr07052a.html>.

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4 in 10 U.S. adults in 2017 would borrow, sell something, or not be able to pay.”²² Independent data shows that if small-dollar lending was fee-based instead of limited by a cap on APR, banks would be able to start small-dollar loans in amounts as low as \$250-\$300 dollars to meet these needs. Moreover, a fee-based model would allow lenders to more precisely capture the risks associated with a particular small-dollar loan based on all of the factors, rather than adhering to an arbitrary standard. This is consistent with the approach taken by small-dollar loans that provide immediate access to credit for consumers to manage misalignments in the timing of their expenses and income.

* * *

OLA strongly supports the FDIC’s goal of promoting access to credit and economic opportunity in underserved communities by providing small-dollar loans. To further this goal, the FDIC must take into account one of the most important ways in which banks can reach LMI borrowers – through bank-fintech partnerships that enable consumers to obtain much-needed small-dollar credit.

We appreciate the opportunity to provide input on this important regulatory initiative. If you have questions or need additional information, please feel free to contact me at mjackson@oladc.org.

Respectfully submitted,



Mary Jackson
President and CEO

²² 83 Fed. Reg. 58,566 (citing “Report on the Economic Well Being of U.S. Households in 2017,” Board of Governors of the Federal Reserve System, May 2018).