January 23, 2019

ATTORNEY GENERAL RAOUL URGES FDIC TO INCLUDE STRONG CONSUMER PROTECTIONS FOR SMALL-DOLLAR LOANS MADE BY BANKS

Raoul, 13 Attorneys General Want Proposed Bank Guidance to Protect Borrowers from High-Interest Loans and Abusive Lending

Chicago — Attorney General Kwame Raoul joined a coalition of 13 states in sending a letter to the Federal Deposit Insurance Corporation (FDIC) urging the agency to ensure strong consumer protections in guidance on small-dollar loans.

Raoul and the coalition submitted the letter Tuesday in response to a request for comments the FDIC issued in November 2018 about how FDIC-insured banks might meet consumer demand for small-dollar-amount lending, and what the FDIC can do to help banks "offer responsible, prudently underwritten credit products." The letter urges the FDIC, in any guidance it produces, to ensure that such loans comply with state laws that regulate high-interest small-dollar loans and other abusive lending practices.

"The FDIC must guard against predatory and abusive practices," Raoul said. "Any FDIC guidance should encourage an ability to repay assessment. Evasion and rent-a-bank schemes should not be condoned."

The FDIC's potential new guidance could alter or rescind previous guidance to banks issued in 2013 that discouraged high-cost "deposit advance" lending by state-chartered banks. While state-chartered banks must obey the interest rate laws of their own states, they generally are not bound by the interest rate laws of other states. Raoul and the other attorneys general said unscrupulous lenders could use state-chartered banks in states with lax interest laws as fronts to offer predatory, high-interest loans across the country – a practice known as "rent-a-bank" payday lending.

Payday and high cost small-dollar installment lending can trap lower-income earners who do not otherwise have access to consumer credit into endless cycles of debt. According to the Pew Charitable Trusts, the average payday loan borrower earns about $30,000 per year, and about 58 percent have trouble meeting their monthly expenses. The average payday borrower is in debt for nearly half the year because they borrow again to help repay the original loan. The average payday borrower spends $520 per year in fees to repeatedly borrow $375.

In the letter, Raoul and the other attorneys general request that the FDIC, in any potential guidance to banks:

- **Discourage banks from becoming fronts for payday and installment lenders:** The letter asks the FDIC to discourage a revival of the rent-a-bank schemes that cropped up in the early 2000s. In these arrangements, payday and high cost installment lenders would contract with federal and state-chartered banks to offer loan services in other states. The bank participated only by lending its name and charter to the transaction, while the actual lending work was done by a payday or installment lender. This practice allows the lender to take advantage of the bank's ability to export its home state's interest rate and evade the usury laws and other interest-rate caps in the state where the borrower resides.
- **Encourage banks to thoroughly consider the consumer's ability to repay:** The letter urges the FDIC to develop guidance with clear rules and tests that ensure banks make small-dollar loans with a reasonable expectation that the consumer will be able to repay. These tests should consider

factors like the borrower’s monthly income, the borrower’s monthly expenses (including payments on other debts), and their ability to repay the loan in full at the end of the loan term without re-borrowing. The attorneys general also recommend that any such test account for the possibility of unforeseen or emergency expenses that the borrower may incur (such as losing a job or medical costs).

Joining Raoul in submitting the letter were the attorneys general from California, Connecticut, Colorado, the District of Columbia, Iowa, Maryland, Massachusetts, New Jersey, New York, North Carolina, Oregon, Pennsylvania, and Virginia.

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January 22, 2019

<u>Via Email: Comments@fdic.gov</u>
Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

Re: Docket No. RIN 3064-ZA04
Request for Information on Small-Dollar Lending

Dear Secretary Feldman:

We, the undersigned attorneys general, submit this comment in response to the Federal Deposit Insurance Corporation's ("FDIC") request for information on small-dollar lending.[1]

We welcome the FDIC's interest in encouraging FDIC-supervised financial institutions such as state-chartered banks to offer prudently structured and responsibly underwritten small-dollar credit products to consumers. As the FDIC's recent data shows, approximately 8.4 million U.S. households were "unbanked" and approximately 24.2 million U.S. households were underbanked in 2017.[2] The short-term credit needs of these households are largely met by the fringe financial sector: non-bank entities such as payday lenders and high-cost installment lenders that "are often usurious, sometimes predatory, and almost always worse for low-income individuals than the services offered by traditional banks to their customers."[3] Most borrowers are unable to repay these loans when they become due and are instead forced to take out new loans – and pay additional fees – to cover the prior loans, which can trap them in an endless cycle of debt.[4] The high cost of fringe

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[1] *See* Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58,566 (Nov. 20, 2018).
[2] *See* "2017 FDIC National Survey of Unbanked and Underbanked Households," Federal Deposit Insurance Corporation, October 2018 [hereinafter "FDIC Survey"].
[3] Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. 165, 166-67 (2014); *see* FDIC Survey, *supra* note 2, at 8 (discussing alternative financial services for unbanked and underbanked households).
[4] According to a 2016 study by the Consumer Financial Protection Bureau, an astonishing 80% of payday loans are rolled over. *See* Consumer Fin. Prot. Bureau, *Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products* at 115-16 (June 2016), *available at* https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf. The fees payday lenders reap from such borrowers – estimated to be $3.8 billion annually – are one of the industry's largest sources of revenue. *See* Ctr. for Responsible Lending, *Shark-Free Waters: States Are Better Off Without Payday Lending* at 1 (Aug.

financial products are, in part, a function of the administrative costs such institutions face in originating and servicing credit extended to unbanked and underbanked households.[5] State-chartered banks face lower administrative costs and can leverage economies of scale to offer small-dollar credit to unbanked and underbanked consumers at lower costs than fringe financial institutions.[6] There are, however, important legal risks for state-chartered banks that seek to enter this sector.

I. Evasion of State Laws

Many states have enacted laws to protect consumers from abuses associated with high-cost small-dollar credit offered by fringe lenders. These laws reflect the will of the citizens in each state to restrict the ability of fringe lenders to engage in predatory practices. Although the details of these laws vary from state to state, there are features common to most state small-dollar lending laws. Many state laws cap the annual percentage rate ("APR") licensed lenders can charge for small, unsecured loans, and prohibit unlicensed lending.[7] In addition to rate caps on installment loans, many state laws substantially circumscribe fringe lenders' ability to offer extremely predatory products such as high-cost payday loans. These limitations include outright prohibitions, structural

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2016), *available* at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-shark-free-waters-aug2016.pdf.

[5] *See* Baradaran, *supra* note 3 at 167; *but see* Mark Flanney & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* (FDIC Ct. for Fin. Research, Working Paper No. 2005-09, 2005).

[6] *See* Baradaran, *supra* note 3 (explaining how similar economies of scale, infrastructure, and clientele can help the Post Office offer affordable small-dollar loans).

[7] CA: licensed lenders limited to monthly interest charges ranging from 1% to 2.5% for loans of various amounts less than $2,500. *See* Cal. Fin. Code § 22303; CT: 36% for small loans less than $5,000 and 25% for small loans between $5,000 and $15,000. *See* Ch. 668, Part III, Conn. Gen. Stat.; CO: *See* C.R.S. §§ 5-2-201, 5-2-214; DC: licensed lenders prohibited from charging rates in excess of 24%. *See* D.C. Code § 28–3301; IL: 99% on consumer installment loans less than $1,500 and 36% on consumer installment loans between $1,500 and $40,000. *See* 250 Ill. Comp. Stat. §§ 670/15 & 17.2; MA: 12% civil usury rate on small dollar loans of less than $6,000 and licensed lenders permitted to charge no more than 23%. *See* Mass. Gen. L. c. 140, § 96; 209 CMR 26.01 (Small Loan Rate Order); MD: licensed lenders prohibited from charging rates in excess of 24% or 33% for consumer loans less than $6,000, depending on the original and unpaid principal balance of the loans. *See* Md. Code Ann., Com. Law §§ 12-301-12-303, 12-306; NC: licensed lenders prohibited from charging interest in excess of blended rate of 30% on loans not exceeding $15,000. *See* N.C. Gen. Stat. § 53-176; NJ: Criminal usury law prohibits lenders from charging more than 30% to individuals. *See* N.J.S.A. 2C:21-19. Civil usury law prohibits unlicensed lenders from charging more than 16%. *See* N.J.A.C. 3:1-1.1; NY: Criminal usury law prohibits licensed lenders from charging more than 25%. *See* N.Y. Penal L. § 190.40. Civil usury law prohibits unlicensed lenders from charging more than 16%. *See* N.Y. Gen. Oblig. § 5-501; N.Y. Banking L. § 14-a; NC: licensed lenders prohibited from charging interest in excess of blended rate of 30% on loans not exceeding $15,000. *See* N.C. Gen. Stat. § 53-176; OR: licensed lenders prohibited from charging in excess of 36% on consumer finance loans of $50,000 or less. *See* Or. Rev. Stat. § 725.340(a); PA: licensed lenders limited to 24% APR under the Consumer Discount Company Act, 7 P.S. §§ 6217.1, and unlicensed lenders limited to 6% APR under Section 201 of the Loan Interest and Protection Law, 41 P.S. § 201; VA: 36% for small loans less than $2,500. Va. Code Ann. §§ 6.2-1501 and 6.2-1520.

limits,[8] and restrictions on the ability to take out multiple loans or rollover credit.[9]

Laws restricting small-dollar lending are not particularly new. State usury laws date back to the late nineteenth century, and efforts to restrict small-sum lending began over a century ago.[10] Since the enactment of these laws, states have struggled with efforts by fringe lenders to evade state restrictions. Evasion schemes include structuring loans to fall outside the scope of state lending laws[11] or characterizing interest as fees.[12] In recent decades, fringe lenders have attempted to leverage relationships with third parties to overcome state restrictions. In the early 2000s, fringe lenders began to associate with traditional banks to take advantage of the fact that traditional banks are generally not subject to state interest rate caps.[13] This method became known as "rent-a-bank" lending because the bank participated only by lending its name and charter to the transaction. Payday lenders would claim the bank was the lender, allowing it to take advantage of the bank's ability to export its home state's interest rate and evade the usury and other interest rate caps in the state where the borrower resides.[14]

By the late 2000s, "rent-a-bank" lending declined as many traditional banks severed their relationships with payday lenders. The financial crisis of 2008 along with increased regulatory scrutiny may have precipitated this decline. When rent-a-bank schemes began to falter, payday lenders turned to Native American tribes in an attempt to take advantage of tribal sovereign

[8] CA: limits traditional personal-check-based payday loans to $300. *See* Cal. Fin. Code sec. 23035(a); CO: effective February 1, 2019, limits rates on payday loans to 36%. *See* C.R.S. 5-3.1-105; DC: prohibiting all lenders from charging rates in excess of 24%. *See* D.C. Code § 28–3301; IL: limits payday loans to the lesser of 25% of consumer's gross monthly income (22.5% for installment payday loans) or $1,000. *See* 815 Ill. Comp. Stat. § 122/2-5(e); MA: *See* Mass. Gen. L. c. 140, § 96; 209 CMR 26.01 (Small Loan Rate Order); NJ: N.J.A.C. 3:1-1.1 and N.J.S.A. 31:1-1(a); OR: requires minimum 31-day term and prohibits certain terms and waivers of rights. *See* Or. Rev. Stat. § 725A.064; PA: limits interest rate to 24% APR, caps late fees, prohibits compound interest. *See* 7 P.S. §§ 6217.1; VA: limits payday loans to $500. Va. Code Ann. § 6.2-1816(5); WA: lesser of 30 percent of the consumer's gross monthly income or $700. *See* Wash. Rev. Code sec. 31.45.073(2).

[9] CA: Cal. Fin. Code sec. 23037(a); CO: C.R.S. § 5-3.1-106 IL: 815 Ill. Comp. Stat. 122/2-30; IA: Iowa Code sec. 533D.10(1)(e); MA: 209 CMR 26.01 (Small Loan Rate Order); Or. Rev. Stat. § 725A.064(6); VA: Va. Code Ann. sec. 6.2-1816(6); WA: Wash. Rev. Code sec. 31.45.073(2).

[10] *See* F. B. Hubachek, *The Development of Regulatory Small Loan Laws*, 8 L. & Contemp. Probs. 108, 113 (1941) (detailing the history and the adoption of uniform small loan laws by states in the early twentieth century).

[11] *See De La Torre v. CashCall, Inc*., 422 P.3d 1004 (Cal. 2018) (holding that loans structured to fall outside California's small-loan rate cap can be unconscionable if the interest rate is too high); *State, ex rel King v. B&B Inv. Group, Inc. et al.*, 329 P.3d 658 (N.M. 2014) (holding that lender's year-long signature loans structured to evade New Mexico payday lending laws were structurally and procedurally unconscionable).

[12] *See, e.g., Livingston v. Fast Cash USA, Inc.*, 753 N.E. 2d 572 (Ind. 2001) (rejecting lender's argument that interest charges were simply check cashing fees); *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997) (same); *see also Illinois v. CMK Inv., Inc. d/b/a All Credit Lenders*, No. 14 C 2783 (N.D. Ill. Judgment entered June 17, 2016) (alleging installment lender's mandatory account protection fee that was charged on a sliding scale based on the amount financed was undisclosed interest in violation of the applicable 36% rate cap imposed by Illinois law).

[13] *See* Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections. Consumer Federation of America and the U.S. Public Interest Research Group, Washington, DC, Nov. 13, 2001, *available at* https://uspirg.org/reports/usp/rent-bank-payday-lending (describing the then emerging trend of "rent-a-bank" schemes among payday lenders).

[14] *See Pennsylvania v. Think Finance, Inc.*, No. 14-7139, 2016 WL 183289, at *1 (E.D. Pa. 2016) (describing rent-a-bank scheme, where payday lender partners with "an out-of-state bank" to act "as the nominal lender while the non-bank entity was the de facto lender" in a partnership that sought to take "advantage of federal bank preemption doctrines to insulate the [payday lending entities] from state regulation").

immunity. Under these tribal lending schemes, "a non-tribal payday lender makes an arrangement with a tribe under which the tribe receives a percentage of the profits, or simply a monthly fee, so that otherwise forbidden practices of the lender are presumably shielded by tribal immunity."[15]

A number of recent decisions have cast doubt on the legality of tribal lending schemes.[16] As a result, payday lenders are once again turning to "rent-a-bank" schemes in order to evade state law. Recent court decisions, however, suggest that "rent-a-bank" schemes are just as legally flawed as tribal lending schemes.[17] State-chartered banks should be wary of entering into relationships with fringe lenders that are structured to evade state rate caps. **We recommend that the FDIC discourage banks from entering into these relationships in any guidance it issues on small-dollar lending.**

II. Ability to Repay

Although state-chartered banks are generally not subject to state usury laws, other than applicable rate caps in a state-chartered bank's "home" state[18], state-chartered banks are still subject to laws of general applicability such as state unfair and deceptive acts or practices ("UDAP") laws and the law of unconscionability embedded in state common law and statutes. A state-chartered bank that directly or indirectly extends credit that is structured to fail,[19] that lacks economic substance,[20] or where there is no reasonable probability of repayment may violate state UDAP or state-law unconscionability.[21] **As such, we recommend that the FDIC discourage banks from extending small-dollar loans without considering the consumer's ability to repay.**

In order to ensure that these small-dollar loans are prudently made, we recommend the FDIC

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[15] Kyra Taylor et al., Pub. Justice Found., *Stretching the Envelope of Tribal Sovereign Immunity? An Investigation of the Relationships Between Online Payday Lenders and Native American Tribes* 6 (2017) (internal quotation marks omitted), *available at* https://www.publicjustice.net/wp-content/uploads/2018/01/SVCF-Report-FINAL-Dec-4.pdf.

[16] *See, e.g., CFPB v. CashCall, Inc., 2016 WL 4820635*, at *6 (C.D. Cal., Aug. 31, 2016) (holding that defendant payday lender was the "true lender" and real party in interest in tribal lending scheme); *MacDonald v. CashCall, Inc.*, 2017 WL 1536427, at *3 (D.N.J. Apr. 28, 2017), *aff'd*, 883 F.3d 220 (3d Cir. 2018) (detailing recent trend of cases in favor of parties challenging tribal lending arrangements across the country).

[17] *See, e.g., Think Finance*, *supra* note 14 (denying motion to dismiss and finding that state's allegations that non-banks were utilizing a "rent-a-bank" scheme to circumvent state usury laws were sufficient to state a plausible claim for relief and not preempted); *CashCall, Inc. v. Morrisey*, 2014 WL 2404300 (W. Va. May 30, 2014) (not published), *cert. denied*, __ U.S. __, 135 S.Ct. 2050 (2015) (holding that substance governs over form in evaluating "true lender" in a "rent-a-bank" scheme); *Meade v. Marlette Funding*, No. 2017CV30377 (Colo. Dist. Ct. Aug. 13, 2018) (order denying non-bank defendant's motion to dismiss on preemption of applicable Colorado rate caps).

[18] *See* 12 U.S.C. § 1831d(a).

[19] *See Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548 (Mass. 2008) (holding that mortgage loans structured to fail unless the borrower's income will increase during the loan's term were unfair under Mass. UDAP law).

[20] *See CFPB v. ITT Educ. Servs., Inc.*, 219 F. Supp. 3d 878 (S.D. Ind. 2015) (denying defendant's motion to dismiss and finding that the CFPB's allegation that for-profit college took unreasonable advantage of its students by steering them into institutional loans with a known default rate in excess of 60 percent in order to achieve objectives beyond the return on the loan was sufficient to state a claim); *See also De La Torre* & *B&B*, *supra* note 11.

[21] As an example, the D.C. Code provides that it is an unlawful trade practice to "make or enforce unconscionable terms or provisions of sales or leases" and that "in applying this [standard], consideration shall be given to," among other factors, "knowledge by the person at the time credit sales are consummated that there was no reasonable probability of payment in full of the obligation by the consumer." D.C. Code § 28-3904(r).

include in any guidance on small-dollar lending factors banks should consider in evaluating a consumer's ability to repay. Specifically, we recommend that the FDIC suggest that banks consider a consumer's monthly expenses such as recurring debt obligations and necessary living expenses in evaluating ability to repay and take into account a consumer's ability to repay the entire balance of the proposed loan at the end of the term without re-borrowing. We also recommend that the FDIC suggest that banks at least consider the consumer's capacity to absorb an unanticipated financial event – for instance, in the unexpected event of a loss of income or the added expense of a medical emergency – and, nonetheless, still be able to meet the payments as they become due.

III. Conclusion

We appreciate the opportunity to submit this this comment. Please contact our offices if you have any questions or need additional information.

Sincerely,

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