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National Association of Federally-Insured Credit Unions

April 27, 2021

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing,
& Urban Affairs
U.S. Senate
Washington, D.C. 20510

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing,
& Urban Affairs
U.S. Senate
Washington, D.C. 20510

Re: Tomorrow's Hearing, "The Reemergence of Rent-a-Bank?"

Dear Chairman Brown and Ranking Member Toomey:

I write to you today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) in conjunction with tomorrow's hearing, "The Reemergence of Rent-a-Bank?." As you are aware, NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 124 million consumers with personal and small business financial service products. We thank you for holding a hearing on this important topic. We have serious concerns with the reemergence of rent-a-bank schemes, and we would like to share our support for S.J.Res.15, which would repeal the rule submitted by the Office of the Comptroller of the Currency (OCC) relating to "National Banks and Federal Savings Associations as Lenders" (the "True Lender rule"). This issue also raises important questions regarding non-bank lending activity, including that of fintechs, and their lack of federal safety and soundness oversight. To that end, we urge you to examine the presence of fintechs and technology firms in the market for consumer financial services and the risks they pose to consumers and the stability of the financial system.

OCC True Lender Rule and the Reemergence of Rent-a-Bank

The OCC finalized its True Lender rule in October 2020, which became effective in December 2020, allowing banks and federal savings and loans to provide their charter for online lenders to deliver high-cost loans with annual rates exceeding 100 percent that evade State consumer protections and usury caps. In this scheme also known as "rent-a-bank," online lenders essentially rent bank charters and documentation to originate their loans in the name of the OCC-chartered banking institution, arguing that it is now a "bank loan" exempt from state rate caps.

As you know, these schemes are not new. State attorneys general, courts, and federal bank regulators had effectively shut down earlier payday loan rent-a-bank schemes. Relying on a centuries-old anti-evasion doctrine, courts followed the money to find that the payday lender, not the bank, was the true lender. The OCC's True Lender rule enables and authorizes this type of lending arrangement. Contrary to statements made under the previous administration, the OCC's rule will add to, rather than relieve, the burdens of high-cost lending. As Hope Enterprise Corporation/Hope Credit Union/Hope Policy Institute (HOPE) highlighted in their September 2020 letter in opposition to the OCC's rule, their members paid over $54,000 in payments to rent-a-bank lenders in the previous 90-day period alone. Such usurious behavior undermines consumer

protection laws and puts hard-working Americans at risk during the ongoing difficulties associated with the economic recovery from the COVID-19 pandemic. It is notable that 8 states have filed suit against the OCC to try to overturn this rule (*New York v. The Office of the Comptroller of the Currency*, No. 1:21-Civ.-00057 (S.D.N.Y. Jan. 5, 2021). It is unfortunate that the acting Comptroller of the Currency does not appear to be inclined to revisit the rule and that is why we think it is important for Congress to further examine the issue.

These predatory payday lenders are operating on an uneven playing field, relying upon the benefits of the OCC's federal preemption to circumvent consumer protections and place borrowers in harms' way. What is most concerning is the lasting damage this form of wealth extraction has on household financial security and on communities. Given the damage caused by these high-cost, unaffordable loans to borrowers' balance sheets, it limits the ability for legitimate and responsible lenders to support those households and communities with productive credit.

Credit unions have been on the frontlines during the pandemic, working to ensure their members stay afloat financially with consumer-friendly financial products. Credit unions have voluntarily implemented programs to protect their members' financial health, including skipping payments without penalty, waiving fees, low or no-interest loans, loan modifications and no interest accruals. Moreover, credit unions are able to meet their members' demands for short-term, small dollar loans, while ensuring accessibility, safety, and affordability. Often times, credit unions offer short-term, small-dollar loans as a service to members with the associated fees solely covering the expenses of loan servicing.

The *Federal Credit Union Act* (FCU Act) establishes an interest rate ceiling cap of 15 percent on loans and provides the National Credit Union Administration (NCUA) with flexibility to establish a higher interest rate for up to 18 months after considering certain statutory criteria. The current interest rate is set at 18 percent and has been in place since 1987. The NCUA has authorized a program referred to as payday alternative loans (PALs) to enable credit unions to offer their members a reasonable alternative to high-cost payday loans. The FCU Act establishes the interest rate ceiling for PALs at an additional 1000 basis points above the prevailing interest rate, so the current maximum allowable interest rate for a PAL is 28 percent. This maximum interest rate is far from the exorbitant interest rates charged by payday lenders and provides a safe, affordable option for consumers in need of a quick, short-term, small-dollar loan. The Consumer Financial Protection Bureau (CFPB) and CFPB Director-nominee Rohit Chopra have previously recognized the benefit credit union PALs provide to their communities.

Rather than pursuing problematic options like the OCC's True Lender rule to increase access to credit, we would suggest Congress consider consumer-friendly alternatives such as expanding credit unions' ability to offer PALs. Too many Americans are unbanked, underbanked, or underserved by financial institutions, and do not have the access that they need to financial services. Credit unions stand ready to help with financial literacy education and access to loans and other financial products, including PALs, but many are limited in their ability to add underserved areas to their fields of membership. Allowing all credit unions to add underserved areas to their fields of membership is one way to help those who need it most have access to capital without burdening the federal government. This request has bipartisan NCUA Board support.

At a time when low-income consumers can least afford it, the OCC's rule is enabling high-cost lenders to prey on consumers that are on even more precarious financial footing, which could threaten COVID-19 economic recovery efforts and the good work of consumer-friendly financial institutions like credit unions. We urge you to support S.J.Res.15 to overturn the True Lender rule and stop this harmful practice.

NAFCU Concerns About the Growth of Novel Charters Used by Fintechs

The "rent-a-bank" issue raises the larger concern about how new chartering options that have emerged with the growth of fintech can also present new threats and challenges as novel entities emerge in an underregulated environment. That is why NAFCU believes that Congress and regulators must ensure that when technology firms and fintechs compete with regulated financial institutions, they do so on a level playing field where smart regulations and consumer protections apply to all participants. NAFCU has outlined some of the challenges and opportunities in this area in a white paper which proposes regulatory recommendations for oversight of fintech companies.[1]

Financial Regulators Should Exercise Greater Oversight and Coordination to Supervise Fintechs

NAFCU believes financial regulators have a role to play in the supervision and regulation of fintechs under their existing authorities. However, Congress should also be willing to step in and clarify the role of regulators when necessary, such as with the OCC's True Lender rule. Another example would be for the CFPB to utilize its "larger participant" authority under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) to regulate and supervise technology firms and fintech companies that enjoy access to the financial services marketplace without the same supervisory expectations that apply to banks and credit unions. If the CFPB determines that supervision of fintech companies cannot be accomplished through its "larger participant" authority under the Dodd-Frank Act, then Congress should consider granting the Bureau explicit authority to supervise and examine fintech companies.

Congress should also consider creating a Federal Financial Institutions Examination Council (FFIEC) subcommittee on emerging technology (the subcommittee) to monitor the risks posed by fintech companies and develop a joint approach for facilitating responsible innovation. We would envision the subcommittee having the following under its charge:

a. Report its findings to Congress annually;
b. define the parameters of responsible innovation to ensure consistent examination of emerging technologies;
c. identify best practices for responsible innovation; and,
d. recommend regulatory improvements to allow FFIEC-regulated institutions to adopt new technologies with greater legal certainty.

[1] NAFCU, Regulatory Approaches to Financial Technology, available at https://www.nafcu.org/fintech-whitepaper.

Technology Companies Pursuing Financial Charters

Recently, fintech companies are enjoying unprecedented liberalization of bank chartering rules to either acquire or become banks. Recent developments with both the OCC's new chartering options and the Federal Deposit Insurance Corporation's (FDIC) approval of deposit insurance for Industrial Loan Company (ILC) applicants also present problems. In each case, a nonbank company can potentially evade regulation under the *Bank Holding Company Act* (BHCA), either because of a statutory loophole unique to ILCs, or because the entity does not accept deposits. Lack of BHCA coverage raises serious concerns regarding the quality and extent of supervision for these specialized or limited purpose banking entities. Chartering additional ILCs or granting new licenses to payments companies could also weaken the safety and soundness of the wider financial system.

In certain cases, specialized, limited purpose bank charters may allow a fintech to operate with national bank privileges but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering schemes as innovative, they are ultimately loopholes which invite unnecessary risk into the financial system and create an uneven playing field.

Special Purpose Fintech Charter

The emergence of new, fintech-powered business models has accelerated the disaggregation of bank services. This has not only increased competitive pressure but also challenged depository-centric models of financial supervision. The diversity of fintech companies and their role in the broader financial sector may necessitate reconsideration of existing models of regulation in the long run; however, an immediate focus for regulators and Congress must be to ensure that fintech companies are operating on a level playing field, and that new chartering options are presented transparently by banking regulators through full notice and comment rulemaking procedures. Furthermore, a level playing field encompasses more than just consistent application of federal consumer financial law. The appropriate application of prudential and supervisory expectations is an equally important consideration.

Research suggests that fintech mortgage lenders may enjoy structural advantages as nonbanks; in essence, benefiting from reduced regulatory burden which corresponds with relaxed federal safety and soundness standards. One report presented at the FDIC's April 2019 Fintech Symposium posited that 60 to 70 percent of "shadow bank" (i.e., nonbank lender) growth is likely due to regulatory arbitrage, and the rest due to advances in technology.[2] Other fintech companies may be enjoying reduced supervisory oversight even if they are subject to federal consumer financial law.

NAFCU recognizes that innovation depends on a fair, but flexible, regulatory regime for financial technology. Many credit unions partner with fintech companies to improve member service and historically these partnerships have proven invaluable to the growth

[2] *See* Piskorski, Tomasz, Fintech and Shadow Banking (April 2019), available at https://www.fdic.gov/bank/analytical/fintech/presentations/piskorski.pdf.

and competitiveness of our industry. Accordingly, NAFCU has advocated for expanding opportunities for credit unions to access pilot programs or regulatory sandboxes to test new products or services. At the same time, we have cautioned that frameworks designed to encourage innovation must not favor certain market participants at the expense of others.

When the OCC first introduced its general plan for a special purpose charter for fintech companies, NAFCU recommended that the OCC retain the core features of a national bank charter; namely, capital and liquidity requirements. Our position then assumed what we believe now, which is that the recipient of a specialized charter must be supervised as if it were a *bank*. The OCC's fintech charter should not serve as an occasion to offload traditional banking activities in exchange for comparatively lighter regulatory treatment.

In order to maintain safety and soundness within the broader financial sector, Congress should ensure that a fintech charter recipient is supervised as if it were a bank, regardless of whether its particular business model places greater emphasis on services other than deposit-taking or lending. Congress should also clarify that any special purpose fintech charter that confers the benefits of national preemption, or other privileges that have traditionally supported banks' deposit taking and lending roles, is bound by the same capital, liquidity, and consumer protection rules applicable to traditional banks and credit unions.

Payments Charter

In 2020, the OCC bypassed normal notice and comment rulemaking procedures to invite payments companies to apply for a limited purpose "payments charter." The payments charter has since drawn significant criticism from banks and credit unions alike and has inspired new litigation based on its core premise: that an entity choosing not to accept deposits can obtain the same privileges as a national bank.

One significant risk associated with the payments charter is the potential for reduced supervision of the bank applicant's holding company. By not accepting deposits, a payments charter recipient might not be regarded as BHCA bank, and its parent could avoid consolidated federal supervision by the Federal Reserve. Depending on the scale or risk of the holding company's activities—which might involve facilitating cryptocurrency transactions or issuing stablecoins per recent OCC guidance—lack of comprehensive Federal Reserve oversight could create additional risks for the American taxpayer if a specialized charter recipient fails because of weaknesses deriving from its parent's activities. Furthermore, the potential for a payments charter recipient to apply for master account access at the Federal Reserve could compromise the stability of our nation's payments systems. A payments charter recipient that does not accept deposits will not be clearly bound to the same capital and liquidity standards applicable to banks that receive federal deposit insurance. Easing or "tailoring" these important standards for entities that might access Federal Reserve payments systems could create new risks for our nation's financial infrastructure.

The OCC's payments charter has been marketed as one way to bring payments companies within the supervisory fold, an idea premised on the assumption that payments companies are willing to subject themselves to OCC supervision in exchange for certain privileges. While preventing "leakage" of financial services activities into unregulated areas is a commendable goal, the reality of a specialized payments charter may be the same as with the OCC's general fintech charter; namely, an occasion for fintech companies to engage in regulatory arbitrage.

We believe that Congress must ensure that payments charter recipients do not take advantage of the BHCA loophole and are subject to the same capital safety and soundness standards applicable to FDIC-insured banks.

Industrial Loan Companies

An ILC charter can offer certain nonbank parent companies the opportunity to skirt registration as a bank holding company and avoid consolidated supervision by the Federal Reserve.[3] This reduced oversight is further exacerbated by the fact that the FDIC lacks a complete range of statutory authority to fully supervise certain parent companies of ILCs.[4] As a result, the relationship between a nonbank parent and its ILC subsidiary lacks the degree of transparency and accountability intended by the BHCA while at the same time inviting potentially hazardous comingling of banking and commercial activities. In other words, the ILC charter frustrates a core principle of prudential regulation: that a bank's parent company should serve as a transparent source of strength rather than an opaque source of risk.

NAFCU believes that the FDIC approving new ILC deposit insurance applications at this time could severely weaken the stability of the financial system, and we have urged the FDIC to suspend further chartering activity for at least three years so that a fully informed analysis of supervisory risks can be conducted. Furthermore, given technology companies' interest in acquiring banks, the FDIC should also take heed of the unique privacy risks that might exist should consumer financial records find their way into the hands of nonbank parent companies through affiliate data sharing arrangements. A moratorium would also give Congress appropriate time to consider whether the ILC charter is conducive to advancing the goals of financial inclusion given the nonbank parent's limited accountability to its banking subsidiary.[5]

The FDIC should be focused on helping ordinary consumers instead of devoting analytical and legal resources towards advancing the financial ambitions of technology giants. To that end, we believe Congress must take decisive action to stop chartering of new ILCs,

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[3] Cocheo, Steve, "Fintech Charters Signal a Tectonic Realignment in Banking," July 22, 2020.
[4] Under Section 10(b)(4) of the FDI Act, the FDIC is permitted to examine any insured depository institution, including an ILC, to examine the affairs of any affiliate, including the parent holding company, "as may be necessary to disclose fully (i) the relationship between the institution and the affiliate; and (ii) to determine the effect of such relationship on the depository institution." 12 U.S.C. § 1820(b)(4). However, this limited grant of authority is no substitute for the full range of examination powers necessary for consolidated supervision.
[5] In contrast to BHCA banks, a non-BHC parent company would not be prohibited from commencing "new activities" if a subsidiary depository institution has a CRA rating that falls below satisfactory. *See* 12 CFR § 225.84.

eliminate the BHCA loophole for current ILCs, and solidify a core principle of banking regulation: that a bank's parent company should serve as a transparent source of strength rather than an opaque source of risk.

National Trust Banks

Recently, the OCC issued novel interpretations of its rules for national trust charters, without soliciting public input through normal rulemaking procedures.[6] In essence, the OCC has paved the way for banks to engage in a novel type of fiduciary activity: cryptocurrency custodial services. The OCC has also taken the position that a permissible fiduciary activity for a national trust bank is any activity that state law permits for a state trust company which comes into competition with a national bank. Previously, the OCC had taken the more prudent approach of first examining whether the proposed fiduciary activity was in fact 'fiduciary' within the meaning of 12 U.S.C. § 92a.[7] The practical consequence of this new interpretation is to relax standards for conversions of state trust companies into non-depository, national trust banks. Already the consequences of this arrangement are apparent—the OCC has already received applications from state trust companies that are heavily engaged in digital asset-related activities. While there may be a role for this, we believe Congress should not allow the OCC to promulgate new chartering standards for trust banks through legal interpretations that bypass normal notice and comment rulemaking processes.

In conclusion, credit unions look forward to continuing to experience growth in the technology space as a way for them to better serve their members. However, as technology companies expand, and new companies emerge, to compete in the financial services area, it is important that they compete on a level playing field of federal regulation—from data privacy and security to consumer protection. Finally, it is important that Congress ensures laws are modernized to allow regulated financial institutions, such as credit unions, to keep up and compete with technological advances.

We thank you for your leadership on this important topic and appreciate the opportunity to share our thoughts on the reemergence of rent-a-bank schemes, the True Lender rule, as well as the growing role of fintechs in the financial services marketplace. We look forward to continuing to work with you on these issues, as well as pandemic relief and economic recovery. Should you have any questions or require any additional information, please contact me or Sarah Jacobs, NAFCU's Associate Director of Legislative Affairs, at sjacobs@nafcu.org or (571) 289-7550.

Sincerely,

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the U.S. Senate Committee on Banking, Housing and Urban Affairs

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[6] OCC, Interpretive Letter #1176 (January 2021), available at https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1176.pdf.

[7] *See id.* at 4, fn. 5.