



Reinvestment
PARTNERS
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January 14, 2017

Comptroller Thomas J. Curry
Office of the Comptroller of the Currency
400 7th St. SW
Washington, DC 20219
specialpurposecharter@occ.treas.gov

RE: Exploring Special Purpose National Bank Charters for Fintech Companies

Dear Comptroller:

Reinvestment Partners and the Maryland Consumer Rights Coalition submits this comment on special-purpose national bank charters for fintech companies.

Reinvestment Partners is a non-profit 501 (c) 3 agency whose mission is to seek economic justice. We use an interdisciplinary approach aimed at improving people, places, and policy. We provide direct services to consumers, either to protect them from financial harm or to improve their financial health. We redevelop real estate in some of Durham's lower-income neighborhoods. In our policy work, we advocate on behalf of lower-income consumers and communities of color to promote systematic reforms to the financial system.

The Maryland Consumer Rights Coalition is a statewide organization that advances fairness and justice for Maryland consumers through research, education, and advocacy. Our 8,500 supporters across the state include individuals, as well as poverty, housing, youth, and older adult advocates. MCRC conducts original research on financial products and services, promotes consumer education through consumer guides, original films, video PSAs, as well as earned and social media, and promotes progressive economic policy and consumer protections at the local, state, and federal level.

We urge the OCC not to adopt a chartering system for fintech companies. We have concerns that the OCC's plans to provide charters to "fintech" firms could, at least with respect to lenders, undermine strong state interest rate caps and other critical consumer protections.

Procedurally, we believe that this system would lead to a scenario where firms choose an OCC Charter only if they feel they can evade a stronger regulatory framework elsewhere. Hypothetically, fintech firms would effectively shop for their preferred regulator. Firms might perceive a national charter as a means to

gain a regulatory advantage against competitors who remain inside a more restrictive state-level regulatory regime. Inevitably, this would lead to a “race-to-the-bottom” scenario.

Definitional Problems:

As the OCC White paper notes “fintech companies vary widely in their business models and product offerings.” This variety makes it extremely difficult to develop appropriately rigorous regulations and policies that encompass the dynamism within this financial sector. Consequently, because of the wide-range of products and services within the sector, some laws would apply to certain actors and not others. As the white paper noted, firms that lend to consumers would be subject to the Equal Credit Opportunity Act while others wouldn’t. Similarly, only those firms with insured depositories would be subject to the Federal Deposit Insurance Act. The very nature of the industry would require the OCC to develop rigorous definitions, oversight, and standards both to foster financial inclusion and promote consumer protection as well as to ensure a level-playing field with traditional financial institutions that abide by stronger regulations so that fintech firms do not engage in charter-shopping.

An alternate charter would allow fintech companies exemptions from state regulatory and consumer protection requirements.

Maryland has a usury rate cap of 33% for small dollar loans. It is possible that a fintech company could skirt longstanding rate caps because of the way the current law is written. The charter may thwart state regulators efforts to examine or investigate fintech firms and would make it difficult to expand consumer protections. It is important that any federal regulations are clearly defined as the floor not the ceiling and that federal authority does not preempt state authority.

Since 2004, North Carolina has had an interest rate cap of 36 percent for small-dollar deferred deposit and single payment loans. In practice, payday lending is illegal in North Carolina.

North Carolina’s Consumer Finance Act (updated in 2015) has strong protections in place already to regulate consumer installment loans.

Loan Amount, by Outstanding Balance (Tiers)	Maximum Interest Rate
Loans Originated for less than \$10,000	
Outstanding balances <\$4,000	30 percent
Outstanding balances between \$4,000 and \$8,000	24 percent
Outstanding balances between \$8,000 and \$10,000	18 percent
Loans Originated for between \$10,000 and \$15,000	18 percent

These caps are far below the rates charged by the largest online consumer installment lenders. The evidence from North Carolina suggests that lenders can make a profit at these rates. In the aggregate, consumer installment lenders have been profitable year after year.

Additionally, the North Carolina experience underscores how a state can apply strong consumer protections to installment lending without reducing access to credit. In 2014, 479 lenders made \$1.06 billion in regulated loans in North Carolina. The current rules do not appear to stifle the supply of credit, nor have they limited the number of entrants into the market.

Financial Inclusion:

While one of the purported benefits of financial innovation to assist under-and-unbanked consumers to develop a banking relationship, many fintech companies are not designed to achieve this result. Because their business model depends upon the ability to collect through ACH, fintech lenders cannot provide credit to the unbanked.

As noted, some are lenders, others offer payment services, while still others engage in digital currencies or block-chain. Many of these products and services rely on internet access, a smartphone, and some relationship with a banking institution which does little to expand financial inclusion.

Moreover, many are not equipped to address the literacy, numeracy, and technological challenges that many low-income consumers experience. Therefore, it's unclear how these fintech firms may expand financial access. The OCC would again have to develop careful and rigorous metrics, methodologies, and benchmarks to ensure that financial access is expanding.

We have concerns about how the OCC plans to define "fintech." How does it differentiate between traditional non-bank FIs and new non-bank fintech companies? Would a prepaid card program manager be designated as a fintech firm, if only because it differs in its approach from a traditional bank? Would a check casher be considered to be "fintech?"

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

Many fintech firms espouse a mission-oriented business model, but still offer high-cost financial products with limited consumer protections. We recognize and agree that new financial technologies may provide greater competition, increase efficiency, and increase access to credit, faster payments, and create innovation in the marketplace.

Conversely, many fintech companies may charge predatory rates, lose wealth for consumers, and contribute to financial instability. One important concern is that many of these innovations remain untested during periods of financial stress. As the Treasury Department's research on online marketplace lending notes the underlying operations and underwriting models remain fairly untested. Many online lenders also outsource their servicing and collections. Should the U.S. face another economic recession, it is unclear how these firms would cope with a rise in defaults and delinquencies. The financial crisis exemplifies the kinds of servicing problems that struggling consumers experienced with large financial institutions. Until several banks agreed under the National Mortgage Settlement Act to abide by new servicing standards, most of which were later codified under the CFPB mortgage servicing to apply to all servicers, homeowners struggling to save their homes faced dual tracking, lost paperwork, misapplied payments, and incorrect information.

In Maryland, which experienced some of the highest foreclosure rates in the country, In Maryland, more than 17,366 families got some form of relief under the settlement between March 1, 2012 and June 30, 2013 but short sales and second-lien extinguishments represented 63% of the relief, while only 13% got principal lien reductions. In the past, oversight of large banks which were required to follow certain consumer protections was insufficient to prevent grievous harm to consumers. To proceed with a new charter for fintech firm, oversight would have to be expanded and deepened. And, these firms remain untested so it remains unclear how successfully they might cope with an economic downturn. Moreover, any charters would have to address the firms as well as any of the servicers they relied upon under a new framework.

Additionally, fintech firms rely on "big data" applications to market and underwrite their products. We are concerned that their methods will challenge the structure of some important laws. Most law regulates

the data that a bank puts into an underwriting model. For example, there are rules in place that make it illegal to use race as a factor in lending. But many fintech companies use dynamic models that make inferences from data to create their unique customer profiles. There is a strong risk that fintech firms use of nontraditional data sources could lead to disparate impact and fair lending violations against consumers.

New data sources have the ability to make unintended correlations that contribute to disparate impact, to penalize consumers who lack a large online presence and are often inaccurate. For example, auto insurance firms in Maryland is prohibited from factoring race or income into its rate-setting but are permitted to use zip code, credit score, marital status, education, occupation, and home ownership. As a result, cumulatively these factors result in a disparate impact that disproportionately affects communities of color and low-income communities. Any new charter must balance the risks and opportunities presented by the use of big data.

Loan flipping: Many small business fintech lenders differentiate their model from that of a traditional bank based on convenience and speed of origination. But we are concerned that this model also means that many lenders will refinance their existing customers into new loans to avoid defaults. Many fintech lenders charge origination fees (for example, OnDeck Capital charges first-time borrowers between 2.5 and 4 percent to originate a new loan and between 1.5 and 3 percent after that for new loans to the same applicant).

Consider the following excerpts from recently published 10-ks:

Approximately 25% percent of our origination volume from repeat customers in 2015 was due to unpaid principal balances rolled from existing loans directly into such repeat originations. Each repeat customer seeking another term loan must pass the following standards: The business must be approximately 50 percent paid down on its debt. The business must be current on its outstanding OnDeck loan with no material delinquency history. The business must be fully re-underwritten and determined to be of adequate credit quality¹.

In fiscal 2016, approximately 81.5% of the Company's loans were generated through refinancings of outstanding loans and the origination of new loans to previous customers. A refinancing represents a new loan transaction with a present customer in which a portion of the new loan proceeds is used to repay the balance of an existing loan, and the remaining portion is advanced to the customer. The Company markets the opportunity for qualifying customers to refinance existing loans before maturity. In many cases the existing customer's past performance and established creditworthiness with the Company qualifies that customer for a larger loan. This, in turn, may increase the fees and other income realized for a particular customer. For fiscal 2016, 2015 and 2014, the percentages of the Company's loan originations that were refinancings of existing loans were 69.4%, 71.5%, and 73.5%, respectively².

While the OnDeck model is better than the World Acceptance approach, its distinction is relative. Both attest to underwriting in the application process, and both insist that a borrower's prior payment history factors into loan approval.

¹ OnDeck Capital. 2015 10-k. Accessed via the Securities and Exchange Commission at <https://www.sec.gov/Archives/edgar/data/1420811/000142081116000111/ondk-20151231x10k.htm#s147C32C98BBE5CEEAC8E15179844BEC2>

² World Acceptance. 2016 10-k. Accessed via the Securities and Exchange Commission at <https://www.sec.gov/Archives/edgar/data/108385/000010838516000127/wrld-331201610xk.htm>

Underwriting with ability-to-repay: We support adoption of a strong ability-to-repay (ATR) for all lending. There should also be transparency as well as a clear set of terms and disclosures to borrowers. Some online lending tends toward the ability-to-collect model, most notably in the case of merchant cash advances.

- Lenders should be prohibited from requesting additional ACH pulls after two successive failed attempts, and in such a circumstance, they should be required to seek re-authorization for the privilege of doing so from the borrower before initiating a new request.
- Borrowers should be prevented from refinancing their existing outstanding balances unless the new loan would provide a material benefit to the borrower. In defining that criterion, the OCC should insist that the borrower must have already paid down at least half of the initial loan amount.
- Lending should not be based upon the value of collateral instead of the verifying that borrowers have the ability to meet expenses while still honoring their debt service.

As far as we can tell, most fintech lenders have created risk-adjusted rates that make their loan products available to most borrowers. But in doing so, they offer debt at interest rates that are far greater than those associated with similar product lines at banks. According to a report from the Opportunity Fund, the average interest rate of an alternative (fintech) small business loan was 94 percent. One bore a rate of 358 percent³.

In our opinion, it would be absurd if a new charter allowed a lender to evade strong state laws to offer high-cost products and then to simultaneously receive a CRA-style credit for doing so.

This underscores the disconnect. CRA tends to focus on extending access to credit. Access is not a problem with fintech lending. Moreover, it does not make sense to believe that a community can be better served by increasing the amount of high-cost credit available to its citizens. A CRA regime for fintech should reorient its aims to championing the availability of affordable, flexible, and safe credit.

Consumer protections: The Treasury found that while some online lenders disclosed rates, terms, and loan-level data, others did not disclose information. Given the nature of online lending, consumer protections should be enhanced for small businesses. The OCC should consider adopting the Small Business Borrowers Bill of Rights which calls for transparent pricing and terms, the right to non-abusive products, fair credit, fair debt collection practices and more. This would provide enhanced protections for small businesses.

2. What elements should the OCC consider in establishing the capital and liquidity requirements for an uninsured special purpose national bank that limits the type of assets it holds?

We cannot assume that fintech firms have the same degree of safety and soundness as we have come to expect from FDIC-insured depositories.

Non-depository lenders present challenges to meeting standards for safety and soundness. Whereas banks can accept deposits, most non-banks are financed through a combination of equity and debt. Whereas deposits are insured, equity and debt are not. The capital costs associated with private equity are very high. Moreover, both equity and debt can be recalled. Typically, private equity investors have a short time

³ “Unaffordable and Unsustainable: The New Business Lending on Main Street.” May 24, 2016. The Opportunity Fund. Accessed at <http://www.opportunityfund.org/media/blog/unaffordable-and-unsustainable-new-opportunity-fund-report/>

horizon. It would not be uncommon for an investor to abandon a business if it did not become profitable in five years. Large investors usually seek board seats and ask for voting power.

Any chartering approach should address these concerns to protect borrowers.

For example, while Green Dot has always been averse to offering credit or overdraft in association with its prepaid cards, it faced an investor challenge in 2015 that would have changed that practice. Harvest Capital had purchased approximately 10 percent of Green Dot's shares. In calling for the resignation of Green Dot's CEO, Harvest announced to the public that it wanted the company to offer credit⁴. While Green Dot held off Harvest's challenge, the affair underscores how an activist investor can pursue a change in business practices, even if such a change would seek short-term gains at the risk of imperiling a company's balance sheet.

Just as banks impose capital adequacy standards on depositories, the OCC should place limits on the leverage of a fintech lender. There are examples of regulatory approaches used for non-bank financial institutions that provide guidance. We would look to the insurance industry as a starting point. Insurance regulators protect consumers by reviewing the capital structure of an insurer's asset holdings. Regulators require insurance companies to develop models for the strength of their investments. Regulators require insurers to hold a blend of risk-free and risky assets and to model the overall degree of risk in their portfolios. In some cases, state insurance commissioners require that insurers hold a capital surplus of risk-free assets (certificates of deposits, US Treasuries).

All types of obligations should be reviewed, with an eye to the amount and timing of the fintech institution's debt service schedule. The OCC should include obligations to pay interest, dividends, and to purchase back outstanding equity from investors.

The OCC should review the role for lenders to invest in derivatives that would reduce specific areas of risk that may be identified inside a lending portfolio. For example, if a lender had a high concentration of small business loans outstanding to businesses in a particular region or sector, then the OCC should encourage the company to hedge against those risks.

Other concerns:

- Geographic risk: does the lender have an unusual concentration of loans extended to borrowers in only a few states?
- Debt obligations: Will upcoming debt repayments (corporate financing with balloon repayment) undermine the long-term safety and soundness of a lender? The OCC should stress test non-banks for their ability to pay their future debt obligations in the context of secular challenges to the economy or to particular business sectors, provided that it was the case that the lender had concentrated exposure.
- Associated investors: What agreements does the lender have in place with investors? If investors have the privilege of withdrawing their capital at any time – rather than selling it to another investor or holding it under conditions that reduce liquidity – it may pose a risk to the going safety and soundness of the non-bank's balance sheet.

The 2008 purchase of Pay Rent Build Credit ("PRBC") by Microbilt provides a cautionary example of how the financial strength of a non-bank fintech company can influence consumer outcomes. Consumers paid for the PRBC service to improve their credit scores. PRBC collected evidence of positive payments (rent, utilities) that would otherwise not be utilized by the mainstream credit bureaus. PRBC was an innovative idea. By any definition, it was an example of a "fintech" solution. At a certain point in time, PRBC encountered financial difficulties. It was placed for sale and subsequently bought by MicroBilt.

⁴ "Harvest Capital Challenges Green Dot's Leadership." BankTalk.org. January 16, 2016. Accessed at <http://banktalk.org/content/harvest-capital-challenges-green-dot-leadership>

MicroBilt is a credit agency that services the kinds of small businesses that draw upon subprime consumers for their customer base. With PRBC, MicroBilt was able to enhance its knowledge base. In theory, it did tap positive payment histories. But consumers used PRBC with the purpose of graduating from subprime credit. Due to PRBC's finances, consumers never realized that benefit. The only beneficiaries were subprime creditors, who could now draw from new data to sharpen the credit performance of their portfolios. This event should underscore how capital adequacy is a significant concern that can impact consumers.

Payments: In evaluating the risks and benefits of new payments solutions, the OCC should review companies for their ability to address settlement risk.

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

Should the OCC proceed with a non-bank charter, we strongly urge the adoption of a rigorously developed CRA-like obligation and furthermore urge that any such obligations be vigorously enforced through examinations as well as at the outset of the approval.

The OCC should require a financial inclusion plan as part of the fintech firm's application for a charter. The financial inclusion plan and the entire business plan should be made publicly available for review and comment.

The financial inclusion plan should include measurable goals for serving low-income and minority borrowers and communities. The goals would be drawn from the firm's business plans. Benchmarks might include making equaling or exceeding the percentage of loans (or other products and services) of their peers and should include a plan on how to reach the stated goals. Fintech firms that engage in mortgage lending should submit their lending records to the CFPB for inclusion in HMDA.

We support a quantifiable approach to determining the geographies where a fintech firm would have a CRA obligation. Some factors to consider:

Determining a geographic assessment area: The CFPB's larger participant approach, where the agency assumed supervisory powers over non-banks when it could be demonstrated that those firms had greater-than-average market shares, could be one model for emulation. If it was evident that a non-bank enjoyed a large market share in a particular line of business (lines of credit, small business term loans, student loan refinances), then an approach might be to expect that firm to develop a strategic plan in its biggest geographic catchments. We believe that the portfolios of fintech lenders tend towards some degree of clustering. For example, 44 percent of OnDeck Capital's fixed term loans are made to borrowers from only five states⁵.

We understand that some approaches might be different and better than those currently utilized by traditional banks. But that optimism is buttressed by concern. A likely service - if the criteria include being offered in an online mode, across any geography, and at a scale that would be small enough to work for a start-up with modest assets - is an online financial literacy program. While financial literacy is important, it is not as critical as building assets for underserved communities through lending, investments, and grants. The evidence we saw in North Carolina suggests that financial literacy is not as effective when delivered via online modules. In-person counseling produces better results than online

⁵ OnDeck Capital, 2015 10-k.

modes. We believe that a CRA commitment for a lender should involve lending, investments, and grants.

Commitment commensurate with scale: Moreover, fintech companies should be expected to offer community development grants, loans, and investments proportionate to their market share. Therefore as a fintech grows and expands its market, so too, should its investments grow.

Timing: Moreover, since the online use of loans, products, and services is less visible than the construction of new bank branches, the OCC should require frequent reporting (at least quarterly) of fintech companies growth and the areas where growth is taking place. The OCC should, at a minimum, assess growth annually and designate new assessment areas.

The OCC should not merely trust, but rather, it should verify that the firm's stated goals for realizing financial inclusion are being realized. The OCC should trust a promise only to the extent that it can be verified. For example, if a fintech offered a technology that would "Graduate" consumers to lower-cost loan products conditioned upon a demonstrated record of repayment, then it would not be valid to grant credit if the empirical evidence failed to show that consumers were realizing the benefits of that program.

The OCC will have to apply CRA to these new institutions. In doing so, they will have to expand the scope of the CRA when examining non-depository institutions.

Engagement with community groups is essential: The financial inclusion plans should include an outreach and engagement plan for firms to meet with national and local groups engaged in economic inclusion, fair housing, fair lending, consumer protection. After a charter is approved, the firms should continue to meet and engage with local partners on a quarterly basis. The OCC must rigorously assess the fintech firms against their business and financial inclusion plans. There must also be strong and meaningful enforcement should a fintech not meet its financial inclusion goals. As is the case with CRA, the OCC must permit time for national, state, and local groups to comment on a fintech firm's performance before determining whether to renew their charter.

Robust ability-to-repay standard: Any loan a fintech firm provides must be subject to a robust ability-to-repay ATR standard to ensure that the loans provided are affordable, accessible, and sustainable. We believe that the ATR should include verified income, living expenses, and borrowing. The ATR must be determined before approving the first loan and again, prior to approving any subsequent loans. Without an ATR standard, fintech firms may expand access but not in an affordable or sustainable way.

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

As described above, there are ways for the OCC to develop a CRA-like requirement of fintech companies. We believe that without such a requirement, it is likely that fintech firms may exacerbate inequalities in access between wealthy and low-income consumers. A requirement of some sort that ties fintech approval and reapproval with a commitment to expand products and services to communities of color and financially distressed communities is critical.

One approach to achieving these goals would be a pooled community reinvestment fund. This approach would require lenders and payments providers to contribute capital to a common fund. The funds could be held in escrow by the OCC. The fund would extend loans to underserved borrowers at affordable rates and with robust consumer protections. The aim would be to create products equal to the cost and quality of those offered by CRA departments at traditional banks. Servicing could still be performed by fintech

firms (or their agents). Oversight, underwriting, and the implementation of consumer protections should be performed by a governance body that includes representation from community groups.

5. How could a special purpose national bank that is not engaged in providing banking services to the public support financial inclusion?

Fintech payment solutions can enhance access for the unbanked.

The Faster Payments Task Force has received proposals from several non-banks which would allow individuals to make payments without having a bank account. These kinds of services can provide consumers with the benefits they need which might otherwise be unattainable in the context of exclusionary policies at traditional banks.

However, providing access is not enough. Unbanked consumers need access that is affordable and sustainable to enable them to both build assets and develop pathways to return to traditional banking. We believe that it is also important to verify that fintech providers can create solutions that reduce consumer cost and enhance capacity. There are current non-fintech solutions that enable access but do so at high costs. Check cashing services may give consumers the ability to access their wages – and in a timely fashion – but they do so at considerable consumer expense.

- Access to new payments systems should be free. Services that cross-subsidize costs by imposing additional expenses are lower-income households will naturally limit inclusion.
- Payments and other non-bank services must take into consideration literacy, numeracy, access to the internet, access to a smartphone, and other issues that may contribute to financial exclusion. Within any CRA-like proposal, providers must demonstrate in concrete and specific metrics with timelines and benchmarks to show they will promote financial inclusion and access.
- A specific goal could be scaled per provider, according to the assets of the fintech firm. These commitments may again include specific commitments in well-defined assessment areas to nonprofit organizations and CDFIs that support financial inclusion goals and activities. The OCC must rigorously assess These financial inclusion commitments. As is the case for other firms, public comment periods before a charter is approved, at the occasion of a fintech’s reporting period, and during its renewal period is critical.

The opportunity for innovation in faster payments can and should reduce the number of unbanked households. Faster payments can reduce settlement risk. If banks can verify good funds in real time, then overdrafts should not occur - except for cases where consumers use overdraft as a form of credit. Consumer surveys repeatedly report that the most common reason for leaving the banking system is because of overdraft. The fintech revolution should herald the demise of this problem. Regulatory activity should strengthen the momentum behind these changes.

Although faster payments will reduce settlement risks, without adequate protections, risks remain for consumers who were persuaded by a scam artist to make a payment. Countless examples of internet fraud, particularly preying upon older adults, exist. It is critical that appropriate consumer protections are in place to allow chargebacks when a credit push request is made by a payee through messaging channels that are outside of the formal payment system (i.e. over the phone, social media, or text).

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

When small businesses use credit cards marketed to businesses, they do not benefit from the same levels of consumer protections that the CARD Act affords to consumers. The OCC should take this opportunity to eliminate that gap.

7. What are potential challenges in executing or adapting a fintech business model to meet regulatory expectations, and what specific conditions governing the activities of special purpose national banks should the OCC consider?

Lending:

Fintech lenders do not use traditional underwriting techniques. In some instances, their models use inputs that most banks would be prevented from utilizing because of regulatory restrictions. Elevate's Elastic Line of Credit, for example, is underwritten with algorithms that use tens of thousands of inputs. Those inputs are dynamic (they interact with each other), and they change regularly. In its 2015 S-1 filing to investors, Elevate reported that it has a team of 35 data scientists who cull information from scores of third-party vendors and that they just finished the 11th update of their model.

In some ways, it seems implausible that they could be held to the same standards as are banks, and still operate under a business-as-usual framework. Consider this excerpt from Elevate's S-1 filing:

*In making a decision whether to extend credit to prospective customers, and the terms on which we or the originating lenders are willing to provide credit, including the price, we and the originating lenders rely heavily on our proprietary credit and fraud scoring models, which comprise an empirically derived suite of statistical models built using third party data, data from customers and our credit experience gained through monitoring the performance of customers over time. Our proprietary credit and fraud scoring models are based on previous historical experience...Our proprietary credit and fraud scoring models are also highly reliant on access to third party data sources. If these data sources are not available at time of credit decisioning or if the companies that have aggregated this data are no longer able or willing to provide this data to us, our products will experience higher defaults or higher customer acquisition costs...If our proprietary credit and fraud scoring models were unable to effectively price credit to the risk of the customer, lower margins would result. Either our losses would be higher than anticipated due to "underpricing" products or customers may refuse to accept the loan if products are perceived as "overpriced".*⁶

The company is saying that its business can only work if it can take advantage of 3rd-party data.

How would a company like Elevate begin to explain its rationale for turning down a credit applicant? Would it list the thousands of factors - and the interpretation made by the company of the interaction among those factors? How would a consumer possibly go about the process of changing information that adversely affected his or her application for credit? How would the customer possibly find the sources for those reports if they came from scores of different data vendors?

The insurance industry is analogous in many ways to online lenders' use of various data sources. For insurance firms, they can demonstrate a correlation between data but not causation. This data is used to rate drivers. For consumers, because so many data points are used, and the weight each factor is given is rarely revealed, there is little a consumer can do to modify his behavior to improve the terms or conditions of the policy. The process is opaque, fraught with the potential to violate fair lending and disparate impact policies, and leaves the consumer with little recourse to improve outcomes. The OCC should, instead, make sure any fintech firms work in a transparent and consistent manner.

Fair Credit Reporting Act: The OCC should allow consumers to access underwriting data that contributed to a decision by a lender to deny an application for credit. However, doing that will be more difficult than might be the case with the kinds of lenders already under supervision by the OCC. This reflects the tendency for fintech companies to create their lending algorithms from hundreds – if not thousands – of data points. Moreover, fintech lenders tend to change the makeup of their algorithms regularly. Lenders

⁶ Elevate Credit, Incorporated. January 11, 2016. Submitted to the Securities and Exchange Commission. Accessed at <http://www.nasdaq.com/markets/ipos/filing.ashx?filingid=10611753>

might argue that the complexity of their lending makes it difficult to provide an explanation for lending decisions. While it might be true that some lenders would find it hard to do so, they should still have to offer consumers an explanation for why they were turned down for credit.

The OCC should prevent lenders from setting rates through the use of price optimization. This practice, common among insurance companies, relies upon inferential analytics to ascertain a consumer's price elasticity of demand. Consumers pay more not because they present a greater risk, but only because their characteristics suggest that they will be unlikely to reject higher prices.

Other Concerns:

Reputational Risk: The OCC should be concerned with consumer confidence in these institutions. We believe that the OCC should be very cautious in extending charters until it has reviewed the business model of new fintech companies. If initial iterations of chartered fintech institutions undermine consumers, then it will undermine the perception of all chartered fintech institutions in the eyes of the public.

Privacy: The OCC should develop and enforce a set of minimum standards for data protection, standards, end-user education and awareness, and compliance practices.

Payments:

The OCC could play a role of facilitating Know-Your-Customer rules by managing a universal directory for payments. The directory would serve non-banks that facilitate payments to and from other non-bank FIs. The directory would register, verify, and authenticate payers and payees. Those records would then be maintained across the system. By taking a collective action, the OCC would reduce system-wide costs and strengthen security. The system would use an alias that protects the privacy of sensitive information. By providing a universal directory, rather than relying upon a system where a variety of directories are operated by diverse private firms, overall costs will be reduced and security will be enhanced.

The CFPB recently published a set of guidelines for the regulation of “faster payments.” The recommendations contained in that white paper should inform how the OCC might supervise a faster payments fintech company.

Investments

There are already many different fintech companies offering investment advice or products. Some draw upon computing power to replace human decision-making with automated machine learning techniques. Others attempt to improve outcomes for investors by introducing ideas from behavioral economics that might contribute to better consumer decision-making.

We believe that it is important that if it does decide to charter these types of firms, that the OCC should hold them to a fiduciary standard. In 2015, the Department of Labor promulgated a final rule to require investment advisors (brokers, insurance agents) to act in the best interests of retirement plan participants and IRA investors - and without regard to their own financial interests or the interests of their financial institutions. Notably, it meant that disclosing a conflict of interest was not satisfactory. If the OCC does charter investment firms (Betterment, Honest Dollar, etc.) then it should make sure that fintech investment services are required to put the interests of consumers first.

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

We are very concerned that lenders capitalized largely by private equity will never have strong balance sheets. If left to themselves, investors may pull their investments from these companies as soon as a better opportunity presents itself. The OCC should establish standards to protect consumers who have borrowed from these firms. The challenge becomes greater when they cannot take deposits. An alternative would be to ask these firms to leave risk-free assets (Treasuries, money markets) in escrow accounts.

The concern would owe to the high levels of loan defaults in some of the loan portfolios held by these firms. At the non-bank lender Enova, charge-offs (*combined, held by the company or securitized) were 18.8 percent of the average loan balance⁷. At Elevate, charge-offs were equivalent to 51 percent, 43 percent, and 48 percent of revenues during the years ending 2014, 2013 and during the first nine months of 2015⁸.

Some lenders choose to hedge their charge-off risk by selling credit-default swaps or by participating in loss-sharing clawback agreements with business partners. While these approaches do mitigate balance sheet risk, they do not address the impact to borrowers.

9. Would a fintech special purpose national bank have any competitive advantages over full-service banks the OCC should address? Are there risks to full-service banks from fintech companies that do not have bank charters?

Certainly, there are competitive advantages. fintech companies do not have to invest in the brick and mortar costs of constructing and staffing bank branches which full-service banks do. The fixed costs are very different for the two entities. Moreover, the online lending space-to-date has not been as well-regulated as the full-service bank space which has enabled fintech firms to be more nimble and flexible in developing new products and services as well as innovating within the space. There are risks to full-service banks from fintech companies.

11. How can the OCC enhance its coordination and communication with other regulators that have jurisdiction over a proposed special purpose national bank, its parent company, or its activities?

An Interagency Working Group, much like the one described in the Treasury report, is needed to ensure coordination with evolving market participants, practices, and regulators with joint oversight. fintech activities affect a number of federal agencies. The workgroup should include the OCC, Treasury, CFPB, FRB, FDIC, FTC, SBA, SEC, and a representative state bank supervisor. The Working Group should ensure adherence to existing regulations that apply to fintech firms, examine the impact of big data on access to credit and loans, monitor risk through the credit cycle, strengthen transparency, expand consumer protections, and develop a strong system for interagency coordination to monitor compliance with current regulations, promulgate new regulations as needed, monitor marketplace developments, and convene community participants to public hearings and town halls to create a robust process for public input.

13. What additional information, materials, and technical assistance from the OCC would a prospective fintech applicant find useful in the application process?

The OCC should model the approach used by the Consumer Financial Protection Bureau to incubate innovation. The CFPB's Project Catalyst is designed to support innovation that enhances the interests of consumers. In Project Catalyst, a private firm can receive short-term regulatory amnesty. to receive that exemption, the firm must submit to regular supervision for the CFPB. Additionally, the project must include a research component so that the process creates positive externalities for the larger marketplace.

⁷ Enova Investor Relations. February 2, 2015. accessed at <http://ir.enova.com/2015-02-03-Enova-Announces-Fourth-Quarter-and-Full-Year-2014-Results>

⁸ Elevate Credit, S-1 filing. <http://www.nasdaq.com/markets/ipo/filing.ashx?filingid=10611753>

In offering a similar regime, the OCC could facilitate the development of a market that is safer for consumers and small businesses.

Conclusion

Our overarching belief is that the OCC should not establish a special purpose national bank charter for fintech companies. In North Carolina and Maryland, existing law already provides strong rate caps whose ceilings fall below many of the interest rates offered by out-of-state fintech firms. We are concerned that pre-emption would ultimately undermine the interests of the consumers in our states. However, our comments include many recommendations for how the OCC might choose to regulate fintech companies. Those insights should be taken to assert that we favor a charter. We have added those answers to advocate for strong protections if the OCC does pursue a charter for these institutions.

We appreciate the opportunity to comment on this important issue.

Sincerely,

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