Reinvestment
PARTNERS
PEOPLE • PLACES • POLICY

April 14th, 2017

Comptroller Thomas Curry
Office of the Comptroller of the Currency
400 7th St. SW
Washington, DC 20219

RE: Evaluating Charter Applications from Financial Technology Companies

Honorable Comptroller Curry:

Please consider this comment from Reinvestment Partners.

Reinvestment Partners is a 501 (c) 3 non-profit group in Durham, North Carolina. We work to expand opportunities for lower-income consumers to access safe and affordable financial services. We achieve our mission by providing direct services to people, by improving places, and by systemic reforms in public policy.

In our prior comment on this proposal, we expressed our concerns that the chartering process could allow financial technology companies ("fintechs") to evade state consumer protection laws. We referred to several examples of non-bank lenders that currently contract with community banks to offer loan products with high rates of interest.

We also added comments on how the OCC might establish a program for financial inclusion ("FI").

Through in-person meetings and via the recent publication from the OCC, we have come to believe that the OCC will only grant a charter to institutions that can meet a high set of standards for

consumer protections. We read of many areas where the OCC is defining high standards to meet those safeguards. We are optimistic the manual will apply strictly-defined benchmarks.

Financial Inclusion

We see challenges in duplicating the same set of criteria for FI by fintech firms as has been utilized in the case of examinations of banks and thrifts. Access carries a different meaning when the cost of the products offered varies so greatly. Whereas traditional insured depositories have created low-cost and fully-compliant products, this is not necessarily the case for fintechs. We do not believe that FI occurs when an under-served consumer accesses a loan with a 60 percent interest rate. We would fail to see the value even for loans with interest rates above 30 percent. Loans at these rates are already available from any consumer finance company in North Carolina – and this is not a good thing.

We offer these comments on specific aspects of how the OCC might operationalize the principles outlined in "Evaluating Charter Applications from Financial Technology Companies:"

Determination of an Assessment Area: Because fintech lenders do not have branches and may offer their product across all of the United States, defining an assessment area creates a challenge for regulators. The shortcoming of defining assessment areas to include every locale where a product is consumers is that it would divide the responsibility too broadly. By choosing a few areas, these non-depositories can be held accountable. Basing the selection on deposits is not an option, but it would be feasible to focus on MSAs where the greatest shares of a firm's revenues are derived would present a workable solution. We think the number of assessment areas should be between five and ten.

Commitment commensurate with scale: Larger firms should devote more capital to financial inclusion efforts. Given the scale needed to justify the costs of a chartering application and the subsequent reporting that is required going forward, we believe the majority of applicants will originate more than $1 billion in loans per year. To put that sum in the context of traditional lending, consider that a sum of $1 billion in loans would be the equivalent of a mortgage lender that makes five thousand loans for $200,000 each. This scale justifies a significant FI effort.

No credit for duplication of already-existing FI programming: It would be suboptimal if each fintech chose to meet its FI requirement by publishing its unique financial literacy curriculum. There is a point where new material is not incrementally beneficial. The OCC should view these kinds of efforts with skepticism. It would be preferable if inclusion exams emphasized lending, services, and investments. The financial community has already created a more than adequate supply of curricula.

To be honest, we would prefer if inclusion credit was not given for any online financial literacy programming. It remains to be seen if financial literacy can be accomplished over an online portal. Presumably, the OCC would only give FI credit would only be extended for financial literacy programming. Successful models usually involve personal coaching. Instead of giving credit for online modules, it would be more sensible to ask providers to fund in-person counseling by HUD-approved housing counseling agencies.

We know that some in the fintech community have given consideration to financial literacy. Consider the following quote in the American Banker from a financial consulting firm:

"Will the OCC be satisfied with, 'We will fund financial literacy programs,' or will the OCC say, 'No, you need to make some loans here'?" said Brian Knight, a senior research fellow at the Mercatus Center.

This advisor to the banking industry hints that his clients may be tempted by to aim for financial inclusion, which he perceives as a lower bar. We are not surprised that the preference of at least a few fintechs would be to do as little as possible for FI. Doing more means that buying white-labeled programming is not acceptable.

As well, financial curricula should never qualify for credit merely for explaining more about a provider's suite of services. This kind of programming is an internal marketing function.

There is one exception to our general resistance to financial literacy. We would support FI credit in cases where a provider is publishing educational information on new services that otherwise do not have pre-published curricula. One upcoming example is faster payments. There will be a need for educational outreach. For non-bank fintech firms that provide faster payments products, it would be a service to the community when a chartered entity created content on how to use FP services globally. A caveat is that it would not be suitable to provide inclusion credit for cases when a chartered firm offered information on using its solution, but only for cases where the content coaches consumers on across-solution services.

No financial inclusion credit for high-cost loans: The fintech standard to date has been to offer loans at interest rates that usually exceed those offered for subprime credit card accounts. Many lenders have products whose interest rates exceed North Carolina's interest rate cap for consumer finance loans. Fintech products often couple those rates with high origination fees.

If the OCC granted credit to fintech firms for this type of lending, wouldn't it be likely that traditional lenders would soon clamor to get credit for their subprime products? The OCC must not allow inclusion to put consumers and small businesses in debt traps.

To answer the question of lending without ability-to-repay, the OCC should review loan performance for cases where inclusion credit was granted. If repayment rates are low, or if loan renewal rates are high, then the OCC should cease to provide credit for those programs.

Documentation and Reporting: As part of an FI program, a charter should require lenders to submit reports of their activities. The data should be collected and then published in searchable digital databases. Because the cost of these loans provokes so much concern, it will be essential that the database provides information on interest rates and origination fees on a loan-by-loan basis. We prefer a model similar to the system in place for the Home Mortgage Disclosure Act.

Engagement with community groups is essential: The FI plans should include outreach and engagement strategy for firms to meet with national and local groups. After a charter is approved, the firms should continue to meet and engage with local partners on a quarterly basis. 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.

We are encouraged to hear in independent media reports that industry leaders believe that the OCC considers FI to be a "front and center" issue[1].

We support the concept of requiring a plan before charter approval, as well as the intention to instigate enforcement actions when plans are not implemented.

Consumer Advisory Task Force: We recommend that the OCC convene a consumer advisory task force (a "CATF") on FI strategic plans. This task force could stand for a finite time during the first opportunities for fintech charter applications. The CATF would provide feedback to the OCC's process of discernment on how to best encourage financial inclusion.

Consumer Protections

Chartering standards must promote the fair treatment of customers, encourage the expansion of access to safe financial services, and maintain compliance with all relevant rules.

[1] Clozel, Lalita. "Financial Inclusion Rules Tougher than CRA in OCC Fintech Charter." American Banker. April 3, 2017.

The nature of innovation in this sector requires ongoing supervision of underwriting: One defining characteristic of new non-bank technology-driven financial firms is their basic instinct for evolution. Whereas many consumer lenders use the same underwriting metrics year after year, many of the "fintechs" redefine how they vet applications several times in a single year. One large fintech lender reports having 35 staffers with Ph.Ds. who have built models with 10,000 dynamic inputs. It reported that it had updated its logarithms eleven times in the prior three years[2].

These changes compel regulators to be zealous in their review of the firms that have been granted a charter. We ask that the OCC require lenders to submit new algorithms for review before implementing the new method in actual underwriting. The OCC should consider the new data for compliance. That should include not just the review of the data points, but also the dynamic conclusions afforded by those data points when used in the context of other information resources.

Lenders say that their algorithms are proprietary. But that presents a challenge for compliance with the Fair Credit Reporting Act. Traditionally, consumers have a right to know why they were turned down for credit. The answer given by the lender should say more than only that a consumer's credit score was too low. Instead, lenders must indicate specific attributes that led to the denial. Given the homogeneity in traditional bank lending, there was no concern that FCRA would compel a creditor to release proprietary underwriting information. It would not harm a bank to indicate that a borrower was denied because of high credit utilization or because the loan-to-value was too great. That may not be the case with a fintech. We expect that the OCC will have to pressure lenders to reveal some of the decision factors used for underwriting. Other information reported to the SEC by the previously referred-to lender, who stated that its underwriting process incorporates approximately 10,000 data points, underscores this possibility.

The trigger of privacy rights should be contingent upon the use of data and not just the storage of data: Regulators may mistakenly believe that it can safeguard consumer privacy by preventing fintech firms from storing data. While it is true that storage does present risks, it is also important to pay attention to the transfer of information.

Fiduciary standards for investment advisors: 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

---

[2] 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

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 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.

Opt-out permissions: Particularly within mobile app interfaces, users may find that a cost of using fintech services is to give up substantial privacy rights. Very few people read disclosures in most settings, but that tendency is greatest on small screens. When combined with the fact that a smartphone or wi-fi connected device can give an app access to location, consumers are not only likely to give up more protections, but they are also likely to give up more information. Consumers should be able to select the degree of information that they release to a lender. While some information is necessary, there are other types of data that are not necessarily essential to underwriting. For example, it is debatable if firms must have location data. They may want such data to market additional services or to sell their data to unaffiliated third-parties.

We ask that the Comptroller monitor consumer decision-making across different device platforms. We suspect that users will act differently depending upon how they access their financial services. If there are statistically significant variations in product usage across mobile, tablet and desktop, then we believe that the Comptroller should seek to understand the origins of those results.

No pre-emption of state usury caps: The OCC should not undermine the progress that has been made on the state level. Many states now apply caps to interest rates. The OCC should not create an opportunity for lenders to evade stronger state rules through chartering. While we must respectfully submit that we do believe that it is the OCC's intention to respect state laws, we feel it is important to restate this priority.

Business Plan

We hold the same concerns as expressed by the part (3) Financial Management. There are many reasons to believe that a different method for evaluating safety and soundness should apply for fintech firms. As non-depositories, fintechs naturally utilize a differing capital structure. In its s-1

filing, Elevate Credit reported that 90.6 percent of its capitalization came from debt[3]. Its allowance for loan losses was double of its cash holdings.

The OCC should establish standards for the provisioning of loan-loss reserves. Companies may use their metrics for their reports to shareholders, but the OCC should not accept those decisions at face value. OnDeck Capital allows its provisioning rate to go down when more loans are rolled over[4]. The OCC should be skeptical of these approaches, because they may mask deteriorations in a portfolio's credit quality.

The rules should also reflect the reduced rates of loan repayments made via online portals. Storefront payday lenders expect to charge-off 20 to 30 percent of their receivables. Online lenders have experienced charge-off rates that are much higher.

Many lenders base future operations on the assumption that they will be able to find buyers of their receivables. They base future lending on the presumption that they will be able to predict the price that they will get for their receivables. For many reasons both internal and exogenous to the fintech, the secondary market might ask for greater-than-expected discounts on the purchase of accounts receivable. The OCC should stress test for this possibility. We support the plan for "alternative business strategy, contingency plans; recovery and exit strategies" (part 5 of Business Plan. As with all of our perspectives, we believe that the challenge for the OCC will be to move from principles to operations.

Conclusion

We believe that new financial technologies may provide greater competition, increase efficiency, and expand access to credit, faster payments, and create innovation in the marketplace. Nonetheless, many fintech companies may charge predatory rates, lose wealth for consumers, and contribute to financial instability.

We find that the standards laid out in the OCC's Charting Manual are promising. We support the principles stated therein. We ask that the results follow in the spirit of those values. To do that, the OCC must implement a robust set of metrics for evaluating inclusion efforts and for enforcing consumer protection laws.

---

[3] https://www.sec.gov/Archives/edgar/data/1651094/000119312515371673/d83122ds1.htm
[4] https://www.sec.gov/Archives/edgar/data/1420811/000142081117000017/ondk-20161231x10k.htm#s37347952E21E541AA17813ECA31DF6EF

The decision by the OCC to update its supervision to new changes in lending are commendable. Thank you for your concern for the needs of underserved consumers.

Sincerely,

//S//

Adam Rust
On behalf of Reinvestment Partners
110 E. Geer St.
Durham, NC 27701
adam@reinvestmentpartners.org