



May 31, 2016

To Whom it May Concern:

The National Community Reinvestment Coalition (NCRC) is pleased that the Office of the Comptroller of the Currency (OCC) is asking for comments about innovation because this topic is too important to be considered by the agency alone or in a process that does not involve open discussion and debate. Innovation has distinct connotations depending on whether the stakeholder is a banker, regulatory agency, a small business, or community organization. Financial institutions often consider innovations as concepts or processes that save money and increase profits. In contrast, members of the community view innovation in the form of automation warily as a process that can potentially exploit consumers, small businesses, and workers.

NCRC is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority- and women-owned business associations, and social service providers from across the nation.

NCRC member organizations are keenly concerned about the regulatory application of the concept of innovation. The concept of innovation, if applied correctly, can facilitate access to responsible credit, or, if applied incorrectly, can amount to one more trap in a string of abuses suffered by vulnerable communities.

What is Innovation?

At the end of its white paper, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*, the OCC asks what the agency should consider with respect to innovation.¹

¹ Office of the Comptroller of the Currency, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*, March 2016, <http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf>

To some, innovation would consist of cost-saving technology that is new and promotes efficiency for financial institutions and customers. For example, in the 1980s, the ATM was a new technology that greatly facilitated simple transactions such as withdrawing money and eliminated the need to wait in teller lines simply to obtain cash. From a community perspective, however, innovation means much more than this. Innovation is developing the means to serve underserved communities at a large scale in a responsible and sustainable manner. For example, the thirty year mortgage was a key innovation that dramatically increased homeownership among working class and middle class families for decades before other supposed “innovations” such as subprime lending and private label securitization wiped out a significant amount of the gains in homeownership and equity building in minority and modest income communities.

In order to realize a consumer- and community-friendly definition of innovation, regulatory agencies must develop systems for monitoring performance of financial institutions. The development of data systems is one of the most important ways to effectively measure whether financial institutions are achieving innovation as defined by serving minority and working class communities at a large scale with responsible products. The Home Mortgage Disclosure Act (HMDA) data is valuable in measuring the volume and percent of loans to minorities and low- and moderate-income borrowers. But HMDA data needs to be supplemented with data on loan performance including delinquency and defaults to determine not only whether institutions are reaching the underserved but also whether their products are sustainable and safe and sound. Also, the new Dodd-Frank² HMDA data elements regarding loan terms and conditions will provide additional insights into the sustainability and affordability of loans.

When HMDA data is more effectively paired with data on loan performance and loan terms and conditions, regulators and the general public can compare institutions regarding the extent to which they are responsibly reaching underserved populations. These analyses would involve comparing institutions with traditional technology and those with “innovative” technology such as on-line lending platforms to actually determine which institutions are more effectively serving overlooked populations. It is NCRC’s position that if traditional institutions reach a higher percentage of minority and modest income borrowers with safe and sound loans than institutions with newer technology, then the traditional institutions are actually more innovative from a consumer and community perspective.

Likewise, mobile branching has received rapt attention but its effectiveness is unclear and untested due to a lack of data. Assertions that mobile branching can efficiently reach large numbers of unbanked or underbanked populations remain assertions only in the absence of systematic data collection. Before the regulatory agencies provide Community Reinvestment Act (CRA) encouragement to the development of mobile branching systems, they have a responsibility to gauge the effectiveness of mobile branching. The agencies must develop robust and publicly available databases on usage and sustainability of deposit accounts by borrower demographics such as income levels of borrowers. How many accounts by income of borrower were opened and closed during a course of a year? What percent of accounts opened and closed are for low- and moderate-income consumers? What are fee levels for basic deposit accounts?

² Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

How do “traditional” institutions with extensive branch networks compare against institutions using mobile branching to a greater extent? NCRC’s position is that the institutions most effective in achieving large-scale usage of responsible and sustainable deposit accounts for the unbanked and underbanked are the most innovative. The regulatory agencies have yet to conduct these types of studies. All the talk about innovation is just talk until rigor and objectivity has been added to the mix.

The Romance and Reality of Fintech

Technology can be enticing. It can be fun. It can make life easier. With a click of a button, a consumer can purchase items instantaneously and have them delivered seamlessly at his or her doorstep. But can technology and on-line platforms happily and quickly serve borrowers or is lending an inherently complicated business that requires care, deliberation, and a high-touch process?

A recent Treasury Department paper examining on-line lending indicates that a key feature is loan approval within 48 to 72 hours.³ The allure of the ease has helped fuel a boom in the so-called “fintech” industry. In its white paper, the OCC estimates that fintech companies in the United States and the United Kingdom increased to more than 4,000 and that investment in fintech companies has surpassed \$24 billion worldwide.⁴ Fintech companies tout up-and coming-technology that appears particularly well suited to the Internet and digital proclivities of the millennial generation now starting to enter their prime earning years and pursuit of homeownership.

Ominous signs, however, counsel caution regarding a regulatory embrace of fintech. A recent survey of small businesses by several Federal Reserve Banks reveals that 20 percent of small businesses obtaining credit used on-line lenders and that microbusinesses used on-line lenders to a greater extent. However, on-line lenders received low satisfaction scores. Only 15 percent of small businesses using on-line lenders were satisfied. Small businesses complained about lack of transparency and unfavorable repayment terms. Seventy percent of those unsatisfied complained about high interest rates.⁵

Investments are slowing down in fintech. In the wake of the Lending Club scandal, investors are increasingly concerned about the on-line and fintech model and how well it can withstand recessions as well as healthier economic times.

Borrowing significant sums of money is a complex financial transaction. For many consumers, particularly low- and moderate-income consumers, it is the most complicated transaction they will ever undertake. Executed responsibly, lending can empower consumers and enable them to build significant equity. Executed irresponsibly, lending can result in financial ruin. And

³ U.S. Department of the Treasury, *Opportunities and Challenges in Online Marketplace Lending*, May 10, 2016, p.5.

⁴ OCC, *Supporting Responsible Innovation*, p. 3.

⁵ Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond, and St. Louis, *2015 Small Business Credit Survey, Report on Employer Firms*, see <https://www.frbatlanta.org/research/small-business/survey/2015/report-on-employer-firms.aspx?panel=2>

given its complexity, lending often requires significant amounts of counseling and underwriting to ensure that borrowers can afford the loan and make payments. A click of a mouse and fancy algorithms are often no substitute for patient counseling and careful underwriting, particularly for those unfamiliar with lending and not possessing an established credit history.

The Regulatory Response to Fintech

The regulatory response to fintech companies will be critical in determining whether they are helpful and responsible financial institutions or whether they will become another in a line of predatory lenders that will ultimately become extinct after fleecing borrowers. The objective must be to apply a comprehensive set of regulations to fintech companies and more traditional lenders so that consumers and financial institutions can both thrive in the marketplace.

The OCC has already put out feelers to the industry and dangled some regulatory favors in front of them. An American Banker article features a senior OCC regulatory official discussing a limited purpose charter for fintech companies so that they can become nationally chartered banks and avoid the hassle of seeking licenses in multiple states.⁶ But before the OCC offers a limited purpose charter to any new financial institution and confers the enormous benefits of a national charter, it must ensure that the institution is responsible (Also, NCRC opposes a national charter that would allow a fintech to operate as a non-bank; it would need to convert to a bank).

Importantly, while the OCC has asked for comments about innovation, several agencies including the OCC have also requested comment regarding reforms to the consumer compliance rating system. In forthcoming comments, NCRC will advocate for public input to examiners conducting compliance reviews and for the public release of ratings. The ratings could then be key for considering applications by non-banks including fintech companies for bank charters. Only fintech companies and other non-bank entities with the highest proposed rating (a proposed “1”) should be allowed to acquire a national charter from the OCC.⁷ In order to be eligible for a bank charter, a non-bank entity must have an outstanding record (a “1” rating) of compliance with consumer and fair lending compliance law.

The limited purpose charter as currently applied in the Community Reinvestment Act (CRA) examination context amounts to an easy-pass with no accountability for so-called limited purpose banks that make substantial amounts of retail loans. Under the current CRA regime, any fintech “bank” designated as limited purpose would have a CRA exam that fails to scrutinize its retail lending. Would it be acceptable, for example, if a company named “Lending Club” that has issued \$18 billion (and \$2.7 billion last quarter) of loans to consumers and small businesses has a CRA exam that does not examine the effectiveness of its retail lending in serving low- and moderate-income borrowers?⁸

⁶ Lalita Clozel, American Banker, *OCC Weighs New Charter for Fintech Firms*, May 10, 2016.

⁷ Some non-bank entities such as mortgage companies or fintechs that issue home loans are regulated and would receive consumer compliance ratings. For those that are not regulated and subject to a consumer compliance exam, they could not apply for a federal bank charter until state or federal law changes to require them to be regulated.

⁸ See <https://www.lendingclub.com/info/statistics.action>.

Regardless of any particular charter that might be granted to fintech companies, CRA exams must scrutinize retail lending since fintech companies, by their nature, are geared towards retail consumers. Limited purpose CRA exams focus on community development (CD) lending and qualified investments. While CRA exams should encourage CD lending and investment, they must also examine fintechs for what they purport to be, namely retail institutions. To do otherwise would violate the guidelines in the OCC's licensing manual which reiterates a need for a strong public duty requirement and emphasizes that newly chartered banks must meet "the credit needs of its entire community, including low-and-moderate income neighborhoods, consistent with the safe and sound operations of the bank."⁹

The OCC in its white paper states that it may offer guidance regarding activities that are considered to be innovative in terms of promoting financial inclusion.¹⁰ While NCRC is not opposed to guidance of this nature, NCRC urges the OCC to promote only activities that are "innovative" in a CRA context if they effectively promote financial inclusion to substantial numbers of low- and moderate-income consumers in a responsible fashion. Such judgments cannot be subjective and must be grounded in careful data analysis.

Ultimately, financial institutions will be innovative in serving low- and moderate-income consumers if they operate in a regulatory framework that applies uniform rules rigorously to all types of financial institutions. Financial institutions will then compete based on truly affordable products responsive to credit needs instead of grabbing market share by promising quick approvals not grounded in careful underwriting or deceptive loan terms that feature adjustable rates that make loans initially affordable but then trap borrowers in unsustainable debt. In the wake of the financial crisis, Dodd-Frank mandated that the Consumer Financial Protection Bureau (CFPB) and prudential regulators promulgate the Qualified Mortgage (QM) and Qualified Residential Mortgage (QRM) rules that helped level the playing field for mortgage lenders by creating a uniform floor of prudent practices such as not lending beyond a borrower's ability to repay. Similar rules are needed for fintech and all other institutions, particularly those in consumer and small business lending. Regulatory agencies ought to collaborate in determining how much statutory authority they have to promulgate rules similar to QM and QRM for consumer and small business lending.

In areas in which the agencies lack statutory authority, they should promulgate best practices regarding responsible lending practices. Currently, community organizations have been working with some fintech companies to develop best practices such as those outlined in the Small Business Borrowers' Bill of Rights.¹¹ These include transparency and clarity regarding interest rates and loan terms and conditions.

Vigorous enforcement of the fair lending laws is vital since fintech companies apply opaque algorithms to assess borrower applications. The Treasury Department, in its paper, notes concerns regarding the possibility of fair lending violations due to the use of new data and credit

⁹ OCC, *Charters: Controller's Licensing Manual*, Feb 2009, <http://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf>

¹⁰ OCC, *Supporting Responsible Innovation*, p. 8.

¹¹ See <http://www.responsiblebusinesslending.org/>

models using undisclosed methodology. The Treasury Department adds that unlike the traditional credit report model, consumers will not have the ability to check and verify the personal data used by fintech companies to determine loan eligibility.¹² The agencies must collaborate in vetting the credit review and approval methods of fintech companies to guard against discrimination and fair lending violations.

An important part of fair lending review will be the proposed reforms to the Consumer Compliance Rating system (CC ratings). CC ratings and exam narrative must be publicly available so that members of the public can determine if rigorous fair lending reviews have been conducted. In addition, the CC ratings and exam must scrutinize bank partnerships with fintech companies in order to ensure compliance with consumer protection and fair lending law.

The OCC must not be the only regulator currently considering innovation. The OCC must consult with the Consumer Financial Protection Bureau (CFPB) and the other agencies in considering the difficult issues associated with the rise of fintech companies and how to regulate them rigorously to ensure that they are offering responsible products serving community and consumer needs.

Enforcement authority may need to be shifted in order to respond effectively to technological change. For example, enforcement of the Equal Credit Opportunity Act (ECOA) is currently split among the prudential bank regulatory agencies and the CFPB. The bank agencies enforce ECOA when banks have assets of less than \$10 billion while the CFPB enforces ECOA when banks have assets of \$10 billion or more. The CFPB enforces ECOA in the case of non-depository mortgage companies. Splitting authority among several agencies for enforcing a fair lending law risks inconsistencies in enforcement. Since the CFPB is currently in charge of enforcing ECOA in the case of the large banks and non-depository mortgage companies, it would make the most sense if the CFPB was in charge of all ECOA enforcement including for smaller banks and any fintech companies receiving a bank charter. At the very least, Dodd-Frank requires cooperation in fair lending enforcement among the prudential bank regulators and the CFPB. In the case of smaller banks (including any fintech companies), Dodd-Frank mandates that the OCC grant the CFPB examiners the opportunity to participate in the exam, review exam documents, and offer input. It would seem that these procedures are especially needed when examining small banks with new fintech-like technologies that may eventually be adopted by larger banks and mortgage companies under the jurisdiction of the CFPB.¹³

In its white paper, the OCC mentions that industry perceives the OCC as an agency with a low risk tolerance for innovation and as an agency that has an extended and deliberate vetting process.¹⁴ However, for an industry that is relatively untested, a deliberate process for developing regulatory and supervisory oversight could be just what is needed in order to ensure that the

¹² U.S. Department of the Treasury, *Opportunities and Challenges in Online Marketplace Lending*, May 10, 2016, p. 20.

¹³ Congressional Research Service, *The Consumer Financial Protection Bureau, A Legal Analysis*, January 2014, <https://www.fas.org/sgp/crs/misc/R42572.pdf>

¹⁴ OCC, *Supporting Responsible Innovation*, p. 6.

fintech industry develops carefully and responsibly instead of rushing headlong into new forms of exploitation.

Conclusion

NCRC considers innovation to be large-scale provision of responsible loans that sustainably respond to credit needs. New technologies and new types of companies could be part of the answer but the romance with innovation should not blind us to the possibility that the new market entrants may not be the long term answer. NCRC believes that high-touch models will still be needed for reaching traditionally underserved populations; this may include counseling agencies partnering with both traditional lenders and fintech companies. Data will be key to measuring success, creating rigorous enforcement, and public accountability. Only if comprehensive and uniform regulation is adopted and applied to both fintech and existing companies will a lending marketplace be created that is responsible, efficient, and equitable.

Thank you for this opportunity to comment. If you have any questions, please contact me on jtaylor@ncrc.org or Josh Silver, Senior Advisor, on jsilver@ncrc.org.

Sincerely,

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John Taylor
President and CEO

