February 4, 2020

Robert E. Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

Re: Proposed Rulemaking: Federal Interest Rate Authority
Docket No. FDIC-2019-0147

Dear Mr. Feldman:

The National Association of Consumer Credit Administrators (NACCA) appreciates the opportunity to provide comments in response to the Federal Deposit Insurance Corporation’s (FDIC) notice of proposed rulemaking, Docket No. FDIC-2019-0147.

NACCA is an association of state financial regulation agencies formed in 1935. NACCA’s members include financial regulators from 49 states, the District of Columbia, Puerto Rico, and Alberta, Canada. NACCA’s members have decades of experience regulating the consumer credit marketplace, including through the enforcement of lending and usury laws.

**Introduction**

NACCA recognizes and appreciates the FDIC’s efforts to limit uncertainty so that financial institutions may offer and assign prudently underwritten loans that meet the needs of consumers. NACCA seeks to foster the safe and sound operation of financial institutions, while protecting consumers from practices harmful to their financial well-being. Accordingly, NACCA member states operate under a dual mandate to achieve the goals of consumer protection and ensuring credit availability.

State regulators are stewards of the credit markets in their states, licensing and overseeing a broad and diverse set of financial services institutions. This authority derives from state and federal law and reflect decisions made in state legislatures and
in Congress about the structure of the financial marketplace and about the role of state regulators in the larger regulatory fabric.

In carrying out these responsibilities, our members evaluate an institution’s ability to operate safely and soundly and to serve borrowers responsibly and effectively. As state regulators, we have an on-the-ground perspective on the need for a stable and well-regulated financial marketplace. From that perspective, NACCA provides the following comments.

**Effect on State Laws**

The proposed regulations undermine the states’ ability to protect their citizens from usurious lending practices. Most states have established laws (including criminal statutes) to limit interest rates on credit transactions. NACCA member states oversee and shape those laws. Preemption of state interest rate limitations could harm consumers and pose a challenge to healthy competition in those industries. This is especially so because the proposed regulations do not address the “true lender” issue, leaving an opening for so-called “rent-a-bank” schemes. As state laws are generally designed to provide protection for the residents of that state, it is likely some companies would attempt to evade state-mandated consumer protection requirements by purchasing high-interest loans from banks under the preemptive protection of the proposed regulations. Allowing this type of business creates a vehicle whereby currently regulated entities can choose to purchase their way out of state usury regulation.

Federal regulators have previously partnered with state regulators in endeavoring to reduce the risks associated with “rent-a-bank” schemes. Together, we’ve worked toward the shared goals of successful lending programs that both promote economic vitality and protect consumers. To strengthen this partnership, the FDIC should consider requiring banks to follow state-law limits. The FDIC could make this requirement a matter of prudential regulation, both because selling loans prohibited by state law may pose serious reputational risks for banks and because state law provides, in many cases, responsible interest rate limitations.

**Questionable Bank Partnerships**

The “rent-a-bank” business model is not new or unique and has been used by payday lenders attempting to bypass state licensure and usury laws by arguing that the loan is technically closed in the bank’s name. While the FDIC’s proposed rulemaking specifically excludes the issue of who the “true lender” is in these arrangements, consumer lenders and regulators have been actively litigating the issue. There are a number of ways to define the “true lender,” including focusing on the party who closes the loan, the party setting the credit terms and disbursing funds, or the entity with predominant economic interest. Case law on the subject thus far is mixed; a number of federal and state courts have reached different conclusions by focusing on either the substance or the form of the transaction.1 Given the questionable nature of “rent-a-bank” partnerships, the FDIC will need to be aware of the “true lender” tests and should speak to this issue, focusing on substance over form.

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1 Compare *CashCall, Inc. v. Morrissey*, No. 12-1274, 2014 W. Va. LEXIS 587 (W. Va. May 30, 2014) (holding that a consumer finance company was the true lender, not the bank, where the finance company retained all credit risk from the loan and the bank did not retain any economic interest); *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015) (holding that a non-bank entity that purchased loans from a national bank cannot benefit from powers under the National Bank Act), with *Sawyer v. Bill Me Later*, 23 F. Supp. 3d 1359 (C.D. Utah 2014) (looking at the form over substance of a transaction and concluding that the bank was the true lender, even though the bank sold the loans after two days). See also *Krispin v. May Department Stores Co.*, 218 F.3d 919 (8th Cir. 2000) (holding that the bank is the true lender where a department store purchased the receivables for accounts held by a national bank, and played a role in account collection).
Supervision of Bank Partnerships

Despite not being fully resolved, the nature of the relationship between banks and third parties is critical to risk management. Both national banks and state-chartered banks have long been able to partner with third parties to provide various consumer credit and deposit products. Banks originating loans for such third parties are expected to operate with comprehensive controls designed to protect the consumer from harm, and to protect the bank from any undue risk associated with third-party partnerships (namely, operational risk, legal risk, and reputational risk). Banks so involved should have particularly robust compliance management systems and vendor oversight programs. Banks should also expect their partners to have developed rigorous compliance management systems and should have contractual rights to audit those programs. Additionally, banks should retain control over approvable credit criteria and oversee loan decision systems.

Federal bank regulatory agencies provide guidance for managing third-party risk, including the FDIC’s Financial Institution Letter 44-2008. This Letter creates a four part risk management process for banks. Banks must first conduct an initial risk assessment when deciding whether or not to enter into a third-party relationship. This step ensures that the proposed relationship is consistent with the bank’s strategic planning and overall business strategy and forces banks to analyze the cost, benefits, and legal aspects of the proposed arrangement. Second, banks must perform their due diligence when selecting a third-party, which includes a review of all available information about the potential third-party. Third, banks ensure that the contractual agreements specifically outline the expectations and obligations of each party, including authorization for the institution and the appropriate federal and state regulatory agency to have access to records of the third-party to evaluate compliance with laws, rules, and regulations. Finally, banks maintain oversight of third-party activities and adequate quality control over those products and services provided through third-party arrangements in order to minimize exposure to potential significant financial loss, reputation damage, and supervisory action. Bank relationships with third parties that fail to manage these risks are at the heart of the “true lender” issue and should be addressed in related regulations, such as those currently proposed by the FDIC.

Mitigating Consumer Harm

All financial services products potentially present risk of harm to borrowers and the larger financial marketplace as a whole. State laws seek to mitigate these risks. While states have product specific laws, including regulatory requirements for the issuance of unsecured credit, the common theme of all state supervisory regimes is the requirement for credentialing and subsequent supervision for compliance with the law.

State consumer credit licensing laws require prospective licensees to file an application that typically includes the submission of credit reports, fingerprints, a business plan, financial statements, and a surety bond. The prospective licensee may be required to provide evidence of policies, procedures, and internal controls that will facilitate the organization’s compliance with state and federal laws, including disclosure, servicing, and debt collection requirements. Once a license is granted, management is required to maintain compliance with federal and state law. State regulators then have the ability to supervise these lenders, ensuring that the company is complying with state lending laws. To accomplish the goals of credentialing efficiently, the states embrace

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cooperative efforts, interstate agreements, and model standards to provide consistent supervision, such as the Nationwide Multistate Licensing System.

Preemption of these requirements, as the FDIC proposes, undermines these licensing systems, the efficiencies states have created, and their cooperative efforts. State regulators are aware that some financial service providers make or service loans without regard to the applicable state laws that regulate or prohibit the activity. By violating those states’ laws, the financial service providers are depriving the consumers of the protections found in the consumer’s state laws, including protection from usurious charges. Further, it is likely that a company with a non-compliant mindset with regard to state licensing laws may be less inclined to comply with other laws or consumer protection practices. NACCA commends the FDIC’s statement in this notice of proposed rulemaking that the FDIC “will view unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity’s licensing State(s).” State regulators urge the FDIC to reflect this view in its rule and otherwise support policies that improve the efficiency of existing licensing regimes and promote consumer protection without undermining the states’ ability to regulate entities that make or service loans for the citizens within their borders.

**Conclusion**

NACCA reiterates its interest in fostering robust lending and servicing industries in a manner conducive to growth and competition while protecting borrowers and financial institutions from practices harmful to their well-being. This outcome requires balanced standards that ensure both consumer protections and credit availability, and that mitigate risks to consumers as well as financial institutions. NACCA appreciates the opportunity to present these comments.

Sincerely,

Carri Grube Lybarker
President
National Association of Consumer Credit Administrators