The undersigned Center for Responsible Lending (CRL) and National Consumer Law Center, on behalf of its low income clients (NCLC), write to comment on the update to the Uniform Interagency Consumer Compliance Rating System (CC Rating System) by highlighting three areas of particular concern:

1. Overdraft practices;
2. Loans with a total cost of credit exceeding 36% annual percentage rate (APR); and
3. Bank partnerships with non-bank lenders whereby non-banks make loans they could not independently make under state law – i.e., rent-a-bank schemes.

The CC Rating System is right to emphasize harm to consumers. The above areas, given their capacity to inflict significant consumer harm and to undermine state laws designed to prevent such harm, merit heightened consideration in any review of compliance with consumer protection and civil rights laws.

I. Overdraft practices

Abusive overdraft fees have long been a stain on the fabric of our nation’s banking system. By CRL’s latest estimates, depository customers pay $14 billion in overdraft fees annually, and this figure appears to be on the rise.¹

Even more striking is how much some individual households pay in these fees. CFPB found that nearly three-fourths of overdraft and NSF fees are paid by only 8% of account holders, who incur 10 or more fees per year.² CRL has found nearly 2 million Americans pay 20 or more overdraft fees annually, translating to $700 or more.³

Further, these funds are often not spread evenly throughout the year but come in unpredictable, sporadic episodes. A single negative balance episode can trigger hundreds of dollars in fees in just a few days.⁴ The real-life account activity of one bank customer, below, depicts an initial overdraft fee triggered by a $4.17 purchase on September 21. Over the next four days, the customer incurs six $35 overdraft fees totaling $210 for overdrafts that total only $128 for less than one week; she incurred $105 in fees for debit card purchases under $5.
A growing body of research has pointed to the income and expense volatility many families experience.\(^5\) When a consumer experiences overdraft fees as the customer above did, these fees can increase volatility, rather than smooth it, putting the account holder only deeper in the hole.

Though the diversion of cash needed for living expenses toward fees is alone enough to devastate a family living on the margins, the consequences do not stop there. Overdrafts are the leading reason that consumers lose their checking accounts.\(^6\) The FDIC’s 2013 survey of unbanked and underbanked households indicates that approximately 778,800 households, and well over a million adults, who once had bank accounts are currently unbanked primarily because of high or unpredictable fees.\(^7\) It is likely that in the majority of those cases, the fees at issue were overdraft/NSF fees, as they are both the largest fees and comprise the majority of checking account service charge revenue.

Other data suggest even greater numbers of affected individuals. Once ejected from the banking system, the ejecting financial institution reports the account holder to a database, like Chexsystems or Early Warning Service – a blacklist, essentially, where the consumer’s name remains for five years, often preventing the consumer from being offered a checking or savings account with another financial institution.\(^8\) While there are no national data on the number of consumers on bank account blacklists, millions of consumers are affected, with one software company estimating that 2.3 million online applicants were denied accounts based on their screening database report in 2012 alone;\(^9\) the large majority of consumers blacklisted are blacklisted because of overdrafts.\(^10\)

The following is but one complaint of many in CFPB’s database demonstrating the effects of overdraft fees causing ejection from the banking system:

“...I am a ... single mother ... I am writing this complaint as I have no where else to turn ... The overdraft on my account was simply an over sight. It was no way intended to cause fraud [as was presumably reported to a database like Chexsystems] ... The overdraft amount was [$7.00] according to my print out. I paid [the bank] for the overdraft and any associated fees a few years ago. The word Fraud [] has been hanging over my head ever[] since .... I am a law abiding working citizen that made a minor mistake and its costing me dearly.”\(^11\)
The costs of exclusion from the banking system can be profound. A banking relationship is important to household financial stability and asset-building. A checking account protects funds from physical risk, offers a relatively low-cost and convenient way to conduct routine financial transactions, provides mechanisms for savings, and, for many families, is the gateway to a broader banking relationship that includes access to reasonably priced credit.

Thus, the costs of exclusion are both direct and indirect. One portion of direct costs is check-cashing fees; the savings from having a checking account versus relying on check-cashing services has been estimated at up to $40,000 over the course of a lifetime. Indirect costs include diminished opportunity to securely save. Indeed, research has found that banking facilitates savings. Pew has found that 88 percent of banked households have at least one savings account, and even in times of economic turmoil, among the working poor, 67 percent of banked households reported still being able to save, while only 9 percent of unbanked households could.

Lack of a bank account is a problem felt most acutely by lower-income individuals and communities of color. Civil rights leaders have noted the cost of this financial disenfranchisement when urging reform of bank overdraft practices:

“Once a person is ejected from the mainstream financial system, it becomes difficult to reenter. And the unbanked and underbanked are more likely to end up with no choice except alternative financial services, which are often more expensive and less secure than a responsible mainstream checking account.”

Banks’ practices play a dominant role in shaping their customers’ experiences with overdraft and, thus, the success or failure of the customer’s banking relationship. For example, the CFPB found that consumers whose debit cards could trigger overdrafts were more than 2.5 times more likely to have their accounts involuntarily closed than those who were not “opted in” to debit card overdraft at several study banks. Some banks, including several of the largest, do not permit point-of-sale and/or ATM transactions to trigger high-cost overdraft fees at all, thereby removing the possibility for their account holders to lose their accounts as a result of those kinds of overdrafts.

Overdraft fees have fueled the development of a profoundly dysfunctional checking account market. When consumers shop for a bank account, they are likely to consider factors like fixed monthly and annual costs of the account. Consumers are less likely to assess the likelihood that they will trigger overdraft charges and cannot easily compare bank overdraft practices. More upfront pricing for checking accounts – based on a transparent, reasonable monthly fee that consumers can shop and compare – would provide incentive for financial institutions to have more responsible checking account models, rather than one based on hidden back-end fees preying upon those with the least resources.

Finally, unfettered overdraft fees stifle development of more appropriate products, both in the checking account space and in the small dollar credit market. So long as financial institutions can charge $35 per loan, regardless of the size or duration of it, they lack incentive to cannibalize that revenue by developing or marketing other credit products that responsibly meet consumers’ needs. Though better models are springing up on a limited basis, the abusive overdraft model continues to dominate the checking account market. And it will likely continue to do so until unfair practices are reined in and a level playing field replaces the existing race to the bottom.

The FDIC’s overdraft guidelines advises that banks charge no more than six overdraft fees in a rolling twelve-month period. Any bank that exceeds that threshold should receive a rating of deficient.
II. Loans exceeding 36% all-in APR

Public policy against loans that exceed 36% APR is strong. The Military Lending Act requires that loans made to military service members and covered family members not exceed 36% fee-inclusive APR. The FDIC’s long-time affordable loan guidelines appropriately advise that loans accrue interest at or under 36%. Fourteen states plus DC limit short-term loans to interest rates of about 36% or lower, and over half of states limit rates likewise on installment loans. Any loan exceeding this cost made to any depository customer should receive heightened scrutiny; the impact on customers should be closely studied, including these loans’ relationship with overdraft fees; and the CC-Rating should be reflective of these analyses.

III. Rent-a-bank schemes

Banks play a critical role in our economy and are entrusted with special powers to carry out their activities. In return, they have corresponding supervision and obligations to serve their communities and the broader public interest. Ratings systems should further the protection and constructive use of these special powers.

Nonbank entities have long sought to take advantage of these bank powers without becoming properly chartered financial institutions and undertaking the supervision and obligations that accompany those powers.

The so-called “rent-a-bank” model – whereby non-depositories make loans at rates prohibited by state usury laws under the pretext that their partnership with a depository permits them to charge the depository’s home state rate, pursuant to national bank preemption and related law24 – has been rejected by federal and state regulators and the courts. But it is once again rearing its head.

Typical structures of these arrangements involve the following: the loans will be technically originated in the name of the bank, but the nonbank entity designs the program, provides funding for the loans, services the loans, and/or guarantees the bank against losses from the loans. In the early-to-mid 2000s, federal banking regulators, through a combination of guidance and enforcement actions, shut down rent-a-bank schemes with payday lenders. While the schemes rested on the payday lender’s claim that it was a mere agent for the out-of-state bank, the payday lender was the de facto lender, with the bank’s economic interest typically limited to the fee it received from the lender for the use of its charter. State regulators also had success forcing lenders with rent-a-bank schemes out of their states.27

Where similar payday lending rent-a-bank arrangements have occasionally popped up in the years since, regulators have continued to quash them.27 In 2014, when issuing the new Handbook on Collective Investment Funds, the OCC made it clear that the banks may not “rent their charters” to third parties,28 in accord with longstanding policy. In more recent years, the rent-a-bank model has been attempted in the multi-payment payday loan space as well. Again, it has been met with state opposition and rejected in court on grounds that the arrangement is a ruse where the non-depository is the de facto lender.29

The rejection of rent-a-bank models is consistent with both the prudential regulators’ mandates and Congressional action in the Dodd-Frank Act. As noted previously, the prudential regulators have explicitly rejected the notion of renting a bank charter. Likewise, Dodd-Frank, while reaffirming the principle of bank preemption of some state laws, narrowed the scope of those entitled to claim that preemption. Prior to Dodd-Frank, operating subsidiaries of national banks were accorded preemption.
Dodd-Frank reversed that position, limiting preemption to the bank itself. Rent-a-bank schemes are far less connected to actions of the bank itself than are activities of bank subsidiaries. Thus, the claims of preemption by nonbank entities run counter to Dodd-Frank.

Nonetheless, new attempts at rent-a-bank arrangements have been on the rise. Online lending by nonbank entities has increased. While some of these lenders are offering loans in compliance with state usury caps, others are charging rates that appear to exceed state law. In addition, payday lenders are morphing into installment loans in anticipation of tougher CFPB rules addressing balloon-payment payday loans and in order to evade state usury laws. Widespread presence of arbitration clauses that prevent private individual or class actions to challenge these lenders’ preemption claims (though the CFPB arbitration rule promises to limit these) has essentially left it to regulators to monitor their supervised banks for these arrangements.

This is an area that requires regulators to carefully monitor bank arrangements with third party partners making these loans, and not merely the most blatant rent-a-bank schemes. Given the potential revenues from these high-cost loans and the desire to evade state usury limits, it is to be expected that nonbank lenders will attempt to restructure their agreements to pass, or appear to pass, the test that the bank has the predominant economic interest in the loan. Agreements we see today involve artifices such as complex loan participation structures, off shore funding sources and complicated guarantees. Regulators should scrutinize these arrangements to ascertain, first, whether the bank is in fact the actual lender, and, second, even if it is, whether the bank is exercising full oversight of these nonbank lenders (which may have weak compliance structures and records) and whether the loan program poses reputational and other risks to the financial institution.

Finally, regulators have duties to ensure compliance regarding the terms and conditions of the loans themselves for any loans in which banks are involved, either by themselves or with a nonbank entity. In the early 2000s, payday lenders partnered with a handful of banks to make payday loans in states that had prohibited these loans. The FDIC responded, in 2005, with guidance focusing on the substance of the loans themselves, finding that they were being repeatedly flipped and that the loan programs raised substantial safety and soundness issues, including reputation risk, for the banks. Today’s high-cost installment loans pose similar problems. Like payday loans, they are dependent on the lender’s obtaining direct access to the borrower’s bank account, ensuring that the lender is repaid even when the borrower cannot afford the loan. They similarly result in debt traps that are very difficult for borrowers to escape.

Such programs create great harm to borrowers, and they also pose a serious threat to the value and integrity of bank charters. Thus, it is imperative that banks and their regulators ensure that nonbank entities not engage in “rent-a-bank” schemes to enjoy bank privileges without the corresponding responsibilities, and this emphasis should be appropriately reflected in banks’ CC ratings.

We thank you for your work to update the CC Rating System and for your consideration of our comments. We would be happy to discuss them further.

Sincerely,

Center for Responsible Lending
National Consumer Law Center (on behalf of its low income clients)


4 See, e.g., this consumer narratives filed with the CFPB Consumer Complaint Database:
   “In the course of 2 days, . . . I had XXXX - {$35.00} fees from [bank] that equated to {$310.00}. Mind you that my account was only {$110.00} negative.” CFPB Consumer Complaint Database, Complaint ID 1451188 (received 7/4/2015)


6 Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures at 6, (June 6, 2008), available at http://www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf (noting that virtually all involuntary bank account closures, when the financial institution closes a consumer’s account, are due to overdrafts, and that their results suggest questions that include: “[T]o the extent that involuntary closure is the endogenous outcome of bank policies to allow liberal opening of so-called ‘free’ accounts (which might be better described as overdraft ‘fee’ accounts), has the banking system exacerbated closures to increase fees from penalty charges?”). The CFPB found that consumers whose debit cards could trigger overdraft fees were more than 2.5 times more likely to have their accounts involuntarily closed than those who were not “opted in” to debit card overdraft fees at several study banks. CFPB, CFPB Study of Overdraft Programs: A white paper of initial data findings at 34 (June 2013), available at http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf [CFPB White Paper]). And as the CFPB’s prepaid card proposal notes, one study found that 41 percent of prepaid card users who had ever had a checking account either closed their account or had an account closed by the institution because of overdraft or bounced check fees. 79 Fed. Reg. 77906 (citing The Pew Charitable Trusts, Why Americans Use Prepaid Cards: A Survey of Cardholders’ Motivations and Views, at 7 (Feb. 2014)).

7 The FDIC finds that there are nearly 9.6 million unbanked households, 45.9% of which were previously banked, with 17.7% of those previously banked households reporting high or unpredictable fees as the main reason they were unbanked. 2013 FDIC National Survey of Unbanked and Underbanked Households at 4-6 (Oct. 2014), https://www.fdic.gov/householdsurvey/2013report.pdf. This computes to approximately 4.4 million previously banked households, 778,000 of which report high or unpredictable fees as the main reason they were unbanked.
The FDIC report further states that the nearly 9.6 million households represent 16.7 million adults and 8.7 million children; this suggests that these 778,000 households represent, on average, 1.35 million adults and 705,000 children.

A Pew survey of the working poor found that even higher rates of the recently unbanked cited unexpected or unexplained fees as the primary driver of account closure, with 32% citing this reason. The Pew Charitable Trusts, “Slipping Behind: Low Income Los Angeles Households Drift Further from the Financial Mainstream,” at 7 (October 2011), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/wwwpewtrustsorg/reports/safe_banking_opportunities_project/Slipping20Behindpdf.pdf.


11 Complaint ID 1375562 (received 5/14/2015). The complaint continues: “And if [this bank] does not want my business, I understand but please don’t make it hard for me to move on to another financial institution ... Life is a struggle as it is and with paying additional fees to cash my payroll check or pay for pre-paid cards is really hard on me ... I have suffered enough. Again, please review your records as the account was not intended to be used for any mis-leading purposes. I have attached the printout that was given to me and a letter.”


Unbanked rates decrease with income: Those making less than $15,000: 27.7%; $15-30,000: 11.4%; $30-50,000: 5.1%; $50-75,000: 1.7%; $75,000+: 0.5%. FDIC 2013 Survey of Unbanked and Underbanked Households at 16, available at [https://www.fdic.gov/householdsurvey/2013report.pdf](https://www.fdic.gov/householdsurvey/2013report.pdf).

The 2013 FDIC survey found that 7.7 percent of all households were unbanked, but the share was much higher for the African-American and Latino communities, at 20.5 percent and 17.9 percent, respectively. FDIC 2013 Survey of Unbanked and Underbanked Households at 16, available at [https://www.fdic.gov/householdsurvey/2013report.pdf](https://www.fdic.gov/householdsurvey/2013report.pdf).


For example, Citi and HSBC do not have POS or ATM high-cost overdraft programs, BoA does not have a POS program, and Chase does not have an ATM program.


As the FDIC explains it, “Federal law authorizes federal and state-chartered insured depository institutions making loans to out of state borrowers to ‘export’ favorable interest rates provided under the laws of the state where the bank is located. That is, a state-chartered bank is allowed to charge interest on loans to out of state borrowers at rates authorized by the state where the bank is located, regardless of usury limitations imposed by the state laws of the borrower’s residence.” FIL FDIC: FIL-14-2005: Guidelines for Payday Lending. However, as described here, this doctrine has not been used to permit evasion of state law through non-depository/depository relationships.

The Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Reserve Board, and FDIC all shut down rent-a-bank in the early-to-mid 2000s.


The Office of Thrift Supervision also issued an advisory, noting “Associations should not ‘lease’ their charter out to nonthrift entities through an agreement that allows the nonthrift entity to circumvent state and local law.” Thrift Bulletin 82, Aug. 18, 2003, at 8.
The Federal Reserve Board stopped the First Bank of Delaware from renting its charter to storefront payday lenders; the relationship is described here: http://www.consumerfed.org/financial-services/166.


26 After North Carolina stopped permitting payday lending in the state in 2001, Advance America asserted it was permitted to continue making payday loans there through a partnership with an out-of-state bank. In 2005, the state banking commissioner ruled that Advance America loans indeed were in violation of state law, and the lender ceased its operations in the state. In re Advance America: Order, N.C. Comm’r of Banks, 05:008 (Dec. 22, 2005).

27 For example, in 2010, the Office of Thrift Supervision shut down a payday loan line of credit, iAdvance, being offered through the non-depository prepaid card issuer Netspend’s cards, through partnership with one of the OTS’s supervisee banks. Form 8-K filed by Meta Financial Group, Inc. with the Securities and Exchange Commission, October 6, 2010, available at http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm (noting the OTS cited unfair and deceptive acts or practices). See also http://www.getdebit.com/debit-news/netspend-ipo-buzz-good-and-bad/ (industry commentary noting, on the eve of Netspend initial public offering:


29 Final Order On Phase II Of Trial: The State’s Usury And Lending Claims, State of West Virginia, ex rel. v. CashCall, Inc and J. Paul Reddam, Kanawha County Circuit Court, Civil Action No.: 08-C-1964, Sept. 10, 2012. http://bit.ly/16lOhAe (upholding the state’s claim that CashCall was the de facto lender in violation of the state’s usury limit, while finding that CashCall purchased all loans made under the arrangement from First Bank of Delaware three days later and clearly bore the economic risk of the loans).