



Advancing Fairness
in the Marketplace for All

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September 27, 2018

Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: Statement for the record for hearing on Examining Opportunities for Financial Markets in the Digital Era, Sept. 28, 2018

Dear Chairman Luetkemeyer, Ranking Member Clay, and Members of the Committee,

Thank you for the opportunity to submit a statement for the record for your hearing on Examining Opportunities for Financial Markets in the Digital Era. A wide range of areas may be encompassed within that topic. This letter, which is submitted on behalf of the National Consumer Law Center's low income clients, makes several overarching points and refers you to a number of our materials on "fintech" topics for more detail..

Financial products and services are developing and changing rapidly as a result of a number of factors, including the spread and capacities of mobile devices and the internet, the growth of computer power, the increasing use of big data, algorithms and machine learning, and an explosion of nonbank startups that are taking a new look at how to design and deliver financial products and services. Many of these developments have led to innovations that will benefit consumers through improved access, lower prices, increased transparency, and financial management.

At the same time, it is critical to keep in mind that consumer protection must remain paramount, and that many innovative approaches also yield problems. "Innovations" such as pick-a-payment mortgages and securitized no-doc loans not only ruined many families but devastated our economy. There is no free lunch, and many products that appear to be free or low cost are paid for in some fashion – whether through hidden fees or costs, or by selling the consumer's personal data. New products or services may result in new problems that are hard to anticipate today or to identify through slick presentations.

The following are key points that we urge the Committee to keep in mind as it digs more deeply into the myriad of complicated fintech topics.

1. Consumer protection in the fintech area must remain a shared federal and state responsibility.

Strong, uniform federal consumer protection standards are of course important. But federal laws do not cover every topic and do not address every problem. States are more nimble and are more likely to address problems early, before they are recognized as national problems. States are also the laboratory of democracy. For example, states adopted laws giving consumers a right to freeze their credit reports long before Congress did so this year.

Unfortunately, federal banking laws and regulations have often preempted state consumer protection laws and inhibited states' ability to protect people when federal laws do not. One important role that states can play is as "first responders," as detailed in our 2009 white paper, "[Restore the States' Traditional Role as 'First Responder.'](#)" Congress recognized the role that preemption played in the financial crisis by imposing limits on the ability of federal banking agencies to preempt consumer protection laws in the Dodd-Frank Act. Yet, ignoring Congress's desire to limit preemption, the Office of the Comptroller of the Currency (OCC) has now proposed to allow a wide range of companies that are not banks to claim the mantle of a "national bank" and to ignore state consumer protection laws.

We strongly oppose a new fintech "national bank" charter for nondepository institutions. The preemption of state consumer protection laws by federal banking laws and regulations has led to numerous severe problems, including the foreclosure crisis, credit card abuses, and banks' unfair and deceptive efforts to increase overdraft fees. Enabling a new class of companies to be considered "national banks" would allow these companies to ignore state interest rate caps, state consumer protection laws, and state oversight to the great detriment of consumers. Maintaining state consumer protection cops on the beat is critical, as federal agencies cannot vigilantly protect consumers in all fifty states, federal priorities wax and wane, and state agencies are closer to the people of their respective states, more nimble, and able to react quickly when local problems first arise. These issues are further discussed in our [January 2017 comments](#) on the OCC's white paper on exploring special purpose national bank charters.

2. State interest rate limits are the single most important protection against predatory lending, and neither special purpose charters nor rent-a-bank partnerships should be used to evade those limits.

For both short-term payday loans and longer-term payday and other installment loans, limits on interest rates and fees are the single most important way of protecting consumers. As described in our report [Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default](#), limits on interest and fees align the interests of lenders and consumers, and give lenders the incentive to lend only to consumers who have the ability to repay their loans. Given the lack of interest rate limits at the federal level, state usury laws are the bulwark against predatory lending and must be preserved.

For over 200 years, since the beginning of our nation, states have had the power to set interest rate limits and to protect their citizens from high-cost lending. The evisceration of state limits on

fees and interest is one of the core reasons we oppose bank charters for nondepository fintech companies. In addition to the comments notes above, our press release earlier this year describes why a new OCC fintech charter could [open the floodgates to predatory lending](#).

For example, U.S. Bank has just announced a new small dollar loan that will cost [70% to 88% APR](#). If the company were not a bank, that rate would be illegal in many states. As detailed in our report on state installment loan laws, a \$500, 6-month nonbank loan with 88% APR is illegal in more than [two-thirds of the states](#). A fintech charter would allow other lenders to make loans at those rates or even higher.

We also oppose rent-a-bank arrangements that allow a nonbank lender to make loans that would otherwise be illegal under state law. We have described the problems of rent-a-bank arrangements in several materials joined by other organizations including:

- Our 2016 [comments on the FDIC's proposed third party lending guidance](#), which could codify standards that may permit dangerous rent-a-bank arrangements.
- Our [opposition letter](#) to H.R. 3299 (McHenry) and S. 1642 (Warner), which would reverse the “Madden” decision
- Our [opposition letter](#) to H.R. 4439 (Hollingsworth), which would reverse courts’ “true lender” decisions and instead permit sham rent-a-bank lender arrangements.

3. The marketplace lending industry is addressing a gap in bank loans but poses some concerns.

In recent years, a number of online fintechs lenders, often called “marketplace” lenders, have begun addressing a need for mid-size loans of the type that many banks do not offer. These loans tend to be fixed rate, fixed term installment loans, which can be safer and more understandable for consumers than endless open-end products like credit cards. Many marketplace loans carry low rates, below those charged by credit cards, and within state interest rate limits.

However, there are a number of potential issues with marketplace loans and other online loan products. While many of these products have APRs below 36%, the loans tend to be quite large – often \$10,000 to \$40,000. For a small \$500 loan, 36% is an appropriate rate, but that is a very high and often unaffordable rate for a large loan. A new report that we will release next month will show that among the 39 jurisdictions (38 states and DC) that impose limits on the interest rate and fees for a \$10,000 loan, the median annual percentage (APR) cap is 25% and almost all are below 36%. Yet many marketplace lenders use rent-a-bank arrangements of questionable legality to evade these caps and make large, higher cost loans than they could legally make directly.

Our 2015 comments to the Treasury Department on [online marketplace lending](#) describe a number of other potential issues with marketplace loans. These issues include:

- Use of consumer data in ways potentially inconsistent with the protections of the Fair Credit Reporting Act, privacy rights, and fair lending laws.

- Skewed origination incentives that could lead to poor underwriting.
- The mandatory or default use of preauthorized electronic payments, which can weaken consumers' control over their bank accounts, cause bank account closures, and create incentives for weaker underwriting.
- Evasion of state laws, including usury caps, consumer protection laws, and licensing and oversight requirements.
- The use of lead generators, which could lead to the sale of sensitive financial information, fraud, and other problems prevalent in the online payday loan market.

In addition, lenders who offer to refinance federal student loans could lead borrowers to lose important protections for loan forgiveness or payment reduction in the event of a drop in income or disability. Private loans carry few if any such protections.

4. Faster payments can benefit consumers, but can also lead to faster fraud.

The payments industry is working on a number of fronts to make faster, near real-time payments more available and ubiquitous. Our current payment infrastructure is decades old. Modernized payment systems offer many potential benefits, including the ability for anyone to easily pay anyone else; just-in-time bill payment for families living paycheck to paycheck; immediate wage access; and easier bank account balancing that may help consumers avoid overdraft or nonsufficient funds fees.

But faster payments can also lead to faster fraud. More ubiquitous faster payments could make it easier for a senior to pay a telemarketing scammer quickly. Even more concerning, some faster payment systems currently on the market or under development will make it much more difficult to recover funds from criminals who defraud consumers.

Today, if a scammer posing as the IRS convinces a consumer to provide her bank account and routing number so the scammer can debit her account, she can later challenge that payment as unauthorized. The rule should be no different if the consumer pushes a button on her smart phone. Either way, the authorization to pay the criminal was obtained through fraud. The payment industry must deny access to scammers and other criminals, and the consumer protection rules governing faster payment systems must provide incentives for the industry to do just that. That means that consumers must be protected from all types of fraud and that institutions that enable scammers to receive funds must bear responsibility.

Sophisticated banks and payment systems are likely to be far more effective than consumers in developing measures to prevent fraud in the first place, identify it rapidly, and shut it down. We should not rely on old-fashioned public service announcements and warnings to consumers as our primary protection against fraud in faster payments.

These issues are discussed in my op-ed in American Banker on [Will Faster Electronic Payments Mean Faster Electronic Fraud?](#)

5. Big data, alternative data, computer algorithms and machine learning offer benefits but we must be attentive to potential issues including discrimination, harm to working families, errors and privacy.

The rapid evolution of computing capacity and the explosion of new types of data available to financial providers is leading to many new ways of analyzing consumer's data. The use of new technologies may make the application and underwriting process faster, simpler, more accessible, and potentially more accurate.

But algorithms can also identify correlations that lead to inappropriate and illegal discrimination against communities of color and other disadvantaged populations. Careful vigilance is important to identify the patterns that algorithms are producing in order to prevent fair lending violations.

In addition, it is important to remember that some sources of data yield their own problems. Credit reports continue to harbor the results of decades of discrimination, as we described in our issue brief, [Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination](#). Use of alternative data to address the issue of credit invisibility also poses number of other issues, as we discussed in our issue brief [Credit Invisibility and Alternative Data: The Devil is in the Details](#) and our [comments to the CFPB in response to its Request for Information on Alternative Data](#).

Similarly, efforts to use utility payments to expand access to financial services are well intended, but could result in harming millions of families who are at times late on their utility bills, such as in the winter or summer months when bills may spike. Today, most utility companies do not report delinquencies unless the bills are charged off, result in a disconnection, or reach 90 days. Monthly and more universal reporting of late utility payments could interfere with state programs to help seniors and others keep the heat on in the winter and could lower credit scores or put families on the map for predatory lenders. These issues are discussed in our issue brief [Full Utility Credit Reporting: Risks to Low Income Consumers](#).

6. Data aggregators and use of consumer's transaction data have many benefits but pose a number of issues.

A number of fintech companies are harnessing consumers' transaction data from bank accounts and other accounts to provide a wide range of services. These companies typically rely on data aggregators to access consumers' accounts.

Transaction data can be used in a number of ways that may benefit consumers, including providing improved or lower cost access to credit for thin or no file consumers; helping with personal financial management; and avoiding fees such as late fees and overdraft fees.

While consumers initially must provide their permission for access to their transaction data, the use of data aggregators poses a number of potential issues.

Companies may gain access to far more data, for far longer, and may share it far wider, than is necessary to deliver the product or that consumers understand or expect. Privacy policies are opaque, consumers have little control, and privacy laws are too weak to protect consumers. Though companies focus on “consumer permission,” that permission may be no more meaningful than the requirement to click “I agree” on a website.

There are a number of security issues. Some companies access data through secure APIs, but others use risky screen scraping and require consumers to turn over their bank account passwords. Even when data sharing is through a relatively secure channel, data breaches happen at even the most sophisticated companies. It is not at all clear if consumers’ sensitive personal information is held in a secure fashion, and consumers have absolutely no way of understanding if a fintech company can be trusted with their data. Banks and fintechs may feud – with the consumer caught in the middle – if a data breach leads to unauthorized charges.

The use of that data may pose the same issues described above for other types of big data, including disparate impacts on protected groups and predatory lending.

The collection of transaction data for credit, insurance or employment purposes by third parties is covered by the Fair Credit Reporting Act. Some data aggregators do consider themselves to be consumer reporting agencies covered by the Act, but some may not. Even for those that do, it may not be clear how FCRA obligations must be carried out in this context, including important provisions such as reasonable measures to ensure accuracy, consumers’ right to get a copy of their “reports,” adverse action notices, and procedures to resolve “errors.” If data is used for purposes other than credit, insurance or employment, the same concerns about accuracy, privacy and appropriate use remain, but there may be no protections in place.

7. Mobile devices have many capabilities but many consumers have limited, uneven, or no internet access.

Many fintech services rely on mobile devices or internet access. Yet even in this digital era, many consumers do not have full access to the internet and many do not have smartphones. [According to the Pew Charitable Trusts](#), over half of households who make less than \$30,000 a year, and even a third of those who make up to \$50,000 a year, lack home broadband. Of adults who do not use broadband at home, only one in five owns a smartphone. Even those who rely on mobile devices for their internet access may live in rural areas where service is spotty or they may have prepaid plans with limited data and service gaps when funds run out.

Thus, it is critical to ensure that a focus on fintech products does not lead us to abandon those on the other side of the digital divide. [Research by the CFPB](#) has found that lack of internet access has a strong relationship to credit invisibility. Improving internet access is one part of the solution. Ensuring that fintech banks and other companies serve the entire communities they serve – not merely around their sole physical headquarters – is also essential, as discussed in our [2015 comments on updating the Community Reinvestment Act](#).

Moreover, a hand-held device may not be sufficient to inform the consumer of all aspects of a complicated financial transaction. Paper-based communications, statements and disclosures remain important for those who want them, especially for those with incomplete, spotty or intermittent access. These issues are discussed in our [2014 comments to the CFPB on mobile financial services](#).

8. Consumers are not a sandbox toy: some fintech “sandbox” proposals eliminate consumer protections in the name of vague, untested promises of innovation.

Efforts to encourage safe and affordable innovations in the financial area are certainly welcome. Older laws and regulations also may need to be updated to address new products – and new problems – not envisioned when those laws were written.

But regulations should be updated through a carefully considered public notice and comment process. Wholesale proposals to waive consumer protection requirements in the name of vague promises of innovation are dangerous. If real consumers are exposed to financial products or services, they need real protections. Fintechs should not be allowed to “play” in the real world without complying with real laws. Indeed, unusual, untested approaches are the ones that most need careful oversight.

Fintechs testing new products are pushing for protection against legal uncertainty. They may seek guarantees that they will not be subjected to enforcement actions for violating current law or committing unfair, deceptive or abusive practices.

But up-front guarantees and agreements not to bring an enforcement action are completely inappropriate. It is impossible for regulators to fully understand how a new product or service will work or the impacts it may have on consumers. Certainly, regulators should exercise discretion in their approach to innovative products and services, and enforcement actions are typically a last resort. But it is not the job of regulators to provide legal counsel to companies or to give them a stamp of approval that they are complying with the law.

If a regulation needs to be updated, regulators should do so in a transparent process that involves input from all stakeholders, and any changes should apply to all applicable companies and consumers in an even-handed fashion. Regulators should not be picking winners and losers and adopting special rules for individual companies.

The word “sandbox” has no precise meaning, and there are some efforts to promote innovation with careful oversight that do not impose significant risks on consumers. But any proposal that involves waiving consumer protection laws or hindering enforcement of those laws should be rejected. These concerns are spelled out in our 2018 letter regarding [Arizona’s HB 2434](#), which created a regulatory sandbox.

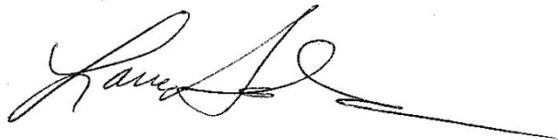
We also strongly oppose the Consumer Financial Protection Bureau’s proposed pilot disclosure program. That proposal would allow a trade organization to ask the CFPB to waive or eliminate disclosure laws – based merely on cost savings, with no showing of an improvement

for consumers – on behalf of an entire industry with no notice and comment and no adherence to the rules of the Administrative Procedures Act. The proposal is also far outside the CFPB’s authority for pilot model disclosures as set forth in the Dodd-Frank Act, 12 U.S.C.A. § 5532(e).

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Thank you for the opportunity to submit this statement for the record.

Yours very truly,

A handwritten signature in black ink, appearing to read "Lauren K. Saunders", with a long horizontal flourish extending to the right.

Lauren K. Saunders
Associate Director
National Consumer Law Center
On behalf of our low income clients