# Fintech and Consumer Protection Considerations

## Regulatory Sandboxes and Online Lending

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**** Presented in Toronto at the Financial Stability Board, semi-annual Financial Innovation Network Meeting (FIN). The FIN is a group of about 50 innovation experts from central banks, ministries of finance and regulators from around the world (G20 countries, major financial centres, and international organizations). The FIN monitors developments in FinTech and other areas of financial innovation from a financial stability perspective. https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/monitoring-of-fintech/

CRL
Center for Responsible Lending

Stanford PACS
Center on Philanthropy and Civil Society

# Broad Consumer Protection Priorities

(1) preserving the progress made so far by state and federal stakeholders to guard consumers from predatory debt trap loan products

(2) ensuring fintech lending evolves in cadence with existing and developing consumer protection laws, and

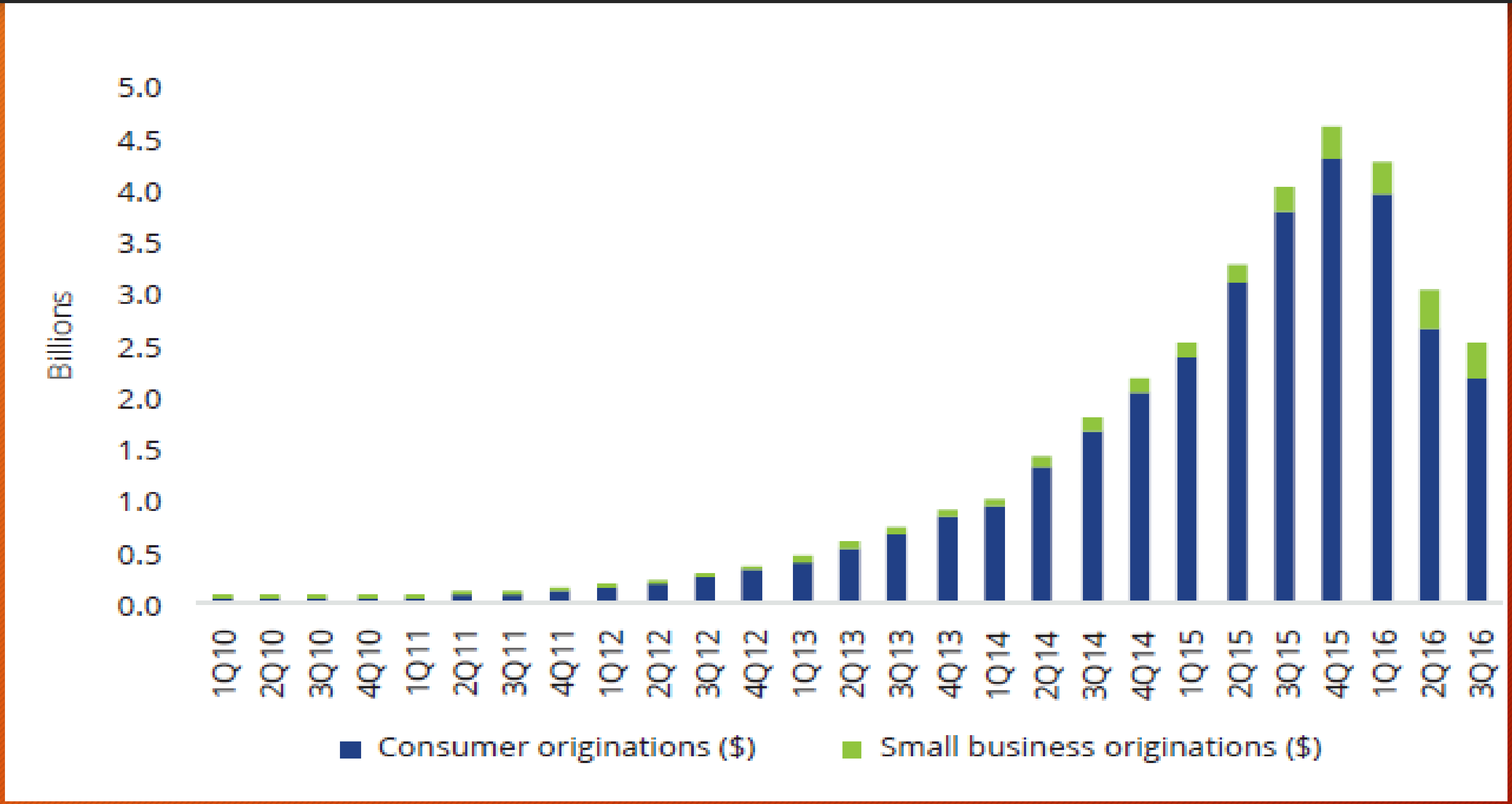
(3) A strong focus on the preservation of state usury laws.

# Marketplace Lending

As one of the fastest areas of growth in fintech, marketplace lending is a quickly growing market at the center of research and data modeling.

Marketplace lending is growing but still represents a small fraction of the overall consumer lending market, with marketplace loans representing a small portion of the $3.5 trillion U.S. consumer lending market. The largest online marketplace platforms originated over $5.0 billion of unsecured consumer credit in 2014, and over $10.0 billion in 2015.

# Marketplace lending originations by quarter ($ billions, cumulative total in the US 2007 to 3Q 2016 is $35.7 billion)

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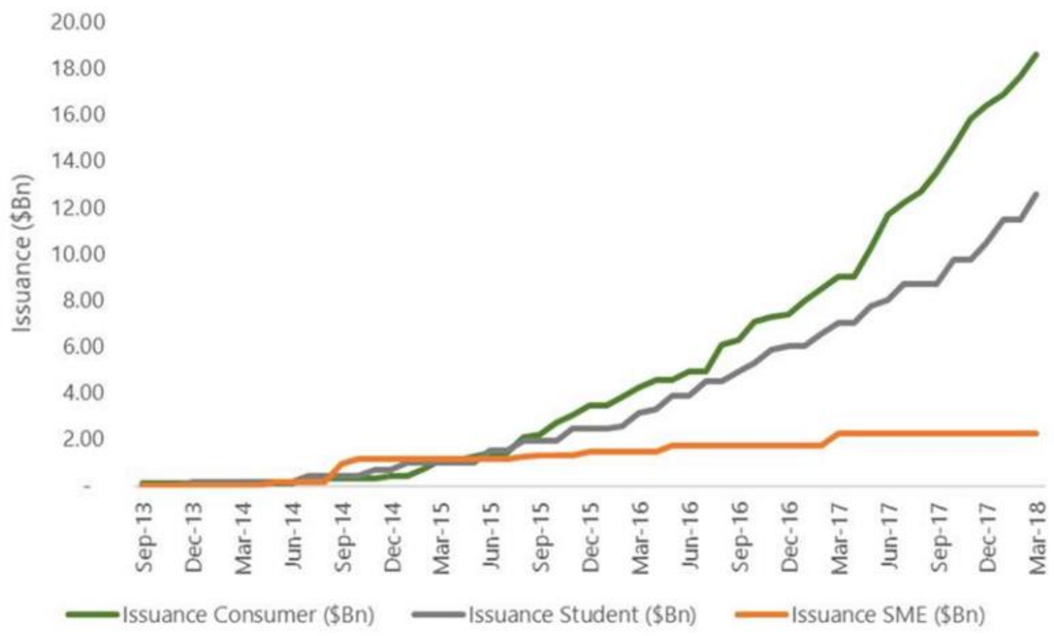
# Cumulative total issuance 2013 to 2018

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# Questions about Marketplace Lending

Marketplace lending is oftentimes touted as providing new access to credit, potentially at lower rates with streamlined underwriting. However, many questions remain:

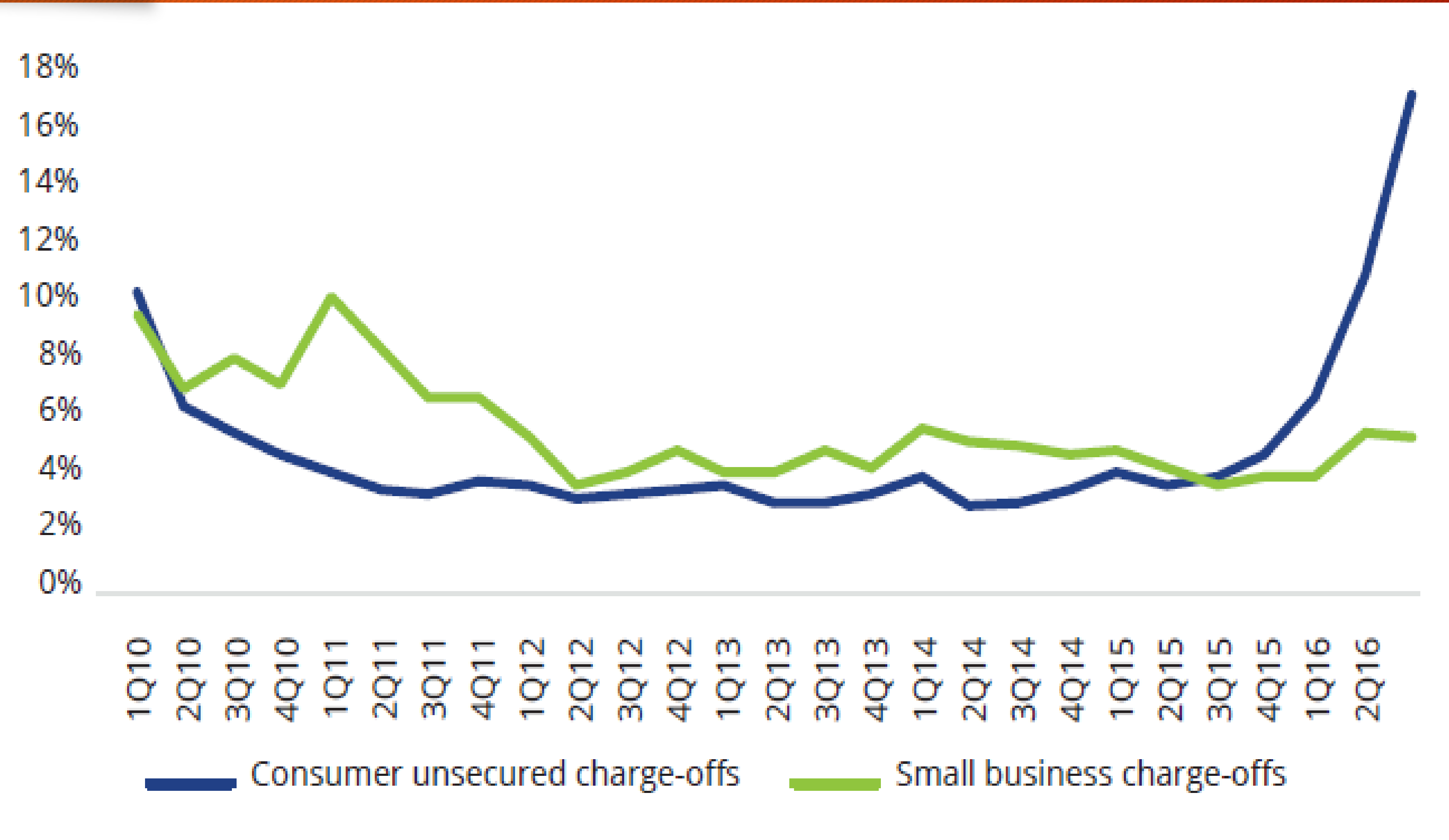
→ Are originations truly new, or is this piled on debt that will not pay off the original loan?

→ Who is accountable for risk and consumer harm, the online platform or the investors making the loans?

→ Who has oversight over the investor/lenders and the platform?

# Charge-off Rates in Marketplace Lending

- Looking at market trends, one concerning data point is that alongside this initial explosion of growth, there are also growing signs of stress and potential market failures as evidenced by a growing number of defaults and charge-offs

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# State Law & OCC Fintech Charter

Another central concern in is fintech's facilitation of the evasion and preemption of state consumer protections. State usury caps play an important role in protecting consumers from predatory and wealth stripping credit products.

An OCC has attempted to address the preemption issue, along with other consumer protections, because a fintech charter "would encourage special purpose national bank charter applicants to meet an ongoing financial inclusion standard of "provid[ing] fair access to financial services by helping to meet the credit needs of its entire community" through setting supervisory expectations and making such a commitment a condition for charter approval. This is far from an adequate resolution to the preemption of state usury limits.

# Valid When Made & True Lender

Another concern around state consumer protection laws has come in the form of efforts to codify so-called “valid when made” and “true lender” doctrines, which would enable rent-a-bank schemes that could gut state interest rate caps.

Decades ago, a few banks — which are generally not subject to state interest rate limits — began renting out their charters to enable payday lenders to make high-cost loans in states where high rates are prohibited. Those schemes were ultimately shut down, and since the mid-2000s, federal regulators have generally kept rent-a-bank arrangements for short-term payday loans at bay (although this has additional challenges).

# Rent-a-Bank

In rent-a-bank operations — both old and new — the non-bank lender is in the driver's seat. The bank is a façade, originating the loan and perhaps having a minor additional role that merely serves as cover for the fact that the main value the bank adds is its interest rate preemption rights.

Typically, virtually all aspects of the loan program other than origination are handled by the non-bank lender. While the bank may approve aspects of these operations, the vast majority of the work and the vast majority of the profits go to the non-bank lender.

# True Lender

The so-called “true lender” rent-a-bank bill, H.R. 4439, or the sanctioning of this ruse by a federal banking agency, would place a blanket stamp of approval on bank partnerships that evade state rules. The bills introduced last Congress to override the Second Circuit’s Madden v. Midland decision would severely undermine the effectiveness of state interest rate caps. which held that a debt buyer purchasing debts originated by a national bank could not take advantage of the National Bank Act’s preemption of state interest rate caps.

# True Lender & Rent-a-Bank

States have weighed in on this already. In a letter by 20 State Attorneys General opposing provisions in another similar bill that would have overturned the Madden decision, the state law enforcement officers warned that the bill “would restrict states’ abilities to enforce interest rate caps.”

# Sandboxes

Starting from the context of financial inclusion and the legacy of economic justice, sandboxes warrant the highest scrutiny because they offer the possibility of hijacking this narrative to obscure other motivations and repercussions, such as anti-competitive behavior and carve-outs from common sense consumer protection oversight.

Civil rights, fair lending and consumer protection laws exist for a reason. Many were passed in direct response to discrimination, financial exclusion and outright racism. Trading these protections for promises of innovation is a bad deal.

# Sandboxes

The question then becomes, is there a sandbox that can be safe for consumers? Can this be done right, from an equity perspective?

This question evades the more fundamental question: why are sandboxes preferable to what is possible without them? The Administrative Procedure Act (APA), and even the Equal Credit Opportunity Act (ECOA) as it pertains to disparate impact liability, are, it can be argued, pro-innovation.

We can't start the discussion on the premise that sandboxes are the best way forward.

Other countries is apples to oranges: the US has a very distinct two-tier regulatory structure, and many of them vary in significant ways compared to the what we see in the US.

# Sandboxes

Regulators struggling with fintech in variety of contexts, and it is not unreasonable to locate the gaps and mismatch between fintech and regulation.

It’s struggle. But it should be.

Consumer protection and civil rights law reform should be a deliberative multi-stakeholder conversation with an inclusive input approach.