September 30, 2015

Laura Temel
Attn: Marketplace Lending RFI
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW.
Room 1325
Washington, DC 20220

Dear Ms. Temel,

The Conference of State Bank Supervisors ("CSBS")[1] and the National Association of Consumer Credit Administrators ("NACCA")[2] are pleased to comment on the Department of the Treasury's notice and request for information on Expanding Access to Credit through Online Marketplace Lending, Billing Code 4810-25-P ("RFI"). CSBS and NACCA commend Treasury's effort to collect information on a new form of lending that has the potential to expand credit availability in the United States but that also raises important questions about regulation and borrower protection. As state regulatory associations, CSBS and NACCA will focus on questions related to the financial regulatory framework.

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 reflects 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

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[1] CSBS is the nationwide organization comprised of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. State banking regulators supervise nearly 5,200 state-chartered financial institutions. Further, most state banking departments also regulate a variety of non-bank financial services providers.

[2] Formed in 1935, the National Association of Consumer Credit Administrators (NACCA) consists of regulatory agencies from 49 states, the District of Columbia, Puerto Rico, and Alberta, Canada that license and regulate non-depository institutions such as finance companies, mortgage companies, small loan companies, pay day lenders, pawnbrokers, and other similar types of industries.

have an on-the-ground perspective on innovation's benefits and opportunities and on the need for a stable and well-regulated financial marketplace.

In what ways should policymakers be thinking about market segmentation; and in what ways do different models raise different policy or regulatory concerns?

As noted in the RFI, marketplace lenders have four general business models:

- Balance Sheet Lenders – originate loans and retain credit risk in their own portfolios;
- Online Platforms (peer-to-peer) – pass-through securitization structure where loans are immediately sold to investors, who retain the credit risk;
- Bank-Affiliated – banks originate and hold, distribute, and/or return loans to the marketplace lender; and
- Bank-Partnerships – loans are funded by a bank and sold to an investor or to the marketplace lender.

Applicable state laws will differ by business model and whether products are consumer or commercial in nature.

Balance Sheet Lenders
Balance sheet consumer lenders are subject to state consumer finance laws. Given the position of trust and confidence held by consumer lenders and their critical function within local economies, state law generally requires the licensing of companies and individuals that extend loans to consumers as a business.

While all states regulate consumer lenders through a comprehensive system of licensure and supervision, the majority of states do not license and supervise commercial lenders. Commercial lenders are instead regulated under general securities and contract laws. In addition, many states license entities that solicit or broker loans, even if the loans will eventually be closed in the name of a bank or other authorized lender.

Online Platform (peer-to-peer)
Peer-to-peer lenders are similar to balance sheet lenders in that under both business models, the marketplace lender holds itself out to consumers, controls the underwriting criteria, sets the interest rates and credit terms, and originates the loans. These companies do not partner with banks. The difference is that peer-to-peer lenders use an originate-to-distribute model where loans are matched to investors. Investors provide funding for the loans, which are originated by the marketplace lender and subsequently held and serviced by the marketplace lender on behalf of the investor.

Direct interaction with consumers and the moral hazards associated with originate-to-distribute models are two policy areas that typically warrant regulation. Accordingly, policymakers should investigate whether a regulatory regime is advisable. CSBS and NACCA commit to working with Treasury to discuss state consumer credit laws, their applicability to different business models, and how these laws can be deployed in a manner that fosters innovation.

Bank-Affiliated Lenders

Bank affiliated lenders are essentially third-party service providers for banks seeking to deploy a new means of originating smaller consumer and business loans. By utilizing software to effectuate a bank's credit policies, some banks are looking to bank-affiliated marketplace lenders to originate credit in circumstances where it might otherwise be cost prohibitive. State and federal laws governing the use of third-party service providers are applicable, as discussed below.

Bank Partnerships

Some marketplace lenders form relationships with commercial banks whereby the bank originates the loans on behalf of the marketplace lender. The loan is then sold to the marketplace lender who can either hold the loan in portfolio or sell it to investors. This business model is not unique to marketplace lenders 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.[3] While this RFI specifically excludes short term/high-cost lenders, other types of consumer lenders have already litigated the issue of who the "true lender" is in these arrangements.

Prior case law related to short term/high-cost lenders is relevant because the underlying legal question is whether lenders can partner with a bank to bypass state licensure laws. When addressed in the context of short term/high-cost lenders, the details of the product – loan duration and interest rate – were inconsequential for determining the "true lender."[4]

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

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[3] Under, the Depository Institutions Deregulation and Monetary Control Act of 1980, state-chartered banks may charge loan interest at rates not exceeding the higher of (i) the maximum rate allowed by the state in which the loan is made, and (ii) the maximum rate allowed by the bank's home state. The National Bank Act contains an analogous provision for national banks. 12 U.S.C. § 85. Payday lenders have attempted to partner with banks to take advantage of these favorable laws.

[4] *Cf. FDIC v. Lattimore Land Corp*., 656 F.2d 139, 147-49 (5th Cir. Unit B 1981).

and state courts have reached different conclusions by focusing on either the substance or the form of the transaction.[5] Treasury will need to be aware of the "true lender" tests and potentially speak to this issue in any policy recommendations.

Describe whether and how marketplace lending relies on services or relationships provided by traditional lending institutions or insured depository institutions. What steps have been taken toward regulatory compliance with the new lending model by the various industry participants throughout the lending process? What issues are raised with online marketplace lending across state lines?

Supervision of Banks Involved in Marketplace Lending

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, 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.

Banks partnering with marketplace lenders for loan origination are also expected to incorporate these arrangements into their concentration risk management programs, to avoid undue reliance on a single vendor or revenue source. Similarly, banks investing in marketplace lending loans (or associated pooled dependent notes) should ensure such activity is captured by a robust concentration risk management regime, and that exposures are fully compliant with applicable state or federal legal lending limits of investing banks.

Federal bank regulatory agencies, including the FDIC's Financial Institution Letter 44-2008, provide guidance for managing third-party risk.[6] FIL 44-2008 creates a four part risk

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[5] *Compare CashCall, Inc. v. Morrisey*, 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*, No. 14-2131-cv, 2015 WL 2435657 (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).

[6] FDIC: Financial Institution Letter 44-2008, *Guidance For Managing Third-Party Risk*, available at https://www.fdic.gov/news/news/financial/2008/fil08044a.html; Federal Reserve Board: Supervision and

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 institution'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 as necessary 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.

Supervision of Third-Party Service Providers

Third-party service providers are extensively monitored by both the bank and state and federal examiners. Many state banking agencies are authorized by state law to examine third-party service providers that provide services to their supervised institutions. While the state statutes themselves vary, the authorities fall generally into four categories:

1) Authority to examine only bank subsidiaries and affiliates,[7]
2) Authority to examine a third-party when a bank outsources certain enumerated services to the third-party, such as electronic funds transfers or data processing services,[8]
3) Authority to examine any entity that provides any type of service to a bank,[9] or

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Regulation Letter SR 13-19, *Guidance on Managing Outsourcing Risk*, available at http://www.federalreserve.gov/bankinforeg/srletters/sr1319.htm#access; OCC Bulletin 2013-29, *Risk Management Guidance*, available at http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html.

[7] Ala. Code § 5-3A-1(b); Alaska Stat. § 06.05.005(a)(1); Colo. Rev. Stat. § 11-102-301(2); Del. Code Ann. tit. 5, § 121; La. Rev. Stat. Ann. § 6:123(A)(2); Md. Code Ann. Fin. Inst. § 5-404; Mass. Gen. Laws ch. 167, § 2(a)(2); Mich. Comp. Laws § 487.12202(1); Neb. Rev. Stat. § 8-108; N.H. Rev. Stat. Ann. § 383:9-i; 71 Pa. Stat. Ann. § 733-402 (West 2015); S.D. Codified Laws § 51A-2-18; Tenn. Code Ann. § 45-2-1602; Wash. Rev. Code § 30.04.060(3); W. Va. Code § 31A-2-6(a).

[8] Colo. Rev. Stat. § 11-102-301(2); Conn. Gen. Stat. § 36a-17(b); Idaho Code Ann. § 26-1102(1); 205 Ill. Comp. Stat. 5/48(2)(b)(2.5); Iowa Code § 524.218; Kan. Stat. Ann. § 9-1127d(a); Me. Rev. Stat. Ann. Tit. 9-B, § 211(5); Mo. Rev. Stat. § 362.105.1(12); Tex. Finance Code § 31.107; Utah Code Ann. § 7-1-501; Va. Code Ann. § 6.2-901; Wyo. Stat. Ann. § 13-9-101(f).

[9] Ga. Code Ann. § 7-1-72(b); N.C. Gen. Stat. § 53C-8-4; Vt. Stat. Ann. Tit. 8, § 11501.

4) Authority based on a statutory requirement that a bank cannot outsource a service unless the service provider affirmatively consents to examination by the state banking agency.[10]

Furthermore, some states have both examination and enforcement authority over third-party service providers, while other states only have examination authority.[11]

Marketplace lending potentially offers significant benefits and value to borrowers, but what harms might online marketplace lending also present to consumers and small businesses? What privacy considerations, cybersecurity threats, consumer protection concerns, and other related risks might arise out of online marketplace lending. Do existing statutory and regulatory regimes adequately address these issues in the context of online marketplace lending?

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.

Licensing and Credentialing

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 cooperative efforts, interstate agreements, and model standards to provide consistent supervision. One such tool is the Nationwide Multistate Licensing System and Registry ("NMLS"). A licensing and registration system and a central repository for licensee information, NMLS provides states the option to

[10] Cal. Fin. Code § 462; Fla. Stat. § 655.0391; Ind. Code § 28-11-3-1 (g); 3 NYCRR SP G § 101.1; Or. Rev. Stat. § 708A.145; Wis. Stat. § 221.1101(5).

[11] Compare Wyo. Stat. Ann. § 13-9-101(f) ("All bank services and bank service corporations shall be subject to regulation and examination by the state banking commissioner to the same extent as if the services were being performed by the bank itself on its own premises."), with Colo. Rev. Stat. § 11-102-301(2) ("The commissioner shall examine . . . any electronic data processing centers of a state bank . . .").

implement their licensing laws through a common electronic system. By eliminating paperwork and tracking individuals across state lines, NMLS serves as an efficient tool for regulators and lenders alike. NMLS is a comprehensive licensing and registration system for the mortgage industry, and since 2012, states have been using NMLS on an expanded basis to license and supervise a broader range of non-depository financial services companies including money transmitters, check cashers, and consumer finance lenders. As of October 1, 2015, 37 state agencies use NMLS to manage 175 license/registration types in the money service business, debt, and/or consumer finance industries.

State regulators support federal legislation to improve a key functionality of NMLS. H.R. 2643 and S. 1957 would allow state regulators to process criminal background checks on non-mortgage financial services professionals like marketplace lenders through the NMLS. Clarifying this authority would streamline the licensing process for state regulators and reduce regulatory burden on the industry. The bills make existing licensing processes more efficient, and do not put any additional requirements on license applicants. Accordingly, CSBS and NACCA recommend the passage of H.R. 2643 and S. 1957 as a means of supporting continued efficiencies in state regulation.

Liquidity Concerns

Like most non-depository financial service providers, marketplace lenders need to keep providing their service to survive. If the marketplace lender is unable to originate loans because of an economic downturn, origination and servicing fees will decline and threaten viability. Like most asset-based lenders, marketplace lenders are subject to the credit and liquidity constraints of the capital markets. Accordingly, credit availability can also threaten the marketplace lending business model in a downturn, especially for lenders focused on the high-touch lending models like small business lending.

In contrast, community banks rely on insured deposits for funding, which have proven to be much more stable across varying economic conditions. Community banks also engage in relationship based small business lending that revolves around long-term, existing relationships with borrowers.

Small businesses that borrow from marketplace lenders are subject to heightened liquidity risk because marketplace lending is only as stable as its funders. Historically, credit markets dry up in an economic downturn. Small businesses dependent on credit markets for funding may consequently be unable to obtain credit. This effect can be compounded by the automated nature of marketplace lending because the marketplace lender – unlike a commercial bank – may lack the staff resources to work with a borrower to explore available credit options. Accordingly, a guide to small business funding that includes marketplace lending may be a useful product to educate small business owners on credit availability and contingency plans.

The Small Business Administration has robust resources for small business owners that might be a good starting point.[12]

Compliance
State regulators are aware that some online lenders make loans to consumers without regard to the applicable state laws that regulate or prohibit the lending activity. By violating those states' laws, the lenders 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 lender with a non-compliant mindset with regard to state licensing laws may be less inclined to comply with other laws or consumer protection practices. Accordingly, state regulators urge Treasury to support policies that improve the efficiency of existing licensing regimes and promote consumer protection without undermining the states' ability to regulate entities that make loans to the citizens within their borders.

Collection Issues

State regulators have observed a surge in improper third-party collection practices, particularly of accounts which have been charged off or deemed uncollectible by the lender. These accounts are often sold to a third-party, in many cases without appropriate documentation to support the loan. There have also been reports of accounts being sold to multiple entities resulting in unwarranted collection activity from multiple entities. While these issues occur with storefront lenders, they appear more prevalent with online lenders. As Treasury explores the expansion of online credit, considerations should be given to the collection of unpaid debts and the importance of ensuring consumers are protected at all stages of the debt process.

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In conclusion, CSBS and NACCA support the use of technology to improve credit availability. Technology advances like marketplace lending can be used to effectively boost economic output, while simultaneously respecting state laws and the time-tested policies these laws represent. CSBS and NACCA look forward to engaging with Treasury, the industry, and other interested parties as this issue continues to develop.

[12] *See* https://www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/preparing-your-finances/understanding-basics.

Sincerely,

John Ryan	Joe Mulberry
President & CEO	President
Conference of State Bank Supervisors	National Association of Consumer Credit Administrators