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TESTIMONY

of

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OFFICE OF THE COMPTROLLER OF THE CURRENCY

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SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON FINANCIAL SERVICES

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Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, I appreciate the opportunity to appear before the Subcommittee on Financial Institutions and Consumer Credit to discuss the Office of the Comptroller of the Currency's (OCC) perspectives on H.R. 6139 "The Consumer Credit, Access, Innovation, and Modernization Act" (hereinafter referred to as H.R. 6139 or "the bill"). The OCC recognizes the importance of providing underserved consumers greater access to innovative and affordable financial products and services, and through many routes we encourage national banks and federal savings associations to do just that. However, we are concerned that H.R. 6139 would hurt the very population of consumers that it seeks to assist, and would encourage the development of businesses with unsafe and unsound concentrations in financial products and services that have serious consumer protection, compliance, safety and soundness, and other risks including Bank Secrecy Act and Anti-Money Laundering (BSA/AML) concerns.

The effective result of H.R. 6139 would be to create a class of federally chartered companies (National Consumer Credit Corporations, hereinafter referred to as "NCCCs" or "companies") focused on consumer credit products of the very nature and character that the OCC has found unacceptable based on consumer protection and safety and soundness concerns. In particular, it is our experience that the profitability of many of the types of small dollar, short-term loans that NCCCs would likely seek to offer is dependent on effectively trapping consumers into a cycle of repeat credit transactions, high fees, and unsustainable debt.¹ Other products that can help provide broader access to payment systems that NCCCs might offer, such as prepaid access cards, can raise other concerns regarding the management of money laundering risks and require extensive and costly oversight, as the Financial Crimes Enforcement Network (FinCen)

¹ See also Uriah King and Ozlem Tanik, "Financial Quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year," Center for Responsible Lending, November 30, 2006.

highlighted when it issued rules to address this concern. Yet, recognizing these significant compliance and safety and soundness concerns, H.R. 6139 would generally compel the OCC to approve an NCCC's proposed products or services within 45 days unless the OCC determines that the products or services would significantly harm the interests of underserved consumers or small businesses. This essentially requires the OCC to prove a negative consequence, based on proposed activities not yet conducted, against a backdrop where the OCC's experience teaches that the activities are harmful to consumers, risky, and in some respects, a brew for BSA/AML problems.

A key premise of H.R. 6139 is that high compliance and regulatory costs significantly impede firms' ability to offer small dollar credit products in a profitable and efficient manner, and that a federally issued charter would significantly lower such costs. The implied premise, however, is that those lower costs will result from lower compliance expectations applicable to an NCCC.

We disagree with this premise. The bill will result in a decrease in protections for categories of consumers that may be the most vulnerable. We have ample evidence from the recent financial crisis that the goal of enhanced access to financial products and services must be coupled with assurances that those consumers are subject to meaningful consumer protections and that the firms offering those products and services must do so on a prudent, safe, and sound basis. In this regard, the Consumer Financial Protection Bureau (CFPB) has been provided the authority to issue rigorous, uniform, and nationally-applicable consumer protection standards for financial products and services. It is important that the types of products envisioned for NCCCs not be carved out of coverage of CFPB-administered lending standards. My testimony provides a brief overview of H.R. 6139 and then more fully describes the OCC's key concerns about the

bill and the potential negative effect it could have on consumers and on the efforts that the OCC and other federal and state agencies have taken to safeguard consumers from lending products with predatory features.

Overview of H.R. 6139

H.R. 6139 would require the OCC to provide a federal charter to non-depository creditors (companies chartered or licensed by a state and engaged in offering consumer and small business loans). The charter application would be reviewed and approved by the OCC pursuant to procedures established by regulation. Section 3 establishes general eligibility criteria for a company to be chartered as an NCCC, such as having adequate capital structure relative to the business plans of the company, and it provides that such criteria may be supplemented by additional criteria established by OCC regulation. Section (3)(c) of the bill permits an applicant to be owned or controlled by other entities, including depository institutions, bank holding companies, nonprofits, and consumer financial services businesses.

Under H.R. 6139, an NCCC would be permitted to enter into joint ventures and partnerships with other NCCCs, as well as with depository institutions, third-party vendors, and other parties to promote or facilitate providing its financial products and services. Section 3(e) provides that the OCC shall “encourage and facilitate” such joint ventures (without specifying any safety and soundness or consumer protection criteria).

In addition to chartering authority, section 3(e)(1) of the bill would require the OCC to conduct examinations and supervise NCCCs to assess their internal controls; evaluate their financial condition; determine if they are meeting the needs of underserved consumers and small businesses; and monitor compliance with the requirements of the bill and all other applicable laws and regulations. In conducting its supervision of NCCCs, the OCC would also be required

to consult and coordinate with other federal and state agencies to ensure that supervisory activities, including examination schedules, are conducted in a coordinated and efficient manner.

Section 3(e)(2) of the bill would require NCCCs to, among other things, make financial education information adopted by the OCC available to its customers; provide certain cost disclosures for loans of one year or less that section 5 of the bill would exempt from the Truth in Lending Act (TILA); and offer underserved consumers who are not meeting the payments on an extension of credit by an NCCC with a term of less than 120 days, an extended loan repayment plan. An NCCC would be prohibited from accepting deposits; making commercial loans except for certain small business loans not in excess of \$25,000; making consumer loans with a term less than 30 days; and intentionally extending credit in certain circumstances, including when the maximum principal amount of all credit outstanding extended by such NCCC to the consumer exceeds \$5,000 (or \$25,000 in the case of a secured credit transaction).

The primary business of an NCCC would be to offer products and services approved by the OCC. The OCC would receive a description of any products or services proposed by an NCCC, including how the product will help meet the credit needs of underserved consumers or small businesses and be commercially viable (which the bill defines as expected to produce a reasonable economic profit). Under section 3(f)(2), the OCC would be required to prescribe regulations with procedures for the review and approval of such proposals, but the procedures may not include disapproval or conditional approval of a financial service or product unless the OCC determines that offering the product or service will significantly harm the interests of underserved consumers or small businesses. A proposal will be deemed to be approved if the OCC has not notified an NCCC of its decision within 45 business days after submission. The bill further provides that any such products or services approved by the OCC for underserved

consumers and small businesses may be offered to other consumers and small businesses.

Section 3(g) would provide for the payment to the OCC of annual fees to offset the cost of carrying out the provisions of the bill.

OCC Concerns with H.R. 6139

The OCC's fundamental concern is that H.R. 6139 would provide special status and federal benefits to companies and third-party vendors that would primarily engage in offering credit products and services that the OCC has previously found to be unsafe and unsound and unfair to consumers. These include payday loans, tax refund anticipation loans (RALs), and automobile title loans. Our supervisory experience with these products is that they are based on a business model that is not sustainable from the perspective of low and moderate income customers—high fees, repetitive use, high defaults, and severely weak legal compliance. Indeed, the very products and services this bill is designed to encourage often result in significant abuses, and, in fact, the OCC took enforcement action related to one of the proponents of this bill (Cash America) for such abuses.²

Against this experience, we are concerned that H.R. 6139 would negate many actions that Congress, the OCC, and other federal and state agencies and supervisors have taken to safeguard consumers from the risks products of this nature present to consumers. For example, based on a Department of Defense study of predatory lending affecting service members, their dependents, and military readiness, Congress (in the John Warner National Defense Authorization Act, P.L. 109-364) restricted the costs and terms of certain abusive credit products offered to members of the military and their dependents. It is unclear whether or how H.R. 6139's prohibitions on establishing usury caps or limits would affect this important protection provided to our nations' service members.

² See <http://www.occ.gov/static/enforcement-actions/ea2003-1.pdf>.

By requiring the OCC to charter NCCCs that present business plans that meet certain chartering criteria, and to approve products or services that such companies would offer unless the OCC makes an express determination that such product or service will significantly harm the interests of underserved consumers or small businesses, H.R. 6139 would undermine steps the OCC has taken over the past ten years to address significant consumer protection issues, BSA/AML, and safety and soundness risks that many of these products pose. For example, H.R. 6139 directs the OCC to encourage and facilitate joint ventures between NCCCs and third-party service providers and vendors to help facilitate innovative products and services. Through our supervisory and examination processes, we have found that financial institutions that have partnered with third-party providers to originate or deliver such products and services can encounter serious risks because of the failure of vendors to adequately control and manage their business operations. The Comptroller has recently singled out third-party oversight as a significant contributor to the operational risks facing financial institutions.

More generally, through a combination of guidance and strong enforcement actions, the OCC has acted to severely limit payday lending, RALs, and similar activity within the institutions we regulate. The OCC has also taken steps to deter and prevent third-party firms from promoting and peddling such products by relying upon the use of a national bank charter through a business arrangement with a national bank or federal savings association.

Specifically, the OCC was the first federal banking agency to issue comprehensive anti-predatory lending standards. In 2000, we issued advisories on payday loans, title loans, and abusive lending practices designed to prevent national banks and their subsidiaries from engaging in lending practices that were unfair and deceptive.³ Between 2001 and 2003, the OCC

³ See “AL 2000-7” (<http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf>), “AL 2000-10” (<http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf>).

also took decisive enforcement actions against a variety of banks and affiliated service providers (*i.e.*, Cash America, Advance America, ACE, Dollar Financial) for unsafe and unsound lending practices and violations of laws, including violations of the Federal Trade Commission Act and TILA.⁴

In 2010, the OCC acted to severely curtail the sale and marketing of RALs among national banks because of the consumer protection and safety and soundness risks arising from the product's unique repayment and cost structures, and because of the banks' reliance on third-party tax return preparers to offer them.⁵ We are concerned that H.R. 6139 would permit—and encourage—insured depository institutions to re-establish such affiliations through NCCCs that the OCC would be charged with approving.

In addition to consumer compliance and protection issues, we believe the narrowly focused charters and the types of products NCCCs would offer raise serious potential safety and soundness concerns. H.R. 6139 would allow and encourage NCCCs not affiliated with insured depository institutions to form affiliations with third-party vendors. As previously noted, our experience suggests that such vendors often lack the requisite systems and procedures to comply with the myriad of BSA/AML and other regulations and risk management practices that are essential to the safe and sound conduct of these activities. We believe NCCCs would face significant BSA/AML exposure resulting from their dependence on products with remote deposit capture characteristics and lack direct customer contact and traditional long-term customer relationships, such as prepaid cards, internet-offered products and money transfer services.

2000-10.pdf), and “AL 2000-11” (<http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-11.pdf>).

⁴ See enforcement action 2003-1 against First National Bank in Brookings (<http://www.occ.gov/static/enforcement-actions/ea2003-1.pdf>), enforcement action 2003-2 against Peoples National Bank (<http://www.occ.gov/static/enforcement-actions/ea2003-2.pdf>), enforcement action 2002-93 against Goleta National Bank (<http://www.occ.gov/static/enforcement-actions/ea2002-93.pdf>), and enforcement action 2001-104 against Eagle National Bank (<http://www.occ.gov/static/enforcement-actions/ea2001-104.pdf>).

⁵ See “OCC 2010-7” (<http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-7.html>).

Information and transparency is vital to the proper management of BSA/AML risk. Our supervisory experience also indicates that companies with limited business focus and product lines face significant concentration risks that can threaten their viability if underlying business conditions in their market area deteriorate or change (for example, the closing of a nearby military base). These risks are magnified for firms that lack a stable funding base and are dependent on non-deposit wholesale funding. We believe that NCCCs created under H.R. 6139 would be highly susceptible to these risks.

We are also concerned that H.R. 6139 could blur authorities and responsibilities for the OCC and the CFPB and create additional confusion for consumers. For example, companies chartered under the bill would be required to provide to their customers any financial education information that is adopted by the OCC. While we endorse efforts to improve financial literacy, this is an area where Congress has given the CFPB broad authority. Similarly, H.R. 6139 would exempt from the requirements of TILA—which the CFPB implements—loans with terms of one year or less if the creditor has provided the borrower with a clear and conspicuous statement in the loan agreement of the cost of the loan expressed as a total dollar amount and as a percentage of the principal amount of the loan. This exemption would apply not only to NCCCs but also to any other creditor making these loans. We are concerned that this provision would exempt short-term loans from important TILA protections and disclosures that currently apply, such as the APR and finance charge; would substitute a different disclosure standard that would not allow consumers to compare costs with credit products subject to TILA; and would thereby mask the potentially high APRs of the categories of short-term loans to be offered by NCCCs, such as payday loans and RALs. A recent study released by the Pew Charitable Trusts Small Dollar

Research Project noted the difficulty consumers may have in trying to compare a product where the rate is quoted as a simple interest rate with one where the rate is expressed as APR.⁶

Finally, we are concerned that the standard H.R. 6139 imposes of “significant harm to the interests of underserved consumers or small businesses” in order for the OCC to deny a proposed product or service would be difficult to implement, and could face challenges. Assessing potential harm or benefit to an individual or even class of consumer would be very fact specific, take a significant amount of time, and could vary over time depending on a consumer’s situation and available product alternatives.

As previously noted, a key motivation for establishing a national charter for credit corporations appears to be the benefits that uniform regulations could provide to such firms. We believe the creation of the CFPB already provides an avenue for achieving this objective without creating a new class of federally chartered financial institutions. Congress has given the CFPB regulatory authority to adopt standards related to consumer products and services offered in the marketplace, without regard to whether they are offered by banks, nonbanks, or state- or federally supervised institutions. Further, the CFPB has general authority to supervise and regulate nonbank lenders, including payday lenders and “large nonbank participants” in consumer credit and services, and will be conducting examinations of such companies. The sponsors of H.R. 6139 may want to consider discussing with the CFPB how its existing regulatory and supervisory authority can be used to achieve the goals of the bill.

We also note that Congress has previously assigned to the Treasury Department the task of developing programs for small-dollar loans that would serve as alternatives to costlier small-dollar loans, and Section 1025 of the Dodd-Frank Act authorizes the Secretary of the Treasury to

⁶ “Payday Lending in America: Who Borrows, Where They Borrow, and Why,” the Pew Charitable Trusts Small-Dollar Research Project. p. 17.

establish demonstration programs for this purpose. The OCC believes such programs would provide a valuable mechanism for supervisors and industry participants to collaborate on innovative approaches to address the needs of underserved consumers and consumers who may have blemished or limited credit history and thus limited access to traditional credit products.

Conclusion

In summary, the OCC is concerned that H.R. 6139 could have a number of unintended and undesirable effects for the population that it is intended to benefit. In particular, H.R. 6139 raises serious consumer protection, compliance, and safety and soundness issues by creating a new federal charter for companies concentrating on products and services most prone to abuse and that are most often targeted to minority populations, low-income neighborhoods, and communities with high concentrations of our military service members. These are products and services that the OCC has largely extinguished from the national banking system, and we would not support, license, nor charter an institution concentrating in these services today.

Furthermore, where these services are offered, state officials and the CFPB have adequate authority to regulate these products and services and the companies that provide them. The OCC shares the authors' goal of providing financial services to underserved communities and unbanked populations, and looks forward to working with members of the Subcommittee to achieve that goal.