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Before the House Committee on Financial Services, Subcommittee on Digital Assets, Financial Technology, and Inclusion

"Modernizing Financial Services through Innovation and Competition"

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Chairman Hill, Ranking Member Lynch, and Members of the Subcommittee:

I am honored to appear before the Subcommittee today on behalf of WebBank to discuss how responsible bank partnerships like WebBank's can drive innovation in financial services, support healthy competition in the marketplace by presenting more product choices for consumers and small businesses, enhance inclusion by expanding access to responsible credit for underserved consumers and small businesses, and bring nonbank fintech companies under the supervision and oversight of their partner banks and the bank's regulators.

About WebBank

WebBank[1] has been in business over 25 years, it has the longest track record of successfully launching and overseeing third-party lending programs through bank partnerships and has originated and funded over $180 billion in consumer and commercial credit products. The Bank provides its loans and other credit products through the platforms of its nonbank strategic partners, including well-recognized technology companies like PayPal, Intuit, Bill (f/k/a Bill.com), Shopify, and Toast Capital, among others. This is why WebBank is often referred to as "The Bank Behind the Brand"™ – because we go to market through branded strategic partner platforms that include retailers, manufacturers, and many fintech companies.

The Bank has been providing consumer loan programs since the early 2000's. In 2007 - 2008, the Bank brought the first "marketplace lending" programs to market through its partners LendingClub and Prosper. Today the Bank has active consumer loan programs with approximately twenty strategic partners, including Avant, Mosaic, Oportun, Petal, and others. The Bank's consumer lending programs include closed-end installment loans, revolving lines of credit, credit cards, private-label cards, auto-refinancing, and more. Through these programs, the Bank has originated over $136 billion in consumer credit across the United States since 2011.

Foundations of Successful Bank-Fintech Partnerships

Based on our experience as a pioneer in the bank-fintech partnership space we understand how our business model can play an incredibly important and beneficial role across constituencies and the economy as a whole. Bank partnerships support innovation in financial services, enhance inclusion by expanding access to capital for underserved consumers and small businesses, and bring nonbank fintech companies under regulatory scrutiny. Bank partnerships with fintech companies unlock the greatest strengths of each participant, yielding a sum greater than its parts.

[1] Sometimes referred to herein as the "Bank" or "we".

Fintech companies develop amazing technology platforms that deliver minimal-friction, state-of-the-art customer experiences, serving customers on their mobile phones and online, where they want to transact. These are technologies that provide the ability to scale quickly and reduce costs but that banks often struggle to develop on their own. Banks like WebBank have deep expertise in financial product design, regulatory compliance, and oversight. When these capabilities are combined, they enable the partners to bring innovative and valuable financial products to market efficiently and at scale while ensuring legal and regulatory compliance with the fintech platform subject to oversight by the bank and its and regulators. And with such scale and efficiency, banks are more capable of serving underserved consumers and small businesses, including low- and moderate-income consumers and "credit invisible" consumers. Below are some of the components the Bank perceives to be critical to a successful, consumer-friendly, responsible bank-fintech partnership.

Third Party Risk Management: Third-Party Lending

WebBank began sponsoring third-party lending programs before there was specific regulatory guidance regarding the business model. WebBank crafted its own approach to lending through nonbank strategic partners that we believe inspired the FDIC's proposed guidance on third-party lending (FIL-50-2016)[2] based on FDIC's examination of WebBank's model, policies, and procedures. WebBank – and other successful bank partnerships - have evolved and refined their approaches to managing strategic partner relationships over time, including based on applicable regulatory pronouncements, but from the Bank's perspective any successful, consumer-friendly, responsible bank partnership should always be grounded in three fundamental pillars:

Due Diligence and *Risk Assessments* – Banks' prospective fintech partners should be subjected to detailed and thorough due diligence and risk assessments upfront, before ever launching a program, and ongoing due diligence and risk assessments should be applied to any fintech partners a bank approves.

For example, WebBank is extremely selective about the fintechs with which it works. Each year, WebBank enters into hundreds of nondisclosure agreements with prospective partners but approves and launches a very limited number of new partnerships. Since 2015, WebBank has launched an average of four new partnerships per year. This average was two new partners per year before the ecommerce and online lending acceleration spurred by the COVID-19 pandemic.

Prospective partners must respond to (and provide supporting documentation for) a due diligence request list that covers hundreds of data elements across multiple subject areas, including the partner's corporate organization, management and board, finance & treasury, detailed information regarding the product construct under discussion, credit and model risk management, operations, IT/information security, collections, vendor management, and legal and regulatory compliance. WebBank's due diligence is designed to capture all relevant information about a

[2] Proposed FIL-50-2016 is now inactive based on the promulgation of FIL-29-2023, Interagency Guidance on Third-Party Relationships: Risk Management. https://www.fdic.gov/news/financial-institution-letters/2023/fil23029.html

prospective partner, including its policies and procedures, financial condition, its specific experience and quality of management, and the effectiveness of its operations and controls.

WebBank evaluates responsive information in its risk assessments, which are designed to be holistic and consider multiple categories of risk, including the following: counterparty; strategic; operational; credit; underwriting; compliance; BSA/AML; financial crimes; legal and regulatory compliance; and vendor management. As part of its upfront due diligence and risk assessment, WebBank seeks to confirm, among other things, that: (i) any new lending product that may be provided by the Bank will be fully compliant with all applicable laws and regulations, will be transparent, and provide real value to customers; and (ii) the prospective partner is culturally aligned with the Bank regarding the requirements to operate an effective and compliant third-party lending program, is well resourced to support the Bank's lending program across all relevant functions (including operations, compliance, IT/information security, and reporting), is capable of operating an effective compliance management system,[3] and has knowledgeable and experienced management and staff who understand and can manage the requirements of the lending program.

One important element of the Bank's upfront (and ongoing) due diligence and risk assessment is model risk management. The Bank requires all relevant information regarding any models that a partner proposes to use in connection with one of the Bank's lending programs, including model development documentation, data used to build the model, area of use (viz., underwriting, marketing, fraud, etc.), model variables and weightings, model performance statistics during development and in production (viz., AUC, KS, PSI), independent model validation, and results of ongoing monitoring, reviews, and audits. The Bank declines to work with prospective partners who claim their models are proprietary and confidential and are unwilling to provide the Bank with the granular information it requires.

The Bank applies similar due diligence and risk assessments over the course of its relationships with approved partners. The frequency of such reviews is commensurate with the Bank's perceived risk of the partner and the Bank's lending program that such partner supports. The Bank also conducts additional risk assessments when the Bank changes its lending operations, or the partner changes its operations in support of the Bank.

We strongly believe that the above due diligence and risk assessment practices are foundational for an effective, safe, and consumer-friendly partnership.

Contract Structuring and Review – We also believe that banks should carefully structure their program agreements with partners to limit the bank's exposure and to ensure the bank has the rights and authority it needs to control and effectively oversee its lending programs.

For example, WebBank's program agreements with its partners require the Bank's final approval of all marketing and customer-facing materials to support compliance with applicable laws and regulations. The Bank's program agreements also reflect the Bank's control of the credit policy for each of its lending programs. For example, such agreements reflect that partners do not

[3] <u>See</u> discussion of Ongoing Supervision and Oversight below.

have the authority to modify or permit exceptions to the credit policy without the Bank's approval and consent.

Such agreements also require the Bank's nonbank partners to adopt and maintain Bank-approved compliance management systems ("CMS")[4] and cooperate in periodic audits by the Bank and annual third-party audits of their CMS programs and their IT systems and information security (and additional/more frequent audits to the extent required for risk or regulatory purposes).

These agreements also provide the Bank with rights to all information and data that the partner obtains or generates on behalf of the Bank, rights to approve and decline vendors used by the partner in connection with the Bank's program, and rights to suspend, winddown, and terminate programs based on the Bank's risk exposure, deterioration of the partner's financial condition, and regulators' directions, among other things.

Ongoing Supervision and Oversight – Finally, we strongly believe that any bank should apply rigorous ongoing supervision and oversight across all aspects of its third-party lending programs. This cannot be stressed enough.

For example, WebBank requires its partners to adopt and maintain a Bank-approved CMS, complaint management systems, and vendor management programs. Partners are required to maintain (periodically revise) and apply policies and procedures covering all aspects of their CMS, complaint management, and vendor management.

Partners are required to provide the Bank with monthly, quarterly, and annual reporting, including the results of regular monitoring and testing across the partner's activities on behalf of the Bank to confirm compliance with applicable policies and procedures and other requirements of the Bank's programs. Partners are also required to support periodic audits by the Bank (often entailing on-site reviews) and annual third-party audits of IT/information security and compliance with the CMS across the Bank's program.[5]

The nature and scope of the required monitoring and testing, site inspections, and audits are determined by the Bank based on the complexity, size, and risk profile of the partner and the program it supports for the Bank. Findings are reported, as appropriate, to the Bank's management and board, exceptions are tracked through final remediation, and corrective actions are taken to the extent necessary and appropriate.

All of this is in addition to the weekly if not more frequent meetings and nearly continuous communication between the Bank's program managers and compliance managers with their counterparts at the Bank's partners. Indeed, the Bank has dedicated teams of program managers,

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[4] The Bank-mandated CMS programs require the adoption (periodic review and revision) and execution of policies and procedures that address all applicable laws and regulations, including, without limitation, BSA-AML/OFAC, TILA/Reg. Z., UDAAP, ECOA/Fair Lending, Model Governance, EFTA/Reg. E, FCRA, Red Flags/ID Theft, GLBA/Privacy, SCRA/MLA, TCPA, FDCPA, E-SIGN, and CAN-SPAM.

[5] Partners are also required to involve the Bank and share draft and final reports in connection with any additional audits in which the partner may engage that involve the Bank's programs.

compliance managers, Vice Presidents, and oversight by more senior officers for each one of the Bank's strategic partners.

Moreover, under the Bank Service Company Act, 12 U.S.C. § 1867(c), the FDIC may examine the Bank's strategic partners and other service providers to the same extent that it may examine the Bank. Both the FDIC and the Utah Department of Financial Institutions have the authority to exercise supervision over the Bank's partners' activities related to their services performed for or on behalf of the Bank, including with onsite visitation, which authority the Bank's regulators have exercised with respect to several of the Bank's third-party lending programs.

These abovementioned core pillars form the foundation of what we believe to be a robust third-party lending platform that can drive innovation in financial services, support healthy competition in the marketplace by proving more product choices for consumers and small businesses, enhance inclusion by expanding access to responsible credit for underserved consumers and small businesses in compliance with applicable laws and regulations, and bring nonbank fintech companies under the supervision and oversight of the Bank and its regulators.

Enhancing Inclusion through Cash Flow Underwriting

One of the significant successes of bank-fintech partnerships is the extension of responsible credit to "credit invisible" consumers through the use of technology. An important example of how WebBank's partnerships drive financial innovation and inclusion is its partnership with Petal Card, Inc. ("Petal").

Petal developed a technology platform that, with the consumer's permission, ingests and analyzes bank statement transactional history and produces a risk score that can be used in lieu of (or in combination with) a traditional credit score. The Bank entered into a partnership with Petal in early 2018 to leverage its cash flow underwriting technology to provide introductory credit cards to people who are new to credit (i.e., "thin file" or "no file" consumers), with a goal of serving "credit invisibles".[6] Through this program, the Bank has been able to approve many consumers who likely would have been declined by other financial institutions and provided them credit cards with higher limits and lower rates[7] than typical introductory credit cards.

In May 2019, FinRegLab,[8] led by former U.S. Treasury Department Deputy Assistant Secretary for Consumer Policy, Melissa Koide,[9] published a report entitled "The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings"[10] in which it (with assistance from Charles River Associates) analyzed data from WebBank's program with Petal as well as five

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[6] https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf; https://files.consumerfinance.gov/f/documents/201612_cfpb_credit_invisible_policy_report.pdf

[7] All Petal branded credit cards issued by the Bank have rates at or below 36% APR.

[8] https://finreglab.org/#process

[9] https://finreglab.org/team/

[10] https://finreglab.org/cash-flow-data-in-underwriting-credit-empirical-research-findings ("Cash-Flow Report").

other fintech programs that used cash flow data in their underwriting models. The executive summary of that report highlighted the following findings:[11]

> **Predictiveness:** For the participants for which loan-level data was available, we found compelling evidence that indicates that the cash-flow variables and scores tested were predictive of credit risk and loan performance across the heterogenous set of providers, populations, and products studied. Standing alone, the cash-flow metrics generally performed as well as traditional credit scores, which suggests that cash-flow variables and scores can provide meaningful predictive power among populations and products similar to those studied where traditional credit history is not available or reliable. Moreover, our analysis indicates that the cash-flow data and traditional credit data provided different insights into credit risk, such that the cash-flow data frequently improved the ability to predict credit risk among borrowers that are scored by traditional systems as presenting similar risks of default. These results occurred across traditional credit score bands.
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> **Inclusion:** We found evidence that the study participants are serving borrowers who may have historically faced constraints on their ability to access credit, although data limitations did not permit a consistent quantitative analysis to be applied across all participants. We used a variety of benchmarks depending on data availability, including the percentage of borrowers with low or no traditional credit scores, borrower income levels, and residence in zip codes in which racial minorities exceed 50 percent or 80 percent of the total population.[12]
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> **Fair lending effects:** Finally, where data was available for analysis, we found that the degree to which the cash-flow data was predictive of credit risk appeared to be relatively consistent across borrowers who likely belong to different demographic groups. Rather than acting as proxies for race and ethnicity or gender, the cash-flow variables and scores appeared to provide independent predictive value across all groups. Moreover, when compared to traditional credit scores and attributes, the cash-flow based metrics appear to predict creditworthiness within the subpopulations at least as well as the traditional metrics, and better in selected cases. These results suggest that cash-flow variables and scores do not create a disparate impact among protected populations.

These findings provide a powerful example (and validation) of how cash flow underwriting technology can enhance financial inclusion by enabling banks to extend responsible credit to consumers who are "thin file", "no file" and "credit invisible".

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[11] Cash-Flow Report, pg. 3.

[12] With respect to inclusion, WebBank was among the lenders serving significant numbers of borrowers with traditional scores below 650 and even below 600 and borrowers in "majority minority" zip codes and "predominantly minority" zip codes. Cash-Flow Report, pg. 30.

Innovative Buy Now, Pay Later and Earned Wage Access Products

The Bank supports innovation in financial products and services to the extent it provides fair and transparent products that deliver real value to customers. Responsible providers of products such as Buy Now, Pay Later ("BNPL") and Earned Wage Access ("EWA") programs provide fair, transparent, and valuable products to consumers, expanding their choices and bringing healthy competition to the market.

The Bank supports efforts to regulate such products as "non-credit" products, regulated based on the activities of the providers and commensurate with the risks of such products. The Bank cautions the Subcommittee against taking a "one-size-fits-all" approach to such products that conflates them with traditional credit products with which members of the Subcommittee may be more familiar. To do so risks unnecessary overregulation that is not appropriately tailored to such products and chills product innovation that would otherwise create valuable and inclusive products for consumers.

The Bank also perceives that "BNPL" is a label that has been applied to many products with significantly different features. Initially, the term BNPL seemed to be understood to describe a financial product in which a consumer would obtain a good from a merchant pursuant to a retail installment sales contract and agree to pay the purchase price of the good in four installments over six weeks. This original product construct did not include a finance charge to the consumer and the BNPL platform received remuneration in the form of merchant discounts. Because the product did not entail a finance charge and was paid in no more than four installments, the product was not subject to the Truth in Lending Act ("TILA") and Regulation Z.[13]

Multiple product variations have come to market since this initial "non-credit" BNPL product construct. Some are loans, including closed-end installment loans that are also paid in four installments over six weeks (i.e., BNPL "style" loans). Other products include financing options available at checkout that entail more installment payments over a longer period, such as 12-month installment loans that are paid monthly. Given the utility and popularity of BNPL-like products, some card issuers have also highlighted the ability of their customers to convert charge card or credit card purchases into a "pay-in-four" or "pay-over-time" installment loans or their equivalent.

Indeed, the Bank has worked with partners to bring some of these products to market. For example, the Bank provides a BNPL-style closed-end installment loan that is paid in four installments over six weeks. It carries a small finance charge, roughly equivalent to an ATM fee, that is disclosed in compliance with TILA and Regulation Z. Because the amount of the finance charge is small, it is disclosed as an absolute value (e.g., $4.00) to clearly convey to the consumer the total cost to obtain the credit rather than an annualized rate, which we believe would be a

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[13] See Regulation Z §1026.2(a)(17).

confusing cost metric for such a short-tenor loan. Regulation Z permits and embraces the logic of this approach.[14]

Bank-Fintech Partnership Challenges

Bank partnerships and bank lending programs through nonbank fintechs continue to face scrutiny and criticism from some stakeholders. Typically, such criticism is directed at the bank partnership model itself premised on the concept that such partnerships are capable of supporting predatory programs (regardless of the extent to which they actually do so). While we understand that some of these policy challenges detailed below may fall out of the jurisdiction of this Subcommittee, we believe it is important to relay so Members of the Subcommittee have a full picture of the headwinds facing bank partnerships that provide responsible credit products to consumers.

Critics of bank-nonbank partnerships express concerns that such partnerships enable nonbanks to avoid state laws that would otherwise apply (such as lender licensing and interest rate caps) if the nonbank was the lender. Such criticisms presume that the nonbank in such partnerships should be deemed the "true lender" and, therefore, be subject to state laws applicable to nonbank lenders. This perspective is most acute when banks, through partnerships with nonbanks, provide consumer financial products that exceed the maximum interest rate that a nonbank lender (properly licensed, to the extent required) could charge in a particular state.

This perspective, advanced strongly by certain groups,[15] has led a number of states to promulgate laws that would treat the nonbank in a bank sponsored third-party lending program as the "lender" for state law purposes if: (i) it holds, acquires, or maintains, directly or indirectly, the ***predominant economic interest*** in the loan; (ii) it markets, brokers, arranges, or facilitates the loan and holds the right, requirement, or first right of refusal to purchase loans, receivables, or interests in the loans; or (iii) the totality of the circumstances indicate that the person or entity is the lender and the transaction is structured to evade the new law's requirements. Factors to be considered under this "totality of the circumstances" analysis include whether the nonbank indemnifies, insures, or protects an exempt lender[16] for any costs or risks related to the loan; predominantly designs, controls, or operates the loan program; or purports to act as an agent or service provider for an exempt entity while acting directly as a lender in other states.[17]

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[14] Regulation Z §1026.18(e) provides as follows: **(e) Annual percentage rate.** The *annual percentage rate,* using that term, and a brief description such as "the cost of your credit as a yearly rate." For any transaction involving a finance charge of $5 or less on an amount financed of $75 or less, or a finance charge of $7.50 or less on an amount financed of more than $75, the creditor need not disclose the annual percentage rate.

[15] https://woodstockinst.org/wp-content/uploads/2021/01/SB1792-fact-sheet-3.16.21.pdf

[16] These recently promulgated state laws typically exempt state- and nationally-chartered banks from their coverage but treat the nonbank as the "lender" under broad "anti-evasion" provisions if the nonbank acts as a purported agent or service provider to a bank and conditions like (i) – (iii) above are satisfied.

[17] This example comes from Illinois SB 1792, the Predatory Loan Prevention Act, that Illinois Governor Pritzker approved on March 23, 2021. https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2021/03/IL-SB-1792_1.pdf Similar laws have been enacted in Maine, New Mexico, Connecticut, and Minnesota.

Any nonbank deemed the "lender" under these state laws would be subject to the state's existing or newly promulgated interest rate limit for nonbanks (sometimes the 36% "all-in" Military Annual Percentage Rate ("MAPR") finance charge cap under the federal Military Lending Act, sometimes lower), often with severe penalties for any violation. Under the recently promulgated Illinois law, for example, any loan exceeding a 36% MAPR is considered null and void, and no entity has the "right to collect, attempt to collect, receive, or retain any principal, fee, interest, or charges related to the loan" and each violation of the new law is subject to a fine of up to $10,000.

Although the Bank is not aware of any attempt to enforce these new state laws, which should be subject to preemption under federal banking laws where state- and nationally-chartered banks are the actual lenders, these laws create legal uncertainty regarding whether bank-originated loans will remain enforceable on their original terms after they are sold to nonbank entities. This legal uncertainty regarding whether these new state laws, if enforced and challenged, would apply creates material risks of disrupting liquidity in credit markets – chilling investor demand for some loan securitizations, limiting loan origination volumes and loan sizes, and reducing the availability of consumer credit in these states.

Banks that sponsor third-party loan programs, their nonbank partners, and the secondary market will not accept such legal uncertainty and, therefore, such banks will not make loans to residents of these states above the state interest rate caps applicable to nonbanks. This will lead to banks serving only those prime and super-prime customers who can be served profitably at such lower rates, if at all, and declining low- and moderate-income applicants with lower credit scores who can only be served profitably at higher rates.

This is not speculation but is an observable fact as seen in the market after the Second Circuit's decision in *Madden v. Midland*,[18] which created similar legal uncertainty regarding whether bank originated loans at APRs above the interest rate caps for nonbanks in NY, CT, and VT were enforceable by nonbank purchasers. That legal uncertainty led to such loans being downgraded and ceasing to be included in secondary market sales and securitizations. As a result, banks stopped making such loans and the low- and moderate-income residents of NY, CT and VT suffered a dramatic decrease in available credit.

All of this is reflected in the August 2017 empirical study by law professors at Stanford, Columbia, and Fordham law schools entitled "How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment".[19] That study found that loans were being made

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[18] *Madden v. Midland Funding, LLC,* 786 F.3d 246, Court of Appeals, Second Circuit (2015).

[19] Colleen Honigsberg, Robert J. Jackson, Jr., Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment,* The Journal of Law and Economics, Volume 60, Number 4, November 2017 (using proprietary data from three of the largest marketplace lending platforms, the study found that the *Madden v. Midland* decision reduced the price of notes backed by loans above the interest rate caps for nonbanks in Connecticut and New York in the secondary market and that bank lenders responded by extending relatively less credit – smaller loans and fewer loans to the higher-risk borrowers, such as those below a 640 FICO score). See also the public filings of marketplace platform companies with the U.S. Securities and Exchange Commission that discuss in detail the litigation, regulatory and compliance risks associated with the "true lender" issue and the "valid when made" doctrine.

to NY and CT consumers with FICO scores below 640 before the *Madden* decision, but after that decision literally none were being made. The study indicated that "loans to the highest-risk borrowers in Connecticut and New York **disappeared entirely from our sample**—even though similar borrowers in other states continued to receive funding." Among the lowest-quality borrowers—those with FICO scores below 625 - the growth rate for these borrowers in Connecticut and New York was negative 52%; whereas outside the Second Circuit states, loan volume for the same borrower risk profile after *Madden* grew by 124%. The study concluded, as noted hereinabove, "if lenders cannot legally charge rates sufficient to compensate for the default risk indicated by prospective borrowers' risk profiles, they will naturally lend less."[20]

Such attacks on third-party lending bank partnerships are misplaced for several additional reasons.

First, high-APR consumer products supported through bank partnerships are the rare exception, not the rule. High-APR products that might be deemed predatory are very rarely done by banks through bank third-party lending partnerships. Certain stakeholders who attack bank partnerships fail to address the real sources supporting high-APR products.

Second, nonbank fintechs that participate in bank partnerships generally obtain and maintain state licenses to the extent required for the activities they conduct in the partnership, such as soliciting customers/brokering, servicing, purchasing receivables, and collections. Such fintechs typically do not also obtain state lender licenses because the bank is the lender in the program and, therefore, the nonbank does not require such licenses.

Third, arguments that fintechs should be deemed the "true lender" in bank partnerships to the extent they obtain the "predominant economic interest" ("PEI") in bank-originated loans are both arbitrary and completely inconsistent with the realities of the secondary market. Banks regularly originate loans and sell them to free up capital to make additional loans. To the extent that there is legal uncertainty regarding the enforceability of bank-originated loans in the hands of nonbank purchasers, nonbanks will cease to purchase such loans and, in turn, banks will cease to originate them.[21] This is the risk created by potential application of the PEI test, which is one-dimensional, overinclusive, and by itself outcome-determinative.

For example, that test would hold that a nonbank could not enforce the terms of a bank-originated loan if the nonbank purchased the loan and received 50.1% of the principal and interest on the loan, compared to the originating bank receiving 49.9%, even though the bank (i) was a party to the loan agreement with the consumer in which the bank was clearly identified as the

[20] The Colorado law promulgated on June 5, 2023 (House Bill 23-1229, Amending Terms Consumer Lending Laws) will create similar legal uncertainty that will cause banks to reduce lending to low- and moderate-income consumers in Colorado. That law, among other things, opted Colorado out of the amendments to the Federal Deposit Insurance Act, the federal National Housing Act, and the Federal Credit Union Act and specified that rates established in the Colorado Uniform Consumer Credit Act apply to consumer credit transactions in the state, which purports to apply a 21% APR cap to loans made by out-of-state state-chartered banks. This opt out will only affect state-chartered banks and does nothing to prevent high-APR loans to Coloradans above the state's rate caps provided by other entities.

[21] See footnote 19 and the corresponding discussion regarding the impact of *Madden v. Midland*.

lender, (ii) funded the loan with its own capital, (iii) established and controlled the credit policy and underwriting criteria that determined the approval and terms of such loan, and (iv) oversaw all aspects of the loan program to ensure that all applicable laws and regulations were observed.

Fourth and finally, responsible bank partnerships like those sponsored by WebBank provide tremendous benefits to underserved consumers and small businesses with financial products that are innovative, inclusive, fairly priced, have transparent pricing and terms, and comply with all applicable laws and regulations. The Bank's consumer products that require APR disclosures are priced at or below 36% APR and the Bank's products for small and midsized businesses ("SMBs") have fair and transparent pricing and terms. (For additional color and context, see the descriptions herein of the Bank's partnerships with Petal and PayPal, above and below, respectively.)

For all the reasons cited above and others, those who attack bank sponsored third-party lending programs should realize that the bank partnership model is not the true culprit behind predatory products and, equally if not more important, that the bank partnership model is a neutral one by which banks and fintechs can work together to leverage what they each do best to drive innovation, inclusion, and compliance, while operating within the "regulatory perimeter" subject to regulatory scrutiny. Said differently, the bank partnership model is not inherently designed to support high-APR consumer products. To the contrary, most bank partnerships do not.[22]

As a result, to distinguish responsible lenders from predatory ones, one must investigate the specifics of the loan program in question and the consumer outcomes associated with them. A holistic perspective should be applied, including customer profiles (credit scores, etc.), product pricing, fees, and other terms, performance metrics, including delinquency and charge off rates, and repeat usage to determine if it is healthy or indicative of a debt trap.[23] Only with such a holistic view can one determine if a loan program is helpful or harmful to consumers. The fact that a given loan program is provided through a bank partnership in and of itself conveys nothing about the nature of the loan products being provided.

In short, state lawmakers and others should be wary to attack bank partnerships lest they "throw the baby out with the bath water". Laws affecting bank partnerships that are intended to keep out predatory programs are often overinclusive and have the effect of keeping out responsible programs as well.

[22] No doubt, in part, because applicable guidance instructs banks to not engage in predatory programs. See FDIC's Supervisory Policy on Predatory Lending (FIL-6-2007), https://www.fdic.gov/news/financial-institution-letters/2007/fil07006a.html#1, FDIC's Expanded Examination Guidance for Subprime Lending Programs (FIL-9-2001), https://www.fdic.gov/news/financial-institution-letters/2001/fil0109.html, and the Interagency Lending Principles for Offering Responsible Small-Dollar Loans (May 2020), https://www.fdic.gov/news/financial-institution-letters/2020/fil20058.html.

[23] This holistic view is consistent with the guidance referenced in footnote 22, which reflects that there is no simple checklist for determining whether a particular loan or loan program is predatory and that one must investigate various factors, including repayment terms, pricing, rates of reborrowing, and repayment outcomes, among others, to determine if a loan program is responsible or not.

Accordingly, we ask members of this Committee to support efforts to create greater legal certainty regarding the treatment of loans originated by banks in bank partnerships.[24] The PEI test is an impractical, single-variable test for determining the "true lender"[25] of a loan that ignores the most relevant and traditionally recognized factors for determining the lender of a loan, such as which entity controlled and made the credit decisions (i.e., to approve or decline and setting the

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[24] Similar clarity was provided by the FDIC and OCC to address the legal uncertainty created by the *Madden v. Midland* decision that adversely affected capital markets. FDIC and OCC issued regulations clarifying that loans originated by federally regulated banks maintain their original terms when sold in the secondary market. On May 29, 2020, the OCC issued its final rule, amending its regulations to re-state the "valid when made" doctrine. The OCC's final rule amended 12 CFR 7.4001 and 12 CFR 160.110 by adding a new section, stating: "Interest on a loan that is permissible under [12 USC 85 and 12 USC 1463(g)(1), respectively] shall not be affected by the sale, assignment, or other transfer of the loan." Similarly, on June 25, 2020, the FDIC issued its final rule adopting the "valid when made" doctrine. The FDIC's final rule amended 12 CFR Part 331, providing in section 331.4(e) that: "Whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made" and "shall not be affected by… the sale, assignment, or other transfer of the loan, in whole or in part." In short, both the OCC and the FDIC final rules clarified that the determination of whether interest on a loan is permissible is determined when the loan is made and that a bank's transfer of a loan to a third party does not impact the validity or enforceability of that interest.

[25] It is important to note that there is no established legal doctrine or test regarding "true lender". It is merely a theory and an argument that critics of bank partnerships advance to attempt to recharacterize the nature of the relationship between the bank and the nonbank. Courts are sharply divided regarding whether it is appropriate at all for a court or jury to deny application of federal banking laws and preemption of state laws based on the "true lender" theory. Among courts that do countenance such arguments, there is no uniform test to determine which entity is the "true lender".

In addition, those who advance "true lender" arguments face some well-established legal principles that undercut their arguments. For example, the Supreme Court in its landmark *Marquette* decision expressly acknowledged the power of a bank to export the interest rate permitted in its home state notwithstanding more restrictive interest rate laws of the state where the borrower resides. *Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). The Supreme Court acknowledged that Section 85 of the National Bank Act "will significantly impair the ability of States to enact effective usury laws." *Marquette*, 439 U.S. at 318. In addition, the Supreme Court provided that "the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to [protect state usury laws] is better addressed to the wisdom of Congress than to the judgment of this Court." *Id*. at 319. The Supreme Court basically proclaimed that this is a fundamental aspect of how the federal banking laws work.

Fifteen months after the *Marquette* decision, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980, P. L. 96-221 ("DIDMCA"). Sections 521 and 522 of DIDMCA, codified as Section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d ("Section 27"), and Section 4(g) of the Home Owners' Loan Act, 12 U.S.C. § 1463(g) ("Section 4(g)"), were modeled on Section 85. Those provisions confer the same interest rate exportation powers to FDIC-insured state banks and to federal and state savings associations, respectively, as Section 85 confers to national banks. By leaving Section 85 intact and by giving state banks and federal and state savings associations the same "most favored lender" and interest rate exportation rights under Sections 27(a) and 4(g) as national banks under Section 85, Congress effectively ratified and extended the Supreme Court's ruling in *Marquette* that banks are entitled to special interest rate exportation powers. In short, banks subject to regulation and supervision by federal and state banking authorities were intentionally afforded the right to preempt more restrictive state interest rate laws.

In addition, almost 200 years ago the Supreme Court held that a loan that is valid when it is made shall not be rendered invalid or usurious by a later transfer to a third party. *Nichols v. Fearson*, 32 U.S. 103 (1833). "There are two cardinal rules in the doctrine of usury which we think must be regarded as the common place to which all reasoning and adjudication upon the subject should be referred: the first is that to constitute usury, there must be a loan in contemplation by the parties, and the second that a contract which in its inception is unaffected by usury can never be invalidated by any subsequent usurious transaction." *Nichols*, 32 U.S. at 109. As discussed above, although the *Madden v. Midland* case muddied the waters, the FDIC and OCC clarified the application of the "valid when made" doctrine.

specific loan terms), which entity is named as the lender on the loan agreement, and which entity funded the loan.

The PEI test is pernicious to responsible bank partnerships and a functioning secondary market for loan products that benefit low- and moderate-income consumers. A more reasonable and practical approach would evaluate factors like the ones just mentioned above and where, on such basis, the bank is deemed the lender, inconsistent state laws like the ones described above would be preempted by federal banking laws.

WebBank's SMB Loan Programs

The Bank has had active and growing SMB lending programs since at least 2009 when the Bank launched its program with Dell Financial Services. Shortly thereafter, the Bank worked with PayPal and others to launch capital solutions for SMBs recovering from the financial crisis of 2007 – 2008. These solutions included working capital/flexible payment loans, in which payments are equal to a percentage of the SMB's sales volume. Since then, the Bank has launched additional SMB lending programs with Toast, Libertas, Shopify, Capital on Tap, and others. The Bank's SMB lending programs include SMB term loans, revolving lines of credit, working capital/flexible payment loans, invoice financing, and business credit cards. Through these programs, the Bank has originated over $43 billion across the United States since 2011.

Paycheck Protection Program Success

While WebBank predominantly supports consumer lending programs, we also leverage technology to extend credit to underserved small businesses. We want to take a small portion of our testimony to highlight our success in the Paycheck Protection Program ("PPP") as a means of demonstrating the importance of robust due diligence and oversight in the bank-fintech partnership space generally.

WebBank partnered with PayPal to serve SMBs in the Paycheck Protection Program ("PPP"). Through that partnership, the Bank funded over 117,000 PPP loans for more than $3 billion. The average loan size was approximately $28,000, indicative of "Main Street" loans, 90% of borrowers had less than 10 employees, and the number of women-owned businesses was above the national average.

Equally important, these results were achieved without escalated fraud rates. Significant attention has been devoted to analyzing the extent to which fintechs contributed to fraud in PPP, including the research study published by the McCombs School of Business at the University of Texas at Austin[26] and the report by the Select Subcommittee on the Coronavirus Crisis (the "Subcommittee").[27]

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[26] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906395 ("McCombs Study").
[27] https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022.12.01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program_0.pdf

The McCombs study indicated that fintech lenders were almost five times more likely than traditional banks to have made “highly suspicious” PPP loans.[28] Because of the Bank’s and PayPal’s strong diligence and screening processes that identify and minimize fraud, the Bank did not experience increases in fraud rates anywhere near the rates of other banks and fintechs investigated by the Subcommittee and the McCombs study deemed WebBank’s PPP lending consistent with that of traditional banks.[29] In addition, WebBank received a letter from the Acting Director of FinCEN recognizing WebBank for making substantial contributions, through the Bank’s Bank Secrecy Act (“BSA”) reporting, to one of the significant PPP fraud criminal cases nominated for award consideration in 2022 as part of the eighth annual FinCEN Director's Law Enforcement Awards Program, which recognizes significant criminal investigations in which information reported under the BSA was critical to prosecutorial success (attached hereto as Exhibit 1).

The above clearly manifests that not all bank-fintech partnerships are created equal and that when they are operated pursuant to appropriate policies, controls, and bank oversight, can expand access to capital to underserved customers without enabling fraud.

Conclusion

WebBank thanks the Subcommittee for the opportunity to provide its input regarding how responsible bank partnerships like WebBank’s can drive innovation in financial services, support healthy competition in the marketplace by presenting more product choices for consumers and small businesses, enhance inclusion by expanding access to responsible credit for underserved consumers and small businesses in compliance with applicable laws and regulations, and bring nonbank fintech companies under the supervision and oversight of their partner banks and the bank’s regulators.

We reiterate the Bank’s request for the Subcommittee to support efforts to create greater legal certainty regarding the treatment of loans originated by banks in bank partnerships, to eschew the PEI test, and to support more rational and practical tests to confirm the “true lender” if and when that challenge is raised to ensure that responsible bank partnerships like WebBank’s can continue to successfully serve low- and moderate-income consumers.

Finally, the Bank reiterates its caution to avoid a “one-size-fits-all” approach to regulating new financial products that conflates them with traditional credit products. The appropriate balance between financial innovation and regulation lies in tailored regulatory frameworks based on the providers’ activities and commensurate with the actual risks associated with such products.

[28] McCombs Study, pg. 34.
[29] McCombs Study, pg. 13.

Exhibit 1

FinCEN Letter

[attached]

Financial Crimes Enforcement Network
U.S. Department of the Treasury

Office of the Director *Washington, D.C. 20220*

December 30, 2022

RECEIVED

JAN 05 2023

WebBank

By:

Mr. Aaron Blankenstein
Senior Executive Vice President and Chief Compliance Officer
WebBank
215 South State Street, Suite 1000
Salt Lake City, UT 84111

Dear Mr. Blankenstein:

I am writing to recognize WebBank for making substantial contributions, through your institution's Bank Secrecy Act (BSA) reporting to one of the significant criminal cases nominated for award consideration in 2022 as part of the eighth annual FinCEN Director's Law Enforcement Awards Program. FinCEN initiated this awards program to recognize significant criminal investigations in which information reported under the BSA was critical to prosecutorial success. Through this program, a variety of federal and state law enforcement agencies nominated significant cases that used BSA reporting to investigate and prosecute a spectrum of serious criminal activity.

The investigations nominated for consideration in this year's awards program may not have been pursued but for the reporting made by financial institutions like yours, pursuant to FinCEN's regulatory requirements. While we are limited in the level of detail that we can share – due to a need to protect investigative methods as well as ensure the confidentiality of your institution's contributions – we want to provide this letter and a summary of the related cases (see enclosure) in recognition of your institution's invaluable contribution.

Financial institution reporting under the BSA is not generated simply for the sake of compliance. Law enforcement, counter-terrorism agencies, financial regulators, and other stakeholders use the financial intelligence that financial institutions report to FinCEN under the BSA extensively. This information is critical in many areas and is a pillar of our national security apparatus. FinCEN and our law enforcement partners use the information your financial institution and others provide to keep our country strong, our financial system secure, and our families safe from harm. When your financial institution reports suspicions about elder fraud, human trafficking, cybercrime, narcotics trafficking, terrorism or other illicit activity, you provide incredibly valuable leads and ongoing support for law enforcement investigations and, importantly, your efforts make it much harder for criminals to benefit from and move or hide their illicit proceeds in the financial system.

The financial reporting to FinCEN by your institution and others also provides the opportunity to collect and benefit from significant financial intelligence. FinCEN is able to study trends and identify typologies associated with new illicit finance schemes, and develop and implement risk mitigation responses as well as risk indicators that are shared with the regulated community through information sharing mechanisms and advisories. We cannot emphasize enough that the value of the BSA is as much about helping to prevent harm, as it is about investigating the financing of that harm after it happens. We hope this letter underscores the importance of your institution's financial integrity efforts, and reminds everyone contributing to anti-money laundering work at your institution – from the CEO to the front-line customer service staff – that their efforts truly make a difference each and every day.

Thank you again for your important efforts to maintain the integrity of the U.S. financial system and protect the most vulnerable among us. If you have any questions about FinCEN's award program, please contact Lynda Gammon via email at lynda.gammon@fincen.gov.

Sincerely,

Himamauli Das
Acting Director

Enclosure

cc: Identical Letter Sent to Mr. Jason Lloyd (w/ enclosure)

ATTACHMENT: Summary of Related Cases

Nominated Cases with BSA Reporting from Your Institution

U.S. Attorney's Office, District of Oregon

This investigation by the Federal Bureau of Investigation, the Internal Revenue Service-Criminal Investigation, and Small Business Administration-Office of Inspector General was initiated as the result of information obtained from a single Bank Secrecy Act (BSA) filing.

The financial information indicated a wire transfer deposit that was determined to be funds from a paycheck protection program (PPP) loan that was immediately transferred to a brokerage account. A search of publicly available information revealed that the company receiving the PPP loan was established in 2020, which meant it could not have paid wages in 2019 and was not eligible for the PPP loan.

Further research indicated that the owner of the company had recently established several businesses, some of which received PPP loans. The investigation revealed that, in total, the subject submitted nine PPP loan applications, six of which were accepted, resulting in a payout of more than \$3.4 million. The subject also applied for numerous Economic Insurance Disaster Loans (EIDL), of which one was accepted, resulting in an additional \$160,000 in payments.

The subject transferred more than \$1.8 million of the above-described PPP loan funds to a securities brokerage account that substantially increased in value. In addition, the subject purchased more than 25 properties with the proceeds of his fraud.

Law enforcement seized the brokerage account, which included 15,740 shares of Tesla stock as well as another account containing more than \$660,000 in securities and cash. The securities and cash seized were valued at more than \$18 million at the time of his sentencing.

The subject was sentenced to 48 months in Federal prison, five years' supervised release, and ordered to forfeit over \$18 million including stock and properties. His accomplice pleaded guilty to bank fraud and was sentenced to Federal prison and ordered to pay \$294,552 in restitution.

The U.S. Attorney's Office, District of Oregon prosecuted the case.