MILKEN INSTITUTE
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October 27, 2016

Via e-mail (thirdpartylending@fdic.gov)

Rae-Ann Miller
Associate Director
Federal Deposit Insurance Corporation
550 17th St., N.W.
Washington, DC 20429-9990

Re: Proposed Guidance for Third-Party Lending

Dear Ms. Miller,

The Milken Institute Center for Financial Markets would like to thank you for the opportunity to respond to the Federal Deposit Insurance Corporation (FDIC) request for comment on proposed guidance for third-party lending.[1]

The Milken Institute (the Institute)[2] is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create jobs, and improve health. The Center for Financial Markets (CFM)[3] promotes financial-market understanding and works to expand access to capital, strengthen and deepen financial markets, and develop innovative financial solutions to the most pressing global challenges.

Before commenting further on the proposed guidance, the Institute would like to express its support for three recent FDIC developments. First, the FDIC should be commended for putting together a working group[4] to analyze innovative financial services and products[5] emanating from FDIC-supervised institutions and nonbank startups and platforms. We believe education in this space is crucial to understanding (and realizing) the potential of emerging technologies and the role FinTech can play in providing capital to underserved areas and advancing financial inclusion efforts.

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[1] Financial Institution Letter FIL-50-2016, July 29, 2016.
[2] http://www.milkeninstitute.org/
[3] http://www.milkeninstitute.org/centers/markets
[4] As described in more detail during an FDIC Advisory Committee on Community Banking meeting on July 20, 2016, the structure of the working group is as follows: A FinTech steering committee composed of executives from FDIC divisions including supervision, compliance, consumer protection, insurance, research, legal, and from the Office of the Chief Risk Officer. The steering committee is tasked with gaining an understanding of, as well as monitoring, FinTech activities, developments, and trends and evaluating the impact of FinTech products and services on the FDIC and FDIC-supervised institutions. The steering committee may also make recommendations for follow-up action and monitor the implementation of those recommendations. Two inter-divisional working groups sit underneath the steering committee, focused on wholesale and retail products and services. On the wholesale side, the working group is monitoring developments in distributed ledger technology, smart contracts, and virtual and alternative currencies. On the retail side, the working group is focused on marketplace lending, alternative scoring systems, mobile and virtual deposit services, account aggregators, and peer-to-peer payments. A webcast of the July 20 meeting is available here: https://www.fdic.gov/communitybanking/2016/2016-07-20_agenda.html
[5] The FDIC looks at FinTech "as the use of technology in an attempt to make financial services more efficient." As stated during the FDIC Advisory Committee on Community Banking meeting of July 20, 2016 (Session 3, 0:04:05).

The Institute is also supportive of the FDIC's focus on data collection and looks forward to reviewing the "2015 FDIC National Survey of Unbanked and Underbanked Households" and the results from the "2016 Small Business Lending Survey."[6] The Institute believes the data derived from these reports may help drive informed and tailored decision making that reflects on the key findings pulled from each report. We also believe that the results will help shape how FinTech innovation can advance ongoing efforts to bring the 27 percent of U.S. households that are unbanked or underbanked[7] into the formal financial system and expand capital access to underserved communities across the country.[8]

With respect to the proposed guidance offered here, the Institute will focus its comments on the following suggestions and observations:

- **The FDIC should make clear that supplemental guidance is merely to provide additional clarification and certainty behind the validity of the bank partnership model.** The supplemental guidance, alongside the "Winter 2015 Supervisory Insights,"[9] makes it clear that the agency views the bank partnership model as valid. The FDIC should provide further clarity that the supplemental guidance is merely to reinforce this particular model, rather than marking a major departure from the FDIC's "Guidance for Managing Third-Party Risk."[10]

- **FDIC guidance should stipulate more precisely the third-party lending models to which its guidance pertains, whilst ensuring that it is not applied uniformly across diverse lending models and segments.** The proposed guidance is ambiguous as to whether the FDIC intends to apply the guidance to certain third-party lender models, and uniform application of the guidance could pose problems for nonbank platforms given the diversity of models and approaches to consumer and/or small business finance.

- **The FDIC should be mindful of the costs of compliance for community banks and promote, rather than dissuade, third-party lender partnerships with smaller insured institutions.** The proposed guidance pertains to institutions with less than $1 billion in total assets, likely resulting in additional compliance costs on community banks, the application of additional bank-like regulation on nonbanks, and furthering the competitiveness gap between small and regional/large institutions.

[6] "FDIC Initiates Small Business Lending Survey," June 28, 2016. Available here: https://www.fdic.gov/news/news/press/2016/pr16054.html
[7] Remarks by Martin J. Gruenberg, chairman, FDIC to the FDIC 16th Annual Bank Research Conference in Arlington, Va. Available here: https://www.fdic.gov/news/news/speeches/spsep0816.html
[8] The Milken Institute and the U.S. Small Business Administration have joined together to launch the Partnership for Lending in Underserved Markets (PLUM) initiative. The two-year initiative will seek to develop actionable solutions to enhance capital access to minority-owned small businesses in two pilot cities: Baltimore and Los Angeles. More on the initiative is available here: http://www.milkeninstitute.org/newsroom/press-releases/view/310
[9] "FDIC Winter 2015 Supervisory Insights," https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/SI_Winter2015.pdf
[10] Financial Institution Letter FIL-44-2008, June 6, 2008.

The FDIC should make clear that supplemental guidance is merely to provide additional clarification and certainty behind the validity of the bank partnership model

Based on the proposed third-party lending guidance, FDIC Advisory Committee on Community Banking meetings, and the "Winter 2015 Supervisory Insights," it is clear that the FDIC has engaged in a thoughtful information-gathering process to understand the various nonbank/FinTech financing models operating in partnership with FDIC-regulated banks. The Institute is also encouraged to hear of the FDIC's views on the potential benefits from third-party lender relationships as stated in the proposed guidance.[11]

What is also clear is that the agency, by virtue of proposing additional guidance that clarifies the "rules of the road," is further validating existing bank-partnership models[12] — and this is a good thing. The "2015 Winter Supervisory Insights" article covering marketplace lending and the proposed third-party lending guidance should therefore help provide needed legal certainty around bank and nonbank partnerships, especially in a post-*Madden v Midland* world*.*

That said, the FDIC needs to make clear that the proposed guidance does not render current third-party guidance as insufficient, but is meant to further solidify the bank partnership model currently utilized by a number of nonbanks and insured institutions.

In prior discussions, including two FDIC Advisory Committee on Community Banking meetings[13] and the Community Banking Conference "Strategies for Long-Term Success,"[14] there was no discussion regarding additional guidance with respect to third-party lending. For those who commented on current FDIC third-party guidance,[15] no one raised objections to it. In fact, both industry and FDIC officials praised current guidance during one of the advisory committee meetings:

*"As we've looked at this space, one of the things that strikes me is, you know we've had guidance outstanding on third-party relationship and the management factors there since 2008, and although the technology is changing ... **the principles in that guidance hold up well**, from at least my point of view."*
— FDIC representative[16]

*"We looked at a potential partnership and our Board read that [guidance] and became familiar with it, and we told this potential partner, 'Here is this guidance. If you want to put a proposal together address these issues here.' Because **the guidance really is excellent** and this is where my culture comment comes from because when we got a proposal back it was completely out of touch with what the guidance was suggesting. That's a culture type of thing."*
— Leonel Castillo, president and CEO, American Bank of Commerce[17]

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[11] "Third-party lending arrangements may provide institutions with the ability to supplement, enhance, or expedite lending services for their customers. Engaging in third-party lending arrangements may also enable institutions to lower costs of delivering credit products and to achieve strategic or profitability goals."
[12] Jackson Mueller. "The U.S. Online, Non-Bank Finance Landscape." Available at: http://www.milkeninstitute.org/publications/view/806
[13] FDIC Advisory Committee on Community Banking meetings held April 7 and July 20, 2016.
[14] April 6, 2016. https://www.fdic.gov/news/conferences/communitybanking/2016/agenda.html
[15] Financial Institution Letter FIL-44-2008, June 6, 2008.
[16] As stated during the FDIC Advisory Committee on Community Banking meeting of July 20, 2016 (Session 3, 0:25:25).
[17] As stated during the FDIC Advisory Committee on Community Banking meeting of July 20, 2016 (Session 3, 0:26:55).

FDIC guidance should stipulate more precisely the third-party lending models to which its guidance pertains, whilst ensuring that it is not applied uniformly across diverse lending models and segments
As proposed, third-party lending "is a lending arrangement that relies on a third party to perform a significant aspect of the lending process, such as some or all of the following: marketing; borrower solicitation; credit underwriting; loan pricing; loan origination; retail installment sales contract issuance; customer service; consumer disclosures; regulatory compliance; loan servicing; debt collection; and data collection, aggregation, or reporting."[18]

This definition is both ambiguous as to the third-party lending models to which it pertains, and implies that guidance will be applied uniformly across the various third-party lender models:

- The proposed guidance does not indicate which types of models and customer segments it intends to cover — for example, does it apply to both consumer and business lending? From our reading, the proposed guidance seems to pertain principally to consumer lending,[19] but this is not explicitly stated in the proposed guidance.[20]
- It also suggests that the FDIC will assess the various risks and an insured institution's governance of its third-party lender relationships uniformly no matter the difference in third-party lender models and no matter the type of lending (consumer or business).

The FDIC should tailor its oversight and how it assesses an insured institution's governance applied to its third-party lender relationships based on the particular model or type of lending, rather than applying an across-the-board assessment not reflective of the difference in lending segments or models.

The FDIC should be mindful of the costs of compliance for community banks and promote, rather than dissuade, third-party lender partnerships with smaller insured institutions
The FDIC should ensure that the proposed guidance is not too onerous for insured institutions with less than $1 billion in total assets to adhere to. As proposed, the guidance could increase an insured institution's compliance costs in managing its third-party lender relationships; potentially act as a disincentive for small, community banks to leverage the technological efficiencies employed by innovative third-party lender platforms; and further the competitiveness gap between smaller insured institutions and larger financial institutions.

Additionally, the proposed guidance risks smaller insured institutions being viewed as unattractive to third-party lenders. By evaluating lending activities conducted through third-party relationships "as though the activities were performed by the institution itself," and suggesting insured institutions establish credit underwriting, administration, quality standards, and impose capital requirements covering each third-party lender relationship, the FDIC could inadvertently lead third-party lenders to seek partnerships with insured institutions with total assets above $1 billion – effectively making it more difficult for small insured institutions to keep up with (and leverage) the technological innovations occurring in finance.

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[18] Financial Institution Letter FIL-50-2016, July 29, 2016.
[19] For instance, the proposed guidance "expands upon the principles in [the Third-Party Guidance] by setting forth safety and soundness and **consumer compliance measures** FDIC-supervised institutions should follow when lending through a business relationship with a third party." Additionally, insured institutions should "ensure the models are developed and operated in compliance with applicable **consumer protection laws and regulations, including fair lending**."
[20] To the extent the rules do cover commercial lending partnerships, there are important distinctions between these markets. We caution against applying a one-size-fits-all approach to commercial lending, which could have the unintended effect of harming access to capital for U.S. businesses.

The Milken Institute appreciates the opportunity to comment on the FDIC's proposed guidance for third-party lending. It is crucial that regulators provide certainty with regards to innovative financial products, services, and models, and we look forward to continuing to work with regulators and industry stakeholders in finding the right balance between supporting innovation and protecting the borrower and investor.

Please let us know if we can provide any additional information, and we would be honored to have the opportunity to continue this discussion in person.

Sincerely,

Jackson Mueller
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Center for Financial Markets
Milken Institute

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Center for Financial Markets
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