



Consumer Federation of America



May 3, 2012

Mr. Thomas J. Curry  
Comptroller of the Currency  
Office of the Comptroller of the Currency  
250 E Street SW  
Washington, DC 20219

Re: Urban Trust Bank partnership with Community Choice Financial  
(CheckSmart) to enable prepaid card payday loans to evade state law

Dear Comptroller Curry:

We write to urge the Office of the Comptroller of the Currency (OCC) to take immediate action to stop Urban Trust Bank, a Florida-based federal savings association, from partnering with Community Choice Financial Inc. (“CheckSmart”) and Insight Card Services, LLC (“Insight”) to facilitate payday loans on prepaid cards in circumvention of state law. CheckSmart operates a chain of payday stores in 14 states under various names.<sup>1</sup> CheckSmart is using Insight prepaid cards issued by Urban Trust Bank to offer 400% payday loans despite Arizona’s 36% usury cap and Ohio’s 28% cap.<sup>2</sup> These loans present significant safety and soundness risks to Urban Trust Bank and potentially violate a number of state and federal laws.

CheckSmart has filed plans with the Securities and Exchange Commission (SEC) to conduct an initial public offering of stock, planned for May 8, 2012, and this scheme to evade state payday laws will spread if not immediately stopped.<sup>3</sup> Other payday lenders will also copy the practice, and rent-a-bank partnerships will spread quickly, as they did in the late 1990s, and be difficult to unwind. A growing number of banks will be used as instrumentalities to help payday lenders eviscerate state laws and will be exposed to safety and soundness risks.

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<sup>1</sup> CheckSmart presently has stores in Alabama, Arizona, California, Florida, Illinois, Indiana, Kansas, Kentucky, Michigan, Missouri, Ohio, Oregon, Utah and Virginia. It formerly used the Buckeye brand and now operates under various names. The brands of Community Choice Financial can be seen on its website, <http://www.ccfi.com>.

<sup>2</sup> CheckSmart’s Chief Executive Officer William Saunders and President Kyle Hanson are directors and minority shareholders of Insight with a combined ownership of approximately 15% of the equity interests of Insight. See Community Choice Financial, Inc., Form S-1 Registration Statement, Securities and Exchange Comm’n at 138 (filed Aug. 23, 2011) (hereinafter “SEC Filing”), available at <http://sec.gov/Archives/edgar/data/1528061/000104746911007583/a2205315zs-1.htm>.

<sup>3</sup> CheckSmart’s CEO and President are directors and minority shareholders of Insight. See SEC Filing, *supra* note 2.

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This letter provides the basics of the operation and identifies some potential legal issues. We focus on the specifics of the Urban Trust-CheckSmart-Insight prepaid card product and the special safety and soundness risks posed by bank partnerships with third parties, beyond the other safety and soundness risks of payday lending.

***Background: Arizona and Ohio Usury Law and the Birth of the Insight Prepaid Card***

Arizona has a 36% usury cap.<sup>4</sup> The state had authorized a payday lending exemption to that cap, but the law had a sunset date of July 1, 2010. The industry attempted to push back the sunset date but failed to persuade voters or the legislature.

In April 2010, with the sunset date approaching, CheckSmart began offering Insight cards issued by Urban Trust Bank<sup>5</sup> in Arizona and promoting the credit features of the card.<sup>6</sup> As CheckSmart puts it:

As a result of the expiration of the enabling statute for deferred presentment loans in Arizona in mid-2010, we transitioned customers from short-term consumer loans to other loan products, such as title loans and loans from third-party lending offerings, which may be delivered via prepaid debit cards.<sup>7</sup>

In June 2010, the Arizona attorney general warned payday lenders against following the path of lenders in other states who have sought to evade the law:

In other states where payday lending has been curtailed, some lenders adopted the guise of a seemingly legitimate business model, but continued to illegally charge exorbitant interest rates on consumer loans. For instance, some lenders ... promoted pre-paid debit cards, ... “rented” a charter of an out-of-state bank or entered into other business arrangements designed to avoid usury laws.<sup>8</sup>

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<sup>4</sup> Loans under \$1,000 may have an interest rate of no more than 36% plus a single 5% origination fee, charged no more than once a year. Therefore, for a \$300 loan 14-day loan, a lender may charge a \$15 origination fee plus \$4.14 in interest but may charge only the \$4.14 interest for subsequent loans within 12 months of the original loan.

<sup>5</sup> One Insight website, which may be outdated, indicates that the cards are also being issued by First California Bank. See <https://www.myinsightcard.com/index.aspx> (last visited 5/3/12), attached as Exhibit 1. But another website states “Insight Card Services, LLC and the Insight Card are not affiliated with any bank other than Urban Trust Bank, FSB.” <http://www.insightcards.com/> (last visited 5/3/12), attached as Exhibit 2.

<sup>6</sup> See SEC Filing, *supra* note 2, at 4. Brochures describing the cards, obtained from Arizona stores in January 2012, are attached as Exhibits 3, 4 and 5.

<sup>7</sup> SEC Filing, *supra* note 2, at 62.

<sup>8</sup> Letter from Arizona Attorney General Terry Goddard to Lenders (June 9, 2010), available at [http://www.azdfi.gov/news/AG\\_Letter\\_to\\_Payday\\_Lenders\\_060910.pdf](http://www.azdfi.gov/news/AG_Letter_to_Payday_Lenders_060910.pdf) (last visited 5/3/12), attached as Exhibit 6.

CheckSmart was undeterred. CheckSmart is using the card to disguise the nature and cost of the loan to permit the company to make payday loans that it cannot legally offer directly.

CheckSmart is now offering cards with credit features in certain stores in Ohio to help CheckSmart's ongoing efforts to evade Ohio's 28% usury cap, which the Ohio legislature enacted in 2008.<sup>9</sup> CheckSmart has stated that "we intend to introduce [the prepaid cards with credit] in additional states in the future."<sup>10</sup>

By June 30, 2011, CheckSmart had 95,000 active Insight card customers. Of those, 19,800 had arranged for direct deposit of their wages or public benefits onto the card. We do not know how many customers have taken out payday loans on the cards.

### ***The Insight Card Payday Loans***

CheckSmart originally offered three different Insight cards, though it is possible that it has streamlined and is now only offering one version.<sup>11</sup> The Silver Insight Card did not have any credit feature. The Gold Insight Card had overdraft fees on an opt-in basis. The Black Insight Card had opt-in overdraft fees and also a "line of credit" up to \$1,000. According to the August 2011 SEC filing, the Silver card was available in all of CheckSmart's stores and the Black cards with overdraft feature or line of credit was only available in Arizona and Ohio."<sup>12</sup>

It now appears that a single prepaid card with opt-in overdraft is available in all of the stores, but the line of credit may only be available to Arizona and Ohio borrowers. The two credit features have complicated structures but at the end of the day operate with traditional payday loan pricing.

**"Line of credit": \$14 per \$100 borrowed, repayable with the next deposit, plus 35.9% annual interest.** The fees listed in the terms and conditions on the Insight card include a \$3.50 "convenience transfer fee" per \$28.50 transferred from "certain" external accounts.<sup>13</sup> This fee is in addition to interest at 35.9% APR that accrues on advances from

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<sup>9</sup> For a description of evasions that CheckSmart and other payday lenders in Ohio are using, see David Rothstein, Policy Matters Ohio, "New Law, Same Old Loans: Payday Lenders Sidestep Ohio Law" (Sept. 2009), available at <http://www.policymattersohio.org/new-law-same-old-loans-payday-lenders-sidestep-ohio-law>.

<sup>10</sup> SEC Filing, *supra* note 2, at 4.

<sup>11</sup> The Insight prepaid cards are advertised on CheckSmart's website on the pages for the states in which they are offered. See, e.g., <https://www.checksmartstores.com/services/arizona/> (last visited 5/3/12), attached as Exhibit 7. Brochures (Exhibits 3, 4 and 5) are also available in their stores in Arizona. The details of two separate credit features are hidden in the terms and conditions for the Insight Card, [http://www.insightcards.com/images/uploads/110223\\_UTB\\_TCS-v3\\_2%20clean.pdf](http://www.insightcards.com/images/uploads/110223_UTB_TCS-v3_2%20clean.pdf) (last visited 5/3/12), attached as Exhibit 8.

<sup>12</sup> SEC Filing, *supra* note 2, at 4.

<sup>13</sup> See Exhibit 8. Originally, this line of credit was only available on the Insight Black card. It is not clear if the terms and conditions attached as Exhibit 8 are current or are the same for all cards currently offered.

the line of credit.<sup>14</sup> If a consumer wishes to borrow \$25, she borrows \$28.50. The \$3.50 is immediately deducted, leaving her with a net \$25 loan. In addition to the \$3.50 fee, the consumer pays 35.9% APR on the full \$28.50 until it is repaid automatically upon the next deposit. A 14-day loan of \$100 would thus cost \$15.38 (\$14 in fees plus \$1.38 in interest), for a true APR of 401%. Subsequent loans would cost the same amount.

**“Overdraft Protection Service Fee”: overdraft loan for \$15 per \$100, repayable upon next deposit.** The Insight card offers another type of payday loan that operates like an overdraft loan. The prepaid card carries an “overdraft protection service fee” of 15% of the negative balance for overdrawing the card, up to \$36 in fees (which would be triggered by a \$240 negative balance). That fee is equal to \$15 per \$100 borrowed—typical payday loan pricing—or 391% APR if repaid in two weeks. Again, the loan is repaid automatically with the next deposit. It is not clear if consumers can overdraw their cards more than \$240. We believe that no additional interest is charged on top of the fee.

The charges for both the “line of credit” payday loans and the overdraft loans exceed the Arizona and Ohio usury caps. Arizona law permits a 36% annual interest rate plus a single 5% origination fee no more than once a year.<sup>15</sup> Ohio law permits a 28% annual interest rate.<sup>16</sup> Even for the first loan, the CheckSmart prepaid card loans exceed the amounts permitted in both states, and the disparity is especially great for the second and subsequent loans within a 12 month period.<sup>17</sup>

Cost of \$300 14-day Loan				
	Insight Card Line of Credit	Insight Card Overdraft Loan	Arizona law	Ohio law
Annual rate	401%	390%	1 <sup>st</sup> loan: 36% + \$15 (166%) Each add'l: 36%	28%
Cost	\$46.14	\$45.00	1 <sup>st</sup> loan: \$19.15 Each add'l: \$4.15	\$3.22

<sup>14</sup> A store clerk described the 35.9% interest during a January 5, 2012 visit to an Arizona store. The paperwork of a consumer who took out a loan in 2010 includes, in addition to the prepaid card agreement, a line of credit agreement with ISF Arizona LLC at 35.9% APR. *See Exhibit 9.* The agreement authorizes the lender to automatically initiate Automated Clearing House debits from the Urban Trust Bank prepaid card account. We believe that CheckSmart is now using a different lender but do not know who or the relationship between CheckSmart and the lender.

<sup>15</sup> Ariz. Rev. Stat. §§ 6-632, 6-635.

<sup>16</sup> Ohio Rev. Code § 1321.40. CheckSmart and other payday lenders are also purporting to operate under mortgage lending laws and others that permit fees not permitted under the basic usury cap. *See supra* note 9.

<sup>17</sup> Research has shown that payday borrowers typically take out at least 8 or 9 loans each year. Recent research on payday loans tied to a deposit account show an average of 16 loans (175 days) per year. *See* Center for Responsible Lending, “High-interest loans through checking accounts keep customers in long-term debt” at 6 (July 21, 2011), available at <http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.html>.

### ***The Relationship Between CheckSmart and Urban Trust Bank***

The prepaid card issued by Urban Trust Bank for CheckSmart is a vehicle for CheckSmart to make loans that it could not legally make directly. CheckSmart explained in its SEC filing:

In most cases, our lending companies make short-term loans without any involvement of either affiliated or unaffiliated third parties. In Ohio and Arizona, however, our customers receive financial services through us from multiple parties.... If a customer obtains both a prepaid debit card and a line of credit, ... [t]he lender charges the borrower the highest interest rate permitted by applicable law on their lines of credit and the card program manager charges cardholders separate monthly, transaction, load and other fees charged for their cards.<sup>18</sup>

Though the Insight cards are offered in all 433 CheckSmart stores, the line of credit appears to be currently offered only in Arizona and Ohio. Of the 14 states where CheckSmart currently operates, those two states have the most restrictive usury rates.

It is unclear which party extends the credit or takes the credit risk from the overdraft loans.

The line of credit appears to be technically made by a third party lender, not CheckSmart, Insight or Urban Trust Bank.<sup>19</sup> However, CheckSmart's SEC filing reveals that it is effectively the real lender. CheckSmart pre-funds certain credit extensions until the funds are remitted to the bank, and CheckSmart has an "obligation to purchase loan participations when our Arizona customers receive loan proceeds from a third-party lender onto their cards."<sup>20</sup> Thus, the card issued by Urban Trust Bank permits CheckSmart to launder the loans and disguise the interest rate as a "transfer fee."

It is unclear how the revenues from these loans are divided between Urban Trust Bank and CheckSmart, how the bank is compensated for its role in issuing the card, or what credit risk Urban Trust is taking.

Disturbingly, the prepaid card may actually be *causing* consumers to become unbanked. CheckSmart's SEC filing notes that "the majority of our customers have banking

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<sup>18</sup> SEC Filing, *supra* note 2, at 24.

<sup>19</sup> See *supra* note 14. CheckSmart's Arizona webpage states: "Line of credit is issued by a lender, licensed or registered under state law and unaffiliated with CheckSmart, Insight, and MasterCard International. Applicants must complete a separate application for the line of credit. Certain fees and eligibility requirements apply. Available to qualified Insight MasterCard® Prepaid Card holders and to individuals who qualify for loans and request that their loan proceeds be distributed by check rather than credited to their card. Cannot be combined with any other loan program offered by CheckSmart or its affiliates." See <https://www.checksmartstores.com/services/arizona/> (note 1) (last visited 5/3/12), attached as Exhibit 7.

<sup>20</sup> SEC Filing, *supra* note 2, at 4.

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relationships.”<sup>21</sup> That is not surprising, as ownership of a checking account is typically a prerequisite to getting a payday loan. However, because direct deposit to the prepaid card is required to access the credit features, some consumers may be disenrolling from direct deposit to their bank account and switching to the prepaid card. Without the income coming into the bank account, or relief from monthly checking fees tied to direct deposit, it is likely that these consumers will close their bank accounts.

### ***Risks of Bank Partnerships with Third Parties***

The OCC and other bank regulators have long warned banks about the risks of partnerships with third parties, especially payday lenders. The OCC has warned that risks “can be excessive if management and directors do not exercise appropriate due diligence prior to entering the third-party arrangement, and effective oversight and controls afterwards.”<sup>22</sup> Losses are especially likely “when management lacks sufficient knowledge about the risks involved with a new product, business, or activity.”<sup>23</sup>

The OCC has promulgated stern warnings about “franchising” activities, in which the bank “lends its name or regulated entity status to products and services originated by others or activities predominantly conducted by others.”<sup>24</sup> In a bulletin that the OCC issued to address the rent-a-bank-payday lending of the last decade, the OCC explained:

Franchising activities often involve significant reputation, strategic, transaction, and compliance risk to the bank.

National banks should be especially mindful of any third party seeking to avail itself of the benefits of a national bank charter, particularly with respect to the application of state and local law. In some instances, nonbank vendors may target national banks to act as delivery vehicles for certain products and services, or to act as the nominal deliverer of products or services actually provided by the third party, in order to avoid state law standards that would otherwise apply to their activities. **Further, some product vendors engage in practices that may be considered predatory, abusive, or unfair and deceptive to consumers under OCC guidelines.**

Whenever a bank permits itself to be used as a delivery vehicle for products or services that are offered under the bank’s name, but provided by an unrelated third

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<sup>21</sup> SEC Filing, *supra* note 2, at 1.

<sup>22</sup>“Third Party Risk,” OCC Advisory Letter AL 2000-9 at 1 (Aug. 29, 2000).

<sup>23</sup> *Id.*

<sup>24</sup> “Third Party Relationships,” OCC Bulletin, OCC 2001-47 at 3 (Nov. 1, 2001), available at <http://www.occ.gov/news-issuances/bulletins/2001/bulletin-2001-47.html>. It is not clear if CheckSmart, Insight and the third-party lender involved are attempting to cloak themselves with the bank’s preemption rights or if they are primarily evading the usury caps due to the structure of the loan and nature of the fees. But either way, the bank’s regulatory status, enabling it to hold deposits and facilitate the scheme, is essential to CheckSmart’s ability to evade state law.

party, it can be exposed to substantial financial loss and damage to its reputation if it fails to maintain adequate quality control over those products and services and adequate oversight over the third-party activities. National banks that participate in this kind of program with nonbank vendors or marketers should take special care to avoid violating fair lending and consumer protection laws and regulations, particularly when the actual involvement of the bank and the third party may be invisible to the customer. National banks should be extremely cautious before entering into any third-party relationship in which the third party offers products or services through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly. **Such arrangements may constitute an abuse of the national bank charter.**<sup>25</sup>

We urge the OCC to subject Urban Trust Bank and CheckSmart to the scrutiny that the OCC warned about a decade ago:

The OCC will scrutinize carefully any such arrangement and may use its supervisory authority to examine the operations of third parties who act as service providers to national banks which are sought out to deliver potentially abusive, predatory, or unfair and deceptive products. Accordingly, the OCC will likely conduct regular examinations of both the bank and the third party to assess the risks associated with these activities.

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The OCC has the authority to assess a national bank a special examination or investigation fee when the OCC examines or investigates the activities of a third party that provides services to the bank. The OCC will conduct such special examinations or investigations if the activities conducted by the service provider for the bank present heightened risks or are of an unusual nature, or if the bank's risk management system is insufficient.<sup>26</sup>

These warnings are even more apt today. In the past decade, a growing body of research has shown the abusive aspects of payday lending.<sup>27</sup> Banks should simply not be involved with payday lending at all, and especially not through third party payday lenders that they cannot control.

Moreover, CheckSmart is not just any payday lender. It has chosen to continue operating in states where its product is illegal. CheckSmart continued in Arizona despite a warning by the Arizona Attorney General.<sup>28</sup> This partnership poses severe reputational, compliance and other risks to Urban Trust Bank and the OCC must shut it down.

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<sup>25</sup> *Id.* at 3 to 4.

<sup>26</sup> *Id.* at 4, 6.

<sup>27</sup> Many of these studies are summarized in National Consumer Law Center, "Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't" (June 2010) available at

[http://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/payday\\_loans/report-stopping-payday-trap.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf).

<sup>28</sup> See *supra* note 8.

### ***Compliance Risks Associated with the Urban Trust Bank/CheckSmart Prepaid Card Payday Loans***

Urban Trust Bank's partnership with CheckSmart poses various types of risk, as outlined by the OCC, including strategic risk, reputation risk, compliance risk, transaction risk, credit risk and others. Below are just a few of laws that may apply to the Insight Card credit features and that pose compliance risks for Urban Trust Bank.

*Truth in Lending Act.* TILA requires disclosures about the cost of credit and imposes statement requirements, among other provisions. It is not clear what TILA disclosures line of credit borrowers receive. Though the line of credit likely purports to be an open-end loan subject to TILA's weaker open-end credit disclosures, it should actually be viewed as a closed-end loan due to the single payment structure and lack of a finance charge computed from time to time on an outstanding unpaid balance.<sup>29</sup> In addition to the 35.9% APR interest, the \$3.50 per \$28.50 "convenience transfer fee" is part of the cost of credit that TILA requires to be disclosed in the account opening disclosures and on periodic statements. Because CheckSmart purports to have separated the fee (charged by one company) from the credit (purportedly offered by a separate company), it is unlikely that consumers receive proper TILA disclosures. It is also unclear if borrowers receive the periodic statements required by TILA.<sup>30</sup>

*Electronic Funds Transfer Act.* The EFTA governs electronic payments to and from consumers' bank accounts. Though prepaid cards are not yet fully covered by the EFTA, the Insight Card must comply with the EFTA if it accepts direct deposit of federal payments (see below). In addition to the general EFTA requirements and rules governing unauthorized transfers, two other sets of requirements are especially worth noting:

*Overdraft fee rules.* Regulation E sets forth the requirements that must be followed before overdraft fees may be charged. Two of the Insight Cards have overdraft fees. Though CheckSmart may be seeking opt-ins as required by Regulation E, it must be careful not to use deceptive methods to induce people to opt in thinking that they are protecting themselves from, not authorizing, overdraft fees. Compliance with the letter of Regulation E has also not protected many banks from liability under lawsuits that have shown other unfair or deceptive practices in connection with overdraft programs.

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<sup>29</sup> See National Consumer Law Center, *The Cost of Credit: Regulation, Preemption, and Industry Abuses* § 2.3.3.12.9 (4th ed. 2009 and Supp.) ("Attacking spurious open-end credit."); National Consumer Law Center, *Truth in Lending* § 6.2.3 (7th ed. 2010 and Supp.) ("Spurious' Open-End Credit").

<sup>30</sup> The paperwork from a 2010 borrower shows consent to obtaining monthly billing statements electronically through a website, *see Exhibit 9*, but requires the borrower to visit the website to confirm the request and the ability to access the electronic statements, as required by the E-Sign Act. *See 5 U.S.C. § 7001(c)(1)(C)(ii)*. It is unlikely that the lender sends paper statements if the E-Sign requirements are not satisfied.

*Rules for preauthorized transfers.* The EFTA and Regulation E prohibit any person (bank or nonbank) from conditioning credit on repayment by preauthorized electronic funds transfer. We believe that the Insight Card credit line is repaid in that fashion.<sup>31</sup> Urban Trust Bank and CheckSmart may believe that they are not subject to this provision because of the single-payment structure of the loans and the technical definitions under the EFTA. However, a payday lender may be subject to the compulsory automatic repayment ban when the loan is rolled over and recurred multiple times, as is typical of payday loans.<sup>32</sup>

*Periodic written statements.* The EFTA requires periodic written statements. If a prepaid card provider wishes to fulfill statement obligations by providing electronic statements, it must comply with the E-Sign Act.<sup>33</sup>

*Treasury Department rules on deposits of federal payments to prepaid cards.* Treasury regulations prohibit a prepaid card from accepting direct deposit of federal payments unless certain conditions are met. The home page of the Insight Card website emphasizes that consumers can get paid 1-3 days earlier by setting up direct deposit of wages or “government benefits.”<sup>34</sup> If any of those benefits are federal benefits, or the consumer arranges for deposit of any other federal payments such as tax refunds,<sup>35</sup> the card must comply with these conditions:

- The funds must be held at an insured depository institution.
- The card must comply with the Regulation E payroll card rules.
- The funds must be held in a manner to qualify for FDIC insurance for the consumer on a pass-through basis.
- The card account cannot be “attached to any line of credit or loan agreement under which repayment from the account is triggered upon delivery of the Federal payments.”<sup>36</sup>

The first requirement is met and the Regulation E issues are discussed above. We do not know if the Insight Card complies with the FDIC rules for pass-through insurance.

The CheckSmart card almost fails to comply with the last requirement. Both the “overdraft protection” and the “line of credit” are repaid automatically upon deposit.<sup>37</sup>

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<sup>31</sup> An account agreement from 2010 is phrased to give the impression that the consumer is voluntarily electing electronic repayment, *see Exhibit 9*, but it is likely that electronic repayment is required.

<sup>32</sup> See Mitchem v. GFG Loan Co., 2000 WL 294119 (N.D. Ill. Mar. 17, 2000); Johnson v. Tele-Cash, Inc. 82 F. Supp. 2d 264 (D. Del. 1999), *rev'd in part on other grounds*, 225 F.3d 366 (3d Cir. 2000). Moreover, if the line of credit purports to be open-end credit, then by definition repeat transactions are reasonably contemplated. *See* 15 U.S.C. § 1602(i); Regulation Z, 12 C.F.R. § 226.2(a)(2); Truth in Lending Act, Official Staff Commentary § 226.2(a)(20).

<sup>33</sup> 15 U.S.C. § 7001 *et seq.*

<sup>34</sup> <http://www.insightcards.com/> (last visited 5/3/12), attached as Exhibit 2.

<sup>35</sup> Under the Treasury rules, “Federal payment means any payment made by an agency.” 31 C.F.R. § 210.2(i).

<sup>36</sup> 31 C.F.R. § 210.5(b)(5)(i)(C).

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The line of credit is covered explicitly by the Treasury rule, and overdraft credit provided under an overdraft protection plan is a “loan agreement” that should also be covered.<sup>38</sup>

*Military Lending Act.* The Talent-Nelson Military Lending Act caps payday loans offered to service members and their dependents at 36% APR including all fees.<sup>39</sup> The regulations issued by the Department of Defense define “payday loan” to include only closed-end loans, and CheckSmart may claim that neither its overdraft protection nor the line of credit fit that definition. However, as discussed above,<sup>40</sup> the loans should be viewed as closed-end credit.

*Ban on Unfair, Deceptive and Abusive Actions under the Consumer Financial Protection Act (CFPAct), the Federal Trade Commission Act (FTC Act), and Similar State Laws.* Payday loans in general, and especially payday loans designed to evade state law, are open to a host of charges of unfair, deceptive and abusive practices. Warning signs relevant here include:

- In 2010, the Office of Thrift Supervision (OTS) shut down a line of credit on another prepaid card on the grounds that it was unfair and deceptive and ordered the bank issuer to pay restitution.<sup>41</sup> The OTS did not detail the basis for its action, but it appears to be based on the lack of underwriting, unaffordable repayment structure, and repeat usage and debt trap that are the inevitable result of the payday loan model.<sup>42</sup>

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<sup>37</sup> The overdraft loan operates as a negative balance, with an overdraft protection service fee, which by definition is repaid once a deposit is made. The 2010 agreement for the line of credit includes authorization for repayment “on or before each payment due date or on your pay or direct deposit dates if you have authorized more frequent payments.” *See Exhibit 9 at 2.*

<sup>38</sup> There is little dispute that overdraft credit is “credit” (and therefore a loan). *See* National Consumer Law Center, Truth in Lending § 2.5.7.2 (7th ed. 2010). Overdraft credit is not currently regulated under TILA because there is no “finance charge” as that term is currently defined under Regulation Z, not because the ability to make purchases today and repay them another day is not credit. *See id.*

<sup>39</sup> 10 U.S.C. § 987.

<sup>40</sup> *See supra* note 29.

<sup>41</sup> In the matter of MetaBank, Order No. CN 11-25 (OTS July 15, 2011), available at [http://www.ots.treas.gov/\\_files/enforcement/97744.pdf](http://www.ots.treas.gov/_files/enforcement/97744.pdf). MetaBank was later ordered to pay \$4.8 million in restitution. The bank 8K SEC filing is available at <http://biz.yahoo.com/e/110718/cash8-k.html>.

<sup>42</sup> OTS required MetaBank, among other requirements, to establish policies governing lending products, including subprime products, that include, “at a minimum, (i) comprehensive written underwriting standards for each type of sponsorship lending approved by the Board; (ii) a requirement that current and satisfactory credit information be obtained on each borrower prior to the granting of credit demonstrating the ability to repay; (iii) a requirement that the anticipated source of repayment for each borrower be documented in the loan file; (iv) establishment of reasonable, maximum debt (including any add-ons such as credit life, credit disability, force placed insurance and service contracts) to income ratios; (v) establishment of reasonable loan maturity terms, amortization periods, and loan renewal policies ....” Order to Cease and Desist, In the Matter of MetaBank, Storm Lake, Iowa, OTS Docket No. 05902, Order No.: CN 11-25 (effective July 15, 2011), available at [http://www.ots.treas.gov/\\_files/enforcement/97744.pdf](http://www.ots.treas.gov/_files/enforcement/97744.pdf).

- The ability to seize bank account funds to repay the loans effectively operates as a confession of judgment, wage assignment, and a waiver of exemptions from garnishment, all practices that were found to be unfair and deceptive in the FTC's Credit Practices Rule.<sup>43</sup>
- Each of CheckSmart's state webpages lists the Insight Visa card and says "Because it's a prepaid card, you can only spend what you load onto the card."<sup>44</sup> But that is not true of the Insight MasterCards if the consumer opts in to overdraft coverage, and the statement is misleading as to the MasterCard with the line of credit.<sup>45</sup>
- Numerous banks have found themselves paying large amounts to settle claims of unfair and deceptive actions arising from their overdraft fee services, despite nominal compliance with the letter of federal regulations. Studies have shown that the tactics that many have used to convince consumers to opt in are deceptive.<sup>46</sup>
- Federal regulators have long warned that one of the hallmarks of predatory lending is making loans based on the ability to seize collateral and not based on ability to pay.<sup>47</sup> The CheckSmart/Urban Trust Bank loans are based on the ability to seize the incoming direct deposit, not an assessment of ability to pay.
- Numerous studies have shown that the short term, single balloon payment, and high cost of payday loans makes them inherently unaffordable on their own terms, forcing the consumer into a series of rollovers and a debt trap.<sup>48</sup>
- If the consumer cancels the direct deposit or otherwise cannot repay the loan, debt collection abuses could result. Though creditors collecting their own debts are not subject to the Fair Debt Collection Practices Act, the unfair, deceptive and abusive practices prohibited by that act apply to creditors through the CFPAct, the

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<sup>43</sup> See National Consumer Law Center, "Time to Update the Credit Practices Rule" (Dec. 2010), available at [http://www.nclc.org/images/pdf/debt\\_collection/credit-practices-rule-update.pdf](http://www.nclc.org/images/pdf/debt_collection/credit-practices-rule-update.pdf).

<sup>44</sup> See <https://www.checksmartstores.com/services/arizona/> (last visited 5/3/12) (Exhibit 7 at 2); <https://www.checksmartstores.com/services/ohio/> (last visited 5/3/12) (Exhibit 10 at 2); brochures attached as Exhibits 3 and 4.

<sup>45</sup> The overdraft feature works by permitting and creating a negative balance beyond what has been loaded onto the card. Technically, the line of credit may include funds loaded onto the card, but the statement could be read to assume that with prepaid cards you can spend more than you have.

<sup>46</sup> See Center for Responsible Lending, "Banks Collect Overdraft Opt-Ins Through Misleading Marketing" (April 26, 2011), available at <http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html>.

<sup>47</sup> See, e.g., Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, OCC Advisory Letter AL 2003-2 at 3 (Feb. 21, 2003) ("abusive lending [is] lending without a determination that a borrower can reasonably be expected to repay the loan from resources other than the collateral securing the loan"); NCUA et al, Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569 (Jul. 10, 2007).

<sup>48</sup> See *supra* note 17.

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FTC Act and state UDAP laws. Some state debt collection laws also apply to creditors.

*State usury and payday laws.* CheckSmart may be assuming that it can escape state usury or payday laws by hiding the cost of credit in an “overdraft protection service fee” or “convenience transfer fee.” But courts or regulators may disagree with that characterization. To the extent that CheckSmart is counting on preemption to shield it from state laws, a court might pierce that veil and also find that Urban Trust Bank’s role in helping CheckSmart to avoid state law is unfair, deceptive or abusive.

Though many of these compliance issues arise in bank’s own deposit advance programs, the risks are compounded when the lending program is largely run by a third party that is not closely supervised. Notably, Urban Trust Bank is a Florida bank whereas CheckSmart is based in Ohio and is making these loans at storefronts in Arizona and Ohio (and possibly on the internet), increasing the likelihood that the bank is not closely supervising the program.

### ***Conclusion***

The OCC was correct in its 2001 guidance: bank relationships with third parties to enable products “with fees, interest rates, or other terms that cannot be offered by the third party directly … may constitute an abuse of the national bank charter.” The CheckSmart/Urban Trust Bank partnership, used to facilitate payday loans in states where the loans are not permitted, is an abuse of the national bank charter, and the OCC should take swift action to terminate the relationship.

Thank you for looking into this matter. Exhibits are attached. If you have any questions, please do not hesitate to contact us.

Yours very truly,

Lauren K. Saunders  
Managing Attorney  
National Consumer Law Center

Michael Calhoun  
President  
Center for Responsible Lending

Jean Ann Fox  
Director of Financial Services  
Consumer Federation of America