

January 22, 2019

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> St. NW  
Washington, DC 20429

**Re: Small-Dollar Lending, Request for Information, RIN 3064–ZA04**

Dear Executive Secretary Feldman:

**I. Introduction**

The **Center for Responsible Lending (CRL)** and the **National Consumer Law Center (on behalf of its low income clients) (NCLC)**, joined by **Americans for Financial Reform Education Fund**, the **Leadership Conference for Civil and Human Rights**, and **NAACP**, submit these comments in response to the FDIC’s request for information (RFI) on small-dollar lending.<sup>1</sup>

We appreciate the FDIC’s ongoing work to encourage banks to meet consumers’ needs and to promote a more inclusive banking system. Indeed, we are very concerned about the persisting racial disparities the new FDIC unbanked/underbanked survey underscores, and we appreciate that the FDIC continues to shine a light on these disparities.<sup>2</sup>

At the same time, we read with concern the RFI’s emphasis on what the FDIC’s unbanked/underbanked report deems “unmet demand” for consumer credit. The metrics used to measure “unmet demand” do not appear to be strong indicators of actual *capacity* to take on additional credit. Credit cannot make up for a fundamental lack of income or consistent incapacity to meet expenses, particularly for the borrowers with damaged credit for whom high-cost bank products tend to be designed. Irresponsible loan products merely put these consumers in a cycle of debt, exacerbating, not helping their situation.

To ensure that their products are responsible and indeed measure true capacity to handle additional credit, banks must adhere to long-established sound banking principles. Those we emphasize here are (i) opposition to rent-a-bank schemes where banks rent their charters to nonbank lenders to circumvent state law; (ii) lending based on ability-to-repay, which requires consideration of both income and expenses; (iii) and responsible pricing that does not exceed 36% APR.

New products consistent with these principles would be welcome, and we discuss these principles and related safeguards for any new products throughout these comments. But new products that stray from these principles will result in bank loans that deepen consumers’ financial needs rather than meet them,

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<sup>1</sup> 83 Fed. Reg. 58566 (Nov. 20, 2018).

<sup>2</sup> FDIC National Survey of Unbanked and Underbanked Households (2017), <https://www.fdic.gov/householdsurvey/2017/2017report.pdf>.

drive people out of the banking system, and exacerbate financial exclusion rather than promote inclusion.

We also urge that, consistent with these principles, the FDIC retain its 2013 guidance addressing unaffordable balloon-payment payday loans by banks. Bank payday loans, so-called “deposit advance products,” were a disastrous experiment. FDIC banks never made these loans, and it would be shameful for them to do so now.

We view the FDIC’s RFI in the context of the broader research and regulatory landscape. In recent years, the harms of high-cost lending have been more comprehensively and thoroughly documented than ever before.<sup>3</sup> High-cost payday lending is a debt trap by design, exploiting the financially distressed and leaving them worse off, leading to a host of financial consequences that include greater delinquency on other bills,<sup>4</sup> high checking account fees and closed accounts,<sup>5</sup> and bankruptcy,<sup>6</sup> and disproportionately impacting communities of color.<sup>7</sup> The harms of the cycle of debt have long been recognized by the FDIC.<sup>8</sup> Since 2013, the number of states whose interest rate caps keep payday lenders out of their state has risen to 16 (plus the District of Columbia).<sup>9</sup>

While the focus of most research has been on short-term payday loans, the dangers of high-cost long-term payday loans have also become apparent as payday lenders have been shifting to longer-term payday installment loans. These loans still carrying triple-digit interest, are still tied to repayment on payday, and are still made with little regard for the borrower’s ability to repay the loan while meeting other expenses.<sup>10</sup> These loans have the potential to inflict as much or more harm—creating a deeper,

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<sup>3</sup> See CFPB, Rule Addressing Payday, Vehicle Title, and Certain High-Cost Installment Loans, Final Rule, 82 Fed. Reg. 54472 (Nov. 17, 2017) (CFPB Payday Rule) and Docket No. CFPB-2016-0025 associated with that rule. CRL and NCLC’s comments, filed with additional consumer and civil rights groups, are available here: <https://www.responsiblelending.org/research-publication/comment-cfpbs-proposed-rule-payday-and-car-title-lending> (CRL, NCLC, et al., Comments on CFPB Payday Rule).

<sup>4</sup> See, e.g., B. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, (2011), Oxford University Press, available at <http://bit.ly/10M01tZ>; Agarwal, S., Skiba, P. M., & Tobacman, J., *Payday loans and credit cards: New liquidity and credit scoring puzzles?* NBER Working Paper (2009), available at <http://bit.ly/RtDsXx>.

<sup>5</sup> CFPB Payday Rule, 82 Fed. Reg. 54564, 73; see also Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School, 12/3/08, available at [www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell\\_jerez\\_tufano.pdf](http://www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf).

<sup>6</sup> Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, Vanderbilt University and the University of Pennsylvania, 10/10/08, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1266215](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215).

<sup>7</sup> See CRL, NCLC, et al., Comments on the CFPB Payday Rule at § 2.2 (pp. 22-24).

<sup>8</sup> See, e.g., FDIC, Guidelines for Payday Lending (2005), limiting indebtedness to three months in twelve.

<sup>9</sup> Most recently, South Dakota passed an interest rate cap by ballot initiative in 2016; Colorado did so in 2018.

<sup>10</sup> CRL, NCLC, et al., Comments on CFPB Payday Rule at § 2.5 (pp. 31-34) and § 10.1-10.3 (pp. 165-172).

longer debt trap—for borrowers than two-week payday loans.<sup>11</sup> NCLC has shown how high interest rates on longer term loans create misaligned incentives that lead lenders to want—and to profit off of—borrowers who will struggle and default at high rates.<sup>12</sup> Research CRL released recently the experience of focus group participants in Colorado, where high-cost longer-term payday loans often triggered significant additional financial hardships for borrowers.<sup>13</sup>

Two-thirds of the states impose rate caps on longer-term loans; among those, the median annual rate including all fees is 37% for a \$500, six-year loan, 31% for a \$2000, two-year loan, and 25% for a \$10,000, five-year loan.<sup>14</sup> While payday lenders are pushing hard at the state level to make high-cost long-term payday loans legal in more states, the large majority of state legislatures have rejected these efforts. But more prevalent high-cost installment lending remains a very real threat.

Permitting high-cost loans has also been rejected by the vast majority of Americans across party lines.<sup>15</sup> Bank engagement in such lending, whether directly or through partnerships, undermines public trust in banks. The FDIC particularly, as the keeper of the public trust in banks through its provision of deposit insurance, would risk banks' reputations and that public trust by permitting an expansion of high-cost lending by the banks it supervises.

The Consumer Financial Protection Bureau's (CFPB or the Bureau) Payday Loan Rule (the CFPB Rule) would address the worst abuses of the short-term payday lending debt trap. Its ability-to-repay requirement and protections against loan flipping are consistent with the longstanding banking principles noted above. Though the rule reflects a careful, measured approach to the payday loan debt trap problem, the future of that rule is uncertain. The FDIC should hold firm to its longstanding principles regardless of whether the CFPB's rule is implemented. In addition, as the CFPB Rule does not establish ability-to-repay protections for longer-term payday loans, the banking regulators must also ensure that protections on longer-term loans are sufficient.

The payday lenders would welcome a change from the FDIC. An attorney who represents payday lenders, for example, hopes that the FDIC will use this RFI opportunity to sanction rent-a-bank

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<sup>11</sup> *Id.*

<sup>12</sup> Lauren Saunders et al., NCLC, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016), <https://www.nclc.org/issues/misaligned-incentives.html>.

<sup>13</sup> Center for Responsible Lending, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans* (July 2018), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf> (CRL, *Sinking Feeling*).

<sup>14</sup> See Carolyn Carter et al., NCLC, *Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans* (Aug. 2017), <http://bit.ly/2vRZkEf>; Carolyn Carter et al., NCLC, *A Larger and Longer Debt Trap? Analysis Of States' APR Caps For A \$10,000 5-year Installment Loan* (Oct. 2018), overview <http://bit.ly/2QOp6AG> and full report, <http://bit.ly/instloan18>.

<sup>15</sup> Voters across party lines consistently support ballot referenda that cap interest rates at 36%, including 76% of South Dakota voters in 2016 and 77% of Colorado voters in 2018.

partnerships.<sup>16</sup> But the consumer, civil rights, and faith advocacy communities across the country have consistently urged the FDIC to stay the course.<sup>17</sup>

How the federal regulators address high-cost loans, including any shift toward high-cost installment lending, has great significance for the high-cost lending landscape across the country, whether by depositories or non-depositories. The federal agencies set the tone for what is considered responsible lending versus what is recognized as predatory. We reject the notion that bank loans as high as 99% APR will drive out higher-priced credit by nonbanks. Rather, we would expect such products to pile onto existing credit loads already unsustainable for borrowers. And significantly, high-cost lending by banks will undermine the most effective measure against predatory lending, state interest rate limits, while lending legitimacy to very high interest rates across the board.

For consumers with credit capacity, banks already offer a range of existing responsible products that could be expanded or redesigned without sanctioning high-cost loans. Banks are well-suited to underwrite loans in a streamlined, cost-effective manner given the amount of data they hold on their customers. Any expansion of such products should be done in adherence to ability-to-repay and responsible pricing, and should include a meaningful cooling-off period as a back-end protection against repeat unaffordable loans.

For consumers without capacity, the agency should encourage capacity-building alternatives, such as secured cards and credit builder loans. These capacity-building products are far preferable to a purported solution that could exacerbate financial distress.

Within this broader context we make the following recommendations, which we then discuss in turn:

- Approach with appropriate caution claims of high “unmet demand” for credit that can be met with responsible loans to consumers with actual credit capacity.
- Approach with caution claims that high-cost bank loans will substitute for high-cost nonbank loans or overdraft fees.
- Encourage banks to continue to serve small-dollar loan needs with reasonably priced, affordable products and those that build credit capacity—like secured credit cards—rather than by sanctioning high-cost products.

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<sup>16</sup> Jeremy T. Rosenblum, *FDIC seeks comment on small-dollar lending*, Ballard Spahr’s Consumer Finance Monitor, Nov. 15, 2018, <https://www.consumerfinancemonitor.com/2018/11/15/fdic-seeks-comments-on-small-dollar-lending/>.

<sup>17</sup> In August 2018, dozens of groups wrote to Chairman McWilliams with generally the same concerns discussed throughout this comment letter, <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-fdic-bankpayday-rentabank-aug2018.pdf>. In addition, in May of 2018, CRL and NCLC, along with several other national consumer and civil rights groups, wrote federal regulators urging that they ensure that bank and credit union loans—whether single-payment or installment—be reasonably priced (compliant with federal credit union regulation for federal credit unions, and no more than 36% for other depositories) and based on the consumer’s ability-to-repay the loan, taking into account both income and expenses.

- Prevent rent-a-bank schemes that enable nonbank lenders to use banks as a fig leaf to circumvent state interest rate limits.
- Require that loans be based on ability to repay, which means consideration of both income and expenses.
- Continue to encourage loans priced at 36% APR and below.
- Retain the 2013 deposit advance guidance, which addressed a high-cost debt trap product.
- Address abusive overdraft fee programs, which undermine the effectiveness of any program aiming to help financially vulnerable members.
- Support the CFPB Rule, which establishes common sense underwriting requirements on short-term loans very few banks make.

**II. Approach with appropriate caution claims of “unmet demand” for credit that can be met through responsible loans to consumers with actual credit capacity.**

The RFI cites the agency’s recent Economic Inclusion report finding that 13 percent of households have “unmet demand” for mainstream small-dollar credit, and that 90% of those households are banked. In addition, it cites that a majority of all households with “unmet demand” reported having stayed current on bills during the past 12 months.

We urge abundant caution to ensure that this report’s characterization of “unmet demand” is not conflated with an ability to afford more credit. Per the report, “unmet demand” was determined where a consumer reported one or more of the following:

- They had applied for and were denied a credit card or bank personal loan or line of credit (23% of banked consumers with “unmet demand”);
- They felt discouraged about applying and did not apply for a credit card or bank personal loan or line of credit (44% of banked consumers with “unmet demand”);
- They used alternative financial services for credit (“credit AFS”), which could include payday, car title, pawn, rent-to-own, or refund anticipation loans (57% of banked consumers with “unmet demand”).<sup>18</sup>

We have concerns about each of these three indicators for “unmet demand.” Where households were denied for credit, they could have been denied appropriately. Where households felt discouraged about applying and did not apply, they could have known or been told that they were unable to take on more credit. Indeed, without more information that conveys the extent to which these households are already overburdened by credit they cannot afford to repay, these descriptions say nothing about a household’s capacity to afford more credit.

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<sup>18</sup> The figures noted in these bullet points were provided by the FDIC via email to CRL in response to a follow-up question from CRL following the agency’s Advisory Committee on Financial Inclusion meeting on October 24, 2018.

And where households had used alternative credit—the largest component of the “unmet need” characterization—they may well not have had an ability to repay that alternative credit while meeting other expenses without falling into a cycle of reborrowing. Indeed, we know that even before turning to payday loans, payday borrowers are already often overburdened by credit, without capacity to repay more. The typical payday loan borrower has median income of \$25,000-\$30,000 per year;<sup>19</sup> of renters in that income range, 55% are paying more than 50% of their gross income for rent alone.<sup>20</sup> Payday loan borrowers have a history of being overburdened by credit, with thick credit files and scores in the low 500s.<sup>21</sup> CFPB has noted that the median payday borrower has a credit card but likely does not have unused credit on the card.<sup>22</sup>

In addition, we know that the typical payday and car title borrowers cannot afford to repay the payday and car title loans they receive. Eighty percent of payday loans are taken within a month of the prior payday loan, indicating the prior payday loan was unaffordable.<sup>23</sup> Moreover, half of payday borrowers incur an overdraft or bounced payment;<sup>24</sup> where an overdraft is incurred, the payday loan payment is made, but only because it triggered another extremely high-cost loan—not because it was affordable. Further, CFPB found that one in five car title loans end in repossession. Thus, use of AFS may well be more an indicator of *inability* to take on more credit than of additional credit capacity.

Our concerns are amplified by CRL’s evaluation of the raw data comprising this 13 percent of households. The data show that these households are disproportionately:

- households of color (21.4% of American Indian/Alaskan households met the “unmet needs” characterization; 20.9% of Black households; 16.9% of Hawaiian/Pacific Islander; 16.1% of Hispanic, versus 10.6% of White households);

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<sup>19</sup> 49% of payday borrowers have family income of less than \$30,000. 2015 FDIC National Survey of Unbanked and Underbanked Households (2016), <https://www.fdic.gov/householdsurvey/2015/2015report.pdf>. CFPB in Final Payday Rule, 82 Fed. Reg. 54556, noted calculations made using custom data tool.

Median income of storefront borrowers was 22,476 (not necessarily household income). CFPB Payday Loans and Deposit Advance Products White Paper at 18 (2013), [https://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf).

See also CFPB Final Payday Rule, 82 Fed. Reg. 54556, n.467, citing other studies with similar results.

<sup>20</sup> Center for Housing Studies of Harvard University, *The State of the Nation’s Housing* (2018), [http://www.jchs.harvard.edu/sites/default/files/Harvard\\_JCHS\\_State\\_of\\_the\\_Nations\\_Housing\\_2018.pdf](http://www.jchs.harvard.edu/sites/default/files/Harvard_JCHS_State_of_the_Nations_Housing_2018.pdf) at 30.

<sup>21</sup> See CFPB Final Rule, 82 Fed. Reg. 54557 for cites to several consistent studies. One shows median Vantage score (which has a 300-850 range) of 532 for storefront borrowers, another shows median of 525 for online borrowers.

<sup>22</sup> CFPB Proposed Payday Rule, 81 Fed. Reg. 47921.

<sup>23</sup> CFPB Data Point: Payday Lending at 9 (2014), [https://files.consumerfinance.gov/f/201403\\_cfpb\\_report\\_payday-lending.pdf](https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf).

<sup>24</sup> CFPB, Online Payday Loan Payments at 3 (April 2016), [http://files.consumerfinance.gov/f/201604\\_cfpb\\_online-payday-loan-payments.pdf](http://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf).

- lower income (17.2% of those earning less than \$15,000 met the characterization; 16.8% of those earning \$15-30,000);
- younger (22.6% of households 15-24 met the characterization; 18.5% of households 25-34);
- unemployed (24.4% of unemployed households met the characterization); and
- disabled (20.7% of disabled households met the characterization).<sup>25</sup>

These findings demonstrate that those deemed to have “unmet need” tend to be the more financially vulnerable, including those who are disproportionately harmed by payday and car title loans, and among those who could be most harmed by additional high-cost unaffordable credit.

The also survey found that that of all households with “unmet demand,” 57.2% reported having stayed current on bills during the past 12 months. This finding too warrants caution. First, nearly half (42.8%) did *not* remain current on bills. Second, consumers’ self-reports are often unreliable. For example, many consumers do not view payday loans as a “bill,” and may not view one-time expenses such as medical debt or unpaid traffic tickets as a “bill.” Lastly, staying current on bills may be an indication that a consumer is barely getting by – perhaps with help from friends and family – while not indicating they have capacity for an additional bill to pay debt service.

Notably, in the payday loan market, the overall loan volume dramatically overstates “demand.” Most payday loans do not provide new credit; they simply flip a previous payday loan and charge a new fee. More than four out of five payday loans are taken out within the same month as the previous unaffordable payday loan.<sup>26</sup> So the greatest driver of demand for payday loans is the prior unaffordable payday loan.

### **III. Approach with caution claims that high-cost bank loans will substitute for high-cost nonbank loans or overdraft fees.**

Additional high-cost, poorly underwritten products push borrowers deeper into unsustainable debt, rather than substitute for even higher-cost products.

For example, bank deposit advance loans have not been shown to reduce overdraft fees; in fact when a borrower cannot afford to repay such loans, they may incur additional overdraft fees. A CFPB study found that the elimination of bank deposit advance loans did not produce an increase in overdraft fees.<sup>27</sup> Further, software consultants for deposit advance software and those anticipating an NCUA Payday Alternative Loan II program (which could permit higher-cost short- and longer-term loans) tout “[l]ittle to no cannibalization of NSF/OD [overdraft] income.”<sup>28</sup> This is inconsistent with the notion that

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<sup>25</sup> Analysis on file with CRL.

<sup>26</sup> CRL, *The State of Lending in America and Its Impact on U.S. Households: Payday Lending Abuses and Predatory Practices* at 3 (2013).

<sup>27</sup> CFPB, Supplemental Findings on payday, payday installment, and vehicle title loans, and deposit advance products at 36 (June 2016), [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental\\_Report\\_060116.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf); see also CFPB Final Payday Rule discussion, 82 Fed. Reg. at 54610.

<sup>28</sup> <https://www.cashplease.com/financial-institution-benefits/>.

these products will substitute for higher-cost credit; a lower cost loan that the consumer has the ability to repay *should* cannibalize NSF/overdraft revenue.

But instead, payday loans and bank deposit advance products (DAP) consistently are shown to trigger overdraft fees. Sixty-five percent of deposit advance users incurred an overdraft or NSF fee versus 14% of eligible non-users.<sup>29</sup> Among consumers with overdraft or NSF fees, fees tended to increase with deposit advance usage.<sup>30</sup> What's more, DAP users represented 8% of all eligible account holders, but 33% of overdraft items, 36% of NSF items, and 40% of debits by likely payday lenders—showing that bank payday loans weren't rescuing bank customers from nonbank payday loans. CFPB further found that 50% of online payday/payday installment borrowers incurred at least one overdraft or NSF return in connection with their loans, with average fees for these consumers at \$185.<sup>31</sup>

More globally, too, bank deposit advance borrowing was not shown to have reduced nonbank payday lending. When six banks were making deposit advance loans at one-half to two-thirds the price of nonbank payday loans, their annual volume was about \$6.5 billion.<sup>32</sup> There is no evidence that suggests this volume drove down the cost or volume of nonbank payday lending, rather than adding to already unsustainable debt burdens.

High-cost installment loans also often add to already unsustainable debt burdens. In Colorado, prior to its recent referendum to cap the state rate at 36%, the average 6-month payday installment loan carried a 129% APR. A default or delinquency occurred in 23% of all loans taken out in 2016.<sup>33</sup> The per borrower default rate was likely higher, given the high rate of reborrowing. Even when the loans were repaid, focus group participants described how these loans compounded their already unmanageable debt burdens.<sup>34</sup>

Thus, we know of no evidence suggesting that high-cost bank loans will drive down nonbank payday lending. They do, however, threaten a regulatory race to the bottom, as nonbank lenders will seek to loosen state usury laws to “compete” with banks; see further discussion at Section VII below.

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<sup>29</sup> CFPB Payday Loans and Deposit Advance Products White Paper at 41 (2013), [https://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf).

<sup>30</sup> *Id.*

<sup>31</sup> CFPB, Online Payments at 3 (2016), [https://files.consumerfinance.gov/f/201604\\_cfpb\\_online-payday-loan-payments.pdf](https://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf).

<sup>32</sup> CFPB Final Payday Rule, 82 Fed. Reg. 54495.

<sup>33</sup> Harnick, Ellen, and Delvin Davis, *Payday Lenders Continue to Put Coloradoans Into High-Cost Debt*, Center for Responsible Lending (Feb. 2018), <https://www.responsiblelending.org/research-publication/payday-lenders-continue-put-coloradoans-high-cost-debt>.

<sup>34</sup> CRL, *Sinking Feeling: Colorado Borrowers Describe their Experiences with Payday Loans* (July 2018), <https://www.responsiblelending.org/research-publication/sinking-feeling-colorado-borrowers-describe-their-experiences-payday-loans>.



**IV. Encourage banks to continue to serve small-dollar loan needs with reasonably priced, affordable products and those that build credit capacity—like secured credit cards—rather than sanction high-cost products.**

Credit must be affordable, or it harms more than it helps. For those who can afford more credit, there are generally credit options available,<sup>35</sup> and banks can expand small-dollar loan programs under existing guidelines. But higher-cost loans to financially vulnerable consumers cannot be justified as everyday risk-based pricing. The rates, instead, are a red flag signaling a business model not based on ability to repay.

Banks already meet small dollar loan needs with a range of existing affordable products—small dollar loans at reasonable rates, overdraft lines of credit, other lines of credit, signature installment loans, and credit cards.<sup>36</sup> An FDIC 2011 report found that 82% of banks offered unsecured personal loans with a minimum loan amount of \$2,500 or less, with many setting no loan amount; that report recommended enhanced marketing of these products because many households (including about a fifth of payday and pawn borrowers) didn't know about them.<sup>37</sup>

Nearly three-fourths of banks responding to a community bank trade survey reported making loans of \$1,000 or less.<sup>38</sup> The large majority of these loans' underwriting included verification of major financial obligations and income.<sup>39</sup>

Indeed, better marketing of existing reasonably priced products is a key way of making sure that consumers' credit needs are met responsibly. For example, after Montana voters adopted a 36% interest rate cap, Montana credit unions embarked on a public campaign to advertise their low-cost small dollar loans, and usage increased 26%.<sup>40</sup>

There are also 76 million subprime credit cards, a number that has been steadily climbing since 2012 when there were 59 million.<sup>41</sup>

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<sup>35</sup> See, generally, 2016 op-ed in the Washington Post: Mike Calhoun, *Think There's No Good Alternative to Payday Loans? Think Again* (June 29, 2016), [https://www.washingtonpost.com/news/in-theory/wp/2016/06/29/think-theres-no-good-alternative-to-payday-loans-think-again/?utm\\_term=.8729835e589a](https://www.washingtonpost.com/news/in-theory/wp/2016/06/29/think-theres-no-good-alternative-to-payday-loans-think-again/?utm_term=.8729835e589a).

<sup>36</sup> Some examples are described in National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't*, June 2010, [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>37</sup> The 2011 FDIC National Survey of Banks' Efforts to Serve the Unbanked and Underbanked, <https://www.fdic.gov/unbankedsurveys/2011survey/2011report.pdf>.

<sup>38</sup> CFPB Proposed Payday Loan Rule, 81 Fed. Reg. 47864, 47891. These loans typically charged 12% interest; one-third carried no origination/application fee, while two-thirds did.

<sup>39</sup> *Id.*

<sup>40</sup> Passman, Wack, CUs Skeptical About Expanding Colorado's payday Loan Law Nationwide, *Credit union Journal* (Dec. 3, 2014), <http://bit.ly/2KvBbbt>.

<sup>41</sup> July 2018 ABA, *Credit Card Market Monitor*: <https://www.aba.com/Press/Documents/2018Q1CreditCardMonitor.pdf>

Even outside of a borrower’s banking relationship, there is a wide range of options for consumers to bridge a budget gap without becoming trapped in payday loans. A number of other sources of liquidity are becoming more prevalent to help cash strapped consumers. These include the growth of employer and non-profit employer-based emergency loan programs,<sup>42</sup> early wage access products,<sup>43</sup> loans from religious institutions, and extended payment plans from suppliers of consumer services such as utility companies<sup>44</sup> and telecommunication companies. Reputable nonprofit credit counseling agencies can also be helpful in contacting creditors and arranging for extended payments at lower interest rates. Additionally, a growing list of local nonprofits and community centers offer emergency debt counseling and financing assistance for such items as rent, transportation, and utilities.<sup>45</sup>

For thin and no-file consumers or those with damaged but now recovering finances, fintech companies and the big three credit bureaus are increasingly using data aggregators to analyze the inflows and outflows from a consumer’s bank account to determine if the consumer has the capacity repay.<sup>46</sup> Petal, for example, uses cashflow underwriting to offer credit cards to thin and no-file consumers with APRs from 15.24% to 26.24%.<sup>47</sup> This type of analysis is even easier for a bank as it can do it directly from its own data without using a data aggregator or a credit bureau.

For credit-impaired or no-file customers, the agency’s focus should be on encouraging expansion of products that build or re-build credit capacity—not on promoting a weak response to financial distress, in the form of a high-cost loan, that exacerbates the distress rather than cures it:

- Secured credit cards hold great potential, and innovations are making secured cards more accessible: partially secured cards; tax-time or incremental funding (say, \$20 every two weeks over 80 days); or using credit builder products to build up the initial savings to convert to a

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<sup>42</sup> See recent L.A. Times article, James Rufus Koren, *Need a loan? Forget the corner payday lender — your boss has you covered*, L.A. Times (Aug. 5, 2018), <http://www.latimes.com/business/la-fi-trueconnect-comcast-20180805-story.html>.

<sup>43</sup> Walmart, Press Release, “Walmart Offers New Financial Wellness Services for Associates Nationwide” (Dec. 13, 2017). It is important not to confuse true early wage access products such as PayActiv and Even (used by Walmart), with look-alikes such as Earnin, which is a form of payday loan.

<sup>44</sup> Charlie Harak, NCLC, *Helping Low-Income Utility Customers Manage Overdue Bills through Arrearage Management Programs (AMP)* (Sept. 2013), [http://www.nclc.org/images/pdf/energy\\_utility\\_telecom/consumer\\_protection\\_and\\_regulatory\\_issues/amp\\_report\\_final\\_sept13.pdf](http://www.nclc.org/images/pdf/energy_utility_telecom/consumer_protection_and_regulatory_issues/amp_report_final_sept13.pdf).

<sup>45</sup> CRL, NCLC, et al., *Comments on CFPB Payday Rule at § 19* (pp. 302 *et seq.*).

<sup>46</sup> Bev O’Shea, NerdWallet, “New UltraFICO Score Could Boost Credit Access for Consumers” (Oct. 22, 2018), <https://www.nerdwallet.com/blog/finance/ultrafico-score/>.

<sup>47</sup> <https://www.petalcard.com/>.

deposit on the cards.<sup>48</sup> Enhanced marketing of secured cards is needed: Over half of those new to credit, and a quarter of those with damaged credit, have never heard of a secured card.<sup>49</sup>

- Credit builder products, whereby the amount borrowed is held by the bank while the customer makes payments, and payments can build a positive credit history.

Over 100 million Americans live in states without payday lending, and these consumers are served by the alternatives above and others.<sup>50</sup>

**V. Prevent rent-a-bank schemes that enable nonbank lenders to use banks as a fig leaf to circumvent state interest rate limits.**

We strongly urge the FDIC to prevent banks from partnering with nonbank lenders to make loans—whether short-term or installment loans—that exceed state interest rate limits.

Attorneys who represent payday lenders have identified this RFI as an opportunity for the FDIC to sanction rent-a-bank scams. They write:

“[P]erhaps most significantly, this RFI could serve as a vehicle for the FDIC to confirm that, in a properly structured loan program between a bank and a nonbank marketing and servicing agent, the Federal Deposit Insurance Act authorizes state-chartered banks to charge the interest allowed by the law of the state where they are located, without regard to the law of any other state, despite “true lender” and *Madden* arguments to the contrary.”<sup>51</sup>

Chairman McWilliams has made known that she would like to bring as much banking activity as possible inside the banks.<sup>52</sup> Sanctioning rent-a-bank lending would do the exact opposite—it increases risks for banks by tying them to abusive high-cost lending taking place outside of the bank.

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<sup>48</sup> Center for Financial Services Innovation (CFSI), *The Secured Credit Card Pathway: Opportunities in Serving Key Demographics* (July 2017), [https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/07/06210343/2017\\_Secured-Credit-Card-Pathway\\_Serving-Key-Demographics\\_Full.pdf](https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/07/06210343/2017_Secured-Credit-Card-Pathway_Serving-Key-Demographics_Full.pdf).

<sup>49</sup> *Id.*

<sup>50</sup> CRL, *Shark-Free Waters: States are Better Off without Payday Lending* (2016), <https://www.responsiblelending.org/research-publication/shark-free-waters-states-are-better-without-payday-lending>

<sup>51</sup> Jeremy T. Rosenblum, *FDIC seeks comment on small-dollar lending*, Ballard Spahr’s Consumer Finance Monitor, Nov. 15, 2018, <https://www.consumerfinancemonitor.com/2018/11/15/fdic-seeks-comments-on-small-dollar-lending/>.

<sup>52</sup> Evan Sparks, ABA Banking Journal, *A Fresh Perspective* <https://bankingjournal.aba.com/2018/12/a-fresh-perspective/>, Dec. 5, 2018 (quoting Chairman McWilliams: “If we have reduced systemic risk in the banking sector, where did it go? We might have made banks more safe, but have we made the system overall less safe. My preferred approach would be to bring as much banking activity as possible inside the banks”).

For the FDIC to sanction these schemes would run counter to many years of federal regulatory precedent and pose safety and soundness risk to the banks it supervises. Instead, the FDIC should be clear that the existing schemes—which, alarmingly, have been expanding—should end, and that new ones should not be initiated.

**A. In rent-a-bank schemes, banks are a minor partner in lending programs designed and run outside the bank.**

Nonbank lenders seek rent-a-bank arrangements to make loans that would be illegal under state law for the nonbank lender to make directly. In so doing, they claim that the loans are not subject to state interest rate caps and other state laws because of the bank’s ability to preempt applicable state laws.

In rent-a-bank operations—both old and new—the nonbank lender is in the driver’s seat. The bank is a fig leaf, originating the loan and perhaps having a minor additional role that merely serves as cover for the fact that the main value the bank adds is its interest rate preemption rights. Typically, virtually all aspects of the loan program other than origination are handled by the nonbank lender, which may include setting the loan terms, designing the underwriting criteria, handling the website, marketing the loans, taking and processing applications, servicing the loans, handling customer service, and, for securitized loans, packaging the loans for investors. While the bank may approve aspects of these operations, the vast majority of the work and the vast majority of the profits go to the nonbank lender. In some arrangements, the nonbank lender keeps as much as 99% of the profits.<sup>53</sup>

The court noted that WebBank “plays only an ephemeral role in making the loans” and that “Avant is for all practical purposes in control of the Avant loans, and it has indemnified WebBank, whose role was short-lived and is now entirely in the past.”<sup>54</sup>

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<sup>53</sup>For example, these undisputed facts were uncovered in litigation by the Colorado Attorney General’s office against Avant, which uses FDIC-supervised WebBank to avoid state licensing and interest rate caps:

For example, Avant, Inc. paid the implementation fee to initiate the lending program, paid all of WebBank’s legal fees in the program, bears all of the expenses incurred in marketing the lending program to consumers, determines which loan applicants will receive Avant Loans and bears all costs of making these determinations, ensures the program complies with federal and state law, assumes responsibility for all servicing and administration of the Avant Loans “even during the period before WebBank sells the loans to Avant, Inc. or its affiliates,” and assumes responsibility for all communications with loan applicants and consumers who receive Avant Loans. ... Additionally, Avant, Inc. bears all risk of default, and indemnifies WebBank against all claims arising from WebBank’s participation in the lending program.... **Avant, Inc., along with the other nonbank entities, collects 99% of the profits on the loans while “WebBank’s share in the profit is only approximately one percent.”** Meade v. Avant of Colorado, LLC, 2018 WL 1101672 (D. Colo. Mar. 1, 2018) (emphasis added).

Avant had attempted to distinguish itself from the rent-a-bank arrangements 20 years ago on the grounds that payday lenders claimed to be agents of the bank whereas Avant was an assignee of the loans. That is not only a distinction without a difference, it is not even a distinction. Payday lenders in the past were also assignees of the loans, and Avant also claims to be a bank “service provider” (i.e., an agent).

<sup>54</sup> *Id.*

**B. FDIC banks are expanding rent-a-bank schemes used to make otherwise illegal high-cost loans.**

FinWise Bank, an FDIC-regulated bank, has been expanding its rent-a-bank operations. The following screenshots come from the bank's website that now lists these lenders among its Strategic Partnerships:<sup>55</sup>

**AMERICAN FIRST FINANCE**

American First Finance is a fintech company with a reputation of creating innovative, non-prime consumer finance solutions that drive more sales with less effort for retailers. American First Finance provides retailers with the ability to provide financing to customers where, when, and how they want to shop.\*

Repayment Term: from 6 months up to 24 months

Origination Fee: 5% of amount financed

Rate: 145.00%

Loan Amount: from \$300.00 and up to \$5,000.00

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**OPPLOANS**

An Installment Loan which may be a better alternative to Payday loans available to qualified borrowers.\*

Repayment Term: Up to 30 months

Origination Fee: None

Rate: Up to 160.00%

Loan Amount: from \$750.00 and up to \$4,000.00

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**RISE**

RISE offers responsible online installment loans designed to meet the needs of non-prime customers who are too often turned away by traditional credit providers. With features such as fast approval, flexible terms, progress to better rates, credit bureau reporting and free credit score monitoring, RISE is a path toward a brighter financial future.\*

Repayment Term: from 7 months up to 26 months

Origination Fee: None

Rate: from 99.00% up to 149.00%

Loan Amount: from \$500.00 and up to \$5,000.00

Opploans makes loans directly in states where high-cost lending is permitted but uses FinWise Bank in states where they are not. Opploans's website makes that distinction clear.<sup>56</sup> For example, OppLoans

<sup>55</sup> <https://www.finwisebank.com/strategic-partnership-products/>.

originates its loans through FinWise Bank in Oregon, where rates for installment loans are capped at 36%.<sup>57</sup>

Another payday installment lender, Rise (owned by Elevate), makes high-cost loans directly under state licenses where permitted – at rates as high as 299% APR – but uses FinWise Bank in other states. For example, Rise is being offered at 149% in Montana, where voters adopted a 36% interest rate cap in 2010.<sup>58</sup>

Another Elevate brand, Elastic, uses a different FDIC-supervised Republic Bank & Trust (Kentucky), to make open-end loans averaging 96% APR in circumvention of the voter-approved 36% or lower rate caps in Arkansas, Montana, South Dakota and other states. Elevate’s entire book of business carries an average APR of 129%.<sup>59</sup>

Elevate’s high-cost loans come with shocking default rates. The CFPB calculated nationwide charge-off rates as a percentage of outstanding loan volume in 2014 of over 50% for Elevate.<sup>60</sup> That is consistent with rates calculated by NCLC using California data.<sup>61</sup> Elevate’s net charge-offs as a percentage of revenues is 51%, a metric that Elevates states it does not intend to drive down.<sup>62</sup> Essentially, Elevate’s is a high-rate, high-default model that profits while making unaffordable loans.

Other FDIC-regulated banks have also engaged in rent-a-bank lending though have been ultimately shut down by courts. Previously, CashCall made high-cost installment loans in Maryland and West Virginia using First Bank of Delaware and First Bank & Trust (S. Dakota). These loans ranged from 99-135% APR, targeting defaults rates of 35-40%, and CashCall engaged in abusive debt collection tactics. The court held that the purpose of the bank arrangement was to hide behind the bank’s charter.<sup>63</sup>

On Deck Capital makes small business loans with rates up to 99.7% APR, originating loans through Celtic Bank in states where it cannot make the loans directly.

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<sup>56</sup> See <https://www.opploans.com/licenses/>, where Opploans lists each state where it makes loans directly and each where it makes loans through FinWise Bank.

<sup>57</sup> For map and spreadsheet of the APRs permitted in all 50 states for a \$500, six-month loan and a \$2,000 two-year loan, see <https://www.nclc.org/issues/predatory-installment-lending-2017.html>.

<sup>58</sup> Visit <https://www.risecredit.com/how-online-loans-work/#WhatItCosts> and select the appropriate state.

<sup>59</sup> Elevate Form 10Q, Sept. 30, 2018, at 43, [http://otp.investis.com/clients/us/elevate\\_inc1/SEC/sec-show.aspx?Type=html&FilingId=13054119&CIK=0001651094&Index=10000](http://otp.investis.com/clients/us/elevate_inc1/SEC/sec-show.aspx?Type=html&FilingId=13054119&CIK=0001651094&Index=10000).

<sup>60</sup> CFPB Proposed Payday Rule, 81 Fed Reg. 47886, n.246.

<sup>61</sup> Lauren Saunders et al., NCLC, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), <https://www.nclc.org/issues/misaligned-incentives.html>.

<sup>62</sup> Elevate Form 10Q, Sept. 30, 2018, at 48, [http://otp.investis.com/clients/us/elevate\\_inc1/SEC/sec-show.aspx?Type=html&FilingId=13054119&CIK=0001651094&Index=10000](http://otp.investis.com/clients/us/elevate_inc1/SEC/sec-show.aspx?Type=html&FilingId=13054119&CIK=0001651094&Index=10000).

<sup>63</sup> West Virginia v. Cash Call, Final Order on Phase II (Sept. 10, 2012) *available at* <https://www.nclc.org/images/pdf/unreported/wv-v-cashcall-phase-II-usury.pdf>.

We are especially concerned about the extremely high-cost rent-a-bank payday lending described above. But marketplace lenders are also using banks to evade state laws that do not permit rates as high as 36% for large loans of \$10,000 to \$40,000.<sup>64</sup> Large loans at those rates are unlikely to be affordable and will not help consumers refinance credit card debt. The State of Colorado has sued two marketplace lenders, Avant and Marlette, for using rent-a-bank arrangements to hide the fact that these state-regulated lenders are the true lender.

### **C. Rent-a-bank schemes have long been rejected by regulators.**

Long precedent against rent-a-bank schemes has served banks and consumers well. Since the mid-2000s, federal regulators have generally kept rent-a-bank arrangements for short-term payday loans at bay. At that time, OCC Comptroller Hawke called rent-a-bank schemes “an abuse of the national charter” and cautioned that “[t]he benefit that national banks enjoy by reason of [preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank.”<sup>65</sup> He further noted that “[w]e are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws.”<sup>66</sup> Under pressure from the Federal Reserve, Fed-supervised First Bank of Delaware ended partnerships with payday lenders in 2003. And the FDIC ended FDIC-supervised bank partnerships with short-term payday lenders in 2005<sup>67</sup>

The 2010 Wall Street Reform Act reinforced the impropriety of rent-a-bank. The Act limited preemption of state law to the bank itself, reversing a Supreme Court decision that had extended preemption to operating subsidiaries of national banks. Rent-a-bank schemes are even less connected to actions of the bank itself than activities of bank subsidiaries.

And earlier this year, the OCC refused to change course, noting in its Installment Lending Bulletin: “The OCC views unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity’s licensing state(s).”<sup>68</sup>

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<sup>64</sup> Of the 38 states that limit rates for a \$10,000, 5-year loan, the median rate is 25% and the vast majority are below 36%. See <https://www.nclc.org/images/pdf/pr-reports/installment-loans/installmentLoan2018-overview.pdf>.

<sup>65</sup> <https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html>.

<sup>66</sup> <https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-3.html>. The Office of Thrift Supervision also issued an advisory, noting “Associations should not ‘lease’ their charter out to nonthrift entities through an agreement that allows the nonthrift entity to circumvent state and local law.” OTS Bulletin 82, Aug. 18, 2003, at 8.

<sup>67</sup> The FDIC issued an advisory addressing payday lending through nonbank partners (FIL FDIC: FIL-14-2005: Guidelines for Payday Lending) and later shut down a straggling rent-a-bank arrangement with an enforcement action (*In the Matter of First Bank of Delaware, and CompuCredit Corporation, Notice of Charges for an Order to Cease and Desist and for Restitution, Federal Deposit Insurance Corporation*, FDIC-07-256b, June 15, 2008, available at <http://www.FDIC.gov/news/perss/2008/FDBNoticeofCharges.pdf>); See also *In the Matter of First Bank of Delaware, Stipulation and Consent to the Issuance of an Order to Cease and Desist, Order for Restitution, and Order to Pay*, Oct. 3, 2008, available at <http://www.FDIC.gov/bank/individual/enforcement/2008-10-20.pdf>.

<sup>68</sup> <https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html>.

Despite general regulatory opposition to rent-a-bank, and the mid-2000s crackdown on short-term payday loan schemes, schemes have sprung up over the years for high-cost installment loans, and current developments are alarming. And as noted above, FDIC-regulated banks have increasingly been renting their charters out to payday lenders to help them avoid state interest rate limits.

#### **D. Rent-a-bank schemes pose serious safety and soundness risk to banks.**

As we have explained at greater length in earlier comments to the FDIC,<sup>69</sup> rent-a-bank arrangements pose significant safety and soundness risks to banks, especially when they enable high-cost predatory lending. Rent-a-bank schemes are inconsistent with the FDIC's stance against third-party arrangements designed to permit circumvention of state law.

This is especially true when they enable lending above the Military Lending Act's (MLA) fee-inclusive 36% interest rate cap. Lending above those rates violates the laws of a significant number of states and poses a number of other risks, including compliance risks of violating the MLA itself, the payment protection portions of the CFPB payday loan rule, rules against unfair, deceptive or abusive practices, and abusive debt collection practices.

High-rate loans are also risky for banks because they are likely to lead to unfair and abusive debt collection practices.<sup>70</sup> High-rate loans are inevitably made to subprime borrowers with deeply impaired credit records who are already overburdened by unaffordable obligations. Thus, high rates lead to high delinquencies and defaults, often deliberately. For example, CashCall – which has attempted to use rent-a-bank arrangements – deliberately aims for a 40% default rate.<sup>71</sup> Aggressive debt collection tactics inevitably devolve into unlawful abuse, threats, and harassment.

Ironically, the more a bank attempts to protect itself from the risks of a high-cost rent-a-bank program, the greater the risk that the arrangement will be found to be a sham and result in litigation risk. The more responsibility the bank takes for the operation of the program and for overseeing the payday lender that is purportedly only a service provider to the bank, the more the conduct will be attributed to the bank. But the more the bank tries to distance and protect itself, indemnifying itself from the risks of the lending program, the more likely that the bank will not be viewed as the true lender but instead as a conspirator helping the third party to avoid state usury laws.<sup>72</sup>

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<sup>69</sup> See NCLC's comment here: <http://www.nclc.org/images/pdf/rulemaking/comments-fdic-3rdparty-lending.pdf> at 8 to 10; see CRL's comment here: [https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl\\_comment\\_fdic\\_thirdpartyguidance\\_oct2016.pdf](https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_comment_fdic_thirdpartyguidance_oct2016.pdf).

<sup>70</sup> We have described the way in which lenders use aggressive debt collection tactics to compensate for lack of a borrowers' ability to repay in our comments to the CFPB on installment loans not covered by the payday loan rule. See <http://www.nclc.org/images/pdf/rulemaking/cmmnt-cfpb-RFI-11072016.pdf> at pages 11 to 18.

<sup>71</sup> Lauren Saunders et al., NCLC, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016), <https://www.nclc.org/issues/misaligned-incentives.html>.

<sup>72</sup> See NCLC's comment to the FDIC on third party lending at <http://www.nclc.org/images/pdf/rulemaking/comments-fdic-3rdparty-lending.pdf>; see CRL's comment at [https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl\\_comment\\_fdic\\_thirdpartyguidance\\_oct2016.pdf](https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_comment_fdic_thirdpartyguidance_oct2016.pdf).



Small banks may be particularly exposed to the risks of rent-a-bank lending. Smaller banks in search of fee income may be susceptible to entreaties from lenders looking for rent-a-charter arrangements and may not have the sophistication to spot potential abuses or the compliance systems to monitor their nonbank partners. Some small banks may be willing to engage in high-risk endeavors, with inadequate controls, that larger banks would avoid. First Bank of Delaware, for example, eventually ceased operations after repeatedly being cited for violations in its consumer lending business – including rent-a-bank lending<sup>73</sup> – and for being lax in monitoring relationships.<sup>74</sup>

A change of course in the regulators' longstanding position against rent-a-bank abuses would invite backlash, litigation, and erosion of confidence in banking system. Rent-a-bank lending poses a grave threat to the strongest protection against predatory lending, state interest rate caps. Most states cap rates on installment loans; of those, the median cap is 37% for a \$500 loan; 31% for a \$2,000 loan, and 25% for a \$10,000 loan. Out of concern for this threat, at least 150 national, states, and local civil rights, consumer, community and faith groups have opposed permitting rent-a-bank arrangements.<sup>75</sup> The Conference of State Bank Supervisors (CSBS) and New York's Department of Financial Services have sued the OCC's plan to grant preemptive fintech charters. The State of Colorado has sued two marketplace lenders, Avant and Marlette, for using rent-a-bank arrangements to hide the fact that these state-regulated lenders are the true lender. Even higher-cost loans are likely to invite more prolific litigation both over the partnerships and over any FDIC policy that facilitates them.

The FDIC should instead emphasize that bank lending should be done inside of banks and that banks should not allow themselves to be used by predatory lenders.

**VI. Require that loans be based on ability to repay, which means consideration of both income and expenses without needing to reborrow.**

Another longstanding banking principle is that loans be based on ability-to-repay. Under longstanding regulatory precedent, proper underwriting requires consideration of both income and expenses. It is absolutely critical that efforts to encourage financial institutions to offer small dollar loans not be at the expense of traditional underwriting principles and that the FDIC reject any notion that income-only underwriting is appropriate.

**A. Ability to repay requires consideration of income and expenses/obligations without needing to reborrow.**

An ability-to-repay determination, as rooted in years of regulatory precedent, requires consideration of both income and obligations and/or expenses. That is, the borrower must be able to manage all of their expenses, including the new debt obligation, on their income, without needing to reborrow.

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<sup>73</sup> FDIC to FIRST BANK OF DELAWARE, "Cease and Desist," Delaware Business Blog (Dec. 21, 2008), <http://www.delawarebusinessblog.com/fdic-to-first-bank-of-delaware-cease-and-desist/>.

<sup>74</sup> Andy Peters, "First Bank of Delaware to Cease Operations," American Banker (May 7, 2012), <https://www.americanbanker.com/news/first-bank-of-delaware-to-cease-operations>.

<sup>75</sup> See Sept. 2017 letter signed by 150+ opposing Congressional legislation that risks sanctioning rent-a-bank here: <https://www.responsiblelending.org/media/congress-should-reject-rent-bank-predatory-lending-legislation>.

HOEPA statutory language since 1994 requires that repayment ability include “current and expected income, *current obligations*, and employment.”<sup>76</sup> The 2000 OCC Advisory Letter on Abusive Lending Practices discusses equity stripping as “*reliance on . . . collateral, rather than the borrower’s independent ability to repay. . .*”<sup>77</sup> The OCC’s 2018 Installment Loan Bulletin references this 2000 Advisory.<sup>78</sup> The 2001 Interagency Subprime Guidance provides that abusive lending practices occur when “the lender structures a loan to a borrower who has little or no ability to repay the loan *from sources other than the collateral pledged.*”<sup>79</sup> The Federal Reserve’s 2009 HOEPA rules required verification of income, assets *and obligations* for both high-cost and higher-priced loans.<sup>80</sup> The Wall Street Reform Act, 2010, for all residential mortgages, requires “a reasonable and good faith determination based on verified and documented information,”<sup>81</sup> including, among other items, expected income, *current obligations*, *debt-to-income ratio* or *residual income*, and other financial resources other than the consumer’s equity.<sup>82</sup> And the 2013 FDIC Deposit Advance Guidance appropriately includes assessment of both inflows and outflows. The regulations implementing the ability-to-repay provision of the Credit CARD Act of 2009 also require credit card issuers to consider “the consumer’s current obligations.”<sup>83</sup>

The level of detail and documentation of a consumer’s obligations may vary depending on the size and type of the loan. But federal banking regulators have long held that safe and sound lending requires consideration of obligations as part of assessment of the borrower’s ability to repay, while rejecting reliance on access to collateral (asset-based lending).<sup>84</sup> Yet making high-cost loans solely in reliance on

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<sup>76</sup> 15 U.S.C. 1639(h): “Prohibition on extending credit without regard to payment ability of consumer. A creditor shall not engage in a pattern or practice of extending credit to consumers under [high-cost] mortgages . . . based on the consumers’ collateral without regard to the consumers’ repayment ability, including the consumers’ current and expected income, current obligations, and employment” (emphasis added).

<sup>77</sup> OCC Advisory Letter on Abusive Lending Practices, AL 2000-7 (June 25, 2000), *available at* <http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf> (emphasis added).

<sup>78</sup> <https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html>

<sup>79</sup> Interagency Expanded Guidance on Subprime Lending Programs, FIL 9-2001, January 31, 2001. The FDIC’s 2005 payday loan guidelines also notes that it clarifies previously issued guidance, including the 2001 Expanded Subprime Guidance; the 2001 Expanded Subprime Guidance also contemplates equity stripping outside the context of mortgage lending, noting that lenders may make a loan to a borrower who has little or no ability to repay other than from the collateral pledged, then take possession of the borrower’s home or automobile upon default.

<sup>80</sup> Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44546 (July 30, 2008).

<sup>81</sup> 15 U.S.C. § 1639c(a)(1).

<sup>82</sup> 15 U.S.C. § 1639c(a)(3).

<sup>83</sup> 12 C.F.R. § 1026.51(a)(1)(i).

<sup>84</sup> For example, in 2001, the agencies issued joint guidance on subprime consumer lending products, emphasizing that banks need to base lending on determination of the borrower’s ability to repay the loan, as opposed to relying

automatic repayment from the borrower's deposit account without making an income-and-expense based ability-to-repay determination is asset-based lending. As described in the following section, considering only income does not ensure that the borrower can continue to meet their remaining obligations and expenses after loan repayment; the borrower must only have enough funds on the day the loan payment is debited. The FDIC should reject the notion that institutions should engage in collateral-based lending that looks only at borrower income—and the ability to seize that income—and does not consider the borrower's ability to afford existing expenses. The bank's ability to collect is not the same thing as the borrower's ability to repay.

Notably, for lower-income and/or financially distressed consumers, a residual income analysis will more likely accurately predict ability-to-repay than a debt-to-income (DTI) ratio. As the CFPB has noted, "A DTI ratio that might seem quite reasonable for the 'average' consumer can be quite unmanageable for a consumer at the lower end of the income spectrum and the higher end of the debt burden range."<sup>85</sup>

#### **B. A payment-to-income ratio of 5% cannot substitute for underwriting for ability-to-repay.**

Payment-to-income ratios cannot substitute for meaningful underwriting, particularly for financially distressed borrowers for whom higher-cost loans are typically designed. Pew Charitable Trusts has proposed that banking regulators sanction high double-digit APRs on installment loans with payments that do not exceed 5% of borrower gross income (payment-to-income, or PTI, ratio). U.S. Bank has also touted that the bank applies this protection to its new high-cost, 70% APR, \$1,000, 3-month installment loan—a product we fear will be unaffordable for too many borrowers.

We strongly oppose this proposal because it would facilitate unaffordable loans to account holders, causing them substantial financial harm. It would also undermine state laws that aim to protect residents from predatory high-cost loans and facilitate a race to the bottom by predatory lenders nationwide. We address this concern when we discuss interest rates at Section VII below.

Evidence overwhelmingly suggests that loans with payments of 5% of gross income will likely be unaffordable for financially distressed borrowers:

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on collateral, and that the failure to underwrite the loan was a safety and soundness concern: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent. Further, examiners should refer any loans with the aforementioned characteristics to their Agency's respective consumer compliance/fair lending specialists for additional review." FIL 9-2001, Interagency Expanded Guidance for Subprime Lending Programs, January 31, 2001, available at <http://www.federalreserve.gov/boarddocs/srletters/2001/sr0104a1.pdf>. This guidance was applicable to subprime consumer lending generally, beyond the mortgage context, and the FDIC has cited its specific relevance to payday lending. FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, available at <http://www.fdic.gov/news/news/financial/2005/fil1405a.html>. For further discussion, see Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products*, January 24, 2013, available at <http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Safety-Soundness-BPD.pdf>.

<sup>85</sup> CFPB Proposed Payday Rule, 81 Fed. Reg. 47941.

- **The large majority of payday loans are made to borrowers who likely do not have an extra 5% of their income to spare toward additional debt.** Consider a family of four at the federal poverty level of \$24,300 annually, \$2,025 monthly. A 5% PTI standard would assume that the borrower has \$101 in extra cash each month, or \$1,215 annually, that they can spare toward service of high-cost debt. Yet, by definition, the poverty level is the level at which a family already has insufficient income. Even at somewhat higher income levels, for credit-impaired consumers, it is far-fetched to categorically assume that a borrower who has already demonstrated financial distress has an extra 5% of her income available to put towards a new debt, even if that debt is not high-cost. Rather, the debt is likely to compound already an unsustainable financial burden.
- **Payday installment loans have very high defaults even when payments are limited to 5% of income or less.** CFPB's research found extraordinarily high default levels on online installment loans even at PTI ratios of 5% or less. For one lender in the Bureau's data whose loans included both storefront and online loans, 28 to 30% of loans with PTI of 5% of less defaulted, excluding loans with first-payment defaults.<sup>86</sup> For all loans for which the origination channel was unknown—about half the dataset, or 1.25 of 2.5 million loans—the Bureau found default rates of 38 to 40% at PTI of 5% or less, including first-payment defaults.<sup>87</sup>
- **Analysis of checking account data shows that even small payday loan payments often cause financial distress.** The Center for Responsible Lending analyzed online payday loan payments from a database of consumer checking account activity for its 2015 paper, *Payday Mayday*.<sup>88</sup> The payday loan payment sizes in this panel were typically much smaller than a typical payday balloon payment, with about 42% of all the payments less than \$100. Yet the analysis found that payments even at these smaller dollar amounts were often associated with significant borrower distress, as evidenced by non-sufficient fund/overdraft activity occurring on the borrower's checking account in the two weeks following the payday loan payment. Many of the payday loan

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<sup>86</sup> CFPB, Supplemental Findings on payday, payday installment, and vehicle title loans, and deposit advance products (June 2016), [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental\\_Report\\_060116.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf), at 17 (Figure 6), 22 (Figure 9) and n.31 at 24. CFPB's analysis of a large dataset uses a conservative definition of default, counting as defaulted loans only those charged off. *Id.* at 19. In addition, the Bureau excluded from this analysis loans with defaults before the first payment. This results in a conservative defaults figure, particularly considering that some portion of first payment defaults are due to inability to repay. At the same time, we note, as the Bureau does, that a nonprime 101 study found that the statistical correlation between PTI and defaults was substantially mitigated or eliminated when first-payment defaults were eliminated.

<sup>87</sup> CFPB Supplemental Findings at 18, 23, 24.

<sup>88</sup> Susanna Montezemolo & Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, Center for Responsible Lending (March 2015), <http://www.responsiblelending.org/research-publication/payday-mayday-visible-and>. To conduct this analysis, we used a national sample of checking account transaction data. We identified instances where accountholders had overdraft fees assessed within two weeks of a payday payment and isolated the payday payment that fell closest in time to the overdraft (in some cases accountholders had either multiple payday payments or multiple overdrafts in this period). We then looked at the distribution of the amounts of the payments.

payments that were associated closely in time with an overdraft were for small amounts: Half were \$100 or less and over a third were \$50 or less.<sup>89</sup>

- **The consumer finance loan market, driven by refinancings, does not support that 5% PTI loans are affordable.** Consumer finance loan data has been cited for support that 5% PTI loans are affordable.<sup>90</sup> But the consumer finance loan business model is not based on a borrower’s ability to repay the loan without reborrowing; rather, it is driven by repeat refinancing used to cover and extend unaffordable loans, increasing profitability for the lender without affordability for the borrower.<sup>91</sup> For example, in 2016, 69.4% of World Acceptance’s originations were refinancings of existing loans; prior to its merger with Springleaf, 60% of One Main’s originations were reportedly renewals—“default masking,” as one analyst put it.<sup>92</sup> Similarly, one lender’s employee training manual suggests this response for a consumer who said he would have trouble paying and had been in the hospital: “Well, how would you like some extra cash to help you out?”<sup>93</sup> We have discussed the ways in which refinancing masks inability to repay in comments to the CFPB.<sup>94</sup>
- **Colorado’s high-default longer-term payday loan market does not provide support that a 5% PTI high-cost loan is affordable.** Colorado payday installment loans averaged 129% APR until voters capped interest rates in the state at 36% this past November (effective February 2019). Those high-cost installment loans had been computed to carry payments that approximate 5% of the borrower’s income.<sup>95</sup> But the loans were unaffordable at unacceptable rates, with data analysis finding that default occurred in 23% of Colorado payday loans taken in 2016.<sup>96</sup> The per

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<sup>89</sup> Analysis on file with CRL.

<sup>90</sup> The Pew Charitable Trusts, Oct. 7, 2016, comment letter to Director Richard Cordray regarding “Proposed Rule for Payday, Vehicle Title, and Certain High-Cost Loans, Docket ID: CFPB-2016-0025,” Appendix C, <https://www.regulations.gov/document?D=CFPB-2016-0025-142716>; The Pew Charitable Trusts, *State Laws Put Installment Loan Borrowers at Risk* (Oct. 2018), <https://www.pewtrusts.org/en/research-and-analysis/reports/2018/10/17/state-laws-put-installment-loan-borrowers-at-risk>.

<sup>91</sup> Comments of CRL, NCLC, et al on CFPB Proposed Payday Rule at 41 *et. seq.* (Nov. 7, 2016), <http://www.responsiblelending.org/research-publication/comment-cfpb-request-information-payday-loans-vehicle-title-loans-installment>.

<sup>92</sup> *Id.*

<sup>93</sup> Cottonwood Financial, LTD, *New Hire Instructor GuideTex, Handling Customers*, Part 1 at 17 (2013).

<sup>94</sup> Comments of CRL, NCLC, et al on CFPB Proposed Payday Rule at 41 *et. seq.* (Nov. 7, 2016), <http://www.responsiblelending.org/research-publication/comment-cfpb-request-information-payday-loans-vehicle-title-loans-installment>; see also NCLC, *Misaligned Incentives* at 22 to 27.

<sup>95</sup> The Pew Charitable Trusts, Oct. 7, 2016, comment letter to Director Richard Cordray regarding “Proposed Rule for Payday, Vehicle Title, and Certain High-Cost Loans, Docket ID: CFPB-2016-0025,” Appendix C, <https://www.regulations.gov/document?D=CFPB-2016-0025-142716>.

<sup>96</sup> Ellen Harnick & Delvin Davis, *Payday Lenders Continue to Put Coloradoans into High-Cost Debt*, Center for Responsible Lending (Feb. 2018), available at

borrower default rate was likely higher, given the high rate of reborrowing. In addition, focus group participants in Colorado in many cases reported that unaffordable loan payments on these loans triggered significant additional financial hardships, either immediately or down the road.<sup>97</sup>

- **The fact that payday lenders often collect approximately \$100 in rollover payments each month is not evidence that the borrower can afford those payments.** Rollover payments are payments the payday lender collects from a borrower around payday to extend the loan until the next payday. They are typically the only way the borrower can prevent the lender from seizing the entire loan principal—a much larger payment—from the borrower’s account on payday. So borrowers do not choose to pay rollover fees because they can afford them; they are coerced into paying them in order to avoid an even bigger shortfall in their ability to meet expenses. Yet even the rollover fees are not collected without distress to borrowers: CFPB found that half of payday borrowers incur an overdraft or bounced payment, with over a third of borrowers with a bounced payment having their account closed.<sup>98</sup> And ultimately, at least one in five borrowers ultimately default—likely often because they cannot sustain the rollover fees.<sup>99</sup>
- **The CFPB has emphasized the importance of meaningful ability-to-repay determinations on longer term loans.** The CFPB rule finalized in October 2017 does not legitimize high-cost installment loans without meaningful ability-to-repay determinations. To the contrary, the CFPB explicitly considered, and then explicitly rejected, a 5% PTI exception from its proposed ability-to-repay requirement for longer-term loans—a decision strongly supported by the undersigned groups, along with a coalition of over 500 civil rights, consumer, labor, faith, veterans, seniors, and community organizations from all 50 states.<sup>100</sup> That CFPB did not yet finalize ability-to-repay requirements for longer-term loans at all—while stating that it remained concerned that “failing to underwrite” such products may pose “substantial risks for consumers” it would address in a later rulemaking—is not an endorsement of high-cost longer-term loans made without an ability-to-repay determination that considers both income and expenses.<sup>101</sup>

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[http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-colorado-payday-highcost-feb2018\\_0.pdf](http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-colorado-payday-highcost-feb2018_0.pdf).

<sup>97</sup> Center for Responsible Lending, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans* (July 2018), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf> (CRL, *Sinking Feeling*).

<sup>98</sup> CFPB, Online Payday Loan Payments (April 2016), [http://files.consumerfinance.gov/f/201604\\_cfpb\\_online-payday-loan-payments.pdf](http://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf).

<sup>99</sup> CFPB Final Rule at 309; CRL research has found a 44% default rate, Center for Responsible Lending, *Payday Loans, Inc.: Short on Credit, Long on Debt* (2011), <http://www.responsiblelending.org/payday-lending/research-analysis/payday-loans-inc-exec-summary.pdf>. This research also found that Oklahoma borrowers’ typical loan size grew from \$300 to \$422, and that days in debt grew from 212 in the first year studied to 372 in the subsequent year.

<sup>100</sup> The undersigned and additional groups state their opposition to a 5% PTI exemption from an ability-to-repay requirement here: <http://ourfinancialsecurity.org/wp-content/uploads/2016/06/Grouprelease.pdf>; [http://stopthedebttrap.org/wp-content/uploads/2016/06/stdt\\_5percent\\_jun2016.pdf](http://stopthedebttrap.org/wp-content/uploads/2016/06/stdt_5percent_jun2016.pdf).

<sup>101</sup> 82 Fed. Reg. 54554. The Bureau’s final rule also notes, in response to feedback from Pew, that it will continue to consider a payment-to-income approach for longer-term loans, but it does not endorse it. 82 Fed. Reg. 54638.

To be sure, the data strongly support that sanctioning a 5% PTI standard would facilitate unaffordable loans. So does intuition: When a consumer is already thick-file and overburdened by debt—the typical payday borrower—an assumption that the consumer can afford to repay up to 5% of gross income toward additional debt, and particularly high-cost debt, is not a reasonable assumption.<sup>102</sup>

In conclusion, there has never been a place for payment-to-income-based underwriting in responsible banking policy, and there should not be now.

**C. Banks are in a strong position to underwrite in an automated, cost-effective manner.**

Automated, low-cost cash-flow underwriting of income and expenses has become a reality, and banks are in a strong position to do this. Vendors also offer products that have this capacity, and, as noted above, emerging nonbank lenders are also demonstrating the feasibility.

**D. Low default rates, particularly for bank loans repaid automatically from the deposit account, do not demonstrate that loans are affordable.**

Regulators should not let low default rates be used to demonstrate categorically that loans are affordable. While high default rates certainly show unaffordability, the converse is not necessarily true when the lender has a leveraged payment mechanism or other means of coercing payment. With payday loans as well as longer-term loans that are repaid automatically, unaffordability is significantly masked because the lender can take the payment even if it is unaffordable. This super-lien position is even more pronounced when the lender is the depository institution and does not need to use the ACH system. The loan itself will often be repaid even while the payments on the additional debt load leave the borrower unable to meet other obligations and expenses.

Certainly, regulators should take action if a loan program has high default rates. As discussed further above, regulators should put a stop to rent-a-bank operations that enable lenders like Elevate to make high-cost loans with high default rates. But when a lender has a strong repayment mechanism, default rates will not tell the whole story, and scrutinizing default rates does not substitute for a front-end determination based on ability to meet expenses.

The unaffordability of an automatic repayment is most obvious when it triggers an overdraft fee. Overdraft fees can be triggered even when loans are repaid through offset immediately upon a deposit, and they may be more likely for installment loans where payments are not timed with payday. Loans repaid despite incurring overdraft fees do not show up in default rates.

But prohibiting banks from taking a payment that would trigger an overdraft fee is not enough to protect borrowers or ensure that payments will be affordable. Even deposit advance bank payday lenders typically provided that the repayment itself could not result in an overdraft fee, but the banks did charge overdraft fees or non-sufficient funds fees on any subsequent debits to the account. So the

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<sup>102</sup> For additional data and discussion, see CRL's analysis at *Assessing Income and Expenses Is Necessary In Test of Borrower's Ability to Afford a Consumer Loan* (Nov. 2017), <http://stopthedebttrap.org/blog/testing-borrowers-ability-afford-consumer-loan/>.



“protection” did nothing to prevent subsequent transactions from triggering an overdraft or non-sufficient funds fee. The same will be true of installment payments.

Even if banks do not take a payment that would trigger an overdraft, they may still find another time to take the payment through a right of offset or resubmitting the payment. Thus, unaffordable loans may still be collected and not show up in default rates.

#### **E. Cooling-off periods should be established.**

Cooling-off periods are no panacea. They do not make an unaffordable loan affordable. For balloon payment loans, like deposit advance, they did not prevent borrowers from being stuck in a large number of loans each year.

At the same time, cooling-off periods can be an important protection against endless loan flipping by lenders of unaffordable loans. Repeat borrowing, or loan flipping, is an indication of lack of ability to repay. Importantly, loan flipping occurs even when a loan is not technically refinanced or rolled over, and even if the subsequent loan is taken days later.

With installment loans, too—particularly where the loan is a high-cost loan to a financially distressed borrower—repeat lending may well signal inability to repay. Lenders also often encourage prepayment of installment loans in order to be able to charge new fees or extend the indebtedness, flipping the borrower into a new installment loan and lengthening the total period of borrowing.

We thus encourage a cooling-off period and no refinancing (other than workout programs at no additional cost) for any loan program tailored to the financially distressed. The cooling off period should begin once the loan is repaid, regardless of whether the loan is paid off early. In addition to preventing flipping, a cooling off period also serves to limit the total number of loans annually, which keeps the total costs down on loans that have an upfront application or origination fee.

The CFPB Rule determined that a loan taken within 30 days of a prior loan should be considered part of the same loan sequence, in part because the CFPB determined that 30 days was a reasonable representation of most consumers’ expense and pay cycles.<sup>103</sup> We offered that 60 days would be a more appropriate period, as the expense cycle for many financially distressed consumers is longer than 30 days.<sup>104</sup> The FDIC’s Deposit Advance Guidance, too, provides for a cooling-off period likely to be longer than 30 days, since it includes the remainder of one statement cycle and an entire subsequent cycle.

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<sup>103</sup> CFPB Final Payday Rule, 82 Fed. Reg. 54709.

<sup>104</sup> CRL, NCLC, et al., Comments on CFPB Payday Rule at § 8.3 (pp. 132 *et seq.*).



## **F. Loan structures should promote affordability and transparency.**

### **1. Loan term.**

The FDIC's affordable small loan guidelines provide for a minimum loan term of 90 days, and this should be retained.<sup>105</sup> Shorter-loan terms, particularly on loans with high application fees, increase the effective cost, and decrease the affordability, of small dollar loans substantially, while encouraging loan flipping to generate additional fees.

Terms longer than 90 day will also often make sense for bigger loans. Repayment of a \$1,000 loan in 90 days, for example, can pose significant challenges to cash-strapped borrowers. If a borrower is facing a cash flow crisis that requires \$1,000 that they cannot meet today, they are unlikely to be able to repay that principal over 90 days. Extending the maturity to a year would promote affordability. At the same time, unreasonably long loan terms for small loans, particularly at higher rates, may reduce the likelihood of full repayment.<sup>106</sup>

### **2. Pricing structure for closed-end loans.**

Loans should be priced in periodic interest so that consumers do not become confused about the APR and can compare them more easily to other loan APRs. Fees, if any, should be a small part of the pricing. For example, a bill introduced in Congress to cap interest rates at 36% permits one \$30 application fee annually to be excluded from that cap for loans of \$300 to \$600.<sup>107</sup>

### **3. Open-end products.**

High-cost lenders notoriously use open-end products—both short- and longer-term—to evade laws and regulations aimed at addressing high-cost loans. CRL and NCLC discuss these evasions at length in our comment on the CFPB Rule at § 6.3.2.1 and § 10.6.1.<sup>108</sup> Banks called their deposit advance payday loans open-end, even as they repaid themselves in full on a date generally known from the borrower's next deposit. Longer-term lenders avoid APR disclosures and use indecipherable pricing that makes it very difficult to determine the loan's true cost. An open-end line of credit also gives the consumer the ability to reborrow without any new ability-to-repay determination. Thus, any open-end product aimed at the financially distressed should be priced and structured responsibly.

First, the only fee on an open-end product should be a single reasonable annual application or participation fee that is a small part of the cost of the loan, with the costs otherwise reflected in a

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<sup>105</sup> FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 (June 19, 2007).

<sup>106</sup> NCLC, *Misaligned Incentives*, at 21.

<sup>107</sup> Under a proposal in Congress to institute a 36% rate cap, \$30 per year in application or participation fees would not be included. See S. 1659 (Durbin)/H.R. 3760 (Cartwright), *Protecting Consumers from Unreasonable Credit Rates Act of 2017*.

<sup>108</sup> CRL, NCLC, et al., *Comments on CFPB Payday Rule*, at § 6.3.2.1 at (p. 95) and § 10.6.1 (p. 179).

periodic rate of interest. A line of credit is underwritten at the outset up to the credit limit, so there should be no additional application fees permitted to be excluded from the APR.

Second, banks should be encouraged to price loans through periodic interest, not through fee-based pricing. The APR rules for open-end credit only include periodic interest, so open-end loans with fee-based pricing will be artificially low – if an APR is disclosed at all. Banks often did not disclose an APR for their DAP products. Similarly, if U.S. Bank’s Simple Loan were restructured as an open-end loan, the \$12 per \$100 pricing might not require any APR at all (and might lead borrowers to believe the rate is 12%, not 70%). In another example, the payday lender Elevate discloses no APR in its pricing terms and obscures the pricing on its Elastic line of credit, even though the cost amounts to a shockingly high 96% APR.<sup>109</sup>

In addition, an open-end product must have minimum payments that ensure repayment in a reasonable period of time that approximates the terms on closed-end loans. Higher-cost credit cards or other open-end credit lines that can take 5, 10 or 20 years to repay should not be permitted. At the same time, open-end credit lines must also be structured to permit amortizing payments over a few months and not be a disguised series of balloon payment loans, as bank deposit advance payday loans were.

## **VII. Continue to encourage loans priced at 36% APR and below.**

We urge the FDIC to be clear that any small dollar loans should be reasonably priced at 36% or less, including fees,<sup>110</sup> consistent with the FDIC’s 2007 Affordable Small-Dollar Loan Guidelines.

### **A. Interest rate limits align incentives, help ensure affordability.**

Interest rate limits are the simplest and most effective way to prevent predatory lending and ensure that lenders properly consider borrowers’ ability to repay. At reasonable interest rates, the interests of the lender and borrower are aligned: They rise and fall together, prospering if a loan is affordable, and suffering if it is not. High interest rates, on the other hand, enable lenders to make profits despite high default rates and even, at times, to profit on loans that default.<sup>111</sup> Extremely high interest rates on loans to financially vulnerable consumers cannot be justified as everyday risk-based pricing. The rates, instead, are a red flag signaling a business model not based on ability to repay.

For example, CashCall (which, as noted above, has attempted to use rent-a-bank arrangements to avoid state interest rates), targeted a 35% to 40% default rate in its profitability model.<sup>112</sup> Even building in high expenses, CashCall made a profit after borrowers made only 19 of 42 monthly payments on its 96% APR loan and only 14 of 47 payments on its 135% APR loan.<sup>113</sup> The chart below<sup>114</sup> shows how CashCall could

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<sup>109</sup> The 96% Effective APR is disclosed in the company’s SEC filing. Elevate 10Q, Sept. 30, 2018, at 59.

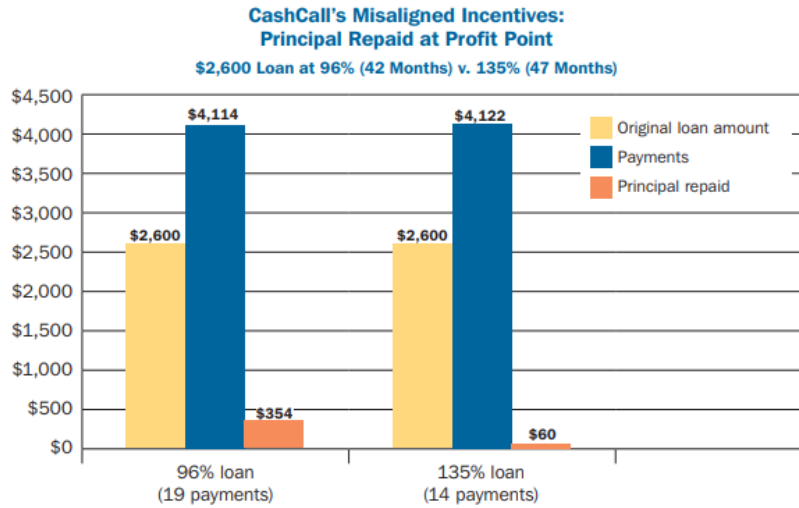
<sup>110</sup> Under a proposal in Congress to institute a 36% rate cap that CRL and NCLC have supported, a \$30 per year in application or participation fees would not be included in the cap for loans from \$300-\$600. See S. 1659 (Durbin)/H.R. 3760 (Cartwright), Protecting Consumers from Unreasonable Credit Rates Act of 2017.

<sup>111</sup> See NCLC, *Misaligned Incentives*.

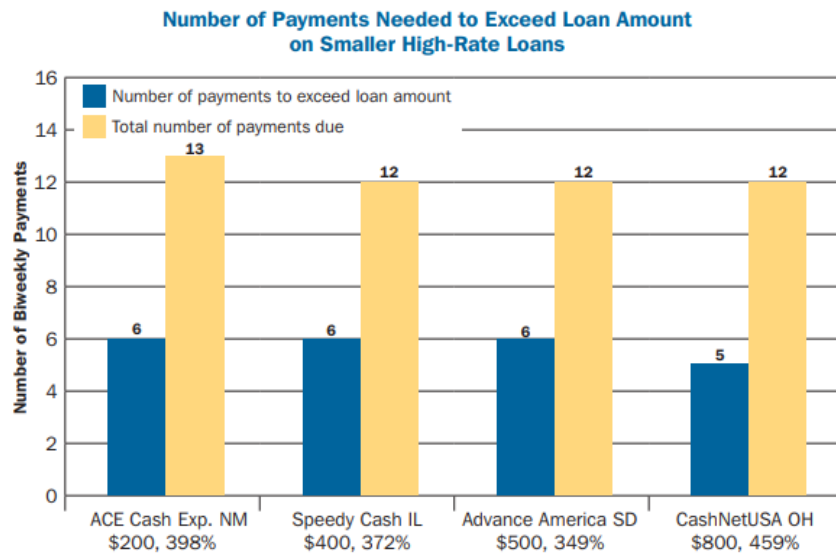
<sup>112</sup> *Misaligned Incentives* at 17 & n.38.

<sup>113</sup> *Misaligned Incentives* at 14.

turn a profit on a \$2600 loan after the borrower made fewer than half the payments, even though the borrower has repaid little of the principal on paper:



Similarly, even with smaller high-cost loans, a lender can recover the principal after fewer than half the payments and may profit even if the borrower defaults before the end of the term.<sup>115</sup>



Banks making loans through checking accounts have the added leverage of holding the customer's bank account. This can ease their ability to profit off loans, even if they leave borrowers without enough money to meet basic needs.

<sup>114</sup> Misaligned Incentives at 16.

<sup>115</sup> Misaligned Incentives at 20.

Interest rate limits are easily understood by lenders and borrowers alike, are easy to comply with, and give lenders flexibility as to how to underwrite to ensure that borrowers can afford their payments.

**B. Interest rate limits of 36% or lower for small loans, and lower for large loans, are broadly supported.**

A 36% rate limit has been the broadly accepted standard as a cap on small loans for over a century. That rate goes back to the model small dollar loan acts of the early 1900s and has been widely supported by states, voters and Congress.<sup>116</sup>

Sixteen states plus the District of Columbia limit the cost of short-term loans such that payday lenders don't have active markets there. Most states have caps on longer-term loans as well; of those, the median cap is 37% for a \$500 loan.

These laws reflect value judgments by legislators and voters about what the cost of credit in those states should be, and non-depository lenders are all subject to those rate limits.

A cap of 36% is also the law of the land, under the Military Lending Act, for active military service members and their families.

An interest rate limit of 36% is strongly supported by Americans across the political spectrum, as seen in Arizona,<sup>117</sup> Ohio,<sup>118</sup> Montana<sup>119</sup> and South Dakota,<sup>120</sup> and Colorado,<sup>121</sup> where voters in recent years have voted overwhelmingly (typically by a margin of two-to-one, or higher) in favor of capping rates at 36%.

For larger loans, rates should be even lower, just as many states have tiered interest rate caps. Iowa for example, caps the first \$1000 at 36% and ratchets the rate down to 18% for amounts over \$10,000. Among the 38 states with caps on installment loans, the median is 31% for a \$2,000 loan, and 25% for a \$10,000 loan.<sup>122</sup>

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<sup>116</sup> Lauren Saunders, *Why 36%?: The History, Use and Purpose of the 36% Interest Rate Cap*, NCLC (April 2013), <https://www.nclc.org/images/pdf/pr-reports/why36pct.pdf>.

<sup>117</sup> <https://www.responsiblelending.org/media/voters-reject-400-percent-interest-payday-loans>

<sup>118</sup> <https://www.responsiblelending.org/media/voters-reject-400-percent-interest-payday-loans>

<sup>119</sup> <https://www.responsiblelending.org/media/montana-voters-reject-payday-loan-abuses>

<sup>120</sup> <http://www.governing.com/topics/elections/gov-south-dakota-payday-lending-ballot-measures.html>

<sup>121</sup> <https://www.coloradoan.com/story/news/politics/elections/2018/11/06/colorado-election-proposition-111-passes-limits-interest-payday-loans/1890551002/>

<sup>122</sup> The 25% median rate is computed in NCLC's report, <https://www.nclc.org/issues/a-larger-and-longer-debt-trap-installment-loan.html>. The 31% median rate is on file with authors, computed from NCLC's 2017 report on \$500 and \$2000 loan state laws, <http://bit.ly/2vRZkEf>.

**C. Higher-cost bank loans would threaten the regulatory landscape for nonbank lending across the country, harming consumers.**

In light of how critical state interest rate limits are to protect consumers from nonbank predatory loans, we urge the agency to consider deeply the impact its approach to small dollar loans will have on state law. Some have argued that bank loans as high as 99% will drive down higher-cost loans by nonbanks. But instead, encouraging high double-digit rates from banks will legitimize exploitative lending.

Though ballot referendums have consistently come out against high-cost predatory loans, state legislative battles are consistently fierce. Should bank loans at 99% APR loans become the norm, nonbank payday and other high-cost lenders will urge weakening of state interest rate caps to permit “home state” lenders to “compete” with banks. And with weaker state interest rate laws, financially distressed consumers will end up far worse off than they are now.

**D. Reasonable interest rates should be promoted under safety and soundness authority.**

The FDIC has the responsibility to ensure that financial institutions under its charge are not engaged in unaffordable lending and do not put their reputations at risk. At high interest rates, both risks are much greater. High interest rates lead to skewed incentives that allow lenders to profit on unaffordable loans.<sup>123</sup> As discussed above in the discussion of rent-a-bank lending, rates above 36% also risk financial institutions’ reputations and blur the line between responsible institutions and predatory lenders.

**VIII. Retain the 2013 deposit advance guidance, which addressed a high-cost debt trap product.**

In 2013, a handful of banks<sup>124</sup> were making high-cost payday “deposit advance” loans, structured just like loans made by nonbank payday lenders. The bank repaid itself the loan in full directly from the borrower’s next incoming direct deposit, typically wages or Social Security, along with annual interest averaging 225% to 300%.<sup>125</sup>

To the agency’s credit, no FDIC-supervised banks made these loans.

The data on bank payday loans make clear that bank payday loans led to the same cycle of debt as payday loans made by nonbank lenders. The Consumer Financial Protection Bureau’s analysis of thousands of bank payday loans found a median number of advances per borrower of 14, with extremely high numbers of advances for many borrowers: Fourteen percent of borrowers had a median

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<sup>123</sup> Lauren Saunders et al., National Consumer Law Center, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016), <https://www.nclc.org/issues/misaligned-incentives.html>.

<sup>124</sup> Wells Fargo, US Bank, Fifth Third, Regions, Bank of Oklahoma and its related banking divisions, and Guaranty Bank.

<sup>125</sup> For further background, see Center for Responsible Lending, *Been There, Done That: Banks Should Stay Out of Payday Lending* (July 2017), <http://www.responsiblelending.org/research-publication/been-there-done-banks-should-stay-out-payday-lending>.

of 38 advances in 12 months.<sup>126</sup> These findings were consistent with the Center for Responsible Lending’s prior analysis of bank payday loans, which found that the median bank payday borrower had 13.5 loans in 2011 and was in bank payday loan debt at least part of six months during the year; over a third of borrowers had more than 20 loans during the year.<sup>127</sup> Bank payday loans created this debt trap despite so-called protections the banks touted, like installment repayment options.

What’s more, while deposit advance borrowers represented 8% of eligible account holders, they incurred 33% of overdraft items, 36% of NSF items, and 40% of debits by likely payday lenders. Further, when deposit advance was discontinued, borrower overdraft activity did not increase. These data all suggest that bank payday loans piled on top of other high-cost unaffordable credit rather than substituted for it. Moreover, deposit advance borrowers were seven times more likely to have their accounts charged off than non-borrowers.

This product was the subject of a Senate Aging Committee hearing, where Annette Smith, a widow who relied on Social Security for her income, testified.<sup>128</sup> Annette’s “direct deposit advance” for \$500 from Wells Fargo cost her nearly \$3,000. As the data above show, her experience was hardly an aberration.

At their peak, these loans—even with only six banks making them—drained roughly half a billion dollars from bank customers annually.<sup>129</sup> This cost does not include the severe broader harm that the payday loan debt trap has been shown to cause, including overdraft and non-sufficient funds fees, increased difficulty paying mortgages, rent, and other bills, loss of checking accounts, and bankruptcy. Payday lending has a particularly adverse impact on African Americans and Latinos. A disproportionate share of payday borrowers come from communities of color,<sup>130</sup> and bank payday loans that jeopardize their bank

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<sup>126</sup> Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 33-34, April 24, 2013, available at [http://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf).

<sup>127</sup> Rebecca Borné and Peter Smith, *Triple Digit Danger: Bank Payday Lending Persists* (March 21, 2013), Center for Responsible Lending, available at <http://www.responsiblelending.org/payday-lending/research-analysis/Triple-Digit-Bank-Payday-Loans.pdf>.

<sup>128</sup> [https://www.youtube.com/watch?time\\_continue=50&v=UG7B3L3oDN8](https://www.youtube.com/watch?time_continue=50&v=UG7B3L3oDN8).

<sup>129</sup> CFPB reports that the market was roughly \$6.5 billion in advances at its peak in 2013. CFPB Proposed Payday Rule, 81 Fed. Reg. 47884. Banks charged from \$7.50 to \$10.00 per \$100 borrowed, computing to a range of \$487.5 million (if every customer were charged \$7.50) to \$650 million (if every customer were charged \$10.00).

<sup>130</sup> For example, studies in California and Texas have both shown that African American and Latinos are far more likely to have been extended payday loans than the population as a whole. California Department of Corporations, “Payday Loan Study (Updated June 2008); Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008). This disproportionate share is even more significant because African Americans and Latinos are much less likely to have a checking account—a basic requirement for obtaining a payday loan. See also Robin Howarth, Delvin Davis, & Sarah Wolff, *Shark-Free Waters: States Are Better Off without Payday Lending*, Center for Responsible Lending (Aug. 2016), available at [http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl\\_shark\\_free\\_waters\\_aug2016.pdf](http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_shark_free_waters_aug2016.pdf) (payday lenders in Florida were more concentrated in majority black and Latino communities, even after controlling for income); Wei Li, Leslie Parrish, Keith Ernst, and Delvin Davis, *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California*, Center for Responsible Lending (March 26, 2009), available at: [30](http://www.responsiblelending.org/payday-lending/research-</a></p></div><div data-bbox=)

accounts can leave these communities even more disproportionately underserved by the banking mainstream.

Payday lending by banks was met by fierce opposition from virtually every sphere—the military community,<sup>131</sup> community organizations,<sup>132</sup> civil rights leaders,<sup>133</sup> faith leaders,<sup>134</sup> socially responsible investors,<sup>135</sup> state legislators,<sup>136</sup> and members of Congress.<sup>137</sup> Bank payday lending also motivated

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[analysis/predatory-profiling.pdf](#) (Payday lenders in California were found 2.4 times more concentrated in African American and Latino communities, *even after controlling for income and a variety of other factors*).

<sup>131</sup> See, e.g., Testimony of Steve Abbot, former President of the Navy-Marine Corps Relief Society, Before the U.S. Committee on Banking, Housing and Urban Affairs (Nov. 3, 2011) (noting bank payday loans among the “most egregious trends”); Comments of Michael Archer, Director of Military Legal Assistance, Marine Corps Installations East, to CFPB (April 4, 2012): “Most ominously, a few large banks have gotten into the business of payday loans through the artifice of calling the loans open ended credit,” <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0056>.

<sup>132</sup> Hundreds of groups urged the prudential regulators to stop banks from trapping borrowers in payday loans. Letters from approximately 250 groups to FDIC, OCC, FRB and CFPB, March 13, 2013 (<http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2013/03/Bank-Payday-Sign-On-Letter-3-13-13-Final.pdf>) and February 22, 2012 (<http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Dear-Regulators.pdf>). Thousands of individuals and many community groups filed comments with the OCC urging that Wells Fargo’s Community Reinvestment Act rating be negatively impacted because it makes payday loans. The comment filed by CRL and NCLC is available here: [http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment\\_wells-nov-29-2012\\_final.pdf](http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment_wells-nov-29-2012_final.pdf).

<sup>133</sup> See, e.g., Letter from Benjamin Todd Jealous, President and Chief Executive Officer, NAACP, to FDIC, OCC, FRB, and CFPB opposing bank payday lending (Feb. 21, 2013), *available at* <http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/NAACP-redatory-Pay-Day-Loans-to-regulators-BTJ.pdf>.

<sup>134</sup> See, e.g., Elaina Ramsey, Faith Groups Take On Payday Lenders, Sojourners, *available at* <https://sojo.net/magazine/stub/faith-groups-take-payday-lenders> (discussing a National Day of Action among faith leaders in early 2013 to address payday lending). In connection with this National Day of Action, Rev. DeForest B. Soaries, jointly with other nationally prominent African American ministers, called for “an end to usury, an end to 300% interest rates, and an end to enslavement to both payday lenders and the banks now offering equally dangerous products” in *An Emancipation Proclamation from Payday Lending*. Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns*, CRL Issue Brief, March 7, 2013, *available at* <http://www.responsiblelending.org/payday-lending/tools-resources/BPD-media-coverage-3-7-13.pdf>

<sup>135</sup> For proxy year 2013, investors filed shareholder resolutions with the four largest banks making payday loans expressing concern about the product and requesting data, which none of the banks agreed to provide. Wells Fargo (<http://www.onlineethicalinvestor.org/eidb/wc.dll?eidbproc~reso~10525>); Fifth Third Bank (<http://www.trilliuminvest.com/resolutions/payday-lending-fifth-third-bancorp-2013/>); Regions Bank; (<https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/dominisocial012513-14a8.pdf>); and U.S. Bank and U.S. Bank (<https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/congregationsisters011413-14a8.pdf>).

<sup>136</sup> See, e.g., “Legislative Black Caucus slams Regions Bank over payday-style loans,” Raleigh News and Observer “Under the Dome,” Oct. 11, 2012, *available at* <http://www.cashcowadvances.com/paydayblog/legislative-black-caucus-slams-regions-bank-over-payday-style-loans.html> (quoting letter from N.C. Senator Floyd McKissick, Jr., chairman of the N.C. Legislative Black Caucus, to Regions Bank, which stated: “We are deeply concerned about recent reports of Regions Bank offering its ‘Ready Advance’ payday loans in North Carolina . . . High-cost, short-

“move-your-money” campaigns.<sup>138</sup> It led groups managing programs aiming to bring people into the banking mainstream to establish policies that excluded banks making high-cost payday loans from the program.<sup>139</sup> And multiple lawsuits involving bank payday loans were filed.<sup>140</sup>

Recognizing the harm to consumers, regulators took action in 2013 to protect bank customers—the OCC and FDIC with their 2013 deposit advance guidance requiring an income-and-expense-based ability-to-repay determination, and the Federal Reserve with its supervisory statement, emphasizing the “significant consumer risks” bank payday lending poses. For the most part, the banks responded by suspending their payday loan products.

We were deeply discouraged by the OCC’s rescission of its deposit advance guidance in October 2017. We responded with an open letter, signed by more than 230 groups, urging banks to stay out of payday lending.<sup>141</sup> The OCC rationalized this rescission in part by noting that the Consumer Financial Protection Bureau’s finalization of its payday lending rule earlier that day subjected banks to potentially inconsistent regulation. But the CFPB’s rule and the deposit advance guidance are both necessary and are complimentary. Moreover, the CFPB has since publicly announced that it is reconsidering its rule,

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term balloon loans like these sharply increase the financial distress of families under economic strain”); Letter from Arizona Democratic Caucus to the prudential banking regulators, February 2012 (noting that Arizona “has spent countless state resources to study and understand the effects of [payday lending], and ultimately outlaw payday lending entirely” and calling on federal regulators to “take immediate action so that meaningful reforms taking place in Arizona and throughout the country in the name of consumer protection will not be undermined.”).

<sup>137</sup> In January 2013, several Senators wrote the FRB, OCC, and FDIC urging action to address bank payday lending (<http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-regulators-to-act-to-stop-abusive-bank-payday-lending>). In April 2013, House members did the same. For further documentation of opposition to bank payday lending, see Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns* at 10, CRL Issue Brief, March 7, 2013, available at <http://www.responsiblelending.org/payday-lending/tools-resources/BPD-media-coverage-3-7-13.pdf>.

<sup>138</sup> See, e.g., Green America’s “Break up with your mega bank” campaign focused on bank payday lending: <http://breakupwithyourmegabank.org/>. In addition, a 2012 North Carolina poll found that 93 percent of respondents were less likely to use a bank that makes payday loans that violate North Carolina law. North Carolina Justice Center, *Regions Bank Halts Illegal Payday Lending in North Carolina* (Jan. 16, 2013), available at <http://www.ncjustice-mail.org/?q=consumer-and-housing/media-release-regions-bank-halts-illegal-payday-lending-north-carolina> citing Public Policy Polling poll conducted on behalf of CRL, Sept. 2012).

<sup>139</sup> In 2012, “Bank On” Savannah (Ga.) adopted as policy that participating banks may not make deposit advance products in excess of 36% APR. Relatedly, Cities for Financial Empowerment, the organization that supports cities in implementing “Bank On” programs to bring people into the banking mainstream, wrote to the prudential regulators expressing serious concerns about bank deposit advance programs ([https://www.fdic.gov/regulations/laws/federal/2013/2013-deposit\\_advance\\_products-c\\_61.pdf](https://www.fdic.gov/regulations/laws/federal/2013/2013-deposit_advance_products-c_61.pdf)).

<sup>140</sup> For example, the following class action lawsuits were filed against Fifth Third Bank: *Klopfenstein v. Fifth Third Bank*, S.D. Ohio (Aug. 3, 2012); *Laskaris v. Fifth Third Bank*, S.D. Ca. (Feb. 12, 2013); *Jesse McQuillen v. Fifth Third Bank*, W.D. Ky. (May 7, 2013). Another was filed against Bank of Oklahoma and its affiliates (*Leland Small v. BOKF, N.A.*, 13-cv-01125), which resulted in a \$1.8 million settlement, <http://fastloansettlement.com/Home/FAQ>.

<sup>141</sup> <http://www.responsiblelending.org/research-publication/open-letter-banks-dont-make-debt-trap-payday-loans>.



and rescission of the deposit advance guidance could leave borrowers entirely unprotected from debt-trap lending by our nation's banks.

The OCC also noted that banks should offer more small-dollar credit because banks are more regulated than nonbank lenders and thus can do so at less risk to the consumer. The Treasury Department expressed the same notion in its fintech paper last month. But again, the data on bank payday loans simply left no question that bank payday loans were the same as those made by nonbank lenders—high-cost, unaffordable, debt-trap loans.

As noted above, no FDIC-supervised banks sold the deposit advance product. It would be a tragic step backward for the agency to signal that this product is acceptable by repealing this guidance and for banks to begin doing so now.

**IX. Address abusive overdraft fee programs, which undermine the effectiveness of any program aiming to help financially vulnerable members.**

Overdraft fees strip billions of dollars annually from struggling consumers, leaving them less able to save to weather shortfalls, more vulnerable to predatory promises of “short-term” loans, and generally financially worse off.<sup>142</sup> Thus, any bank program aiming to provide more vulnerable customers with responsible credit options en route to better financial stability will be far less effective when paired with a high-cost overdraft program.

Banks will have little incentive to offer affordable small dollar loans as long as they are making lucrative fees off of abusive overdraft programs. Banks will be afraid of “cannibalizing” their overdraft fee revenue if they give consumers a better option. The single most important thing the FDIC can do to encourage its banks to responsibly serve the small dollar credit needs of consumers is to curtail overdraft fee abuses.

The FDIC's 2010 overdraft guidance establishes important guardrails to help minimize damage from abusive overdraft programs, including by advising the fees not exceed six in twelve months. The agency should advise institutions that its expectation is that they adhere to this guideline. Further, we encourage the agency to advise that no overdraft fees be charged on debit card and ATM transactions, which the institution can decline at no charge to the customer when the account lacks sufficient funds.<sup>143</sup> These changes would go a long way toward making bank customers less vulnerable to payday loans and other predatory practices and would encourage banks to develop better ways to serve consumers.

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<sup>142</sup> See Center for Responsible Lending, *Broken Banking: How Overdraft Fees Harm Consumers and Discourage Responsible Banking Products* (May 24, 2016), available at <https://www.responsiblelending.org/media/broken-banking-overdraft-penalties-harm-consumers-discourage-responsible-products>.

<sup>143</sup> The FDIC's 2010 overdraft guidance and follow-up FAQs advise reasonable and proportional fees, no more than six in one year, and no posting of transactions in order from highest to lowest. Federal Deposit Insurance Corporation, Supervisory Guidance for Overdraft Protection Programs and Consumer Protection, FIL-81-2010 (Nov. 24, 2010).

**X. Support the CFPB Rule, which establishes common sense underwriting requirements on short-term loans very few banks make.**

The CFPB Rule represents a careful and logical approach to addressing the worst aspects of the payday loan debt trap. The payday loan debt trap hurts bank customers everywhere, driving people out of their checking accounts and exacerbating financial exclusion from the banking mainstream.

The rule simply requires some streamlined underwriting of income and expenses in order for lenders to make a high volume of payday loans to the same borrower. These underwriting requirements apply to loans repayable within 45 days (or longer loans if they have a large balloon payment)—products most banks don't offer anyway. The rule also (lamentably) allows up to six short-term loans a year even without any underwriting.

Notably, CFPB took significant steps between the proposed and final rule to further accommodate depositories' concerns. As the Independent Community Bankers Association noted when the rule was finalized, the rule exempts thousands of community banks by exempting any lender that makes 2,500 or fewer covered loans and derives no more than 10 percent of its revenue from such loans, which, as ICBA noted, "will enable community banks the flexibility to continue providing safe and sustainable small-dollar loans to the customers who need it most."<sup>144</sup>

**XI. Enumerated Questions Posed by RFI**

***Consumer Demand***

**1. To what extent is there an unmet consumer demand for small-dollar credit products offered by banks?** See discussion of the notion of "unmet demand" at Section II above.

**2. To what extent do banks currently offer small-dollar credit products to meet consumer demand?** See discussion at Section IV above.

**3. To what extent and in what ways do entities outside the banking sector currently satisfy the consumer demand for small-dollar credit products?** See discussion at Section IV above.

**4. What data, information, or other factors should the FDIC consider in assessing the consumer demand for small-dollar credit products?** See discussions at Sections II, III, and IV above.

***Benefits and Risks***

**5. What are the potential benefits and risks to banks associated with offering responsible, prudently underwritten small-dollar credit products?** Banks already offer a wide range of affordable small dollar products for those with capacity to repay; see discussion at Section IV above. Banks could benefit from expanding and promoting current offerings and expanding those that build capacity for those who lack it, such as secured credit cards and credit builder

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<sup>144</sup> <https://www.icba.org/news/press-releases/2017/10/05/icba-statement-on-cfpb-final-small-dollar-lending-rule/>

loans. Expansion into high-cost loans, including through rent-a-bank arrangements (see Section V) poses severe safety and soundness risk and should not be sanctioned or tolerated.

**6. What are the potential benefits and risks to consumers associated with bank-offered small-dollar credit products?** As discussed throughout our comments, consumers benefit from credit that is affordable and reasonably priced. They are harmed by loans they cannot afford, and by an erosion of responsible lending practices, including reasonable interest rates. Bank expansion into high-cost lending risks erosion of those rate limits for bank and nonbank loans alike.

**7. What are the key ways that banks offering small-dollar loan products should manage or mitigate risks for banks and risks for consumers?** Emphasis should be placed on expanding responsible offerings, including capacity-building products. Income-only-based underwriting or loans exceeding 36% APR carry risk that exceeds potential benefits.

**8. What are the potential benefits and risks related to banks partnering with third parties to offer small-dollar credit?** We support partnerships that enable banks and nonbanks to make affordable, responsible products for consumers in compliance with state law. We strongly oppose partnerships that result in nonbanks making high-cost loans that would be prohibited by state law but for the bank partnership. See discussion of rent-a-bank arrangements at Section V above.

**9. What steps could the FDIC take, consistent with its statutory authority, to encourage banks to develop and offer responsible, prudently underwritten small-dollar credit products?** The most important step the FDIC can take is to address abusive overdraft fee programs, which give banks little incentive to offer lower cost, better alternatives. (See Section IX.) The FDIC should focus on emphasizing that safety and soundness considerations require sound underwriting, programs that do not pose reputational risk, and sound lending practices.

### ***Challenges***

**10. Are there any legal, regulatory, or supervisory factors that prevent, restrict, discourage, or disincentivize banks from offering small-dollar credit products? If so, please explain.** Again, banks offer a range of responsible small dollar credit products. The single greatest deterrent to banks' expanding such offerings is abusive overdraft fee programs, which turn their customers' financial distress into a profit center which with a responsible small dollar loan program cannot compete. The single most effective credit-related change the FDIC could make for economic inclusion is to rein in these abusive programs. To the extent banks are discouraged from raising rates to offer high-cost, unaffordable loans, they are appropriately so.

**11. Are there any operational, economic, marketplace, or other factors that prevent, restrict, discourage, or disincentivize banks from offering small-dollar credit products? If so, please explain.** Banks often point to cost as a barrier to offering affordable small dollar loans to a broader swath of the credit spectrum. Again, overdraft fee programs are a great disincentive, as a productive small dollar loan program would cannibalize that revenue. But even still, banks should be able to underwrite in a streamlined manner more cheaply than virtually any other lender. Further, profitability should be more than an evaluation of product line-by-product line, quarter-by-quarter, or even year-by-year. Small dollar loans, especially credit building programs

which will not be highly profitable, can serve as long-term investments for banks, a gateway for customers who may cross over into more profitable products down the road.

**12. What factors may discourage consumers from seeking responsible, prudently underwritten small-dollar credit products offered by banks?** As discussed in Section III above, some consumers are appropriately discouraged from seeking additional credit from any lender because they simply lack additional credit capacity. Banks also typically do not broadly advertise the availability of smaller dollar loans or credit building products. Other consumers may be discouraged from seeking credit from a bank because they believe, correctly, that they would not qualify for a bank loan but could get credit from a payday or car title lender. That payday and car title lenders are willing and eager to make loans that borrowers do not have the capacity to repay does not mean banks should do the same.

That said, we are struck by the finding that over half of those new to credit, and a quarter of those with damaged credit, have never heard of a secured credit card.<sup>145</sup> This suggests that banks can and should do more to market the responsible offerings they do have.

### ***Product Features***

**13. Are there specific product features or characteristics of small-dollar loan products that are key to meeting the credit needs of consumers while maintaining prudent underwriting?** See Sections VI and VII above, on ability-to-repay and responsible pricing, respectively.

**14. Are there specific product features or characteristics that are key to ensuring the economic viability to a bank of responsible, prudently underwritten small-dollar credit products?** Banks have the ability to engage in streamlined cash flow underwriting, which should increasingly permit them to underwrite in a cost-effective manner. Banks should not rely on first-in-line access to the checking account in order to be repaid; this reliance promotes an interest in ability-to-collect over the borrower's ability-to-repay.

### ***Innovation***

**15. How can technology improve the ability of banks to offer responsible, prudently underwritten small-dollar loan products in a sustainable and cost-effective manner? Please specify the technology or technologies and the use case(s).** We support the assessment of inflows and outflows as a cost-effective method to determine ability-to-repay.

**16. Are there innovations that might enable banks to better assess the creditworthiness of potential small-dollar loan borrowers with limited or no credit records with a nationwide credit reporting agency?** Again, a bank's access to deposit activity provides it the ability to do this. For a new customer, a bank would need to review account activity from a prior institution or engage in more manual underwriting. Technology to analyze cashflow data is also

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<sup>145</sup> Center for Financial Services Innovation (CFSI), *The Secured Credit Card Pathway: Opportunities in Serving Key Demographics* (July 2017), [https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/07/06210343/2017\\_Secured-Credit-Card-Pathway\\_Serving-Key-Demographics\\_Full.pdf](https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/07/06210343/2017_Secured-Credit-Card-Pathway_Serving-Key-Demographics_Full.pdf).

increasingly being incorporated, with consumer permission, into credit scoring models at the credit reporting agencies.

**17. What role should the FDIC play, if any, in supporting innovations that enhance banks' abilities to offer responsible, prudently underwritten small-dollar loans? Are there specific barriers that prevent banks from implementing such technologies or innovations?** The FDIC should retain and enforce its third party guidance to ensure that bank partnerships are safe and sound, and it should reject rent-a-bank schemes with online "fintech" lenders, as discussed at Section V above. The FDIC could also highlight low-cost, responsible loan programs.

**18. How can technology be leveraged to improve consumers' experiences and reduce potential risks to consumers associated with small-dollar credit products?** There are many financially innovative companies doing innovative things that can improve consumer experiences in a host of ways. The key question for the FDIC is whether their banks are engaging, directly or through partnerships, in safe and sound practices, including sound underwriting and responsible pricing.

### ***Alternatives***

**19. What other products and services that supplement or complement small dollar credit offerings should banks consider? Are there other ways that banks can help consumers address cashflow imbalances, unexpected expenses, or income volatility besides small-dollar credit products?** As discussed in Section IV above, we encourage the FDIC to focus on encouraging products that build credit capacity, such as secured credit cards and credit builder loans.

### ***Other***

**20. Are there any distinguishing characteristics of particular institutions, such as a bank's size, complexity, or business model, that the FDIC should consider, and if so how?** We are sensitive to the reality that small institutions face different challenges than larger institutions. At the same time, our primary concerns—that loans be made based on ability-to-repay, that they not exceed 36% APR, and that partnerships not facilitate loans illegal under state law—are critical to consumer protection regardless of financial institution size or other factors. Moreover, technology – such as the ability to incorporate cashflow data, with consumer permission, into credit reporting agency credit scoring models – may make it easier for small banks to adopt such techniques.

**21. Please provide any other comments or information that would be useful for the FDIC to consider.** See conclusion below.

## **XII. Conclusion**

Any small dollar loan programs made or facilitated through a bank must be based on borrower's ability to repay and not exceed 36%, or, if made through a bank partnership, applicable state rate caps.

Bank involvement in unaffordable or high-cost lending is both a consumer protection and a safety and soundness concern. For consumers, it causes substantial harm. It also violates the basic safety and soundness principle of lending based on the borrower's ability to repay based on income and

obligations/expenses; it poses severe reputational risk, as evidenced by sweeping negative reaction; and it risks violation of consumer protection laws, which itself poses safety and soundness risk.<sup>146</sup> Ultimately, high-cost loans erode the assets of bank customers and, rather than promote savings, make checking accounts unsafe for already financially distressed customers.

High-cost loans made or facilitated by banks will not drive out even higher-cost lending by nonbank lenders. To the contrary, high-cost lending by banks will undermine the most effective measure against predatory lending, state interest rate limits.

We thus urge the FDIC to reject calls to explicitly authorize high-cost loans and to take every necessary step to prevent them. Instead, we encourage the agency to encourage banks to promote the responsible products they do offer and to focus on products that help build credit capacity.

We appreciate your consideration of our comments and would be happy to discuss them further.

Sincerely,

**Center for Responsible Lending  
National Consumer Law Center (on behalf of its low income clients)**

*joined by*

**Americans for Financial Reform Education Fund  
The Leadership Conference on Civil and Human Rights  
NAACP**

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<sup>146</sup> For further detail, see Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products*, January 24, 2013, available at <http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Safety-Soundness-BPD.pdf>.