Comments of
National Consumer Law Center
(on behalf of its low income clients)
to the
Federal Deposit Insurance Corporation
and
Office of the Comptroller of the Currency, Treasury
on
Proposed Guidance on Deposit Advance Products

FDIC: 78 Federal Register 25268 (April 30, 2013)
OCC: 78 Federal Register 25353 (April 30, 2013); Docket ID OCC 2013-0005

Thank you for the opportunity to comment on the proposed guidance on deposit advance products issued by the Federal Deposit Insurance Corp. (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the "agencies"). On behalf of our low income clients, the National Consumer Law Center[1] joins the longer comments submitted by the Center for Responsible Lending and a number of other groups in support of the guidance.

In these comments, we write separately to emphasize the importance of the agencies' guidance in preventing abusive credit products in connection with prepaid cards. While the agencies' guidance does not ban credit on prepaid cards, it does require sound underwriting that will discourage the abusive forms of credit that have sometimes been coupled with prepaid cards. Consequently, the proposed guidance is important both in its own right and as a step to ensure the safety of prepaid cards.

Overview

So-called "deposit advance product" are simply payday loans, with the same destructive attributes that are well documented for payday loans. Bank payday loans may have a slightly lower fee structure than traditional payday loans. But the ease of accessing the loans, and the veneer of a more traditional financial institution, can lead to even more borrowers being trapped in a cycle of debt, which may be even more persistent than with brick and mortar payday loans.

[1] Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. These comments were written by Lauren Saunders, managing attorney of NCLC's Washington, DC office.

Abusive deposit advance products have been coupled not only with bank accounts but also with prepaid cards. Although regulators have stopped many of those products, preventing them from re-emerging is important not only for the same reasons as for other bank payday loans, but also for two reasons unique to prepaid cards.

First, the inherent purpose of a prepaid card is to be "prepaid," a safe transaction account for those shut out of or harmed by traditional bank accounts or for others who have a need to control spending or make a safe payment. Bank payday loans can undermine the safety of prepaid cards and lead to unfair, deceptive and abusive practices. Second, state-regulated payday lenders can use prepaid card to evade state payday lending and usury laws. Deterring banks from developing abusive deposit advance products will help prevent those products from endangering prepaid cards and eviscerating state protections against predatory lending.[2]

Abusive Deposit Advance Products Have Been Coupled with Prepaid Cards

While credit on a prepaid card might sound like an oxymoron, there have been attempts in the past to offer deposit advance products on prepaid cards, and they have led to the same destructive cycle of debt as other deposit advance products. These products pose the same concerns that the OCC, FDIC and Consumer Financial Protection Bureau have described in connection with deposit advance products linked to traditional bank accounts.

A few years ago, the iAdvance line of credit was offered by Account Now on Netspend cards issued by Meta Bank.[3] The line of credit was modeled after the Wells Fargo account advance and cost $2.50 per $20 borrowed (or $12.50 per $100). This line of credit was a payday loan short and simple. It was an advance of pay or public benefits repayable in a lump sum in a short period of time at a triple digit annual rate. The only difference between this line of credit and a traditional payday loan was the slightly cheaper rate and a likely shorter repayment period (upon the next deposit, most likely in less than 14 days). These Netspend payday loans were offered on prepaid cards sold by payday lenders, online and by tax preparers. We believe that they were available to consumers throughout the country notwithstanding state usury or payday laws.

In 2010, the Office of Thrift Supervision shut down the Meta Bank iAdvance line of credit on the grounds that it was unfair or deceptive, and ordered the bank to pay restitution.[4] The OTS did not detail the basis for its action, but it appears to be based on the lack of underwriting, the unaffordable repayment structure, and the repeat usage and debt trap that are the inevitable result

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[2] For reasons explained at length in our comments last year to the Consumer Financial Protection Bureau, we do not believe that any credit product should be permitted to be coupled with a prepaid card. *See* Comments of the National Consumer Law Center, et al. to Consumer Financial Protection Bureau on Electronic Fund Transfers (Regulation E) (Rev. July 24, 2012) (hereinafter, "NCLC Prepaid Card Comments to CFPB"), available at http://www.nclc.org/images/pdf/rulemaking/cm-prepaid-card-july2012.pdf. Credit may be offered to prepaid card users, but only as a fully separate and independent credit account based on ability to repay and in full compliance with credit laws.

[3] See NCLC Prepaid Card Comments to CFPB at 4.

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

of the payday loan model. This is not surprising, given that the terms were modeled after the Wells Fargo deposit advance product, one that has prompted the agencies' guidance and was the subject of the CFPB's latest research.

Other banks have partnered directly with payday lenders. In 2010, Urban Trust Bank (UTB) began issuing a prepaid card with credit features, managed by Insight Card Services, through Community Choice Financial, Inc., which operates a chain of payday loan stores under the CheckSmart and other names. The very purpose of the card was to evade the Arizona usury cap that went into effect in 2010, and the card was later used to evade the payday laws of Ohio and other states. The prepaid cards carried optional overdraft "protection" that allowed purchases when the card was empty, at a cost of $0.15 for every $1 in negative balance (effectively a $15 per $100 payday loan). A separate credit feature added a "line of credit" purportedly at 36% APR but with a "courtesy transfer fee" of $3.50 per $28.50 in credit loaded onto the card (or effectively a $14 per $100 payday loan). The two loans had true annual rates of nearly 400% despite interest rate caps of 28% in Ohio and 36% in Arizona.

These loans had a structure similar to the deposit advance products described in the agencies' proposed guidance and the CFPB's report. The loans were single, balloon-payment loans, repayable upon the borrower's next direct deposit, with fees that equated to triple-digit APRs. UTB and its partners did little to no true underwriting for ability to repay. The loans relied merely on the bank's ability to seize incoming deposits in order to collect, with no regard for the consumer's ability to pay for necessities and expenses in the next month.

In the fall of 2012, acting in response to a letter from the National Consumer Law Center and other groups about the UTB prepaid card payday loans,[5] the OCC found "violations of law and regulations and unsafe and unsound banking practices."[6] The public terms of the Formal Agreement between the OCC and the bank did not directly require the bank to eliminate the credit features,[7] but those features disappeared shortly thereafter.[8]

Shortly after UTB ceased offering prepaid card payday loan products, another prepaid card company, Tandem Money, withdrew its prepaid card payday loan product, which was still in the beta testing stage and not yet available to the general public.[9] Tandem Money combined prepaid card payday loans with a purported savings feature. Borrowers were required to save $20 per month to be able to access the credit line, which claimed to lead to savings rather than borrowing over time. The Tandem Money product was promoted as a way of helping consumers wean themselves off credit and into savings, a goal that many share. However, the product contained a

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[5] Letter from NCLC et al. to Comptroller Thomas J. Curry (May 3, 2012), available at http://www.nclc.org/images/pdf/high_cost_small_loans/letter-checksmart-occ.pdf.

[6] Formal Agreement # 2012-190, available at www.occ.gov/static/enforcement-actions/ea2012-190.pdf; Letter from Thomas J. Curry to NCLC et al (Aug. 23, 2012), available at http://www.nclc.org/images/pdf/high_cost_small_loans/letter-occ-check-smart-urban-trust-bank.pdf.

[7] Formal Agreement # 2012-190, available at www.occ.gov/static/enforcement-actions/ea2012-190.pdf

[8] National Consumer Law Center, Press Release, Bank Halts Overdraft Fees on Payday Lender Prepaid Cards; Stops Use of Cards to Evade State Payday Laws (Feb. 1, 2013), available at http://www.nclc.org/images/pdf/pr-reports/pr-prepaid-paydayhalt-2013.pdf.

[9] National Consumer Law Center, Press Release, Prepaid Card Payday Loan/Savings Product Folds (Nov. 9, 2012), available at http://www.nclc.org/images/pdf/pr-reports/pr-tandem-money.pdf.

dangerous payday loan feature with fees of $8 to $10 per $100, for an annual percentage rate of 292% to 365% if repaid in 10 days. The loan also required mandatory electronic repayment off the top of the next direct deposit of wages or public benefits unless the consumer paid a $50 fee. In practice, the Tandem Money loans, for the few consumers who used them, led to the same cycle of debt as other bank payday loans.

We appreciate the fact that both the OCC and the Office of Thrift Supervision have taken supervisory action to stop payday loans offered by banks on prepaid cards. The fact that these agencies were compelled to act in such a decisive fashion illustrates the dangers of these products and supports the OCC's and FDIC's guidance for the market as a whole.

Individual enforcement actions and a "whack-a-mole" approach cannot by itself protect consumers. Prepaid card credit products will continue to emerge. Many commenters to the CFPB in connection with that agency's upcoming prepaid card rulemaking have expressed an interest in adding credit features to prepaid cards. Thus, guidance for the entire industry is important in order to eliminate the possibility of deposit advance products that lead to a cycle of debt.

Credit Products Undermine the Purpose and Safety of Prepaid cards

Coupling a prepaid card with a credit product leads to irresponsible forms of credit and undermines the safety of the prepaid card. The agencies' guidance, which requires responsible underwriting, is very important for prepaid cards.

Credit products that are coupled with prepaid cards are invariably harmful forms of credit, with the same features and dangers of the deposit advance products described by the OCC, FDIC and CFPB. The purpose of adding a credit feature to a prepaid card, rather than offering a stand-alone product, is to avoid underwriting for ability to repay, to ignore laws that regulate credit and make its price transparent, and to take advantage of the ability to seize the incoming deposit. The products usually have a single, balloon-payment structure in order to evade rules on conditioning credit on preauthorized electronic repayment or to fall within the "overdraft" loopholes in credit laws.

If banks or the third parties with whom they deal wish to offer credit products to prepaid card users, they are free to offer independent credit products such as credit cards or other traditional credit products based on ability to repay. Prepaid card credit products should not be used as a vehicle for offering irresponsible credit without underwriting and without regard for the cycle of debt to which those products can lead.

The very purpose of prepaid cards is to offer a safe transaction account that avoids the problems of overdraft fees and credit that have made bank accounts and credit cards unavailable to, or dangerous for, many consumers. "Prepaid" should mean prepaid. The prepaid nature of the cards is the essence of the product, the feature that is promoted and the factor that makes the card useful for their purpose. Permitting abusive credit products to be coupled with prepaid cards is unfair, deceptive and abusive.

Prepaid cards are overwhelmingly marketed to and used by a variety of vulnerable groups, including low income consumers, consumers with blemished credit histories, unbanked and underbanked consumers with limited access to traditional accounts, young consumers and students, undereducated consumers and public benefit recipients. These are the very consumers who struggle paycheck to paycheck and are susceptible to falling into a cycle of debt. Even for less vulnerable consumers, the very purpose of prepaid cards and the needs to which they are addressed and marketed is to control spending.

Prepaid card are routinely marketed as "no credit check needed." Any credit feature added to a product that is promoted as not requiring underwriting will by definition lead to credit without regard to ability to repay.

Credit on prepaid cards also evades laws that protect income and benefits needed for necessities. The creditor gets the first cut of a wage or benefit check, before food, rent or medicine, ignoring laws that protect that income from being assigned to repay a debt or garnished by a creditor.

The credit offered through overdraft and other immediate repayment products is deceptive and illusory. Overdraft protection is not needed where there are no checks that can overdraft. Prepaid card credit products create, rather than help with, shortfalls. Many consumers fall into a cycle of debt with no net increase in spending power and only added fees every month.

Funding a prepaid card program even in part through overdraft fees or credit features will undercut honest, up-front pricing for both prepaid cards and credit products. Back-end fees and predatory practices on prepaid cards will lead to an uneven playing field and a race to the bottom, undercutting providers who offer honest, up front prices. Payday loan products that are added onto prepaid cards also undermine the transparency of credit products. Fees for using the prepaid card are part of the cost of accessing credit but will not be considered to be part of the finance charge and will be difficult to evaluate.

For all of these reasons, credit should be kept completely separate from prepaid cards. While the agencies' guidance does not ban credit on prepaid cards, it does require sound underwriting that will discourage the forms of credit that have migrated to prepaid cards.

Deposit Advance Products on Prepaid Cards Can Be Used to Evade State Payday and Usury Laws

As described above, prepaid cards can be used by payday lenders and other nonbanks to evade state payday and usury laws. If unaffordable bank small dollar loans are permitted to continue, those loans will return to prepaid cards and will eviscerate state protections against predatory lending. These evasions happen in two ways.

First, the involvement of the bank in a prepaid card can lead to complicated issues of preemption and the applicability of state law. Prepaid cards are often partnerships between banks, nonbank program managers, and retail establishments. Entities that are not financial institutions may be the driving force behind a credit product: designing its terms, offering it to consumers, keeping much of the profits and, through various mechanisms, taking most of the credit risk. But because the card is issued by a bank and the credit may be initially extended by a bank, those nonbank entities will likely assert that the laws of the bank's home state – invariably, one that does not restrict credit terms – will control. Uncovering the facts and unwinding intricate relationships is difficult and contentious, and the treatment by a court is uncertain. For this reason, both state attorneys general and consumers may be reluctant to litigate the applicability of state law.

Second, credit offered on prepaid cards is often structured in complicated ways that mask the cost of credit. The credit may be offered as a purportedly open-end line of credit – as deposit advance products are – without any (or with a misleading) APR. Or, load fees like the "courtesy transfer fee," or other fees on the prepaid card, may be added that are not included in the disclosed APR in connection with the credit. In both instances, applying a state interest rate to the credit may be difficult.

The Proposed Guidance Will Deter Predatory Credit Products on Prepaid Cards

The proposed guidance does not directly address either the ability to offer credit on a prepaid card, or the means by which prepaid cards can be used to evade state credit laws. We have separately urged the CFPB to require credit products to be offered independently of prepaid cards. But unless and until that happens, the proposed guidance will help to keep prepaid cards safe. The agencies' emphasis in the guidance on ability to repay will undermine the essence of prepaid card credit products: predatory lending to consumers without regard to ability to repay.

Requiring banks to extend small dollar loans only to consumers who can afford to repay the loans will deter prepaid card credit products that evade state and federal laws regulating credit and predatory lending. Consequently, the proposed guidance is important both in its own right and as a step to ensure the safety of prepaid cards.

Thank you for the opportunity to submit these comments.

Yours very truly,

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(on behalf of its low income clients)