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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
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Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Proposed guidance on deposit advance products
Docket ID OCC-2013-0005

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the proposed guidance related to deposit advance products published by the Comptroller of the Currency[2] and the Federal Deposit Insurance Corporation[3] (Agencies) on April 30, 2013. The proposed guidance is intended to clarify the Agencies' application of principles of safe and sound banking practices and consumer protection in connection with deposit advance products.[4] The Agencies expect banks "to apply the principles set forth . . . to any deposit advance product they offer." Included are requirements to consider, review, and analyze customers' checking account activity and to limit access to six loans per year, one loan per month, with a minimum one-month cooling off period between loans.

ABA strongly encourages the Agencies to refrain from adopting the proposed guidance, as it will harm customers who value and appreciate deposit advance loans. The guidance as proposed would eliminate an important source of credit, particularly for customers who have limited access to other sources of credit. If the proposed guidance is adopted, these customers

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.
[2] 78 Fed Reg. 25353, April 30, 2013.
[3] 78 Fed. Reg. 25268 April 30, 2013.
[4] A deposit advance product is small-dollar, short term loan that a depository institution makes available to customers who have recurring deposits. Loans are repaid, for example, from proceeds of the next direct deposit, though other repayment methods are available.

will still need credit but will have to resort to more costly, less consumer-friendly alternatives. We also believe that a strong argument against adopting the proposed guidance is to comply with Congress' intent in creating the new Bureau of Consumer Financial Protection (Bureau), to avoid the proliferation of different rules for different banks and different financial institutions.

- Given the prescriptive, onerous nature of the "guidance" and the lack of options, the purpose of the proposed guidance appears to be elimination rather than improvement of the product. The net effect will be hardship for users of the product, who include those who are unqualified for mainstream products and who will have to resort to more expensive, harmful options or endure the sometimes harsh consequences of lack of funds.

- The proposed guidance will chill innovation to develop or offer products for those who want and use such products, including those ineligible for mainstream credit products. Notwithstanding the Agencies' claims that it continues to support affordable small dollar loans, the message is that any product designed for this type of customer is suspect and should be avoided.

- Using a "safety and soundness" argument to justify the prudential regulators' imposition of consumer protection rules sets a precedent inconsistent with the intentions of the Congressional decision in creating the consumer Bureau: to have consumer regulation designed by a specialized federal agency, and one that can provide a single rule for the same product, regardless of the company offering the product, and thereby achieve a level playing field among competitors. Under the Agencies' articulated standard, ***all*** bank consumer financial products could be subject to competing rules of the Bureau and the prudential regulators.

- Any future guidance based on supervisory authority should be issued on an interagency basis, founded on well-substantiated and supported authority that includes an understanding of the market and the customers choosing these products. Any guidance should continue to allow banks to offer the products by providing a flexible, non-prescriptive approach that permits options and innovations, while identifying areas of concern such as those related to underwriting and credit management.

Background.

The proposed guidance attempts to address the Agencies' concerns with regard to deposit advance products, which are offered by a small number of banks and are distinct from overdraft protection products. The products offer customers a small amount of credit that is usually repaid automatically from a recurring direct deposit such as payroll. While individual products vary, the amount advanced is limited to the lesser of a cap (typically $500) or a percentage of the average recurring payment (e.g., 50 percent). Programs usually charge a fee based on the amount advanced (e.g., $7.50 or $10 per $100 borrowed). To help protect users against overuse and getting into a cycle of debt, programs also typically limit consecutive use and impose a "cooling-off" period that requires a break from use before the customer may again access the credit. Notably, these products are designed as "open-end" products that allow customers to take the allowable amount in increments so that they can access funds as needed and not pay to borrow money they do not need. Some banks also offer customers the option to repay in installments under certain circumstances.

Direct advance products are attractive to people who lack sufficient funds to cover emergencies and unexpected or temporary income reductions or are faced with other short-term funding needs. Many users do not qualify for other flexible, less expensive credit products, such as credit cards, because they have had trouble managing those products in the past or have ended up with sizable debts that strained their finances. Many prefer these products to installment loans, because they offer more control. The deposit advance amount borrowed is typically small and must be paid automatically and quickly. In contrast, larger installment loans can present temptations to borrow more than is needed and spend more, and the longer repayment period can become a temptation not to make a payment on a loan that has already been spent. These products also satisfy customer demand for speed, convenience, and anonymity.

In the Bureau's White Paper of Initial Data Findings on "Payday Loans and Deposit Advance Products," released April 21, 2013, the Bureau found that the median size of an individual advance was $180, and the median average daily balance of all advance balance episodes $343.[5] It found that the average annual amount users deposit into their checking account (which excludes any deductions for taxes, Social Security, Medicare, health care costs, and other items, if applicable) to be $43,600 and the median just under $36,000.[6] Banks offering the product usually do not actively market the product and warn customers that it is expensive, that they should inquire about less expensive options, and that they should use it sparingly and for emergencies.

The Center for Financial Services Innovation (CFSI) in its August 2012 report found a high rate of satisfaction among users of deposit advance loans, with 94 percent saying they would use the product again, a majority without hesitation. It also reported that on a scale of 1 (not satisfied) to 5 (very satisfied) ninety percent ranked deposit advance loans a 3 or above.[7]

Summary of proposal.

The proposed guidance is intended to ensure that banks offering deposit advance do so in a safe and sound manner and do not engage in practices that would increase credit, compliance, legal, and reputation risk to the institution. Safety and soundness risks are enumerated as:

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5 Consumer Financial Protection Bureau. "Payday Loans and Deposit Advance Products: a White Paper of Initial Data Findings." April 2013. p. 27.

6 *Ibid.,* p. 28 (To illustrate gross pay, assuming the person is a single person with one exemption, and a Washington, DC resident, the gross income would be $62,300 and $49,400 respectively).

7 Levy, Rob, and Joshua Sledge. "A Complex Portrait: An Examination of Small-Dollar Credit Consumers." *Center for Financial Services Innovation,* August 2012. p. 21.

- Credit risk;
- Reputation risk from “negative news coverage and public scrutiny” which can cause a bank “to lose community support and business”;
- Legal risk; and
- Third-party risk if a vendor is involved, which may increase legal, operational, and reputation risks.

The proposed guidance then outlines supervisory expectations for—

1. Credit quality, including underwriting policies and practices;
2. Adequacy of capital;
3. Reliance on fee income;
4. Adequacy of the allowance for loan and lease losses; and
5. Compliance with applicable federal consumer protection statutes, management’s oversight, and relationships with third-parties.

Underwriting criteria must be designed to “assure” that loans can be repaid while allowing the borrower “to continue to meet typical recurring and other necessary expenses such as food, housing, transportation and healthcare as well as other outstanding debt obligations.” The assessment should include an analysis of the customer’s checking deposits and withdrawals. Customers are limited to six loans per year. They may obtain one loan per month and must wait at least one month in between loans.

The proposed guidance appears intended to eliminate the product rather than improve it and harms the people it is intended to help.

The proposed guidance imposes significant and burdensome underwriting requirements not required for other loans that include mandatory cooling-off periods, an analysis of checking account transactions, and determination of whether the bank believes an installment repayment is “more appropriate.” In addition, banks must re-evaluate the customer’s eligibility every six months. The prescriptions will increase costs, and therefore prices and availability, and reduce competition. In short, the proposed guidance will harm users of these products.

The underwriting standard proposed is onerous and stricter than for other loans and increases prices and reduces options for customers. The proposed guidance imposes onerous and unworkable burdens that will discourage if not effectively prohibit banks under the Agencies’ jurisdiction from offering direct deposit advances, reducing competition and leaving those who use and value the product with fewer and potentially more expensive and less consumer-friendly options. The consumer need for the products will not disappear, but options will and the preferences of users of the products will be frustrated.

Specifically, under the proposed guidance to determine the financial capacity of the customer banks must:

- Analyze “the customer’s account for recurring deposits (inflows) and checks/credit/customer withdrawals (outflows) over at least six consecutive months . . . In reviewing the customers’ transactions to determine deposit advance eligibility, the bank should consider the customers’ net surplus or deficit at the end of each of the preceding six months, and not rely on a six-month transaction average.”

- After conducting the above described analysis, determine whether an installment repayment is more appropriate.

- Consider the customer’s ability to repay a loan without needing to borrow repeatedly from any source, including re-borrowing, to meet necessary expenses.

Eligibility criteria must be:

- Designed to ensure that the loan can be repaid “while allowing the borrower to continue to meet typical recurring and other necessary expenses such as food, housing, transportation and healthcare as well as other outstanding debt obligations.”

- Prevent churning and prolonged use of these products.

These requirements are unnecessarily burdensome, will put banks at a competitive disadvantage, ignore the needs and financial management characteristics of the users of these products, and go beyond underwriting requirements for other, larger loans that pose greater credit risk to the bank and debt management risk to the borrower.

Requirement to analyze checking account transaction patterns. For example, the requirement to analyze checking account transaction patterns and details is unnecessarily costly, not particularly useful in gauging the customer’s capacity to repay, and uncomfortably intrusive to customers.

- First, outflows are not indicative of obligations, but include discretionary transactions that vary depending on changes in priorities, expectations, opportunities, and other factors. The bank, for example, cannot know the nature of a transaction, whether it is an emergency, essential, or discretionary expense.

- Second, the proposed guidance requires banks to review the net surplus or deficit for every month and prohibits using a six-month average, which ignores the reality that some people’s inflows and outflows are not regular and that they manage their finances on something other than a monthly timeframe.

- Third, the inflows and outflows of a checking account do not take into account other resources the customer may have. Indeed, the CFSI found that 35 percent of users of small dollar credit had savings, and of those with savings, 55 percent (or 19 percent of all small dollar credit consumers) left their savings untouched.[8]

- Finally, the expectation of how closely banks are expected to analyze—and judge—the spending decisions and habits of their customers is not clear.

The requirement is costly and likely to increase prices or limit covered banks' ability to offer these products, leaving borrowers with fewer, more costly, and less consumer-friendly options.

Requirement that the underwriting criteria be consistent with criteria used for other credit products. The proposed guidance also states that eligibility and underwriting criteria for deposit advance products should be consistent with eligibility and underwriting criteria for other bank loans,[9] but then proceeds to impose a much stricter, more costly underwriting requirement on deposit advance products even though they may pose less risk of loss to the bank given the average amount borrowed. The effect will be to eliminate banks' ability to offer the product and increase their costs, which will be reflected in the availability and price, depriving borrowers of choice and/or increasing what customers must pay.

Banks and other lenders generally do not analyze the checking account activity of borrowers, as the proposed guidance requires, even when they maintain the customer's checking account. In addition, when analyzing income, lenders rely on gross income, not adjusted income as the proposed guidance does, when determining a borrower's ability to repay and base the loan decision and amount on a percentage of the gross income. This is a longstanding standard accepted by regulators.

Another new element to the underwriting process is the expectation that banks specifically consider the healthcare, transportation, and other specific expenses of customers. Banks may inquire generally about expenses or make general assumptions about expenses based on income, but usually do not require applicants to provide the detail the proposed guidance suggests. For example, while banks may (under certain circumstances) inquire about healthcare costs, they typically do not, as it can raise compliance risks related to limitations on the consideration of medical information. Moreover, many people's healthcare costs may be deducted from payroll so would already be reflected in the recurring direct deposit. The Agencies do not explain the reason for the need to obtain more granular information about the borrowers' expenses that banks usually do not obtain for other, larger consumer loans.

The Agencies have not articulated the reasons for applying to direct advance products a new, stricter, more costly underwriting standard nor offer proof of its efficacy. However, the result will be higher customer costs and/or fewer options.

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[8] *Ibid.,* p. 14.

[9] It is not clear how this requirement is reconciled with the FDIC's Affordable Small-Dollar Loan Guidelines which provide, "Given the small-dollar amounts of each individual loan, documenting the borrower's ability to repay could be streamlined significantly for existing customers and may only need to include very basic information, such as proof of recurring income."

Requirement that the bank determine whether an installment repayment is more appropriate. After the transaction analysis, banks are expected to determine whether an installment repayment is "more appropriate." Some banks offering direct advance products have experimented with an installment feature, and we believe they may be useful to some customers as a single large payment may increase the risk of having to borrow again. However, the Agencies should also recognize that some users of direct advance products specifically do not want an installment loan and that the installment option may *increase* the risk of nonpayment.

Some users of deposit advance loans prefer the single payment option. While a single large payment may be more difficult to repay in some cases, some customers understand that if payments are extended out over a longer period, notwithstanding good intentions to repay, they are likely to find reasons to use the money for other purposes, face other claims on their resources, pay late or default on the loan, or otherwise be subject to the risks and vicissitudes of time. As Sheila Bair reported in "Low-Cost Payday Loans: Opportunities and Obstacles":

> Interviews with depository institution officials offering payday alternatives suggest that many of their customers also like the certainty and finite nature of a near-term, single repayment. These customers have difficulty managing money; thus a series of monthly payments may be more challenging for them than a single payment. If they are unsuccessful in managing multiple installment payments, they can incur significant late fees. [10]

In addition, while some banks have found that an installment option may be feasible, the feature may *increase* the risk of nonpayment: the products rely for repayment on the likelihood of recurring deposits, but recurring deposits may disappear if the customer loses or changes a job, redirects the deposit to another bank, or changes to an alternative payment method like a check. The longer a loan is outstanding, the greater the risk that obstacles to repayment will arise.

While we believe that installment options can be permissible elements of a deposit advance loan program, and some banks have experimented with this option, the Agencies should recognize that they are not necessarily the only or best choice of the user and may increase costs given the increased risk. A requirement that banks (not their customers) judge whether an installment repay is "more appropriate" may create a supervisory expectation to convert to installment payments and raise bank fears of being second-guessed by a regulator. The perceived mandatory installment option may put upward pressure on the price of the product and/or discourage banks from offering the product. Customers who do not want an installment plan may go elsewhere. The reduction in competition will further limit customer choices. For these reasons, banks and their customers should continue to have flexibility in the use and availability of installment repayment options.

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[10] Bair, Sheila. "Low-Cost Payday Loans: Opportunities and Obstacles." June 2005. p. 31.

Cooling-off period. The cooling-off provisions will also harm consumers and discourage banks from offering these products and are fundamentally inconsistent with an open-end line of credit product. Under the proposal, advance loans are limited to six per year. All advances must be repaid in full before the extension of a subsequent loan, and the customer is not allowed another advance until one month after the repayment of the previous loan.

While banks offering deposit advance products have adopted cooling-off periods and continue to adjust them based on customer and regulator feed-back, the proposed limitations appear arbitrary and not responsive to the preferences and needs of the customer. The Agencies offer no data to support how this particular cooling-off schedule helps customers avoid repeated borrowing or otherwise helps them. In fact, there are negative consequences for customers. Under this schedule, customers are encouraged to take the maximum advance in each month when it is available, whether or not they want or need it at the time, just to be sure that they have financial liquidity during a "cooling off" period. This increases customer costs and promotes over-borrowing. For example, assume the customer may borrow up to $500 per month, pay $10 per $100, and borrow in $20 increments as needed. If the proposed guidance is adopted, knowing they can only take one loan in a given month, customers will be encouraged and likely to borrow the full $500 just in case they need it later in the month. Similarly, they may take the advance in a month that they don't need it. Knowing they cannot take an advance two months in a row, they take it each month it is available. They then pay for the additional amount borrowed, which they may or may not need. These customers are then more likely to spend the money, which they might not have done if they had had the option to obtain smaller or consecutive advances.

In turn, there is no evidence offered in the proposal to demonstrate how this compelled cooling-off period, or the likely behavioral response of customers to it, will translate to a change in the deposit advance product's impact on the *bank's* safety and soundness, the grounds for the proposed guidance by the Agencies.

In addition, customers may turn to other lenders, like payday lenders, during the cooling-off period. Under the proposed guidance's requirement that banks review other obligations, the customer could then become ineligible for direct advance products from a bank so would permanently rely on the alternative lender not subject to the Agencies' rules.

Not only is this proposed cooling-off not beneficial to customers, it is unnecessary in light of the underwriting provisions of the proposed guidance. The proposed guidance requires banks to subject advance products to the same underwriting standards of other loans, plus, unlike other loans, review deposit account patterns to determine surpluses and deficits. *Why is it necessary to provide any cooling-off period if the customer has demonstrated an ability to repay under standards that are stricter than those used for other loans?* It only increases what customers pay, limits their options in managing their money, and reduces competition by making it more difficult for banks to offer these unique, short-term, small-dollar credit accounts.

The eligibility re-evaluation requirement will harm customers by increasing costs and prices. Another proposed provision that harms customers and adds burdens that make it difficult to offer a deposit advance product without increased cost is the requirement that banks reevaluate the customer's eligibility at least every six months. Reevaluation includes pulling a credit report and reviewing overdrafts and "evidence that the borrower is overextended with respect to total credit obligations."

Pulling a credit report every six months may reduce some customers' credit scores due to multiple inquiries, especially harsh for customers who already may be in the lower end of credit score ranges. It is also not clear whether banks may rely solely on credit reports to determine other credit obligations or have to take additional steps. If a bank must take additional steps, those steps, when aggregated with the other obligations including the cost of regularly pulling credit reports, increase the cost of providing the product so that either prices increase or banks limit availability or even discontinue the product, none of which benefit customers.

In sum, the proposed guidance harms users of the products, including those who are ineligible for mainstream products, by increasing their prices and reducing their options. Banks will find it more difficult and more expensive to offer small dollar loans to this segment of their customers. Competition, which puts downward pressure on prices and encourages consumer protection features and other terms attractive to users, will be reduced. Customers will resort to more expensive, less consumer-friendly alternatives not subject to the guidance.

The proposed guidance will have a significant chilling effect on innovation and experimentation in trying to design appropriate small dollar short-term credit for people who do not manage well or qualify for mainstream credit products, contrary to the Agencies' message to develop products for this market.

While the Agencies and examiners may intend to target only a single product for the prescriptive requirements of the proposed guidance, their "guidance" will necessarily and prudently be interpreted to apply to all small-dollar loan design efforts. The parallels between the customer characteristics and challenges being addressed between direct deposit advances and any other small dollar loan products are obvious. There is simply too much regulatory risk for a bank to invest in a small-dollar loan product designed for those ineligible for mainstream credit, a product that regulators and examiners subsequently could second-guess and in effect shut down. By definition, these particular customers need different and flexible underwriting standards and access and repayment structures. However, the underlying message of the proposed guidance is that banks that offer different and flexible alternatives risk supervisory and regulatory criticism. The guidance promotes rigid uniformity designed away from the actual markets and direct needs of the customers.

This underlying message to avoid products designed for those with deficient credit history applies equally to the FDIC's small-dollar loan model envisioned in its 2007 Affordable Small-Dollar Loan Guidelines. The FDIC model considers that "given the small-dollar amounts of each individual loan, documenting the borrower's ability to repay should be streamlined significantly for existing customers and *may only need to include very basic information, such as proof of recurring income.*" (Emphasis added.)[11] Yet, it appears that such streamlined underwriting is inconsistent with the proposed guidance, as it requires that underwriting standards be consistent with standards applied to other loans and, *in addition*, that banks analyze deposit account patterns for determining continued eligibility. While some features of the FDIC model and typical deposit advance loan vary, it is not clear how or why the FDIC model would be exempt from the Agencies' proposed guidance. Certainly, it would be risky for banks to speculate and proceed with advancing any small dollar loan program under these circumstances.

The subjective criteria of the FDIC's Affordable Small-Dollar Loan Guidelines coupled with the proposed guidance will also now present obstacles in developing any small-dollar loan product. Absent the proposed guidance, banks may feel comfortable interpreting the subjective criteria from a supervisory risk perspective. However, the proposed guidance puts a different light on how to interpret the FDIC's Affordable Small-Dollar Guidelines' criteria and the FDIC's expectations. Subjective provisions such as "credit that is both reasonably priced and profitable," "repaid in affordable installments within a specified period," "credit . . . that offers borrowers a meaningful opportunity to repay based on their circumstances" have to be viewed with much more caution in light of the proposed guidance.

The FDIC's Affordable Small-Dollar Loan Guidelines also provide that "safe and sound small-dollar lending programs that comply with consumer protection laws will not be criticized by FDIC examiners." Given the proposed guidance, it is not clear what would be considered a "safe and sound small-dollar program," and when banks offering small-dollar loans can expect supervisory criticism.

Indeed, the FDIC understood and acknowledged banker fear of supervisory criticism for offering small-dollar loans when developing its FDIC pilot project for affordable small-dollar loans. A Memorandum dated May 30, 2007, from FDIC staff to the FDIC Board of Directors notes the reluctance of many bankers to expand or implement small-dollar loan programs because of concerns about perceived regulatory hostility, potential reputation risk, and skepticism over the business case for such programs.[12] The proposed guidance will not allay those fears.

Many banks will determine that, in light of the proposed guidance, offering even a small-dollar loan based on the FDIC model is too great, especially as the FDIC's recommended Affordable Small-Dollar Loan model has had other challenges, not the least of which is its cost structure for banks. The FDIC states in the proposed guidance that its case study found that affordable small-dollar lending is "feasible" for banks. However, "feasible" is not necessarily profitable. In fact, the FDIC's report on its Small-Dollar Loan Pilot Program remarked that banks

[11] Federal Deposit Insurance Corporation. "Affordable Small-Dollar Loan Guidelines." June 2007.

[12] Memorandum to Board of Directors: Michael H. Krimminger and Sandra L. Thompson. "FDIC Pilot Project for Affordable Small-Dollar Loans." May 30, 2007. p.3.

in the pilot program found that "the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products."[13] Thus, it appears that, to be profitable, the products rely on increased volume (including repeated use) and the hope that cross-selling other products to this customer base will make up for the losses. Indeed, a few banks in the pilot "focused exclusively on building goodwill and generating an opportunity for favorable Community Reinvestment Act considerations,"[14] apparently not expecting the product to be profitable. Short-term profitability was the primary goal only for a few pilot bankers.[15]

The meeting of the FDIC Advisory Committee on Economic Inclusion held June 24, 2010 similarly reported that such loans were not profitable. The CEO of one bank in the pilot, while enthusiastic about the program, "emphasized the importance of identifying alternative revenue sources to offset the higher costs of providing such loans."[16] Ms. Rae Anne Miller, from the FDIC, in reporting on the question of whether banks can profitably offer small dollar loans, offered no conclusion that the product could be profitable and instead focused on other aspects of the pilot.[17] In summarizing recommended incentives for banks to offer small-dollar loans, she included "loss sharing in the form of guarantees to offset loan losses" and Community Reinvestment Act credit,[18] strongly suggesting that profit is not anticipated for these loans.

More recently, a California thrift recently shut down its small-dollar loan program, a program modeled on the FDIC Affordable Small-Dollar Loan Guidelines. The CEO of the thrift was quoted as saying in the *American Banker* that the reason for discontinuing the program was that it "lost too much money."[19] Depending on the institution's goal and how it measures costs, for example, there may be institutions offering "successful" small dollar loans. However, there are clearly significant challenges which will be exacerbated by the proposed guidance.

In addition, from a supervisory risk perspective, given the proposed guidance, the FDIC small-dollar loan model may be the safest choice from the bank offering the product, but not necessarily the best choice for many of the intended customers. In effect, rather than encouraging innovation and experimentation, the government model becomes the only option, even though it does not appeal to or fit the needs of many customers seeking small-dollar loans, and it is likely to be unprofitable, especially in light of the proposed guidance.

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13 Federal Deposit Insurance Corporation. "A Template for Success: the FDIC's Small-Dollar Loan Pilot Program." *FDIC Quarterly,* Vol. 4, No. 2; 2010. p. 32.

14 *Ibid.*

15 *Ibid.*

16 Federal Deposit Insurance Corporation. "Minutes of the Meeting of the FDIC Advisory Committee on Economic Inclusion." June 24, 2010. p. 116.

17 *Ibid.,* p. 114.

18 *Ibid.,* p. 117.

19 See "California Thrift's Woes Show Challenges Competing with Payday Lenders," May 2013.

In effect, the proposed guidance will punish banks that innovate or experiment in developing bank products, in particular those designed for people ineligible for mainstream credit. The proposed guidance discourages banks from developing and offering products designed for this market segment, including a loan program based on the FDIC's own Affordable Small-Dollar Model. Customers in this segment will have fewer choices and less convenience and resort to more expensive, less consumer-friendly alternatives.

The Agencies' claim that the products pose safety and soundness concerns is a fiction, representing a thinly disguised attempt to regulate consumer products that will lead to multiple, competing rules for the same product and an unlevel playing field, contrary to the purpose in creating the Bureau.

The Agencies have not articulated a safety and soundness rationale. The Agencies justify their proposed guidance to regulate deposit advance products on the basis of safety and soundness. The Federal Reserve Board, however, while it released a statement about consumer risks associated with deposit advance products, notably declined to assert a link between safety and soundness and deposit accounts.

The Agencies explain that the safety and soundness risk is related to the credit risk, reputation risk, legal risk, and third-party risk of offering such products. For reasons similar to those discussed in our earlier August 2011 letter regarding direct advance products and overdraft protection programs, the Agencies' argument lacks credibility and sets a precedent for the adoption of multiple competing rules and variations in rules based on the type of institution, thwarting one of the primary goals in creating the Bureau.

As discussed in our August 2011 letter, while the Agencies have "broad authority to define and eliminate unsafe and unsound conduct, it is well-established that conduct considered to be unsafe and unsound is 'conduct deemed contrary to accepted standards of banking operations which might result in *abnormal risk or loss* to a banking institution or shareholder'[20] (Emphasis added)." The Agencies, however, have not demonstrated how deposit advance products present an "abnormal risk" to a bank.

The Agencies assert that deposit advance products raise "credit risks" because lenders do not consider whether the income sources are adequate to repay the debt "while covering typical living expenses, other debt payments, and the borrower's credit history" and that "numerous and repeated extensions of credit to the same individual may be substantially similar to continuous advances and subject the bank to increased credit risk." However, to raise a credible safety and soundness concern that might result in abnormal risk or loss to the bank, a bank offering this product would have to be highly concentrated in and receive a high percentage of its income from this product. Otherwise, even if there is a credit risk associated

[20] See *Cavallari v. OCC*, 57 F.3d 137(2nd Cir. 1995); *Sinclair V. Hawke*, 314 F. 3d 934 (8th Cir. 1978); See also *The Director's Book: The Role of a National Bank Director*.

with the product, the risk is insufficient to rise to the level of threatening profitability let alone safety and soundness. The Agencies have not offered any data showing that banks offering the product are highly concentrated in and reliant on these products or that their concern is limited to banks with high concentrations of these loans.

In addition, the Agencies have not shown that these loans present a notable credit risk. Banks can and do make reliable predictions of likelihood of repayment based on current standards and actual experience. That the eligibility criteria and underwriting are not identical to those of other products is a reflection of the customer using the product rather than inadequate underwriting. Moreover, the price will also reflect any higher credit and loss risk. Further, banks offering these products have an incentive to manage and monitor them, because, contrary to mortgages, for example, these loans are not sold to a secondary market, and the banks must consider the continuing long-term deposit-account relationship. Finally, as discussed later, the Agencies have not demonstrated why and how the proposed prescriptive and burdensome underwriting criteria address any shortcomings in the existing practices.

In addition to credit risk, the Agencies assert that the product raises reputation risk, which "is the risk arising from negative public opinion." They explain:

> Deposit advance products are receiving significant levels of negative news coverage and public scrutiny. This increased scrutiny includes reports of high fees and borrowers taking out multiple advances to cover prior advances and everyday expenses. Engaging in practices that are perceived to be unfair or detrimental to the customer can cause a bank to lose community support and business.[21]

This is a less than rigorous analysis of reputation risk and invites a poor precedent for invoking safety and soundness authority. On this basis, it is difficult to imagine ***any*** bank product that would not be subject to a safety and soundness concern and therefore subject to additional or competing rules from the Bureau and the various prudential regulators. Many other bank products, e.g. prepaid cards, credit cards, checking accounts, mortgages, home equity loans, student loans, have received "significant levels of negative news coverage" at one time or another, including complaints about high fees and using credit for "everyday expenses." However, while there have at times been regulatory efforts to make adjustments to those products' specific practices, there has been no effort to so closely design the products, define their terms in such detail, or eliminate them altogether through prescriptive rules as the proposed guidance will do.

Deposit advance products have been available for years. One large bank has offered its product for 18 years. Others have offered it for five or six years. Many made adjustments to the product to address concerns raised by the regulators, consumer groups, and media, as well as to meet customer needs better. If there were to be a reputation risk that even remotely

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[21] 78 Fed. Reg. 25355; 78 Fed. Reg. 25270

threatened safety and soundness, it would be apparent and have had consequences by now. Such reputation risk has not materialized.

The Agencies do not offer any details about the negative news coverage or public scrutiny, but users of the loans offer positive responses. As noted, the CFSI found in its August 2012 report that "a majority of users of direct deposit advance products would use the product again without hesitation, compared to only 5% of borrowers who said they would not use it in the future."[22] It also reported that on a scale of 1 (not satisfied) to 5 (very satisfied) ninety percent ranked deposit advance loans a 3 or above.[23]

In addition, the Bureau in its recent "White Paper of Initial Data Findings on Payday Loans and Deposit Advance Products" acknowledges that at its field hearing and in response to a subsequent request for information, "consumers provided favorable response about the speed at which these loans are given, the availability of these loans for some consumers who may not qualify for other credit products, and consumers' ability to use these loans as a way to avoid overdrawing a deposit account or paying a bill late."[24] The white paper also notes that "consumers" also raised concerns about deposit advance products.[25] However, no *user* of deposit advance loans spoke negatively about them or submitted complaints to the Bureau in response to its request for information about direct deposit loans.

Furthermore, banks offering direct advance products report that they get few complaints, and that most of them are complaints about being denied access to the product, e.g., during a cooling-off period. One bank reports that 96 percent of respondents in its 2012 survey of customers using the product in 2011 ranked the product satisfactory or higher.

Nor do these products present legal risks different from any other bank product, either from private lawsuits or regulatory enforcement actions. Most state unfair or deceptive acts and practices laws do not permit a private right of action, and Agencies and other bank regulators themselves examine banks to ensure they comply with the federal consumer financial protection laws listed in the proposed guidance.

The safety and soundness rationale will lead to a patchwork of overlapping regulations and an unlevel playing field, contrary to the goal in establishing the Bureau. One of the primary purposes in creating the Bureau was establishment of a single, uniform regulatory scheme for consumer financial products. As we discussed in our August 2011 letter:

> From the Obama administration's initial white paper announcing its plan for restructuring federal and state regulation and supervision of the financial services industry, a foundational principle was the recognition that "fairness,

22 Levy, o*p. cit.,* p. 20.
23 *Ibid.,* p. 21.
24 Consumer Financial Protection Bureau, o*p. cit.,* p. 3.
25 *Ibid.*

effective competition, and efficient markets require consistent regulatory treatment for similar products."[26] Accordingly, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA) created the Consumer Financial Protection Bureau (CFPB) and granted its director exclusive rule-writing authority for an enumerated list of consumer financial protection laws.

Elizabeth Warren echoed that sentiment when setting up the Bureau in 2011. “Thanks to this new law, for the first time ever, critical consumer financial protection activities performed by seven different agencies will be consolidated into one agency, closing gaps in oversight.[27]

The Agencies independent proposed guidance, as we explained in our August 2011 letter, is inconsistent with that goal:

> The goal of consistent regulatory treatment of similar products, however, is undermined by individual regulatory agency issuances of “guidance” announcing supervisory expectations inconsistent with those required by the underlying rule. The resulting patchwork of federal agency interpretations – coupled with individual examiner application of that guidance in the field – will create an unlevel playing field for financial institutions, and the disparate regulatory standards for identical products and services will confuse consumers unnecessarily.

The current proposed guidance also advances a consumer financial world where “there is little uniformity in federal consumer protection regulation, despite the clear intent of the Administration and Congress for there to be one rule-writer and one set of rules.” We further noted in our August 2011 letter:

> The consequences of this piling on of regulatory requirements should not be underestimated. Regardless of the issuing agency, each new statement of regulatory expectation sets in motion an industry-wide review and attempt to reconcile it with existing regulations and guidance. Next, institutions must consider its impact on their business model and must identify the operations, systems, and compliance adjustments that may need to follow. For many institutions, the cost of implementing the new regulatory requirements means that they must raise fees or restrict product availability. Even for those institutions not directly impacted by particular guidance, the uncertainty about what it portends for future regulatory action by their regulator discourages innovation and frequently restricts access to financial products. Thus, it is the consumer who ultimately feels the impact of these regulatory tangles in the form of higher fees, decreased product availability, or both.

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[26] See U.S. Department of the Treasury, *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation*. June 2009. p. 53.

[27] Warren, Elizabeth, Remarks to Financial Services Roundtable, September, 2010.

As we also pointed out in our August 2011 letter, prudential regulators asserting that their authority to issue guidance on consumer protections—and examine their constituent banks for compliance—springs from their broad authority to define and eliminate unsafe and unsound banking practices, the Agencies *ensure* that disparate standards will exist, and that certain institutions with assets greater than $10 billion will be examined twice, a wasteful and burdensome exercise.

In sum, the Agencies' argument that direct advance products pose safety and soundness risks is unpersuasive and specious. They offer no data showing that any credit risk or reputation damage is sufficient to threaten safety and soundness. This attempt to regulate consumer products under the auspices of safety and soundness will result in multiple, competing rules and an unlevel playing field that will give some institutions a competitive advantage, contrary to the intent of the creators of the Bureau.

The Agencies are circumventing the rulemaking and regulatory process under the guise of "guidance." The Agencies are creating regulations where there is no apparent regulatory authority. The Agencies' labeling what is clearly a regulation as instead "guidance" undermines transparency, and avoids the important due process accorded to the normal regulatory procedures. Guidance is intended to clarify existing rules or standards, not create new obligations, prohibitions, and intrusions into the market. As noted in our August 2011 letter, "Ironically, the consumer will lose as a result of this agency one-upmanship as choice will be limited rather than empowered, and simplicity and clarity will be sacrificed to compliance complexity."

Rather than adopt prescriptive guidance that will eliminate options and increase costs to customers, the Agencies should consider promoting genuine guidance that will encourage innovation and focus on helping banks to improve these popular products that users like and value, in a coordinated process among all concerned regulators, including the Bureau.

Deposit advance loans have been designed to help achieve the important goal of providing small dollar credit that responds to the customer demand for speed, anonymity, and convenience. They have evolved over the years to reflect customer preferences and responses as well as regulators' concerns and recommendations, including those enumerated in the OCC's proposed Deposit-Related Consumer Credit Products published on June 8, 2011. For example, banks have added cooling-off periods and installment payment options and lowered fees and amounts that can be borrowed. Indeed, as noted, the CFSI found a high rate of satisfaction among users of deposit advance loans, with 94 percent saying they would use the product again and only 20 percent reporting that it took more time to repay than expected.[28]

Genuine guidance from the Agencies, offered in a joint way and in coordination with the Bureau, should identify and address areas of concern and encourage adjustments without eliminating the product. Before doing so, they need to study and recognize the different needs,

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[28] Levy, o*p. cit.,* p. 21.

characteristics, challenges, and preferences of users of these products and not apply the same approach applied to customers who use mainstream products. To illustrate, credit cards meet many of the requirements of the FDIC Affordable Small-Dollar Loan model, but customers using deposit advance loans often do not qualify for those cards. Even those customers who do have credit cards have made an informed choice to use the deposit advance product instead of their credit card to manage their personal finances.

Imposing limitations on consumer choice, especially for an opt-in product like the deposit advance product, is to apply presumptions about users of mainstream products that disregard the perspectives of customers ineligible for mainstream products and over-generalize about the preference of mainstream product customers. Equally, it is important that any guidance recognize the differences among the users of the products. As CFSI reports, the matter is complex. "The overall picture that emerges from our research illustrates the sheer diversity and complexity of needs, choices, and experiences faced by SDC [small-dollar loan] consumers." [29]

Eliminating the product is not the answer for users of these products. They will simply pay more and get less because competition and options will be reduced. Guidance that adds further pressures to avoid insured depository products will only add to the ranks of the unbanked and under-banked. Banks—and service providers supporting banks—are already and regularly engaged in improving deposit advance products to serve their customers' needs better. The product continues to be safe and sound, and the customers who use it, praise it.

Conclusion.

ABA strongly encourages the Agencies to refrain from adopting the proposed guidance. The guidance will chill innovation and reduce the availability of and increase the price of these popular short-term, small-dollar products. We are happy to discuss the Agencies' concerns, especially in light of the absence of evidence to support a safety and soundness justification, and the harm from creation of multiple rules for the same product, contrary to Congress' purpose in creating the Bureau. We encourage the Agencies to examine and study this market and develop an understanding of the demand side of the deposit advance product so as to achieve the goal of creating viable alternatives for stream-lined underwriting of small dollar credit options.

Sincerely,

Nessa Eileen Feddis

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29 *Ibid.,* p. 5.