May 30, 2013

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Re: **Docket Number FDIC-2013-0043, Proposed Guidance on Deposit Advance Products**

To Whom it May Concern,

I am writing on behalf of Woodstock Institute and the undersigned organizations in response to the Federal Deposit Insurance Corporation's (FDIC) and the Office of the Comptroller of Currency's (OCC) request for comment on Proposed Guidance on Deposit Advance Products published in the *Federal Register* on April 30, 2013, at 78 FR 25268 – 25273. We commend the FDIC and the OCC for releasing strong proposed rules that highlight the significant risks associated with deposit advance products and implement changes that will prevent banks from making payday loans that trap consumers in a cycle of debt. The proposed rules include strong underwriting standards that direct banks to determine a borrower's true ability to repay, a limit of one loan per month with a mandatory one-month cooling-off period between each loan, and a requirement that banks monitor their reliance on fees and charges. We recommend that the FDIC and OCC further strengthen the proposed rules by creating a cap on the total fees and charges, requiring up-front disclosure of the total APR, and eliminating mandatory automatic repayment.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. We conduct research on financial products and practices, promote effective state and federal policies, convene a coalition of community investment stakeholders working to improve access to credit, and help people use our work to understand the issues and develop and implement solutions.

Background

Six banks currently offer deposit advance products: Wells Fargo Bank, US Bank, Fifth Third Bank, Regions Bank, Guaranty Bank, and Bank of Oklahoma. Of these, Wells Fargo, US Bank, Fifth Third Bank, and Regions Bank operate in Illinois. In a report released by the Consumer Financial Protection Bureau (CFPB), deposit advance products were shown to have many of the same predatory features as traditional payday loans, including:

- Annual percentage rates (APR) that are often as high as 300 percent;
- A lack of underwriting requirements and no consideration of a borrower's ability to repay;
- Mandatory automatic repayment through direct access to a borrower's bank account; and
- Balloon or lump-sum payments that often cause borrowers to take out loan after loan, leading to a cycle of debt that is extremely difficult to escape. [1] The below table illustrates how the minimal limits on the period of time a borrower can be in debt for Wells Fargo's Direct Deposit Advance product can result in the borrower paying excessive fees and remaining in debt for 8-11 months.

Table A. Wells Fargo Direct Deposit Advance Loans and the Cycle of Debt.

Pay cycle	Principal	Fees	Cumulative fees	Pay cycle	Principal	Fees	Cumulative fees
1	$500	$ 37.50	$ 37.50	9	$500	$ 37.50	$ 337.50
2	$500	$ 37.50	$ 75.00	10	$500	$ 37.50	$ 375.00
3	$500	$ 37.50	$ 112.50	11	$500	$ 37.50	$ 412.50
4	$500	$ 37.50	$ 150.00	12	$500	$ 37.50	$ 450.00
5	$500	$ 37.50	$ 187.50	13	$500	$ 37.50	$ 487.50
6	$500	$ 37.50	$ 225.00	14	$500	$ 37.50	$ 525.00
7	$500	$ 37.50	$ 262.50	15	$500	$ 37.50	$ 562.50
8	$500	$ 37.50	$ 300.00	16	$500	$ 37.50	$ 600.00

Many states have prohibited payday lending or instituted usury caps or other consumer protections on small consumer loans. Deposit advance products are frequently offered in these states under the argument that federally chartered banks can preempt state consumer protections. In Illinois, for example, state laws restrict the loan-to-income ratio for payday loans to 25 percent of a borrower's gross monthly income. Borrowers who access Wells Fargo's Direct Deposit Advance product can borrow up to half of their average deposit amount rounded up to the nearest $20 increment, or $500, whichever is less. The table below demonstrates how this underwriting practice, combined with finance charges of $7.50 per $100 borrowed, fails to comply with Illinois state law by allowing loans with loan-to-income ratios well above 25 percent. Offering deposit advance products that do not comply with state consumer protection laws ignores the desire of the residents to limit high-cost lending.

[1] Consumer Financial Protection Bureau. *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings.* April 24, 2013.

Table B. Wells Fargo Direct Deposit Advance Products and Loan-to-Income Ratios.

Monthly Income	Pay frequency	Average Deposit	Maximum loan size	Finance charges	Loan-to-income ratio
$1500	Weekly	$375	$200	$15	14.3%
$1500	Biweekly	$750	$380	$28.50	27.2%
$1500	Monthly	$1500	$500	$37.50	35.8%

The FDIC and OCC proposals also point to these negative characteristics and highlight concerns that the products can be harmful to consumers and increase safety and soundness, compliance, and consumer protection risks. They note that the minimal existing consumer protections in some states—such as a cooling off period— are easy to bypass and do not do enough to ensure that borrowers are not indebted for substantial periods of time. Consumer advocates have long pointed to the dangers of bank payday products and called on all regulators to enact strong consumer protections. Woodstock Institute commented to the OCC in June 2011 raising concerns about insufficiently rigorous proposed rules on deposit advance products. We support the OCC's withdrawal of that proposed guidance. Woodstock Institute also testified before the Consumer Financial Protection Bureau in May 2012 and the Illinois Senate Commerce Committee in March 2012 on the importance of prohibiting deposit advance products on prepaid cards. In collaboration with organizations across the country, we called upon the OCC in November 2012 to downgrade Wells Fargo's Community Reinvestment Act rating because of the harmful impacts of their deposit advance products. The proposed rules, if strengthened and implemented, would fundamentally change bank payday products and ensure that consumers are receiving safe, short-term, small-dollar loan options.

Instituting Strong Underwriting Standards

The FDIC and OCC proposed rules document significant concerns about safety and soundness risks due to a lack of underwriting standards and procedures for deposit advance loans. Regulators noted that banks focus on a borrower's total monthly deposit to determine loan eligibility and loan size. The banks do not take into consideration whether the borrower's income is enough to cover the cost of the loan in addition to normal living expenses and other outstanding debts. Additionally, banks allowing deposit advances do not review credit history. Both the OCC and FDIC stated that, "the decision to advance credit to borrowers, based solely on the amount and frequency of their deposits, stands in contrast to banks' traditional underwriting standards for other products, which typically include assessment of the ability to repay the loan based on an analysis of the borrower's finances." Failing to take other financial obligations and credit history into account goes against sound underwriting practices and increases the likelihood that a borrower would have to take out another loan to repay the initial loan.

Under the proposed rules, banks offering deposit advance products would need to create eligibility and underwriting criteria consistent with those for other loan products to ensure that borrowers can repay the credit while ensuring that they can cover their other routine monthly expenses. At a minimum, the new rules require that:

- Borrowers must have a customer relationship with the bank of at least six months. Anything less does not provide the bank with enough transaction history to adequately access a person's ability to repay a loan;
- Any customers with delinquent or classified credits are deemed ineligible for this type of product;
- A customer's ability to repay is determined by looking at the six months of inflows and outflows from the individual's account (where other lines of credit cannot be considered as inflows) with a focus on the net surplus or deficit at the end of each of the six months;
- A deposit advance credit limit cannot be increased without a completely new underwriting assessment. This cannot be automatic and must be specifically requested by the borrower; and
- Continued eligibility must be measured and assessed every six months at a minimum to ensure that a customer's ability to repay has not changed.

We commend the FDIC and OCC for clearly articulating the need for strong underwriting criteria. In addition to the required analysis to determine a borrower's ability to repay the loan, the regulatory agencies also ask that the bank to take into account a borrower's overdraft history in the underwriting process and assess whether a shorter-term installment loan is a better option for the customer. The FDIC and OCC should also strongly recommend that banks include a savings component to their deposit advance products, as recommended by the FDIC's Affordable Small-Dollar Loan Guidelines. Participants in the FDIC Small-Dollar Loan Pilot Program successfully incorporated mandatory savings of a portion of the loan into their small-dollar loan products. Helping customers develop a savings habit could reduce the need for using deposit advance products in the future. [2]

Limiting the Number of Loans Per Year

The CFPB report on payday loans and deposit advance products notes that borrowers were often in long periods of sustained use and indebtedness over the course of the year. The CFPB report indicated that the median number of deposit advance loans was eight per year, while those who had more than $3,000 in loans had between 17 and 38 loans.[3] The median number of months that a consumer had an outstanding deposit advance balance was seven, but those consumers who had more than $3,000 in total loans had outstanding advances for nine months out of the year. The median number of days between advances was 13 and the median period of indebtedness was 112 days or 31 percent of the year. The research indicated that the period of indebtedness was 40 percent of the year for those customers who had more than $3,000 in advances over the 12-month period.[4]

In order to ensure that borrowers do not continue to become trapped in these long-term cycles of debt, the proposed OCC and FDIC rules will institute a cooling off period between loans and require that loans be paid back in full before a subsequent loan can be offered. Customers will be limited to one loan per month

[2] *See* FDIC Financial Institutions Letter FIL-50-2007, "Affordable Small-Dollar Loan Guidelines," (June 19, 20070).

[3] Consumer Financial Protection Bureau. *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings.* April 24, 2013.

[4] Consumer Financial Protection Bureau. *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings.* April 24, 2013.

with a one-month cooling off period in between. In essence, this guarantees that borrowers will be limited to a maximum of six loans per year. The mandatory cooling off period will help to reduce the number of loans and the period of indebtedness for consumers.

Preventing Over-reliance on Deposit Advance Fees

In addition to underwriting criteria and a limit on the total number of loans a borrower can take, the proposed rules require financial institutions to monitor the amount of revenue generated from fees and charges associated with deposit advance products. High revenue from such fees could indicate repeat borrowing and poor underwriting standards. Furthermore, banks should monitor whether fees from deposit advance products are concentrated in communities of color or low-income communities. If so, banks should immediately modify their lending practices or risk an investigation for violating the Fair Lending Act and Equal Credit Opportunities Act.

In addition to the strong rules referenced above, we encourage the FDIC and OCC to include the following protections.

Institute a Cap on Total Fees and Charges

In addition to the strong underwriting criteria delineated in both the OCC and FDIC proposed rules and the clear directive to monitor undue reliance on deposit advance fees and charges, regulators should go one step further by creating a hard cap on the total number of fees and charges that can be assessed on deposit advance products. An APR cap of 36 percent on all fees and charges would be consistent with the FDIC's guidelines for affordable, small dollar loans and would further ensure that safety and soundness risks are minimized.[5] Research indicates that a 36 percent cap on APR would make loans much more affordable for consumers and increase the likelihood that they will pay back the loan on time. It would also create an incentive for lenders to use smart underwriting criteria, offer a variety of longer-term loan products, and practice good lending.[6] With a reasonable interest rate cap, borrowers would meet their emergency credit needs through mainstream depository institutions and avoid other high-cost, predatory products. Additionally, banks should abide by all state laws that set usury caps lower than 36 percent or prohibit payday lending.

Require Upfront APR Disclosure

While deposit advance products are currently marketed as checking account features, we strongly encourage the FDIC and OCC to require that banks accurately characterize these loans as credit products. Customers should be able to compare this product to other credit options. Regulators should specify that the APR must be clearly disclosed up-front in compliance with the Truth in Lending Act, so as to provide borrowers with a complete understanding of the terms of the loan. The APR should be calculated as it would for a closed-end credit product, even if the advance product is classified as open-end credit, since

[5] *See* FDIC Financial Institutions Letter FIL-50-2007, "Affordable Small-Dollar Loan Guidelines," (June 19, 2007).

[6] Saunders, L. *Why 36%? The History, Use, and Purpose of a 36% Rate Cap*. The National Consumer Law Center. April, 2013.

the full balance will be repaid from the borrower's next direct deposit. The frequency of the borrower's direct deposit schedule should be used to calculate the loan term. For example, if a borrower receives a regular paycheck biweekly, the loan term for the APR calculation should be 14 days.

Prevent Mandatory Automatic Repayment

One area of concern that remains completely unaffected by the proposed rules is banks' mandatory automatic repayment requirement. Traditionally, a deposit advance product is paid back as soon as funds are deposited into the borrower's bank account. The bank automatically repays itself from the newly deposited funds up to the full available amount before the customer has a chance to use these funds for any other purpose. If the deposit is not sufficient, the bank takes the remaining balance from the next incoming deposit. If the loan has not been paid back in full within 35 days, the bank initiates a forced repayment from the borrower's account even if this results in an overdraft.[7]

This type of unfettered access prevents borrowers from maintaining control over their accounts and spending choices and discourages sound underwriting practices. In the same way that consumers can actively choose to pay bills, or pay off other loans, consumers should be able to make that decision for deposit advance loans. Financial institutions offering deposit advances should be required to perform the same sort of underwriting as any other lender that does not have full control over whether the loan will be paid back. We strongly urge the FDIC and OCC to prohibit banks from requiring automatic repayment through direct access to the borrower's account.

Enforcement

We strongly encourage the FDIC and OCC to strictly enforce the proposed rules once they are finalized. Conducting prompt, frequent, and detailed examinations of banks' compliance with the underwriting standards and loan number limits is crucial to ensuring that consumers are protected from predatory products. The ability to monitor payday lending in real time has been essential to determining compliance with the laws in Illinois. Payday lenders are required to report loans and their terms and conditions in real-time to a database monitored and controlled by the Illinois Department of Financial and Professional Regulations. We encourage the FDIC and OCC to consider whether a database or real-time reporting system for deposit advance loans would better enable enforcement.

Conclusion

Woodstock Institute and the undersigned organizations commend the FDIC and OCC for proposing strong new rules to rein in depository institutions offering deposit advance products. These products, offered by mainstream banks, have been disguised as legitimate aids to consumers in need of funds despite the fact that they have the same predatory features as payday loans and have been shown to trap consumers in long-term cycles of debt. Furthermore, banks have offered these payday products in blatant disregard for state laws that ban payday products or have rate caps of 36 percent or less.

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[7] Consumer Financial Protection Bureau. *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings.* April 24, 2013.

These proposed rules would require strong underwriting criteria that ensure a borrower's ability to repay while also covering their other normal expenses, limit the annual number of loans that a borrower can take on that account and periods of payday indebtedness, and require banks to assess their reliance on revenue and fees from these products. We urge the agencies to strengthen the proposed rules by mandating an APR cap of 36 percent on all charges and fees; requiring standard up front disclosure of the APR; and prohibiting banks from requiring automatic repayment.

We support the development of properly underwritten, affordable, small-dollar loans and stand ready and willing to work with banks and regulators to make improvements in the marketing and oversight of these loans. We thank you for the opportunity to comment.

Sincerely,

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