May 30, 2013

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
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Office of the Comptroller of the Currency
Legislative and Regulatory Activities
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Via email:
regs.comments@occ.treas.gov
comments@fdic.gov

Re: Proposed Guidance on Deposit Advance Products
OCC Docket ID: OCC-2013-0005

Dear Sir or Madam:

Appleseed appreciates the opportunity to comment on the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) proposed guidance addressing deposit advance products (DAPs). Appleseed and nine Appleseed Centers [1] support the proposed guidance and, based on our Centers' on-the-ground state-level advocacy work, offer suggestions for the Agencies' consideration to help promote reasonable, affordable small dollar consumer loans.

Appleseed is nonprofit network of 17 public interest justice centers in the United States and Mexico dedicated to building a society in which opportunities are genuine, access to the law is universal and equal, and government advances the public interest. National Appleseed's financial access and asset building program is devoted to promoting fairness, transparency, multiple options, financial education, and safe and secure banking and asset building options for low-income persons, including immigrant communities. Several Appleseed Centers have worked for years to combat practices that trap people in a cycle of debt, such as payday loans and auto title loans, and promote fair and affordable small dollar loans.

The two substantially similar guidance documents apply to banks that make small dollar, short-term loans – functionally similar to payday loans made by non-depository institutions. As the guidance notes, DAP loans are frequently made without regard to consumers' ability to repay. The balloon payment feature makes the true cost of the loans less transparent and places

[1] These comments are submitted on behalf of Appleseed, Alabama Appleseed Center for Law & Justice, Chicago Appleseed Fund for Justice, Hawai'i Appleseed Center for Law and Economic Justice, Kansas Appleseed, Massachusetts Appleseed Center for Law and Justice, New Jersey Appleseed Public Interest Law Center, South Carolina Appleseed Legal Justice Center, Texas Appleseed and Washington Appleseed.

consumers (and their households) at unnecessary risk of financial shortfall, resulting in repeat refinancing and a heightened risk of seeking out fringe lenders for payday and title loans. Further, the lack of sufficient underwriting often results in overdrafts and related charges and account closures, which complicate the customers' relationship with previously-trusted financial institutions. The recent study by the Consumer Financial Protection Bureau affirms these findings and the need for this guidance.[2]

The Consumer's Perspective

A recent series of research reports by The Pew Charitable Trusts highlights the harm that payday loans inflict on low and moderate income communities by engaging consumers in a cycle of high-interest indebtedness.[3] In some instances, DAPs are functionally similar to payday loans made by non-depository institutions; the Pew data is illustrative from this perspective. While these loans are marketed as short-term loans to cover unexpected expenses, most borrowers use these loans to cover ordinary living expenses at an average annualized interest rate for these loans of 391%.[4] Only 14% of borrowers find paying off a payday loan to be within their monthly budget—the majority are required to renew or re-borrow loans for months before they can afford to pay them off. [5] The Pew reports show that conventional payday lenders rely on repeat usage in order to be profitable. [6] Appleseed's comments are directed at curbing these dangers for consumers both within the DAP and payday loan contexts.

Appleseed, other consumer organizations and the media note that installment loans can be just as risky as traditional payday loans when they carry triple digit interest rates. As a basic structure, installment loans are better than payday loans, with a fixed term and principal repayment. However, high charges and frequent refinances replicate the payday loan cycle of debt. Our Centers note that installment payday loans can average 600% APR for six-month loans. Improving the structure of the loan is only one part of the equation. A good structure at an unsustainable cost will be equally damaging to borrowers.

Appleseed's Framework: Balancing Lender and Borrower Success

Appleseed and its Centers approach the issue of fair small dollar loans using the basic standard of borrower and lender success. Borrowers succeed when they obtain loans that they have

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[2] For example, according to the study, the average direct deposit advance user is in debt for seven months and incurs an average of 12 NSF fee charges. *See:* Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products* (April 24, 2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[3] *See, e.g.*, The Pew Charitable Trusts. Payday Lending in America: Who Borrows, Where They Borrow and Why (July 2012) (hereinafter "Pew 2012 Report"); Pew 2013 Report.

[4] Pew 2012 Report, at pp. 6, 13.

[5] Pew 2013 Report, at pp. 13-14.

[6] *Id*. at 19.

every reasonable expectation of being able to pay back on time without additional fees: they can repay without the need to re-borrow; build credit; and carry manageable fee and interest charges. If borrowers have access only to high-cost products that keep them in debt, then the market has failed them. If lenders are unable to make a profit, then there is no motivation to offer the loan products. Finding the right balance has been elusive in recent years in the small dollar lending market, but it is by no means an impossible goal.

We encourage a system where incentives and rewards are provided for products that lead to borrower success and commend the OCC and the FDIC for noting the importance of offering small dollar loans that provide fair alternatives to high-cost DAP, payday and auto title loans. Encouraging positive innovations is an essential complement to standards that ensure existing products promote safety and soundness and borrower financial stability.

Appleseed has long supported transparency in financial transactions, particularly important in DAP or payday loans that have triple digit interest rates. Consumers find interest rates misleading, when, for example, a 20% interest rate may only be 20% for two weeks because it is designed to be renewed or rolled-over.

The explosion of loan products that carry annual percentage rates of 300% APR to 600% or more has hindered positive market innovations, with the allure of high profits diminishing the incentive to leverage innovations to lower cost and improve the structure of the loan products. For example, Texas has seen a doubling of the number of high-cost payday and auto title locations since 2005, from 1,400 to nearly 3,500 locations. During this same time period, the cost of an average payday loan jumped from around 391% APR to nearly 600% APR. DAP loans expanded in this market context—serving a market need, but through mimicking the flawed loan structure of the payday loan model rather than leveraging the efficiencies of the banking relationship to offer a better product.

Low and moderate income families need access to small dollar loans for a number of understandable purposes: for small capital expenditures to start or expand a business, to pay fees associated with processing immigration applications, to fix cars necessary to get them to work, to name just a few of many scenarios. We support a system that encourages positive small dollar credit offerings, similar to the FDIC's 2007 "Affordable Small-Dollar Loan Guidelines," while diminishing incentives to offer products at excessive cost that promote a cycle of debt.

Hardship for Particular Demographic Groups

Payday lending patterns suggest that high dollar, short-term loans – whether functionally equivalent DAP, payday, or auto title – can create hardships for particular groups. Payday lending has a particularly adverse impact on Latinos and African Americans, as a disproportionate share of payday borrowers come from communities of color.[7] Finally, payday loan shops have been shown to target people of color when locating their stores.[8]

Recent immigrants, who increasingly need small dollar loans to assist with visa, residency, and citizenship applications, among other needs, and with little credit history, too often fall into the trap of high-cost short-term loans. The Migration Policy Institute's summary of the U.S. Census Bureau's 2010 American Community Survey indicates that a significant portion of immigrants were in or near poverty: 18.8 percent were in poverty, 13 percent were between 100 and 149 percent of the poverty level, and an additional 11.7 percent were between 150 and 199 percent of the poverty level.[9] Immigrants and their children (including U.S.-born children under age 18) were also found to be more likely to live in poverty or near-poverty than non-immigrants.[10]

The Center for Responsible Lending has found that African Americans comprise a far larger percentage of the payday borrower population than they do the population as a whole. [11]

Seniors are another financially vulnerable demographic that has been adversely affected by high-cost small dollar loans. A large number of bank payday borrowers are Social Security recipients, whose benefits banks take for loan repayment before borrowers can use those funds for healthcare, prescription medicines, or other critical expenses.[12]

Unsustainable Deposit Advance Products May Evade Predatory Lending Reform at the State Level

Cities across the country have passed zoning ordinances to limit the expansion of payday and auto title businesses, because these businesses hurt the public welfare and give neighborhoods a

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[7] 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).

[8] Rebecca Borné, Joshua Frank,Peter Smith, and Ellen Schloemer, *Big Bank Payday Loans: High-Interest Loans through Checking Accounts Keep Customers in Long-term Debt* (July 2011).

[9] *See* Migration Policy Institute, MPI Data Hub: The United States - Income & Poverty, Tables 1 & 2, *available at* http://www.migrationinformation.org/datahub/state4.cfm?ID=US.

[10] *Id*. at Table 2 (finding a 23.2 percent poverty rate for immigrant families with children under 18, compared to a 16.6 percent poverty rate for non-immigrant families with children under 18). Table 2 also indicates that 43.5 percent of all immigrants were below 200 percent of the poverty level compared to 33 percent of non-immigrants. *Id*.

[11] Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis,P*redatory Profiling The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (March 26, 2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatoryprofiling.pdf .

[12] Center for Responsible Lending, *Triple Digit Danger: Bank Payday Lending Persists* (March 21, 2013), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/Triple-Digit-Bank-Payday-Loans.pdf; Center for Responsible Lending, *Big Bank Payday Loans:* High-interest loans through checking accounts keep customers in long-term debt (July 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

look of economic decline. In Texas, a growing number of cities have passed ordinances that restrict payday and auto title loan products in the face of inaction at the state level.

For years, several Appleseed Centers and our collaborative partners have sought state legislative and municipal ordinance remedies to curb the impact of fringe loan products, like payday and title loans. In South Carolina, four local jurisdictions have passed municipal ordinances; in Texas, six local jurisdictions have passed regulatory ordinances. The ordinances attempt, within legal constraints, to ensure the payday and auto title loans are designed to be repaid by limiting the loan size based on borrower income and requiring that the loans be paid in full in a maximum of four payments through mandatory principal repayment. In addition to the regulatory ordinances, at least 10 Texas local jurisdictions have passed zoning ordinances, and another 10 cities and counties have passed resolutions asking the state to rein in abusive practices have adopted municipal ordinances. This advocacy is complicated by the entrance of banks into the short-term consumer loan market.

At least since the calamitous run on the banks in the early 1930's, banks and bank regulators alike have made tremendous efforts to convince customers that putting their trust and finances in banks is safe and responsible. There is a general assumption that the products offered meet basic standards of fairness and quality. If DAPs continue to expand in their current form they could serve to further legitimize storefront payday and title loans and hinder efforts to expand safe and affordable small dollar loans. Moreover, the DAP loan is falsely viewed as healthy competition by some policymakers who do not fully comprehend the plight of credit-strapped consumers and the detrimental impacts of on-going high-cost debt.

The significance of the proposed guidance cannot be overstated, particularly in states where DAP loans are currently available. State-level advocates too often lack the power to influence a corporate decision. For instance, Alabama Appleseed and collaborative partners met twice with a bank that offers deferred DAP loans in Alabama. While the meetings were cordial, there was no change in the bank's practice or product. Consumers generally have trust in banks, as distinguished from storefront payday operations. And if banks are essentially acting like payday institutions, some banks' entrance into this market jeopardizes the reputation of banks generally as being fair, regulated, and financially conservative and careful institutions that can promote financial access and responsibility.

Appleseed Recommendations

Four Appleseed Centers – Alabama Appleseed, Chicago Appleseed, South Carolina Appleseed and Texas Appleseed – are at the forefront of small dollar loan reform in their states. We make recommendations based on their experiences.

For example, Chicago Appleseed was part of the Egan Coalition of public interest organizations that spearheaded a multi-year advocacy effort to pass The Consumer Installment Loan Act. The

Act created interest rate caps; bans on balloon payments, which often perpetuated a cycle of loan renewal; and limits on the number of consecutive days over which a borrower can be in debt to a particular lender.

Appleseed and the nine Centers below offer these recommendations:

Promote Use of Technology in Consumers' Interest

New and emerging technology can cut underwriting and loan processing costs and reduce credit risk. We urge the Agencies to make certain that consumers derive the benefit of these technologies so that lending carries fewer risks for consumers.

Creativity and Innovation in Creating New Products

Consumers need fair small dollar loan products that meet their needs in this marketplace. In anticipation of payday lenders pulling out of the small dollar loan market, Chicago Appleseed collaborated with Illinois Asset Building Group to research the business case for small banks and credit unions to offer payday alternative loans. In late 2010, Chicago Appleseed coauthored "Alternative Small Dollar Loans: Building the Business Case" and an appendix report, "Case Studies of Financial Institutions that Offer Alternative Small Dollar Loans." [13]

In comments on Community Reinvestment Act (CRA) guidance, Appleseed and six Centers encouraged the Agencies to promote a "race to the top" with respect to CRA by creating additional incentives for financial institutions to improve small dollar loan products and achieve an outstanding CRA rating.[14] We similarly urge the Agencies to incentivize creativity and innovation, including development of new products that will differ from standard, accepted approaches, particularly in geographies where there is a high penetration of high cost lenders.

Opportunities to Increase Small Dollar Lending through Federal Interagency Coordination

Appleseed has recommended that the Agencies use CRA guidance to encourage financial institutions to provide low-cost small dollar loan alternatives. In recent comments to OCC, FDIC and Board of Governors of the Federal Reserve System, Appleseed and six Appleseed Centers noted the urgency of increasing access to credit in low- and moderate- income

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[13] Building on the results of their 2011 and 2012 reports, Chicago Appleseed developed an "Alternative Small Dollar Loan Toolkit, a resource for banks and credit unions interested in offering a safe, profitable, small dollar loan product. The complete toolkit, including a portfolio profitability calculator and explanatory webinar, is available at http://www.chicagoappleseed.org/?s=alternative+small+dollar+loan+toolkit&submit=Search.

[14] Texas Appleseed, *Reshaping the Future of Small-Dollar Lending in Texas: Alternatives to High-Cost Payday and Auto Title Loans* (January 2012). Available at http://www.texasappleseed.net/index.php?option=com_docman&task=doc_download&gid=698&Itemid= .

communities, including among constituencies that Appleseed serves: the urban poor, immigrant communities and rural farmers and farmworkers.[15]

Address Low-income Immigrant Lending Needs

We urge the Agencies to recognize the impact predatory loans have on low-income immigrants who may not speak English and face language challenges in understanding APR and the terms of high dollar loans. We urge the industry to develop and market loans targeted at the needs of immigrant communities, including loans to assist with visa, residency, and citizenship applications.

Appleseed joins with other consumer organizations in advancing these recommendations:

Underwriting/Credit Policies

Banks must ensure borrowers can repay the loan according to the loan's terms without refinancing or borrowing from others while meeting ordinary and necessary expenses. Ten years ago, South Carolina Appleseed helped lead an effort to pass underwriting criteria for all lenders. Sufficient underwriting should include a requirement that consumers have a satisfactory history with the bank, that DAPs should not be made to borrowers with delinquent/adverse accounts, and that borrowers have sufficient financial capacity to repay the DAP loan without borrowing. Financial capacity should be reviewed periodically to determine if smaller and more frequent installment repayments are more appropriate and credit limits should be increased only upon consumer request, and only with full underwriting.

Cooling-Off Period

A cooling-off period is essential to limit the number of DAP loans that a bank may make to a consumer. We support the requirement of at least one monthly statement cycle between repayment of a DAP loan and a new advance and a limit of no more than one loan per monthly statement cycle. Taken together this means no more than six loans per year.

Fees

The guidance states that DAP fees should be based on safe and sound banking principles and banks should not unduly rely on DAP fee income for revenue and earnings. The APRs on DAP are expensive with an average APR of 304% to 456% depending on fees and duration.[16] We ask the Agencies to consider in this context the Military Lending Act payday cap of 36% APR or annualized interest rate on DAP loans, or such lesser amount as is permitted under each state's usury law.

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[15] Appleseed, *Community Reinvestment Act: Interagency Questions and Answers regarding Community Reinvestment (May 2013).* Available at https://www.appleseednetwork.org/what-we-do/projects/financial-access/financial-consumer-protection/.

[16] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products* (April 24, 2013), p. 28, *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

Automatic Repayment
Banks, like any other lenders, have an interest in ensuring that legitimate, non-predatory loans they make are repaid. However, the requirement that DAP loans be paid first, before any other bills, by the automatic deduction from the consumer's next paycheck, is unfair and amounts to a prioritized, secured loan. Lenders have a right to repayment but consumers may need to prioritize other bills first.

Consumer Compliance and Oversight
We encourage the FDIC and OCC to monitor DAP programs through careful supervision, compliance, and enforcement.

Conclusion

We greatly appreciate the opportunity to comment on the Proposed Guidance on Deposit Advance Products. If you have any questions, please do not hesitate to contact Appleseed at the addresses below.

Sincerely,

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