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RESPONSE TO FDIC REQUEST FOR INFORMATION ON SMALL-DOLLAR LENDING

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I conduct research with low-income people with mental illness, exploring their financial difficulties including their engagement with the financial services industry. I will answer the questions below mainly with this population in mind. Note that one in five Americans experience some type of mental health problem during any given year, and close to five percent has a serious and often persistent mental illness. There is a strong correlation between mental illness and poverty; approximately one in three people with serious mental illness live in poverty.

1. *To what extent is there an unmet consumer demand for small-dollar credit products offered by banks?*

This population relies mostly on disability benefits and/or low wage work. Those who rely entirely on disability benefits have the advantage of a steady, though very low income (as long as they abide by strict asset limits, particularly those receiving Supplemental Security Income (SSI)). Those relying on work income may earn more than disability benefits, but their wages are often low, with unreliable hours, and insecure employment. A significant number of people have income from both disability benefits and employment; depending on their particular type of benefit and situation, this can often result in overpayments, whereby Social Security pays them benefits to which they are not entitled for a period of time due to their earned income, which then has to be repaid. This can cause enormous unexpected financial shocks. As a result of very low and/or unreliable incomes, compounded by the limits on saving and income earning, this population is frequently in need of affordable, small dollar credit products to enable them to manage situations where they do not have funds to pay for an immediate and essential expense.

2. *To what extent do banks currently offer small-dollar credit products to meet consumer demand?*

Those in this population who have bank accounts (rates of being unbanked are higher than among those who are low income but do not have a mental illness) frequently go overdrawn and pay high fees. Thus, we can say that banks are currently offering small-dollar credit products to some among this population, in the form of extremely high cost overdrafts. This is an unacceptable situation.

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

Debt levels among this population are high. While some have more well-known types of debt such as credit card, student loan and medical debt, many more are burdened with relatively small amounts of debt from the alternative financial services sector or informal personal loans. Non-loan debt – rent and utility arrears, unpaid taxes, fines and fees etc. - is also a serious problem. Thus, while many of this population may be in debt, it is costly and does not effectively meet the need.

4. *What data, information, or other factors should the FDIC consider in assessing the consumer demand for small-dollar credit products?*
    a. Consider the many types of debt that low income people are already burdened by – including non-loan debt – before assuming that they can afford to take on additional debt. Income alone is an inadequate measure of a person's ability to take on debt. Data about the types of debt that low-income people are burdened by can be hard to come by, but important to assess. The types of debt that we know more about – mortgages, student loans, credit cards, auto loans, and medical debt – are often not the main debt that burdens low income people, particularly those struggling with mental health problems.
    b. Consider the lack of effective savings products for low-income people, and the constraints that asset limits put on people receiving benefits. It may be irresponsible to promote small dollar credit products among populations whose primary need is to be able to save money, rather than borrow, but who are unable to save due to lack of appropriate products or asset limits.

Benefits and Risks

5. *What are the potential benefits and risks to banks associated with offering responsible, prudently underwritten small-dollar credit products?*

Affordable products with terms that accommodate the particular needs of low-income people would enable banks to provide more equitable service and help more people attain financial stability.

6. *What are the potential benefits and risks to consumers associated with bank-offered small-dollar credit products?*

Bank-offered small dollar credit products could help people smooth consumption, but could also be taken by people who are in need, but ultimately are made financially worse off by utilizing the products. Thus, while there would no doubt be high demand for the proposed small dollar credit products, my concern is that unless they are affordable these loans could increase, rather than decrease, financial instability.

7. *What are the key ways that banks offering small-dollar loan products should manage or mitigate risks for banks and risks for consumers?*

Ideally, any small-dollar loan product from banks should be very low cost. For example, no-cost overdrafts up to a certain amount and/or for a limited period, particularly for customers with regular incomes, as well as low-cost loans. Risks for banks could be mitigated in various ways, such as by limiting loan access to established customers, keeping loan amounts small, creating convenient and flexible repayment mechanisms, and by denying future loans until previous loans are repaid.

8. *What are the potential benefits and risks related to banks partnering with third parties to offer small-dollar credit?*

Partner organizations could guarantee loans, or provide support in assessing customer credit-worthiness, particularly for those with poor credit as measured through current mechanisms, and collecting loan repayments. However, any partner organization would also have to be strictly regulated to ensure responsible practice.

9. *What steps could the FDIC take, consistent with its statutory authority, to encourage banks to develop and offer responsible, prudently underwritten small-dollar credit products?*

Challenges

10. *Are there any legal, regulatory, or supervisory factors that prevent, restrict, discourage, or disincentivize banks from offering small-dollar credit products? If so, please explain.*

11. *Are there any operational, economic, marketplace, or other factors that prevent, restrict, discourage, or disincentivize banks from offering small-dollar credit products? If so, please explain.*

12. *What factors may discourage consumers from seeking responsible, prudently underwritten small-dollar credit products offered by banks?*

Product Features

13. *Are there specific product features or characteristics of small-dollar loan products that are key to meeting the credit needs of consumers while maintaining prudent underwriting?*

Quickly available, easy to understand terms, timely and clear communication, convenient and flexible ways to make payments (the latter is crucial given fluctuating and insecure incomes)

14. *Are there specific product features or characteristics that are key to ensuring the economic viability to a bank of responsible, prudently underwritten small-dollar credit products?*

Ultimately it is unlikely that banks will make an immediate profit from such products, if they are well designed from the perspective of the borrower. Some customers may become more financially stable such that they can in the future become eligible for products which do generate greater profits for banks, but this will not be true for all given broader structural causes of poverty. There is a reasonable argument for allowing banks to charge higher rates/fees for small-dollar loan products such that they are profitable, which would incentivize more banks to create and offer such products. However, this risks being counter-productive for many borrowers, as it may not fix the deeper financial difficulties that they are facing, and could exacerbate them. Most causes of those financial difficulties, particularly those that affect people with mental illness, lie in conditions outside the immediate reach of banks – low benefits levels, the economic situation, wage levels, stigma etc. Bank should certainly consider in their longer-term strategies how they can positively impact these conditions, but in the narrow area of small-dollar loan products, they best they can do is ensure those loans are affordable and designed to be useful for low-income borrowers. The issue of profitability could be resolved through cross-subsidizing the costs of such loans from other more profitable products targeted at different types of customers. Until broader conditions change, cross-subidization of this nature should be considered normal, good business practice to ensure that people in greater need have their needs met. An additional strategy could be to develop partnerships whereby costs that banks may not be willing to take on are borne by separate entities, such as loan guarantees from other organizations, or subsidies for particular types of products.

Innovation

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

16. *Are there innovations that might enable banks to better assess the creditworthiness of potential small-dollar loan borrowers with limited or no credit records with a nationwide credit reporting agency?*

Regular direct deposits into the bank, regular rent payments, guarantee from a community organization.

17. *What role should the FDIC play, if any, in supporting innovations that enhance banks' abilities to offer responsible, prudently underwritten small-dollar loans? Are there specific barriers that prevent banks from implementing such technologies or innovations?*

18. *How can technology be leveraged to improve consumers' experiences and reduce potential risks to consumers associated with small-dollar credit products?*

Alternatives

19. *What other products and services that supplement or complement small-dollar credit offerings should banks consider? Are there other ways that banks can help consumers address cash-flow imbalances, unexpected expenses, or income volatility besides small-dollar credit products?*

Other

20. *Are there any distinguishing characteristics of particular institutions, such as a bank's size, complexity, or business model, that the FDIC should consider, and if so how?*