

January 22, 2019

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17th St. NW  
Washington, DC 20429

**Re: Small-Dollar Lending, Request for Information, RIN 3064–ZA04**

Dear Executive Secretary Feldman:

The Center for Financial Services Innovation (“[CFSI](#)”) is pleased to respond to the FDIC’s Request for Information on Small-Dollar Lending and how banks can be encouraged to offer products that are “responsive to customers’ needs and that are structured prudently and responsibly.” As an authority on the financial health of Americans, we have researched the consumer behaviors, products, and providers that comprise the market for small-dollar credit (“SDC”). And we have supported and highlighted innovations in this market that are most consistent with advancing consumers’ financial health.

Our research suggests that a variety of different needs and use cases underlie the demand for small-dollar credit and that many of them are symptomatic of one or more dimensions of poor financial health on the part of borrowers. Payday lenders, auto title lenders, pawn shops and other subprime lenders have dominated the provision of small-dollar loans until recently. Many of the products they have offered are expensive, not safely underwritten, and rely on cycles of continuous use, and harsh collection practices that both exploit and perpetuate borrowers’ financial distress.

Banks have been largely absent from this market for a variety of reasons, including financial and reputational risk aversion, as well as regulatory constraints. Industry earnings from overdraft-related fees, which exceed annually all fees earned on all non-bank payday and auto title loans, have also likely kept many institutions from offering higher quality sources of just-in-time credit.<sup>1</sup> Yet, in their safekeeping roles, and as the hubs of our payment systems, banks are well-positioned to offer small-dollar credit products that advance borrowers’ financial health.

To better serve this market, banks can draw on a growing number of innovations that allow providers to advance small-dollar credit prudently and responsibly. With broadened portability of transaction and account data, a number of fintech challengers have begun to offer SDC alternatives at much lower cost in the form of early access to wage (PayActiv, Earnin, Flexwage) and overdraft insurance products (e.g., Dave, Brigit,

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<sup>1</sup> [2017 Financially Underserved Market Size Study](#), CFSI, December 2017.

Oportun). New liquidity management features tied to checking accounts promise to help liquidity-challenged consumers better manage their spending and savings, thereby reducing demand for just-in-time credit. Short-term, fully-amortizing installment loans of the sort [advocated by the OCC in a recent bulletin](#)<sup>2</sup> offer a superior structure, as compared to balloon loans to enable consumers to repay loans used to meet emergency needs.

Understanding the nature of demand for such products will inform how banks can meet it prudently and responsibly—and the limits to their doing so. Short-term, small-dollar credit products must generate sufficient profit in order for banks to make them available to credit-worthy depositors who need them. But the success of responsible products must be measured not simply by whether they meet demand, but by their potential to transcend it by helping users improve their financial health. We hope this letter will help the FDIC and its supervised institutions thread this needle.

## About CFSI

CFSI is a national authority on consumer financial health. We lead a network of financial services innovators – banks and credit unions, the fintech community, processors, servicers, nonprofits, and community-based organizations – all committed to building higher-quality products and services. CFSI informs and advises our network, seeding innovation that aims to transform the financial services ecosystem. Our activities include [research](#), [consulting](#), and the [Financial Solutions Lab](#) (a partnership with JP Morgan Chase). Most recently we launched the [U.S. Financial Health Pulse](#)<sup>3</sup> – a rigorous, regularly updated snapshot of how Americans manage their finances, with actionable insights to improve financial health.

CFSI is intimately familiar with the products, providers, and customer needs and behaviors that comprise the U.S. market for small-dollar credit. In 2012 we published path-breaking consumer research describing and quantifying the different use cases for which borrowers obtain small-dollar loans. In 2015, we published “[The Compass Guide to Small-Dollar Credit](#)<sup>4</sup>,” based on our broader “[Compass Principles](#)” for consumer financial services that embrace inclusion, build trust, promote success, and create opportunities for users. The Guide defines core practices that make for high-quality SDC products and stretch practices that represent cutting-edge approaches to fulfilling the Principles.

To foster innovation in this market, we launched a “[Test and Learn](#)” [working group](#)<sup>5</sup> of financial services providers offering new small-dollar credit products and published learnings from this effort in 2015. Since 2014, our Financial Solutions Lab has also sponsored several start-ups with products that meet credit needs induced by temporary cash shortfalls and timing mismatches between deposits and expenses. And we have consulted numerous members of our network, including some of the country’s largest

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<sup>2</sup> [Core Lending Principles for Short-Term, Small-Dollar Installment Lending](#), OCC, May 2018.

<sup>3</sup> [U.S. Financial Health Pulse: 2018 Baseline Survey](#), CFSI, November 2018.

<sup>4</sup> [The Compass Guide to Small-Dollar Credit](#), CFSI, April 2014.

<sup>5</sup> [Designing High-Quality, Small-Dollar Credit: Insights from CFSI’s Test and Learn Working Group](#), CFSI, September 2015.

financial institutions, on how to develop and offer responsible SDC products to their customers.

## **Consumer financial health and the demand for small-dollar credit**

Like most other forms of credit liabilities that reside on consumers' balance sheets, demand for small-dollar credit is derived demand. Mortgage credit derives from consumers' needs and preferences for shelter; auto loans from needs and preferences for personal transportation; student loans for human skills and credentials; and some credit card and installment credit from needs and preferences for purchases of large durable goods. For each of the above credit liabilities, a corresponding asset or future use value also resides on the consumer's balance sheet.

Most small-dollar credit derives from a different quarter. As the term "liquidity lending" implies, such loans generally go to pay either for regular living expenses when the borrower has insufficient cash on hand pay for them, unexpected or emergency expenses, or to displace another short-term liability, such as overdue bills or payments due on existing debt.

There is ample evidence to suggest that a large portion of American households face expenses for which they do not have the cash on hand to cover at one or more times during the year. Our [Financial Diaries Project](#), which studied the day-to-day earnings and expenses of 235 LMI households over the course of a year, found that month-to-month spikes in expenses, coupled with income volatility associated with variable and uncertain work scheduling and employment insecurity, led expenses to exceed income in multiple months of the year.<sup>6</sup> Separately, the Federal Reserve's [Report on the Economic Well-Being of U.S. Households](#) in 2017 found that "Four in 10 adults...would either borrow, sell something, or not be able to pay if faced with a \$400 emergency expense."<sup>7</sup>

In 2012, [CFSI surveyed over 1,600 lower and middle class \(LMI\) consumers](#),<sup>8</sup> including 1,100 SDC users, plus an additional 500 non-SDC users. We found an estimated 15 million consumers used at least one SDC product<sup>9</sup> in the past year. The SDC users had disproportionately lower incomes as compared to the non-users. Only 27% reported having active credit card accounts, and only 34% reported having any liquid savings.

Our [subsequent report based on the same consumer research](#)<sup>10</sup> identified four situations that borrowers most often reported as their reasons for using small-dollar loans:

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<sup>6</sup> Rachel Schneider and Jonathan Morduch, [Spikes and Dips: How Income Uncertainty Affects Households](#), CFSI and the Financial Access Initiative at New York University, October 2013.

<sup>7</sup> [Report on the Economic Well-Being of U.S. Households in 2017](#), Board of Governors of the Federal Reserve, May 2018.

<sup>8</sup> [A Complex Portrait: An Examination of Small-Dollar Credit Consumers](#), CFSI, August 2012. We defined LMI as consumers with annual household incomes of \$75,000 and below.

<sup>9</sup> Our definition of SDC products included payday, pawn, auto title, high-cost installment, and bank deposit advance loans.

<sup>10</sup> [Know Your Borrower: The Four Needs Cases of Small-Dollar Credit Consumers](#), CFSI, December 2013.

- **An unexpected expense** such as a car repair, medical bill, home repair, or help provided to family and friends.
- **Misaligned cash flow**, when income and expenses are mistimed due to income variability or expense management issues and borrowing is needed to pay a recurring expense such as utilities, rent, or groceries.
- Expenses that **regularly exceed income**.
- A **planned purchase** of a personal asset or paying off debt.

These use-cases were cited as primary reasons for taking out one or more SDC loans by 32%, 32%, 30%, and 9% of borrowers, respectively.<sup>11</sup> We believe it is useful to think of these use cases as the primary drivers of demand for small-dollar credit.

CFSI defines financial health as having a day-to-day financial system that builds resiliency and enables people to pursue opportunities. We have identified [eight key indicators of financial health that characterize how consumers spend, save, borrow, and plan for the future](#).<sup>12</sup> Consumers are financially healthy when they:

- Spend less than income
- Pay bills on time and in full
- Have sufficient living expenses in liquid savings
- Have sufficient long-term savings or assets
- Have a sustainable debt load
- Have a prime credit score
- Have appropriate insurance
- Plan ahead for expenses

When combined to provide an overall measure of consumers' financial health, these indicators can help financial institutions better understand how their services are supporting improvements in their customers' financial health over time.

Viewed through the lens of consumer financial health, the primary use cases for SDC represent constrained choices and are indicative of financial ill-health. While it may palliate an immediate symptom, use of credit may fail to address the underlying problems and in some cases—particularly with sustained use of credit—may worsen them. For example:

- **Unexpected expense:** Using SDC to meet unexpected emergency expenses may reflect that a consumer does not have an adequate **cushion of liquid assets** (one key positive indicator of financial health) or does not carry **appropriate insurance** (another indicator) to cover emergency medical, auto, or home repairs.
- **Misaligned cash flow:** Dealing with volatility that can cause mismatches between income and expenses requires even larger liquidity cushions and

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<sup>11</sup> Note: borrowers in the survey may cite more than one reason for using loans.

<sup>12</sup> [Eight Ways to Measure Financial Health](#), CFSI, May 2016.

increases the difficulty of replenishing them. Building and maintaining such cushions involves **planning ahead** (another key indicator), while the use of credit to meet them may reflect a lack of planning.

- **Planned purchases:** Some types of credit are designed to facilitate large purchases cost-effectively spreading purchase costs over the life of the asset. However, these sources of credit are generally only accessible to consumers who have established **good credit scores** (another key indicator). Use of subprime, small-dollar credit for such purchases can be far more expensive and can reflect lack of access to prime credit, and possibly that a consumer is already saddled with an unsustainable **debt load** (a negative indicator).
- **Expenses regularly exceed income:** And no source of credit can sustainably address cash shortfalls that occur when a consumer chronically **spends more than they earn** (another negative indicator).

### **Too many sources of SDC exacerbate, rather than improve, poor financial health**

Much research has been done and much written about the most prevalent non-bank sources of small-dollar credit, primarily focusing on the high cost and long periods of indebtedness that characterize the market. The typical two-week, single-payment payday or auto title balloon loan carries an APR of 400 percent; but the cycles of extended re-use are what cause the most damage. While many borrowers are able to pay off such loans and not re-borrow after one or two uses, the majority of loans are to the subset of borrowers who cannot.<sup>13</sup> Because the business model of such products relies on the most frequent users' inability to retire these loans without extended periods of re-borrowing, it aligns lenders' interests against the financial health of these borrowers, who can easily end up paying more in interest than they initially received in principal. And while default rates are low on individual loans, an extremely high portion of loan sequences end in default, with borrowers facing collection actions, lawsuits, and court judgments.

Online payday lenders, and a number of storefront lenders in some states, have introduced longer-term installment loans to meet short-term credit needs; sometimes these loans are secured by vehicle titles. While theoretically, these products provide more affordable repayment structures, they often replicate long sequences of single-payment loans because of their high cost, slow amortization structures, and repeated refinancing offers, and may result in borrowing larger amounts for longer periods than necessary to address a borrower's need. For unsecured loans, default rates have run at 24% for individual loans and 38% for loan sequences. On loans secured by auto titles, default rates at the sequence level have been reported to be 31% and repossession rates, 11%.<sup>14</sup>

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<sup>13</sup> See for example, [Data Point: Payday Lending, CFPB, March 2014](#), which found that half of all payday loans were in loan sequences--continuous borrowing over sequential pay periods--of 10 loans or more.

<sup>14</sup> [Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products, Chapter 1](#), CFPB, June 2016.

## **Banks' current role in the provision of small-dollar credit**

Up to now, and with the exception of the relatively short period during which a few banks offered deposit advance products, banks have generally offered small-dollar credit in two distinct forms: credit card revolving credit and overdraft. At face, these products serve two distinct groups of consumers.

**Credit Cards:** Credit cards are arguably the predominant form of small-dollar credit in the U.S. and the one used by the greatest number of U.S. households. Roughly 44% of U.S. families carried credit card balances from month to month in 2016 with a median amount owed of about \$2,300.<sup>15</sup>

Some portion of these debts was incurred to make large purchases to be paid off over time. These can include durable goods, down payments on autos, or some tuition payments, for example. However, another portion of credit card debt is incurred to meet short-term needs for cash that cannot be met with earnings or savings on hand. These can include some of the SDC use cases we identified above, including unplanned emergency expenses or timing mismatches between income and expenses.

In some ways, credit cards are an ideal source of short-term, small-dollar credit. They are easy to access; in comparison to payday and auto title loans, they are relatively inexpensive; and they offer flexible repayment terms, with minimum monthly payments paying down as little as 1 percent of principal, but also allowing full repayment with no prepayment penalty. One study of LMI households found a large portion use credit cards to cover regular expenses one or more times during the year.<sup>16</sup>

In fact, what may most define frequent users of payday loans and other non-bank sources of small-dollar credit is that they do not have access to credit cards. An analysis in the early 2000s found that payday loan applicants had a median credit score of 517; while a majority had one or more credit cards, few had the ability to borrow on them.<sup>17</sup> Indeed, it is likely that a substantial portion of the deep subprime borrowers who no longer have access to credit cards once used them to address short-term liquidity challenges. The open-ended structure and small minimum payment amounts, in fact, point to a negative feature of credit cards when used as a source of emergency credit: they require users to exercise a high degree of self-discipline to pay down their credit lines so that they are ready for the next emergency.

**Overdraft:** Overdraft is the second form of SDC currently offered by banks and the primary source of small-dollar credit banks provide to consumers who do not have access to credit cards. While the credit card market is dominated by a handful of very large banks, overdraft is a feature of checking accounts at most banks and credit unions. At an estimated \$15 billion in fees, bank and credit union revenues from overdraft are

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<sup>15</sup> [Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances](#), Federal Reserve Bulletin, September 2017.

<sup>16</sup> [The Plastic Safety Net: 2012](#), Demos, May 2012

<sup>17</sup> Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, [Payday Loan Choices and Consequences](#), Vanderbilt Law and Economics Research Paper No. 12-30, October 2012. Table 2: 59% of applicants had one or more credit card accounts; of those 69% were delinquent on one or more of their accounts; of those with credit card accounts, the ratio of the mean average credit card balances outstanding to the mean total limit on credit card accounts (i.e. average credit card utilization) was 96%.

nearly twice those from fees generated by all payday and auto title loans combined, and they approach what financial institutions generate annually from the interchange on all debit card transactions.<sup>18</sup>

While overdrafts are used by 25% to 35% of account holders, roughly 10% of account holders (who incur more than 10 overdrafts or NSF's per year) pay roughly 80 percent of overdraft fees. These frequent users, with a median credit score of 563, generally don't have access to credit cards or do not have unused credit on their cards if they have them.<sup>19</sup> Whether intentionally or out of necessity, these consumers draw their checking balances close to zero during each pay period, making them vulnerable to timing mistakes with respect to deposit and debit posting times.

Pursuant to the 2009 amendment to Regulation E, banks have required a consumer's permission or "opt-in" before charging for overdrafts on non-recurring debit card and ATM transactions. Many consumers may choose to do so in order to maintain the option of accessing emergency funds when account balances are insufficient. Banks have featured the credit optionality of debit card overdraft to widely varying degrees, with some not permitting their customers to opt in at all and others promoting it aggressively. As a result, opt-in rates vary widely from bank to bank,<sup>20</sup> as does overdraft intensity, measured as the ratio of overdraft-related fees to debit card charge volume.

**Deposit Advances:** In addition to overdraft, a few large banks offered "deposit advances" for a period of time. These loans were repayable in full after a short period and banks could control credit risk by securing the loans against the borrower's next deposit. Because they could underwrite access to advances based on the consumer's deposit history, and because they had immediate access to the consumer's next deposit, banks took less risk than payday lenders and could price loans somewhat lower as a result. However, deposit advances resulted in long sequences of advances, similar to those characterizing payday loan use.<sup>21</sup>

Importantly, the availability of deposit advances didn't serve as a substitute for overdrafts. Most deposit advance users overdrew their accounts regularly, even while they were using the product. And when deposit advances were largely discontinued, users' overdraft usage did not increase.<sup>22</sup>

Due to their single-payment structure, borrowers' susceptibility to long re-borrowing sequences, and their ineffectiveness at helping users avoid overdrafts, we recommend that the FDIC retain the effective consumer protections for deposit advance products reflected in its 2013 guidance.

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<sup>18</sup> Banks with assets over \$1 billion reported overdraft-related fees of over \$11.6 billion in 2017. The CFPB has estimated that credit unions and smaller banks received an approximately \$4 billion in overdraft-related fees in 2015.

<sup>19</sup> [CFPB Data Point: Frequent Overdrafters](#), CFPB, August 2017

<sup>20</sup> For example, see [CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings](#), CFPB, June 2013.

<sup>21</sup> For similarities between deposit advance and payday loan usage characteristics, see [Payday Loan and Deposit Advance Products: A White Paper of Initial Data Findings](#), CFPB, April 2013.

<sup>22</sup> [Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products](#), CFPB, June 2016.

## CFSI Compass Principles: Characteristics of safe, high-quality SDC products

In 2014, as part of our Compass Principles, CFSI issued The Compass Guide to Small-Dollar Credit. We outline seven characteristics of small-dollar credit products that embrace inclusion, build trust, promote success, and create opportunity among borrowers. A high-quality loan:

- 1. Is made with high confidence in the borrower's ability to repay.** We advocate using the best available underwriting techniques to ensure a borrower's ability to repay without re-borrowing and while still meeting basic needs and financial obligations. We discourage reliance solely on collateral to assure repayment.
- 2. Is structured to support repayment.** We encourage lenders to make closed-end loans that are fully amortizing and without prepayment penalties. We encourage lenders to strike a balance between making payment amounts affordable (including minimum payments on lines of credit) and minimizing cost over the length of the loan. We encourage products that get borrowers to pay their balances down to zero (so that credit is available for the next use).
- 3. Is priced to align profitability of the provider with success for the borrower.** We encourage lenders to reward positive repayment behavior by lowering costs and to avoid relying on penalty fees and interest rates as profit drivers.
- 4. Creates opportunities for upward mobility and greater financial health.** We encourage reporting to the major credit bureaus to help borrowers improve their credit scores when they successfully repay. We also encourage institutions to combine small-dollar credit products with savings opportunities and incentives, helping borrowers improve their ability to manage future emergencies or cash shortfalls (even when doing so reduces borrowers' future demand for the loan product).
- 5. Has transparent marketing, communications, and disclosures.** We encourage lenders to disclose the full cost of the loan to the borrower in simple, clear, and easy-to-understand language, with no hidden fees, industry jargon, or misleading information or fine print. This includes providing pricing information prior to the application. We discourage bundling of add-on products (such as credit insurance) that cloud the separate costs the add-ons entail.
- 6. Is accessible and convenient.** We encourage lenders to allow loan payments through multiple channels, such as ACH, in-person, online, mobile, or via kiosk. Likewise, flexibility in loan applications and loan disbursements can help to increase access and improve the customer experience.
- 7. Provides support and rights for borrowers.** We encourage lenders to ensure that borrowers can obtain customer support easily and are treated respectfully. This means assigning borrowers to individual relationship managers when servicing and collection issues arise. It means not using collections tactics that employ harassment or intimidation under any circumstances.



## **A note about cost of credit**

It is likely that responses to this request for information will elicit strong points of view about loan pricing: whether or not to permit loan APRs above a certain level (primarily 36%). Some will argue reasonably, that usury caps (such as those prevailing in some states and under the federal Military Lending Act) provide an implicit incentive for institutions to make loans that borrowers have the ability to repay—and to underwrite in ways that limit default risk to what cost of credit will cover. Others will argue with some validity that price caps, either explicitly imposed under usury laws or implicitly under the guise of safety and soundness concerns, limit lenders' ability to offer credit to consumers who pose a higher default risk—often those most in need of liquidity credit.

When it comes to short-term credit, the true cost of a loan depends heavily on the structure of the product, the length of time in debt, and the anticipated range of borrower outcomes. A two-week, \$500 deposit advance, at a cost of \$10 per \$100 advanced, may seem relatively inexpensive at \$50 if it avoids a utility shut-off or repossession of a borrower's car. But if it loan comes with a high-risk of triggering a long sequence of re-borrowing (for example, 6 loans, over 12 weeks and a total cost of \$300), the transparency and safety of the product are less clear. In contrast, a \$500 closed-end, 90-day installment loan with an upfront cost of \$12 per hundred has a higher cost on its face but may have a lower chance of leading to re-borrowing and an extended cycle of fees. Even a traditional credit card (at a subprime APR of 36 percent) may ultimately lead to a higher cost per use if the borrower carries a balance for a sustained period: a \$500 cash advance on such a card, with the typical 3 percent advance fee and repaid only using minimum payments for the six months following use, would cost roughly \$115.

Ultimately, we recognize that there may be a trade-off between cost and availability. This approach is consistent with the OCC's recent guidance that in offering small-dollar credit products, institutions should adopt pricing that "reflects overall returns reasonably related to product risks and costs"(simultaneously, we note that this guidance is hardly followed under most banks' overdraft programs, the prevailing subprime small-dollar credit banks offer today). We encourage regulators to allow institutions to experiment along the cost and availability spectrum, including for products with pricing above 36% APR. However, regulators should test not just whether such products fill immediate demand, but also whether they ultimately improve consumer outcomes, in a measurable and demonstrable way.

## **Innovations in safe SDC: The time is ripe for experimentation**

The FDIC has requested input on what role banks can play in offering small-dollar credit at a propitious time. The industry is in the midst of a flurry of innovation, thanks to important technological developments and to the large number of fintech firms that are developing and testing products to meet the financial needs of the most underserved households. In seeking to serve these consumers' small-dollar credit needs, banks will have an opportunity to learn from these innovations and to adopt and test some of the most promising ones—either through partnerships with fintechs or through their own

bootstrap development efforts. The following are among the most important developments:

- **Early wage access:** Several companies, including PayActiv, Flexwage, and Earnin, allow a consumer to obtain early access to wages for hours already worked before payday arrives. In some cases, these services are offered through employers as an employee benefit. By tying repayment automatically to deductions from upcoming paychecks, the advances minimize risk of default and thus dramatically lower cost. In early experiments both uptake and employee satisfaction have been high, and there is evidence of employer benefit in the form of lower employee turnover.<sup>23</sup>

Allowing early access to wages can help consumers manage needs frequently filled by SDC products, particularly mismatches in income and expense timing. At present, many early wage access products share the same structural weakness of payday loans and other single-payment forms of credit: they have the potential to leave borrowers short on the next payday and can lead to a high degree of repeat use. However, providers and their employer partners can address this by allowing wage advances to be repaid in installments over multiple pay periods.

- **Overdraft insurance:** At least three companies (Dave, Oportun, and Brigit) have launched subscription services that advance small amounts of credit specifically to enable users to avoid overdrawing their accounts. Loan offers are automatically triggered when checking account balances fall below a pre-set threshold. Underwriting based on the consumer's cash flow data is made possible when users provide the services permission to view their daily account balances and transaction histories. Savings to consumers appear substantial as the monthly subscription fees and voluntary payments received by these innovators are far less than what users would otherwise pay in overdraft fees.
- **Cash flow-based underwriting:** A variety of non-bank lenders are pioneering the use of consumers' deposit and spending patterns to assess creditworthiness. Some are applying these techniques to lower default risks and costs in the small-dollar credit arena. The data are made available with the customer's permission through aggregators, who are increasingly using secure Automatic Program Interfaces (APIs) to obtain data.

Cash flow-based underwriters include both some early wage access providers and overdraft insurance providers. Of course, banks already possess account deposit and spending history on their customers and are readily positioned to use this asset in underwriting their own credit products.

- **Advanced liquidity management tools:** Some of the most promising offerings for meeting small-dollar credit needs are actually tools that help consumers better manage their day-to-day spending and thereby help avoid cash shortfalls. These can effectively reduce demand for small-dollar credit while addressing the

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<sup>23</sup> Todd H. Baker, [FinTech Alternatives to Short-Term Small-Dollar Credit: Helping Low-Income Working Families Escape the High-Cost Lending Trap](#), Mossavar-Rahmani Center for Business and Government, at the Harvard Kennedy School, May 2017. See also "[Walmart's pay-advance app Even used by 200,000 employees.](#)" American Banker, July 19, 2018.

daily challenges of managing limited incomes and spending budgets. These tools have been introduced as both stand-alone fintech tools and as account features by a growing number of banks. Those that are seeing the greatest uptake by consumers include:

- **Income earmarking**, which allocates portions of incoming earnings to expected recurring obligations before they can be used for discretionary spending;
- **Digital registers**, which use automated intelligence to predict automated bill payments and other recurring transactions and, accordingly, adjusting consumers' discretionary spending balances;
- **Automated savings**, which operate in the background of consumers' daily financial lives to build cushions of liquid assets that can be drawn on in emergencies and automatically replenished.

Generally, the potential for banks to introduce new ways for consumers to better manage their short-term liquidity needs, through both better forms of credit and new spending management and savings tools, has never been greater. We believe regulators such as the FDIC have a role to play in encouraging experimentation with such new products and services and measuring their impact on consumers.

### **Banks that provide transaction accounts are well-positioned to offer high-quality, small-dollar credit products as part of a suite of offerings to improve financial health**

In their roles as hosts to our national payment systems and providers of deposit and transaction accounts, banks have unique insights into the day-to-day earning and spending—and ultimately, the financial health—of their customers. Thus, they are well-positioned to offer solutions that financially vulnerable consumers need to improve and maintain their financial health. Small-dollar credit products can be a part of these offerings.

Banks are also well-positioned to lower the risk and cost of extending small-dollar credit. Lending to existing customers can largely eliminate fraud risk, while banks' insight into customers' earning and spending behavior can enable them to assess default risk and extend credit to some who might otherwise appear too risky based on their credit history alone. Separately, banks' ability to debit repayments from consumers' incoming deposits can reduce their default risk, though permission to collect payments via auto-debit should not be made a condition for extending credit. Likewise, loss of one's checking account should never be made a consequence of non-payment of credit.

### **Taking a financial health perspective on testing small-dollar credit products**

Almost by definition, users of small-dollar credit represent our country's most financially vulnerable individuals and households who face a wide range of challenges. For some

of them, better-structured, less expensive, and more readily available small-dollar credit will be helpful to their situation. But not for all, and certainly not based on the simple volume-based metrics of a product P&L statement. More credit may not be better than less, cost-of-credit may be less important than how loans are structured, and default may sometimes be a better outcome for the consumer than carrying unsustainable debt loads for protracted periods.

We recognize—and institutional safety and soundness dictates—that banks must earn returns that are commensurate with costs and risk when offering any new product or service, including to consumers who might pose a high level of credit risk. At the same time, we would hardly deem it a public good if banks' expansion into the small-dollar credit market resulted in merely displacing the high cost and sustained indebtedness that so often characterizes the products offered by non-banks.

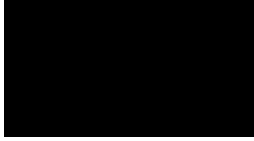
Arguably, the FDIC's small-dollar credit pilot initiated a decade ago achieved limited participation from institutions and consumers because it was too narrowly prescriptive: limiting the size, price, and term of allowable loans, and providing too little incentive to either offer or use them. While its goals were admirable, it did not arrive at scalable solutions or wean banks from their dependence on overdraft revenue.

We encourage the FDIC to consider a wider funnel for innovation regarding product price and structure. At the same time, we hope it will recognize that merely lengthening the menu of product options is not inherently beneficial. If the new forms of credit merely add to, rather than substitute for, existing forms of liquidity borrowing, borrowers will be worse off. Likewise, banks will fail to adequately meet borrowers' needs if they merely introduce new SDC products without also making available innovations that help liquidity-challenged consumers better manage spending and build emergency savings.

Fundamentally, we urge the FDIC to measure borrower outcomes and to make the improvement of small-dollar credit users' financial health the primary measure of success in any program of experimentation. This approach will mean developing a flexible screen for determining which products are permissible for testing and ensuring that this screen is applied to products offered directly by banks, as well as to those offered by their non-bank partners. It will mean not just assembling performance metrics at the product level (e.g., loans made, dollars lent, default rates), but measuring outcomes broadly at the consumer level using something like CFSI's Financial Health metrics. It will mean establishing baseline measures of financial health before product introductions and re-measuring after some meaningful periods of use. Ideally, it will also mean establishing "treatment" and control groups of similarly situated consumers and comparing their outcomes.

Ultimately, the success or failure of any small-dollar credit program should be based on whether consumers are better or worse off as a result of using the product. The FDIC has an opportunity to encourage banks to develop high-quality SDC products while learning how they can be structured to move borrowers toward greater financial health.

Sincerely,



Jennifer Tescher  
President & CEO  
CFSI



John Sledge  
Director, Program Team  
CFSI