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January 22, 2019

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St. NW
Washington, DC 20429
Via email: comments@fdic.gov

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

Dear Executive Secretary Feldman:

I write on behalf of Empire Justice Center, a statewide, multi-issue, multi-strategy public interest law firm focused on changing the systems in which poor and low income New York State families live.

We appreciate the opportunity to comment in response to the FDIC's request for information on small dollar lending. Several safeguards are critical to ensure that bank loan programs—particularly those designed for financially distressed consumers—promote financial inclusion rather than exacerbate financial exclusion and distress. To that end, Empire Justice Center urges the FDIC to (1) prevent bank partnerships ("rent-a-bank" schemes) that evade state interest rate limits; (2) require lenders to consider consumers' ability to repay (taking into account both income and expenses) and advise that small dollar installment loans to be priced at 36% or less; and (3) retain the FDIC's critical 2013 guidance addressing payday loans ("deposit advances") made by banks. These recommendations come from our experience in representing clients; working with lower income working consumers at our CASH vita sites; experiences of local, state and national coalition members; and our own research.

In September 2018 Empire Justice Center released its most recent report, "Too Big to Fail…Too Poor to Bank: How Mainstream Financial Services Can Help Low-Income Working Families Succeed,"[1] a review of traditional bank products and services, as well as those provided by alternative financial services, like check cashers. One of our key recommendations is that banks and credit unions have affordable and responsible emergency and non-emergency small dollar loans that take into account the borrower's ability to repay, and that they market these products to customers and communities likely to need them. We will share our findings from our "access to credit" report throughout this letter.

[1] https://empirejustice.org/wp-content/uploads/2018/09/Access-to-Credit-Report-2018-FINAL.pdf

Protect Strong State Usury Laws

New York State strongly enforces its centuries-old usury laws, including law(s) which make it a felony to charge more than 25 percent interest on a loan. These are the best protection against predatory payday and high-cost lending. Still, financial and quasi-financial sectors repeatedly try to expose consumers to expensive and predatory products. The check-cashing industry has lobbied for bills that would gut New York's longstanding usury laws and other vital consumer protections, introducing high-cost loans into our state. Out-of-state interests float high-tech proposals to allow them to partner with New York businesses with the same goal: marketing expensive loans.

The Changing Economy and the Need for Responsible Small Dollar Loans

American workers increasingly live paycheck to paycheck. Research documents a "new normal" of a labor market with employees required to work irregular hours.[2] Wages have not kept up with housing, child care, education and medical costs, and volatile incomes can vary from month to month. Millions of low- and moderate- income workers don't earn enough all 12 months of the year to pay for basic necessities. The Federal Reserve's 2017 report on economic well-being documented that three in ten adults have family income that varies from month to month. Ten percent of adults face challenges because of this income volatility; and 20% can't meet their monthly bills.[3]

As a result many working families regularly face overdrafts or need small dollar loans to tide them over until the next paycheck. The long term solutions lie in reversing the trends of income inequality with higher wages and a higher earned income tax credit. In addition, affordable housing, health insurance and child care are critical components of a more equitable economy. Until these long term solutions become a reality, financial education and counseling, as well as aggressive enforcement of strong consumer protections against predatory small dollar loan products, are key to helping consumers keep their hard-earned money.

In September 2017, the New York Federal Reserve released a Community Credit Profile for Rochester New York and documented the credit profile of city of Rochester residents. [4] The data set looked at who is included in the credit economy (those having a credit file and a score with a major credit bureau), credit utilization, as well as the number of prime and subprime borrowers. The data set included on-time payers, those with a good payment history and those who were delinquent.

The report compared Rochester's credit profile to the neighboring cities of Buffalo and Syracuse, and to New York State and the US. The study found that only 77% of city of Rochester residents were in the credit economy, well below comparable numbers for the US, New York or Monroe County, but better than those for Buffalo and Syracuse.[5]

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[2] https://assets.aspeninstitute.org/content/.../12/AFN_2017_Income-Volatility_Final.pdf
[3] https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf
[4] FEDERAL RESERVE BANK of NEW YORK. September 2017. City of Rochester Credit Profile 2016, as found at: https://www.newyorkfed.org/medialibrary/media/outreach-and-education/community-development/credit-conditions/City-of-Rochester-Credit-Profile-2016.pdf
[5] Ibid, p. 9.

Percentage of Adults in the Credit Economy*
(*Having a credit file and a score with a major credit bureau)

Place	% Adults in Credit Economy
City of Rochester	77
US	90
NYS	85
Monroe County	91
City of Buffalo	76
City of Syracuse	70

The NY Fed report also found that more than half (52%) of Rochester city residents in the credit economy are only able to access subprime credit.[6] In fact, in six of the city zip codes, 57 to 70% of those in the credit economy have a subprime credit score.[7] This means that the majority of these consumers don't have access to safe and affordable small dollar loans to respond to emergencies. As a result their only option is to use subprime products that put their financial security at further risk.

We recognize that financial education has a role to play in helping lower income consumers budget. However 41 percent of households in Monroe County do not have enough income to afford basic necessities.[8] They live paycheck to paycheck and need safe and affordable small dollar loans to meet emergency and non-emergency credit needs and build assets. Our access to credit report consumer focus group reported they most often borrowed money from family members or friends when faced with an emergency, or second most often, borrowed from an alternative financial service. Without affordable and accessible small dollar loans low income residents turn to the multibillion dollar payday loan industry that offers such loans at 400 percent and up.

All of this illustrates the need for **safe and affordable loan products that build assets and wealth for all residents,** with an emphasis on supporting those who live paycheck to paycheck.

How Payday and Other Small Dollar Loans Harm Consumers

American consumers "currently spend more than $30 billion annually to borrow small amounts of money from payday, auto title, pawn, rent-to-own, and other small-dollar lenders outside the banking system."[9] Unfortunately, many of these small dollar loans are unaffordable, particularly for low- and moderate-income households. Nontraditional lenders, those outside of the banking system, which 20% of Americans use *in addition* to using their bank(s), dominate the small dollar loan market, and they are harmful to consumers.[10]

In fact, the business model of payday lenders is built on loans that people cannot afford to repay. Current small dollar loan products, particularly payday loans, are characterized by triple-digit interest rates, unaffordable periodic payments, and loan repayment terms designed to bring in the most income.

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[6] Ibid, p. 10.
[7] Ibid, p. 37.
[8] Choose the NYS and Monroe County in the maps on this page: https://www.unitedwayalice.org/in-the-us.
[9] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions
[10] Ibid.

Payday loans are typically 14- or 30-day balloon-payment loans at 391% interest or more. People who cannot afford to repay the loan must re-borrow to meet their other expenses, putting them in a cycle of debt.[11] At the other end of the spectrum are examples of 18-month terms for loans of only $500, yielding astronomical fees.[12] Often, borrowers pay more in interest and fees than the principal amount originally borrowed.

There are copious reasons to be concerned about how the payday lending industry conducts business. For example, to ensure repayment, payday lenders, and other small dollar lenders outside of the banking system, obtain access to the bank accounts of their borrowers by requiring repayment by electronic funds transfer (EFT) from their borrowers' accounts. These lenders can then withdraw funds from the borrower's account without any additional notice or consideration for other expenses due. This, in turn, can trigger overdraft and other fees that keep a borrower in a revolving door of debt. The cost structure of these loans often incentivizes lenders to keep borrowers in the revolving door; it is more advantageous to push borrowers to take out another loan and pay another set of steep fees than it is to encourage them to pay off the loan balance in full.[13] This is how payday loans trap borrowers into a cycle of unaffordable debt they cannot escape.

Despite the unaffordability, there are legitimate reasons that consumers continue to use these products. The nonprofit focus group noted that, in addition to emergencies, income volatility and poor credit are other reasons consumers resort to these loans. Most who take out payday loans are in immediate financial distress, so the fact that the loans are easy to apply for, likely to be approved, and are issued within a short period of time [14] positions the product as an immediate and viable solution when there is no other.

<u>Responsible Small Dollar Loans—A benefit to both consumers and financial institutions</u>

After five years of research and extensive input from a broad range of stakeholders, in October 2017 the Consumer Financial Protection Bureau (CFPB) issued its final payday rule to help mitigate the issue of short term loans.[15] One of the rule's key requirements is that lenders check a borrower's ability to repay before making the loan. This ensures that a borrower can repay without re-borrowing and without defaulting on other expenses, that is, without getting into the cycle of debt mentioned several times above. [16]

With proper guidelines, banks and credit unions are well-positioned to both responsibly and profitably issue small dollar loans. Three-quarters of those who use alternative financial services have an account at a bank or credit union, so banks already have an in-house market; the customer acquisition and underwriting costs for banks and credit unions would be significantly lower than those of payday

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[11] https://www.nclc.org/issues/stop-payday-loan-debt-trap-preserve-cfpb.html

[12] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions.

[13] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/08/from-payday-to-small-installment-loans.

[14] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions.

[15] This rule, with a compliance date of August 2019, is expected to be reconsidered by the CFPB, with a proposed rule to be out in early 2019. See: https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=3170-AA80. However, this does not mean that other agencies should not follow this model, research-based rule.

[16] http://stopthedebttrap.org/blog/court-cfpb-payday-lending-rule-compliance-date-stays-intact/

lenders.[17] To align with the CFPB payday rule, a consumer's ability to repay should be considered and documented. Banks and credit unions can use information already available to them from their customers' bank accounts to determine ability to repay as part of an inexpensive and automated underwriting process. Research suggests that customers with low credit scores "can afford payments of around 5 percent of their gross paychecks,"[18] so banks can "use this threshold for a standard of affordable payments."[19] In addition, the terms of these loans should be dictated by the loan amount, with a maximum of one year for a $1,000 loan.

Banks experimenting with small dollar loan products have found success; three regulated programs saw a collective default rate of 2% to 4%.[20] By strategically setting payments, fees, terms and so on, banks and credit unions can profitably offer small dollar loan products while offering safer and more practical financial alternatives to their customers.

A few banks and credit unions in the Rochester NY area already offer small dollar consumer loans or home improvement loans, or are developing small dollar products.

- One national bank and one credit union currently offer small dollar consumer loans to their customers. These loans have terms ranging from 6 months to 2 years depending on the interest rate, the client's credit profile and ability to repay.

- Another bank piloted a small dollar home improvement loan in specific branches. It is currently developing another small dollar loan product and fine tuning its home improvement loan with the needs of its customers.

- After reading the recommendations of our access to credit report, another bank shared with us that it is working on a small dollar loan product. This bank also noted that its unsecured home improvement loan is now being advertised in low-moderate income branches and in low-moderate income neighborhoods. The loan can be for as little as $2500, and it can be used for any home purpose, i.e. water tank, roof, windows.

Conclusion

We share the FDIC's goal of greater financial inclusion for low-income consumers and communities of color. We also know too well the harm that unaffordable, high-cost loans cause these communities. And we know that state interest rate limits are the most critical protection against predatory small dollar loans. Thus, any bank product must carry critical safeguards.

1. The FDIC must not sanction "rent-a-bank" schemes, where non-bank lenders partner with banks to facilitate high-rate loans that would otherwise be illegal. These schemes pose an existential threat to state law and promise to cause severe harm to our nation's most financially distressed consumers.

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[17] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions
[18] Ibid.
[19] Ibid.
[20] Ibid.

2. The FDIC must require that any bank product be (i) affordable and (ii) reasonably priced:

    i. To ensure loans are affordable, the bank must consider the customer's income and expenses before making the loan. Relying on income-only standards like a "payment-to-income" ratio is not ability-to-repay, and it will result in widespread unaffordable lending.

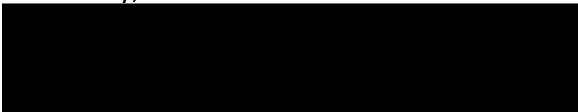
    ii. On pricing, a 36% interest rate limit is already the law of the land for military service members, it has been upheld by the FDIC for over a decade, and it is the state interest rate cap in many states. Erosion of this standard--like by (OCC-supervised) US Bank's "Simple Loan" product at 70% APR--will harm the consumers the FDIC most aims to help.

3. The FDIC must retain its 2013 guidance against unaffordable bank "deposit advance" loans. The evidence overwhelmingly shows that these were debt-trap payday loans that piled onto bank customers' existing unsustainable debt load. FDIC-supervised banks never made these loans, and for the Agency to encourage them now would be reckless.

Finally, given that many financially struggling consumers are already overburdened by unaffordable credit, we urge the FDIC to encourage expansion of credit builder products and secured credit cards, to help consumers build or rebuild credit capacity at the front end, without falling further behind. In addition, given the tremendous burden overdraft fees impose on banks' most distressed customers, we urge the Agency to enforce its guidance addressing abusive overdraft fees; discourage charging these fees on debit card and ATM transactions; and strongly encourage safe accounts without these fees.[21] These initiatives would go a long way toward increasing economic inclusion among our nation's financially vulnerable.

We thank the FDIC for considering our comments.

Sincerely,



Barbara Van Kerkhove, Ph.D.
Researcher/Policy Analyst

[21] See more about overdraft fees and responsible checking and transaction accounts in our above-referenced report "Too Big to Fail…Too Poor to Pay."