American Bankers Association
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January 22, 2019

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58,566 (Nov. 20, 2018) [RIN 3064-ZA04]

Dear Mr. Feldman:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) request for information on small dollar lending.[2]

ABA shares the FDIC's goal to preserve and encourage the role banks play in providing small dollar credit to customers. Because borrowers' needs are diverse, there should be a vibrant credit market with many small dollar credit options, including credit cards, installment loans, single payment loans, and overdraft protection services, among others. ABA believes that the banking industry can and should continue to be a major participant in this market, but the costs, complexity, and compliance risks presented by the existing regulatory framework act as impediments to banks making these loans. When people in need cannot meet their credit needs through financial institutions, the need does not go away; instead, people are driven to "informal" sources. The FDIC should use this opportunity to remove obstacles that hamper the ability of banks to meet their customers' needs for small dollar credit.

I. Summary of Comment

ABA appreciates the FDIC's encouragement to banks to offer small-dollar credit products that are economically sustainable while meeting the needs of bank customers. Small dollar loans provide an opportunity for a bank to deepen its relationship with its customers, and, when repaid as agreed, for those customers to improve their credit scores and graduate to other credit products. Expanding access to small dollar credit also supports economic activity in the communities where these borrowers live.

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[1] The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits, and extend nearly $10 trillion in loans.
[2] Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58,566 (Nov. 20, 2018).

Although most banks provide small dollar loans, banks can only provide this credit at the scale needed to meet customer demand if they can use a simple, streamlined underwriting process to evaluate and provide credit, in a manner that is both fair and convenient for customers, and with no arbitrary limits on re-borrowing. The FDIC's 2013 Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products[3] (DDA Guidance) imposed prescriptive underwriting expectations that are inconsistent with a streamlined underwriting process. The DDA Guidance stands as a significant barrier for banks that seek to establish or expand a single-payment credit program, a product that meets many consumers' needs for short-term sources of funds. Direct deposit advance (DDA) services provided customers with fast and convenient access to small dollar credit, at lower rates than offered by competing products. The DDA Guidance effectively ended the program, as all but one bank discontinued its program in response, depriving customers of another valued form of small dollar credit. We urge the FDIC to rescind the DDA Guidance immediately. Rescission will remove a key barrier constraining FDIC-supervised banks from establishing sustainable small dollar lending programs.

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Congress centralized many elements of consumer protection regulation in the consumer bureau, while maintaining the authority of the FDIC and other prudential regulators to take regulatory action to promote the safety and soundness of banks.[4] Despite this division of responsibilities, the FDIC premised its DDA Guidance on consumer protection concerns, endeavoring to equate such concerns with safety and soundness risk. Moreover, the FDIC asserted (without evidence) that the product created reputational risk, despite evidence that the product was valued by customers, profitable, and well-managed.

More broadly, we urge the FDIC to create a regulatory framework that encourages banks to establish sustainable small dollar lending programs. This framework should permit banks to use automated, efficient underwriting, and should acknowledge the value provided by a variety of small dollar loan options, including single payment loans, installment loans, and fee-based loan structures. We also urge the FDIC to reject a regulatory approach that imposes prescriptive underwriting standards, relies on use of an *annualized* measure of interest to assess the affordability of short-term small dollar credit, or imposes arbitrary limitations on reborrowing.

In designing a suitable regulatory framework, the FDIC should consider the Office of the Comptroller of the Currency's (OCC) May 2018 bulletin on "core lending principles" for small dollar installment loans.[5] The OCC's bulletin described, as "reasonable" underwriting standards for small dollar loans, standards that are not prescriptive and that permit reliance on a customer's deposit activity with the bank.[6] As the OCC suggested, allowing banks to innovate in their underwriting approaches to meet customers' short-term credit needs can be expected to lead to more diverse products, greater consumer choice, and lower prices.

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[3] Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products, 78 Fed. Reg. 70,552 (Nov. 26, 2013) [hereinafter, FDIC Guidance].
[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2012) [hereinafter, Dodd-Frank Act].
[5] Office of the Comptroller of the Currency (OCC), OCC Bulletin 2018-14, Core Lending Principles for Short-Term, Small-Dollar Installment Lending (2018) [hereinafter, OCC Bulletin].
[6] *Id.*

Furthermore, the FDIC should engage with the OCC, the Board of Governors of the Federal Reserve System, and the Bureau of Consumer Financial Protection to promote a coordinated approach to the regulation of small dollar lending. It is critical that the resulting regulatory framework is clear and consistent, to encourage banks to enter or expand their presence in this market.

II. Banks Could Expand their Small Dollar Offerings to Meet the Significant Demand for this Credit Should Regulatory Conditions Permit

People of all walks of life benefit from using small dollar credit to meet a variety of needs, such as to pay emergency expenses, to manage misalignments in the timing of their expenses and income,[7] to cover a transition period between jobs, or, for seasonal workers, to cover disruptions in pay. The demand for this credit is significant: according to a 2017 study by the Federal Reserve, a "disconcertingly large" share of American adults — 41% — could not cover an emergency expense that costs $400 using cash or its equivalent.[8] Yet many of these consumers do not have access to revolving credit card accounts, which offer the least expensive, flexible, and sustainable small dollar credit product. Between 2008 and 2017, the total number of credit card accounts held by subprime customers decreased by 16%.[9]

Banks are ideally situated to meet consumers' short-term credit needs. Small dollar loans made by banks are underwritten, contain simple and clear terms, and are designed to be repaid — and are repaid — according to their terms. Two surveys that ABA recently conducted of its member banks' small lending practices demonstrate these points. A 2016 ABA survey of 60 banks revealed that 60% of surveyed banks that made small dollar loans charged off *no such loans*, and another 23% charged off *no more than 1%* of such loans.[10] A 2015 ABA survey of 93 banks

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[7] As the FDIC observed in its request for information, 20.0% of Americans earned income that varied "somewhat" or "a lot" from month to month. Fed. Deposit Ins. Corp. (FDIC), FDIC National Survey of Unbanked and Underbanked Households 19 (Oct. 2018), https://www.fdic.gov/householdsurvey/2017/2017report.pdf (Table 3.2). For Americans that are "underbanked," the percentage whose income varied somewhat or a lot from month to month increased to 54.4%. *Id.* at 20 (Table 3.3).

[8] Bd. of Governors of the Fed. Reserve Sys., Report on the Economic Well-Being of U.S. Households in 2017, at 21 (May 2018), https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf.

[9] These data reflect analysis by Keybridge LLC of general purpose cards issued by companies that provide data to Argus Information and Advisory Services. The latest year for which full data are available is 2017.

These data are also consistent with Marshall Lux and Robert Greene's 2016 report, which found that consumers with credit scores less than 680 originated 50% fewer credit card accounts in 2015 as compared with 2007, and borrowed 19% less over this time period. Marshall Lux & Robert Greene, Out of Reach: Regressive Trends in Credit Card Access 10 & 12 (Apr. 2016), https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/Out_of_Reach_Lux_Greene_4_7.pdf.

[10] "Small dollar loan" was defined in the survey consistent with the definition provided by the Bureau of Consumer Financial Protection in its then-proposed rule regarding "Payday, Vehicle Title, and Certain High-Cost Installment Loans" issued in June 2016. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864 (proposed July 22, 2016). The proposed rule defined a small dollar loan as "closed-end or open-end credit that is extended to a consumer primarily for personal, family, or household purposes" and meets the following criteria: (a) loans that have a term of 45 days or less; or (b) loans that have a term of more than 45 days, have a "total cost of credit" (all-in APR) that exceeds 36%, and provide the lender with a leveraged payment mechanism or vehicle security. *Id.* at 48,168.

revealed similar data[11]: one-third (34%) of surveyed banks that made small dollar loans in 2014 charged off *no such loans*; another 61% of banks charged off *no more than 3%* of such loans.[12]

Default rates can be expected to rise if economic conditions deteriorate because of national or local conditions. For example, a plant closure, local natural disaster, or sectoral economic downturn (e.g., fall in crop prices) will create upward pressure on default. Nonetheless, the currently low default rates reflected by the survey results attest to banks' underwriting standards.

Banks can and would like to do more to meet their customers' small dollar credit needs. This view is underscored by additional survey research that provide insight into the prevalence of bank-provided small dollar credit and how consumers access this credit. An ABA survey conducted in March 2018 revealed that 10% of consumers surveyed reported having taken out a personal loan for less than $5,000 (not including credit card use) during the 12-month period prior to the survey, a significant portion of the population.[13] However, fewer than half of these borrowers — 43% — received the loan from a bank or credit union, despite evidence that consumers would like to meet their small dollar credit needs with bank-provided loans. More than two-thirds of survey respondents — 68% — expressed support for policy changes that would encourage banks and credit unions to offer small dollar loans.

The fact that relatively few consumers met their small dollar credit needs with bank-provided loans may reflect the scarcity of established bank programs to provide this credit. Although 73% of banks that responded to the 2015 ABA survey made small dollar loans in 2014, only 35% of responding banks made small dollar loans as part of an established program. These survey results suggest there is significant room for banks to expand their small dollar credit offerings should regulatory conditions permit. An expansion of bank-provided small dollar credit would benefit both the banks offering this credit and their customers. Small dollar loans provide an opportunity for a bank to deepen its relationship with its customers and allow those customers to build — or rebuild — a positive credit history through their positive performance on the loans (and graduate to other credit products), while also providing financing that funds local economic activity.[14] ABA members advise that, unlike some nonbank lenders, banks typically report their small dollar loans to the credit reporting agencies.

Without access to small dollar credit through regulated financial institutions, consumers may turn to informal funding sources or forego necessary goods and services or the payment of important bills. Inasmuch as consumers' needs and conditions are varied, their options for short-

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[11] ABA surveyed 93 banks in fall 2015 to gather data about small dollar "accommodation" lending within the banking industry. "Small dollar loans" were defined in the survey as loans that (a) were in an amount of $5,000 or less and (b) had a maturity of less than one year.

[12] Roll over rates of bank-provided small dollar loans are similarly low. The 2016 ABA survey found that one-third of surveyed banks that made small dollar loans in 2015 rolled over no such loans. Overall, the median roll over rate of these loans was 5%.

[13] The polling firm Morning Consult conducted, for ABA, an online survey of 2,201 registered voters from March 27-30, 2018. Results from the full survey have a margin of error of +/- 2 percentage points.

[14] *See* FDIC, A Template for Success: The FDIC's Small-Dollar Loan Pilot Program, 4 FDIC Quarterly 28 (2010), https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf (stating that a "key lesson learned" of the FDIC's 2010 small-dollar loan pilot program "was that most pilot bankers use small-dollar loan products as a cornerstone for building or retaining long-term banking relationships").

term, small dollar credit should also be varied. Regulatory actions should encourage a competitive marketplace with a number of different products.

III. The FDIC Should Rescind its Guidance on Direct Deposit Advance Products

In the Dodd-Frank Act, Congress chose to centralize many elements of consumer protection regulation in the Bureau.[15] Despite this division of responsibilities, in 2013 the FDIC, via guidance, sought to impose consumer-protection requirements on a popular bank small dollar lending product — direct deposit advance (DDA) services — under the guise of safety and soundness concerns. DDA services provided a sustainable and valued small dollar credit option within the regulated banking system. As they were offered, DDA services permitted eligible customers, for a fee, to borrow funds that were deposited directly into the customer's account. Banks underwrote the borrowings using information derived from the customer's relationship with the bank, including the customer's history of incoming credits. Because of these underwriting efficiencies, banks could offer the product at competitive rates, significantly lower than the typical rate charged by some non-bank providers, and earn a return proportionate with their costs and risk. Knowledge of the customer's borrowing history also allowed the bank to set reasonable limits on product use, without the need to resort to arbitrary limits.

DDA customers appreciated that they could quickly access funds in a convenient manner (including from the customer's online bank account) and at a lower cost than competing non-bank short-term credit products. Reviews of accounts that used the product show that many customers used the product as a means to manage actively their short-term, emergency credit needs and to avoid overdraft, NSF, or returned check fees. They valued the fact that the advance was made directly into their checking account. Deposit advance customers also appreciated that advance limits were low (usually the lesser of $500 or 50% of the total of recurring electronic deposits into the account).

In 2013, raising unfounded and undemonstrated safety and soundness concerns, the OCC and FDIC published identical guidance that expressed the agencies' "expectations" that banks would follow a prescriptive set of underwriting requirements in offering these credits and self-impose arbitrary cooling off periods on customers' use of the product, which is inconsistent with the variable reality of life and customer credit needs.[16] There was, however, no evidence offered by the agencies to demonstrate that the operation of DDA programs presented operational, credit, or reputational risks that were not addressed adequately by existing supervisory policies, regulation, and guidance.[17]

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[15] Dodd-Frank Act § 1011(a) (authorizing the Bureau to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws").

[16] FDIC Guidance, 78 Fed. Reg. at 70,552; Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products, 78 Fed. Reg. 70,624 (Nov. 26, 2013) (OCC guidance).

[17] The supervisory concerns raised in the DDA Guidance were, at bottom, consumer protection concerns, and did not express true safety and soundness risks. These alleged consumer protection concerns include the following, none of which affects the bank's safety or soundness: (a) that a customer could use the DDA product over an extended period of time; (b) that banks' self-imposed cooling-off periods could be avoided and would not prevent repeated usage; and (c) that banks' automated underwriting may result in overdraft fees. FDIC Guidance, 78 Fed. Reg. at 70,554.

As ABA noted at the time,[18] the agencies' assertion of safety and soundness concerns appeared to reflect an attempt to impose additional and unnecessary consumer compliance requirements on a legal and popular product that agency leadership disfavored.[19] As a direct result of the guidance and simultaneous pressure that regulators exerted on individual banks, all banks that offered a DDA service exited the market or, in the case of one bank, limited use of the product to previously enrolled customers.

With no bank-provided, single-payment loan option available, customers resorted to nonbank small dollar loan products to meet their short-term credit needs. One bank that had a deposit advance program saw a 20-30% increase in withdrawals from payday lenders in the month following the discontinuation of its deposit advance program. Those customers who had used the program most frequently showed, instead, an approximately 30% greater incidence of payday lender withdrawals a full year after the program was discontinued, as compared with those customers' payday usage while the deposit advance program was in operation. These findings demonstrate that consumer demand for single-payment small dollar loans is substantial and cannot be "regulated away."

In 2017, the OCC rescinded[20] its guidance on the same day that the Bureau released a final rule governing payday, vehicle title, and certain high-cost installment loans (Final Rule).[21] In rescinding the guidance, the OCC stated that it sought to avoid subjecting OCC-regulated banks to underwriting requirements and cooling-off periods that were "inconsistent" with the requirements in the Bureau's Final Rule.[22] Additionally, the OCC expressed its concern that "in the years since the agency issued the guidance, it has . . . become difficult for banks to serve consumers' need for short-term, small-dollar credit,"[23] and that "consumers who would prefer to rely on banks and thrifts for these products may be forced to rely on less regulated lenders and be exposed to the risk of consumer harm and expense."[24] In the OCC's view, its guidance "may

[18] Letter from Richard Riese, ABA, to Office of the Comptroller of the Currency 9 (Aug. 4, 2011), https://www.aba.com/archive/Comment_Letter_Archive/Comment%20Letter%20Archive/OCCGuidanceLetter8411.pdf.

[19] Customer reviews of deposit advance products were overwhelmingly positive, as demonstrated by the following results of surveys conducted by banks that offered the product:

- One bank's survey of its deposit advance customers found that 88% of customers were satisfied or very satisfied with the program. Of those customers who had also used a similar service offered by a nonbank, 95% preferred the bank's product.
- A second bank's survey of its deposit advance customers found that customers rated their experience well (4.62 on a 5-point scale), and the overwhelming majority (80%) were "very likely" to use the service again.
- In a third bank's survey, 90% of its deposit advance customers rated their experience with the product as "good" or "excellent," and 91% of customers planned to continue to use the product in the year after the survey was conducted.

[20] OCC, Docket ID OCC-2017-0019, Rescission of Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products (Oct. 5, 2017) [hereinafter, OCC Guidance Rescission].

[21] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041). The Final Rule was released by the Bureau on October 5, 2017, and published in the *Federal Register* on November 17, 2017.

[22] OCC Guidance Rescission, *supra* note 20, at 2-3.

[23] News Release, OCC, Acting Comptroller of the Currency Rescinds Deposit Advance Product Guidance (Oct. 5, 2017), https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-118.html [hereinafter, OCC News Release].

[24] OCC Guidance Rescission, *supra* note 20, at 3.

even hurt the very consumers it is intended to help, the most marginalized, unbanked and underbanked portions of our society."[25]

The OCC's concerns apply similarly to the FDIC's DDA Guidance. That guidance imposes the same underwriting and cooling-off requirements that are present in the OCC's guidance. Thus, it may subject FDIC-regulated banks to regulatory requirements that are inconsistent with those imposed by the Bureau and discourage banks from entering the market that Bureau rules would allow.[26] As the OCC suggested in announcing the rescission of its guidance, a responsible small dollar credit program can be guided by "prudent underwriting and risk management as well as fair and inclusive treatment of customers" without imposing prescriptive underwriting expectations and arbitrary cooling-off periods.[27]

We reiterate our call that the FDIC rescind its DDA Guidance.[28] The guidance effectively precludes banks from offering one form of short-term credit — single-payment borrowing — despite the demonstrated consumer demand for this type of credit. The guidance constrains not only FDIC-supervised institutions from offering single-payment loans through an automated program but also other banks too because of the risk that the bank would be subject to unfounded criticism for operating its program in the face of the FDIC's guidance. Without rescission of the guidance, banks will remain reluctant to enter this market.

IV. The FDIC Should Create a Regulatory Framework that Will Encourage Banks to Establish Sustainable Small Dollar Lending Programs, Offering Diverse Options for this Credit

As described above, a sizeable majority of banks provide small dollar loans for their customers that need the credit, but most banks provide the credit as an accommodation to a customer who requests a loan, not as part of an established program.[29] Rescission of the FDIC's DDA Guidance is a necessary and important step to encourage banks to expand their small dollar credit offerings.

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[25] OCC News Release, *supra* note 23, at 1.

[26] Although the Bureau is reconsidering the Final Rule, the Bureau has stated it is limiting its reconsideration to the Rule's ability-to-repay provisions, suggesting that other aspects of the Rule, such as the cooling-off requirements and payment provisions, are not currently under consideration for revision. Press Release, Bureau of Consumer Fin. Protection, Public Statement Regarding Payday Rule Reconsideration and Delay of Compliance Date (Oct. 26, 2018), https://www.consumerfinance.gov/about-us/newsroom/public-statement-regarding-payday-rule-reconsideration-and-delay-compliance-date/.

[27] OCC Guidance Rescission, *supra* note 20, at 3.

[28] We previously urged the FDIC to rescind its DDA Guidance in letters dated October 12, 2017, and October 10, 2018, and in a white paper submitted to Secretary of the Treasury Steven T. Mnuchin in April 2017. *See* Letter from Shaun Kern, ABA, to Thomas Lyons, FDIC, 2-4 (Oct. 10, 2018), https://www.aba.com/Advocacy/commentletters/Documents/cl-Retirement2018Oct10.pdf; Letter from Virginia O'Neill, ABA, to Martin J. Gruenberg, Chairman, FDIC (Oct. 12, 2017), https://www.aba.com/Advocacy/commentletters/Documents/Ltr-Gruenberg-DepositAdvance-2017.pdf; ABA, White Paper, Small Dollar Credit: Millions of Small Needs Add Up to a Big Deal: Banks Should Be Allowed to Offer Customers Multiple Choices 4-5 (2017), https://www.aba.com/Advocacy/Documents/SmallDollarWhitePaper2017Apr.pdf.

[29] *See supra* Part II.

More broadly, the FDIC should create a regulatory framework that will encourage a diversity of sustainable small dollar lending programs offered by banks. Both installment loans and single payment loans represent an important source of credit for many customers; the best product for a customer will depend on that customer's financial circumstances and ability to manage a series of payments. For example, a customer who expects to receive a substantial credit to the customer's account, such as a tax refund or holiday bonus, may best be served by a single-payment loan. Moreover, for a variety of reasons, some customers can manage a loan requiring only a single payment more effectively than an installment loan, which requires multiple payments over a period of time. Conversely, a customer who is not awaiting a large credit to the customer's account and can manage a series of payments may be better served by an installment loan.

The FDIC should not favor — or disfavor — a certain form of small dollar credit as compared with others but instead encourage a vibrant credit market with many choices for this credit. A more flexible regulatory framework that expands bank-provided small dollar credit offerings should include the following elements.

a. The FDIC Should Encourage Use of Efficient, Predictive Underwriting

To offer a sustainable small dollar credit product, banks need the latitude to design efficient, predictive underwriting that allows the institution to offer fast and convenient access to small dollar credit while minimizing underwriting costs. Prescriptive and complex underwriting expectations — such as an expectation that the bank will calculate a borrower's residual income and major expenses — are inconsistent with efficient and affordable underwriting standards and with the reality that many consumers need to borrow small amounts of money because they *lack* the residual income to cover in short order an emergency expense or to cope easily with a temporary disruption or fluctuation in income. Prescriptive underwriting standards, particularly those that mandate credit bureau usage, will also increase the loan's cost and limit access to credit by many credit worthy borrowers who, by successfully repaying past loans, have demonstrated their *willingness to repay*. As a result, less small dollar credit will be available from banks to customers who need it.

An expectation that the bank would document a borrower's income and expenses as part of the underwriting of the loan will impose particularly significant burdens on borrowers who are seasonal workers, work "odd jobs," or are paid in cash. These workers may not have pay stubs readily available. For borrowers who possess these documents, it is unlikely they will come to the bank with all of the paperwork necessary for the bank to document income and major expenses in a time frame that matches well the borrower's needs. Instead, the customer will be forced to take time to locate and subsequently provide the required documents, delaying the loan. This delay will inconvenience all but may also result in more significant harm if, for example, the borrower's car needs immediate repair or the borrower's rent payment is due.

More broadly, prescriptive underwriting expectations will stifle innovation in the market for small dollar loans by preventing banks from designing products to meet the existing and evolving needs of their customers. Many banks and even non-bank companies are already developing streamlined and predictive underwriting tools and algorithms to evaluate credit risk. For those banks that are not currently exploring new underwriting tools, prescriptive underwriting standards will discourage the refinement of existing approaches, without evidence that a prescriptive approach produces superior outcomes. A narrow, one-size-fits-all underwriting formula will prevent utilization of important information, discourage acceptable risk taking, and limit consumer access to small dollar credit.

A better approach is reflected in the OCC's bulletin released last May on "core lending principles" for small dollar bank installment loans.[30] As the OCC stated, a responsible small dollar credit program can be guided by "reasonable policies and practices," including the use of "deposit activity to assess a consumer's creditworthiness."[31] In permitting banks to innovate in designing appropriate underwriting standards, the OCC concluded that a bank may determine that a customer has "an ability to repay a loan despite a credit profile that is outside of the bank's typical underwriting standards for credit scores and repayment ratios."[32] The OCC did not suggest that prescriptive underwriting expectations were necessary or even helpful in predicting a borrower's creditworthiness for small dollar borrowing.

b. The FDIC Should Not Evaluate Short-Term Small Dollar Credit by Applying an Annual Interest Measure

An annual measure of interest, such as an annual percentage rate (APR), is an inappropriate metric to measure the cost of credit of a small dollar, short-term loan. It is akin to assessing the value of a hotel room rented by the night based on the room's annualized rate (i.e., cost if rented for the entire year). Small dollar loan customers are much more interested in knowing how much this credit will cost them than the loan's interest rate if annualized. A small dollar loan can be priced simply and transparently through use of a flat fee (for a single payment loan) or through a series of monthly or other regular payments (for an installment loan) — information that can readily and meaningfully be compared to the cost of alternative products such as nonbank payday loans that are more costly. Applying an annual measure to a credit having a term measured in weeks is inapt and misleading.

Moreover, a regulatory approach that requires a bank to disclose a misapplied APR may discourage banks from offering this form of credit due to reputational concerns derived from its mischaracterization. Even with streamlined underwriting, compliance and operational expenses dictate a cost structure that can be misbranded as unfair by use of an inapt measure. However, the FDIC's small dollar lending pilot program illustrates the challenge of evaluating a small dollar loan through an annual measure of interest and imposing arbitrary constraints on the price of the loan. The pilot program, which ran from 2008 to 2010, established a maximum APR of 36% for a loan to qualify for participation in the program. At the end of the two-year program, the FDIC concluded that the interest and fees generated by loans that qualified for the program were "not always sufficient to achieve robust short-term profitability."[33]

[30] OCC Bulletin, *supra* note 5.
[31] *Id.*
[32] *Id.*
[33] FDIC, Template for Success, *supra* note 15, at 32.

c. The FDIC Should Not Impose Arbitrary “Cooling-Off” Periods

Arbitrary limits on re-borrowing harm consumers by imposing unnecessary barriers to access to small dollar credit and incentivizing them to borrow more than they need. ABA members report that customers typically do not access the full amount available under the bank’s small dollar loan program. For example, a bank that previously offered a short-term loan product with an open-end line of credit reported that 96% of its customers did not access the maximum amount of the line in each of six consecutive months of usage. A limit on re-borrowing would incentivize a customer to borrow more than needed, because the customer may be barred from re-borrowing should a need for additional funds subsequently arise. This may lead the customer thus to pay more in fees (for a larger loan) than had the customer borrowed only the amount anticipated.

In addition, customers who successfully repay their small dollar loan should not be denied repeat use of the product. Customers repeatedly access other types of credit, such as credit cards and home equity lines of credit, to manage responsibly their credit needs. Regulators should not view repeat usage of small dollar loans differently from repeat usage of these other forms of credit.

More broadly, there is a paucity of evidence that small dollar loans made by banks lead customers to enter into a “cycle” of debt. Although default rates on small dollar loans will be influenced by national and local economic conditions, one bank reported a successful repayment rate of 99% for its short-term, open-end credit product. Even the Bureau, in justifying its Final Rule that targeted payday loans, included no reference to, or discussion of, studies demonstrating that the origination and servicing of small dollar loans by banks causes injury to customers. Moreover, banks monitor usage, set reasonable limits on product use, and offer “fresh start” installment loans to customers exhibiting challenges managing their existing indebtedness. There is no need for arbitrary cooling off periods determined by regulatory fiat.

d. The FDIC Should Permit the Use of Automatic Debits as a Means of Payment

Automatically debiting a customer’s deposit account to make payment on a small dollar loan is popular with customers and reduces operational costs. ABA members report that customers appreciate the auto-debit option, because it eliminates risk that the customer will forget to make payment, saving the customer potential late charges. For higher risk customers, an auto-debit option reduces credit risk and permits the bank to offer the credit on more affordable terms.

The FDIC should not limit a bank’s use of an automatic debit feature to receive payment on a small dollar loan. Regulation E already requires that the customer authorize automatic debits in writing.[34] Absent a showing of customer confusion over use of this feature, no such additional regulation is warranted.

[34] 12 C.F.R. § 1005.10(b) (2013).

V. The FDIC Should Coordinate with the Bureau and other Federal Banking Agencies

It is critical that the FDIC coordinate its regulatory actions regarding small dollar lending with the Bureau and other Federal banking agencies. A primary barrier to the expansion of bank small dollar lending is the presence of inconsistent rules and supervisory expectations expressed in "guidance" for making these loans. These inconsistencies create confusion and add unnecessary regulatory costs. Moreover, as stated above, the FDIC's regulatory approach impacts not only the banks the agency supervises, but also other banks, which may expand their presence in this market only if their product complies with the regulatory expectations of all the Federal banking agencies and with regulations issued by the Bureau.[35]

Conclusion

ABA appreciates the FDIC's request for information on steps it can take to encourage small dollar lending by banks. Banks have been and should be major participants in the small dollar credit market, but banks wish to do more and need a regulatory environment that encourages a vibrant credit market with many choices for small dollar credit, rather than a regulatory environment that progressively chokes off customer access.

As an initial — and critical — step, we urge the FDIC to rescind its DDA Guidance, which applies consumer protection strictures on DDA products but was issued under the guise of safety and soundness risk. The FDIC should also adopt a regulatory approach that encourages automated and/or streamlined underwriting for small dollar loans, eschews prescriptive underwriting standards, refrains from the misuse of an APR to assess small dollar credit, and avoids arbitrary limitations on reborrowing.

Sincerely,

[redacted]

Jonathan Thessin
Senior Counsel, Center for Regulatory Compliance

[35] The FDIC also should ensure that its examiners apply expectations consistent with the agency's regulations and supervisory policy. On a range of issues, ABA members report that there is often a disconnect between the regulatory expectations announced by the agency and the application of those expectations during examinations.