January 22, 2019

**SUBMITTED VIA FDIC.GOV**

Robert E. Feldman, Executive Secretary
Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

**Re: RFI on Small-Dollar Lending, RIN 3064-ZA04**

Dear Section Chief Robin and members of the Supervisory Policy Section,

UnidosUS (formerly the National Council of La Raza) submits the following comments in response to the Federal Deposit Insurance Corporation (FDIC) request for information (RFI) on small-dollar lending.

UnidosUS applauds the FDIC's commitment to understanding the small-dollar lending market and its impact on consumers seeking credit. We look forward to furthering the discussion by highlighting the benefits and potential harm to communities of color, specifically Latinos,[*] and immigrants.

The supply of safe and affordable small-dollar loans is critical to the financial security of all Americans, but especially consumers of color. People of color, who have historically faced barriers to the mainstream financial system,[1] have also consistently had lower incomes than their White counterparts. For example, Latinos earn 73 cents for every dollar earned by Whites, and African Americans earn only 64 cents for every dollar earned by Whites.[2] With lower wages, these families have fewer funds to draw on to weather job losses, reductions in income or hours worked, sickness, or unforeseen expenses.[3] Similarly, they are at a disadvantage when trying to obtain assets and build intergenerational wealth. Latinos—and other communities—need small-dollar credit products to help smooth income variability for both short-term financial needs in addition to building credit history for long-term economic security.

[*]The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

## Background

UnidosUS is the largest Latino civil rights organization dedicated to improving life opportunities for the nation's 58 million Hispanics. Through a network of nearly 300 affiliated community-based organizations ("affiliates"), UnidosUS reaches millions of Latinos each year in 37 states, Puerto Rico, and the District of Columbia. To achieve its mission, UnidosUS expands opportunities for Latinos through capacity-building assistance to a national network of multi-service affiliate organizations rooted in Latino communities; robust and tested program models; applied research, policy analysis, advocacy; and civic engagement efforts. UnidosUS provides a Latino perspective in five key areas: assets/investments; civil rights/immigration; education; employment and economic status; and health.

For almost three decades, UnidosUS has conducted research and analysis and has testified in front of Congress on issues related to improving the financial standing of Latinos; including strengthening the Community Reinvestment Act and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and lending laws, and expanding access to affordable credit. In addition, UnidosUS manages a network of over 30 community-based, financial coaching agencies in more than 20 states across the country. Since its inception, the UnidosUS financial coaching network has helped over 50,000 families better understand the credit landscape and improve their credit standing to pursue their financial goals.

Additionally, in 2016, UnidosUS began exploring how to increase access to small-dollar lines of credit through our small-dollar loan program. Our program, Fuente Credito, helps community-based service providers connect underserved Latinos and immigrants to credit unions, community banks, and Community Development Financial Institutions (CDFIs) that offer safe and affordable loan products to build credit and finance small-dollar expenses. Several of the lenders that participate in Fuente Credito obtain credit scores from the big three traditional credit reporting agencies—Equifax, Experian, and TransUnion—in addition to alternative data bureaus, such as Clarity and LexisNexis, to help supplement credit history for Latino applicants who have a thin credit history or none at all.

Our policy history, affiliate network, and small-dollar loan pilot allows us to offer a unique and well-informed perspective on the demand and supply of small-dollar lending. The following are insights and impressions regarding small-dollar lending, specifically related to the current landscape for Latinos, and immigrant market participants.

## Consumer Demand

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

Through research conducted in collaboration with our affiliate network,[4] we have observed ongoing credit challenges in Latino communities across the country. Specifically, many of our affiliates have shared information regarding the lack of existing products designed to reduce the financial barriers experienced by Latino families and have trouble referring clients to affordable lines of credit for unexpected expenses or emergencies.[5] Additionally, most small-dollar lines of credit, such as secured credit cards or credit building loans, do not account for time sensitive needs and require consumers to make an upfront investment or make several payments before receiving the total amount needed. Banks have also been slow to respond to Latinos who need to refinance loans with exorbitant interest and fees—perpetuating their subprime credit issues.

FDIC data supports our affiliates' observations, finding that Latinos, like many low-income communities and communities of color, are disproportionately unable to access small-dollar credit and are more likely to experience income volatility. For example, in 2017, 3.1% of Latinos were denied a credit card, personal loan, or line of credit from a bank in the past 12 months—compared to 2.4% of Whites.[6] These denial rates have deterred Latinos from seeking a line of credit from a mainstream bank. For example, 7% of Latinos did not apply for a line of credit from a bank in the past 12 months due to fear of denial, compared to 4.5% of Whites.[7] While lower income Latinos are more likely to have no mainstream credit, Latinos at all income levels remained more likely to not have mainstream credit compared to Whites.[8]

Additionally, FDIC data also supports our finding that the inability to access mainstream lines of credit causes many Latinos to turn to alternative financial services (AFS)—nonbank products that may be used in lieu of bank credit, such as payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, and auto title loans.[9] In 2017, 8.2% of Latinos used an AFS provider for credit in the past 12 months, compared to 5.6% of Whites.[10] Similar trends occur for immigrant consumers, who must start a new credit history upon their arrival in the United States, and are more likely to be credit invisible or have unscored records.[11]

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

Over the last two years of our small-dollar pilot program, we have found that banks are ambivalent at best to consumers' small-dollar credit needs. Most banks are reluctant to offer small-dollar loans because of the perceived risk and the reportedly high servicing costs.[12] Small-dollar consumers tend to have thin-to-no credit profiles or compromised credit histories which banks interpret as higher risk. As a result, many banks must be lobbied heavily with loan loss reserves to cover any defaults or charge-offs that may occur, which is limited to grant funding and poses sustainability challenges in the long-term.

We must note that U. S Bank recently launched a Small-dollar loan product, Simple Loan, —the first major institution to do so.[13] While this is a positive step in the right direction, this product is well above 36% APR, a rate cap which finds precedent in the Military Lending Act and should not set precedent for banks moving in this direction.

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

There are several non-bank lenders—such as credit unions, CDFIs and online lenders—who offer small-dollar credit products, yet these institutions do not satisfy the high demand for these products. In our small-dollar loan pilot, we have observed the following challenges:

- Lending footprint: Many non-bank lenders have limited lending footprints that exclude Latino and immigrant communities, which creates a geographic divide between the supply and demand of small-dollar loans. Fintech companies have partially overcome this hurdle due to their robust lending technology, but still face some difficulties in connecting to potential borrowers without a physical presence.
- Underwriting criteria: Some non-banks maintain underwriting criteria that is steered toward prime consumers for their small-dollar credit products, which excludes credit invisible or subprime Latinos who need small-dollar loans the most. Fintechs, who have

adopted more flexible underwriting criteria, have made progress with lending to market entrants but remain reluctant to help consumers with refinancing needs.

- Regulations: Nonbanks must also comply with the Know Your Customer (KYC) regulations[14] mandated through the U.S Patriot Act of 2001,[15] and the Bank Secrecy Act (BSA) of 1970,[16] which are often cited as a reason to not lend to immigrant borrowers. Banks should invest in more robust identity verification systems that would allow them to lend to immigrants with alternative forms of ID or with Individual Tax Identification Number (ITIN)s.

While non-banks have developed innovative models for increasing access to credit, the larger market failure of affordable small-dollar credit continues to be a barrier. Without a market-resolution, Latinos, immigrants, and other individuals of color will continue to face credit challenges that will stifle, and could even derail, their financial journey. This is not only a disservice to the growing community of Latinos and immigrants in our country, but is also a detriment to the local, state and national economies that could directly benefit from Latino and immigrant financial inclusion.

## Benefits and Risks

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

Banks have a competitive advantage in helping consumers cover expenses when they are in a financial crisis and help steer them away from AFS products. Banks' lending infrastructure enables them to enter the market at prices six times lower than those of payday lenders and other non-banks.[17] Additionally, four-out-of-five payday loan customers said they would prefer to borrow from their banks or credit unions, as they already had checking accounts, which is a requirement for getting a payday loan.[18]

Small-dollar lending is often considered risky in comparison to other business lines, but research shows small-dollar loans have the same default risk as other lines of unsecured credit, including credit cards. Even though there are still inherent risks for banks in offering small-dollar credit products, banks can overcome these risks. For example, by adopting prudent underwriting—such as the ability to repay determination—lenders will reduce risk or potential defaults associated with small-dollar loans. Similarly, structuring the loan repayment over time versus immediate short-term payments will increase the likelihood of full repayment.

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

Bank-offered small-dollar lines of credit can increase Latinos access to credit significantly. Instead of navigating the patchwork of existing small-dollar credit providers, Latinos will be able to access credit regardless of their location. Bank-offered small-dollar credit will also reduce Latinos reliance on AFS credit providers and help integrate them into the financial mainstream. Latinos will be able to visit physical bank branches to make payments, as well as, build a relationship with a financial institution who can assist them with medium- and long-term financial goals.

Consumers will be at risk if bank-offered small-dollar loans mimic the structure and features of predatory lenders. In the past, many banks provided deposit advances that were paid back in a lump sum on the borrower's next payday, at a fee most often of 10 percent per pay period—or roughly 260% (APR).[19] It is essential that FDIC not allow banks to reintroduce deposit advance loans or any small-dollar loan product that includes: excessive pricing, unaffordable payments, and insufficient time to repay. This will ensure that both consumers and lenders are set up for success.

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

Building formal referral relationships with community-based service providers can reduce risk in small-dollar lending. As demonstrated in the mortgage space, financial counseling reduces delinquency.[20] Applicants from community organizations that provide financial coaching will perform better because community partners undergo broader financial coaching and ensure that applicants understand the product and terms. Therefore, lenders seeking to enter the small-dollar market must work with community organizations and be transparent about their rates and underwriting criteria.

In our small-dollar loan program, lenders expanded definition of "creditworthiness" to include factors other than FICO scores to supplement information from consumers with minimal to no credit history. Banks should implement alternate ways of assessing credit risk that include verifying rent and utility payments, analyzing cashflow histories, verifying repayments of informal loans from friend**s** and families, and analyzing remittance payments. [21]

To ensure loans are affordable, the bank must consider the customer's income and expenses before making a 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.

On pricing, a 36% interest rate limit is already the law of the land for military servicemembers, 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.

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

Banks will potentially improve their efficiency while reducing lending costs by partnering with third party companies, such as fintechs. Fintechs are equipped with alternative data and automated underwriting systems that enable banks to shift from paper-based manual underwriting procedures to automated and data-driven algorithms that can assess a higher volume of loan requests. Similarly, fintechs include alternative data sources that enable banks to perform more thorough risk assessments for thin credit or credit invisible consumers. Lastly, fintechs also make it simple for banks to receive and process remote applications and payments. The origination, underwriting and servicing innovations provided by fintechs will enable banks to bring those efficiencies into their own business models and reduce costs significantly.

Potential risks can include underwriting inaccuracy and poor loan performance. The accuracy of data-driven algorithms used by many fintechs is unclear as much of this data is proprietary.[22] Underwriting criteria has the potential to include value-based biases that can adversely impact the borrower and include variables that correlate with characteristics protected by fair lending laws, such as race or gender.[23] Inaccurate underwriting can result in borrowers being incorrectly rated as a higher credit risk, or if the underwriting is too lenient, loans could be made to borrowers who may not be able to repay them.[24] Both scenarios could disparately impact

Latinos, immigrants, and other consumers of color who are more likely to be credit-invisible[25] and most in need of supplemental information to access credit.

Indirect lending arrangements between banks and third-party lenders such as marketplace lenders could result in unsafe and higher-priced products for consumers. Marketplace lenders typically operate almost entirely online with minimal physical retail space, their underwriting is almost entirely automated and algorithmic, and they are funded by issuing equity or selling loans to investors.[26] Through partnerships with banks, marketplace lenders can to avoid being subject to individual state laws that have more stringent regulations, such as require low APRs or specific ability to repay requirements.[27] This undermines the consumer protections put in place by state governments to protect its consumers from bad actors. Similarly, marketplace lenders are not subject to risk retention rules, which requires lenders to retain a stake in underlying securities, and thus enables them to make poor loans and collect fees but not endure any losses.[28]

## Challenges

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

As discussed in the response to question 3, banks must comply with KYC and BSA requirements, which they often cite as the reason they do not lend to immigrant borrowers. More regulatory guidance is needed on how banks can comply with these requirements and serve immigrant consumers who need small-dollar credit to start their financial journey in the United States.

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

Consumers will not take advantage of responsible, prudently underwritten bank-offered small-dollar credit products if they are unaware that they exist. As noted in our small-dollar loan pilot program, many small-dollar lenders do not dedicate funds to market their product. Banks try to preserve the nominal anticipated profits associated with small-dollar loans, but subsequently have trouble reaching their targeted audience. Banks must invest in media advertising and list their products on a centralized database or clearinghouse, like Fuente Credito and NerdWallet, which will connect them to a pipeline of potential borrowers.

## Product Features

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

Embracing new forms of identification is an important first step in reaching immigrant consumers in need of small-dollar credit. Under the Patriot Act,[29] banks can accept consular IDs, foreign passports and other forms of identification to verify the identities of their customers but some institutions do not do so out of fear of regulatory scrutiny.[30] However, a growing number of financial institutions in immigrant communities have begun accepting alternate forms of identification including the *matricula consular*, an identification card issued by the Mexican consulate, and ITINs for opening accounts and taking out loans. Broader acceptance of alternative forms of identification from banks is needed for immigrant access to credit, particularly in rural areas and emerging gateway cities.

## Innovation

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

Banks can provide responsible and prudently underwritten small-dollar loans in a cost-effective manner by streamlining and automating their application and underwriting process. Faster processing times would allow lenders to assess a larger volume of applications quickly and at a lower cost compared to manual underwriting. Automated underwriting also allows potential borrowers to know whether they are eligible for a loan quickly and increase their access to funds, while lowering cost for the lender.[31]

While upgrading a lending system can be costly— particularly for smaller banks —bundled or collective purchasing of technology platforms among banking institutions could streamline processes and allow more resources to be devoted to serving consumers.[32] One example is the CU Impact Initiative, a shared banking platform specifically designed to help credit unions deliver affordable financial services to low-income consumers. The platform allows credit unions to switch from a fragmented, high-cost processing systems to a flexible, shared cost system.[33]

Investments like these are needed for banks to compete with non-traditional lenders. Banks can also reduce their origination costs by listing their products on centralized databases or clearinghouses for small-dollar credit. Lead generators like Fuente Credito and NerdWallet, filter potential borrowers based on the banks underwriting to produce only qualified applicants in need of small-dollar loans.

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

Expanding definitions of "creditworthiness" to include factors other than FICO scores can help address Latino and immigrants' perceived risk. For example, LexisNexis Risk Solutions has developed a RiskView score, drawing upon alternative data to develop a more granular understanding of borrower's risk profile.[34] Similar approaches, which can be tailored specifically to common Latino and immigrant profiles, such as newcomers' traditional aversion to debt, and non-traditional household arrangements, should be further developed and tested.

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

The FDIC can play an integral role in helping banks acquire lending innovations or technology upgrades to meet the needs of Latino and immigrant consumers. Dedicated matching-grants can assist smaller banks upgrade their lending systems to adopt automated and data driven algorithms, as well as, remote servicing features. Such innovations are imperative to helping banks scale their products to meet consumer demand and compete with nontraditional lenders.

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

Technology can eliminate steps and ease the application process for Latino and immigrant consumers. In the small-dollar loan pilot many of the non-banks that offer small-dollar loans are not located in the areas where Latino immigrants reside—especially rural areas without reasonably-priced products nearby. Innovative models that include remote applications and servicing of affordable loan products via phone, tablet, or computer save the potential borrower time and money—and mitigates the number of individuals who do not complete their loan application.

## Conclusion

The cost of credit for Latinos, immigrants and other underserved consumers is too high or many times unattainable. There are solutions to this problem, including an increase in the supply of small-dollar lending by mainstream banks. Small-dollar loans can help Latinos and immigrants handle income variability, build or repair credit, and enter the financial mainstream. They can also help banks become a trusted resource for a growing market of consumers and cross sell larger products in the future. However, there are also several ways in which small-dollar loans can be detrimental to consumers and lenders, such as innovations that result in underwriting inaccuracies or poor loans from third party providers. Small-dollar lending must include industry standards, transparency, and diversity to ensure its optimal impact on underserved populations, including Latino and immigrant borrowers. At the same time, access to credit is just one aspect of a consumer's financial picture, and we must continue to build a more inclusive and well-regulated financial system to correct larger systemic issues that impact the ability of Latinos, and other underserved borrowers to perform well.

Thank you for your consideration. For any inquiries regarding the UnidosUS small-dollar loan pilot program or Latino access to credit, please contact Sabrina Terry, Senior Strategist, at (202) 776-1574 or sterry@unidosus.org.

Sincerely,

[redacted]

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