From: Bruce Howard
Sent: Tuesday, January 22, 2019 2:14 PM
To: Comments
Subject: November 20, 2018 - Request for Information on Small-Dollar Lending; Comment Request (RIN 3064–ZA04)

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

Nearly one in five, or 20% of qualified bank customers used deposit advance or small-dollar loan products when made available by their bank. All banks except for one were forced to stop offering deposit advance products in 2013.

At one time six regional banks (top 50) offered deposit advance products. Other regional banks were on the verge of launching deposit advance products. Two of these banks offer small-dollar loan products today.

Percentages approaching 10% of a customer base used deposit advance products when they were available. Nearly 20% of qualified customers (direct deposit was one of the underwriting criteria, and half of bank customers did not have DD) used deposit advance products.

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

To my knowledge only two regional banks offer deposit advance or small-dollar credit products:

- Fifth Third Bank offers Fifth Third Early Access, an open end credit product with no installments and a transaction fee.

- US Bank offers Simple Loan, a closed end credit product with installments and transaction fees.

Banks seem to be reluctant to get back into the small-dollar credit space after the abrupt change by the CFPB, OCC and FDIC in 2013. These projects are expensive to execute and require many resources so I can see why banks would not jump at the opportunity to offer these products despite the high customer satisfaction results that many of the banks captured through customer and employee surveys while their programs were in force.

3. To what extent and in what ways do entities outside the banking sector currently

satisfy the consumer demand for small-dollar credit products?

Some web-based companies have taken payday loans and applied installments to the product so a customer has longer to pay back a loan vs. payday loans. These loans are called "Installment Loans"

There is strong demand for these loans. Companies that are not banks that offer these loans appear to be forced to abide by state banking laws on a state by state basis, so they can't offer their products in states where there are interest or fee caps on open end or closed end credit products (in some cases, like Georgia, both are prohibited). As a result the demand might not appear to be as great, and customers in these states have been found to use overdraft services such as courtesy overdraft (an undisclosed OD limit that a customer must opt-in to use) and marketed overdraft programs where a customer knows their OD limit and customers can write checks against that account, even if it brings them to a negative balance. In my experience smaller community banks used marketed OD programs with both customer experience and financial success. In some instances these are the only short-term credit-like solutions available in a state.

4. What data, information, or other factors should the FDIC consider in assessing the consumer demand for small-dollar credit products?

1. Customer and employee surveys taken by banks that offer(ed) the deposit advance products would be a very enlightening read for FDIC decision makers.
2. ALLL reporting would provide a snapshot of the number of customers that used these products and risk performance at a portfolio level. This would provide the demand and risk perspective.

5. What are the potential benefits and risks to banks associated with offering

responsible, prudently underwritten small-dollar credit products?

Risks

1. There is PR risk associated with these products from media outlets, activist groups and government agencies that regulate banking products. Small-dollar loan products with APRs over 36% are considered to be payday loans by some or all of these groups. In my experience this did not impact customer demand in any way. In fact, before TILA was updated and posted in February 2010 the banks used to post a 120% APR. After February 2010 most banks removed the APR disclosure. The actual average APR was higher than 120%, but I am unaware of any complaints by customers that used these products that the fees were too high.

2. The banks the offered these products installed protections such as cool-off and prohibitions due to questionable deposit activity (spelled out in the terms and conditions. Results merit continuation of these product features. The biggest complaint, by far, was customers that used these products disliked the cool-off feature, and while it's hard to measure the benefits it probably makes sense.

3. These projects are expensive to launch and can be technically complicated, though the best programs in my experience as a consultant and a banker were those built into that bank's own systems.

4. Banks need to steer clear of defining how a customer should use the funds. Stating these funds are for emergency purposes should be avoided in my experience. Some people might say an emergency use is for a broken arm. I might say advancing $20 to buy something for a family to eat is an emergency. Law makers got continually caught up on this point prior to the product essentially being shut down (shut down and essentially shut down used interchangeably in this RFI).

Benefits

1. Bank employees can offer these products across their footprint. You don't need $20k to open an account and get a better rate. Customers with direct deposit and consistent deposit activity get treated equally regardless of where they live or bank.

2. A fully automated program takes underwriting decisions out of the hands of the bank employees, allaying fair lending risks.

3. These programs are expensive to develop but banks should expect a financial return if they design their programs responsibly.

4. Extremely high customer satisfaction results. Some reported these surveys were the most widely embraced surveys their bank had ever taken. I can support point this in my experience as a banker. These results could mitigate any PR risk and should fully address any regulator concerns.

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

Risks

1. Budgeting risk: A deposit advance / small-dollar credit user that does not understand how automatic repayment mechanisms work might find themselves in overdraft situations. An example using straight-forward pricing the bank formerly used could be that a customer takes a $500 advance. If the fee is $50 (10% of the advance amount) that customer owes $550. There could be situations where a customer is not expecting $550 to be taken out of their account, and when it is they will either overdraft or have to take another advance.

    a. Installments can help with these situations. One big 5 bank offered installments and they were well received by deposit advance customers.

    b. Easy to understand FAQs with examples will also help. Keep in mind that its not the $50 fee (in this example) that might throw a customer off, it's the $500+$50. This is why installments could help.

2. Usage risk: Deposit advance customers using short-term lending vehicles outside of the bank could easily encounter financial risks. Installment, payday or even overdraft services from another institution could create risk to the customer. Deposit advance customers do use other short-term credit vehicles, but based on available information that amount on a unit basis was relatively low.

3. Technology risk: Banks should notify customers that they are going to take advanced or borrowed funds from an account or an incoming ACH. Notifications should be via text or email or electronic means if possible so that the message arrives quickly. Customers should be able to opt-in to letters if that is their requirement.

Benefits

1. Speed to funds- the number one program feature ranking of deposit advance customers is/was real-time access to advanced or borrowed funds into an account that can be immediately accessed.

2. Convenience and Anonymity- another top priority of deposit advance customers. Being able to see how much is owned, how much could be borrowed, how much a transaction will cost are all highly ranked priority features, as well as the ability to conduct their banking business in private.

3. Access to credit- in some cases deposit advance / bank small-dollar loans are a customers only access to credit.

4. New regulations from the OCC and CFPB state credit bureau reporting. Is required, so use of this product might open customers up into other forms of credit like a credit card or personal loan.

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

1. Banks should offer installments.

- Less of a charge-off risk to the bank, and even if the customer does not budget appropriately the amount of the payment will be less than a single payment. In addition, a bank has offered a deposit advance solution and installment payments were well received by customers that originally embraced a single-pay repayment option.

2. Deposit-based underwriting should be used.

- Deposit activity provides leading and lagging indicators to account health or distress. Excessive OD activity signals possible cash flow issues. New direct deposit activity signals a new job, or severed direct deposit indicates a lack of job and lack of ability to repay a loan

3. Banks need to charge enough to make a return.

- a bank might spent north of $5MM just to develop the software associated with a deposit advance program. This does not include the 15,000+ hours of total project hours and then ongoing support from operations and administration like product management and legal / compliance. Addition of installments reduces the amount a bank can make at the customer level, so fees and/or interest must be sufficient to cover sunk and ongoing costs. The disclosures, as before, should clearly state all terms and conditions and require an E or wet signature for acknowledgement and acceptance.

4. Pricing and credit limit setting should be easy to understand for customers and bank employees. -
Historically banks charged 10% of a transaction amount, and the credit limit was 50% of the monthly deposit amount with a cap of $500. So if a qualified customer had $2,000 in monthly deposits they could qualify for a $500 line of credit. If they advanced $220 the fee would be 10%, or $22. This seemed to be easy for employees and customers to understand, and as a result inquires to the customer and employee customer service contact centers were muted in number.

5. Credit scoring most likely won't mitigate risks for consumers or the bank. -Most banks dispute processes include write off limits that exceed the amounts a customer might have outstanding in the event of a charge-off. The deposit activity has served as leading and lagging indicators of account health, while a credit score (for these products) might be a lagging indicator. It seems like an investment that might not yield a result that helps consumers or the bank when it comes to opening the loan / line / advance. Credit score reporting to the agencies could help the consumer and bank later.

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

Benefits

Banks will benefit from consulting or hands-on guidance arrangements with regulators that will help navigate the legal and compliance landscape, develop business cases that address the revenue and risk components associated with this banking product. Due to the unique features of these products and the attention from some legislators it makes sense for banks to work with someone that Deposit Advance / Small-Dollar loans designed for bankers.

External groups have made their opinions known and maybe even embraced by banking agencies regarding new small-dollar products. If banks follow their pricing guidelines they should do so understanding their products will most likely be unprofitable based on proposed product designs.

1. Banks can benefit from either regulators and/or someone with experience with Deposit Advance / small-dollar loan products to help explain what needs to be completed from a regulatory perspective.

Deposit advance / small dollar loans have almost no understanding within the banking community. Six top 50 regional banks ever launched these types of products, and half of these banks didn't have nearly as long as a life span as the other three banks that launched before 2009. Two other large banks (regional) that had solutions ready for launch never had a chance to see how their solutions would perform.

2. Banks that use a technology vendor for their small-dollar solution must understand that installment product designs will drive much less revenue than the former product design, so their risks must be measured vs. program profitability.

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

If the FDIC supports a small-dollar loan program they should consider providing a safe harbor period where a bank can slowly wind down a program in the event of a new FDIC leadership team enters and determines small-dollar loans should not be offered by banks despite meeting or exceeding all product regulations. The other agencies, whether in conjunction with the FDIC or not should offer the same to banks can protect their investment to some degree.

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

Banks will be reluctant to offer small-dollar loan products based on how these products were treated by the regulatory community earlier in this decade. The banks that offered these products ensured their products met all banking regulations, and they were still essentially shut down by the CFPB, OCC and FDIC. When I say essentially, what I mean is these agencies inserted new loan provisions / underwriting criteria that made over 99% of these customers ineligible for these products, not to mention that usage limits were created that would have made these products very unprofitable and not worth an investment of any kind. This is why I think banks need a safe harbor period, otherwise they won't consider the significant investment these programs require.

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

Yes

Like any lending product, banks meet federal AND state loan requirements. For small-dollar loans the fees and /or interest rates will exceed usury caps set by some states, such as Georgia, and these loans cannot be offered in that state if a banks charter originates in that state. A bank can offer a small-dollar loan in Georgia if they are chartered in a bank where usury caps accommodate small-dollar loan pricing.

The overall banking threats coming from the House Financial Services committee won't help banks move into small-dollar loan products.

I do not think the "installment loans" that are available and offered by Fintech companies are a threat to the loans that can be offered by banks.

Regulators should strongly consider making all small-dollar loans treated the same way. That has not been the case in the past, the banks have had a much higher standard to address when offering these products. Add in the complexity from a legal and compliance standpoint, challenges in determining how much in revenue and expenses should be expected and ongoing regulatory risks might make small-dollar loans a tough sell without some sort of safe harbor.

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

Demand was robust when the six banks offered Deposit Advance products before they were shut down in 2013. The proof of concept has been addressed.

Making the product hard to understand, opaque pricing, lack of convenience and strict underwriting will turn off customers.

What was in place prior to the 2013 shut down worked well. It might be prudent to understand those product designs and work backwards to determine what you might want to change outside of my recommendations.

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?

These products must be offered in electronic channels for optimal success. Using deposit-based underwriting criteria identifies real-time risks to the customer and the bank, and changes to the ongoing loan status can be made quickly, well ahead of any credit score usage model. Installments make sense, and while installments will dial back on the bank's revenue an installment feature will still yield a profitable product.

"prudent underwriting" should not include pricing. At a portfolio level there is a certain amount of charge-off risk that a bank must address, and that is addressed in the pricing. To balance the risk/reward equation fees and / or interest might seem high and will encourage discussions amongst your regulatory teams. I'd advise you to see if you can work with the banks that have survey results and see what customers think of the pricing. You'll be surprised by the results, and it will help moderate internal discussions around pricing and setting loan/line/advance credit limits.

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

Electronic channels, convenience, speed, pricing flexibility and well thought out ongoing qualification criteria are critical. If an agency decides to cap the number of transactions at four or six for a year banks considering these products and customers that would actually use these products will not react well to those restrictions based on my experience from other small-dollar loan programs.

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).

The technology that was used by the first five regional banks worked extremely well. These were all homegrown solutions, and in my experience probably could not have worked better. Bank's connected their deposit products to a loan or loan-type of product to create their hybrid product. One bank still has their product in operation, consider asking them for a demonstration and maybe they can show you how it works.

I had hands one experience with a vendor hosted solution. In my experience the homegrown solutions met branding standards set by those five regional banks that a hosted solution might / did not. Also, these banks had the flexibility to modify or even shut down their products without expensive delays or penalties.

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

Maybe down the road, but someone needs to think about how this might add to the complexity of a project and if banks might just do without offering such a product. Due to the small loan size I don't see the need for a credit score for underwriting, but reporting positive credit activity to FICO or whomever might address this idea better than a whole new process that might never be worth it.

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 developed its own small-dollar loan program about 10 years ago. A number of banks, including Keybank, adopted the program but it was unsuccessful due to the critical to quality features I mentioned above: speed, convenience and transparency. It was a positive step in the right direction, but should have pivoted and worked with one of the banks to see how that bank's program worked and what might not have worked. More of a partnership rather than a take it or leave it position. I think the banks would much rather partner with a regulator than an activist group, which is happening in some cases.

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

Technology was used by the big five banks that offered this product before. Systems were used to count and keep track of transactions and monitor customer activity to help identify and mitigate risks where possible.

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

besides small-dollar credit products?

Yes, to a degree and with fewer risk controls.

The FDIC used to endorse or allow "marketed overdraft programs", which were used by many community banks. These programs allowed (or allow, not sure if they are still being used) customers to overdraft their checking account and gain access to courtesy funds until their next paycheck. A customer could walk into a bank, cash a check for $350 or $700, overdraw their account and pay a $35 fee (or whatever) for access to $350 (in this example). $35 fee for access to $350 for 10 days (on average) translates to a 360% APR. Sounds expensive, but customers in states where they had no access to any small-dollar credit (GA, NC, AZ, others) used this program to their benefit and had good relationships with banks that offered these programs.

This is not a technical solution, and there are not any real time risk controls, but customers can benefit from these programs in my experience and banks revenue balances with the risk.

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

Back to the state lending laws consideration, banks might be able to offer closed ended small-dollar loans, but not open ended small-dollar loans, and vice versa. Or maybe they can offer both. Or neither. Closed end vs. open end might create the need for multi-pronged regulations / guidance (regulation please, not guidance if possible). Just because a federal regulator says its ok to offer a product does not mean a bank will be able to do so based on state lending laws, and the FDIC needs to understand this on a state by state basis.

21. Please provide any other comments or information that would be useful for the FDIC to consider.

It takes about a year on average to develop and successfully roll out one of these programs, with some taking over 18 months. Depending on how a bank designs their product it could cost between $5MM and $10MM and over 15,000 project hours, which means other important projects might bump a small-dollar loan project, or a small-dollar loan project might be the biggest thing a bank does all year. Ensuring banks can offer these products without the threat of having them shut down and their reputations besmirched by other areas of government is pretty important.

Fair lending associates at the bank have endorsed Deposit Advance / small-dollar loan products in my experience. The underwriting was and should continue to be the same for every single customer. If you have direct deposit and have stable balance and transaction activity you qualify for a loan/line/advance. Underwriting it exclusively systematic, so there are zero concerns regarding unethical behaviors.

New York Magazine posted a lengthy piece on November 23, 2008 titled ***Check Cashers, Redeemed***. I'd encourage anyone looking at the viability of this product and whether or not bank should offer them to read this article. The behaviors of the underbanked and Low-Moderate Income (LMI) customers differ from other customer segments often seen in banks. Short-term, small-dollar credit is often the center of these customer segments financial relationships, rather than a transaction account like a checking account. To bring more customers into the banking world access to small-dollar loans are critical.

Finally, the greatest risk has nothing to do with safety and soundness. Evaluations of ALLL reporting and customer surveys demonstrate this point.