

May 30, 2013

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

**Re: FDIC Proposed Guidance on Deposit Advance Products**

Dear Mr. Feldman:

The Center for Financial Services Innovation (CFSI) is submitting this letter in response to the request for comment by the Federal Deposit Insurance Corporation published on April 30, 2013. We appreciate the opportunity to respond to the FDIC's notice and request for comment on proposed guidance on deposit advance products.

CFSI is a nonprofit organization, in our ninth year of providing national leadership, research, and insights on the financial services needs of underserved consumers. We conduct consumer research and work with the financial services industry to develop a broad understanding of consumers in this segment and the products offered to them. We invest in nonprofits and for-profits serving underbanked consumers with sustainable, innovative financial products and services. And we advance financial services policy to spur product innovation and market competition and address impediments to accessing high-quality financial services.

Our vision is to see a strong, robust, and competitive financial services marketplace, where the diversity of consumer transaction, savings, and credit needs are met by a range of providers offering clear, transparent, and high-quality products and services at reasonable prices. This vision is guided by our Compass Principles – Embrace inclusion, Build trust, Promote success, and Create opportunity. These principles are built on a solid foundation that recognizes the core market values of profitability and scalability, deep customer knowledge, safety, variation and choice, relationships, and cross-sector participation.

CFSI's 2011 Underbanked Market Sizing Study estimated that underbanked consumers represent a \$78 billion marketplace.<sup>1</sup> Within the underbanked segment, the small-dollar, short-term credit market is sizeable. We estimate that about \$41 billion in revenue comes from short-term credit – subprime auto loans, rent-to-own, installment loans, subprime credit cards, auto title loans, and secured credit cards. An additional \$20.5 billion in revenue comes from very-short-term credit – overdraft, payday loans, pawn, deposit advance, and credit-type products related to income tax refunds.

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<sup>1</sup> See [http://www.cfsinnovation.com/system/files/CFSI\\_2011\\_Underbanked\\_Market\\_Sizing\\_Study\\_November\\_2012.pdf](http://www.cfsinnovation.com/system/files/CFSI_2011_Underbanked_Market_Sizing_Study_November_2012.pdf)

In 2012, CFSI published a research report, *A Complex Portrait: An Examination of Small-Dollar Credit Consumers*, based on data from a nationally-representative survey.<sup>2</sup> Our survey covered payday, pawn, direct deposit advance, auto title, and non-bank installment loans. We found that an estimated 15 million consumers used at least one small-dollar credit product in 2011 – and that this group was highly diverse in terms of income, access to other credit (such as credit cards), and their reasons for turning to small-dollar credit products.

We fully support the FDIC's goal of encouraging banks to respond to customers' small-dollar credit needs consistent with safety and soundness and in ways that do not increase the bank's credit, compliance, legal, and reputational risks. We believe that well-structured credit products can help consumers address short-term credit needs and build positive credit histories. Further, we believe that high-quality credit is marketed transparently and priced fairly, and that it is affordable and structured to support repayment without creating a cycle of repeat borrowing.

Our consumer survey work revealed the need for a range of small-dollar credit products for a variety of situations: some consumers need to smooth income and consumption over time (due to a mismatch in the timing of income and expenses), others may have unexpected events and emergencies, and some may want to buy assets (e.g. vehicles) over time. Better budgeting tools, financial management behaviors, and savings are crucial to financial health, but will not solve the need for credit in its entirety. In CFSI's small-dollar credit survey, the main reasons for using small-dollar credit were to pay utility bills (36%), for general living expenses (34%), and to pay rent (18%). Events that triggered the need for the small-dollar loan included having a bill due before receiving a paycheck (32%), having an unexpected expense (e.g. medical bill or car repair; 32%), or having an unexpected drop in income (e.g. job loss or hours cut back; 25%); three out of ten (30%) reported that their general living expenses were consistently more than their income. In addition to borrowing, respondents reported cutting back on their general spending (43%) and going without something they needed (40%) in order to address their cash shortage. This is not a one-size-fits-all market segment and there is a need for a suite of credit products – as well as new savings and budgeting tools – so that financial institutions can match their product offerings to the diverse needs of consumers. Credit products that provide consumers with an advance against future cash inflows are potentially part of the suite of products necessary to meet these diverse credit needs as long as they meet the criteria for high quality – that is, they are affordable, marketed transparently, priced fairly, structured to support repayment without creating a cycle of repeat borrowing, and support credit building.

Credit products are important tools for consumers' financial management, but they need to be matched with the needs of the consumer. We agree with the FDIC that underwriting is necessary to appropriately match the borrower's needs to a well-structured credit product. We also agree that it is a problem if the main share of profits from a product line comes from consumers who are harmed by using it – we do not want to see consumers get trapped into a cycle of debt. CFSI believes that financial service providers need to align the long-term financial outcomes of their customers with company profitability.

It is important that the guidance strike the right balance between product sustainability and ensuring affordability, while protecting consumers and the safety and soundness of financial institutions in ways

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<sup>2</sup> See <http://www.cfsinnovation.com/system/files/A%20Complex%20Portrait-%20An%20Examination%20of%20Small-Dollar%20Credit%20Consumers.pdf>

that do not overly constrict product offerings. And in that spirit we offer the following comments and suggestions.

## **Our Recommendations**

**1. Promote flexible underwriting.** We agree that it is important for financial institutions to assess consumers' ability to repay. Underwriting needs to be accomplished efficiently and cost-effectively, without cutting off access to small-dollar, short-term credit for those who can use it without falling into a dangerous overextension of credit. One of the values underlying our Compass Principles is doing business based on deep customer knowledge – knowledge that helps match consumers with high-quality credit products. There have been huge strides in the market around underwriting, using data sources beyond credit reports and scores to really understand a consumer's financial picture. For example, some providers are analyzing consumer data – such as transaction and experience data generated internally or purchased from outside sources – to develop ways to underwrite customers who might not otherwise qualify for mainstream credit sources. In fact, many consumers may not qualify not because they have bad credit but because they have “thin” credit files – or no credit files – that are usually the basis of traditional underwriting. The FDIC's guidance should enable a range of tools to be brought to bear in underwriting decisions. Furthermore, we know that income and expense flows are often uneven – as in the case of seasonal or commissioned workers or people who face large, infrequent bills such as taxes or insurance payments. Credit products can help smooth consumption for some consumers – allowing for some month-to-month variation in inflows and outflows, consistent with safety and soundness, would seem reasonable. Likewise, we believe that financial institutions should be able to assess derogatory credit information, such as an “on us” versus “on others” delinquency, in their decision making, rather than having a bright-line of ineligibility for “any delinquent or adversely classified credits.” Also related to underwriting, regulators, financial institutions, and credit bureaus will need to consider how the proposed underwriting process, with the potential for multiple inquiries to credit reports, might affect credit records and credit scores.

**2. Prevent overuse of small-dollar credit products.** CFSI believes that credit products should be structured to support repayment without creating over indebtedness that can lead to a cycle of repeat borrowing. Repeat borrowing itself may not be the real problem here – after all, many people revolve balances on their credit cards. The real issue is whether consumers are accumulating more debt than can be reasonably repaid, not whether they owe money for a certain number of months out of the year. And while we agree that a cooling-off period might make sense, we believe that additional research is necessary to better assess the best mechanisms and structures for these credit products. For example, banks may want to explore the option of converting the balance owed on a deposit advance to an installment structure, or aim for more careful underwriting that better matches the consumer's borrowing needs with the credit product and thus makes a cooling off period unnecessary. The recent study by the Consumer Financial Protection Bureau provides additional data that could be used to tease out the nuances of the right timing for a cooling off period.<sup>3</sup>

**3. Promote innovation for small-dollar credit.** CFSI believes it is critical to provide a market environment that supports and sustains high quality, innovative credit products, although we recognize that this arena can be fraught with difficulties that make innovation a potentially high-risk activity. In the FDIC's report on its Small-Dollar Loan Pilot Program, the authors note the diversity of product

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<sup>3</sup> See [http://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf)

offerings and the need for financial institutions to be able to custom-tailor the structure of their products for their clientele.<sup>4</sup> FDIC's pilot helped spark an industry-wide conversation, and we encourage the FDIC to continue promoting innovations of other kinds, beyond the basic structure tested by FDIC pilot. For example, we encourage the FDIC to work with the CFPB through its Project Catalyst to promote more innovation, possibly by exploring waivers or other safe harbors for small, controlled tests of small-dollar, short-term credit. In April of this year CFSI announced our second round of Financial Capability Innovation Fund grants. Among the recipients is the Center for Community Self-Help (Self-Help), who will design a suite of small-dollar credit products to be launched across its California branch network. The product details are still under development, but may include features such as default settings that encourage borrowers to pay down their balance at an accelerated rate or auto-enrollment in an offset savings account; interest would only be charged on the loan's outstanding principal net of any accumulated savings. In addition, Self-Help will explore several underwriting models to test their relative cost-effectiveness for facilitating the credit approval process. Innovations for Poverty Action has joined Self-Help to do a randomized controlled trial evaluation of the products to gauge whether and how the behavioral design features promote successful use of credit among the underserved.<sup>5</sup>

**4. Encourage well-structured products with transparent pricing.** CFSI believes the structure of the product – for example, the term, repayment schedule, and degree of amortization – is as important as having a clear price tag for the loan. We have always supported the need to provide understandable and transparent pricing of financial products and services. The cost of credit needs to be disclosed to consumers in a way that is useful to them in their decision making – and this is especially important if credit products are designed as open-end credit where the APR may not provide full cost information, and could actually be misleading in terms of the total cost of the loan. For example, an open-end line of credit could come with a low APR but a variety of high fees, as was the case with some sub-prime credit cards prior to CARD Act regulations. We believe that additional research is needed to identify the key disclosures that both provide an accurate picture of the costs and implications of deposit advance products and really matter to consumers who use short-term, small-dollar credit products. Design and consumer testing may be needed to determine how to deliver these key disclosures so that consumers can use them to compare options when making decisions.

## Conclusion

Ideally, financial service providers would frequently review consumers' use of credit products and help them find the products that best fit their needs and are most affordable. For some consumers, the right product might be a short-term loan. For others, products with longer terms and multiple payment structures, such as installment loans or secured or unsecured credit cards, may be more appropriate than single-payment, short-term credit. From both a safety and soundness perspective and an "it's the right way to do business" perspective, financial institutions need to align their business model with the long-term financial health of consumers. Lenders should engage in thoughtful underwriting that assesses the consumer's ability to succeed with these products and build positive credit histories, consistent with safe and sound lending practices.

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<sup>4</sup> See [http://www.fdic.gov/bank/analytical/quarterly/2010\\_vol4\\_2/FDIC\\_Quarterly\\_Vol4No2\\_SmallDollar.pdf](http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf)

<sup>5</sup> For more information, see [http://www.cfsinnovation.com/system/files/Stretch%20Time-%20Trends%20From%20the%20Financial%20Capability%20Innovation%20Fund%20II\\_Report\\_April2013\\_Digital.pdf](http://www.cfsinnovation.com/system/files/Stretch%20Time-%20Trends%20From%20the%20Financial%20Capability%20Innovation%20Fund%20II_Report_April2013_Digital.pdf)

As our recent market sizing study and small dollar credit studies have shown, there is a consumer need for high-quality, small-dollar credit products. High-quality credit needs to be affordable, marketed transparently, priced fairly, structured to support repayment without creating a cycle of repeat borrowing, and should support credit-building. More than ever, innovation is required to meet this need in such a way that enables both consumers and providers to succeed financially.

Sincerely,



Jennifer Tescher  
President & CEO



Jeanne M. Hogarth  
Vice President of Policy