May 23, 2013

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

RE: "Proposed Guidance on Deposit Advance Products" (FR Doc. 2013–10101)

Dear Mr. Feldman:

The Center for American Progress appreciates the opportunity to comment on the FDIC's Proposed Guidance on Deposit Advance Products ("Proposed Guidance").

This comment is submitted by the Center for American Progress (CAP), a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. As part of its activities in developing policies to reduce poverty and ensure a stable middle class, CAP considers public issues that concern the financial well-being of low- and moderate-income households, and promotes a financial system that works for all Americans.

General Comments on the Proposed Guidance

The Center for American Progress applauds the FDIC's heightened attention to deposit advance products. As noted in the Consumer Financial Protection Bureau's recent report on payday lending and deposit advance products, both types of products may lead to repeat borrowing at high costs, making it difficult for consumers to escape a cycle of debt.[1] In recent years, much attention has been paid to high-cost, short-term lending by nonbank financial institutions such as payday lenders. And more recently, banks have been scrutinized for permitting recurrent automatic withdrawals from consumers' bank accounts to repay largely unregulated, high-cost online lenders.[2]

But as the Consumer Financial Protection Bureau's recent report illustrates, some banks are making high-cost loans themselves–often at triple-digit annual interest rates. A typical two-week payday loan from a nonbank financial institution may cost $15 per $100 borrowed, or 391 percent annual interest, while a typical bank deposit advance loan may cost $10 per $100 borrowed, which suggests an annual interest rate of 304 percent for a 12-day advance.[3] These practices are not consistent with the FDIC's 2007 guidelines on small-dollar loans ("2007 Guidelines"), which encourage a maximum annual interest rate of 36 percent.[4]

The same concerns about repeat borrowing for nonbank payday loan products also apply to deposit advance products, as illustrated in the Consumer Financial Protection Bureau's analysis. Two-thirds of payday loan borrowers took out seven or more loans in a year, and nearly half took out more than ten loans. Similarly, the median deposit advance user took out advances eight times a year. And deposit advance users frequently demonstrate financial distress: 65 percent of consumers who took out an advance during the 12-month period that the CFPB analyzed were also charged a fee for having insufficient funds or overdrawing their account, compared to only 14 percent of consumers who were eligible for a deposit advance but chose not to take one. Clearly, deposit advances are not helping these consumers better manage their accounts.

The proposed guidance contains three very significant provisions:

- **The examination of deposit advance products on safety and soundness grounds.** The Proposed Guidance notes that "deposit advance loans often have weaknesses that may jeopardize the liquidation of the debt." This is consistent with other recent actions taken by bank regulators recognizing that products potentially harmful to consumers may also present risk to financial institutions. For example, the FDIC opted to oppose banks' tax refund anticipation loans on safety and soundness grounds.[5]

- **The insistence on determining the consumer's ability to repay.** The Proposed Guidance would require banks to conduct "financial capacity assessments" of their customers that consider six months of account behavior. Considering the consumer's ability to repay is a fundamental tenet of lending. Because banks have access to extensive data on customers' regular inflows and outflows, they should be able to efficiently use these data to determine what levels of borrowing are reasonable and appropriate—and only make loans with a reasonable likelihood of timely repayment. The Proposed Guidance also makes clear what constitutes excessive borrowing, noting that "repetitive deposit advance borrowings indicate weak underwriting." This is consistent with the 2007 Guidelines, which state that "sound underwriting criteria should focus on a borrower's history with the institution and ability to repay a loan within an acceptable timeframe."[6]

- **The introduction of a minimum cooling off period.** Repeat borrowing suggests broader financial distress for both payday loan and deposit advance users. The Proposed Guidance would limit deposit advance loans to once per monthly statement cycle, and require a full statement cycle to take place before permitting consumers to take out another deposit advance loan. This provision will lead to stronger underwriting, as noted above, and will also reduce the likelihood of consumers falling deeper into debt.

These three provisions will strengthen banks' deposit advance offerings, reducing both risks to consumers and to financial institutions.

Recommendations

The FDIC's recent guidance acknowledges both the risk associated with deposit advance loans and the need to assess consumers' ability to repay. We believe that this guidance is a valuable starting point, but it could be made more effective. Specifically, we recommend the following two improvements:

- **First, the FDIC should set a specific fee cap to eliminate ambiguity about what constitutes an excessive fee.** The proposed guidance points to the 2007 Guidelines, and demands compliance with state usury laws, but does not offer a specific fee cap. CAP believes that this may be unclear for both financial institutions and consumers.

  The 2007 Guidelines note that successful small-dollar loan programs at some institutions have had annual interest rates between 12 and 32 percent, with minimal fees, and encourage lenders not to exceed 36 percent APR.[7] Limiting interest and fees to 36 percent APR would be a useful starting point, consistent with the 2007 Guidelines as well as usury laws in many states where high-cost payday loans are banned. This cap would also be consistent with the 2006 Military Lending Act, which restricts lenders' ability to make high-cost loans to servicemembers and their families. As noted in a column published in the *Richmond Times-Dispatch* this February, high-cost loans that are unsuitable for members of the armed forces are likely unsuitable for other borrowers as well.[8]

  Incorporating all fees into the APR calculation is crucial. Some states that have limited interest rates

on payday loans have nevertheless allowed much higher overall costs to borrowers by permitting lenders to impose additional fees. For example, while Virginia adopted an annual interest rate cap of 36 percent in 2009, the average APR on payday loans is 282 percent once two additional fees—a loan fee and a verification fee—are included.[9]

One possible side effect of establishing a limit of 36 percent APR for deposit advance loans would be to encourage financial institutions to make loans of longer duration. These loans would be more likely to be repaid. Longer repayment terms, and shifting toward affordable installment lending, may be less risky for financial institutions and consumers alike.

- **Second, the FDIC should strongly urge uniform guidance for deposit advance loans across financial regulators.** Clearly, financial regulators are paying attention to deposit advance loans. The Federal Reserve released a policy statement noting "potential consumer harm and the potential for elevated compliance risk" in deposit advance products.[10] The National Credit Union Administration is looking into the practice of credit unions making high-cost, short-term loans.[11] At the same time, we regret that only the FDIC and OCC have adopted uniform guidance. Consumers deserve the same financial protections regardless of which regulator oversees the financial institutions at which they have accounts, and as evidenced by the financial crisis, inconsistent regulations can lead to regulatory arbitrage.

Conclusion

Thank you again for the opportunity to comment on this notice. If you have any questions or would like to discuss anything in this letter in more detail, please contact Joe Valenti, Director of Asset Building, at 202-478-5316 or jvalenti@americanprogress.org.

Sincerely,

Center for American Progress

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[1] Consumer Financial Protection Bureau, "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings," April 24, 2013, available at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[2] Jessica Silver-Greenberg, "Major Banks Aid in Payday Loans Banned by States," *New York Times*, February 23, 2013, available at http://www.nytimes.com/2013/02/24/business/major-banks-aid-in-payday-loans-banned-by-states.html.

[3] "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings."

[4] Federal Deposit Insurance Corporation, "Financial Institution Letters: Affordable Small-Dollar Loan Guidelines," June 19, 2007, available at http://www.fdic.gov/news/news/financial/2007/fil07050a.html.

[5] Robert Barba, "Republic Bancorp in Kentucky Exiting Tax Refund Lending," American Banker, December 9, 2011, available at http://www.americanbanker.com/issues/176_238/republic-refund-anticipation-loan-1044734-1.html.

[6] "Financial Institution Letters: Affordable Small-Dollar Loan Guidelines."

[7] Ibid.

[8] Joe Valenti and Lawrence J. Korb, "Congress protects troops from predatory lenders; what about everyone else?" *Richmond Times-Dispatch*, February 4, 2013, available at http://www.timesdispatch.com/opinion/their-opinion/columnists-blogs/guest-columnists/valenti-and-korb-congress-protects-troops-from-predatory-lenders-what/article_b8952933-77a0-5d8b-a351-5a02a8b2afc5.html.

[9] Ibid.

[10] Federal Reserve Board of Governors, "Statement on Deposit Advance Products," April 25, 2013, available at http://www.federalreserve.gov/bankinforeg/caletters/CALetter13-07.pdf.

[11] Kevin Wack, "Payday Loans by Credit Unions Come Under Fire," *American Banker*, May 20, 2013, available at http://www.americanbanker.com/issues/178_96/payday-loans-by-credit-unions-come-under-fire-1059226-1.html.