



January 21, 2019

Via Electronic Submission to: *comments@fdic.gov*

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

Re: Small-Dollar Lending [RIN 3064-ZA04]

**Comments of the Consumer Advocacy & Protection Society (CAPS)
University of California, Berkeley, School of Law**

Dear Mr. Feldman:

The Consumer Advocacy and Protection Society (CAPS),¹ a student-run organization dedicated to the promotion of consumer law and consumer protection at Berkeley Law, appreciates the opportunity to provide comment on the FDIC's Request for Information regarding small-dollar lending. Many of us have served clients struggling to rehabilitate their credit in the East Bay Community Law Center's Consumer Justice Clinic, while others have studied the deleterious consequences of abusive interest rates on payday loans. In light of the

¹ Consumer Advoc. & Protection Soc'y (CAPS) – Berkeley L.'s Consumer Hub (last visited Jan. 19, 2019), <https://consumer.berkeley.edu/>.

OCC's rescission of its deposit advance guidance, we hope to assist the FDIC as it reassesses its position on small-dollar lending.

We share the FDIC's goal of greater financial inclusion for low-income consumers, borrowers with little or no credit history, and communities of color. Because of the often catastrophic effects of high-interest payday loans on these consumers, we wish to encourage the FDIC to retain its 2013 guidance and caution against the potential risks associated with its rescission.

I. Allowing banks to issue small-dollar loans does not make the loans safe or affordable.

In the wake of the OCC's policy change on small-dollar lending, banks are experimenting with new programs that cater to consumers who need money quickly.² U.S. Bank's "Simple Loan" program, for example, permits customers to borrow up to \$1,000 with a three-month repayment schedule.³ Customers must have a U.S. Bank account and may pay a fee of \$12 per \$100 borrowed if they authorize the bank to automatically debit their account, or \$15 per \$100 borrowed if they do not.⁴ The fees result in what would be an APR over 70%, almost double the maximum APR permitted for loans to servicemembers and their families, according to the FDIC's examination materials.⁵

Although U.S. Bank has argued that its process is transparent, merely informing consumers of an abusively high interest rate is not equivalent to a safe lending practice. Given that personal loan debt is growing faster than any other type of debt (including auto, credit card,

² Maria LaMagna, "More banks are trying to get a piece of the payday loan pie," *Marketwatch*, (Sept. 16, 2018). <https://www.marketwatch.com/story/banks-are-trying-to-get-a-piece-of-the-payday-loan-pie-2018-09-12>

³ *Id.*

⁴ *Id.*

⁵ FDIC, Military Lending Act, <https://www.fdic.gov/regulations/compliance/manual/5/v-13.1.pdf>.

mortgage, and student loan debt),⁶ irresponsible lending in this arena could be disastrous for consumers and for the economy as a whole. It is true that these “bank payday loans” are far smaller in amount than mortgages, yet banks authorizing subprime loans without consideration of a borrower’s ability to repay evokes troubling echoes of the 2008 financial crisis. If the true purpose of reevaluating the regulation of small-dollar lending is to make access to credit realistic, safe, and manageable, merely bringing the same problematic payday loans into more “reputable” institutions will not accomplish those goals, and could negatively affect consumer perception of banks.

II. Rescinding the 2013 Guidance would create a race-to-the-bottom, harming public faith in FDIC-regulated institutions.

Without adequate regulation, some institutions will start a race-to-the-bottom to compete with payday lenders who aren’t regulated by the OCC, the FRS, the FCUA, or the FDIC. Following the OCC in merely repealing the current guidance would be a mistake. The current OCC core lending principles do not give sufficient guidance for banks to develop safe lending practices. While the OCC is correct to note that borrowers have turned to abusive lenders, the proposed guidance does not ensure sufficient backstops for banks to prevent similarly abusive practices. The OCC materials suggest that loan amount and repayment terms should “promote fair treatment and access”⁷ but say little on procedural safeguards to ensure this result.

The FDIC’s previous experience exploring payday-type lending at covered institutions points up the need for great caution in incentivizing access to credit for underserved

⁶ Matthew Tatham, “Personal Loans are the Fastest Growing Consumer Debt,” *Experian* (Aug. 3, 2018), <https://www.experian.com/blogs/ask-experian/personal-loans-are-the-fastest-growing-consumer-debt/>

⁷ OCC, “Core Principles for Short-Term, Small-Dollar Installment Lending,” OCC Bulletin 2018-14, <https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html>

communities. The 2010 FDIC Small Dollar Loan Pilot Program produced results that suggest prioritizing community engagement and long-term financial planning over short-term profit is essential to the success of small-dollar lending.⁸ When customers were given longer repayment terms and encouraged to develop a lasting relationship with the financial institution, the loan programs were more successful and saw lower risks of default.⁹ However, not all financial institutions put the borrower's financial health first, and many sought to increase short-term profits through interest rates that were substantially higher than other loan products offered to consumers.¹⁰ Ultimately the Pilot Program was not expanded because banks were unwilling to prioritize the lower profits of sustained customer service over the immediate reward of high interest rates. That lesson is one that may usefully inform the current proceeding.

One critical step to ensuring public trust is to bar banks from partnering with third-party lenders to facilitate otherwise illegal high-interest loans. The “rent a bank” era ended a mere ten years ago, in part as a result of the FDIC's efforts.¹¹ Giving payday loan providers the air of legitimacy both puts consumers at risk and degrades the integrity of better known financial institutions. Moreover, these relationships create regulatory tangles that permit unsavory lenders to evade state laws and inhibit the fair regulation of federally-insured institutions.¹² Providing

⁸ Rae-Ann Miller et al., “A Template for Success: The FDIC's Small-Dollar Loan Pilot Program,” FDIC Quarterly, Vol. 4 No. 2, 2010.

<https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf>

⁹ *Id.*

¹⁰ *Id.*

¹¹ In 2008, the FDIC issued an advisory addressing payday lending through non-bank partners, FIL FDIC: FIL-14-2005: *Guidelines for Payday Lending*, and later shut down a rent-a-bank arrangement with an enforcement action. *In the Matter of First Bank of Delaware, and CompuCredit Corporation*, Notice of Charges for an Order to Cease and Desist and for Restitution, Federal Deposit Insurance Corporation, FDIC-07- 256b, June 15, 2008, available at <http://www.FDIC.gov/news/perss/2008/FDBNoticeofCharges.pdf>; see also *In the Matter of First Bank of Delaware*, Stipulation and Consent to the Issuance of an Order to Cease and Desist, Order for Restitution, and Order to Pay, Oct. 3, 2008, available at <http://www.FDIC.gov/bank/individual/enforcement/2008-10-20.pdf>.

¹² See Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates under the Unconscionability Standard*, 31 Hous. L. Rev. 721, 729 (1994) (“[L]enders and merchants have developed creative evasions of usury regulation that are

safe access to credit should not become synonymous with subprime lending practices that undermine Americans' faith in their financial institutions and their trust in effective government oversight.

As the Pilot Program demonstrated, lenders as a group will not focus on the lofty goals of encouraging greater mainstream financial participation or building credit in low-income communities. Without limits on interest rates (and there are none at the federal level outside the military), a ban on interest balloons, and realistic repayment schedules that are tailored to a borrower's ability to repay, too many FDIC-regulated lenders will perceive a need to take advantage of their most financially vulnerable customers in order to compete with other lenders — both those that are regulated by the FDIC and those that are not. Because the FDIC is tasked not only with ensuring stability in its institutions but also bolstering consumer confidence in institutional legitimacy, such practices could be devastating for the banks the FDIC regulates. Creating an experimental, unregulated atmosphere risks painting banks with the same brush as loan sharks and payday loan servicers whom the public does not trust.¹³

III. A permissive small-dollar loan program would be difficult for the FDIC to supervise effectively.

Well-regulated small-dollar loans can be an important means for low-income consumers to gain access to credit, but the high interest rates which often make these loans profitable pose substantial risk that requires careful oversight by banks and their regulators. Unfortunately,

exploitative but nonetheless legal.”); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 Temp. L. Rev. 1, 98 (2005) (discussing how widespread evasion of state consumer credit laws undermines markets and harms consumers); Christopher Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 Minn. L. Rev. 1110 (same).

¹³ The Pew Charitable Trusts, “Americans Want Payday Loan Reform, Support Lower-Cost Bank Loans” (April 2017) (finding that 70% of Americans support increased regulation of payday loans), <https://www.pewtrusts.org/~media/assets/2017/04/americans-want-payday-loan-reform.pdf> [<https://perma.cc/3KWA-78K5>].

repealing the FDIC's well-established policy would make it harder for the agency to encourage only the type of lending that will benefit consumers. Without clear and predictable enforcement guidelines, banks are all too likely to engage in abusive practices in the name of competition.¹⁴

Efforts to make small-dollar lending more profitable for banks may result in substandard underwriting. Deputy Comptroller Barry Wides of the OCC remarked in 2011 that certain protocols, including requiring "high touch" manual underwriting to reasonably evaluate each applicants individual circumstances, may mitigate risk in small-dollar lending provided that "the customer has otherwise properly managed credit and has the capacity to repay the loan."¹⁵ However, more and more banks are turning to automated underwriting systems (AUS), ostensibly to make lending more efficient and less prone to general error. But while using an AUS can help a lender determine which potential borrowers are safe investments, small-dollar borrowers are by nature more likely to have a history of poor credit or no credit and thus require more individual evaluation. Industry experts are already considering implementing AUS technology to cut their costs in making small-dollar loans.¹⁶ Ensuring that underwriting is fair and safe for all consumers requires clear guidance, especially when the majority of borrowers may have troubled credit histories. If the FDIC permits its members to issue payday-type loans,

¹⁴ See John D. Skees, *The Resurrection of Historic Usury Principles for Consumption Loans in a Federal Banking System*, 55 Cath. U. L. Rev. 1131, 1168 n.242 (2006) ("[E]ven though usury laws discourage competition, the companies that usury laws prevent from entering the marketplace are those who would seek to exploit borrowers, and thus consumer protection increases."); Erin Delaney & Samuel Issacharoff, *Credit Card Accountability*, 73 U. CHIC. L. REV. 157, 166 (2006) ("Increasingly, the relations between large sellers and multiple small buyers becomes a world of contracts of adhesion, with terms and conditions set by the seller with no realistic prospect of negotiation. When markets prove not to have price competition, or when information is difficult to obtain and the transactional barriers to leaving one seller to find another are high, the risk of seller misbehavior is heightened.").

¹⁵ OCC, "Statement of Barry Wides Before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services," Sept. 22, 2011.

<https://www.occ.gov/news-issuances/congressional-testimony/2011/pub-test-2011-121-oral.pdf>

¹⁶ Lorie Konish, "Your neighborhood bank may now offer short-term, small dollar loans," CNBC (May 24, 2018). <https://www.cnbc.com/2018/05/24/big-banks-get-green-light-to-make-short-term-small-dollar-loans.html>

the agency should at the very least impose exacting quality control standards to ensure that the loans are fair to the consumer and carefully underwritten, as the 2013 Regulation prescribes.¹⁷ Trusting that banks will come up with reasonable safeguards of their own volition is a dubious proposition¹⁸ that will result, through injury to honest lenders and borrowers alike, in an increased burden on the FDIC over time.

Rescinding the 2013 Guidance without an adequate regulatory replacement may create significant administrability concerns for the FDIC. When banks have engaged in small-dollar or payday loans in the past, many have knowingly risked financial viability and continued safe supervision of their lending programs in hopes of higher profit yield.¹⁹ Under a bright line rule that bars payday lending, the OCC and FDIC have been more able to clearly and easily determine when a bank has crossed a boundary of safe practice; if the FDIC were to follow the OCC in repealing its current guidance, the agency would need to calculate and examine various layers of risk before acting to halt risky or unfair lending practices. Simply repealing the current rule guidance by which to evaluate whether small-dollar loans are high-risk enough to pose a risk to other customers or to the small-dollar borrowers themselves would be an insufficient solution to accomplish the FDIC's stated goals.

¹⁷ FDIC, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products," 6714-01-P, p. 18, Nov. 21, 2013. <https://www.fdic.gov/news/news/press/2013/pr13105a.pdf>

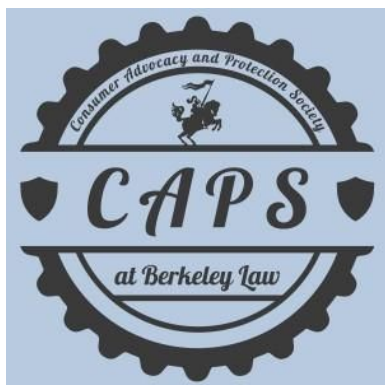
¹⁸ See National Consumer Law Center, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016) (describing how lenders are incentivized to skirt underwriting requirements), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.

¹⁹ OCC, "Fact Sheet: Eagle National Bank Consent Order," Jan. 3, 2000. <https://www.occ.gov/news-issuances/news-releases/2002/nr-occ-2002-1b.pdf>

Conclusion

The FDIC's mission remains to promote sound public policies, address risks in the nation's financial system, and carry out its insurance, supervisory, consumer protection, resolution planning, and receivership management responsibilities. The deposit advance prohibition was implemented to ensure quality lending practices and protect particularly vulnerable consumers. While promoting greater access to credit and enabling safe, responsible small-dollar lending may fall within the FDIC's vision for improved public engagement with mainstream financial institutions, that new vision cannot come at the expense of consumer safety or public trust in FDIC-regulated banks. Without clear regulatory backstops to mitigate the profit incentive, reputable institutions may sacrifice stability and security in pursuance of short-term gain. Rescinding the current guidance risks creating an unmanageable supervisory role for the FDIC where new and long-time patrons suffer.

For the reasons stated in this comment, we urge the FDIC to retain the 2013 Guidance.



Sincerely,

Consumer Advocacy and Protection Society
University of California, Berkeley, School of Law

Hanne Jensen
hanne.jensen@berkeley.edu

caps@law.berkeley.edu
<https://consumer.berkeley.edu/>