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Docket ID OCC–2011–0012
"Deposit-Related Consumer Credit"
A guidance released on June 8th, 2011

Dear Sirs:

We believe that the Office of the Comptroller of the Currency should not allow national banks to offer deposit-related consumer credit products. In our opinion, there products undermine the banking relationship, pose a reputational risk, and put consumers at risk.

- These products, as currently offered in the market, cost far more than similar credit alternatives. The prices exceed usury laws in many states.
- The products mirror the model of payday lending. Technically, a payday loan is an advance against a future deposit. Technically, a deposit-related consumer credit product is the same thing. Both advance a customer a short-term high-cost loan that is collateralized by a future deposit.
- These loans are likely to have an unfair and disparate impact upon protected classes.
- These consumer loans are regulated by states. The OCC will pre-empt existing state laws in order to implement the standards in its guidance. Given that most states have passed laws with far more restrictive rules for the price of loans and for the consumer protections afforded to borrowers using this product, the guidance is in violation of the Dodd-Frank Act.
- The CFPB has rulemaking authority over these products. The OCC is asking for comments on a guidance written less than 45 days prior to the first day of the CFPB. There is no place for the OCC to make this guidance and the process of seeking comments is only a false means of creating some kind of justification for the sequestration of the CFPB's privileges.

If the OCC does go ahead with implementing this guidance, then the five elements of the guidance should be rewritten.

We can agree in principle with parts of the standards outlined in its June 8th guidance ("Deposit-Related Consumer Credit Products. ")

Even so, the guidelines fall short because they are too vague. The report lacks details about the scope of product cost, of how consumer protections will be applied, and are omitted and there is little mention given to the scope and motivation for regulatory enforcement.

Advance products are designed to prevent overdrafts. Nevertheless, this is a high cost credit product. Disclosures made by both Wells Fargo and Fifth Third emphasize this fact.

We have the following recommendations:

The OCC should use enforcement powers when depositories fail to meet the standards in the guidance for monitoring customer accounts. As written, the guidance holds issuers to monitor the usage of credit by their customers. It does not explain the actions that would constitute irresponsible use of credit. It does not make clear when the OCC would intervene to enforce their guidance. Will any form of monitoring by lenders serve to satisfy the OCC's guidance? Is there a defined expectation for monitoring and reporting? We believe that the OCC needs to create a standard for monitoring, hold the lenders to that standard, and enforce the standard if lenders fail to meet it.

Establish a national database, available to the public, which tracks the usage of this product. The best way to enforce this standard is to create a national database which tracks the usage of deposit-related consumer credit products. The database's contents should be updated regularly and the database should be made available to the public. The database should be downloadable into some form of delimited file.

The database should include the following elements: bank name, location (census tract), customer unique id, date of origination, date of repayment, fees, amount of advance, borrower military status, borrower race, borrower ethnicity, and borrower age.

Such a database will create an enforcement regime that taps the capacity of third-party observers. This is cost-efficient.

Establish a rule that interest rates may not exceed an APR of 36 percent, and calculate that amount based upon the actual term of the advance. It would be a different question if the overdraft products currently offered by national banks were issued at an affordable price point. They are not. Annual percentage rates on deposit-related consumer credit products offered by OCC-regulated national banks are very high cost. In some instances, they parallel the cost of many non-secured high cost consumer credit loans. Consider this list of banks and their checking account advance product prices:

Bank Product	Fee/Increment	APR for 35 days	APR for 1 week
Wells Fargo Direct Deposit Advance	$1.50 per $20	78 percent	391 percent
Fifth Third Early Access	$1 per $10	143 percent	521 percent
US Bank Checking Account Advance	$2 per $20	143 percent	521 percent

The disclosures with each account calculate an APR based on the assumption that a consumer takes out the advance over one month ahead of their next direct deposit. This is a false premise. Most people get paid every two weeks. Social Security checks come once per month. Moreover, it is not likely that a person will take out an advance at the beginning of their pay cycle. Common sense says that they will take an advance when they are about to run out of money. The logic of the advance is that it helps to avoid an overdraft. Overdrafts don't take place the day after a paycheck is deposited. Thus, the APR calculated on a 1 week term is far more relevant. These numbers show that the usurious rates on a 35 day loan are actually far more usurious.

A critic of the idea of capping interest rates might argue that the small loan amounts require higher fees in order to justify transaction costs. This logic does not hold up with this product. For one, the product is only made available to customers that have already enrolled with a checking account. There is no need to assess the credit of customers or even to process demographic data. The customers signs up with an electronic form. For a lender, the time involved is probably equivalent to the time it takes to set up an ACH payment.

Loan prices should be lower in part because the cost of acquiring capital is so low. These loans are funded through deposits. Most checking accounts pay no interest or else very little interest. A Wells Fargo checking account pays 5/100ths of 1 percent interest. The net interest margin on any of these loans is going to be well beyond the standard internal rate of return sought by a bank.

The lack of a basis for credit at an APR of 120 percent or more is underscored by the comparative success of small consumer finance lenders. These lenders make money by offering loans that cost much less than those proposed by this guidance.

Consumer finance companies make money from providing installment loans with far lower interest rates. In North Carolina, consumer finance companies make loans at a maximum of 30 percent on the first $7,500. In 2009, the average interest rate was 24 percent (North Carolina Office of the Commissioner of Banks, 2011). The average profit margin was between 9 and 10 percent (North Carolina Office of the Commissioner of Banks, 2011).

These lenders have costs that the big banks are not going to experience. They have to hire staff and pay for stores to make their loans. By contrast, banks have sunk costs in employees and branch construction. The provision of a deposit-related consumer credit product has no marginal cost. The biggest cost for consumer finance companies is through charge-offs, which came to about 5 percent in the NCCOB sample. Deposit-related accounts should not experience this level of delinquency.

In spite of these differences, the OCC appears ready to allow national banks to charge far more to offer a product that costs them far less to provide.

Create an explicitly expressed ceiling on the use of the deposit-related consumer credit products. CRA-NC affirms the notion of an explicit six use per twelve month standard. This means that the customer would still be able to use the product every other month.

The FDIC's April 2011 guidance, "FDIC Overdraft Payment Program Supervisory Guidance" explicitly states that lenders should intervene when a customer makes more than six overdrafts in any one twelve month period. Moreover, the FDIC even defines how the number of overdrafts should be counted. The quantification is based on the number of overdrafts and not the number of overdraft incidents: the account of a customer that overdraws and then subsequently records two more transactions on the same day would have three overdrafts for the purposes of the FDIC guidance.

Do not pre-empt state law

The implementation of the standards in the OCC guidance, if applied with pre-emption, would have the effect of increasing costs to consumers. Under Dodd-Frank, federal law cannot pre-empt state laws that offer greater protections for consumers.

This is another example where pre-emption interferes with the ability of states to apply consumer protections in financial services. Do not offer credit at an APR that exceeds state usury laws, or that exceeds thirty-six percent on an annualized basis.

Currently, states have the ability to prevent this product from being offered locally. In North Carolina, neither Wells Fargo nor Fifth Third has brought their checking account advance products into the state. Fifth Third's Early Access is not available in Georgia, Pennsylvania, or West Virginia. Wells does not have Direct Deposit Advance in those states, either. It does have it in 26 of the 40 states in their branch network.

Wells Fargo and Fifth Third do not offer this product in North Carolina. If they tried to, state usury laws would intervene. However, if the OCC counters with a new rule, then pre-emption would allow the national banks to create a new and lower standard for protecting consumers.

In North Carolina, Section 53-173 of the North Carolina consumer finance law limits interest rates on loans of less than $7,500 to an APR of 30 percent. Within that pricing environment, consumer finance companies are able to make a profit. Companies like Heritage Finance, Patriot Loan Company, AIG American General, North State Acceptance, and CitiFinancial offer loans for thirty percent APR.

Cede to the authority of the CFPB

The Consumer Financial Protection Bureau has regulatory authority over deposit-related consumer credit.

The timing of this guidance is itself questionable. The CFPB is scheduled to being operations before the end of July. Why is the OCC asking for guidance on this product now? OCC is rushing this guidance. There are only four banks seeking to offer this product right now. Three are currently regulated by the OCC (US Bank, Fifth Third, and Wells Fargo) and the fourth (Block Bank) is scheduled to move to the OCC in the near future.

No Overdraft Fees for overdue bills

The OCC says that lenders should establish a system for making sure that customers do not use the advance too often. The important thing is to provide a meaningful limit that creates a balance between customer choice and customer protection.

The OCC should prohibit lenders from applying overdraft fees to these products. Currently, US Bank will charge an overdraft fee when an account is not settled by the due date. This bank applies direct deposit payments to fees and then to principal.

US Bank charges an overdraft fee when a customer is delinquent on their outstanding checking account advance. To make matters worse, US Bank puts any future payments toward the overdraft fee before satisfying the principal. This has the effect of creating more overdrafts.

This is another instance when the proposed guidance of the OCC would have the effect of diluting state laws. North Carolina G.S. 53-173 does not allow consumer finance companies to charge more than 8 percent interest on unpaid principal balances.

No Rollover of Outstanding Debts
Lenders should not allow another checking account advance to satisfy an outstanding balance from a previous advance. Lenders should not rollover debts. If a consumer's direct deposit does not cover the principal and fees from the advance, then the customer should not be allowed to take out a new advance.

The OCC's guidance has language about this but it is without any specificity: The guidance states "deposit-related credit products should be subject to prudent limitations on credit extensions, customer costs, and usage." But what does it mean to be prudent? What happens if the bank's notion of prudent is not at all prudent? If the OCC and the bank differ about prudent, will the OCC step in to enforce their opinion and what will the penalty be for the bank?

Wells Fargo appears ready to go ahead with a "rollover" product. This language shows the current standard at Wells Fargo:

> "When you access the Service, the advance is automatically deposited into your Wells Fargo checking account. If your checking account balance is negative, the advance will be applied as a "deposit" against your negative balance."

US Bank will charge an overdraft when a balance is due at the end of 35 days. This creates a new fee, which is paid before the principal.

This is the same approach as utilized by payday lenders.

Apply Consumer Protections against Debt Collection to Social Security Recipients
The Exempt Income Protection Act makes it against the law for debt collectors to take "subsistence funds" in order to pay private debt. These funds include social security payments, pensions, and other government benefits. The law also protects the collection

of debts due a private company on the first $212.50 of income earned by a Social Security recipient.

Section 207 of the Social Security Act reiterates this specific protection for Social Security recipients.

The disclosures ("terms and conditions") at Fifth Third, Wells Fargo, and US Bank fail to disclose this protection.

In spite of that explicit protection, collections of direct deposits have violated these protections. MetaBank, formerly and OTS-regulated thrift but soon to come under the supervision of the OCC, appears to have broken these rules.

When the OTS directed MetaBank to close its i-advance product, the bank sought immediate repayment of all outstanding credit. Many customers made comments on the finance blog BankTalk.org about the subsequent collection of outstanding debts. The comments suggested a pattern of garnishments against government payments.

- "Metabanks, garnished my social security $737.00 until I am unable to pay rent. I will call ssI [sic] to see what can be done; I also, was not informed."
- "MetaBank today garnished my Social Security Deposit for my loan payment in full after giving me little time to make alternate arrangements. I am now risking eviction and becoming homeless. Where can I get help?"
- "My Mother is on disability and got debited full payoff of 540.00 now has no money and is frantic..... What can be done, This is such a bad way to do business....... They give someone availibilty [sic] to funds that are on a fixed income and then take it back to leave them high and dry!!!!"

Section 207 of the Social Security Act bars creditors from garnishing benefits. The records indicate both an illegal garnishment and a lack of adequate disclosures.

Monitor the use of these products for adverse and disproportionate impacts upon protected classes. The only way to do this is to collect information on the demographics of users. OCC should require lenders to reveal the demographics of their checking account advance customers. The arrival of this product sets the stage for separate channels for accessing credit. If most white borrowers have a line of credit but most minority borrowers used only the checking account advance, then there is a clear disproportionate impact in access to credit.

Research has documented that high-cost consumer loans are more likely to be used by underserved borrowers. A 2011 study by the North Carolina Commissioner of Banks discussed the demographics of the borrowers:

> "From 1998 to 2007, this product was least popular among the more affluent, although the use of this product decline across all income groups. Renters were more likely than owners to hold these loans, and residents of rural and non-major metro areas (MSAs or metropolitan statistical areas) were more likely than residents of MSAs to have "other installment loans." Minorities were more likely than white non-Hispanic households to use these loans. Those with at least a college degree were less likely to use these loans than those without, while families with heads of households aged 44 and younger and household with children tend to be more likely than older households to use these loans. Many of these preferences contrast with the penetration of credit cards. (North Carolina Office of the Commissioner of Banks, 2011)"

Toward that point, we believe that disclosures about the checking account advance should include a discussion about how many minority households are able to choose between the deposit-related consumer credit product and other more low-cost credit products. The data should be released to the public. The guidance should have a clear "line in the sand" about the acceptable level of difference in the uptake of these products for different protected classes.

Require Parity in Access to Personal Line of Credit Products

The guidance should explore the comparative ability of customer access to mainstream financial credit products that are linked to their deposit account. Part of monitoring appropriate use by customers should include some verification that consumers using the checking account advance product are not suitable for a better form of short-term credit. We also believe that regulatory attention should examine the possibility of disparate impacts on protected classes.

The personal line of credit and the credit card are traditional resources for short-term credit. Other consumers tap "consumer installment loans" – often characterized as smaller loans made by non-bank financial institutions.

National banks offer credit cards and personal lines of credit. The three banks offering the deposit-related consumer credit product are national banks. The OCC should make sure that the arrival of this new product does not create separate channels for accessing credit.

The guidance speaks to that expectation, but the language is vague:

> *"Customers should be provided clear and conspicuous disclosures prior to enrollment, consistent with applicable law, about program costs, terms, and material limitations before they are provided a deposit-related credit product. Customers also should be provided information about alternative deposit-related credit products, if any, offered by the bank."*

The guidance stops there. This is one example of how the guidance's principles are fair but the specification of how they would be implemented is lacking. The guidance should disclose the consequences for failure by a lender to honor these disclosures. Moreover, the guidance should include plans to monitor disparate impacts related to the use of this product.
The cost of drawing upon a traditional credit line usually entails a small fee of several dollars, plus interest. Interest rates are generally consistent with prime credit card rates. A $250 draw on a line of credit with a 13 percent rate of interests costs $2.71 per month. A checking account advance would cost $25.

The line of credit provides more flexibility, as well. Generally a consumer must make a minimum payment. It begs the question: why is this innovation needed in the first place? The line of credit is not a new product and it is clearly a superior alternative to the checking account advance. In fact, its existence a priori to the arrival of the checking account advance provokes some question about the need for a substitute product.

Apply the Service members Civil Relief Act to Deposit-Related Credit Products
The SCRA says that service members cannot be charged more than six percent interest on any outstanding debt that existed at the point in time when the soldier was put into active duty. This means that any outstanding advance should not accrue overdraft fees and that the debt on balances should accrue interest of no more than six percent. The same law should pose a question about US Bank's plans to charge additional overdraft fees for unpaid advances.

Moreover, is it legal to collect on a direct deposit paid by the US military to the family of a deployed service member?

Unfortunately, the SCRA says that no interest can accrue on a credit obligation at a rate above 6 percent. The name of the guidance - "Deposit-Related Consumer Credit"- should make it obvious that the rules of the SCRA are relevant. The OCC should include the SCRA in the list of laws that it explicitly states are incumbent upon lenders to follow in the provision of deposit-related consumer credit.

Reputational Risk

The prospect of collecting on delinquent debts could have a negative effect on the public reputation of OCC-regulated banks. Sooner or later, people with delinquent debts will enter branches. They will be falling into the same debt spiral that plagues consumers of payday loans. It isn't hard to imagine the scene: a mother begging a teller for more time to pay her small-dollar loan, only to be told that there is nothing that can be done. The scene will create a disturbing parallel between national banks and payday lenders.

Conclusion

We believe that the OCC should not issue any guidance that allows national banks to offer consumer credit on deposit accounts. The place for the OCC to make this guidance in and of itself is flawed. This is an issue to be decided upon by the CFPB. Even if the OCC does insist on applying its own standards to this question, we believe that the correct answer is to eliminate this product.

If the OCC goes forward with writing a guidance that claims authority over this product and also approves it as a legitimate form of credit, then we believe that the guidance should add to its explicitness. The current guidance is too vague and provides little clarity on how the OCC would apply its rules and when it would intervene to enforce those rules. Important consumer protection issues are overlooked. In absence of clear rules that would hold banks and the OCC accountable, consumers are pushed one step closer to a second-tier banking system.

Bibliography

North Carolina Office of the Commissioner of Banks. (2011). *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly.* Raleigh: NCCOB.