REINVESTMENT PARTNERS
"ADVOCATING FOR ECONOMIC JUSTICE AND OPPORTUNITY"

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Docket ID OCC-2013-0005
Guidance on Deposit Advance Products

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Docket ID FDIC-2013-0043
Proposed Guidance on Deposit Advance Products

Dear Sirs:

Reinvestment Partners would like to offer our comment on the new proposed guidance on checking account advance products.

Reinvestment Partners is a 501 © 3 non-profit organization based in Durham, North Carolina that advocates on behalf of low-income and minority consumers to help them gain access to good financial products.

We support the emphasis in the new guidance (s) to place expectations upon institutions to offer products that "address potential reputational, compliance, legal and credit risks." Our general position is that the new rules would create a regulatory framework that represents the needs of consumers. As a result, the main thrust of

our comment is to underscore that this guidance should be preserved. Our comment does propose several possible enhancements.

Currently, no institutions offer the deposit advance in North Carolina. This may reflect the presence of an energetic set of consumer advocacy groups in the state, as well as our history in pushing payday loans out of the state in 2004. Nonetheless, several of the banks that do offer the product elsewhere have branches in our state. We participated in a coalition of groups that successfully challenged the plans by Regions Bank to introduce its ReadyAdvance in our state. As well, we have asked regulators to downgrade banks on their CRA exams when they offer this product.

Summary:

1. Place limits on usage of the product below four times in any one calendar year. Any usage should count regardless of whether or not the borrower draws the full line of credit.
2. Calculate APR based upon a term that reflects actual duration of borrowing. Although banks allow as long as 35 days, research shows that the median time before repayment is twelve days.
3. Prohibit automatic collection of debts.
4. Banks should have to set aside one dollar of capital for every dollar extended to a consumer under the calculation of their risk-based capital ratios.
5. When establishing the "financial capability" of a borrower to repay a loan, lenders should factor the cost of possible overdraft fees to the likely cost of future debt service.
6. Offer an option to repay in installments.

Some lenders insist that the high cost of this product is justified. One such argument relies upon the idea that the alternative – a payday loan – is even more expensive.

This is poor logic, as it ignores the needs of borrowers while providing a defense for pricing that is far in excess of most state usury caps.

As a point of fact, it is even worth acknowledging that banks have a number of cost advantages over retail payday lenders. Banks generally pay no marginal cost to provide these loans. Storefront payday lenders must rent retail space and pay employees. As well, banks have no customer acquisition costs. Online payday lenders pay as much as $100 for each new customer. Finally, payday lenders pay a higher cost of capital. In the end, payday lenders generate rates of return of between ten and fifteen percent.

In our opinion, these products present several important challenges to the needs of consumers and to the safety and soundness of the institutions that offer them.

Currently, six banks offer a deposit advance product: Wells Fargo (OCC), US Bank (OCC), Fifth Third (Federal Reserve), Bank of Oklahoma/BOK Financial (OCC), Regions Bank (Federal Reserve), and Guaranty Bank (OCC). Empirically, we have not seen any iteration of a "bank payday" product which we believe provides a beneficial impact to consumers.

We believe that most of the consumers that use these products could qualify for a better product. Notably, all of the banks limit the deposit advance to their customers, and some only provide it to those with a tenured relationship. This suggests that all of those individuals have passed some kind of score; it is likely that most have credit scores of some quality and no presence on ChexSystems. In all likelihood, most could probably qualify for a credit card or a secured card and some might be reasonably able to have a standard line of credit. On average, users of deposit advance products make almost twice as much as do those that use payday loans (Consumer Financial Protection Bureau, 2013).

Product Allows Consumers to Roll Over; Cooling-Off Periods Are Poorly Applied

Usage limits are as important as price caps. In the sample population of a study published by the Consumer Financial Protection Bureau in April, 48 percent of payday loan users made more than 10 transactions during the preceding 12 months. Repeat use is the norm. Only one in seven payday consumers used two loans or fewer over the course of the year (Consumer Financial Protection Bureau, 2013).

Unfortunately, the CFPB's analysis of deposit advance products revealed the same trends (Consumer Financial Protection Bureau, 2013):

- Among checking accounts with deposit advances, the median number of draws was eight. Amazingly, those that drew more than $9,000 over the course of a year did so by utilizing the product 19 times (median).
- Some borrowers were able to take out new advances only days after satisfying their previous debt. Among the account holders characterized by higher rates of usage, the typical gap between episodes was only twelve days.
- Borrowers were indebted (median) for 112 days or 31 percent of the year.

The repeat borrowing demonstrates that the consumer protections established on a voluntary basis are not working.

As a result, usage limits are a necessary regulatory intervention. Intuitively, there is little reason to imagine that similar results would not occur with deposit advances. Currently, most banks cap usage at six times per year, but some only stop a borrower after six consecutive draws and Regions only rejects after six consecutive months of full draws.

A spokesperson from one OCC-member bank told us that while they do have a “cooling-off” period, as suggested under the OCC’s earlier proposed guidance; it is only enforced after 9 months. This could mean that a customer with a bi-monthly direct deposit, a not uncommon frequency, could use their Checking Account Advance 18 times. Given that their product allows for draws of as much as $500, which corresponds to a scenario where a consumer pays $900 in fees to borrow $500.

Another bank claims to make a similar effort toward protecting against repeat use, but significantly, it only defines a period of use as one in which a customer takes out the entirety of the credit available under their line. In either method, lenders “churn” loans in much the same way as do payday lenders. As the OCC’s guidance concludes, “‘cooling off’ periods can be easily avoided and are ineffective in preventing usage of these high-cost, short-term loans.”

We agree.

Although the following example does not reference a bank regulated by the OCC or the FDIC, its practice is still instructive of how those cooling-off periods can be ignored. This lender only counts a month in its analysis of repeat usage if the borrower takes out the maximum advance allowed under their account. If the bank allows an advance of $500 but the borrower only takes $350, then the bank does not count it as a roll-over.

In its guidance, the OCC proposes that no borrower should be able to get more than one loan per statement cycle and that there should be a waiting period of one month before the borrower may apply for another loan. In our opinion, if the product remains, then the guidance for it should be supplemented by a requirement that the borrower must maintain an account free of any overages during the gap month. Moreover, a one-month waiting period is still too short. Such a policy would still make it possible for a borrower to take out six advances in one year.

Safety and Soundness Risk is High

Until it can be demonstrated that deposit advance products are not risky, banks should have to set aside one dollar of capital for every dollar extended to a consumer under the calculation of their risk-based capital ratios. Similarly, banks should have to be very aggressive in setting aside allowances for losses.

The proposed rule to require the Board of Directors to approve the design of deposit advance products in writing is an excellent step to force accountability.

Some Deposit Advance Products Allow Banks to Collect Outstanding Debts and Fees First: This Violates the Electronic Funds Transfer Act

Under the EFTA, no lender can force a borrower to pay an outstanding debt. Payday lenders often step around this including contractual language which requires a borrower to give up his or her EFTA rights. For banks to insist on such a practice represents a lowering of standards which could compromise the reputations of those institutions.

Guaranty Bank, an OCC-regulated bank, is the exception to the rule. It allows manual repayments in $20 increments. But these protections are only voluntary and a rule is the only step that could make this a standard practice.

Finally, no recurring federal benefits payment should be used as a source of repaying an advance.

Banks should Disclose APRs in Standard Truth-in-Lending Act Format

Given that advance products are often repaid far in advance of their 35-day term, calculations of APR on these loans are difficult. Under existing Truth-in-Lending Act rules, there are different methods for calculating an APR for many different types of loan products. Unfortunately, no model fits perfectly with the deposit advance.

Absent a specific rule, lenders take many approaches to disclosing price.

One lender regulated by the Federal Reserve reports the APR as only 21 percent, even though the real cost is far higher. This lender charges a fee and interest. Specifically, the deposit advance costs $1 per every $10 plus interest of 21 percent.

Two OCC-regulated lenders do not disclose the APR. Wells Fargo offers a list of advance fees associated with incremental levels of an advance of between $100 and $500. In a box at the top of the Guaranty Bank EasyAdvance Line of Credit Agreement, a box reports that the advance fee is ten percent of each payment. One OCC-regulated lender lists an APR of 120 percent. Nonetheless, this number is located at the end of a paragraph at the bottom of a web page. There is no TILA-style box (US Bank, 2013). As well, there is no link to the disclosure from the checking account page.

To give borrowers more clarity, it would be useful if regulators could identify a new type of “Schumer Box:” Such an instrument would express the rate in in the context of the likely timing of the repayment: For

example, if an advance is made to a borrower whose recent history would suggest that a direct deposit will occur in less than 35 days, then the APR should adjust for a shorter term. For the sake of standardization, this could be achieved with a staggered set of loan terms. The following table could be one iteration of a standard disclosure form.

Example of a possible Disclosure Format for a Product with Indeterminate Term

Repayment Period	*APR*
5 days	730 percent
14 days	261 percent
28 days	130 percent
35 days	104 percent

Currently, some banks include language which warns consumers. For example, Guaranty's EasyAdvance says "Easy Advances are costly and must be repaid quickly."

It goes against intuition to expect these loans to go for the full thirty-day term. An exception would be recipients of federal benefits payments. But in a system where most borrowers get a paycheck every two days, it would seem implausible that many would need 35 days. Moreover, it is equally unlikely that most loans would be applied for immediately after a direct deposit. Demand builds as the month ages.
In its analysis of deposit advance products, the CFPB examined a sample of 100,000 deposit advances. It determined that the median loan duration was twelve days. This means that an APR built on an assumption of a 35-day term is very inaccurate. We support a rule that uses a shorter term as the basis for disclosure.

Underwriting should Assess Ability-to-Repay

Most products decision loans based upon the size of the most recent direct deposit. Most products do not include fees in their calculation of maximum advance amounts. As well, they do not set aside a cushion for future over drafting in the event that an overage remains after the term of the loan.
Under the proposed rule, a bank would have to follow a set of criteria for underwriting a deposit advance. The new rules establish the following standards for assessing the ability of a borrower to repay this debt:

- The institution should review six months of account activity in order to assess likely capacity for additional financial fees. In turn, the applicant should have had a relationship of at least six months with the bank.
- The institution should deny an advance to any person whose credit report reveals the existence of a delinquency.

- In addition, the guidance proposes specific methods for guaranteeing that a borrower remains capable of paying: The lender should review the account every six months. Additionally, any increases in credit lines should be accompanied by a new underwriting process.

We believe that these requirements are sensible but that they could be enhanced by adding specifics to the minimum debt service obligation.

The guidance should incorporate the potential cost of ensuing overdrafts in the assessment of a borrower's "financial capacity." In many instances, borrowers will not be able to repay by the end of the month. The median daily checking account balance of a deposit advance user is approximately $400. For one-fourth, the average daily balance was less than $178 (Consumer Financial Protection Bureau, 2013).
Thus, to the extent that a lender can collect all of the remaining balance, then an account is very likely to overdraft, particularly if there are any automatic payments set up to pay other bills.

Conclusion

We applaud the direction of the proposed guidances. This proposed rule could diminish or eliminate the number of OCC-regulated banks that offer the product and it may preclude the introduction of a deposit advance product from an FDIC-regulated institution.

There are other alternatives.

The FDIC's pilot small-dollar loan program provides an example of a more reasonable alternative. Not only did this program foster the availability of loans at prices below state usury levels, but it also gave consumers the option to repay their debt over periods of as long as six months. By contrast, none of the deposit advance products offer a term longer than 35 days and at an APR below 100 percent.

In a related context, we strongly assert that no credit products should be made available on any prepaid debit cards. The MetaBank I-Advance was itself a deposit advance collected against the card holder's next direct deposit. Reinvestment Partners believes that a secured credit card product with strong consumer protections, low pricing, and some connection to a savings account could be a better alternative for consumers in the under-banked segment.

In conversations with the spokespersons in the deposit services divisions of some of the participating bank, our organization has heard that it is not possible to profit while offering a product that offers important consumer protections. By this rationale, the banks argue that they should be allowed to create products that

circumvent many consumer protections. This argument suggests that banks will not reform without regulatory intervention.

Thanks for your consideration.

Sincerely,

Adam Rust
Director of Research
Reinvestment Partners