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By Electronic Delivery

RE: Guidance on Deposit Advance Products
(FDIC: 78 FRB 25268 et. seq.; OCC: 78 FRB 25353 et. seq.; Docket OCC-2013-0005)

Ladies and Gentlemen:

Enclosed are comments on guidance that the FDIC and OCC (the Agencies) have proposed regarding deposit advance loans. We congratulate you on a thoughtful proposal, and we are highly supportive of it. As your guidance recognizes, the essential issue is the borrower's ability to repay. Deposit advance loans, like payday loans offered by non-bank lenders, unrealistically require lump-sum repayments that far exceed most borrowers' financial capacity. The predictable result is that customers are unable to repay the loans and meet their other financial obligations, resulting in prolonged periods of renewing or re-borrowing. The product poses significant risk of harm to consumers, as the Agencies have noted, and it is based on a business model that is highly inconsistent with sound banking practices.

The Pew Charitable Trusts is a non-profit, research-based organization. Our interests include providing research and analysis to help ensure a safe and transparent marketplace for consumer financial services. Pew's safe small-dollar loans research project focuses on conducting research that identifies the needs, perceptions, and motivations of those who use payday, deposit advance and similar loan products, as well as the impacts of market practices and potential regulations. We hope this research will inform efforts to protect consumers from harmful practices and promote safe and transparent small-dollar credit.

The comments below are informed by in-depth research we have conducted over the past two years. This research includes a unique, nationally representative telephone survey of payday loan borrowers and more than a dozen focus groups with payday loan borrowers (including bank deposit advance customers) across the country. We have published two reports so far in our *Payday Lending in America* series, available at www.pewtrusts.org/small-loans.

We would welcome the opportunity for further discussion at any time.

Sincerely,

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The Ability to Pay Standard is the Appropriate Guiding Principle

In Pew's nationally representative survey of payday loan customers, the average borrower reports being able to afford only $100 per month, or $50 per two-week paycheck, toward a payday loan while still being able to keep up with basic expenses. While the interest rates are quite high on bank deposit advances, Pew draws a distinction between the loan's high cost and whether or not it can fit into a borrower's budget. We are pleased to see the Agencies taking this same approach and emphasizing a bank's responsibility to assess a borrower's ability to repay any loan.

The Agencies note that "the combined impact of an expensive credit product coupled with short repayment periods increases the risk that borrowers could be caught in a cycle of high-cost borrowing over an extended period of time." The Consumer Financial Protection Bureau's recent study of deposit advance loan usage demonstrates the validity of this concern. This report found that the median bank deposit advance user renewed or re-borrowed the loan over eight episodes, carrying deposit advance loan debt for about four months of the year.[1] Heavy users were in debt for an average of 19 episodes totaling more than eight months of the year.

The Agencies also note that bank deposit advance products "share a number of characteristics seen in traditional payday loans, including: high fees; very short, lump-sum repayment terms; and inadequate attention to the customer's ability to repay." Pew's research corroborates these findings. Payday loan borrowers face chronic cash shortfalls, with 58% saying they have trouble paying bills at least half the time, and nearly a quarter saying they have trouble doing so every month.[2] Seven in ten payday borrowers report using payday loan proceeds to pay for recurring expenses such as utilities, credit card payments, and rent.[3]

Whether it is wise to use credit to cope with such persistent cash shortfalls is debatable, and policy makers will surely continue to examine the merits of promoting the use of credit by consumers who are already indebted and struggling to make ends meet – especially when that credit comes at significantly higher cost than mainstream credit products. It is entirely possible that consumers, who are already struggling with debt and living paycheck to paycheck, have financial problems that cannot be solved by applying more credit to the situation. But requiring banks to assess a borrower's ability to repay, and structuring a loan accordingly, can give those who choose to use credit to deal with a cash shortfall an opportunity to do so without creating an unsustainable reliance on borrowing new loans to deal with shortfalls caused by repaying old ones. This recognition is an important element of the Agencies' guidance, and Pew agrees with the Agencies' position that "repetitive deposit advance borrowings indicate weak underwriting."

[1] Consumer Financial Protection Bureau, "Payday Loans and Deposit Advance Products: Initial Findings" (2013), at p. 43. Available at: http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf

[2] The Pew Charitable Trusts, "Payday Lending in America: How Borrowers Choose and Repay Payday Loans" (2013), at p. 10. Available at: http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf.

[3] The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), at p. 14. Available at: http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf

Treatment of Cash Advances at an ATM

Today, many banks allow customers to receive cash at ATMs even when funds are not available in their accounts, in exchange for a fixed fee.[4] Often, the bank's system will not alert the customer at the time of the withdrawal that the transaction will exceed the customer's available balance, but will simply allow the ATM to provide the requested cash and charge a fee to the account. At some banks, however, the system will alert the customer of the lack of available funds before it occurs and ask the customer whether he or she consents to receiving the cash in exchange for a fee.[5]

When ATMs dispense cash in this way, the bank charges a fee, typically characterized as an "overdraft fee" in an amount of about $35. For example, if a customer attempts to withdraw $200 but only $20 is available in his or her checking account, the ATM would dispense $200 in cash, and charge a $35 fee to the account. The customer would then "owe" the bank $180 plus $35 (or $215), which the bank would automatically withdraw from future paychecks or other deposits. If such a deposit does not occur within several days, the bank may charge an additional "extended overdraft fee."[6]

The similarities between a fee-based ATM cash withdrawal / overdraft and a deposit advance loan are obvious. Despite technical distinctions, the overall structure, cost, eligibility and repayment characteristics of fee-based ATM cash advances hew closely to the well-crafted definition of deposit advance loans that the Agencies put forth.[7] Further, ATM cash advances are distinguishable from standard "overdraft protection services" in important ways. For example, unlike overdraft transactions occurring through debit cards at retail points of sale (POS), or through checks, ATM withdrawals provide cash in hand to the bank's own customer, with no need for the bank to take additional actions such as honoring a transaction with a third party.

We note that fee-based ATM cash advances do not include any service to the customer other than extending a direct cash loan that is generally repayable out of the customer's next deposit. However, the Agencies are not clear in their draft about how fee-based ATM cash advances will be treated under the deposit advance guidance. Therefore, we are concerned that such advances could be exploited as a loophole to avoid the Agencies' intention of making small-dollar, short-term loans affordable based on an analysis of the customer's ability to repay. Pew encourages the Agencies to pay close attention to fee-based ATM cash advances to guard against this risk. Oversight should include scrutinizing communication practices to ensure that banks are not

[4] As the Agencies noted, overdraft lines of credit – which draw on established lines of credit that may be repaid over time – have different characteristics. Here, we refer to fee-for-service plans, often referred to as "overdraft protection," whereby a bank honors a transaction and allows an account to enter negative balance in exchange for a fixed fee, which is typically $35.

[5] Regulation E requires banks to obtain general customer opt-in to overdraft at the time an account is opened, but there is no requirement for per-transaction disclosures.

[6] Pew's review of bank disclosures suggests that the median *extended* overdraft fee is in the $10 to $15 range and typically applies if the advance is not repaid after 5 days. Extended overdraft fees at some banks reach $35.

[7] Additionally, as the Agencies note, deposit advance loans "are typically not included with the bank's list of available credit products, but are instead listed as a deposit account 'feature,'" and it is not clear whether customers are made equally aware of less expensive alternatives. The same is generally true of fee-based ATM cash advances.

encouraging the use of fee-based ATM cash advances as de facto deposit advances, and monitoring ATM cash advance usage patterns to ensure that the types of harms and systemic risks associated with deposit advance products are not apparent.[8]

Aside from the logical and practical similarities between fee-based ATM cash advances and deposit advance loans noted above, there are several important reasons to strive for consistency in how deposit advance loans are treated and how ATM cash advances are treated.

If ATM cash advances were to fall outside of the proposed guidance, the Agencies would have to work to counter the incentive that banks will have to hide fees from customers. As noted above, a small number of banks have decided to warn customers when they are about to overdraft their accounts at the ATM.[9] However, if fee-based ATM "overdrafts" appear to be immune from scrutiny under the deposit advance guidance, there could be a perverse incentive for banks to make ATM cash advances look as much like an overdraft as possible, and as little like a consensual loan as possible. Thus, banks would have an incentive to hide fees and charge customers after-the-fact for ATM transactions that overdrafted their accounts. Until such time as the regulations governing underwriting of ATM cash advances are clarified, the Agencies should advise that clear and timely disclosure of fees is always preferable.[10]

Another consequence of allowing ATM cash advances to fall outside the deposit advance guidelines would be to discourage the development of safer and more transparent small-dollar loan alternatives. Fee-based ATM cash advances / overdrafts generate revenues that will in most cases be far more attractive to banks than interest revenue that would be available through small-dollar installment loans that are structured according to the borrower's ability to repay.[11] However, as long as banks may continue to generate sizeable fees through ATM cash advances / overdrafts, they will have little incentive to try to make affordable, small-dollar alternative products work.[12]

It is worth noting here that there is significant overlap in the customer base for ATM cash advances / overdrafts and deposit advance loans. According to CFPB research, 65 percent of all deposit advance customers also overdrafted during a year-long study period, with the most frequent deposit advance borrowers also showing the highest level of overdraft/NSF fees (more than 80 percent of accounts in the two highest usage groups also overdrafted).[13] Clearly, many

[8] For example, it would be helpful to evaluate the overdraft usage patterns of former deposit advance customers.

[9] Reasonable minds could differ about the affordability or cost of the cash advance / overdraft itself; but most would agree that giving clear disclosures and asking customers to agree to pay the fee *before every transaction* is a more transparent practice than the conventional bank practice of allowing the account to become overdrafted and charging a customer a fee after the fact.

[10] It will be especially important for the Agencies to ensure clear disclosure in cases where customers initiate cash withdrawals, while also ensuring that banks are not *promoting* the initiation of cash withdrawals that would lead to overdrafts, as noted above.

[11] Though there is not yet agreement on exactly what small-dollar loans should look like or how they should be priced, there is general agreement among experts that it would be a positive development for banks to offer affordable small-dollar loan alternatives throughout their existing networks.[11] Pew shares this sentiment.

[12] Among other things, developing such loan products would potentially place the more lucrative fee-based cash advance revenue at risk, making the risk, effort and cost of developing an alternative product seem unattractive.

[13] Consumer Financial Protection Bureau, "Payday Loans and Deposit Advance Products: Initial Findings" (2013), at pp. 41-42. Available at: http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf. As

of those who use deposit advance loans also overdraft regularly. This finding strongly suggests that such customers could be using ATM cash advances as de facto deposit advance loans, or could easily migrate (or be led) to doing so. This is further evidence of problems that could arise if the Agencies treat fee-based ATM cash advances differently than other lump-sum cash loans that may exceed the borrower's ability to repay.

To be clear, Pew strongly supports the Agencies' proposed deposit advance guidance as written. But the Agencies must closely monitor developments with fee-based ATM cash advances / overdrafts as discussed. It may ultimately be necessary to clarify underwriting requirements for such ATM transactions. It may also help if banking regulators make the rules governing deposit advance and other deposit-related cash advances more consistent over time.

Potential Impacts of Guidance

Any time that a major policy shift occurs, there are risks of creating problematic incentives, such as bank customers borrowing more in anticipation of not being able to take a new loan for a month after repayment. However, in states that have made major and sudden changes to their payday loan policies, there is no indication that borrowers took larger loans in reaction to these shifts. For example, Washington imposed a cap of eight loans per borrower per year, effective January 1, 2010. In 2009, when there was no limit on how many loans someone could take, the average payday loan size was $411.84. In 2010, after the eight-loan cap was in effect, the average payday loan size was $396.89. Colorado also made a major change to its payday loan law, which took effect in August 2010, switching the loan term from the borrower's next payday to a six-month minimum duration. In 2009, the last year before the law change, the average loan size was $368.09, while in 2011, the first full year with a six-month term, the average loan size was $375.45. These data points come from reports issued by state regulators, and they suggest that customers are not borrowing more in reaction to the policy changes.

Another important area to consider after a policy shift occurs is whether customers who used a product that has been altered will substitute an inferior product. The CFPB's recent white paper examined the small number of banks that offer deposit advance products. At those banks, 15 percent of all eligible checking account customers are utilizing deposit advances.[14] Other data indicate that only four percent of adults use storefront payday loans, and even fewer use online payday loans.[15] In other words, where banks are offering payday-like loans, they are experiencing very high levels of usage compared to payday loan usage in the general population. Conversely, where banks do not offer such loans, there is no evidence of higher usage of payday loan stores. Thus, it should not be assumed that bank deposit advance borrowers will shift to storefront or online payday loans.

discussed elsewhere in these comments, this and other research shows that payday and deposit advance loans do not eliminate overdraft risk.

[14] Consumer Financial Protection Bureau, "Payday Loans and Deposit Advance Products: Initial Findings" (2013), at p. 26.

[15] The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), at p. 23.

Pew's research also shows that people are no more likely to seek cash advances online when storefronts are not unavailable in their communities. The rate of online borrowing in states that essentially prohibit storefront payday lending is identical to the rate of online borrowing in states where payday loans are available from stores.[16] These figures have important implications as we think about substitution as compared with demand generation in the broader small-dollar credit market.

Pew's research with storefront and online payday borrowers indicates that people who find themselves unable to pay bills are often not choosing between formal credit products. Instead, they choose between a variety of options, with a majority saying they would cut back on expenses, delay paying bills, borrow from family or friends, or sell or pawn possessions if they did not have access to payday loans. Thus it is important to place bank deposit advance loans in the larger context of borrowers' decision making, recognizing that they are choosing between many options, and will not necessarily be motivated to seek the services of conventional payday lenders because of a lack of payday loan options at banks.

Because of a deposit advance's unaffordability, it is unclear whether it functions as a substitute for other credit products or overdrafts, or whether deposit advance borrowers simply pay more fees as they use both products. The CFPB report's finding that 65 percent of deposit advance customers overdraft too is instructive. While it is still unclear whether deposit advances on net increase or decrease overdrafts, it is clear that they do not eliminate overdraft risk, and most borrowers pay fees for both.

In conclusion, Pew applauds the Agencies' recognition of the harms and unsound business practices associated with deposit advance loans. By affirming that banks have a responsibility to assess the borrower's ability to repay a loan, the proposed guidance sets the proper emphasis on ensuring that borrowers have sufficient residual income to repay loans without the need for extended re-borrowing. In most cases, this assessment would show that lump-sum repayment loans are not affordable for typical borrowers. The importance and necessity of this guidance is difficult to overstate. It should protect against the replication of the payday loan business model throughout the banking system and instead favor the provision of loans that are structured to be repaid in smaller, more manageable installments over time.[17] It will be important for the Agencies to minimize incentives for banks to exploit loopholes to this guidance (especially through fee-based ATM cash advances), and create the most favorable possible circumstances for the innovation of safe, transparent and affordable small-dollar loan alternatives.

[16] Ibid.

[17] As Pew has noted in the *Payday Lending in America* report series, payday loans fail to work as advertised. Under the lump-sum repayment structure, most borrowers struggle to repay the "short-term" loans for nearly half the year, even as lenders rely on this kind of extended indebtedness to drive profitability, a situation that pits the interests of borrowers against those of lenders.