**Comments to the**
**Federal Deposit Insurance Corporation**
**and**
**Office of the Comptroller of the Currency, Treasury**

***Proposed Guidance on Deposit Advance Products***
FDIC: 78 Federal Register 25268 (April 30, 2013)
OCC: 78 Federal Register 25353 (April 30, 2013); Docket ID OCC 2013-0005

by

**AARP**[1]
**Center for Responsible Lending**[2]
**Consumer Federation of America**[3]
**Leadership Conference on Civil and Human Rights**[4]
**NAACP**[5]
**National Consumer Law Center (on behalf of its low income clients)**[6]
**National Council of La Raza**[7]

---

[1] **AARP** is a nonprofit, nonpartisan organization, with a membership of more than 37 million, that helps people turn their goals and dreams into real possibilities, strengthens communities and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.
[2] **The Center for Responsible Lending** (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund. SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded SHFCU to expand Self-Help's mission.
[3] **Consumer Federation of America** is an association of nearly 300 non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, education and advocacy.
[4] **The Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goal of a more open and just society – an America as good as its ideals. The Leadership Conference is a 501(c)(4) organization that engages in legislative advocacy. It was founded in 1950 and has coordinated national lobbying efforts on behalf of every major civil rights law since 1957.
[5] **The NAACP**, founded in 1909, is the nation's oldest and largest civil rights organization. From the ballot box to the classroom, the thousands of dedicated workers, organizers, leaders and members who make up the NAACP continue to fight for social justice for all Americans.
[6] Since 1969, the nonprofit **National Consumer Law Center®** (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.
[7] **The National Council of La Raza** (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300

## I. Introduction

We write to thank the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) for the proposed guidance addressing bank payday lending,[8] particularly the underwriting requirements and limits on repeat loans. These critical provisions address a central problem with payday lending: lenders' failure to verify the borrower's ability to repay the loan, and meet other expenses, without reborrowing, leading to a destructive cycle of repeat loans that trap borrowers in long-term debt.

This proposed guidance is urgently needed. The great majority of banks do not offer payday loans, but we are aware of at least six that do. Four are supervised by the OCC: Wells Fargo Bank, U.S. Bank, Bank of Oklahoma and its bank affiliates,[9] and Guaranty Bank. Two are supervised by the Federal Reserve Board (FRB): Fifth Third Bank and Regions Bank.

Though the number of banks making payday loans remains small, there are clear signals that bank payday lending will grow rapidly without strong action by all the banking regulators. In mid-2011, Fiserv, Inc., a provider of bank payday software, reported that its "pipeline" was "extremely strong" and that it had "some very nice mid-tier signings."[10] Fiserv was promising that a bank's revenue from the product would be "greater than all ancillary fee revenue combined" within two years.[11]

But recent research has left no doubt that fees generated by bank payday loans are earned through unsafe and unsound banking practices and at great consumer harm to consumers. Bank payday lenders, like other payday lenders, do not assess the borrower's ability to repay the loan, and meet other expenses, without reborrowing, resulting in a cycle of repeat loans: The Consumer Financial Protection Bureau (CFPB)'s analysis of thousands of bank payday loans

---

affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families. Founded in 1968, NCLR is a private, nonprofit, nonpartisan, tax-exempt organization headquartered in Washington, DC, serving all Hispanic subgroups in all regions of the country. It has regional offices in Chicago, Los Angeles, New York, Phoenix, and San Antonio and state operations throughout the nation.

[8] Federal Deposit Insurance Corporation, Proposed Guidance on Deposit Advance Products, 78 Fed. Reg. 25268 (April 30, 2013); Department of the Treasury—Office of the Comptroller of the Currency, Proposed Guidance on Deposit Advance Products; Withdrawal of Proposed Guidance on Deposit-Related Consumer Credit Products, 78 Fed. Reg. 25353 (April 30, 2013).

[9] Bank of Albuquerque, Bank of Arizona, Bank of Arkansas, Bank of Kansas City, Bank of Texas, and Colorado State Bank and Trust.

[10] Fiserv Investor conference webcast, October 11, 2011, *available at* http://investors.fiserv.com/events.cfm.

[11] Fiserv, Relationship Advance program description, *retrieved from* http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

found that banks put borrowers into an average of 14 loans annually and keep them indebted for a significant portion of the year.[12] Fourteen percent of borrowers took out an average of 38 loans averaging $200 each in one year, paying from $570 to $760 in interest.[13]

The fundamental structure of payday loans—a very high cost and short loan term with a balloon repayment—coupled with a lack of traditional underwriting makes repeat loans highly likely. Borrowers already struggling with regular expenses or facing an emergency expense with minimal savings are typically unable to repay the entire lump-sum loan and fees and meet ongoing expenses until their next payday. Consequently, the borrower often must take out another loan before the end of the pay period to meet other expenses, becoming trapped in a cycle of repeat loans.

We appreciate the Agencies' explicit recognition of the "shared characteristics" of bank payday lending and traditional payday lending and note that it is appropriate that this proposed guidance is intended to supplement the Agencies' existing guidances addressing payday lending.[14]

Failure to verify the borrower's ability to repay the loan poses clear safety and soundness risk to banks, as supported by a wide range of regulatory precedent. It is inconsistent with fundamental safe and sound lending practices; it exposes banks to legal risk, including, as the Agencies highlight, risk of violating provisions prohibiting unfair, deceptive, and abusive practices and the Equal Credit Opportunity Act; and it poses reputational risk, as evidenced by widespread opposition to bank payday lending.

Bank payday lending poses these risks in part because it causes severe harm to banks' customers. Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.

Senior Americans receiving Social Security benefits make up over a quarter of bank payday borrowers. At a time when older Americans have already experienced severe declines in wealth resulting from the Great Recession, banks take these borrowers' benefits for repayment before they can use those funds for healthcare, prescription medicines, or other critical expenses. The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.

---

[12] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 34, April 24, 2013, *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf [hereinafter CFPB Findings].

[13] The CFPB found that for the 14% of borrowers who borrowed over $9,000 in one year, the median number of loans was 38 and the median size was $200. *Id*. at 34. We computed the total interest paid as $570 to $760, assuming a fee range of $7.50 per $100 borrowed to $10 per $100 borrowed based on the fees currently charged by banks making payday loans.

[14] FDIC: 78 Fed. Reg. 25268-70; OCC: 78 Fed. Reg. 25353-54.

Payday lending also has a particularly adverse impact on African Americans and Latinos, as a disproportionate share of payday borrowers come from communities of color, who are already overrepresented among unbanked and underbanked households.

Preventing the cycle of debt and its resulting harms is essential. Thus, we strongly support the Agencies' proposed underwriting and related requirements in combination, including (1) requiring that banks verify the borrower's ability to repay the loan and meet expenses without reborrowing based on an analysis of the customer's inflows and outflows, and (2) limiting the number of bank payday loans banks can extend to each customer.

Other pernicious elements of bank payday lending are its cost and the bank's repaying itself first directly from the borrower's next deposit. Bank payday loans average 225% to 300% annual percentage rate (APR)—extraordinary by any measure. The Agencies' proposal underscores that fees must be based on safe and sound banking principles; clearly, these loans' current fees are not. We urge the Agencies to clarify that safe and sound banking principles require that interest and fees be reasonable and, consistent with the FDIC's affordable small loan guidelines, should not exceed 36% APR, subject to more restrictive state laws. We also urge the Agencies to prohibit banks from requiring that the loans be automatically repaid from incoming deposits as a condition of making a loan, which denies borrowers control of their checking account and discourages sound underwriting.

In the last two years, we are aware of no additional banks entering the high-cost payday lending market. This is thanks in large part to the Agencies' refusal to condone this product: the OCC's not finalizing its 2011 proposed guidance,[15] the OCC's 2012 testimony before the House of Representatives calling payday loans "unsafe and unsound and unfair to consumers" and noting that profitability "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt";[16] and the FDIC's 2012 announcement of its investigation into bank payday lending and longstanding leadership on responsible small dollar lending.[17]

Today, by proposing guidance explicitly requiring verification of ability to repay without reborrowing, the Agencies are bringing much-needed clarity to the marketplace for the banks

---

[15] The undersigned groups were among those who urged the OCC to withdraw its 2011 proposed guidance (76 Fed. Reg. 33409, June 8, 2011) out of concern that it would have resulted in additional banks beginning to make payday loans. Concurrent with the issuance of the current proposed guidance, the OCC withdrew the previous proposed guidance. 78 Fed. Reg. 25353.

[16] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 1, 5.

[17] Letter from FDIC to Americans for Financial Reform, May 29, 2012, *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Bank-DDA-FDIC-OC12-65R-1.pdf, also noting that the FDIC was "deeply concerned" about payday lending by banks.

they supervise while protecting the safety and soundness of those institutions and the consumers who bank with them.

Recommendations

With respect to the Agencies' proposal, we recommend the following:

- Preserve the proposed underwriting and related requirements *in combination*, including:
    - requiring that banks determine the borrower's ability to repay the loan without reborrowing, based on an analysis of the customer's inflows and outflows; and
    - limiting the number of bank payday loans.
- Clarify that safe and sound banking principles require that interest and fees be reasonable; consistent with the FDIC's affordable small loan guidelines, cost should equate to no more than 36 percent in annualized interest rate terms, subject to more restrictive state laws.
- Advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.
- Conduct prompt and vigilant examination of banks' compliance with the guidance and take swift enforcement action to address any noncompliance.
- Work with the CFPB to encourage improvements to existing consumer regulations, including the annual percentage rate (APR) disclosure under the Truth in Lending Act (TILA) and protections against mandatory automatic repayment under the Electronic Fund Transfer Act (EFTA).

## II. Ability to repay is a fundamental principle of sound lending that payday lenders, including banks making payday loans, are violating.

### A. Payday loans are made without regard to the borrower's ability to repay the loan, leading to a cycle of debt.

Payday loans are made without regard to the borrower's ability to repay the loan.[18] The lender instead relies on its ability to seize the borrower's incoming direct deposit, which serves as

[18] As the Agencies note, the decision to make a bank payday loan is "based solely on the amount and frequency of their deposits," standing "in contrast to banks' traditional underwriting standards . . . which typically include an analysis of the borrower's finances." FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354. The CFPB also recently recognized that payday loans involve "very limited underwriting." CFPB Findings at 6.

collateral.[19] It would be inaccurate to conclude that lenders do assess ability to repay because they typically have the ability to collect the loan proceeds from the borrower's direct deposit. As discussed below, regulatory precedent makes clear that lending with regard to ability to repay means determining the borrower can repay the loan *from sources other than the collateral*; in the payday loan context, that means that the borrower can *both* repay the loan *and* meet other obligations *without reborrowing*. Thus, repeat loans are evidence of disregard for ability to repay.

### 1. Repeat loans are evidence of disregard for ability to repay.

The Agencies note that "[d]eposit advance loans that have been accessed repeatedly or for extended periods of time are evidence of 'churning' and inadequate underwriting."[20] The CFPB's recent analysis notes that "a pattern of sustained use may indicate that a borrower is using payday loans to deal with expenses that regularly outstrip their income."[21]

The banking regulators have long recognized that serial refinancings are an indication that lenders are not assessing a borrower's ability to repay the loan, both in the context of payday lending specifically and more broadly. The FDIC's existing payday loan guidelines, which this proposed guidance supplements, describe concerns with "payday loans to individuals who do not have the ability to repay, or that may result in repeated renewals or extensions and fee payments over a relatively short span of weeks." The FRB's 2009 rules under the Home Ownership and Equity Protection Act (HOEPA) note that "[l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings."[22]

The banking regulators have also long recognized that a payday loan taken out within a short time of repaying another one is the economic equivalent of a refinancing (where the borrower uses the proceeds from a new loan to pay off an existing loan) or a rollover (where the borrower pays the finance charge essentially to extend the loan term).

The FDIC's 2005 payday loan guidelines note that "[w]here the economic substance of consecutive advances is substantially similar to 'rollovers' - without appropriate intervening 'cooling off' or waiting periods - examiners should treat these loans as continuous advances . . . ."[23] The OCC's 2000 payday loan guidelines note that payday loans are repaid when the

[19] FDIC: 78 Fed. Reg. 25272, n.22; OCC: 78 Fed. Reg. 25356, n.22 (citing 2001 Interagency Subprime Guidance noting that lenders should determine ability to repay from sources other than the collateral pledged, "in this case the borrower's direct deposit").

[20] FDIC: 78 Fed. Reg. 25272; OCC: 78 Fed. Reg. 25356.

[21] CFPB Findings at 24.

[22] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44542 (July 30, 2008).

[23] FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

borrower "'roll[s] over' the loan by renewing the old loan (or taking out another loan)," essentially equating the two.[24] The CFPB's supervision manual for small dollar, short-term loans explains that back-to-back transactions may occur where a borrower is asked to repay one loan before opening a new loan, while noting that a pattern of these, like rollovers and refinancings, "may constitute sustained use."[25] And the CFPB's white paper defines "sustained use" in terms of loans that occur the same day a previous loan was closed "*or soon after*."[26]

The regulators have also typically contrasted loans made based on the value of the underlying collateral (and that are thus frequently refinanced) with loans made with regard to a borrower's ability to repay the loan, indicating that these practices are mutually exclusive. The 2001 Interagency Expanded Guidance on Subprime Lending Programs (2001 Interagency Subprime Guidance), which the current proposal supplements, describes that abusive lending practices occur when "the lender structures a loan to a borrower who has little or no ability to repay the loan from sources other than the collateral pledged."[27] As the Agencies note in the current proposal, in the case of bank payday lending, the collateral is the customer's incoming deposit.[28] The OCC's 2000 letter on abusive lending practices, which is applicable to payday loans,[29] discusses collateral or equity stripping as "reliance on . . . collateral, *rather than* the borrower's independent ability to repay. . . ."[30] The OCC's 2003 letter on abusive and predatory lending does the same.[31]

---

[24] OCC Advisory Letter, Payday Lending, AL 2000-10 (Nov. 27, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf [hereinafter OCC 2000 Advisory Letter on Payday Lending].

[25] CFPB Supervision and Examination Manual, Small-Dollar, Short-Term Lending, Version 2 (October 2012), , at 12.

[26] CFPB Findings at 24.

[27] Interagency Expanded Guidance or Subprime Lending Programs, FIL 9-2001, January 31, 2001. The FDIC's 2005 payday loan guidelines also notes that it clarifies previously issued guidance, including the 2001 Expanded Subprime Guidance; the 2001 Expanded Subprime Guidance also contemplates equity stripping outside the context of mortgage lending, noting that lenders may make a loan to a borrower who has little or no ability to repay other than from the collateral pledged, then take possession of the borrower's home or automobile upon default.

[28] FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[29] The OCC's 2000 Advisory Letter on Payday Lending states that the OCC's 2000 Advisory Letter on Abusive Lending Practices is applicable to payday lending.

[30] OCC Advisory Letter on Abusive Lending Practices, AL 2000-7 (June 25, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf (emphasis added).

[31] OCC Advisory Letter, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, AL 2003-2 (Feb. 21, 2003), *available at* http://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-8-advisory-ltr-2003-2.pdf [hereinafter OCC 2003 Letter on Predatory and Abusive Lending Practices]: "When a loan has been made based on the foreclosure value of the collateral, rather than on a determination that the borrower has the capacity to make the scheduled payments under the terms of the loan, based on the borrower's current and expected income, current

Thus, there is ample precedent for concluding that reliance on collateral, and the repeat loans such reliance generates, is a clear evidence of inability to repay.

### 2. The data on bank payday lending make clear repeat loans are typical.

The data on bank payday loans make clear that repeat loans, or "churning," are typical, confirming that lenders are not verifying borrowers' ability to repay. The CFPB's recent analysis of thousands of bank payday loans found a median number of advances per borrower of 14, with extremely high numbers of advances for many borrowers.[32] Fourteen percent of borrowers who took out more than $9,000 in loans over 12 months took out a median of 38 advances.[33]

The CFPB further found that borrowers were indebted an average of 112 days during the year, with borrowers with $9,000 or more in loans spending an average of 254 days in debt.[34] And it found an average of only 13 days between "advance balance episodes,"[35] indicating that bank payday loans do not typically sustain borrowers through even a single pay cycle. For those with more than $9,000 in loans, the average number of days between episodes was six.[36]

These findings are consistent with CRL's recent analysis of bank payday loans, which found that the median bank payday borrower took out 13.5 loans in 2011 and was in bank payday loan debt at least part of six months during the year—that is, a typical borrower had one or more bank payday loans outstanding at some point during six discrete calendar months during the year.[37] The mean number of loans was 19, far higher than the median, because over a third of borrowers had more than 20 loans.[38]

---

obligations, employment status, and other relevant financial resources, the lender is effectively counting on its ability to seize the borrower's equity in the collateral to satisfy the obligation and to recover the typically high fees associated with such credit."

[32] CFPB Findings at 34.

[33] *Id*. at 33-34.

[34] *Id*. at 37.

[35] *Id*. at 40. The CFPB defines "advance balance episode" as the consecutive days during which a consumer has an outstanding deposit advance balance. *Id*. at 27.

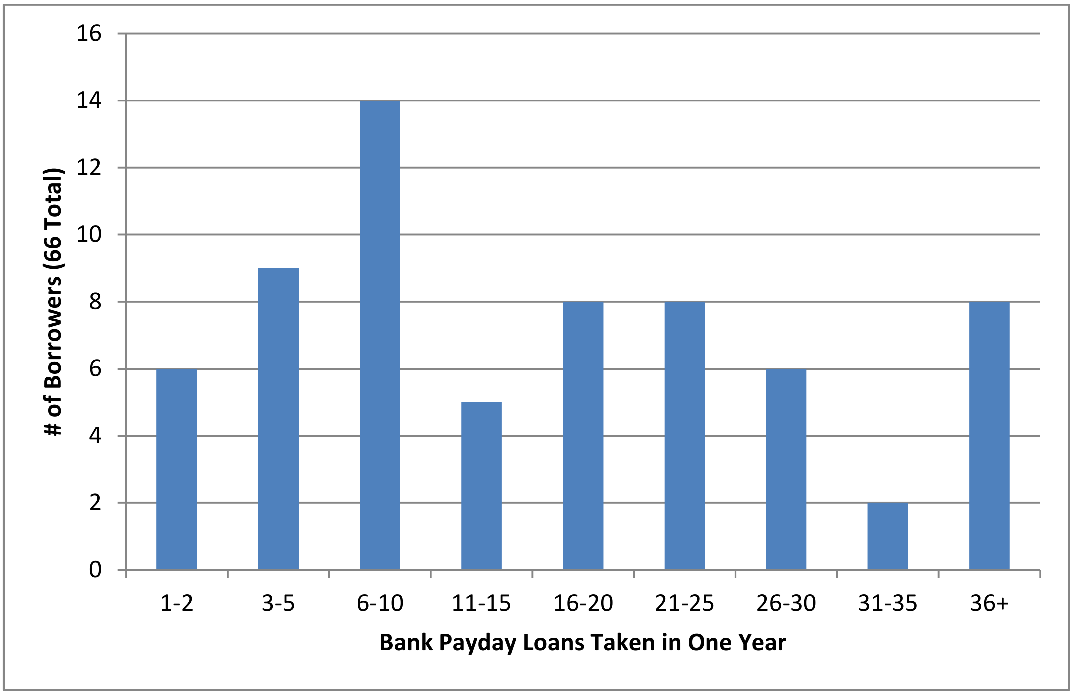
[36] *Id*. at 40.

[37] Rebecca Borné and Peter Smith, *Triple Digit Danger: Bank Payday Lending Persists* (March 21, 2013), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/Triple-Digit-Bank-Payday-Loans.pdf [hereinafter CRL, *Triple Digit Danger*].

[38] *Id*.

As Figure 1 illustrates, CRL found that many borrowers take out twenty, thirty, or more loans annually:[39]

**Figure 1: Bank Payday Loans Taken in One Year**




**Source:** CRL report, *Triple Digit Danger* (March 2012) (based on analysis of Lightspeed checking account data)

These data clearly refute banks' claims that these products are meant for occasional use to manage a short-term cash shortfall and not as long-term credit.[40] We are aware of no data on bank payday lending inconsistent with the data above.

### 3. Ineffective safeguards do not prevent the cycle of debt.

Banks often point to "safeguards" they have in place to ensure that borrowers do not become trapped in long-term debt, including installment plans and ineffective cooling-off periods.[41] The data discussed above clearly demonstrate that these "safeguards" are not effective. As the Agencies note, banks that offer installment plans impose obstacles to qualifying for them.[42] For

[39] *Id*.

[40] Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use. For an example from each of these banks, *see* Appendix.

[41] In the payday lending context, a "cooling-off" period is a period following repayment of one payday loan during which the lender will not extend the consumer another payday loan.

[42] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

example, Wells Fargo Bank's "payment plan" (which allows payments in $100 increments rather than balloon repayments) is available only to customers who have already been in balloon payment loans in three consecutive months and have at least $300 in bank payday debt outstanding.[43]

Banks' cooling-off periods allow borrowers to become mired in a cycle of debt before the cooling-off period is triggered. Wells Fargo Bank's cooling-off policy, for example, allows six consecutive months of loans until a one-month cooling-off period.[44] After six consecutive months with loans, a borrower will typically have paid hundreds of dollars in fees and still owe the original principal on the loan. By contrast, if provided an affordable loan at the outset, after six months the borrower would have been finished, or be well on the way toward, paying off the loan. Thus, a cooling-off period is not a substitute for a meaningful determination of the borrower's ability-to-repay at the outset.

These bank "safeguards" are the same ones that non-bank payday lenders have long touted but that have proven ineffective in that context as well.[45]

### B. Lending without regard to ability to repay is a safety and soundness issue.

Regulatory precedent has long clearly established that lending without regard to ability to repay is a safety and soundness issue. Other troubling characteristics of consumer lending practices have also been addressed on safety and soundness grounds. This has been true even when a product has proven profitable to banks in the short-term.

#### 1. Banking regulators have long cautioned that collateral-based lending—that is, lending without regard for ability to repay—is a safety and soundness issue.

The OCC, FDIC, and FRB have consistently addressed collateral-based lending—that is, lending without regard for ability to repay—on safety and soundness grounds.[46] As the Agencies'

---

[43] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[44] *Id*.

[45] CRL examined millions of loans across several states that adopted similar "best practices" to ostensibly reform payday loans. Nevertheless, there was no measureable reduction in repeat borrowing. For example, over 60 percent of all loans from these states go to borrowers with 12 or more transactions in a year. *See generally*, Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are the only proven reform*, December 13, 2007, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf [hereinafter CRL, *Springing the Debt Trap*].

[46] For CRL's issue brief discussing how bank payday lending poses safety and soundness risk and relevant regulatory precedent, *see* Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products*, January 24, 2013, *available at* http://rspnsb.li/Yqd0uH.

current proposal notes, the 2001 Interagency Subprime Guidance cautioned that "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."[47]

The OCC's 2000 payday loan guidelines, which explicitly applies to both payday lending done directly by banks and programs operated by third parties,[48] cautioned: "[M]ultiple renewals without principal reduction . . . are not consistent with safe and sound banking principles."[49]

In 2007, the agencies issued a statement on subprime mortgage lending, again emphasizing, as a risk management practice, the need to assess the borrower's ability to repay the loan rather than relying predominantly on collateral: "[I]nstitutions should ensure they do not engage in . . . [m]aking loans based predominantly on the foreclosure or liquidation value of a borrower's collateral rather than on a borrower's ability to repay the mortgage according to its terms."[50]

### 2. Banking regulators have long addressed concerns with consumer lending products on safety and soundness grounds.

The regulators have addressed troubling characteristics of a range of consumer lending products on safety and soundness grounds, even when those practices were generating significant profits for the bank.

In the early 2000s, both the OCC[51] and the FRB[52] took enforcement actions against subprime credit card companies citing safety and soundness concerns, even as the companies were

---

[47] 2001 Interagency Subprime Guidance, cited in the current proposals at FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[48] *Id*. at 5 ("The OCC will closely review any payday lending activities conducted directly by national banks, as well as any payday lending or financing activities conducted through arrangements with third parties.").

[49] OCC's 2000 Advisory Letter on Payday Lending, at 3.

[50] Department of the Treasury-Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Interagency Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569, 37573 (July 10, 2007).

[51] In 2000, the OCC took enforcement action against Providian, requiring that it pay customers at least $300 million in the agency's largest ever enforcement action at the time. Comptroller John Hawke stated: "'When a bank engages in unfair or deceptive marketing practices, it damages its most precious asset -- the trust and confidence of its customers . . . . That relationship of trust and confidence is central to the bank's safe and sound operation. We will not tolerate abuses that breach that trust through unfair and deceptive practices . . . . This settlement . . . ensures that, going forward, Providian will conduct its business in a way that both respects the interests of its customers and protects the safety and soundness of the bank.'" OCC News Release 2000-49, *Providian to Cease Unfair Practices, Pay Consumers Minimum of $300 Million Under Settlement with OCC and San Francisco District Attorney* (June 28, 2000), *available at* http://www.occ.gov/static/news-issuances/news-releases/2000/nr-occ-2000-49.pdf.

[52] In 2003, the FRB took enforcement action against First Premier on safety and soundness grounds, while noting that the bank must comply with the Board's applicable guidance related to subprime lending. *Written Agreement by and among United National Corporation, Sioux Falls, South Dakota; First PREMIER Bank, Sioux Falls, South*

recording record profits generated by these products.[53] The high fee-generating practices like those the regulators addressed at these credit card companies share stark similarities with bank payday loans—they are profitable to the bank, but largely because they trap borrowers in debt.[54]

### 3. Disregarding ability to repay, and the churning it results in, also poses safety and soundness risk through reputational risk and legal risk.

#### a. Reputational risk

The OCC's supervision manual describes reputation risk as "the risk arising from negative public opinion," which affects the bank's relationships and "may expose the institution to litigation, financial loss, or a decline in its customer base." It "includes the responsibility to exercise an abundance of caution in dealing with customers and the community."[55]

The FRB's supervision manual defines reputational risk similarly, as "the potential that negative publicity . . . will cause a decline in the customer base, costly litigation, or revenue reductions."[56]

Bank payday lending poses severe reputational risk to the few banks engaging in it.[57] Payday loans generally are unpopular and, increasingly, illegal. They are prohibited or significantly

---

*Dakota; PREMIER Bankcard, Inc., Sioux Falls, South Dakota; and the Federal Reserve Bank of Minneapolis*, Federal Reserve Board (Sept. 25, 2003), at 3, *available at* http://www.federalreserve.gov/Boarddocs/Press/enforcement/2003/20030925/attachment.pdf.

[53] *See*, *e.g*., PR Newswire, *Providian Financial Corporation Announces Record Earnings in the Second Quarter Fueled by 50% Growth in Revenues and Customers*, July 22, 1998 (noting record earnings and projected increases going forward).

[54] The founder of Providian, for example, said in 2004: "It didn't require a lot of investigation to see that the people who paid in full every month were not profitable"; the most lucrative customers were the "revolvers," who routinely carried high balances, but were unlikely to default. Robin Stein, *The Ascendancy of the Credit Card Industry*, PBS Frontline, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html (quoting Andrew Kahr, founder of Providian). The CFPB recently noted that credit losses for bank payday loans appear lower than for storefront payday loans, the latter averaging 5 percent according to industry data. CFPB Findings at 7.

[55] OCC, Bank Supervision Process, Comptroller's Handbook, at 121 (September 2007), *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

[56] Federal Reserve System's Commercial Bank Examination Manual, Examination Strategy and Risk-Focused Examinations, at 4.5 (April 2011), *available at* http://www.federalreserve.gov/boarddocs/supmanual/cbem/cbem.pdf. The OCC's supervision manual's definition is similar: "Reputation risk is the risk arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with customers and the community." OCC, Bank Supervision Process, Comptroller's Handbook (September 2007) at 121, *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

restricted in 18 states and the District of Columbia, and the numbers have been growing. Some states have never allowed these loans to be part of their small loan marketplace, while several have prohibited or significantly restricted them in recent years.[58] Since 2007, seven states and the District of Columbia have enacted or enforced meaningful reform to address payday lending[59]—while no state without payday lending has authorized it since 2005. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected payday lending, despite payday industry campaigns costing tens of millions of dollars.[60] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for laws that do not allow high-cost payday lending.[61]

It is not surprising, then, that payday lending by banks has been met with opposition from virtually every sphere— the military community,[62] community organizations,[63] civil rights

---

[57] A 2007 article on reputational risk by a FRB staff provided only a few examples of practices posing reputational risk; payday lending was one of them: "There is also a stigma attached to institutions involved with payday lending." William J. Brown, Federal Reserve Board Enforcement Specialist, *Understanding Reputational Risk: Identify, Measure, and Mitigate the Risk*, 4th Quarter 2007, *available at* http://www.phil.frb.org/bank-resources/publications/src-insights/2007/fourth-quarter/q4si1_07.cfm.

[58] High-cost single-payment payday loans are not authorized by law in the following states/jurisdictions: Arkansas, Arizona, Colorado, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. Although interest rate caps vary by state, most are about 36 percent APR. In a few instances, payday lenders attempt to circumvent state protections by structuring their loans to operate under other loan laws not intended for very short-term, single payment loans.

[59] The seven states are Arkansas, Arizona, Colorado, New Hampshire, Ohio, Oregon, and Montana.

[60] In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

[61] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for a 36 percent annual rate limit on payday loans. Recently in Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. *See* Jason Hancock, *Coalition to rally for payday lending reform,* Iowa Independent (Jan. 26, 2011), *available at* http://iowaindependent.com/51369/coalition-to-rally-for-payday-lending-reform; Ronnie Ellis, *Payday Lenders Targeted for Interest Rates*, The Richmond Register (Feb. 8, 2011), *available at* http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates; Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House*, WHSV.com (Jan.18, 2011), *available at* http://www.whsv.com/home/headlines/Virginia_Payday_Lending_Bill_Dies_in_Senate_Survives_in_House_114169549.html.

A 2009 national survey found that three out of four Americans who expressed an opinion thought Congress should cap interest rates; 72 percent thought the cap should be no higher than 36 percent annually. Center for Responsible Lending, *Congress should cap interest rates: Survey confirms public support for cracking down on high-cost lending* (March 2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf.

[62] *See*, *e.g*., Testimony of Steve Abbot, former President of the Navy-Marine Corps Relief Society, Before the U.S. Committee on Banking, Housing and Urban Affairs (Nov. 3, 2011) (noting bank payday loans among the "most

leaders,[64] socially responsible investors,[65] state legislators,[66] and members of Congress[67]—which has resulted in widespread negative publicity.[68]

In North Carolina, a state that does not permit payday lending, public outcry and state attorney general opposition led Regions Bank to stop making its payday loans there in January.[69] North

---

egregious trends"), http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=ca463f82-0902-4a6d-9a08-d8b7e6860fe0; Comments of Michael Archer, Director of Military Legal Assistance, Marine Corps Installations East, to CFPB (April 4, 2012): "Most ominously, a few large banks have gotten into the business of payday loans through the artifice of calling the loans open ended credit" http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0056.

[63] Hundreds of groups have urged the prudential regulators to stop banks from trapping borrowers in payday loans. Letters from approximately 250 groups to FDIC, OCC, FRB and CFPB, March 13, 2013 (http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2013/03/Bank-Payday-Sign-On-Letter-3-13-13-Final.pdf) and February 22, 2012 (http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Dear-Regulators.pdf). Thousands of individuals and many community groups filed comments with the OCC urging that Wells Fargo's Community Reinvestment Act rating be negatively impacted because it makes payday loans. The comment filed by CRL and NCLC is available here: http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment_wells-nov-29-2012_final.pdf.

[64] *E.g*., Letter from Benjamin Todd Jealous, President and Chief Executive Officer, NAACP, to FDIC, OCC, FRB, and CFPB opposing bank payday lending (Feb. 21, 2013).

[65] For proxy year 2013, investors filed shareholder resolutions with the four largest banks making payday loans expressing concern about the product and requesting data, which none of the banks agreed to provide. Wells Fargo (http://www.onlineethicalinvestor.org/eidb/wc.dll?eidbproc~reso~10525); Fifth Third Bank (http://www.trilliuminvest.com/resolutions/payday-lending-fifth-third-bancorp-2013/); Regions Bank and U.S. Bank (http://www.calvert.com/sri-resolutions.html).

[66] *E.g*., "Legislative Black Caucus slams Regions Bank over payday-style loans," Raleigh News and Observer "Under the Dome," Oct. 11, 2012, *available at* http://projects.newsobserver.com/under_the_dome/legislative_black_caucus_slams_regions_bank_over_paydaystyle_loans#storylink=cpy#storylink=cpy (quoting letter from N.C. Senator Floyd McKissick, Jr., chairman of the N.C. Legislative Black Caucus, to Regions Bank, which stated: "We are deeply concerned about recent reports of Regions Bank offering its 'Ready Advance' payday loans in North Carolina . . . . High-cost, short-term balloon loans like these sharply increase the financial distress of families under economic strain"); Letter from Arizona Democratic Caucus to the prudential banking regulators, February 2012 (noting that Arizona "has spent countless state resources to study and understand the effects of [payday lending], and ultimately outlaw payday lending entirely" and calling on federal regulators to "take immediate action so that meaningful reforms taking place in Arizona and throughout the country in the name of consumer protection will not be undermined.").

[67] In January 2013, several Senators wrote the FRB, OCC, and FDIC urging action to address bank payday lending (http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-regulators-to-act-to-stop-abusive-bank-payday-lending). In April 2013, House members did the same (http://democrats.oversight.house.gov/images/stories/Bank%20payday_Letter%20to%20Prudential%20Regulators.pdf).

[68] For documentation of recent opposition to bank payday lending by community leaders and state and local officials, *see* Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns*, CRL Issue Brief, March 7, 2013, *available at* http://rspnsb.li/10wra0y.

Carolina Attorney General Roy Cooper said the following when discussing Regions Bank's product: "Payday loans are like a consumer needing a life preserver being thrown an anvil."[70]

Bank payday lending has motivated "move-your-money" campaigns.[71] It has led groups managing programs aiming to bring people into the banking mainstream to establish policy that excludes banks that make high-cost payday loans from the program.[72] Multiple lawsuits involving bank payday loans have been filed.[73] And in light of growing regulatory scrutiny of bank payday lending, and payday lending generally, there is clear risk that regulatory action against the product, on a safety-and-soundness or a consumer protection basis, will cause banks to lose substantial revenue associated with it. Indeed, the CFPB recently noted that it "expects" to use its authorities to provide protections against harm caused by sustained use of payday loans, whether offered by non-bank payday lenders or by banks.[74]

### b. Legal risk

The Agencies discuss a variety of legal risks payday lending poses in their proposal. We underscore here the risks of violating (1) federal and state provisions prohibiting unfair and deceptive acts or practices and (2) the Equal Credit Opportunity Act (ECOA). Unfair and deceptive acts or practices typically stem from causing consumer harm which, as we discuss in Part III below, bank payday lending clearly causes. ECOA prohibits creditors from discriminating on the basis of, among other characteristics, race, color, or age.[75] Discrimination

---

[69] D. Ranii, *Regions Bank stops offering controversial loans in N.C.*, Raleigh News and Observer (Jan. 17, 2013), *available at* http://www.newsobserver.com/2013/01/17/2614414/regions-bank-stops-offering-controversial.html#storylink=cpy.

[70] D. Ranii, *Regions Bank assailed for payday-style loan*, Raleigh News and Observer (Sept. 18, 2012, *available at* http://www.newsobserver.com/2012/09/18/2352194/regions-bank-assailed-for-payday.html.

[71] *See*, *e.g.*, Green America's "Break up with your mega bank" campaign focused on bank payday lending: http://breakupwithyourmegabank.org/. In addition, a 2012 North Carolina poll found that 93 percent of respondents were less likely to use a bank that makes payday loans that violate North Carolina law. North Carolina Justice Center, *Regions Bank Halts Illegal Payday Lending in North Carolina* (Jan. 16, 2013), *available at* http://www.ncjustice.org/?q=consumer-and-housing/media-release-regions-bank-halts-illegal-payday-lending-north-carolina (citing Public Policy Polling poll conducted on behalf of CRL, Sept. 2012).

[72] In 2012, "Bank On" Savannah (Ga.) adopted as policy that participating banks may not make deposit advance products in excess of 36% APR. Agreement on file with CRL. Relatedly, Cities for Financial Empowerment, the organization that supports cities in implementing "Bank On" programs to bring people into the banking mainstream, has written to the prudential regulators expressing serious concerns about bank deposit advance programs (http://cfefund.org/sites/default/files/Deferred%20Deposit%20Advances.pdf).

[73] Three class action lawsuits have been filed against Fifth Third Bank within the last year: *Klopfenstein v. Fifth Third Bank*, S.D. Ohio (Aug. 3, 2012); *Laskaris v. Fifth Third Bank*, S.D.Ca. (Feb. 12, 2013); *Jesse McQuillen v. Fifth Third Bank*, W.D. Ky. (May 7, 2013).

[74] CFPB Findings at 44.

[75] 15 U.S.C. 1591 *et seq*.

can be proven through overt evidence of discrimination, evidence of disparate treatment, or evidence of disparate impact.[76] Given the impact payday lending has on communities of color and older Americans discussed in Part III.E below, banks making payday loans are at significant risk of being found in violation of this law.

As collection and analysis of bank payday loan data continues to become more robust, the likelihood that violations of the law will be identified and acted upon only increase.

## III. The cycle of debt, and resulting extraordinarily high accumulated fees, causes severe consumer harm, contributing to safety and soundness risk.

Bank payday lending poses the safety and soundness risk discussed above in part because it causes severe harm to banks' customers. Research on the payday lending industry demonstrates that the cycle of debt—which the data increasingly show is typical, including for bank payday loans—causes severe harm. Payday lenders themselves, including banks making payday loans, have long acknowledged that repeat loans are harmful. Further, regulatory precedent has long provided that repeat payday loans cause harm, that loan churning generally causes harm, and that other analogous practices cause harm. Certain subsets of the population are particularly at risk to the harms caused by bank payday lending: older Americans, communities of color, and military servicemembers.

### A. Research makes clear that repeat payday loans cause severe harm.

There is a growing body of evidence that the cycle of debt resulting from making payday loans without regard to the borrower's ability to repay causes severe harm—that is, it leaves borrowers worse off than if they had never taken out a payday loan in the first place.

Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.[77]

[76] Interagency Task Force on Fair Lending, Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266 (Apr. 15, 1994), *available at* www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf (noting that the courts have recognized those three methods of proving lending discrimination under the ECOA). Regulation B under ECOA also recognizes that the legislative history of ECOA indicates Congress intended an "effects test" concept. 12 C.F.R. § 1002.6. The CFPB recently reaffirmed the disparate impact test and confirmed it would be applying it in its supervisory examinations. CFPB Bulletin 2012-04 (Fair Lending) (April 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

[77] *See* the following studies for discussions of these negative consequences of payday lending: Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), *available at* www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; Sumit Agarwal, Paige Skiba, and Jeremy Tobacman. *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), *available at* http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf; Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873; Brian T.

This is unsurprising in light of the financial strain the cycle of debt has been shown to have on borrowers over time. CRL research published in 2011, which tracked borrowers over a two-year period, found that the typical non-bank payday borrower take out loans for more and more over time as they are driven deeper into debt and that nearly half of borrowers (44 percent)—after years of cyclic debt—ultimately default.[78] Previous CRL research has found that the typical borrower will pay back $793 in principal, fees, and interest for the original $325 borrowed.[79]

Other studies support CRL's findings. For example, in his book on the history of the payday lending industry, Professor Robert Mayer finds that one in four payday borrowers ultimately default, concluding that these borrowers "flounder and drown, but in most cases not before they have generated more in fee income than must be written off in principal."[80]

Another study of a large Texas-based payday lender found a 54 percent default rate for payday borrowers who took out loans on a bi-weekly basis; the study concluded that by the time the borrower defaults, he or she will have serviced that payday loan five or six times and have paid over 90 percent of the amount of the principal in fees and interest alone.[81]

A real-life case study from our database of bank payday borrowers provides an example of the harm caused to one borrower over the course of a six-month period:

---

Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, University of Chicago Business School (November 15, 2007), *available at* http://insight.kellogg.northwestern.edu/index.php/Kellogg/article/the_real_costs_of_credit_access; and Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans" (April 1, 2008 ), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

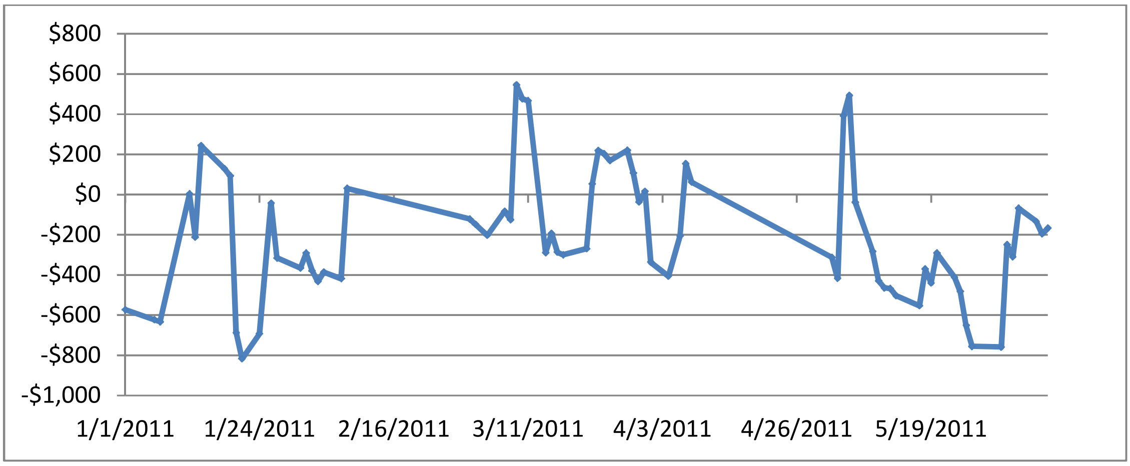
[78] CRL's analysis of Oklahoma payday lending data showed that payday borrowers were loaned greater amounts over time (i.e., an initial loan of $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half of borrowers (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf [hereinafter CRL, *Payday Loans, Inc*.]. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

[79] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year* at 6, Center for Responsible Lending (Nov. 30, 2006), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf.

[80] Robert Mayer, *Quick Cash: The Story of the Loan Shark* at 152-53, Northern Illinois University Press (2010).

[81] Paige Marta Skiba and Jeremy Tobacman, *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default*, Vanderbilt University Law School and University of Pennsylvania (Aug. 21, 2008), *available at* http://www.law.vanderbilt.edu/faculty/faculty-personalsites/paige-skiba/publication/download.aspx?id=1636.

**Figure 2: Melinda's Checking Account Balance – January to June 2011**




Melinda is a 33-year-old residing in Texas. During the five-and-half-months during which she provided her account information to Lightspeed, Melinda had 19 bank payday loans, typically grouped into clusters of 2-3 loans extended over the course of a few days each month. The median loan size was only $100, yet Melinda paid $233.50 in fees. She also incurred 21 overdraft fees during this period. At the end of the period, her account remained in the red.

### B. Payday lenders themselves have long acknowledged that repeat payday loans cause harm.

Payday lenders themselves have long acknowledged that long-term use of what is intended to be a short-term product is harmful. Every bank of which we are aware making payday loans cautions that these loans are not intended for repeat or long-term use.[82] And the Community Financial Services Association of America (CFSA), the payday industry's trade group, stated in its consumer guide that payday loans are "not a long-term solution" and that "[r]epeated or frequent use of payday advances can cause serious financial hardship."[83]

Yet even as they purport to discourage long-term use, payday lending industry representatives have often acknowledged that repeat borrowing not only occurs but is encouraged.[84] Payday

---

[82] *See* Appendix.

[83] *Your Guide to Responsible Payday Advances,* Community Financial Services Association of America, *viewed at* www.cfsa.net/downloands/Your_Guide_to__Responsible_Use _of_Payday_Advances_English.pdf (viewed on 3/31/11).

[84] Several examples are cited in CRL, *Springing the Debt Trap*, at 11-12, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf: "A note about rollovers. We are convinced the business just doesn't work without them" (Roth Capital Partners, First Cash Financial Services, Inc., Company Update, July 16, 2007); "We saw most of our customers every month—a majority came in every month" (Rebecca Flippo, former payday lending store manager, Henrico County, VA); "This industry could not survive if the goal was for the customer to be 'one and done.' Their survival is based on the

lenders also frequently offer the borrower's first loan for free or at a discount, further exposing that repeat loans are expected.[85]

### C. Research demonstrates that bank payday borrowers are more likely to incur overdraft fees.

Banks have pitched their payday loans as a way for customers to avoid overdrafts and associated overdraft fees.[86] The Agencies note, however, that weak underwriting associated with bank payday lending increases the risks that the borrower's account will become overdrawn and overdraft fees will be incurred.[87] Indeed, the CFPB's analysis found that 65 percent of bank payday borrowers incurred overdraft fees, which was more than three-and-a-half times the portion of customers eligible for a bank payday loan who did not take one out.[88]

---

ability to create the need to return, and the only way to do that is to take the choice of leaving away. That is what I did" (Stephen Winslow, former payday lending store manager, Harrisonburg, VA).

Wells Fargo has also on occasion acknowledged that "[m]any [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken." Wells Fargo insider quoted in David Lazarus, *120% rate for Wells' Advances*, San Francisco Chronicle, Oct. 6, 2004.

Payday industry researchers and analysts have noted the same: "The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers" (Michael Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly,* Vol. 17, No. 1 (February 2003); "We find that high-frequency borrowers account for a disproportionate share of a payday loan store's loan and profits… the business relies heavily on maximizing the number of loans made from each store" (Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf).

[85] A survey of company websites and direct mail advertisements of the 15 largest payday lending companies from 2008-2010 showed that nine of these companies offered a free or discounted first loan and six offered a discount on loans for returning customers. CRL, *Payday Loans, Inc.* at 12. Offering a free first loan gives demonstrates industry's confidence that borrowers will need to return often for new loans once the payday lending cycle begins, making up for an initial "discount" many times over.

[86] CFPB Findings at 40; Burbach, K., Hargarten, J., Heskett, C., & Schmickle, S., *Big Banks' quick-cash deals: Another form of predatory lending?* MinnPost (Feb. 4, 2013); Wells Fargo Bank's comment to CFPB (Apr. 23, 2012) (noting: "[The deposit advance loan] allows a customer to quickly move money into their checking account when needed to help cover an unexpected expense or bill . . . . they can avoid higher cost overdraft fees . . . ."); Wells Fargo Bank's 2012 product agreement (providing a chart comparing borrowing $300 for 30 days as costing $22.50 with the deposit advance (payday loan) product versus $70 with overdraft (assuming two overdraft items at $35 each) and also stating: "If you find yourself in a situation where the funds in your . . . checking account may be insufficient to cover checks or other items that will post to your deposit account, you may choose to advance from [the direct deposit advance] service to avoid the overdraft . . . . The Direct Deposit Advance service is an expensive form of credit, and while the advance fee may be lower than an overdraft or insufficient funds fee, you may want to consider speaking with a banker regarding overdraft protection options that may be available to you.").

[87] FDIC: 78 Fed. Reg. 25270; OCC: 78 Fed. Reg. 25355.

[88] CFPB Findings at 41. CRL's previous research had found similar results—that nearly two-thirds of bank payday borrowers also incurred overdraft fees, and these borrowers were two times more likely to incur overdraft fees than bank customers as a whole. CRL, *Triple Digit Danger*.

The CFPB further found that a quarter of the bank payday borrowers most heavily steeped in the cycle of debt incurred an average of 18 or more overdraft or non-sufficient funds fees during the 12-month period.[89]

These findings are consistent with what consultants selling bank payday loan software have promised banks: that payday lending will result in little-to-no "overdraft revenue cannibalization."[90] The findings also confirm prior research finding that non-bank payday loans often exacerbate overdraft fees, leading to checking account closures.[91]

### D. Federal regulators have long cautioned that repeat payday loans, lending without regard to ability to repay more generally, and high fees due within a short period, cause consumer injury.

Regulators have long cautioned that long-term use of payday loans causes injury. The FDIC's 2007 affordable small loan guidelines caution that "the inability to repay these short-term, high-cost credit products often leads to costly renewals and *exacerbates a customer's difficulties in meeting cash flow needs*."[92] In its warning to national banks considering partnering with payday lenders, the OCC stated that repeatedly renewing a payday loan either through extending a loan directly or through a series of back-to-back transactions was an exceedingly expensive and unsuitable way to borrow over the long term.[93] The National Credit Union Administration (NCUA) has also concluded that extensive use of payday loans is harmful.[94]

The CFPB has also recently discussed the harm that debt traps cause, noting that they "can turn short-term credit into long-term debt that deepens people's problems and leaves them worse off . . . . For a certain subset of borrowers, the fees will pile up and people will ultimately end up worse off than before taking the first loan."[95]

---

[89] CFPB Findings at 42.

[90] Fiserv, Relationship Advance program description, retrieved from http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

[91] Center for Responsible Lending, *Payday Loans Put Families in the Red* (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

[92] FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 (June 19, 2007), *available at* http://www.fdic.gov/news/news/financial/2007/fil07050a.html [hereinafter FDIC Affordable Small Loan Guidelines].

[93] OCC Advisory Letter on Payday Lending.

[94] National Credit Union Administration, *Short-Term, Small Amount Loans*, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

[95] Prepared Remarks of Richard Cordray, Director of the CFPB, to National Association of Attorneys General. February 26, 2013, *available at* http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-national-association-of-attorneys-general/.

More generally, federal regulators have found that lending without regard to ability to repay and equity stripping cause harm. In 2009, the FRB found that lending without regard to a borrower's ability to repay a higher priced or HOEPA mortgage loan caused substantial injury.[96] It found that [l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings . . . that actually . . . convert borrowers' equity into fees for originators without providing borrowers a benefit."[97] It also noted that lending without regard to ability to repay could cause "serious emotional hardship."[98] Similarly, the OCC's 2003 letter addressing predatory and abusive lending cautioned that "[e]quity stripping practices will almost always involve substantial consumer injury."[99]

Banking regulators have found in other contexts that fees required to be repaid over a short period of time increase potential injury. For example, the FRB, Office of Thrift Supervision (OTS), and NCUA noted that the potential for injury caused by high-cost subprime credit cards increases when deposits and fees are charged to the account in the first billing cycle rather than over a longer period of time: "[C]onsumers who open a high-fee subprime credit card account are unlikely to be able to pay down the upfront charges quickly."[100] Also in the high-cost credit card context, those agencies determined that costs above a reasonable threshold cause substantial consumer injury.[101] Payday loans are similar in that they require very high fees to be repaid in very short order.

---

[96] It found substantial injury even if allowing refinancing into a loan with a lower payment was an option, noting that refinancing can slow the rate at which the consumer is able to pay down the principal and build equity. 73 Fed. Reg. 44541.

[97] 73 Fed. Reg. 44542.

[98] *Id*. The CFPB's Supervision and Examination Manual notes that "[e]motional impact and other more subjective types of harm also will not ordinarily amount to substantial injury. Nevertheless, in certain circumstances . . . emotional impacts may amount to or contribute to substantial injury." CFPB Supervision and Examination Manual, Version 2 (Oct. 2012), CFPB Consumer Laws and Regulations—UDAAP, at 2.

[99] OCC 2003 Advisory Letter on Predatory and Abusive Lending at 6.

[100] Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury, and National Credit Union Administration, Unfair and Deceptive Acts and Practices, Final Rule, 74 Fed. Reg. 5498, 5539 (Jan. 29, 2009).

[101] The FRB, OTS and NCUA concluded that upfront security deposit and fees exceeding 50% of the initial credit limit caused substantial consumer injury. They further determined that such costs exceeding 25% of the initial credit limit must be charged to the account over six months. 74 Fed. Reg. 5538.

## E. Payday lending by banks has a uniquely harmful impact on certain segments of the population.

### 1. A large portion of bank payday borrowers are older Americans receiving Social Security benefits.

Senior Americans are at particular risk of harm from bank payday loans. CRL's recent analysis of bank payday loans found that more than one-quarter of bank payday borrowers are Social Security recipients.[102] This finding was consistent with CRL's previous analysis of 2010 loans, which found that nearly one-quarter of all bank payday borrowers were Social Security recipients.[103]

Many senior Americans are financially vulnerable. The Great Recession led to a 13 percent decrease in net worth for households headed by someone age 65 or older from 2005 to 2010.[104] Coupled with declines in the value of their largest assets—homes and retirement assets—many older Americans struggle with limited incomes. More than 13 million older adults are considered economically insecure, living on $21,800 a year or less.[105] People over age 55 make up the fastest-growing segment of people seeking bankruptcy protection.[106]

The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.[107] Benefits that have been distributed by paper check, often to those most financially vulnerable, are now directly deposited to checking accounts or prepaid cards. As part of the new rule, the Treasury Department prohibited government deposits to prepaid cards that allow payday loans out of concern that credit products would siphon off exempt benefits.[108] However, benefits

---

[102] CRL, *Triple Digit Danger*.

[103] Rebecca Borné, Joshua Frank, Peter Smith, and Ellen Schloemer, *Big Bank Payday Loans: High interest loans through checking accounts keep customers in long-term debt* (July 2011), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[104] U.S. Census Bureau, *Net Worth and Asset Ownership of Households* (2005 and 2010), *available at* https://www.census.gov/hhes/www/wealth/wealth.html

[105] National Council on Aging, *A Blueprint for Increasing the Economic Security of Older Adults: Recommendations for the Older Americans Act* (March 2011), *available at* http://www.ncoa.org/assets/files/pdf/Blueprint-White-Paper-web.pdf.

[106] Brandon, E. *More Seniors Declaring Bankruptcy in Retirement*. US News and World Report (Nov. 17, 2010), *available at* http://money.usnews.com/money/blogs/planning-to-retire/2010/11/17/more-seniors-declaring-bankruptcy-in-retirement.

[107] Department of the Treasury, Interim Final Rule, Federal Government Participation in the Automated Clearing House, 75 Fed. Reg. 80335, 80338 (2010).

[108] The Treasury Department rule states: "In order to prevent Federal payments from being delivered to prepaid cards that have payday lending or 'account advance' features, we are prohibiting prepaid cards from having an attached line of credit if the credit agreement allows for automatic repayment of a loan from a card account triggered

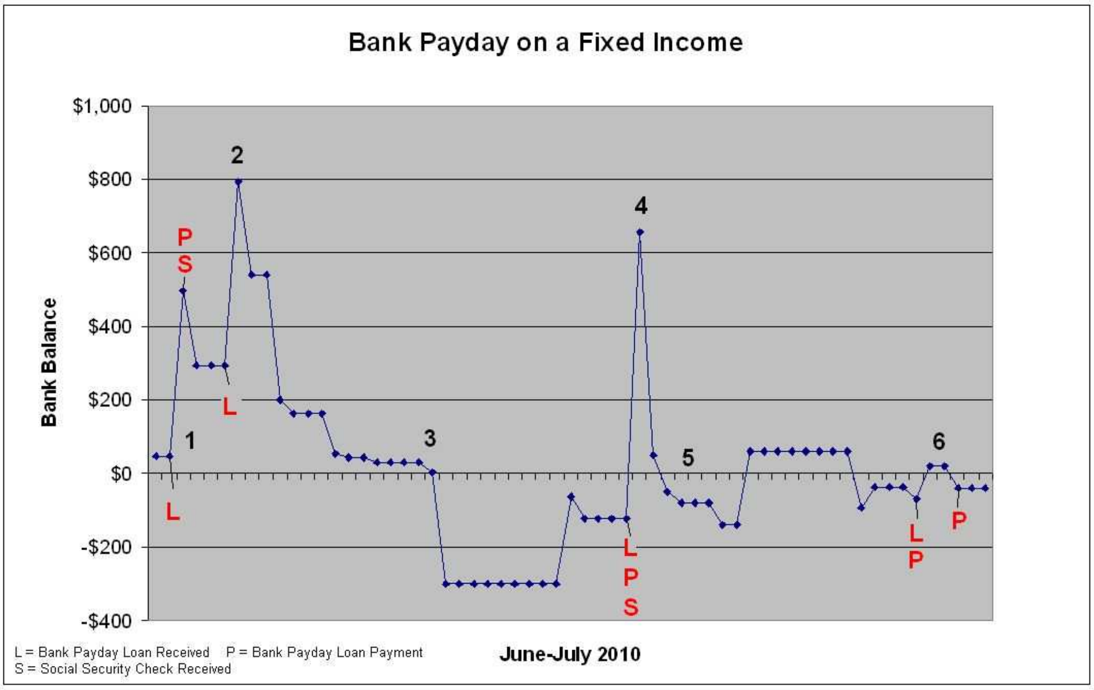
deposited into traditional checking accounts remain at risk to bank payday loans, where banks repay themselves the loan amount before any other expense or creditor.[109]

Figure 3 below demonstrates the impact that bank payday loans have on a Social Security recipient in CRL's 2010 database, whom we call Alice. Alice's primary source of income is Social Security. The figure maps two months of her checking account activity and demonstrates how bank payday loans only make it more difficult for Alice to use her Social Security income for the bills and other expenses for which it is intended. The line on the graph represents Alice's account balance. It goes up when she receives a direct deposit or other deposit or when a payday loan or overdraft loan are extended on her account. It goes down when checks, bill payments, debit card transactions, or other withdrawals are posted to the account, or when the bank collects the payday loans (after a direct deposit is received) or overdrafts and related fees.

by the delivery of the Federal payment into the account. Our intention is that this restriction will prevent arrangements in which a bank or creditor 'advances' funds to a cardholder's account, and then repays itself for the advance and any related fees by taking some or all of the cardholder's next deposit." 75 Fed. Reg. 80338.

[109] In its discussion, Treasury cited Regulation E's prohibition on compulsory electronic repayments as the comparable protection on traditional checking accounts, *id*., but this prohibition is typically not read to apply to single-payment loans, as bank payday loans typically are. Thus, federal benefits direct deposited to traditional checking accounts remain vulnerable to bank payday loans.

**Figure 3**




1: Bank payday loan takes balance up to $500.
2: Alice receives June Social Security Check, and bank uses deposit to pay off first bank payday loan. Alice then takes out second bank payday loan, reaching her highest balance for the two-month period.
3: Several large bills and payments put Alice on the verge of overdraft, and the payback for the payday loan is about to come due.
4: July's Social Security Check and a new bank payday loan bring Alice's account balance to positive for only a few days.
5: More bills and the payday loan repayment take her right back into overdraft.
6: Small bills and payday loan fees and repayments offset small deposits, transfers, and bank payday loans, and Alice begins August in the red.

This graph demonstrates that bank payday loans only briefly increase Alice's account balance. Several days later, when the principal and fees ($10 per $100 borrowed in this case) are collected in one lump sum, Alice's account balance drops dramatically and overdraft fees soon follow. At the end of a two-month period during which Alice spent 47 of 61 days in payday loan debt, she is again left with a negative balance, in an immediate crisis, in need of another loan.

In CRL's recent report on bank payday loans, we also highlighted the story of another senior borrower, whom we called Annette. Annette is a 69-year-old, disabled widow who lives on a fixed income in California. More than two years ago, she found herself unable to afford the fees for smog repair and registration for her truck. Her bank, Wells Fargo, suggested that she take out a Direct Deposit Advance. In the 26 months since, from January 2011 through February 2013, Wells Fargo has made 25 advances to Annette, and she has paid over $900 in fees. This is in spite of a "continuous use" policy the bank claims prevents extended indebtedness. As of the publication of our report in March, Annette remained stuck in a cycle of debt.[110]

[110] Source: Andrea Luquetta, California Reinvestment Coalition, as included in CRL, *Triple Digit Danger*.

### 2. Banks harm communities of color by making payday loans.

Banks making payday loans have promoted their products as providing access to credit in communities that have few other options. But it is a false choice to say that the communities represented by several of the undersigned groups must decide between dangerous, wealth-stripping credit and none at all. Allowing the spread of high-cost credit discourages development of responsible products and entrenches a two-tier financial system: one group of consumers who can access a mainstream financial system and another group of consumers who are further marginalized and relegated to predatory lenders selling risky products.

Americans have lost income and wealth over the past decade, and the declines have been greatest for people of color. Today, white non-Hispanic families earn an average of $55,000 annually, while African Americans and Latinos earn $32,000 and $39,000, respectively.[111] The foreclosure crisis, with its devastating impact on communities of color, is exacerbating already dramatic wealth disparities.[112]

Surveys repeatedly find that borrowers of color are disproportionately detached from the traditional banking system. A recent FDIC study found that 21 percent of African American and 20 percent of Latino households are unbanked, compared to 4 percent of white households.[113] These 2011 disparities had not improved since the FDIC's 2009 survey.

Payday lending has a history of disparate impact on communities of color. A disproportionate share of payday borrowers come from communities of color,[114] and research has found that

---

[111] U.S. Census Bureau, *Quick Facts*, 2011.

[112] Rakesh Kochhar, Richard Fry and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics*, Pew Research Center, Social and Demographic Trends (July 26, 2011), *available at* http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[113] 2011 FDIC National Survey of Unbanked and Underbanked Households at 14 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf.

[114] Amanda Logan and Christian E. Weller, *EZ Payday Loans: Who Borrows From Payday Lenders? An Analysis of Newly Available Data*, Center for American Progress (March 2009), summary of findings at page 1 (finding, based on the FRB's Survey of Consumer Finances conducted in 2007 and released in 2009 payday borrowers are more likely to be minorities); The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* at 9 (July 2012) (finding that, after controlling for other characteristics, payday loan usage was 105% higher for African Americans than for other races/ethnicities); California Department of Corporations, *Payday Loan Study* (updated June 2008), *available at* http://www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf (finding that, although they represent about one-third of the overall state population, over half of California payday borrowers are African American and Latino); Skiba and Tobacman, *Do Payday Loans Cause Bankruptcy?, supra* (analysis of a database of a large Texas-based payday lender finding that African Americans (who make up approximately 11 percent of the total adult population) made up 43 percent of payday borrowers and Latinos (who make up approximately 29 percent of the total adult population) made up 34 percent of payday borrowers).

payday lenders target these communities.[115] This disparity is even more significant since African Americans and Latinos are much less likely to have a checking account than whites—a basic requirement of getting a payday loan—which would lead one to believe that the concentration of payday lenders should be lower than in white neighborhoods.

By making payday loans, banks increase the ranks of the unbanked and underbanked among communities of color, both by the direct harm the loans cause members of these communities[116] and by the negative impact these products have on the communities' trust in banks.[117]

By making payday loans, banks also undermine the Community Reinvestment Act, the objective of which is to ensure that financial institutions meet the banking needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods and individuals.[118] This legal obligation is considered a *quid pro quo* for the valuable public benefits financial institutions receive, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window.[119] Making payday loans contradicts this

---

[115] Wei Li, Leslie Parrish, Keith Ernst, and Delvin Davis, *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (March 26, 2009), *available at*: http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf (finding that payday lenders in California are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos compared with white neighborhoods, draining nearly $247 million in fees from communities of color, and that even after controlling for income and a variety of other factors, payday lenders were 2.4 times more concentrated in African American and Latino communities); Delvin Davis, Keith Ernst, Uriah King, and Wei Li. *Race Matters: The Concentration of Payday Lenders in African-American Communities in North Carolina*. Center for Responsible Lending (March 2005) *available at* http://www.responsiblelending.org/north-carolina/nc-payday/research-analysis/racematters/rr006-Race_Matters_Payday_in_NC-0305.pdf (finding that, even when controlling for a variety of other factors, African-American neighborhoods had three times as many payday lending stores per capita as white neighborhoods in North Carolina in 2005); Assaf Oron. *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State*, Department of Statistics, University of Washington (March 2006) (concluding based on a study of Washington State payday lenders that "payday businesses do intentionally target localities with a high percentage of African Americans.").

[116] The FDIC found that for 9.5 percent of previously banked households who were now unbanked, the bank closed their account, and nearly half of those were closed due to overdrafts. 2011 FDIC National Survey of Unbanked and Underbanked Households at 14, 27. As discussed earlier, bank payday borrowers are more likely to incur overdraft fees than customers as a whole.

[117] Another 8.2 percent of previously banked households listed not liking dealing with banks or not trusting banks as the reason they were now unbanked. *Id*. at 27. A recent Pew study found that some bank payday borrowers mistakenly believed that bank payday loans were safer or more regulated than other payday loans because they were offered by a bank. The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Small_Dollar_Loans/Pew_Choosing_Borrowing_Payday_Feb2013.pdf, at 28 (February 2013). The contrast between this expectation and the typical experience—a long-term, high-cost debt trap—likely further damages trust of banks.

[118] 12 U.S.C. 2901 *et seq*.

[119] FRB Chairman Ben S. Bernanke, "The Community Reinvestment Act: Its Evolution and New Challenges," Speech at the Community Affairs Research Conference, Washington, D.C. (March 30, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm#f2.

obligation: CRA requires that banks serve communities' credit needs,[120] but the data show that these loans do the opposite, leading to repeat loans that not only leave borrowers' needs unmet but leave them affirmatively worse off than before the lending began.

### 3. Bank payday lending puts military service members and their families at risk.

Members of the military are also vulnerable to bank payday lending, even as they are protected by the Military Lending Act (MLA) from other payday loans. The 2006 MLA stemmed from Department of Defense and base commander concern that troops were incurring high levels of high-cost payday loan debt, which was threatening security clearances and military readiness.[121] At that time, the President of the Navy-Marine Corps Relief Society testified:

> "This problem with . . . payday lending is the most serious single financial problem that we have encountered in [one] hundred years."[122]

Congress then prohibited making payday loans to service members and their families, but banks structure their loans in a way that attempts to evade this law,[123] even making payday loans on military bases.[124]

We were encouraged by the OCC's testimony before Congress last year highlighting the importance of MLA in protecting members of the military and their dependents by "restricting the cost and terms of . . . abusive credit products." [125]

---

[120] 12 U.S.C. 2901.

[121] U.S. Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (2006), *available at* www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf.

[122] Testimony of Admiral Charles Abbot, US (Ret.), President of Navy-Marine Corps Relief Society, Hearing before the Senate Banking, Housing and Urban Affairs Committee, 109th Cong. (2006).

[123] The regulation under the law covers only "closed-end" loans. 32 CFR 232.3(b). Banks categorize their payday loans as "open-end" instead, even though the due date for the loan, much like a closed-end loan, is fixed as the next deposit date or, at the latest, after 35 days.

[124] Jean Ann Fox, *The Military Lending Act Five Years Later*, Consumer Federation of America, May 29, 2012, at 58-60, *available at* http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf.

[125] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 5.

## IV. We support the Agencies' proposed underwriting and related guidelines taken in combination.

### A. The proposed underwriting and related guidelines, in combination, help ensure borrowers can repay the loan and meet expenses without reborrowing.

In light of the risks posed by lending without regard to ability to repay and the harm caused by repeat payday loans, we support the Agencies' proposed underwriting and related guidelines which, in combination, help ensure that borrowers can afford the loan and meet ongoing expenses without reborrowing. As the weakening or the omission of any single criterion could render the guidelines as a whole ineffective, we urge that the Agencies preserve them in their entirety.

We elaborate here on two provisions in particular: (1) determination of the borrower's ability to repay the loan by analyzing the borrower's inflows and outflows; and (2) the limit on the number of loans that may be made.

### B. Requiring determination of the borrower's ability to repay the loan is necessary and appropriate.

#### 1. Analyzing inflows and outflows is necessary, as the data clearly indicate that assessment of inflows alone results in high numbers of repeat loans.

Payday lenders, including banks making payday loans, have typically approved loans based on the expectation that the borrower's gross inflows on payday, or upon receipt of public benefits, will cover repayment of the loan.[126] While this approach often ensures the lender's ability to *collect* the loan proceeds, the data on repeat use make clear that this approach fails to ensure the borrower's ability to *repay* without reborrowing.

Thus, it is necessary and appropriate that the Agencies propose requiring that lenders analyze the borrower's inflows and outflows to determine ability to repay the loan without reborrowing. As the Agencies note, underwriting for other credit products typically entails this analysis.[127] The Agencies propose consideration of the customer's inflows and outflows over no less than the preceding six consecutive months. This is an appropriate time period and should be no less. The Agencies also emphasize that the bank consider the net surplus or deficit at the end of each month, without relying on a six-month average. This too is appropriate, as larger one-time inflows could significantly skew a six-month average that would not reflect the borrower's ongoing financial capacity.

[126] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

[127] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

### 2. There is clear precedent for regulators and Congress requiring a determination of ability to repay.

Years of regulatory guidance, advisory letters, and rules, as well as a growing body of federal legislative precedent, explicitly require that a lender determine the borrower's ability to repay a loan, and that the determination be based on income and obligations.

As applicable to all loans, the 2001 Interagency Subprime Guidelines provide that loans to borrowers who do not "demonstrate" the capacity to repay are unsafe and unsound.[128] The OCC's 2003 letter addressing predatory and abusive lending states in strong terms that "disregard of basic principles of loan underwriting," which the OCC describes as failing to determine ability to repay, "lies at the heart of predatory lending."[129]

In the credit card context, the 2009 Credit Card Act explicitly required that lenders "consider[] the ability of the consumer to make the required payments under the terms" of the account.[130] The FRB interpreted this provision to require that the lender consider ability to repay "based on the consumer's income or assets *and* current obligations."[131]

In the mortgage context, since 1994, the Home Ownership and Equity Protection Act has prohibited making high-cost HOEPA loans without regard to the borrower's repayment ability,[132] "including the consumers' current and expected income, *current obligations*, and employment." In 2009, the FRB expanded this provision to a lower cost category of loans than "high-cost" loans, called "higher priced mortgages" (essentially subprime loans), and required verification of income, assets and obligations for both high-cost and higher-priced loans.[133] The 2010 Dodd-Frank Act extended an ability-to-repay requirement to all mortgage loans, requiring "a reasonable and good faith determination based on verified and documented information,"[134]

---

[128] Interagency Expanded Guidance for Subprime Lending Programs, 2001: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."

[129] OCC 2003 Advisory Letter on Predatory and Abusive Lending.

[130] 15 U.S.C. 1665e.

[131] 12 CFR 226.51(a) (emphasis added).

[132] 15 U.S.C. 1639(h): Prohibition on extending credit without regard to payment ability of consumer. A creditor shall not engage in a pattern or practice of extending credit to consumers under [high-cost] mortgages . . . based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment."

[133] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44546 (July 30, 2008).

[134] 15 U.S.C. 1639c(a)(1).

including, among other items, expected income, current obligations, debt-to-income ratio or residual income, and other financial resources other than the consumer's equity.[135]

Thus, explicitly requiring an ability-to-repay determination, and requiring that it be based on income and expenses, is consistent with a range of existing credit regulation.

### C. Limiting the number of payday loans is necessary and appropriate.

As discussed earlier, payday lenders, including banks making payday loans, assert that these loans are intended for occasional use, but the data indicate they are used on a sustained basis. The regulators' proposal that these loans be limited, consistent with previous regulatory action, helps to ensure that these loans are provided as intended.

#### 1. The limit of one loan per month and a full statement period between loans helps to ensure that loans are used as marketed—on an occasional basis.

As discussed in Part II, a payday loan made within a short period of repayment of another loan is effectively a renewal or a refinance. Thus, the Agencies' proposed limit of one loan per statement period and a break of one statement period is essentially a prohibition on renewals and refinances, consistent with regulatory precedent previously cited that advises against them. It also helps to ensure that loans are used as marketed—on an occasional basis.

To be effective, it is important that the provision limits loans to no more than one per statement period (typically, approximately one month) and that the period of the required break between loans be at least one statement period (again, approximately one month), as the Agencies propose. Further, we support the FDIC's clarification that this provision should be applied in combination with its existing indebtedness limit for payday loans (discussed in part IV.C.2. below) across all lenders, bank or non-bank, requiring that banks review customers' account activity to identify payday loan activity with other lenders.[136]

Most borrowers take out a payday loan to meet recurring expenses.[137] A recent Pew study found that 53% borrowed to pay "a regular expense, such as utilities, car payment, credit card bill, or prescription drugs;" 10% borrowed to pay mortgage or rent; and 5% borrowed for food and groceries.[138] As most recurring expenses are on a monthly billing cycle, a month is the minimum

---

[135] 15 U.S.C. 1639c(a)(3).

[136] 78 Fed. Reg. 25272, n.22.

[137] The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf, at 14 (July 2012) (69% of the 450 borrowers surveyed took out their first loan to pay recurring expenses).

[138] *Id.*

period of time over which a borrower's ability to repay, and meet ongoing expenses, should be assessed.

Further, the experience at the state level demonstrates that renewal bans that allow a loan to be extended too soon after another is repaid are ineffective at stopping the cycle of debt.[139] Payday lenders often support these measures but routinely circumvent them by having borrowers pay off their loan and then take out another shortly thereafter. This process is termed a "back-to-back" transaction.[140] Because these types of transactions technically do involve paying off the loan, they are typically not considered renewals under state laws prohibiting renewals. Some state laws require a "cooling-off" period of a business day or two between each loan, or after a certain number of consecutive loans.[141] But this period is far too short to stop the cycle of debt.[142]

### 2. There is clear precedent for limiting the number of payday and other relatively short-term loans.

Regulatory precedent, including long-standing guidance by these Agencies which the current proposed guidance is intended to supplement, is consistent with limiting the number of payday loans a bank may make to a customer.

Eight years ago, the FDIC issued payday loan guidelines, applicable to loans made through bank partnerships with non-bank payday lenders and by banks directly,[143] advising: "When a customer has used payday loans more than three months in the past 12 months . . . an extension of a payday loan is not appropriate under such circumstances."[144] Assuming a typical loan term of approximately two weeks, this indebtedness limit equates to approximately six loans per year. Those guidelines also provided that lenders establish "appropriate 'cooling off' or waiting periods between the time a payday loan is repaid and another application is made."[145]

---

[139] CRL, *Springing the Debt Trap*, n.42.

[140] The CFPB recently found that the majority of payday loans made to borrowers with seven or more loans over twelve months were nearly continuous, i.e., taken out shortly after the previous loan was repaid. CFPB Findings at 25. This is true even though most states limit technical renewals.

[141] States with cooling off provisions include Alabama, Florida, Illinois, Indiana, North Dakota, Ohio, and Oklahoma.

[142] The Department of Defense's 2006 report addressing predatory lending highlighted that "[e]ven when the [payday loan] transactions are separated by a couple of days or a week, the borrower is still caught in the cycle of debt." U.S. Department of Defense, "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," Aug. 9, 2006, *available at* http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

[143] FDIC 2005 Payday Lending Guidelines ("Examiners should apply this guidance to banks with payday lending programs that the bank administers directly or that are administered by a third party contractor.").

[144] FDIC 2005 Payday Lending Guidelines.

[145] *Id*.

Thirteen years ago, the OCC's payday lending advisory letter advised: "[m]ultiple renewals—particularly renewals without a reduction in the principal balance, and renewals in which interest and fees are added to the principal balance, are an indication that a loan has been made without a reasonable expectation of repayment at maturity." It specifically advised that banks have no more than one payday loan outstanding to a borrower at any one time.[146]

When the National Credit Union Administration authorized small dollar loans at up to 28% APR in 2010, it explicitly limited these loans to three every six months, or six over a twelve-month period.[147]

### D. The Agencies should preserve the other proposed underwriting-related provisions so that they are at least as strong as proposed.

The Agencies' proposal also includes requirements that the duration of the customer's relationship with the bank be sufficient to prudently underwrite the loan, no less than six months; that credit limits not be increased without a full underwriting reassessment and only upon request from the borrower; and that ongoing customer eligibility be reassessed no less than every six months, with a particular emphasis on repeat overdrafts and other credit obligations.[148] We support these requirements and urge that they be finalized at least as strong as proposed.

## V. The Agencies should clarify that safe and sound banking principles require that interest and fees be reasonable, not to exceed 36 percent in annual percentage rate terms.

Cost is a critical element of any credit product, and bank payday loans are extraordinarily high-cost by any measure. Banks impose fees in the range of $7.50 to $10 per $100 borrowed for bank payday loans.[149] CRL's latest analysis of checking account data for the year 2011 found that the average bank payday loan term is 12 days—that is, the bank repays itself from the borrower's next direct deposit an average of 12 days after extending the credit.[150] The CFPB similarly found that the typical period during which a bank payday borrower had an outstanding advance balance was 12 days.[151]

---

[146] OCC 2000 Advisory Letter on Payday Lending.

[147] NCUA, Short-Term, Small Amount Loans, 75 Fed. Reg. 58285, 58287. The minimum loan term for these loans is one month.

[148] FDIC: 98 Fed. Reg. 25272 ; OCC: 98 Fed. Reg. 25357.

[149] While it continues to charge $10 per $100 borrowed, as it did in 2011, during a borrower's first year of payday loan use, Regions Bank. FRB-supervised, recently began charging $7 per $100 borrowed under certain circumstances for customers whose first Regions payday loan was taken out at least one year prior (Regions Ready Advance Account Agreement and Disclosures, 2013).

[150] CRL, *Triple Digit Danger*. The median loan term was found to be 12 days; the mean loan term was14 days.

[151] CFPB Findings at 28.

This cost and loan term translates to an annual percentage rate ranging from 225% to 300%, an extremely high cost for credit, particularly since the lender virtually guarantees repayment by putting itself first in line when a direct deposit hits the account.

The Agencies advise that fees be "based on safe and sound banking principles;" clearly, these loans' current costs are not. The Agencies do not, however, elaborate on what fee size is safe and sound. We urge the Agencies to be as explicit as the FDIC was in its 2007 Affordable Small Loan Guidelines, advising that loans not exceed an annualized interest rate of 36 percent, subject to more prescriptive restrictions under state law.[152] Even if banks continue to assert that their payday loans are open-end, they can measure the cost in annualized interest rate terms based on the average number of days their payday loans are outstanding, as the CFPB did in its discussion of deposit advance products in its recent white paper.[153]

## VI. The Agencies should advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.

Banks typically require repayment of bank payday loans through electronic payment of the fee and the loan amount from the next direct deposit,[154] ensuring their own ability to collect the loan but not the borrower's ability to repay it. Indeed, relying on this "priority position," as the recently CFPB noted, creates a disincentive against ensuring the borrower has the ability to repay the loan without reborrowing.[155] It also denies the borrower the ability to make a measured decision about the order in which to pay debts and expenses.[156]

Mandatory automatic repayment runs counter to long-standing principles found in the Credit Practices Rule's prohibition on irrevocable wage assignments;[157] the Truth in Lending Act's protections against a lender offsetting outstanding balances on credit cards against the borrower's

---

[152] For information on the history of, rationale for, and growing momentum for a 36% APR cap, *see* Lauren Saunders, *Why 36%: The History, Use, and Purpose of the 36% Interest Rate Cap*, National Consumer Law Center (April 2013), *available at* http://www.nclc.org/images/pdf/pr-reports/why36pct.pdf.

[153] CFPB Findings at 27-28.

[154] 78 Fed. Reg. 26268; OCC: 78 Fed. Reg. 26353.

[155] CFPB Findings at 44. *See also* National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones That Don't* (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf, at 15-17.

[156] *Id*. ("This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses.")

[157] 12 CFR 227.13 (Regulation AA).

deposits with that lender;[158] and Treasury's rule regarding delivery of Social Security benefits to prepaid debit cards.[159]

It also wholly undermines an intention of the EFTA, which prohibits creditors from conditioning an extension of credit on the consumer's repayment of that debt by "preauthorized electronic fund transfer."[160] Banks have ignored this prohibition as it technically applies to transfers authorized to recur at "substantially regular intervals," and bank payday loans are nominally structured as single-payment loans.

In light of the safety and soundness and consumer protection implications of requiring mandatory automatic repayment, the Agencies should prohibit banks from doing so, regardless of whether the loan is recurring or single-payment, and particularly when that repayment is triggered by the borrower's deposit.

## VII. The Agencies should perform prompt and vigilant examination and enforcement.

The Agencies caution that they will take "appropriate supervisory action" to address unsafe and unsound practices associated with bank payday lending and to prevent harm to consumers they cause.[161] Given the small number of banks making payday loans, the Agencies should be able to promptly and thoroughly examine banks' compliance with this guidance. They should vigilantly assess compliance with the underwriting and related requirements and take swift enforcement action if necessary. The Agencies should also continue to watch closely for any potential new entrants into the high-cost payday lending market.

## VIII. The Agencies should work with the CFPB to encourage strengthening existing consumer financial regulations.

### A. Cost of credit disclosures under the Truth in Lending Act should allow for meaningful comparison across products.

Bank payday loans currently carry no annual percentage rate (APR) disclosure because banks classify their loans as "open-end" credit, even though the due date for the loan is fixed as the next deposit date or, at the latest, 35 days.[162] This omission limits consumers' ability to compare the cost of a bank payday loan to other forms of credit that do require APRs, including credit card purchases, credit card cash advances, overdraft lines of credit, and other small dollar loans.

[158] 15 U.S.C § 1666h.

[159] 75 Fed. Reg. at 80338. *See also* Part III.E.3, *supra*.

[160] 15 U.S.C. § 1693k; Reg. E, 12 C.F.R. § 205.10(e)(1). That ban applies to transfers from one account to another account at the same institution, even though such transfers are otherwise outside of the scope of the EFTA.
[161] FDIC: 98 Fed. Reg. 25271; OCC: 98 Fed. Reg. 25356.

[162] Some bank payday loan products may carry a double-digit APR disclosure of, e.g., 21 percent, in addition to the fee per $100, but by far the most substantial portion of the cost is the fee charged per dollar borrowed.

It also encourages banks to disclose pricing that may appear cheaper than it is (e.g., $1 per $10 borrowed) or that is likely to mislead consumers in comparisons to other products (e.g., 10% of the amount borrowed). This is inconsistent with the principle of transparency so critical in credit markets, and the Agencies should work with CFPB to address it.

### B. The Electronic Fund Transfer Act should ensure that lenders cannot require automatic repayment as a condition of receiving a loan.

As discussed earlier, a technicality has thus far allowed banks to skirt the protections against mandatory automatic repayment intended by the EFTA. The Agencies should work with CFPB to close the loophole in EFTA that has both encouraged lenders to require mandatory automatic repayment for single-payment loans and, conversely, encouraged lenders to make single-payment loans rather than installment loans. Together, the agencies should ensure that the law provides borrowers the ability to make a meaningful decision about the order in which to repay debts and other expenses.

## Conclusion

The need for strong regulatory action is certain: The data make clear that banks are lending without regard to ability to repay, and regulatory precedent makes clear that lending without regard to ability to repay is unsafe, unsound, and harmful to banks' customers.

The work of the Agencies has been instrumental in temporarily curbing the spread of bank payday lending. But clarity in the marketplace is needed. The current proposed guidance, which provides clear underwriting expectations and limits on repeat loans, is critical to stop the cycle of debt at banks making these loans and to ensure that no additional supervisees begin trapping borrowers in payday loans going forward. For the Agencies to do less would increase safety and soundness risk at the banks the Agencies supervise and harm the customers whose deposits those banks hold.

We thank you for your responsiveness to this critical issue. Please do not hesitate to contact us if you have any questions about our comments.

**APPENDIX**

Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use:

**<u>OCC-supervised:</u>**

**Wells Fargo Bank**: "The Direct Deposit Advance service may be helpful if you are experiencing a financial emergency and need money on a short-term basis . . . . Advances are intended to assist with short-term cash needs and are not recommended as a solution for your long-term financial needs."[163]

**US Bank**: "Checking Account Advance is a loan product designed for short-term credit needs. We do not recommend ongoing use of the Checking Account Advance service."[164]

**Bank of Oklahoma**: "The service is designed to help our customers meet their short-term borrowing needs, but is not intended to provide a solution for longer-term financial needs."[165]

**Guaranty Bank**: "This service . . . is designed to help our customers meet their short term needs and is not intended to provide a solution for longer-term financial needs or recurring expenses that you can plan for."[166]

**<u>FRB-supervised</u>:**

**Fifth Third Bank**: "[Early Access is a] line of credit used to assist our customers with short-term, financial emergencies or unexpected financial needs."[167]

**Regions Bank**: "Ready Advance is an open-end credit plan that is designed to provide you with funds when you have an emergency or other unexpected expense. Ready Advance is not intended for customers who need to repay an extension of credit over an extended period of time. Ready Advance should not be used for planned purchases, discretionary spending, or regular monthly expenses."[168]

---

[163] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[164] U.S. Bank Checking Account Advance, Summary of Key Features, https://www.usbank.com/checking/caa/agreement.html (last visited February 26, 2013).

[165] Fast Loan Terms and Conditions, 2011, *available at* https://www.bankofoklahoma.com/sites/Bank-Of-Oklahoma/asset/en/theme/default/PDF/Bank%20of%20Oklahoma%20FastLoanSM%20Terms%20and%20Conditions.pdf (last visited February 25, 2013).

[166] Guaranty Bank Easy Advance Line of Credit Agreement and Disclosures, as of December 12, 2012, *available at* http://www.guarantybanking.com/ContentDocumentHandler.ashx?documentId=183421.

[167] Fifth Third Early Access, Summary of Key Features, https://www.53.com/doc/pe/pe-eax-tc.pdf (last visited February 26, 2013).

[168] Regions Ready Advance Account Agreement and Disclosures, http://www.regions.com/personal_banking/ready_advance_tc.rf (last visited February 26, 2013).