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PAYDAY LENDING: SHORT-TERM SOLUTION OR LONG-TERM PROBLEM?

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BEFORE THE

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PAYDAY LENDING: SHORT-TERM SOLUTION OR LONG-TERM PROBLEM?

WEDNESDAY, JULY 24, 2013

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 2:07 p.m., in Room SD–562, Dirksen Senate Office Building, Hon. Bill Nelson, Chairman of the Committee, presiding.

Present: Senators Nelson, Wyden, Donnelly, Warren, Collins, and Heller.

OPENING STATEMENT OF SENATOR BILL NELSON, CHAIRMAN

The CHAIRMAN. Good afternoon. We have an important subject to discuss today, payday loans and other short-term lending products and how they impact seniors, and especially how they impact seniors' Social Security income.

The marketplace for these products has evolved rapidly, just in the last several years. We have been aware of these storefront payday lenders, which have been around for some period of time, where people can bring a pay stub or proof of income into a store and get an advance on their next paycheck while paying a very high premium in fees for the privilege. But now there are additional players in this market. Some online lenders and even now big banks are offering seniors these short-term loans.

The Center for Responsible Lending just released a report showing that one in four users of the bank payday loan known as a deposit advance, one in four, 25 percent is a Social Security recipient. Well, think about how the math works on this, or how it does not work for seniors with fixed income and fixed expenses.

Seniors take one of these deposit advances out because they cannot make ends meet or they have some sort of emergency—health issue, car problems, you name it. Then when their next Social Security check arrives, that amount they borrowed plus very high fees are automatically deducted before the money even hits their bank account. So how do these senior citizens get through the month when they still have all the same expenses but their income is cut, in some cases, we will hear in testimony, potentially cut in half, for the rest of that whole month?

The answer in most cases is, what happens? The cycle repeats and they borrow again and again. And some people even borrow from a variety of different sources, from storefronts, from banks, and online lenders.

Take the case of Annette Smith, who has traveled here and she will testify in the second panel. She has traveled here all the way from California to tell just how hard it is to get out from under this cycle of debt. She took out a $500 loan about five years ago, and in the same time since, she has gone back to her bank 63 times to secure a deposit advance, paying out a total of around $3,000 in fees and interest for a $500 loan.

Or, consider the story of Donna Johnson, a grandmother. She is from Ocoee, Florida. She managed to break a two-year payday loan debt trap only after receiving insurance money associated with her husband's death.

We are grateful to Ms. Smith for being here today, and she is going to talk about her financial struggle.

And we also want to thank the regulators for joining us to talk about why they are considering stepping into this market. This is a critical time for these products, and we want to hear from the Consumer Financial Protection Bureau and the Federal Deposit Insurance Corporation about what they have seen from these loans and the regulatory power that they already have to protect these customers and these consumers.

Well, one thing is clear. Millions of Americans with poor or no credit have a need for money in emergencies, and the focus of this committee clearly is our senior citizens who are in that position.

But how can we make sure that the products available to these people, especially the seniors, will not trap them in the cycle of debt? We brought all the parties involved here this afternoon to see how we can answer this question. While everyone agrees payday lending and deposit advance products are many times necessary, and they are expensive forms of short-term credit and borrowing, we must ensure that they are properly overseen with adequate consumer protections and safeguards against predatory lending.

And so we have two very fine panels of witnesses today. Thank you all.

I turn to our Ranking Member, Senator Collins.

OPENING STATEMENT OF SENATOR SUSAN M. COLLINS

Senator COLLINS. Thank you very much, Mr. Chairman, for holding this hearing to examine the impact of payday loans on American consumers and for assembling such an impressive group of witnesses.

I am particularly pleased that the committee will be hearing today from Eric Wright, an attorney with the Maine Bureau of Consumer Credit Protection. Since the Bureau was first established in 1975, it has earned a well-deserved reputation as the leader in the field of consumer credit protection. Some two decades ago, I had the privilege of overseeing the Bureau when I served as Maine's Commissioner of the Department of Professional and Financial Regulation for five years. It was a wonderful experience and I am delighted to have a witness from the Department here today.

Payday loans are typically unsecured, closed end, small dollar amount loans of short duration with high upfront cost. Repayment of the loan is typically structured as a single balloon payment tied to the borrower's next paycheck or some other regular source of income, such as a Social Security check. Payday loans are usually made without underwriting, in other words, without a credit check or any other attempt to determine the borrower's ability to repay.

In years past, the borrower would simply give the lender a check to be cashed on the borrower's next payday, which explains why this kind of financial arrangement came to be known as a payday loan. Today, however, it is more likely that the borrower will authorize the lender to draw the funds directly out of the borrower's savings or checking account on a preset date.

Studies show that payday loans are relied upon by low-and moderate-income customers who need the short-term flexibility that these loans provide or who have poor credit ratings and simply cannot get a traditional bank loan or a credit card. According to a study by the Federal Reserve, two-fifths of all households considered underbanked have used payday loans, and most of those households have done so in the past year. By contrast, only one out of 20 fully banked households has ever taken out a payday loan.

While payday loans can provide consumers with a useful way to get cash quickly when they need it, the high cost built into the loan, the fees can make it difficult or impossible for low-income borrowers to repay them. Too often, then, the consumer gets trapped into a cycle of debt and then may be subjected to aggressive, even abusive, collection practices.

For many years, the Maine Bureau of Consumer Credit Protection has been able to protect my constituents from the worst of these abuses largely because Maine State law tightly regulates unsecured consumer debt and requires lenders who wish to provide these products to register with the State and abide by legal limits on fees and interest rates. For these reasons, Maine's experience with payday lenders differs from those of other States. Storefront payday lenders have not been much of a problem in Maine as they have been elsewhere. Banks also are not a source of abusive payday loans in the State of Maine. In fact, Will Lund, the longtime Superintendent of the Maine Bureau, who came to work at the same time I did for the Department, has told me that the Bureau has never fielded a consumer complaint over a payday loan when the lender was a State or Federally-licensed bank.

But that does not mean that Mainers are not victims of abusive payday loan practices. With the advent of the Internet, online and offshore lenders have direct access to Maine consumers. Not a day goes by when the Bureau does not get a call from the victim of an unscrupulous online lender who has been trapped—who has trapped the consumer into paying off a loan that was never legal to offer in the State of Maine in the first place, and that is what is so frustrating. For Maine to try to protect consumers against these offshore or online lenders is very difficult.

I understand that online payday loans still make up a minority of payday loan volume nationally, but I will predict right now that it will continue to grow and may eventually overtake storefront lending, particularly if States start following Maine's example and regulating payday lenders more closely.

This raises troubling issues, since online lenders typically get authorization from their borrowers to draw funds directly from their bank accounts. Since so many of the abusive payday loans affecting

Maine consumers were made by online lenders, this is a topic that I am particularly interested in exploring with our regulators today.

Again, Mr. Chairman, thank you so much for calling this important hearing.

The CHAIRMAN. Thanks for your personal perspective on this.

All right. The first panel. First, we are going to hear from David Silberman. He is Associate Director for Research, Markets, and Regulations at the Consumer Financial Protection Bureau, what we refer to as CFPB.

Then, Mark Pearce, the Director of the Division of Depositor and Consumer Protection at the FDIC.

And then to hear our guest, our witness from Maine, Eric Wright, a Staff Attorney for the Bureau of Consumer Credit Protection for the State of Maine.

So, Mr. Silberman.

STATEMENT OF DAVID SILBERMAN, ASSOCIATE DIRECTOR, RESEARCH, MARKETS, AND REGULATIONS, CONSUMER FINANCIAL PROTECTION BUREAU

Mr. SILBERMAN. Chairman Nelson, Ranking Member Collins, and members of the committee, thank you for the opportunity to provide you with an overview of the Consumer Financial Protection Bureau's recently released white paper on payday loans and deposit advance products.

This is perhaps the largest study to date on the short-term small dollar loan market. With this paper, the Bureau endeavored to provide all stakeholders with a shared set of facts on this market. What the Bureau found is precisely what Senator Nelson and Senator Collins were describing, that too often, consumers are finding themselves caught in a extended and costly period of debt, likely as a result of chronic cash flow shortages.

A little bit of background. In January 2012, the Bureau added payday lenders to its supervision program. We held a field hearing that month, our first field hearing as a Bureau, to hear directly from consumers and lenders and we began to study these issues, resulting in our white paper issued in April.

Our study found that payday and deposit advance loans lead many consumers into long-term expensive debt burdens. For far too many consumers, payday and deposit advance loans are traps. Returning every two weeks to reborrow the same dollar amounts at a high cost becomes a drag on the financial well-being of consumers already facing income shortfalls.

The findings in our study were developed from information obtained from a number of storefront payday lenders covering a 12-month period. For each account with activity in the first month of the study period, we then studied all activity over the full 12 months. Similarly, our deposit advance findings were developed from information obtained from a number of depository institutions offering this product. And for this group, we examined for a 12-month period a random sample of accounts that were eligible to receive a deposit advance during the first month of our study or during the previous quarter.

So allow me to summarize some of our key findings. First, we found that a fairly small segment of consumers using payday loans or deposit advances do so on an occasional basis. For example, 13 percent of the borrowers in our study took out only—payday borrowers in our study took out only one or two loans over 12 months, and 18 percent of the deposit advance borrowers obtained total advances of $750 or less over 12 months.

However, a much larger group of consumers used payday or deposit advance on a sustained basis. Forty-eight percent of the borrowers in our study took out 11 or more loans over 12 months, and 52 percent of deposit advance borrowers obtained advances totaling $3,000 or more. Fourteen percent of payday borrowers had 20 or more loans during that 12-month period, and the same percentage of deposit advance borrowers were advanced more than $9,000 over 12 months.

Many of these loans are taken on a nearly continuous basis, particularly for consumers who take out seven or more payday loans or obtained more than $3,000 in deposit advances. Most frequently, new loans are extended the same day or within a week or two of a prior loan being paid back. These consumers are unable to get to the next paycheck or the next regular infusion of cash without borrowing again.

While most consumers in our study report income from employment, 18 percent of the payday borrowers reported public assistance rather than employment as their source of income, and these consumers were more highly concentrated toward the lower end of the income range as compared to the borrowers with income from employment.

Although payday loans and deposit advances are sometimes described as tools to enable consumers to avoid either incurring overdraft fees or bouncing a check, in our deposit advance study, we were able to observe the relationship between the use of deposit advances and the incidence of overdraft and non-sufficient funds, or NSF, fees. And what we found is that 65 percent of those who took out a deposit advance also incurred at least one overdraft or NSF fee during the 12 months of the study. This percentage increased as the usage of deposit advance increased. It increased, going from 45 percent for light users to 83 percent of the heaviest users having one overdraft or NSF fee. And, similarly, the number of overdraft or NSF fees also increased with deposit advance usage, from an average of seven for light users to an average of 16 for the heaviest users.

The Bureau is concerned that many consumers use these high-cost products in a sustained way. Lenders do not currently assess whether a borrower can afford to repay a loan and the fees while meeting their other expenses. Because the entire loan is generally repaid or due to be repaid in each pay cycle, it appears to be hard for many consumers to repay the loan and meet other expenses without experiencing another shortfall, taking out another expensive loan, and/or overdrawing an account. Financial products that trigger a cycle of debt can exacerbate the precarious balance of consumers' financial lives.

The Bureau's white paper underscored significant consumer protection issues in the small-dollar loan market, and as we have said, further attention to these products is clearly warranted. The Bureau intends to continue its inquiry into small-dollar loan products to better understand why some consumers are able to use these products in a light or moderate way while others seem to find themselves trapped in prolonged borrowing cycles. We also would like to better understand the effectiveness of limitations that have been put into place by State laws and by providers, limitations designed to curb the sustained use that can lead to adverse financial consequences.

As the Bureau looks to next steps, we will determine how best to exercise our authorities to protect consumers while still enabling access to affordable credit. The Bureau will work to make sure that consumers can get the credit they need without jeopardizing or undermining their finances. As Director Cordray has said, debt traps should not be part of consumers' financial futures.

In closing, I just would like to thank the committee for its continuing work to protect older Americans. Protecting older consumers' financial well-being is one of the Bureau's most important missions. Our Office of Older Americans is working to help the approximately 55 million consumers age 62 and older lead safer and more productive financial lives. And as the older population dramatically increases the next two decades, we are likely to see an increase in the number of older consumers facing financial challenges, bringing substantial urgency to your work and to ours.

So, again, thank you for the opportunity to share the Bureau's findings. I would be happy to respond to your questions.

[The prepared statement of Mr. Silberman follows:]

Testimony of David M. Silberman
Associate Director for Research, Markets, and Regulation
Consumer Financial Protection Bureau

Before the
Senate Special Committee on Aging
July 24, 2013

Introduction

Chairman Nelson, Ranking Member Collins, and Members of the Committee, thank you for the opportunity to provide you an overview of the Consumer Financial Protection Bureau's recently released white paper on payday loans and deposit advance products.[1] This is perhaps the largest study to date on the short-term, small-dollar loan market. With this paper, the Bureau endeavored to provide a shared set of facts from which stakeholders of all types could engage in conversations with the Bureau on issues related to short-term, small dollar loans. What the Bureau has found is that too often consumers are getting caught in an extended and costly period of debt, likely as a result of chronic cash flow shortages.

Background

Payday loans and deposit advance products are small dollar loans often described as intended for use to cover unexpected expense or to bridge a temporary gap between paychecks. Payday loans are offered by non-banks and deposit advances are offered by a small number of depository institutions to their customers with deposit accounts. Lenders typically describe the cost of these products as a fixed fee per dollar borrowed; most commonly $15 per $100 for a payday loan and $10 per $100 for a deposit advance. Since most payday loans have a fixed due date, they are treated as closed end loans under federal law and lenders also are required to disclose the APR; there is no similar requirement for deposit advances which are structured as open-end lines of credit. Repayment for such services is timed to the borrower's next regular receipt of cash, which is most typically a paycheck, but may also be from unemployment insurance, social security benefits or, in the case of deposit advances, other electronic deposits.

In January 2012, the Bureau added payday lenders to its supervision program on top of its existing efforts to supervise the depository institutions that offer deposit advance products. We also held a field hearing in January 2012 in Birmingham, Alabama, to hear directly from consumers and providers of these products. At that time, the Bureau began its study, which resulted in our white paper, issued in April of this year. The purpose of all our outreach, research, and analysis is to help better understand the best approach to protect consumers while ensuring that they will have access to a small dollar loan market that is fair, transparent, and competitive.

1 CFPB's Payday Loans and Deposit Advance Products report can be accessed at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

The Bureau's study found that payday and deposit advance loans, while designed for short-term or emergency use, are leading many consumers into long-term, expensive debt burdens. For far too many consumers, payday and deposit advance loans are traps. Returning every two weeks to re-borrow the same dollar amounts at a high cost becomes a drag on the financial well-being of consumers already facing income shortfalls.

Overall, the Bureau found that a substantial percentage of consumers using either payday loans or deposit advances do so in a frequent and sustained way. Loans are often taken in rapid succession, with borrowers in nearly continuous debt, which is especially true for heavier users.

Key Findings

The Bureau's payday findings were developed from information obtained from a number of storefront payday lenders over a 12-month period. For each account with activity in the first month of the study period, we studied all activity over 12 months. Our deposit advance findings were developed from information obtained from depository institutions offering this product. For this group, we examined for a 12-month period, a random sample of accounts that were eligible to receive a deposit advance during the first month of our study or during the quarter prior to the start of our study.

Allow me to summarize some of the Bureau's key findings.

We found that a fairly small segment of consumers use payday loans or deposit advances on an occasional basis. For example, 13 percent of the payday borrowers in our study took out only 1 or 2 loans over 12 months. Eighteen percent of the deposit advance borrowers obtained total advances of $750 or less.

However, a much larger group of consumers use payday or deposit advance on a sustained basis. Forty-eight percent of payday borrowers took out 11 or more loans and 52 percent of deposit advance borrowers obtained advances totaling $3,000 or more. Fourteen percent of payday borrowers had 20 or more loans and the same percentage of deposit advance borrowers were advanced more than $9,000.

Many of these loans are taken out on a nearly continuous basis, particularly for consumers who take out seven or more loans or obtained more than $3,000. Most frequently, new loans are extended the same day or within a week or two of a prior loan being paid back. These consumers are unable to get to the next paycheck or the next regular infusion of cash without borrowing again.

While most consumers report income from employment, 18 percent of payday borrowers report public assistance rather than employment as their source of income. These consumers are more highly concentrated towards the lower end of the income range than consumers with income from employment.

Although payday loans and deposit advances are often described as tools to enable consumers to avoid incurring overdraft fees or bouncing checks, in our deposit advance study we were able to observe the relationship between the use of deposit advances and the incidence of overdraft and nonsufficient fund or NSF fees. The Bureau found that 65 percent of consumers in our study sample who took out a deposit advance also incurred at least one overdraft or NSF fee. This percentage increased as the usage of deposit advances increased, from 45 percent of light users to 83 percent of heaviest users. Similarly, the number of overdraft or NSF fees also increased with overdraft usage from a mean of seven for light users to a mean of 16 for heaviest users.

The Bureau is concerned that many consumers use these high-cost products in a sustained way. Lenders currently do not assess whether a borrower can afford to repay a loan and the fees while meeting their other expenses. Due to the fact that the entire loan amount is generally repaid or due to be repaid in each pay cycle, it appears to be hard for many consumers to repay the loan and meet other expenses without experiencing another short-fall, taking out another expensive loan, and/or overdrawing an account. Financial products that trigger a cycle of debt can exacerbate the precarious balance of consumers' financial lives.

Next Steps

The Bureau white paper underscored that consumer protection issues exist in the small dollar loan market, and that further attention to these products is warranted. The Bureau intends to continue its study of small dollar loan products to better understand why some consumers are able to use these products in a light to moderate way, while others seem to get trapped in a prolonged borrowing cycle. The Bureau would also like to better understand the effectiveness of limitations that have been put into place by state laws, trade associations, and institutions to curb the sustained use that can lead to adverse financial consequences for consumers.

As the Bureau looks to next steps, we will consider how best to exercise our authorities to protect consumers while protecting access to affordable credit. There is a demand for small-dollar credit products, which can be helpful at times for consumers who use them on an occasional basis and can manage to repay them. As Director Cordray has said, "the Bureau will work to make sure that consumers can get the credit they need without jeopardizing or undermining their finances. Debt traps should not be part of their financial futures."

Finally, I would like to thank the Committee for its continuing work to protect older Americans. Protecting older consumers' financial well-being is also one of the Bureau's important missions. Our Office of Financial Protection for Older Americans is working to help the approximate 55 million consumers age 62 and older lead safer, more productive financial lives. As the older population is expected to dramatically increase in the next two decades, we are likely to see an increase in the number of older consumers facing financial challenges. Among other things, unlike their younger counterparts, older consumers have less time to recover when they suffer a financial loss; are more often victims of fraud; are at higher risk for cognitive impairment, which can diminish their ability to make financial decisions; and, according to a Federal Reserve survey, three out of five families headed by a person 65 or older had no money in retirement savings accounts. And, these are just a few of the reasons why many older Americans are financially at risk.

Chairman Nelson and Ranking Member Collins, thank you for the opportunity to share the Bureau's findings. I am happy to respond to your questions.

The CHAIRMAN. And, Mr. Silberman, we want to know from you in the questions what are those next steps and when are we going to see some results by virtue of your regulatory power on the protections.

Mr. Pearce.

STATEMENT OF MARK PEARCE, DIRECTOR, DIVISION OF DEPOSITOR AND CONSUMER PROTECTION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. PEARCE. Chairman Nelson, Ranking Member Collins, and members of the committee, thank you for inviting the Federal Deposit Insurance Corporation to participate in today's hearing related to payday loans.

I am pleased to have the opportunity to share our recently proposed guidance on deposit advance products, which are quite similar to payday loans, as well as to discuss the FDIC's research and perspective related to payday loans, small-dollar credit, and older Americans.

Recent FDIC survey results show that in the previous 12 months, almost six percent of households obtained credit from an alternative financial service provider, such as a payday lender or a pawn shop. For a household headed by someone 65 or older, the proportion was nearly two percent, and for households headed by a person between 55 and 64, the proportion was nearly four percent. Our research also indicates that among those who use alternative credit products, households headed by a person 55 or older account for 17.5 percent of all users of those products.

In 2003 and again in 2005, the FDIC provided guidance to the institutions we supervise regarding the risks associated with offering payday loans. The guidance provided our supervisory expectations that institutions offering these products should monitor customers' use of payday loans and avoid making recurring short-term payday loans to customers with long-term credit needs and to take other steps to appropriately manage the risks of offering these loans.

Recognizing that consumers need access to small-dollar loans to handle unexpected emergencies, the FDIC has sought opportunities to encourage financial institutions to offer responsible small-dollar loans. In 2007, the FDIC issued guidance to encourage financial institutions to offer affordable small-dollar loans. This guidance encourages institutions to offer products that are affordable and structured with payments that reduce principal rather than repayment in one immediate lump sum.

In addition to this guidance, we initiated a pilot program to demonstrate the feasibility of small-dollar lending by financial institutions in a safe and a sound manner. The loans made part of this pilot program were for $2,500 or less and they met certain common standards. The loans had to be 90 days or longer in term. They had to have an Annual Percentage Rate of 36 percent or less. And in addition, banks utilized streamlined underwriting to establish that consumers could reasonably be expected to make their loan payments and have sufficient funds remaining to meet their basic living expenses and other obligations while still providing a loan decision to them typically within 24 hours.

Twenty-eight financial institutions with assets ranging from $28 million to nearly $10 billion participated in our two-year pilot. Participating banks made over 34,000 small-dollar loans for a total of approximately $40 million. The performance of these loans were shown to be in line with the performance of other unsecured consumer credit products, and the pilot concluded that it was feasible for banks to offer such loans in a safe and sound manner.

Since we issued guidance on payday loans and affordable small-dollar loans, we have observed that a small but growing number of large financial institutions have begun to offer products that share characteristics with payday loans. These products, called deposit advances, are typically open-end lines of credit that have high fees, very short lump sum repayment terms, and limited or no analysis of the consumer's ability to repay the loan without subsequent borrowing.

Our concern was heightened when we became aware that third parties had begun to market these deposit advance products to smaller community banks that had not traditionally offered payday loans or similar products.

Although the products and practices appeared to be concentrated in a limited number of institutions, we thought it was important to be proactive to develop guidance to ensure that FDIC-supervised institutions that were considering offering these products were aware of the significant safety and soundness and consumer protection risks associated with these products.

In April, the FDIC issued proposed guidance that outlines the credit, reputational, legal, third party, and compliance risks related to these products, as well as our expectations regarding how institutions can manage those risks. In particular, our proposed guidance details our expectation that institutions will engage in prudent underwriting to determine the borrower's ability to repay the loan without the need for recurring borrowing. We have received over 100 comments on our proposed guidance from a variety of stakeholders, including some members of this committee. We are carefully reviewing these comments as we work to finalize our guidance.

Thank you again for the opportunity to testify today on this important topic. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Pearce follows:]

Oral Statement of
Mark Pearce
Director, Division of Depositor and Consumer Protection
Federal Deposit Insurance Corporation
on
Payday Loans: Short-Term Solution or Long-Term Problem
Special Committee on Aging
U.S. Senate
July 24, 2013

Chairman Nelson, Ranking Member Collins, and members of the Committee, thank you for inviting the Federal Deposit Insurance Corporation to participate in today's hearing. I am pleased to have the opportunity to share our recently proposed guidance on deposit advance products, as well as to discuss some of the FDIC's research and experiences related to small dollar credit needs and older Americans.

This is a timely topic. Recent FDIC survey results showed that in the previous 12 months, almost 6 percent of households obtained credit from an alternative financial services provider, such as a payday lender or a pawn shop.[1] For households headed by someone 65 or older, the proportion was nearly 2 percent, and for households headed by a person between 55 and 64, the proportion was nearly 4 percent. When narrowing the data to households that are unbanked, the numbers rose to close to 17 percent for all households, 6 percent for households headed by someone 65 or older, and nearly 10 percent for households headed by someone between 55 and 64. These figures would appear to indicate that consumers have small dollar

[1] *See* 2011 FDIC National Survey of Unbanked and Underbanked Households (*available at* http://www.economicinclusion.gov)

credit needs, and that these needs become more pressing for those who do not have a bank account.

As you know, the FDIC is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System, which means the banks we supervise are generally the smaller community banks. The FDIC examines these banks for operational safety and soundness, and for compliance with consumer protection laws. Larger banks and bank holding companies are generally supervised for safety and soundness by the Office of the Comptroller of the Currency and the Federal Reserve, and for consumer protection compliance by the Consumer Financial Protection Bureau (CFPB).

The FDIC has recognized the need for responsible small-dollar loan products for a number of years and issued guidance in 2007 to encourage insured institutions to offer such products to consumers to meet this need.[2] The guidance specifies that these products should be affordable, have reasonable interest rates with no or low fees, and be structured with payments that reduce the principal balance. That same year, we initiated a pilot program which demonstrated that affordable small dollar loans can be done safely and are feasible for banks.

At the same time, in its role as supervisor, the FDIC has provided guidance to delineate risks and troublesome practices that may be associated with other kinds of small dollar credit

[2] *See* Affordable Small-Dollar Loan Guidelines (June 19, 2007), *available at* http://www.fdic.gov/news/news/financial/2007/fil07050a.html.

offerings, such as payday loans. In 2003 and 2005, the FDIC provided guidance to banks that offered or were considering offering payday loans (either directly or through partnerships with third parties), stating our supervisory expectations that institutions should monitor customers' use of payday loans, prevent customers from relying excessively on the product, and take other steps to appropriately manage risks.[3]

While the FDIC continues to encourage banks to respond to the small dollar credit needs of its customers, we have observed that some of the products and practices that were beginning to appear in some segments of the industry closely resembled ones that had previously caused concern. Although the products and practices appeared to be concentrated in a limited number of institutions, we felt it was important to provide guidance to ensure that FDIC-supervised banks considering offering these products are aware of the potential of harm to consumers, as well as the potential for safety and soundness concerns.

As a result, earlier this year, the FDIC proposed guidance on deposit advance products, a credit instrument that can be quite similar to payday loans as evidenced by high fees, very short lump-sum repayment terms, and inadequate attention to a consumer's ability to repay the loan. A copy of the proposed guidance is attached to my testimony.[4] The OCC issued nearly identical guidance at the same time. The proposed guidance outlines supervisory expectations, including

[3] *See* Press Release, FDIC Issues Examination Guidance for Payday Lending (July 2, 2003), *available at* http://www.fdic.gov/news/news/press/2003/pr7003.html ; Guidelines for Payday Lending (March 1, 2005), *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[4] *See* Press Release, FDIC Issues Proposed Guidance on Deposit Advance Products (April 25, 2013), *available at* http://www.fdic.gov/news/news/press/2013/pr13031.html.

detailed underwriting expectations, to make banks aware of what examiners would assess in conducting a review. Before issuing the guidance in final form, we wanted to solicit public comments, and we received over 100, including from members of this Committee. We currently are carefully reviewing the comments as we work to finalize the guidance.

As I mentioned earlier, it is possible for banks to make affordable small dollar loans that do not include the features that pose unnecessary risks for banks and their customers. From 2007 to 2009, the FDIC conducted a pilot project with 28 financial institutions with assets ranging from $28 million to nearly $10 billion to demonstrate the feasibility of small dollar lending for banks. The loans made as part of this pilot program were for $2,500 or less and met certain core standards. For example, the loan terms had to be 90-days or longer, and prudent, streamlined underwriting was required to establish that consumers could reasonably be expected make their loan payments and have sufficient funds remaining to meet basic living expenses and other obligations. Annual percentage rates on these loans were 36 percent or less, with low or no fees, and a loan decision was typically provided within 24 hours.

Ultimately, as a result of the pilot, these banks made 34,400 small dollar loans for a total of approximately $40 million. The performance of the loans was shown to be in line with the performance of other unsecured consumer credit products and the pilot concluded that it was feasible for banks to offer such loans in a safe and sound manner. I have included a copy of a report on the pilot with my testimony.[5]

Lastly, I thought this Committee would be particularly interested to learn about an effort the FDIC is undertaking with the CFPB to provide older adults with resources to help them make better financial decisions. Our two agencies recently released a new financial resource tool targeted to older adults.[6] This financial literacy tool --"Money Smart for Older Adults" -- aims to help older individuals and their caregivers prevent elder financial exploitation through increased awareness and understanding of possible pitfalls and of prudent money practices. The module is part of a larger FDIC Money Smart program that serves as a comprehensive financial education resource designed to help low- and moderate-income consumers enhance their financial skills and create positive banking relationships.

Again, thank you for the opportunity to testify today. I would be happy to address any questions you might have.

[5] *See* "A Template For Success: The FDIC's Small-Dollar Loan Pilot Program" (FDIC Quarterly, 2010, Volume 4, No. 2), *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf.

[6] *See* Money Smart for Older Adults Training Module, *available at* http://www.fdic.gov/consumers/consumer/moneysmart/olderadult.html.

The CHAIRMAN. Be thinking about the question, since you started this with your pilot in 2007. It is like the camel's nose getting under the tent and it has blossomed into something that is not in the interest of the consumer, where they are paying 300 percent. You put a limit on the annual rate that you testified and here we are going to have testimony that some of these banks that you are one of the regulators are charging upwards of 300 percent in fees and interest. So we would like to know what you can do about that.

Okay. Mr. Wright, please proceed, and welcome from Maine.

STATEMENT OF ERIC WRIGHT, STAFF ATTORNEY, MAINE BUREAU OF CONSUMER CREDIT PROTECTION

Mr. WRIGHT. Chairman Nelson, Ranking Member Collins, and members of the Special Committee, thank you for your invitation to appear.

We at the Bureau of Consumer Credit Protection in Maine deal with the brutal reality of Internet-based payday lenders every day. Early last week, a consumer from Monticello in Senator Collins' home county called us to say that she has eight payday lenders hot on her heels, most from Internet-based Tribal lenders. She is in a real pickle.

Previously, another woman had called to say that she owed $16,000 on six loans. Another consumer may tell us—did tell us that having already paid, say, $750 on a $300 loan, she reported, "now they are telling me that I still owe the $300 that I borrowed."

A consumer in Gardiner, where my office is located, near Augusta, the State capital, recently complained, "They have been harassing me, calling me at work. I have asked them to stop, but they will not."

For them, horrors. For us, another day at the office. When such calls are routine as they are, something is very wrong. Here is a snapshot.

As Senator Collins pointed out, lenders in Maine must be licensed to make payday loans lawfully. The Internet-based payday lenders are never licensed and interest rates that they charge are excessive under Maine law, so their loans are illegal. This does not mean that the consumer has no obligation to pay back the principal borrowed. One has at least a moral obligation to do so. But it does mean under our unlicensed provisions of our law that the consumer does not owe any interest on the amount he or she has borrowed.

Many callers—probably most—have multiple payday loans. They often take out one, then a second to pay off the first, then a third to pay off the second, and so on. These debts can go on endlessly, because all the money that is being paid if one does not pay back the loan fully on the first maturity date goes to paying interest and the loans just drive people deeper and deeper into debt.

When the consumer has been paying—what the consumer has been paying, as I say, is only interest, associated fees, finance charges, and automatic rollover costs, whereby the lender asserts that the consumer has, often without knowing, obligated himself or herself to pay new loans.

The consumers often have been bullied and tormented by collection calls and threatened with all manner of impending doom, and these are real examples. If they do not pay it now, a court action will be filed. If they do not pay it by credit card by 2:00 p.m., the caller will send someone to the consumer's home or workplace to deal with her to the fullest extent of the laws in her county. If they do not pay by 4:00 p.m. today, they will be arrested. They are threatened with jail or fraud of a financial institution. They are told their wages will be garnished, or that their driving privileges will be suspended or revoked, or that their employer will be notified of their debt status, or that the lender will notify the credit bureaus, thus damaging their credit.

Now, we deal with these situations in two primary ways, or two primary circumstances. One is often before the principal has been paid off and the other is after the principal has been paid off. In either event—or let me go back and talk about the first. The first is to make sure that the consumer understands that he or she must pay off the loan, and we tell the consumer how to do that, and it is certainly not to pay by personal check but rather by a bank check and tell the lender, this is how I will pay, and that gives the lender to refuse if they do not want to accept that method. And we direct the consumer to be sure that they are telling the lender that this is at the direction of State regulators.

If consumers have paid back more than they borrowed, they should consider the debt satisfied and they should, at our advice, close the bank account, their bank account that the lender has been debiting. In Maine, no payday lender has ever brought suit against a borrower who refuses to continue to pay more and more. Legally, they cannot do so, because as foreign businesses—that is, out-of-State businesses—they are not registered to do business in the State and so cannot maintain, under Maine law, court actions. They cannot use Maine courts when they themselves are operating in violation of Maine law.

I also assure individual consumers that as a practical matter, these companies cannot chase individuals here and there across the country to bring actions against all the people they think owe them still more and more money.

None of this minimizes the fear that consumers feel and the almost self-loathing that consumers have for having put their families at financial risk.

And, finally, whether or not we can locate the lenders, we issue cease and desist orders on our public Web site to warn away consumers, and we also attempt to get collectors to cease their efforts to collect by convincing them that the consumer knows their tactics and will not be paying any more.

I welcome any questions you have.

[The prepared statement of Mr. Wright follows:]

Written Testimony of Eric E. Wright, Staff Attorney for the Maine Bureau of Consumer Credit Protection

Submitted to the Senate Special Committee on Aging
Wednesday, July 24, 2013, 2:00 p. m.
Room 562, Dirksen Senate Office Building

Chairman Nelson, Ranking Member Collins, and members of the Senate Special Committee on Aging: I am Eric E. Wright, the Staff Attorney for the Maine Bureau of Consumer Credit Protection. The Bureau is a Maine state governmental agency with responsibilities, given by the Maine Legislature, to administer and enforce laws in some two dozen areas relating to consumer credit and other consumer financial services. We appreciate your invitation to have our Bureau participate in this hearing.

Payday loans are short-term, extremely high-interest rate loans, generally of less than $1000, and most often between $200 and $500, secured by lender access to consumers' bank accounts. Payday lending has been around for longer than anyone can probably say for sure. The name is derived from the manner in which the payment is obtained by the lender from the consumer. Historically, workers borrowed money on a given day, a Monday, provided a post-dated check to the borrower, which coincided with the borrower's payday, and the lender, after holding the check until that next payday, Friday, and cashed it at that time.

The means by which today's payday loan industry on a national scale operates have changed. Today, Internet-based payday lenders require that borrowers, as a condition of borrowing, provide their bank account and routing numbers so that the lenders can, by automated clearing house (ACH) transactions, periodically debit the accounts of borrowers after they electronically deposit the loan amount in the consumer's account. That mode of operation is both an unsurprising reflection of modern technology and an invitation for abuse by the unscrupulous. These transactions present problems for regulators. Today, every day, there exist problematic payday loan transactions. It is only these Internet-based payday lenders that I am referring to today.

The essential problem is that consumers, too often unaware of fees, finance charges, automatic rollover provisions, and interest associated with payday loans, wind up paying back many times the principal amounts they have borrowed. Being unable as a practical matter to pay off the principal because lenders refuse to assign payments to that, borrowers face the prospect of being required to pay back still more and more, with no end in sight. The results: consumers are plunged further into debt, and the lenders rake in unseemly amounts of money.

It is these lenders that I characterize as unscrupulous, for several reasons. First, the money these companies are making must be considered by any fair measure as hideously large. Second, in addition to these lenders making profits that seem well beyond reasonable, they do so without regard for the licensing and interest-rate limitation laws of the states in which the consumers live. Third, they do so without apparent concern for the impact on consumers. While the payday loan industry maintains that it meets a need—to assist individuals who are unable to obtain affordable loans from more traditional sources—the industry has to know very well that what it is doing is making enormous amounts of money from those least able to afford it.

There have been studies done about the demographics of borrowers. There is some truth to a commonly held three-fold perception of borrowers—lower income, poor credit, and an attendant, critical need—but not necessarily as much as one might assume. Studies in the last few years, including by the Pew Charitable Trusts, have found the more likely borrowers are white women, parents, divorced or separated, between 25 and 44 years old, and making less than $50,000 a year. Payday loans are attractive not just to those with lower incomes: while 25% earn less than $30,000, 22% earn over $60,000 and $15% over $100,000. One in five borrowers is over 50. Four out of 10 payday loan borrowers are homeowners.

We pay considerable attention to what has happened and how we can help, certainly more so than abstract demographics. Nevertheless, Maine's experience is that payday loan arrangements often aggravate the depletion of resources of those who are already financially vulnerable. In our experience, payday loans feed on the desperation of people in need. No one has ever told me that he or she took out a payday loan because one *wanted* to, but only because one felt one *needed* to.

Our Bureau currently licenses only seven payday lenders, including a few located out of state, and one in Maine with seven locations. They do not present problems, because they obey the law. Maine requires payday lenders to be licensed as "supervised lenders" (a category that applies to all high-rate, unsecured lenders) and to post a surety bond. Maine law limits finance charges, calculated *per annum*. On unsecured loans of less than $2000, Maine limits the interest rate to 30% APR. Because of the very short-term nature of payday loans, these charges would be slight, and in recognition of the complexities of calculating APRs with payday loans, the model Uniform Consumer Credit Code in 1974 provided as an alternative a flat fee to be imposed on short-term loans. Maine adopted this approach in 1975. These fees are strictly limited in Maine—for instance, $25 on a loan of $250 or more.

It is the unlicensed, Internet-based companies that we hear about from consumers. These payday lenders, which I am addressing today, do not want to be licensed by the state of Maine, because they do not want to adhere to our fee limitations. These are illegal loans because the lenders are unlicensed and exceed Maine's finance charge restrictions. We have issued publically accessible Cease & Desist orders against some of these companies that, we hope, will at least warn consumers away.

To be sure, borrowers, sadly, do not always take out just one loan. Multiple loans are not unusual. More than one consumer I have dealt with has had 10 or 12 or more at the same time. Some people take out a second or third to pay off a first or second—or, more precisely, to pay off *the interest and fees* on those prior loans. In a case I recall in particular a Maine consumer borrowed $200 and wound up paying back $1400. (We managed to get that consumer's $1200 back for her, but I do not recall how, and that result is a rare turn of good fortune.) In another, a Maine consumer borrowed $300, repaid $360, and then was told he still owed another $593.84. In the year 2012 alone, our Bureau handled 86 formal complaints against payday lenders, and in addition took many more calls from consumers with questions.

The annual percentage rates that come with these loans have been reported to *average* 470%. A 2011 study of one state, Kansas, found six lenders charged between 378% and 780%. The APRs have been found to be as high as 1825% with one well-known lender. If one is charged $25 per $100 per week, the equivalent APR is 1300%. After just two months, the consumer will have paid $200 in interest on an original debt of $100, with the entire principal debt still due. Unless one pays back the loan, including interest, when it is first due, the finance charges quickly spin out of control. Consumers seldom can repay fully, and so suffer enormous shock when they finally realize how much they are required to pay.

Finally consumers in these predicaments call our Bureau. Too often they do not know how much they have paid back, but they have a gnawing sense that maybe their debt should be regarded as sufficiently repaid, or they simply want to know what their rights are. These consumers inevitably have been pushed more deeply into debt by their payday loans. We take such calls on a nearly daily basis. Many callers tell us of unseemly efforts to get them to pay more than the consumers can understand they owe.

The calls are frustrating because these companies do not want consumers and regulators to know where they are located and are mostly just unresponsive to us. These companies typically do not list a physical or mailing address in the websites or, when they occasionally communicate by fax, on their stationery. The locations of some have been found—all across the United States, and in Canada, the Caribbean, and even Malta. I suspect many of the problematic companies of whom I speak actually are not truly located anywhere, other than somewhere to maintain computer terminals to send the loan to an individual's account and then to make ACH withdrawals, seemingly endlessly, from consumers. They tend to mask their phone numbers so the numbers do not appear on caller IDs. Even when we know how to reach a company, the lender normally will just ignore us if we try to intervene on behalf of the consumer.

These companies certainly do not want to abide by the finance charge or interest rate limitations of the states in which the borrowers live. If there is some truth to the notion that the astronomically high fees associated with payday loans are explained by a higher than ordinary default rate among borrowers, there is also this: the unwillingness of lenders to comply with licensing requirements of states is precisely because the lenders, if licensed, would then be constrained by the limitations on how much they can charge, and this they do not want to do. In short, these lenders are not motivated by an altruistic sense of helping those in some difficulty, but more certainly are driven by pure greed.

There are related issues. First, there are efforts at collection of debts, whether by third-party debt collectors whose activities are governed by the Fair Debt Collection Practices Act, or by the lenders themselves. These efforts begin either because the consumer does not have sufficient funds in his or her account to cover the next charge to be taken by the lender, or because the consumer has closed his or her bank account, so the lender cannot take more money.

I have long thought that honey works better than vinegar, but too many collection efforts involve threats and intimidation of innocent consumers who know no better than to worry when they hear:

- that they must pay by credit card by 2:00 p. m. today
- that will be arrested and jailed
- that a court case will be filed against them for defrauding a financial institution
- that their wages will be garnished
- that they will be dealt with to the fullest extent of the law
- that their privileges to drive will be taken away

—or that any of these things may happen to a family member. Too often these calls are made, improperly, to employers or others in one's family. Some calls come from phony collectors where, in fact, there has never been a loan taken out by the consumer who is subjected to a call. A favorite tactic is to pretend the caller is an officer of the Federal Bureau of Unpaid Debt, or some such nonexistent agency. Or a written notice will arrive with something mimicking a seal used by a federal agency.

Consumers generally do not know how to respond to these aggressive, illegal tactics. That they *are* scared and distraught simply proves they are vulnerable to such techniques. When they call us we can satisfactorily advise them that nothing bad is going to happen because they are protected by our state's laws and court rules. In Maine, wages cannot be garnished without a court order. People cannot be arrested for civil debts. These companies cannot—and as a practical matter, are unable to—maintain a court action in Maine if they are not registered with the Secretary of State as a foreign (out-of-state) company. No payday lender has ever used the Maine court system to advance its claim that a consumer owes it still more money.

The phone calls impose a real emotional toll, however. I suppose our advice—close your account so they cannot take any more money from you, but get ready for some nasty calls, and tell your family and your employer to get ready for nasty calls—is similar to that provided by other consumer protection agencies in other states. In a number of cases, the lenders start calling even before the principal has been paid—thereby revealing that the charges being imposed are not being applied to payment of principal, but to all the other imaginable costs. And worse: sometimes lenders cause consumers' bank accounts to become overdrawn by making withdrawals so often.

Second, there are possible credit report consequences. Under the Fair Credit Reporting Act, creditors can report to credit (or consumer) reporting agencies. Those national agencies have a duty to report accurately. The national credit reporting agencies have told me that they do not accept reports of payday loan debts because they consider them notoriously unreliable. But I cannot say that this is uniformly the case. And even if it is true that the national credit reporting agencies do not, or do not always, report payday loan debts, this is most tellingly an acknowledgement that borrowers do not, or should not, owe the amounts the lenders claim.

Third, we have seen more and more lenders who claim to be associated with or adjuncts of Native American Tribes that have been given sovereign immunity by Congress by, for example, the Indian Reorganization Act of 1934. Such lenders assert that they are governed solely by tribal laws and that states have no authority to regulate them. At least seven federally-recognized Tribes own or are associated with payday lending companies. This is an added feature that some lenders assert allows them to avoid licensing laws and finance charge restrictions.

Of these lenders, some are legitimate creations of a Tribe, but by others this is just a ruse. The Chief of a small Tribe in Oklahoma, when asked where his payday loan operation was located, said, "somewhere in Kansas." Most prominently, one person, well known to regulatory authorities especially in western states, owns as many as nine Internet-based payday lending companies, all of which, he has claimed, are entitled to the sovereign immunity of the Native American Tribe of which he is a member, solely by virtue of his membership and his residence on the Tribal land. Yet the Supreme Court has said that "the doctrine of sovereign immunity . . . does not immunize individual members of [a] Tribe." *Puyallup Tribe, Inc. v. Dept. of Game of Washington,* 433 U.S. 165, 171-72 (1977).

In any event, in our view sovereign immunity is, at best, a defensive and protective legal device, not a tool that gives one the right to affirmatively come into Maine and violate our nondiscriminatory state laws. Even if sovereign immunity does not allow us to require that tribal lenders obtain a license, those lenders should not have *de facto* license to violate our laws. The Supreme Court has said: "There is a difference between the right to demand compliance with state laws and the means available to enforce them." *Kiowa Tribe of Oklahoma v. Manufacturing Technologies, Inc.,* 523 U.S. 751, 755 (1998). And: "Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State." *Mescalero Apache Tribe v. Jones,* 411 U.S. 145, 148-49 (1973).

There are others who know far more than I do, and who have written scholarly law review articles, about sovereign immunity for Native American Tribes. Several states and the Federal Trade Commission have litigated these issues. I do not minimize the complexities of a legal abstraction. But there are real consequences to the status. Given that tribal sovereign immunity, "developed almost by accident," *Kiowa Tribe,* 523 U.S. at 756, as the Court has said, it seems reasonably clear that Congress has authority to act to modify the immunity that allows many payday lenders associated with tribal entities to continue to flout state loan fee and interest rate laws. *See* Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?,* 69 Wash. & Lee L. Rev. 751 (2012).

If, as the United States Court of Appeals for the Second Circuit held just last week, the tribal entity that owns and runs Foxwoods Resort and Casino in Connecticut is liable to pay state tax on personal property—slot machines it leases—because such a tax is an important feature of the uniform application of the state's tax system (*Mashantucket Pequot Tribe v. Town of Ledyard,* Nos. 12-1727-cv(L) & 12-1735-cv(CON) (2d Cir. July 15, 2013)), then surely Congress can legislate in the area of interstate payday lending under the authority of the Indian Commerce Clause and ensure that payday lenders abide by nondiscriminatory state legislation. This calls for a global, legislative approach that will be much more efficient and effective than trying to fight these battles a case at a time in court or in the administrative process.

If one were able to get a handle on the size of APRs, fees, and rollover provisions associated with Internet-based payday lenders, the worst of the abusive practices of those lenders could be eliminated. I end many calls with consumers who are up against, from their perspective, who-knows-what-kind of trouble, by telling the consumers, "Promise yourself you will not do this again." Uniformly, they say they never will. They are not clamoring to take out new payday loans.

On behalf of the Maine Bureau of Consumer Credit Protection, thank you for inviting me to testify. I hope these remarks contribute to focusing the Committee's attention on this troublesome financial practice.

The CHAIRMAN. Understand that I come to the table having been involved in this issue with regard to payday loans to our active duty military and of which we had a witness table that was full of the Joint Chiefs of Staff, which included the Chairman and the Vice Chairman, years ago that said this thing had to stop with regard to their military members because they were getting fleeced right outside the gates of the military installation. And as a result, we passed a bill that set a cap of 36 percent APR on those payday loans made to active duty servicemembers and their dependents and, of course, granted the regulatory authority.

Now, if we can do that and if we are dealing, as you all have testified—and I am going to turn the gavel over to Senator Collins because I am going to have to temporarily go and testify in front of another committee—if we can do that with active duty military and if, in fact, you all are the regulators of Federal institutions that have now gotten into this business, why can you not do the same, or do you need some kind of legislative authority? I cannot imagine. I would think that you have the regulatory authority. I would like to hear from you, Mr. Silberman and Mr. Pearce.

Mr. SILBERMAN. Thank you, Senator Nelson, for the question and for focusing our attention on the concerns of servicemembers, which, as you know, is a very large area of concern for the Bureau. Holly Petraeus, who runs our Office of Servicemember Affairs, has been an effective advocate for servicemembers and has helped sort of bring sensitivity to servicemembers' issues throughout the entire Bureau.

We—last year, Congress amended the Military Lending Act to give the Bureau the authority to enforce the Military Lending Act for the first time and also a seat at the table in consulting with the Department of Defense around regulations under the Military Lending Act. And while that is a relatively new authority, I can assure you that we are actively engaged with the Defense Department in consultations around the regulations affecting the Military Lending Act and affecting servicemembers directly.

The CHAIRMAN. All right. We did that. We passed that several years ago. I want to know, what about now, particularly with emphasis on these folks that we have just heard about here and that you are going to hear more of.

Mr. SILBERMAN. So, with respect to the very specific question you asked, the Dodd-Frank Act does expressly state that the Consumer Financial Protection Bureau cannot establish a usury cap. So, if it were Congress' judgment that the kind of legislation that was enacted for military borrowers should apply beyond the military sector, beyond protecting servicemembers, we would require additional Congressional authority.

We do, however, have a large amount of authority. Our job is to assure that the laws that are on the books are implemented effectively and enforced effectively. We have large authority under that and we will use that authority to the full extent that we can to try and regulate practices to assure that these markets are, in the words of the Dodd-Frank Act, fair, transparent, and competitive.

The CHAIRMAN. Mr. Pearce, I am not entirely satisfied with the confidence of what Mr. Silberman has just said that this is going to stop this fleecing of folks with 300 percent interest. You do have jurisdiction and so does the Comptroller of the Currency over these Federal institutions. So what can you do about it?

Mr. PEARCE. Right. So, first of all, I should probably say that, currently, to our knowledge, there are not any institutions that we directly regulate that are offering deposit advance products with the kind of interest rates that you are talking about, and Mr. Silberman is correct that the Military Lending Act is somewhat unique in that it establishes a Federal usury ceiling of 36 percent interest that we do not have in other areas. It is normally a State law matter as to what the interest rate for each State is.

That having been said, that does not mean that we cannot take some action to address some of the problems with the product. As I mentioned in my opening statement, we have issued proposed guidance that takes a look at the deposit advance product which has those high fees, but also really short repayment which leads to that cycle, recurring cycle that you pointed out in your opening remarks. We can identify that there are some issues there that we can address and encourage institutions to make sure that they are underwriting the borrower so that they can repay the loan that they take out over time rather than in one single up-front lump sum.

So that really—we do have authority to require institutions to operate in a safe and sound manner and make loans with prudent underwriting and we are currently working on that.

The CHAIRMAN. Well, other banks outside the FDIC scope are offering these high interest loans, banks regulated by the OCC and the Fed. Do we need to go to them to get them to crack down?

Mr. PEARCE. Well, yes. So, I cannot speak for the OCC or the Federal Reserve. I would note that OCC, when we issued our proposed guidance, the OCC issued nearly identical guidance on the same day and the Federal Reserve also communicated that it had significant concerns with these products. So I would think it would be fair to say that all the regulators, those here and those who are not here today, have significant concerns with the deposit advance product.

The CHAIRMAN. Senator Collins.

Senator COLLINS [presiding]. Thank you, Mr. Chairman, and I remember your good work on the issue with our military personnel. I think you and Jim Talent worked hand in hand on that.

I want to put this issue into a broader context just to illustrate how pervasive of problem it is. According to the Pew Charitable Trust, an estimated 12 million Americans take out payday loans. These borrowers spend about $7.4 billion in payday loans annually. Payday loans are obtained at more than 20,000 storefronts and hundreds of Web sites. To me, most startling, the CFPB found that 22 percent of consumers secure these loans with public assistance or retirement income sources.

So I think the picture that is painted is of lower-income individuals who are frantic for some short-term money spending enormous amounts in order to get these loans. And I would suspect that there is an educational program that is needed here to alert them to the downsides of these loans.

I was thinking about—since I am in the midst of refinancing a mortgage—of how much paperwork you have to go through and how many disclosures there are. And that is one of the issues that I am going to raise, is what kind of disclosures do payday lenders have to provide, and we will go right down the panel. Mr. Silberman.

Mr. SILBERMAN. Senator Collins, with respect to under Federal law, which we are responsible for enforcing, a payday loan, a storefront payday loan or a closed-end payday loan is subject to disclosures with respect to the APR, so that the lender would have to disclose what the APR is to the consumer.

The deposit advance product we have been discussing is structured as an open-end line of credit, and under the law as it currently stands, there is no comparable requirement for disclosure of an interest rate or an APR. The fees would be disclosed. And that is certainly one of the issues we will be looking at, is whether the disclosures that are currently required are effective to achieve the goal of assuring that consumers can understand, appreciate, and make judgments with respect to the cost and risks of this product.

Senator COLLINS. Mr. Pearce.

Mr. PEARCE. Sure. I would agree with what Mr. Silberman said, but also, I would add to that that most of the research on these types of products indicate that people utilize them not for one time emergencies, but really to meet basic living expenses——

Senator COLLINS. Good point.

Mr. PEARCE [continuing]. And when the disclosures in the marketing of these loans will often indicate that these loans are not appropriate for long-term use. And so there may be disclosures that they are expensive products, but they really target that they are for short-term use only.

I think from our proposed guidance, we want to make sure that institutions that are marketing the products actually have the products line up with how they are marketing, so that if they are intended for short-term use, they actually are used for short-term use and not for this long-term recurring, as so many borrowers, as Mr. Silberman pointed out in his research, clearly use them.

Senator COLLINS. Mr. Wright, you gave very vivid examples of consumers who had gotten into trouble, then often were harassed for repayments and who were paying exorbitant amounts on these loans despite the fact that Maine has a usury law that limits the interest rate and the fees. And I would note that usury laws usually are considered at the State, not the Federal, level. Do you think these consumers had any idea what they were getting into——

Mr. WRIGHT. No.

Senator COLLINS. Have you taken a look at any of the online disclosures that they have——

Mr. WRIGHT. Yes. Beyond the—and I am speaking here today only about the online or Internet-based payday lenders——

Senator COLLINS. Right.

Mr. WRIGHT [continuing]. Not the storefront folks, not the banks. We do not have problems, as you pointed out in your opening statement, with the banks. The storefront lenders obey the law. Those folks are licensed with us and those people do not give us any heartburn, or consumers, I should say.

But these—the Internet-based payday lenders, like any lenders, are required to comply with Truth in Lending requirements. What they do not disclose is the true cost in dollars and cents of the loans that consumers are taking out, so that you can use any figure you want. You can put—inject into that any finance charge you want, and that is all done by—set by the lender at a rate or an amount that he or she thinks that they can get away with. You can calculate it all out and you can arrive at enormous, astronomical APRs, 1,800 percent in some cases.

What the consumer is not told—they are told—for instance, they are told the amount you are financing, say, $500. Here is the finance charge, say, $90, repayable in two weeks. Well, $590 does not sound bad, but, of course, the reality is that somebody who takes out one of these loans is not going to be in much of a financial position to repay $590 in two weeks when they had to two weeks earlier take out the loan to begin with. And so it does not get repaid, and then what happens is, because it is not repaid on time, these loans get rolled over. The interest rates fly away.

And they might get—this is a real example that I have just given you. The annual APR—this is a real case—as calculated by the lender in the case I am speaking of, is about 469 percent. Well, that sounds pretty awful, but also fairly abstract. The reality is that the true cost of that $500 loan, calculated by APR, is $2,300.

Senator COLLINS. Gee.

Mr. WRIGHT. Over $2,300. And so I would say to you, yes, that there is room for improvement in disclosure by which the consumer has a better understanding of what he or she is really getting into.

Senator COLLINS. Because, again, to think of a mortgage situation, you are told how much you will spend over the life of the loan, assuming the interest rate stays at a certain percentage, and it is always a wake-up call for me when I see how much I am going to end up actually spending for that mortgage.

Mr. WRIGHT. Yes.

Senator COLLINS. So there is not that kind of disclosure in dollars and cents?

Mr. WRIGHT. No, that is right, and that is when people call us. I mean, I do not hear from anybody who has had a wonderful experience with Internet payday lenders.

Senator COLLINS. I am sure you do not.

Mr. WRIGHT. What we hear about are the problems that I have described to you, and we try to deal with them in a very realistic way, a very reality-based way to help that consumer. But the common theme is they had no idea how much these loans were truly going to be costing.

Senator COLLINS. And one final question before I turn to my colleagues. Is there anything that individual States can do to regulate online lenders that are domiciled outside of their States, or is that a matter of interstate commerce——

Mr. WRIGHT. I think it is largely a matter of interstate commerce. Our law, by its terms, reaches payday lenders wherever located. But the reality of these payday lenders is that, in many, many cases, they do not want the consumer, let alone the regulator, to know where they are located or who they are or what their name is. I heard of one the other day called cashinawink.com. It was a call yesterday morning that I took. That company may have a different name by next week for all I know.

And so I think it really requires Federal action in terms of disclosure that I have just mentioned. There are some other things I think that Congress can do. Congress certainly has the authority, plenary authority in the area of interstate commerce. Nobody can deny that this is interstate commerce.

The powers that we have, such as licensing and so on, while we would like to think them to be real, are largely ignored by these companies. So something, I think, more globally needs to be done at the Federal level.

Senator COLLINS. Thank you.

Senator Warren.

Senator WARREN. Thank you very much, Ranking Member Collins. Thank you again, and thank the Chairman for holding this hearing.

I also want to say, your statement about the reputation of the Maine Consumer Credit Protection Bureau is spot on. They are known around the country for the great work that they have done and the great leadership you have shown.

Mr. WRIGHT. Thank you.

Senator WARREN. I also want to say that Mr. Pearce and I had a chance to work together when I was at the Consumer Agency and he was working for Chairman Bair on multiple consumer issues, including particularly mortgages, and so I know you have great experience and want to thank you for being here today.

And, Mr. Silberman, whom I worked with at the Consumer Bureau and for whom I have great respect, has great knowledge of the industry and great judgment, and so I very much appreciate your being here today and appreciate the work that all of you are doing on behalf of our consumers.

I thought what I would follow up on is where Ranking Member Collins started us, and that is on online lending, if I could. Payday lenders do not have a physical presence in Massachusetts, as well, but we remain very concerned about the growth of online payday lending. I understand from the Pew Charitable Trust that more than three million Americans received an online payday loan in 2010. The number is expected to increase significantly. It is now at about 35 percent of payday loans were online in 2011, and it is expected to be about 60 percent of all payday loans by 2016. That is a grim future to think about.

So I am very pleased to have sponsored with Senator Merkley the Stopping Abuse and Fraud in Electronic Lending Act, with the acronym of SAFE Lending Act. It is an Act that would help close loopholes and better protect consumers in online lending and other forms of electronic lending.

So, Mr. Wright, I wanted to ask you, if I could, to take, I think, what is the next question, and that is what things would be helpful at the Federal level in terms of making sure that consumers are better protected.

Mr. WRIGHT. Well, I appreciate that question. I have seen and familiarized myself in a general sense with the SAFE Act proposal that is being sponsored. We have a SAFE Act in Maine. Of course, the Federal Act from a few years ago mandated States to adopt SAFE Acts——

Senator WARREN. That is right.

Mr. WRIGHT [continuing]. In the area of mortgage lending, and we did that promptly. The proposal now, as I understand it, would be essentially to expand that same kind of licensing requirement and so on to the area of payday lending.

In addition, as I read the proposals, and I may have not gathered them all, there is one point that I think that needs to be stressed here and that is meaningful—for instance, meaningful disclosure is one thing, and that may go to consumers not being bamboozled. But some are going to be, and so how do we get a handle on that?

And I think the answer is, keeping in mind that these transactions these days now are not literally paychecks, post-dated paychecks, or checks, but are all done by ACH debiting, I would propose to you consideration of requiring banks to be sure before debits are made to consumer accounts that those debits are compliant with State laws.

Senator WARREN. So, superb point, Mr. Wright, and, in fact, can I just expand the point a little bit in asking about this with remotely created checks, the notion that payday lenders are getting access, direct access to people's checking accounts——

Mr. WRIGHT. That is right.

Senator WARREN [continuing]. Whether or not better protection to give consumers control over their own checking accounts and the ability to stop the access and the withdrawals from their accounts when they see a problem. Would that be a useful tool?

Mr. WRIGHT. It is. I think some of that actually has already been done under the Electronic Fund Transfer Act at the Federal level, allowing consumers to stop payments and so on, but it obviously can be beefed up because, to the extent that it is already the law, perhaps that law has not been working as effectively as it might be.

Senator WARREN. Right. And then I think you mentioned earlier, and I just want to see if we can kind of go through a list here, the idea of making sure there is a level playing field, and that is that everyone must be compliant with local State laws on usury. So if someone is lending online in Maine, they must follow Maine law. If they are doing it online in Massachusetts, they must follow Massachusetts law. Would that be helpful?

Mr. WRIGHT. Yes. I think that is the real point at which these abuses can be pinched.

Senator WARREN. Good. Good. And then if I can ask you about one more, are you familiar at all with lead generators?

Mr. WRIGHT. Well, generally, yes. Somebody will go online and—and I always ask people, how did you find these folks, and they are up at 2:00 a.m. clicking away on their computers and hit a button. It does not necessarily go directly to a lender, but it goes to a lead generator and then the inquiry made by the consumer gets kind of farmed out, shipped out to one lender or another.

And so while we do not deal directly with the lead generators, what we hear about—and, frankly, the consumers do not even know how the lead generation process is working. What we are dealing with and the complaints we take are about the payday lenders, you know, flybynight.com, cashforyou——

Senator WARREN. Right.

Mr. WRIGHT [continuing]. Or whatever. That is what we hear about.

Senator WARREN. So, I take it, more restriction on the lead generators, too——

Mr. WRIGHT. Oh, sure.

Senator WARREN [continuing]. Could be very helpful.

Mr. WRIGHT. Oh, absolutely.

Senator WARREN. Good.

Mr. WRIGHT. It goes hand in hand.

Senator WARREN. Good. Thank you very much, Mr. Wright.

Mr. Silberman—may I have one more minute?

Senator COLLINS. Absolutely.

Senator WARREN. Thank you.

Mr. Silberman, could you comment on Mr. Wright's comments, since—not directly on the bill, I know that is not what you are here to do, but on Mr. Wright's comments about what might be helpful at the Federal level to deal with payday lending?

Mr. SILBERMAN. So, Senator Warren, I appreciate your understanding that the Bureau does not comment on particular pieces of legislation, but the principle of a level playing field is a sort of core bedrock principle on which the agency was founded. That applies with respect to depository and non-depository institutions, but it certainly should apply equally with respect to lenders who take different forms, online versus—a marketplace cannot work—a competitive, fair marketplace cannot work if not everybody is governed by the same set of rules. So having consistent rules that all players have to abide by seems to me to just be a sort of first principle of consumer protection.

Senator WARREN. Thank you, Mr. Silberman. Very helpful.

And, Mr. Pearce, would you like to add anything to that?

Mr. PEARCE. Sure, if I could. I think Mr. Wright makes an important point about banks being really the gatekeepers of the processing networks, and the FDIC has been active in this area, to remind banks about their responsibilities to do due diligence in monitoring of transactions that go through the payment system. Just last year, we issued guidance that really encouraged institutions to be careful and attentive to higher-risk types of transactions, whether they are online payday lending or they could be online gambling or different other kinds of activities. They do have a role to monitor that and make sure that they are not illegal.

Senator WARREN. Good. Thank you very much, and thank you very much for your indulgence. I appreciate it.

Senator COLLINS. Thank you, Senator.

Senator Donnelly.

Senator DONNELLY. Thank you, Madam Chair.

This is in regards to what was mentioned before about lead generators, that oftentimes online, the company advertising the loan—some are the lenders, but others are just selling the information to the highest bidder. So when you see that, my question would be, and this is to any of the three of you, what are the kind of things that you see out there that we can do to track the ones who are the bad actors who are not providing suitable financial products with this but are trying to prey on people in the online process?

Mr. SILBERMAN. Senator Donnelly, I think you point to a very large concern that we have about the online payday space. It was not the subject of our study, but is something we said we very much want to study.

A concern we have is not simply that the lead generator is selling the lead to the highest bidder, but that they are either selling it to or at least distributing it to multiple would be bidders. And so a consumer provides financial information and potentially their Social Security number, a checking account number, and it is not—that that information then gets pinged across multiple number of unknown lenders. The consumer has no idea who that information is going to, and the risks of privacy invasions, even identity theft, these are all serious risks that we need to be addressing in as comprehensive a way as we can.

Mr. PEARCE. I do not have much to add. As the regulator of State chartered banks, they are not generally engaged in lead generation. It is really the question for banks is when they are processing these transactions, to make sure they are doing the due diligence with the processors and institutions the processors work with, on one hand, and also for the consumer's bank account, if a consumer goes into a bank and tries to stop payment, you know, make sure that the laws are followed in honoring a stop payment request when those transactions are unauthorized or the consumer does not want to make further payments.

Senator DONNELLY. Mr. Pearce, let me ask you, on the deposit advance payments, have any of the banks indicated that, at a 36 percent interest rate, that they would not be profitable, those products?

Mr. PEARCE. So, we have received comments as part of our proposed guidance on deposit advance from a few of the banks that do offer deposit advance and they do not specifically, to my recollection, speak to whether they would be profitable at 36 percent interest.

Senator DONNELLY. The reason I ask that is, you know, is there a point where, when you look at, okay, maybe this will not get paid back, but you have deposit advance as a protection, as well. How is 36 percent not a significantly profitable enough operation on those kind of loans?

Mr. PEARCE. That is a good question. I do think that the cost structure——

Senator DONNELLY. Just picking that number, as opposed to 33 or 39, I am not saying, but it is a pretty significant interest rate, and so how is that not enough of a compelling number for these companies to make these loans?

Mr. PEARCE. So, we did research just last year on bank efforts to serve the unbanked and underbanked, and one of the things from our findings, we asked banks, do you make loans of less than $2,500 that are repayable in 90 days or more, that have streamlined underwriting, that are 36 percent, you know, so we have asked them these questions. Sixty-five percent of the banks indicated that they offer those kinds of products. Our small-dollar loan pilot, which I mentioned earlier in my oral statement, you know, the institutions were able to make those loans and identified, three-quarters of them, that they were beneficial in establishing long-term relationships with their customers. So we think it can be done at 36 percent interest.

Senator DONNELLY. Okay. Well, then, one other question, and that would be this. I was privileged to talk to Ms. Smith earlier today, who will be on the second panel, and in talking to her, one of the things she mentioned is that on these deposit advance loans, they would not accept partial paydown each month, that if it is a $500 loan, they are not willing to take the interest plus $100 so that next month it is $400, and then you pay another $100 and so that the next month it is $300 that you are paying on. You either pay the $500 or the whole thing rolls over. And this is with some well-known banks. I am wondering about your view at the FDIC of the appropriateness of not being able to make partial paydowns of the principal.

Mr. PEARCE. So, you point out one of the things that—one of the features of deposit advance that is very common and closely related to a payday loan, that it is sort of a lump sum, have to repay it in a very short time period, which then leads you to not have enough money to make the next month's expense, and then you roll it over and over and over. That is one of the concerns with the products that we have that led us to issue our proposed guidance on deposit advance products.

Senator DONNELLY. All right. Thank you very much. Thank you, Madam Chair—or Mr. Chair now.

The CHAIRMAN [presiding]. Senator Wyden.

Senator WYDEN. Thank you very much, Mr. Chairman. I want to commend you, Mr. Chairman, and Senator Collins. I think this is a very important topic.

Mr. Silberman, a question for you about installment loans, and particularly, I want to take a look at what you all can do to help seniors, clearly a vulnerable population, from installment lenders, because in many respects, they are quite similar to the payday lenders. In both cases, you have got both types of loans, in effect, offered by the same lender.

And I particularly was struck by an investigation by the publication ProPublica into installment loans. I mean, this was a jaw-dropping drill showing how consumers, particularly seniors and others, are being ripped off by some of these unregulated installment loan companies that, in effect, are targeting seniors and those in the military. And you have got companies—they cite one like World Acceptance. It sets up shop outside of military bases, in low-income areas to provide loans that have interest rates attached to them that, in effect, are over 150 percent.

And what ProPublica is saying is they are basically using a business model to get around interest rate caps, interest rate caps that are established in the law. We have one, for example, in Oregon, and they do this by wrapping in insurance products to the loans. And the model is to structure the loan payments so that the insurance premiums and the interest is paid up front and then they go out and chase the borrowers hither and yon and try to persuade them to refinance in order to trap them into this cycle, this cycle of just paying premiums and interest and never paying down principal. Evidently, they go out and harass them in their homes. They go out and harass them in the workplace.

What are your thoughts about what the Consumer Financial Protection Bureau can do in this area to deal with these kinds of practices that you see utilized by World Acceptance and similar companies?

Mr. SILBERMAN. Well, Senator, to begin with, the Federal consumer protection laws which we are charged with enforcing apply—are product agnostic, if you will. They apply to all forms of products, and one of our jobs is to regulate in a consistent manner. So we are attempting to take a holistic approach to the small-dollar credit market, which is why our first report was on both payday loans and deposit advances, followed shortly thereafter with a report on overdraft, so that we would intend to look holistically at all products and make sure that we are not simply squeezing air in the balloon from one place to another. That would not serve anybody's interest.

With respect to the practice that was reported of selling, I guess we would call, add-on products in conjunction with installment loans, that, as you know, has been an area in which the Bureau has been particularly active. Our first enforcement action was around add-on products in the credit card market and there have been several of those. We recently brought an action which involved products being sold to servicemembers, and one piece of that was add-on products that were not clearly transparently disclosed.

So we have ample authority to assure that in that sort of situation, the products—that consumers understand what is being sold, they are not finding themselves that they have bought a product without even realizing that they actually had bought it, without ever saying yes to it, without understanding the terms of the product. That is a very important part of what we are all about.

Senator WYDEN. So what can be done about World Acceptance? I mean, this is evidently an important investigation by a credible consumer rights group, something that has been an ongoing problem. Is there anything else that you need to do, that the Congress needs to do, that regulators need to do?

Mr. SILBERMAN. Well, Senator, we have the authority to supervise both depository institutions and non-depository institutions. For non-depository institutions, Congress actually gave us plenary authority over payday lenders. But for other types of lenders, we first have to—our authority is limited to larger participants, which we have to define by rule. So that would be something we would have to do before we could engage in our supervisory activity.

Senator WYDEN. So you would need to pass a rule to go after people like World Acceptance?

Mr. SILBERMAN. Not quite, Senator. I said that we have—in order for us to be able to do a supervisory exam, that would be true. But our enforcement authority is not so limited. We have the authority to investigate and enforce the consumer protection laws against any non-depository institution. Obviously, I am not at liberty to talk about any particular investigations that may or may not be going on.

Senator WYDEN. Well, why do we not do this. I would like you to get back to me in writing with what the tools you have are with respect to World Acceptance, A, and what your take is of the urgency of this matter, because this looks to me like—and I thought you were spot on with respect to how you want to look at this holistically—that this looks like another way to get around efforts by some who are pro-consumer, like in our State of Oregon you get around limits on payday lenders and so you try to tuck this kind of approach in and you basically can accomplish the same thing. So get back to me in writing on both of those points, okay?

Mr. SILBERMAN. I would be delighted to do so, Senator.

Senator WYDEN. How long will that take? Can you have that done within, say, two weeks?

Mr. SILBERMAN. I would—I would think so, but let me just—yes.

Senator WYDEN. Very good. Thank you.

[Laughter.]

Thank you, Mr. Chair.

The CHAIRMAN. Your minders behind you suggested that two weeks was sufficient time.

Mr. SILBERMAN. I am mindful, Senator, that Director Cordray is out of the country and I am sure he would want to be able to review anything we sent on a topic as important as this, so I just wanted to double-check on that one.

The CHAIRMAN. I want to invite each of the three of you to remain and hear the second panel, because I think it is important testimony that you hear. And so may I invite up the second panel, please. And as you hear, Mr. Silberman and Mr. Pearce, as you hear this testimony, just think about what we are trying to accomplish in this committee in stopping some of these egregious cases.

All right. First, we are going to hear from Annette Smith. She will share her personal experience as a deposit advance customer and the difficulties she has had in getting out of this cycle of debt.

And then Rebecca Borne, who serves as the Senior Policy Counsel of the Center for Responsible Lending.

And then Dennis Shaul, CEO of the Community Financial Services Association of America.

And then Richard Hunt, population and CEO of the Consumer Bankers Association.

And I might tell everyone, in 25 minutes, the Senate will take and observe a moment of silence in the memory of Officer Jacob J. Chestnut and Detective John M. Gibson of the U.S. Capitol Police, who were killed 15 years ago in the line of duty defending the Capitol, defending the people who work here and the visitors against an armed intruder, and they paid for that defense and protection with their lives. So we will stop for a moment at 3:40.

So, Ms. Smith.

STATEMENT OF ANNETTE SMITH, DEPOSIT ADVANCE CONSUMER AND SOCIAL SECURITY BENEFICIARY

Ms. SMITH. Good afternoon, Mr. Chairman and Mrs. Collins. Thank you for having me here.

My name is Annette Smith. I am a 69-year-old widow. I live in a small town outside of Sacramento, California, and I am a longtime customer of Wells Fargo. I was once a business owner and a land owner, but an identity theft scam left me without assets or credit. The thieves were prosecuted, but I was not compensated and was never able to rebuild from that experience.

Many years later, I am still poor. I have received Social Security as my only source of income for the last seven years. My Social Security check is for about $1,200 a month. That is the only income I have to pay all of my expenses.

Five-and-a-half years ago, I asked my local branch for a small personal loan, just enough to fix my car so it would pass California's smog test requirement. They told me they did not offer those but that I could get a direct deposit advance online. I went home and with just a few clicks I had $500 in my account.

A couple of weeks later when my Social Security check was electronically deposited to my account, the bank withdrew the $500 plus a $50 fee. Back then, my monthly Social Security check was far less than the $1,200, and the $550 that Wells Fargo took was half of my monthly income. Without it, I could not pay my rent and other bills and expenses. So a few days later, I took out another $500. But the same thing happened the next month. The bank withdrew the entire amount plus a fee again. I could not pay the advance in full and all of my bills and expenses. I had to take another loan, again and again, to my surprise, for five years.

A few times, I tried not to take another advance, but to do that, I had to let other bills go. The next month, those bills were behind and harder to pay. I never made it two full months without having to borrow after paying the last advance. A few other times, I tried taking out less than $500, maybe only $200 or $300, but I still could not stretch my Social Security check to pay the whole advance and make ends meet. Any time that I tried to not borrow again or to borrow less, the bills and expenses I could not pay would catch up a month or two later and I was back where I started.

It was horrible, but I thought there was no way out. I did not have a credit card. I am sorry. I do not want to cry. I did not have a credit card. Wells Fargo had already told me that they would not give me a personal loan. I could not borrow from my kids, who were themselves struggling. And I never considered going to one of those payday loan stores because I knew they had a reputation for charging really high interest rates and those are things I could not afford. In fact, I thought that since banks were required to follow certain laws, they could not do what those payday loan people were doing.

I thought that the problem was me, that I just could not figure a way out, even though I tried everything I could think of. I recently learned that Wells Fargo has installment plans. If I had known that then, I would have been really happy. In fact, I tried to set up an installment plan recently, but they told me it was impossible.

Finally, I talked to someone at the California Reinvestment Coalition who was looking for people who borrowed a Wells Fargo direct deposit advance. I described my situation and answered their questions. They looked into my bank statements and helped me figure out how much this was costing me. In total, I got 63 advances from Wells Fargo in five years and the fees I paid totaled almost $3,000. I was shocked, but mostly deeply embarrassed.

But then I realized that I could not be the only one that this had happened to in this situation. That is when I agreed to tell my story, so that other seniors would not think like I did, that borrowing a direct deposit advance was safe and you could end up paying your Social Security on a loan that is so hard to get out of.

With CRC's support, I even went to the Wells Fargo shareholder meeting to tell CEO John Stumpf about my situation. He told me that someone from the bank would work with me. A few days later, I went with CRC to my local branch to ask for an installment plan. I wanted to pay the money I owed in small amounts that I could afford. CRC had told the bank we were coming, so when we got there, the branch manager and the district manager were there waiting for me. They also had someone from the corporate office on the phone.

We asked for an installment plan so that I could pay the advance over time like you would other loans. The bank people said their system was automated, that there was no way to stop the next withdrawal or fix it so that I could pay in small installments that I could afford. Instead, they offered to forgive my last advance as long as I never borrowed an advance again from them. I agreed.

A few days later, I saw that after they withdrew the payment, they credited me the same amount with a label marked "Customer Satisfaction Credit." It was finally over. It feels good not to owe Wells Fargo anymore, but I know that there are others like me who have not had their loans forgiven and are still struggling with the direct deposit advance.

I am asking you today to please do something, whatever you can, to stop banks from doing this to other seniors across the country. Thank you.

[The prepared statement of Ms. Smith follows:]

Testimony of Annette Smith to the Senate Committee on Aging
July 24, 2013

Good afternoon, thank you for having me here.

My name is Annette Smith. I am 69 years old, I live in a small town outside of Sacramento, California and am a long-time customer of Wells Fargo. I was once a business and land-owner but an identity theft scam left me without any assets or credit. Even though the thieves were prosecuted, I received no compensation and I was unable to rebuild from that experience. I have been receiving Social Security as my only income for about 7 years. Today, my Social Security check is for about $1,200 – that is the only income I have to pay all of my expenses.

Five and a half years ago, I asked my local branch for a small personal loan, just enough to fix my car so that it would pass California's smog test requirement. I was told that they did not offer those kind of personal loans but that I could get something called an "advance" online. I went home and with just a few clicks, received $500 into my account. A couple of weeks later when my Social Security check was deposited electronically to my account, the bank withdrew the $500, plus a $50 fee.

Back then my monthly Social Security check was for less than $1,200. That means that the $550 that I paid Wells Fargo that month was about half of what I had to live on for the month. Without it, I could not afford to pay my rent and all my other bills and expenses. So, a few days later, I took out another $500. But the same thing happened the next month, too. The bank withdrew the entire amount, plus a fee. But because I could not afford to both pay the advance in full and also pay all of my bills and expenses, I had to take another loan. Again and again, for five years.

A few times, I tried not taking another advance after I paid back the last one. But to do it, I had to not pay for other things that month. That meant that the month after that, I was overdue on those bills, and faced fees- making them even harder to pay. So, I broke down and got another advance. I never made it even two full months without having to borrow to pay my expenses after paying back the last advance.

A few other times, I tried taking out less than $500, maybe only $200 or $300- but the same thing happened. I just couldn't stretch my Social Security check to pay Wells Fargo the whole amount that I borrowed the month before and also pay my other bills and expenses. Any time that I tried to not borrow again, or to borrow less, the bills and expenses I couldn't pay would catch up to me a month or two later and I was back where I started.

It was a horrible way to feel every month. I needed help but did not know where any was available. I did not have a credit card and Wells Fargo had already told me they wouldn't give me a personal loan. I could not borrow from my kids, who were themselves struggling. And I never considered going to one of those payday loan stores because I knew they had a reputation for charging really high interest rates that I could never afford. In fact, I thought that, since banks were required to follow certain laws, they couldn't do what those payday places do.

I thought that the problem was me, that I just couldn't figure a way out even though I tried everything I could think of. I have recently learned that Wells Fargo offers a way to pay the advance in installments. If I had known that then, I certainly would have tried to do that. In fact, I tried to do it recently but the bank told me it wasn't set up to do it.

Finally, I talked to someone at the California Reinvestment Coalition who was looking for people who had borrowed from Wells Fargo through the advance program. I described my situation and answered their questions. They looked at my bank statements and helped me figure out how much this was costing me. In total, I received 63 advances from Wells Fargo in about over five years. The fees I paid totaled almost $3,000.

I was shocked and embarrassed that I had let this happen. But then I realized that I couldn't be the only one in that situation. I agreed to tell my story so that other seniors wouldn't think what I did: that borrowing an advance from a bank was a safe thing to do and end up paying their Social Security on a loan that you could just never seem to get out of. With the California Reinvestment Coalition's support, I even went to the Wells Fargo shareholder meeting to tell the CEO, John Stumpf about my situation. He told me that someone from the bank would work with me.

A few days later, I went with a lawyer from the California Reinvestment Coalition to my branch to ask for an installment plan so that I could pay the money I owed in small amounts that I could afford on my tight budget. All I wanted was to not have to borrow again and again just to make ends meet. CRC had told the bank that we were going to do that the day before, so when we got there, the branch manager and the district manager greeted us at the door. They also had someone from the corporate office on the phone.

We asked for an installment plan so that I could pay off the last advance over time and end this predicament. The bank representatives told me that the bank was not set up to do that. They said that neither the branch nor the corporate office could stop the next withdrawal from happening and fix it so I could pay in small installments that I could afford. Instead, they offered to forgive my last advance as long as I never borrowed an advance again. I agreed. A few days later I saw that the bank had indeed withdrawn the payment for my last advance but then credited me the same amount with the label of "customer satisfaction credit". It was finally over.

It feels great not to owe Wells Fargo any more but I know there are others like me who have not been given the help I got. It is for them that I ask you to do what you can to stop banks from selling these advances that are so hard to get out of.

Please do whatever you can to stop banks from doing this to other seniors.

Thank you,

Annette Smith

The CHAIRMAN. That is one of the reasons for this committee, Ms. Smith, is to learn from senior citizens such as yourself about your real world experience and to try to change the system so that this does not happen to other people.

Ms. SMITH. Thank you.

The CHAIRMAN. Now, you paid $50 a pop in fees 63 times.

Ms. SMITH. The first few years. Lately, it has been $37.50. A couple of years ago, it got lowered——

The CHAIRMAN. The total amount——

Ms. SMITH [continuing]. But a total of $3,000.

The CHAIRMAN. Okay. Ms. Borne, tell me what you think about this.

STATEMENT OF REBECCA BORNE, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. BORNE. Good afternoon, Chairman Nelson, Ranking Member Collins, and members of the committee. Thank you for the opportunity to testify today.

I would like to begin by sharing a couple of comments from former payday lenders about borrowers receiving Social Security or other Federal benefits. One former manager of payday loan stores described the industry's affection for these borrowers, saying, "These people always get paid, rain or shine. They will always have money every 30 days."

A former employee of Advance America, the nation's largest payday lender, said, "Borrowers receiving Social Security or disability payments would come in for a small loan and write a check to the company dated the third of the month, when their government checks would arrive. All the Advance America employees were required to come in early on that day so we could quickly cash their checks and wipe out their checking accounts."

Older Americans are particularly attractive to payday lenders because of their steady stream of benefit income. It is not surprising that a study commissioned by the Wall Street Journal found that payday loan stores clustered around subsidized, disability, and senior housing.

Payday loans are aggressively marketed as a short-term loan, a quick solution, but in reality, they quickly engulf most borrowers in an expensive cycle of long-term debt. Though their loan is typically technically repaid on the due date, the repayment of the loan plus the fee does not leave borrowers enough money to pay for necessities, like rent or food, for the rest of the pay period or month, so borrowers are forced to renew their loan or reborrow before the end of the next pay period, paying a new fee each time with no reduction in principal.

CRL's research has found that payday borrowers remained in debt an average of 212 days of the year, and that 76 percent of all payday loans are made within two weeks of a previous payday loan being repaid. Eighty-two percent of all payday loans made within one month of the previous loan being repaid. And these findings include data from States that have implemented so-called best practices or safeguards that purport to stop the debt trap but clearly do not. Ultimately, about half of payday borrowers eventually default, many after spending months or years in debt and paying fees that far exceed the principal borrowed.

Research has shown that payday loans cause serious financial harm to borrowers, delayed medical care, paying other bills late, increased likelihood of bankruptcy, and these harms are particularly acute for older Americans, many of whom are already struggling with a decline in the value of their home and retirement assets and who often have less income and a shorter time horizon to recover from financial shortfalls.

In a disturbing trend, a few banks have now joined the ranks of the payday lenders. We know of six: Regions Bank, Fifth Third Bank, Wells Fargo Bank, Bank of Oklahoma, U.S. Bank, and Guarantee Bank. These banks make payday loans even in States where laws clearly prohibit payday lending by non-banks. Banks call these deposit advances, but they are designed to function just like any other payday loan. Bank payday borrowers end up with 13 loans a year and spend large portions of the year in debt, even as the banks claim the loans are intended for occasional emergencies.

Our research found a striking number, over one-quarter, of bank payday borrowers were Social Security recipients. On average, banks repaid themselves 33 percent of the borrower's next Social Security check to repay the loan.

Though only a few banks make payday loans today, the threat that payday lending by banks becomes the norm is very real. We are at a tipping point. As already noted today, the OCC and FDIC, recognizing that this product poses both safety and soundness and consumer protection concerns, recently proposed guidance that would address the central problems with bank payday lending. We urge these agencies to issue finalized guidance that preserves their proposals' key provisions.

The Federal Reserve Board, the prudential regulator for Regions Bank and Fifth Third Bank, did not issue the same proposed guidance. We continue to urge the Federal Reserve to do so. The Board did, however, issue a supervisory statement, the content of which should compel Regions and Fifth Third to make meaningful changes to the product that eliminate the debt trap it has been shown to cause. To our knowledge, the banks have not indicated plans to do so.

The CFPB's recent extensive study of storefront and bank payday loan data both confirmed and expanded on prior research finding that payday lending puts borrowers in a debt trap. The CFPB has indicated it will use its authority to address this problem and we urge it to do so.

Twenty-two States, home to over 40 percent of all Americans, have decided they do not want unfettered payday lending for their residents. As mentioned earlier, Congress, with the leadership of Chairman Nelson and at the urging of the Department of Defense, decided seven years ago that payday lenders should be prohibited from making payday loans to members of the military.

Payday loans affirmatively harm rather than help older Americans. They affirmatively harm rather than help Americans of all ages.

We thank you for holding this hearing today and we ask that you support ending the payday lending debt trap by banks and non-banks alike. Thank you.

[The prepared statement of Ms. Borne follows:]

Testimony of Rebecca Borné
Senior Policy Counsel, Center for Responsible Lending
Before the Senate Special Committee on Aging
Hearing: "Payday Loans: Short-term Solution or Long-term Problem?"

July 24, 2013

Good afternoon Chairman Nelson, Ranking Member Collins, and Members of the Committee. Thank you for inviting me to testify to discuss payday lending and its impact on older Americans.

I am a senior policy counsel at the Center for Responsible Lending (CRL), a nonprofit, nonpartisan 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, a nonprofit community development institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through safe, affordable home loans and small business loans. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

My testimony will make the following points:

- **Payday loans are designed to create a long-term debt trap.**

- **Payday loans cause borrowers severe harm, leaving them worse off than they were before the first payday loan.**

- **Payday loans were legalized only in relatively recent years based on the claim they would be used for emergencies, but they typically are not used this way.**

- **A few banks are payday lenders, posing severe consumer protection concerns and safety and soundness risk to banks. Without decisive regulatory action by all the bank prudential regulators, many banks will likely become payday lenders.**

- **Older Americans are particularly attractive to payday lenders and particularly vulnerable to the harm payday loans cause. Research has found that over one-quarter of bank payday borrowers are Social Security recipients.**

- **Public policy is trending against payday lending, with a growing number of states—now 22, home to over 40 percent of Americans—prohibiting or significantly restricting it.**

- **Strong policy responses are critical to stopping the harm that payday lending causes.**

I. Payday loans are designed to create a long-term debt trap.

A. Payday lenders, as a matter of practice, make loans borrowers likely do not have the ability to repay.

Payday loans—loans of around $350 averaging 300-400% annual percentage rate (APR) repaid from the borrower's next paycheck or receipt of public benefits—are designed to create a long-term debt trap.

Borrowers already struggling with regular expenses or facing an emergency expense with minimal savings are typically unable to repay the large payment of principal and fees due and meet their other expenses until their next payday. Though their loan is typically technically repaid on the due date, the repayment of the loan plus the fee does not leave borrowers enough money to pay for necessities, such as rent or food, for the rest of the pay period or month. Consequently, borrowers are forced to renew their loan before the end of the next pay period, paying a new fee. Payday lenders repeat this cycle over and over again, leading to a long-term cycle of churned loans. A forthcoming report from CRL finds that borrowers pay $3.4 billion in fees alone annually for payday loans by non-bank payday lenders, not including fees paid for payday loans made by banks.[1]

Rather than determine the borrower's ability to repay the loan, payday lenders rely on their ability to seize the borrower's incoming funds by holding a personal check or an ACH authorization for the entire amount due, which serve as collateral. 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 bank account. Federal 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*.[2] Thus, the high number of loans per borrower demonstrates payday lenders' disregard of the borrowers' ability to repay.

B. The data overwhelmingly demonstrate that borrowers cannot afford to repay.

Data measuring frequency of payday loans and days of indebtedness overwhelmingly demonstrate that borrowers typically do not have the ability to repay payday loans. Most recently, the Consumer Financial Protection Bureau (CFPB), in the most comprehensive data set on payday lending ever compiled and analyzed, found that the median borrower took out ten payday loans from a single storefront lender during one year, and spent 199 days of the year in payday debt.[3] These findings were generally consistent with other studies by CRL (nine loans,[4] 212 days in a year[5]); Pew (eight loans averaging 18 days each, or 144 days total);[6] the Center for Financial Services Innovation (CFSI) (11 loans, 150 days);[7] and even Advance America, the largest payday lender, which has reported that its borrowers average eight loans per year.[8]

Further, data quantifying payday loan "churn"—when a borrower's loan is renewed or when the loan is technically repaid but the lender flips the borrower into a new loan shortly thereafter —underscores the existence of a long-term debt trap. CRL has found that half of new loans are the result of a previous loan being flipped virtually immediately,[9] 87% within two weeks, and 94% within one month.[10] Similarly, the CFPB recently found that most of the transactions conducted by consumers with seven or more loans were taken within 14 days of a previous loan. The effective impact of churned transactions is simply repaying fees to float the same principal debt, rather than being extended new credit each time.

Payday loans made by banks, which banks refer to as "deposit advances," show the same patterns of long-term indebtedness and loan churn. CFPB found that bank payday borrowers spend an average of 112 days in debt, with only 13 days between paying off an advance in full and taking out a new one—indicating that bank payday loans do not typically sustain borrowers through even a single pay cycle.[11] CRL found that borrowers took out 13.5 bank payday loans in 2011 and spent at least part of six months in bank payday loan debt.[12] The mean number of loans was 19—far higher than the median, because over one-third of borrowers had more than 20 loans.[13]

C. High-cost payday installment loans can be the functional equivalent of a series of short-term balloon-payment loans.

The following five elements contribute to the debt trap: lack of underwriting for affordability, high fees, short-term due date, single balloon payment, and direct access to the borrower's checking account through a personal check or electronic access. But all of these elements need not be present for loans to create a debt trap. Indeed, although payday loans are typically due in full in a single payment, some payday lenders are moving to payday installment loans that carry triple-digit interest rates and are the effective equivalent of a series of short-term, single-payment payday loans.[14]

As discussed below, payday lenders attempt to justify the triple-digit annual interest rates on their loans on the basis that they are short, two-week loans; these high rates are particularly unjustified for longer-term loans. In addition, the very high rates on these loans cause most of the borrower's payment to go toward interest, not principal; as a result, as with two-week loans, the borrower often pays as much or more in interest than in principal. Thus, whether a triple-digit-APR payday loan is a single-payment loan or an installment loan, it leaves the borrower in extended triple-digit-APR debt.

D. Car-title loans are similarly structured and lead to similar cycles of debt.

A close cousin of the payday loan is the car-title loan, which averages around $1,000 and is secured by the title to a borrower's vehicle that is owned free-and-clear. These are expensive, 300% APR loans that are often marketed as short-term (with a one-month due date) but tend to be renewed multiple times (eight times on average).[15] Nationally, we estimate that borrowers pay $4.3 billion in fees alone annually for these loans—more than double the amount of credit extended.[16] As with payday loans, there is an emerging trend toward longer-term and still high-cost installment products. Most car-title loan borrowers end up paying far more in fees than principal borrowed, and a significant share of borrowers face repossession of their cars.[17]

II. Payday loans cause borrowers severe harm, leaving them worse off than they were before the first payday loan.

The typical payday borrower pays more in interest than they receive in principal. Studies find that *on average* borrowers pay $450-$500 in fees for approximately $350 in non-churn principal, with many paying far more.[18] Strikingly, approximately half of payday borrowers have been found to ultimately default, many after spending months or years in debt and paying large fees that far exceeded principal.[19]

Research has long shown that payday loans cause serious financial harm to borrowers. Payday loan usage is associated with paying credit card debts and other bills late,[20] increased likelihood of bankruptcy,[21] delayed medical care,[22] and loss of basic banking privileges because of repeated overdrafts.[23]

The large share of borrowers who ultimately default experience additional financial stress, including NSF fees from the bank and the lender, legal ramifications (garnishment or court action), and having their debt sold to a collection agency (impacting credit reports and scores and leading to repeated solicitations, illegal harassment, or debt collection scams).[24]

One academic researcher who compared low- and middle-income households living in areas with and without payday lending establishments recently concluded: "I find no evidence that payday loans alleviate economic hardship. To the contrary, loan access leads to increased difficulty paying mortgage, rent and utilities bills."[25] The same researcher also found that payday loans are associated with higher rates of delinquency on child support payments.[26]

We also hear from credit counselors and other advocates that payday loans cause severe emotional distress. One former employee of a major payday lender described visiting borrowers' places of employment while working for the lender's collections department:

> *We would not tell their bosses where we were from, but we would carry a clip board with our [company's] name on it in a prominent way. We would request that a person be pulled off the factory floor, not to collect, but to keep them on the hook. The key was embarrassment and intimidation.*—former Advance America employee[27]

Researchers have studied how residents in states that prohibit payday loans deal with financial shortfalls and how payday borrowers report they would handle shortfalls in the absence of payday lending due to regulation. They have found that borrowers choose or would choose options such as cutting back on expenses, delaying or not paying a bill, entering payment plans for bills, tapping into savings, borrowing from friends and family, or visiting a pawnshop.[28] Importantly, these are the same options that payday borrowers who do not default ultimately take advantage of in order to finally retire their payday debt.[29] The difference is that residents in states that do not allow lenders to charge triple-digit annual interest rates do not pay hundreds or even thousands of dollars in fees before exercising those other options. In addition, in North Carolina—a state where payday lending was made illegal—more than twice as many former payday borrowers reported that the absence of payday lending had had a positive rather than a negative effect on them; nearly 90% of households thought that payday loans were bad for their finances.[30]

III. Payday loans were legalized only in relatively recent years based on the claim they would be used for emergencies, but they typically are not used this way.

Historically, states had usury caps in place that prevented payday and other high-cost loans from being made. In the early 1990s, many states exempted payday lenders from those caps based on the industry's claim that their loans were for emergency, short-term use, and were thus entitled to a far higher interest rate limit.

To the contrary, the evidence shows that the majority of payday borrowers are trying to plug budget gaps caused by recurring, everyday expenses, rather than trying to get through occasional emergencies.[31] That payday loans are used for everyday, recurring expenses suggests a structural budget problem where expenses exceed income, which helps explain why it is so difficult to repay two-week balloon payment or escape the ensuing cycle of debt. High-cost, short-term loans are unaffordable for these borrowers.

Yet even as they purport to discourage long-term use, payday lending industry representatives have often acknowledged that loan churning not only occurs but is encouraged:

> *[T]he theory in the business is [that] you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is.*—Dan Feehan, CEO of Cash America[32]
>
> *Advance America's disclosures show that repeat borrowing is important.*—Morgan Stanley[33]

That payday lenders also frequently offer the borrower's first loan for free or at a discount further exposes that churned loans are expected.[34]

IV. A few banks are payday lenders, posing severe consumer protection concerns and safety and soundness risk to banks. Without decisive regulatory action by all the bank prudential regulators, many banks will likely become payday lenders.

The great majority of banks do not offer payday loans, but we are aware of at least six that do. Two are supervised by the Federal Reserve Board (Federal Reserve): Fifth Third Bank and Regions Bank. Four are supervised by the Office of the Comptroller of the Currency (OCC):

Wells Fargo Bank, U.S. Bank, Bank of Oklahoma and its bank affiliates,[35] and Guaranty Bank. Banks are attempting to use the doctrine of federal preemption to make payday loans even in states whose state laws do not authorize payday lending, grossly undermining state law.[36]

A. Payday loans by banks function like other payday loans.

Bank payday loans, which banks typically refer to as "deposit advances," are structured to function the same as other payday loans. The bank deposits the loan amount directly into the customer's account and then repays itself the loan amount, plus a high fee, directly from the customer's next incoming direct deposit of wages or public benefits. If the customer's direct deposits are not sufficient to repay the loan, the bank typically repays itself anyway after 35 days, even if the repayment overdraws the consumer's account, potentially triggering high overdraft fees for subsequent transactions. Banks impose fees in the range of $7.50 to $10 per $100 borrowed for bank payday loans; for the typical loan term of 12 days, these fees translate to APRs ranging from 225% to 300%. **CRL's research has found that more than one in four bank payday borrowers are Social Security recipients.**

Banks have pitched their payday loans as a way for customers to avoid overdrafts and associated fees, but the data show that bank payday borrowers are significantly more likely to incur overdraft fees than customers not taking out bank payday loans.[37]

Banks, like non-bank payday lenders, often point to "safeguards" they have in place on payday loans to ensure that borrowers do not become mired in a long-term debt trap. But these "safeguards" are set by bank and non-bank payday lenders at levels that have little impact on the cycle of long-term indebtedness; indeed, it is in the lenders' interest to perpetuate the debt trap, as that is where most of their revenue is generated. For example, banks permit installment plans but make these plans difficult to qualify for or obtain.[38] They also establish "cooling-off" periods that still allow borrowers to become mired in a cycle of debt before the cooling-off period is triggered.[39] The data above demonstrate that banks' "safeguards" are ineffective, just as similar "safeguards" that non-bank payday lenders have long touted have proven ineffective as well.[40]

B. Bank payday lending threatens to grow rapidly absent decisive regulatory action by all the bank prudential regulators.

There are clear signals that bank payday lending may grow rapidly if swift regulatory action is not taken. A software consultant marketing a bank payday software program has promised banks massive revenue potential and has reported a high level of interest from banks.[41]

Bank payday lending clearly falls within the purview of both the prudential banking regulators (the OCC, FDIC, and Federal Reserve)—which are responsible for the safety and soundness of the banks they supervise—and the CFPB, which is responsible for consumer financial protection generally. Indeed, bank payday loans pose serious safety and soundness concerns, including that they violate the basic safety and soundness principle of lending based on the borrower's ability to repay a loan; they pose severe reputational risk, as evidenced by sweeping negative reaction to these products;[42] and they risk violation of consumer protection laws, which itself poses safety and soundness risk.[43]

In April 2013, the OCC and the FDIC, recognizing that payday lending poses both safety and soundness and consumer protection risk to banks, proposed supervisory guidance that would address central problems with payday loans by requiring determination of the borrower's ability to repay the loan while meeting other expenses and limiting churned loans. Public comments on the proposed guidance were due June 30, 2013; as of this writing, the proposed guidance has not been finalized.[44]

Unlike the OCC and the FDIC, the Federal Reserve did not propose bank payday supervisory guidance with explicit underwriting guidelines. It did, however, issue a supervisory statement emphasizing the "significant consumer risks" bank payday lending poses.[45] The statement highlighted the CFPB's recent findings of sustained and harmful usage and underscored that examiners should thoroughly review bank payday products for compliance with laws prohibiting unfair and deceptive practices. This statement should compel Fifth Third Bank and Regions Bank to make meaningful changes that eliminate the debt trap the bank payday loan product has been shown to cause. To our knowledge, however, the banks have not indicated plans to do so since the supervisory statement was issued.

In addition, based on its extensive study of bank and non-bank payday loans, the CFPB, concluding that there is "substantial probability" that consumers will be indebted for longer than anticipated, announced that it expects to address the problems identified by its study.[46]

V. Older Americans are particularly attractive to payday lenders and especially vulnerable to the harm payday loans cause. Research has found that over one-quarter of bank payday borrowers are Social Security recipients.

A. Older Americans are showing signs of greater financial hardship than other age groups and are often less able to recover from financial distress.

Since 2006, the wealth of American households dropped $6 trillion because of decreased home values and losses in stock market-based retirement savings.[47] The impact of this financial shipwreck can be especially severe for older Americans, who have a shorter remaining time horizon and therefore less ability to rebuild their wealth and financial security. The problem is even more acute for older African-American households, who have only one-sixth of the wealth of older white households.[48]

Coupled with recent dramatic 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 per year or less.[49] Senior women in particular face diminished incomes because of lower lifetime earnings and Social Security and pension benefits.

Faced with insufficient incomes, many older Americans take on debt to cover medical and living expenses. Over the last twenty years, the percentage of households with credit card debt has decreased for every age category except those aged 55 and over, with those aged 75 and older experiencing the largest increase.[50] Amidst the deleveraging of the last five years, credit card debt for households aged 50+ decreased somewhat (to a still-large average of $8,300 for indebted families), but by much less than it did for younger households.[51]

The result is not just more debt, but also greater levels of unaffordable debt. One-fifth of older households with annual incomes below $50,000 report spending more than 40 percent of their income on debt payments.[52] The results are sadly predictable: Those over age 65 make up the fastest-growing segment of people seeking bankruptcy protection.[53]

Facing these financial hardships, older Americans are particularly vulnerable to payday lenders' claims of quick cash, only to find themselves trapped in payday debt that makes their situation worse. For real-life examples of older Americans trapped in payday loan debt, see the Appendix.

B. Social Security benefits provide lenders with a steady source of repayment.

Older Americans are particularly attractive to payday lenders because they have a steady source of income in the form of Social Security payments. As one payday lender described federal benefits recipients:

> *"These people always get paid, rain or shine . . . [They] will always have money, every 30 days."*—former manager of payday loan stores[54]

As another put it:

> *"[Borrowers receiving Social Security or disability] payments would come in for a small loan and write a check to the company dated the 3rd of the month, when their government checks would arrive. All the Advance America employees were required to come in early on that day, so we could quickly cash their checks and wipe out their checking accounts."*—former Advance America employee[55]

Indeed, an analysis by one researcher found that payday lender storefronts cluster around government-subsidized housing for seniors and the disabled in a number of states across the country.[56]

C. Significant numbers of older Americans become trapped in payday loans, comprising a growing share of all payday borrowers.

Though older Americans do not make up a disproportionate share of payday borrowers overall,[57] they make up a significant and growing share of payday borrowers. In both Florida and California, approximately one in five payday borrowers is aged 55 and over.[58] And the number of older Americans in payday loan debt appears to be growing rapidly: In Florida, the proportion of payday borrowers aged 65 and over increased by 73% from 2005 to 2011, while this age group among the general Florida population increased by only 4%.[59] Data on payday lending in Florida indicate most of its borrowers become trapped in debt. Despite "safeguards" in Florida technically prohibiting renewals (where the borrower pays the only fee without retiring principal) and imposing a 24-hour cooling-off period, borrowers average nine loans per year. About half of borrowers' subsequent loans resulted from a loan being extended immediately following the 24-hour cooling off period; nearly 90% resulted from additional loans within the same pay period the previous loan was repaid.[60]

In addition, as noted earlier, research has found that over one-quarter of bank payday borrowers are Social Security recipients, making these borrowers 2.2 times as likely to have a bank payday loan as bank customers as a whole.[61] The CFPB also found that a significant share of payday borrowers—nearly one in four—reported some form of public assistance or other benefits or retirement funds as an income source.[62]

D. Social Security funds are protected from creditors in other contexts yet are routinely seized by bank and non-bank payday lenders.

Congress has long sought to protect Social Security funds and other public benefits intended for necessities from the unilateral reach of creditors.[63] The Social Security Act prohibits collection of Social Security benefits through assignment, garnishment, or other legal process. The policy underlying this legal protection is to ensure the debtor a minimum subsistence income—for essential needs like food, shelter, and medicine—and courts have repeatedly upheld it.[64]

Payday lenders grossly undermine this critical protection by requiring Social Security recipients to provide direct access to their bank accounts—either through a post-dated check or electronic access—and immediately taking the income for repayment. Indeed, CRL research has found that bank payday lenders take an average of 33% of the recipient's next Social Security check to repay a bank payday loan.[65] The Treasury Department recently made significant strides in protecting Social Security funds in checking accounts from bank freezes in response to garnishment orders,[66] but these rules do not address the informal wage assignment routine to payday lending model. They also do not apply to the practice whereby the financial institution repays itself as creditor, as with bank payday loans.[67]

E. Seniors became more vulnerable to payday lenders following the March 1, 2013 requirement that all Social Security benefits be distributed electronically.

The threat payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.[68] 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.[69] However, benefits deposited into traditional checking accounts remain at risk to payday loans by both banks and non-banks.[70]

VI. Public policy is trending against payday lending, with a growing number of states—now 22, home to over 40 percent of Americans—prohibiting or significantly restricting it.

Some states have never allowed payday loans to be part of their small loan marketplace, while several have prohibited or significantly restricted them in recent years.[71] Since 2007, eight states (including the District of Columbia) have enacted or enforced meaningful reform to address payday lending[72]—while no state without payday lending has authorized it since 2005.

In addition, federal policy is increasingly opposed to payday lending. In 2006, Congress passed the Military Lending Act, which prohibited payday loans to military service members and their families. This law 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.[73] 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.*—President of Navy-Marine Corps Relief Society[74]

VII. Strong, comprehensive policy responses are critical to stopping the harm that payday lending causes.

Today, we highlight the following policy recommendations needed to eliminate the cycle of debt inherent to payday lending:

- **The OCC and FDIC should finalize their supervisory guidance addressing bank payday lending,** preserving in particular the proposed underwriting requirements that aim to ensure borrowers have the ability to repay their loan without reborrowing, and the limit on the number and frequency of payday loans.[75]

- **The Federal Reserve Board should likewise issue supervisory guidance addressing bank payday loans** that clarifies appropriate underwriting procedures and limits the number and frequency of payday loans.

- **Congress and the states should enact the strongest protection possible against payday lending. An interest rate limit of about 36% annually** has been demonstrated to be the most effective way to ensure that loans are structured in an affordable manner:[76]

- **Congress should enact a 36% APR limit** applicable to all borrowers, similar to what it enacted for active-duty military and their families in the 2006 Military Lending Act.

- **States should continue to put in place and enforce 36% APR limits applicable to small dollar loans, including payday loans.**

- **The CFPB should issue regulations** that require lenders to determine the borrower's ability to repay the loan and afford their regular expenses without taking out another loan, and that limit the length of time lenders can keep borrowers in debt.

- **Policymakers should ensure that borrowers' checking accounts—especially income, like Social Security benefits, that is used to pay for necessities—are protected from the effective wage assignment that payday lending creates.** Lenders should be prohibited from requiring, or effectively requiring, access to a borrower's checking account as a condition of making a loan.

Thank you for the opportunity to testify today. I look forward to answering your questions.

Appendix A: Real-life examples of older Americans trapped in payday loans

***As reported in* AARP The Magazine (text reproduced verbatim):**[77]

Mary Love, of Kentucky:

> Love, 67, is a divorced LaGrange, Kentucky, resident and a minister in the Presbyterian Church (U.S.A.). When she got her first payday loan, in 2003, she wasn't destitute; she was working for UPS Logistics in Louisville. But she'd fallen behind on her rent.
>
> Her first loan was for $200. She doesn't recall the name of the place that sold her the short-term cash advance. "They were everywhere," she says of the storefront operation. Love wrote a check for $230, including the $30 fee for the cost of the loan. The lender handed her $200 in cash. Two weeks later, Love came back to retrieve the check and repay the loan in cash.
>
> Now, though, she was out of money again. So she wrote the store another check, but for twice as much — $460, including a $60 finance charge for the second loan — because she needed to pay off other bills. This cycle of repeat borrowing spun on for months. By the end of the year, Love says, she'd spent $1,450 in fees. Two years later, with the debt still churning and no end in sight, Love was living rent-free in her sister's basement and relying on temp work to pay off the loans.
>
> ***
>
> For Mary Love, escape from the debt trap wouldn't come for several years. In 2005 she saw a billboard advertising the debt-relief referral services of the Red Cross, which put her in touch with the Consumer Credit Counseling Service. That led to a payoff plan; she finally emerged from the debt in 2007. The total payoff, she believes, was "way into the thousands." Years later, she doesn't think she's fully recovered.
>
> "This is not how you get out of debt," she says. "This is how you get into it."

The 96-year-old mother of Randy Morse of Lynchburg, Virginia:

> Payday lenders also aggressively collect debt from borrowers who bounce checks, even garnishing (seizing) Social Security benefits. Technically, the 1935 Social Security Act bars creditors from garnishing benefits. But because the transaction usually takes place between the lender and a local bank, it often escapes regulatory notice. That's what Randy Morse of Lynchburg, Virginia, discovered when a local Allied Cash Advance outlet threatened his 96-year-old mother with garnishment last March. She had fallen behind on a loan she'd taken out the previous September.

As recorded by the National Consumer Law Center:[78]

Mr. B, a Social Security recipient using Wells Fargo's payday loan program, found himself paying exorbitant interest rates and locked in a cycle of debt that aggravated rather than alleviated financial distress. A review of 39 consecutive monthly statements showed that Mr. B had taken out 24 payday loans of $500, averaging approximately eight days each, with the shortest running just two days and the longest 21 days. The finance charges for these short-term loans totaled $1,200, and their effective APRs ranged from 182 percent to 1,825 percent. Ironically, even though bank payday loans are marketed as a way of avoiding overdraft fees, Mr. B still ended up paying $676 in overdraft penalties on top of the $1,200 in loan fees.

As told to CRL by the borrowers:

Arthur Jackson,[79] a 69-year-old warehouse worker and grandfather of seven, went to the same Advance America payday shop for over five years. His total interest paid is estimated at about $5,000 for a loan that started at $200 and eventually increased to a principal of $300. Advance America flipped the loan over a hundred times, collecting interest of up to $52.50 each time. Every payday, rather than defaulting or coming up short on bill money, Jackson went into the Advance America store, renewed his loan, and paid the fee. The clerks knew him by name, and often had his paperwork ready for him when he came in.

Anita Monti,[80] an older American, went to an Advance America store in hopes of finding a solution to a common problem—how to afford Christmas gifts for her grandchildren. Unable to repay both the principal and interest on the initial loan, Monti had no choice but to renew her loan with Advance America every payday, paying $45 many times to keep the same $300 loan outstanding. She went to a second payday lender, Check 'n Go, to help repay Advance America. Monti could not afford the $820 it would take to pay off the two loans in full and get out of the trap. After just four months, she had paid almost $1,000 in fees and still owed the $820 in principal borrowed. "I got a promotion and a raise, but I never saw any of that money," said Monti. She finally went to her church for help making her rent payment and to a consumer credit counseling agency for help in negotiating a repayment plan for the payday loans. It took Monti nine more months to complete these payments.

As reported in the Texas Observer:[81]

Roger Tillman, a 64-year-old living in Houston, took out a $500 payday loan from The Money Center in 2008 after the security company he worked for scaled back his overtime shifts. The Money Center currently offers $500 two-week loans for $150 in interest and fees, or about 650% APR. Like many borrowers, Tillman was unable to pay off the loan and thus renewed it, resulting in deepening debt until October 2009, when he was laid off. He reports that he requested an extended repayment plan but was not given one. In November 2009, the lender filed a criminal complaint against him, demanding that he pay $1,020 within ten days or potentially face felony charges that carry two to 20 years in jail and fines up to $10,000. "In all, the district attorney demanded $1,250, including 'district attorney fees' of $140 and merchant fees of $90"—even though Texas law prohibits payday loan companies from threatening to pursue criminal charges against their customers, except in unusual circumstances.

APPENDIX B

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

FRB-supervised:

Fifth Third Bank: "[Early Access is a] line of credit used to assist our customers with short-term, financial emergencies or unexpected financial needs."[82]

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 based for planned purchases, discretionary spending, or regular monthly expenses."[83]

OCC-supervised:

Wells Fargo Bank: "The service can help get you through a financial emergency . . . . Advances are intended to assist with short-term cash needs and are not recommended as a solution for your long-term financial needs."[84]

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."[85]

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."[86]

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."[87]

NOTES

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[1] CRL's forthcoming 2013 *State of Lending in America* chapter on payday lending (on file with CRL).

[2] The 2001 *Interagency Expanded Guidance on Subprime Lending Programs* 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." *Interagency Expanded Guidance or Subprime Lending Programs,* FIL 9-2001, January 31, 2001. The OCC's 2000 letter on abusive lending practices, which is applicable to payday loans, discusses collateral or equity stripping as "reliance on . . . collateral, *rather than* the borrower's independent ability to repay . . ." [emphasis added]. *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. The OCC's 2003 letter on abusive and predatory lending does the same. *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.

For further discussion, see comments of AARP, CRL, Consumer Federation of America, Leadership Conference on Civil and Human Rights, NAACP, National Consumer Law Center (on behalf of its low income clients), and National Council of La Raza, to the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) on their *Proposed Guidance on Deposit Advance Products,* dated May 30, 2013, available at http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/advocates-support-proposed.html [hereinafter Comments to OCC and FDIC].

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

CFPB examined data from15 million payday loan transactions from 1.5 million borrowers and covering one year of activity. Its findings are likely conservative because it did not examine borrower experiences across multiple lenders.

[4] CRL's forthcoming 2013 *State of Lending in America* chapter on payday lending (on file with CRL).

[5] U. King and L. Parrish, *Springing the Debt Trap: Rate Caps Are the Only Proven Reform* (2007), Center for Responsible Lending, *available at* http://bit.ly/VBx3Fa [hereinafter CRL, 2007].

[6] The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* at 8, 13 (2012), *available at* http://bit.ly/UnPjTq [hereinafter Pew, 2012].

[7] R. Levy & J. Sledge, *A Complex Portrait: An Examination of Small-Dollar Credit Consumers*, Center for Financial Services Innovation (2012), *available at* http://1.usa.gov/Xmo6Rp [hereinafter CFSI, 2012].

[8] C. Dougherty, *Payday Loans Get U.S. Consumer Bureau Scrutiny as "Ddebt Traps,"* (2013), Bloomberg, *available at* http://bloom.bg/Y0tYzu.

[9] These include loans that are not flipped the same day the previous loan is renewed but immediately following the expiration of a mandatory cooling-off period; for example, Florida has a 24-hour cooling-off period.

[10] L. Parrish & U. King, *Phantom Demand: Short-term Due Date Generates Need for Repeat Payday Loans, Accounting for 76% of Total Loan Volume,* (2009), Center for Responsible Lending, *available at* http://bit.ly/WJNQa0.

[11] CFPB Findings at 37.

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

[13] CRL, 2013.

[14] *See,* e.g., Advance America's payday installment loan in Delaware, whereby a borrower loaned $500 pays $108 every two weeks for approximately 20 weeks, eventually paying $493 interest on a $500 loan, or 388% APR: https://www.advanceamerica.net/apply-for-a-loan/fees/DE.

[15] Affidavit of J. Robinson, President of Titlemax Holdings LLC, U.S. Bankruptcy Court for the Southern District of Georgia, Savannah Division (2009).

[16] For a recent comprehensive report on car title lending, *see* S. Montezemolo, *The State of Lending in America & its Impact on U.S. Households: Car Title Lending*, Center for Responsible Lending (July 2013), *available at* http://rspnsb.li/s45r67 [hereinafter CRL, *Car Title Lending*, 2013].

[17] CRL and Consumer Federation of America's analysis of data from a class action lawsuit against a Delaware car title lender found that one in six borrowers paid a repossession fee. CRL, *Car Title Lending*, 2013. Two national car title loan companies report comparable annual rates of default, with Community Loans of America reporting a 15% default rate and TitleMax reporting a charge-off rate of 11% of loan volume. *See*, respectively, Affidavit of J. Robinson, President of Titlemax Holdings LLC, U.S. Bankruptcy Court for the Southern District of Georgia, Savannah Division (2009) and R. Reich, President of Community Loans of America a d Texas Car Title Loans Services, Testimony before the Texas Senate Committee on Business and Commerce (2011) and Affidavit of John Robinson, President of Titlemax Holdings LLC, U.S. Bankruptcy Court for the Southern District of Georgia, Savannah Division (April 20, 2009). In addition, one study found that in New Mexico in 2008, 60% of borrowers lost their cars. *See* N. Martin, N. & O. Adams, O, *Grand Theft Auto: Repossession and Demographic Realities in Title Lending*, Missouri Law Review, *available at* http://bit.ly/Zl2wSX.

[18] CFPB found that borrowers paid an average of $458 in fees to borrow $350 in principal (CFPB Findings); Pew found that borrowers pay $520 in fees alone for an initial loan of $375 (Pew, 2012) ; a forthcoming CRL analysis of state regulator data found that borrowers repay $504 in fees alone for $346 in credit (forthcoming *State of Lending* payday chapter, on file with CRL).

[19] CRL's analysis of Oklahoma payday lending data showed that payday borrowers were loaned greater amounts over time (e.g., 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). Thirty-seven percent of the payday borrowers experienced default in the first year of borrowing; within the first two years, 44% did (CRL, 2011). This finding is consistent with another study of data from a large Texas-based payday lender that found a 54% default rate. *See* P.M. Skiba & J. Tobacman, *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default* (2008), *available at* http://bit.ly/ZCsSur.

[20] Research has found that once credit card users began borrowing from payday lenders, they were 92% more likely to become delinquent on their credit card payments. S. Agarwal, S., P.M. Skiba & J. Tobacman, *Payday Loans and Credit Cards: New liquidity and credit scoring puzzles?* (2009), NBER Working Paper, *available at* http://bit.ly/RtDsXx. *See also* B. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, (2011), Oxford University Press, *available at* http://bit.ly/10M01tZ [hereinafter Melzer, 2011].

[21] One study found that payday borrowers nearly doubled their chances of filing for bankruptcy compared with households of similar financial status who were denied a payday loan. P.M. Skiba & J. Tobacman, *Do Payday Loans Cause Bankruptcy?*, (2008), SSRN working paper, *available at* http://bit.ly/UhdRNJ.

[22] Melzer, 2011.

[23] Research has shown that payday lending is linked with increased rates of involuntary bank account closures, which makes routine financial transactions more expensive and risky. *See* D. Campbell, A.S. Jerez, & P. *Tufano*, *Bouncing Out of the Banking System: An empirical analysis of involuntary bank account closures*, Harvard Business School (2011), *available at* http://bit.ly/VWJGk9.

[24] For an example of a payday illegal debt collection scam, see Federal Bureau of Investigation (FBI), *Extortion Scam Related to Delinquent Payday Loans*, (2010), *available at* http://1.usa.gov/1bl4wyJ. *See also* Liana Gonzales, *Woman says she paid off a debt twice and is now being harassed to pay it again*, (2013), *available at* http://www.azfamily.com/news/consumer/Woman-says-she-paid-off-a-debt-twice-and-is-now-being-harrassed-to-pay-it-again-186515611.html.

[25] Melzer, 2011.

[26] B. Melzer, *Spillovers from Costly Credit* (2010), *available at* http://bit.ly/10FsYmE.

[27] *Bailed-Out Banks Finance Predatory Payday Lenders*, Center for Media and Democracy (Sept 16, 2010) (reporting from a GRO-MO action, September 16, St. Louis, MO, and quoting a former Advance America employee who remained anonymous because he was reportedly forced to sign a confidentiality agreement upon leaving the firm), *available at* http://www.prwatch.org/node/9456 [hereinafter Center for Media and Democracy, 2010].

[28] Pew, 2012 at 16; *See also* University of North Carolina (UNC) Center for Community Capital, *North Carolina Consumers After Payday Lending: Attitudes and experiences with credit options* (2007), *available at* http://bit.ly/10SKPr8 [hereinafter UNC, 2007].

[29] The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* at 36 (Feb. 2013), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf.

[30] UNC, 2007.

[31] For example, Pew (2012) found that despite payday lender claims to the contrary, 69% of payday loans are taken out for recurring expenses, with only 16% for unexpected emergencies, 8% for "something special," and 2% for "other."

Other researchers similarly have stated that payday loans do not go to people who are managing temporary short-term income shocks, but rather to people with "extremely persistent weakness in credit record attributes" over the long term. *See* N. Bhutta, P.M. Skiba, & J. Tobacman, *Payday Loan Choices and Consequences*, (2012), Vanderbilt University Law School Law & Economics Working Paper Number 12-30 *available at* http://bit.ly/UheCWR. In addition, CFSI (2012) similarly found that payday loans primarily cover recurring expenses.

[32] Dan Feehan, CEO of Cash America, at a Jeffries Financial Services Conference in 2007.

[33] Morgan Stanley Analysis Report. *Advance America: Initiating with an Underweight V-Rating* (Jan. 25, 2005) at 10.

[34] 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, 2011 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.

[35] These affiliates are Bank of Albuquerque, Bank of Arizona, Bank of Arkansas, Bank of Kansas City, Bank of Texas, and Colorado State Bank and Trust.

[36] 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. *See* 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.

[37] CRL analysis finds that nearly two-thirds of bank payday borrowers incurred overdraft fees, and these borrowers were three times as likely to incur overdraft fees as bank customers as a whole (CRL, 2013). The CFPB's analysis found similar results, with 65 percent of bank payday borrowers incurring overdraft fees, which was more than 3.5 times the portion of customers eligible for a bank payday loan who did not take one out (CFPB Findings). The CFPB further found that one-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 (CFPB Findings).

[38] For instance, Regions Bank's installment option is available only to borrowers who call the bank prior to taking out the advance and explicitly request an installment plan, while the bank places any borrowers who request a payday loan online, at a branch, or over the phone without specifying the installment option, into the default balloon repayment structure. *See* Regions Ready Advance Account Agreement and Disclosures, http://www.regions.com/personal_banking/ready_advance_tc.rf (last visited July 19, 2013).

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. 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.

[39] 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. Wells Fargo Bank's cooling-off policy, for example, allows six consecutive months of loans until a one-month cooling-off period. 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 installment loan at the outset, after six months the borrower would have been finished, or be well on the way toward, paying off the loan. *Id.*

[40] CRL examined millions of loans across several states that adopted similar "best practices" to ostensibly reform payday loans, but loan churn persisted; for example, over 60 percent of all loans from these states go to borrowers with 12 or more transactions in a year (CRL, 2007).

[41] Fiserv, Inc., a provider of software systems to the financial industry, has actively promoted a bank payday software product it calls "Relationship Advance." Fiserv has reported significant interest in the product: "The pipeline is extremely strong. We've had some very nice mid-tier signings over the last three, four months and we see this as an interesting driver of … high-quality recurring revenue . . ." Fiserv, Investor conference webcast (Oct. 11, 2011), retrieved from http://investors.fiserv.com/events.cfm.

Fiserv's marketing of the Relationship Advance product has included promises that a bank's revenue from the product "will be greater than all ancillary fee revenue combined" within two years. Fiserv's Relationship Advance program description, retrieved from http://www.relationshipadvance.com/ in August 2011, on file with CRL.

[42] Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns* (March 7, 2013), *available at* http://rspnsb.li/10wraOy.

[43] Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products* (Jan. 24, 2013), *available at* http://rspnsb.li/YqdOuH.

[44] The prudential regulators' recent supervisory steps are also consistent with concerns they have expressed about payday lending for many years. In the early 2000s, payday lenders were partnering with banks to use bank preemption law to skirt state restrictions on payday loans. The federal banking regulators, noting safety and soundness and consumer protection risks stemming from payday lending, put an end to this so called "rent-a-bank" practice.

[45] Federal Reserve Board, *Statement on Deposit Advance Products,* April 25, 2013, *available at* http://www.federalreserve.gov/bankinforeg/caletters/CALetter13-07.pdf.

[46] CFPB Findings at 44-45.

[47] Federal Reserve. *Balance Sheet of Households and Nonprofit Organizations, available at* http://www.federalreserve.gov/releases/z1/current/z1r-5.pdf.

[48] Federal Interagency Forum on Aging-Related Statistics, *Older Americans 2010: Key Indicators of Well-Being* (July 2010), *available at* http://www.agingstats.gov.

[49] National Council on Aging, *A Blueprint for Increasing the Economic Security of Older Adults* (March 2011), *available at* http://www.ncoa.org/enhance-economic-security/economic-security-Initiative/a-blueprint-for-economic-security.html [hereinafter, National Council on Aging, 2011].

[50] Alicia H. Munnell, *More Retire with Mortgages,Credit Card Debt*, Marketwatch (June 5, 2013), *available at* http://blogs.marketwatch.com/encore/2013/06/05/more-retire-with-mortgages-credit-card-debt/.

[51] Amy Traub, *In the Red: Older Americans and Credit Card Debt*, Middle Class Security Project: An Initiative of the AARP Public Policy Institute, Demos (Jan. 2013) *available at* http://www.aarp.org/content/dam/aarp/research/public_policy_institute/security/2013/older-americans-and-credit-card-debt-AARP-ppi-sec.pdf.

[52] National Council on Aging,2011.

[53] J. A. E. Pottow, *The Rise In Elder Bankruptcy Filings And The Failure Of U.S. Bankruptcy Law (Working Paper No. 10-015)* (2011), University of Michigan Law School, *abstract available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669298##.

[54] Ellen E. Schultz and Theo Francis, High-Interest Lenders Tap Elderly, Disabled, *Wall Street Journal* (Feb. 12, 2008), *available at* http://online.wsj.com/article/SB120277630957260703.html [hereinafter Wall Street Journal, 2008].

[55] Center for Media and Democracy, 2010 (citing former Advance America employee).

[56] Wall Street Journal, 2008. An analysis of data from the U.S. Department of Housing and Urban Development shows many payday lenders are clustered around government-subsidized housing for seniors and the disabled. The research was done by Steven Graves, a geographer at California State University at Northridge, at The Wall Street Journal's request.

[57] Pew found that the typical payday borrower is younger, with most borrowers between 25 and 44 years old. Pew, 2012.

[58] Per CRL's analysis of Florida regulator data tracked in a Veritec database, in 2005, 12.2% of Florida payday loan customers were 55 and over (8.4% were 55-64, and 3.8% were 65 and over). By 2011, the share of customers 55 and over rose to just over 20% (13.2% of customers were 55-64, and 6.9% were 65+).

[59] The general Florida population aged 65 and over increased from 16.6% in 2005 to 17.6% in 2011. U.S. Census Bureau's American Community Survey.

[60] Forthcoming CRL *State of Lending* payday lending chapter (on file with CRL). *See also* Comment letter to CFPB from several Florida organizations that represent or work on behalf of Florida's low-income residents (May 1, 2012) (noting "the devastation that . . . payday loans cause to budgets of financially stressed Floridians" and urging the CFPB to take action to stop the payday lending debt trap), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0603.

[61] CRL, 2013; analysis on file with CRL. These findings, based on 2011 checking account data, are consistent with our analysis of 2010 data, which found that nearly one-quarter of all bank payday borrowers were Social Security recipients, who were 2.6 times as likely to have a bank payday loan as bank customers as a whole. R. Borné, J. Frank, P. Smith, and E. Schloemer, *Big Bank Payday Loans: High interest loans through checking accounts keep customers in long-term debt* (2011), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[62] CFPB Findings at 18.

[63] *See, e.g.*, Social Security Act, at 42 U.S.C. § 407(a).

[64] For further discussion and detail, see Testimony of Margot Saunders, National Consumer Law Center (on behalf of its low income clients) before the Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, June 24, 2008, *available at* http://www.nclc.org/images/pdf/other_consumer_issues/exempt_public_benefits/NCLC_exemptBenefitsTestimony_House_June2008.pdf..

[65] *Id.*

[66] 31 C.F.R. § 212.1.

[67] 76 Fed. Reg. 9947

[68] U.S. Department of the Treasury, Interim Final Rule, Federal Government Participation in the Automated Clearing House, 75 Fed. Reg. 80335, amending 31 CFR Part 208 (2010).

[69] "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 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. at 80338.

[70] 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.

[71] The following 16 states (including the District of Columbia) eliminate the payday debt trap through APR limits: Arizona, Arkansas, Connecticut, District of Columbia, Georgia, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Vermont, and West Virginia.

The following 6 states limit but do not eliminate the debt trap: Colorado, Delaware, Maine, Oregon, Washington, and Virginia.

[72] The eight states, including DC, are Arkansas, Arizona, Colorado, the District of Columbia, New Hampshire, Ohio, Oregon, and Montana.

[73] 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.

[74] 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).

[75] The guidance should also 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 usury laws. For further detail, see Comments to OCC and FDIC.

[76] *See, generally*, CRL, 2007.

[77] J. Sandman, *The New Loan Sharks, Payday lenders have more tricks up their sleeves*, AARP The Magazine, (Dec. 7, 2012), *available at* http://www.aarp.org/money/scams-fraud/info-12-2012/the-new-loan-sharks.2.html.

[78] L. Plunkett and M. Saunders, *Runaway Bandwagon: How the Government's Push for Direct Deposit of Social Security Exposes Seniors to Predatory Bank Loans* at 21, National Consumer Law Center (July 2010), *available at* http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf.

[79] Longer account *available at* CRL's website: http://www.responsiblelending.org/payday-lending/tools-resources/victims-4.html.

[80] Longer account *available at* CRL's website: http://www.responsiblelending.org/payday-lending/tools-resources/victims-3.html.

[81] F. Wilder, *Fast Cash: How Taking Out a Payday Loan Could Land You in Jail*, Texas Observer (July 16, 2013), *available at* http://www.texasobserver.org/cash-fast-how-taking-out-a-payday-loan-could-land-you-in-jail/.

[82] Fifth Third Early Access, Summary of Key Features, https://www.53.com/doc/pe/pe-eax-tc.pdf (last visited July 19, 2013).

[83] Regions Ready Advance Account Agreement and Disclosures, http://www.regions.com/personal_banking/ready_advance_tc.rf (last visited July 19, 2013).

[84] 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.

[85] U.S. Bank Checking Account Advance, Summary of Key Features, https://www.usbank.com/checking/caa/agreement.html (last visited July 19, 2013).

[86] 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 July 19, 2013).

[87] Guaranty Bank Easy Advance Line of Credit Agreement and Disclosures, as of February 27, 2013, *available at* http://www.guarantybanking.com/ContentDocumentHandler.ashx?documentId=18342.

The CHAIRMAN. Thank you, Ms. Borne.

Okay, Mr. Shaul. We want your perspective as the Community Financial Services Association, and you have longstanding experience in this position, having been a member of the staff of the Banking Committee under Chairman Barney Frank for years. So give us your perspective and what can we do about this, and in States that prohibit, as Ms. Borne said, payday lending, what is, in essence, the same thing that she has testified, tell us if that is what is occurring, and if so, what can be done about it.

STATEMENT OF DENNIS SHAUL, CHIEF EXECUTIVE OFFICER, COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA

Mr. SHAUL. Thank you, Mr. Chairman. Thank you, Ranking Member Collins and members of the committee. I am Dennis Shaul. I am the Chief Executive Officer of the Community Financial Services Association of America.

CFSA's member companies represent more than half of all traditional payday loan storefronts across the country. We are regulated at the Federal level and by the individual States where we operate. Also, CFSA members adhere to a strict code of best practices that cover everything from advertising to collection practices. We believe in providing consumers with a product that is fully disclosed and easy to understand if the structure of a payday loan is simple and clear to the borrower. Members have left our organization and others have not joined CFSA because they are unwilling to comply with these best practices.

There are unregulated offshore entities and other illegal or unscrupulous lenders who prey on the most vulnerable, and here I would say it is important to note that not everyone who is online is either unregulated or preying on the vulnerable. We share your commitment to protecting consumers from those that engage in such practices.

Payday loans serve those who need to borrow relatively small sums to meet critical short-term expenses. Eliminating access to storefront payday does not eliminate their needs. Borrowers turn to unregulated lenders. The protections States want to extend to their citizens are not in force for those loans.

Today's hearing looks specifically at the use of payday loans by senior citizens, which is an extremely small set of payday loan borrowers, about eight percent from storefronts, a figure that is verified by Clarity, a quasi-credit examining organization that collects data across the country, and also by Veritech, which does the same thing. Payday loans' usage among senior citizens is even lower than their use of other forms of credit.

We recognize that payday loans are just one of many tools in a consumer's financial toolbox. Our member stores are friendly and convenient and typically provide a wide range of financial services. Our member companies work extremely hard to ensure that their consumers take payday loans that meet but do not exceed their individual needs.

It hurts both the lender and the customer when a loan is not repaid. If a customer is unable to pay back a loan, we will work with them to find the best solution. One option is an extended payment plan, which is a part of our best practices. The plan offers customers more time to repay a loan without additional fees or interest.

We know from experience that educated borrowers are our members' best customers. Access to clear, consistent, unbiased information benefits both the lender and the borrower.

Here, Senator, I would like to say that it is not usual for a person of my background to take the position I have had. Neither did I see it in my future nor would our members have readily chosen someone with my political disposition. What is clear is that our members recognize what has been, I think, well pronounced during this hearing. Payday loans as we have known them are not likely to survive another five years. Each member that I talk to realizes that not only is reform necessary, but a greater product variety.

To speak specifically of things that need to be done, first of all, we need to do a different and better form of underwriting so that we catch people much earlier who might wind up in a cycle of debt.

Secondly, we need to offer installment loans that are truly installment loans and not a way of making further profit, but are geared to the customer who cannot make a payment within two weeks.

Third, we need to register all companies that are making loans, whether they are Internet or storefront lenders, so that we have greater access to supervision of them.

And, fourth, I think we need—and I am here campaigning with the CFPB—I think we need to make our code of business practices, of best business practices, a part of the rulemaking process and make sure that it is enforced across the board. Many of the examples, anecdotal examples that we hear from people who have been abused stem from those who do not accept or practice the kind of best business practices that we demand.

Finally, I would say that one thing that is very important, and we say this over and over again to the CFPB, is that we readily accept supervision both at the Federal and State level. But the States provide us with a dynamic, multi-faceted approach toward lending in this sector. I hope that there is not a form of preemption that occurs, but I do think there is a need for a Federal presence such as the Bureau has. We gain much from the experience that each State has. Your State of Florida is very different from the State of Illinois, which is different from Michigan, which is different from California. There are good and bad aspects in all those States and we have yet to come up with a perfect solution to what will work in terms of regulation or what would be the perfect product.

But what we surely know is that the product availability that we now have is not enough to meet the needs of the customers in this sector. Installment lending will help. We also know that we need to be vigilant in not forcing people into a less good situation, and we see the numbers crawling up dramatically on those who go offshore to unregulated entities.

I am grateful for the opportunity to be here and particularly eager to answer any questions you might have.

[The prepared statement of Mr. Shaul follows:]

TESTIMONY OF W. DENNIS SHAUL

CHIEF EXECUTIVE OFFICER

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA

BEFORE THE UNITED STATES SENATE SPECIAL COMMITTEE ON AGING

JULY 24, 2013

Good morning, Chairman Nelson, Senator Collins, and other members of the Committee. My name is Dennis Shaul, and I am Chief Executive Officer of the Community Financial Services Association of America (CFSA), the national organization for small-dollar, short-term lending, or payday loans. We are very pleased to be here today to discuss the use of payday loans by seniors.

CFSA and the Payday Lending Industry

The Community Financial Services Association was formed in 1999 to promote laws and regulations that protect consumers while preserving access to credit options, and to support and encourage responsible practices within the payday loan industry. CFSA's member companies represent more than half of all traditional payday loan storefronts across the country, in more than 30 states. Our members provided payday loans to more than 19 million households in 2010, as well as a wide range of other financial products and services, including bill payment, check cashing, installment loans, prepaid debit cards, and tax preparation services.

Our members' storefront locations put us in the heart of many financially underserved communities. CFSA members are heavily regulated at the federal level and at the state level in the individual states where they operate. Additionally, to serve our customers responsibly, CFSA has developed a set of 13 Best Practices that begin with compliance with all applicable state and federal laws. A list of these Best Practices is attached to this testimony. They cover everything from advertising to collection practices. Our members hold themselves to a higher standard, and we believe that these practices differentiate our members from other providers in the short-term credit industry.

Those other providers include unregulated offshore entities and other illegal or unscrupulous lenders who prey on the most vulnerable segments of our population: people with important credit needs and limited access to responsible, reputable providers. Unfortunately, it is sometimes the very laws and rules imposed to protect consumers that actually restrict consumers' access to regulated lenders and drive them to these unregulated and unscrupulous lenders. Those businesses have no place in CFSA, and we are as committed to protecting consumers from them as you are.

A payday loan is an unsecured, short-term loan generally under $500 and typically due on the borrower's next payday. An average payday loan is between $300 and $400, with a typical fee of $15 per $100 borrowed over a repayment period of two to four weeks. The member companies of CFSA make these loans face-to-face, in borrowers' own communities, and consumers can and do use payday loans for an almost infinite variety of needs. Borrowers must complete an application and meet certain income levels, and lenders make loans with confidence that they will be repaid. Our customers appreciate that the process of applying for and receiving a payday loan is faster and more straightforward than applying for some other forms of short-term credit, which makes these products more attractive to many borrowers.

We have long believed in—and in fact have championed—the concept of providing consumers with a product that fully disclosed and easy to understand. The structure of a payday loan is simple and clear to the borrower. CFSA Best Practices include a requirement that members disclose loan fees and terms on large poster-sized displays inside all storefronts, including the cost in both dollar amount and as an annual percentage rate. An example of one of these disclosures is included with this testimony. As you can see, this disclosure is far more straightforward, easier to understand and more transparent than the truth-in-lending disclosures that arrive with your monthly credit card statement.

Because payday lenders do not accept federally-insured deposits, they are regulated and supervised at the state level. Thirty-three states have specific statutes that allow for payday lending. Compliance with all applicable state laws and regulations is the first of CFSA's Best Practices, and we consider these requirements a floor, not a ceiling.

CFSA members have long been subject to state supervision and audit requirements. This state supervision includes extensive licensing and renewal requirements, examination and audit procedures, and other consumer protection laws and regulations. Requirements for a state license typically include a bond, background investigations and fingerprinting of company officials, evidence of industry experience, and minimum capitalization and liquidity requirements. State examinations monitor compliance with laws and regulations, and often include a review of loan agreements, customer files, federal and state disclosures, and collection procedures. States may also impose other regulatory requirements on the operations of payday lenders, such as caps on the fees that may be charged, maximum loan transaction amounts, and minimum and maximum loan terms.

CFSA believes that these state licensing and regulatory procedures are fundamental to establishing accountability for good business practices. Because CFSA member companies have a physical presence in the communities we serve, we have a vested interest in making sure that our members and our competitors are good corporate citizens. The openness and transparency required by state laws and regulations serve as a deterrent to the types of problems that may arise in other, less-regulated distribution channels, such as offshore lenders whose ownership may be obscure, and whose avenues for consumer redress may be limited or nonexistent.

The Demand for Payday Loans

Payday loans serve a critical need for many American consumers, filling a gap for those who need to borrow relatively small sums to meet critical short-term expenses. This need is substantial and growing, and crosses almost all demographic lines.

A 2011 study by the National Bureau of Economic Research found that half of American households could not come up with $2,000 for an unexpected expense in a 30-day period from all sources, including savings and borrowings. Roughly half of all American families are living paycheck-to-paycheck, and lack adequate savings to cover for unplanned expenses. Millions of Americans simply do not have the cash flow to pay all their bills at the beginning of the month. Payday loans are one option for those who need help to make it to the next paycheck.

The need for and use of short-term credit is significant and is growing. Total payday loan volume was approximately $48.7 billion in 2012, an increase of 10 percent over 2011, according to the investment firm Stephens Inc.

The economic downturn has unquestionably led to an increase in the number and types of people seeking short-term credit. A 2009 study for the Financial Services Research program at George Washington University School of Business found that the overwhelming majority of borrowers seeking payday loans — 70.8 percent — agreed with the statement, "I had an unexpected expense that could not be postponed." As this study notes, however, "Assigning a single reason for using a payday loan may be arbitrary and inconsistent across consumers."[1]

Eliminating access to storefront payday lenders for these borrowers raises the question of where these consumers might go to meet their short-term cash flow needs in the absence of regulated providers. These needs simply do not just go away. Unfortunately, we have seen evidence of where they go: to unregulated

[1] Elliehausen, Gregory. "An Analysis of Consumers' Use of Payday Loans," Financial Services Research Program Monograph No. 41, The George Washington University School of Business, January 2009.

lenders, often offshore, who may charge unlimited interest rates and undisclosed fees at much higher risk, including the risk of identity theft. While CFSA makes no judgments about the trustworthiness of these lenders, the protections states want to extend to their citizens are not in force for these loans.

Today's hearing looks specifically at the use of payday loans by senior citizens, Americans aged 65 and up. The Equal Credit Opportunity Act prohibits discrimination in lending on the basis of age and requires lenders to treat pension and Social Security income the same as income from employment for purposes of loan eligibility. As an age group, however, senior citizens form an extremely small subset of payday loan borrowers – less than 8 percent, according to most sources that track these data. In Florida, for example, borrowers over age 65 account for only 7.2 percent of payday loan transactions, although seniors account for 25.5 percent of all adults in the state.[2] These results are consistent with other academic studies[3] and with our members' broad experiences nationwide. This usage pattern is consistent with seniors' use of all forms of credit, which is lower than that of the general population; but per capita use of payday loans among senior citizens is even lower than their use of other forms of credit.

The most important reason for this is lifecycle. Younger families, particularly those with children, tend to have strong demand for credit, because their shorter employment history allows less time to accumulate savings and because the benefits

[2]Veritec Solutions LLC report to Florida Office of Financial Regulation (June 2012), available at www.veritecs.com/Docs/2012_06_FL_Trends_FINAL.pdf
[3]Elliehausen, *supra*, n. 1.

of investments in durable goods tend to be greater. It makes economic sense, for example, for a family with toddlers to finance the purchase of a car, a crib or even a highchair. Older families and senior citizens have had more time to accumulate precautionary savings, to establish credit histories with mainstream lenders, and to acquire household durable goods that may last a lifetime. Moreover, senior citizens, particularly those who experience fixed incomes, are much less likely to have income "shocks" – unexpected interruptions or reductions in income, such as from a layoff or reduction in overtime hours – than their younger counterparts.

The Choice to Use Payday Loans

CFSA recognizes that payday loans are just one of many tools in a consumer's financial toolbox, albeit a critically important one. As a Federal Reserve Board economist and his colleagues found, "initial payday loan applications occur precisely when consumers' access to liquidity from mainstream creditors is lowest."[4] Our members provide fast financial help to consumers when they need it most urgently.

This does not mean that other options are not available. In fact, it means that consumers often make the informed decision that a payday loan from a CFSA member is a better choice, based on their individual needs, than alternatives such as bank overdrafts, credit card advances, automobile title loans, installment loans, or

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[4] Bhutta, N.; Skiba, P.M.; and Tobacman, J. "Payday Loan Choices and Consequences," Vanderbilt University Law School Law & Economics Working Paper Number 12 – 30, January 25, 2013.

pawn transactions. As the demand for short-term credit has increased, CFSA has welcomed the entry of new regulated entities into this market, particularly credit unions. Competition among regulated lenders is not only good for the consumers we serve, but it also helps to push prices down.

While many choose to label payday loans as a high-cost credit product, they are often less expensive than other short-term credit options available to borrowers. A table attached to this testimony compares typical short-term finance costs; as you can see, financial institutions' insufficient funds fees or overdraft protection service fees are routinely more expensive than a payday loan.

Beyond the question of costs, CFSA members provide a friendly, convenient, and community-oriented atmosphere for our customers, many of whom may find a bank intimidating. CFSA members typically provide a wide range of financial services; no stigma attaches to walking into a storefront that also serves as a money transmitter, check casher, tax preparer or other financial service provider.

The economic profile of a CFSA member's customer base is very similar to the broader economics of the population as a whole, as reported by the most recent U.S. Census. In 2011, Advance America, the largest storefront lender in the United States reported that the median household income of its customers was just over $54,000. The vast majority – over 90 percent – have a high school diploma, and more than half have completed some college. Approximately 48 percent of Advance America's borrowers are homeowners, and a significant portion have major credit cards. Because of the nature of payday loans, they all have steady income sources, and they all have bank accounts. They are fully participating members of the American economy.

Consumer Protection and the Collection Process

Our member companies work extremely hard to ensure that their customers take payday loans that meet, but do not exceed their individual needs. It hurts both the provider of the loan and the customer when a loan is not repaid.

Individual state laws govern the collection processes for payday loans, and CFSA Best Practices provide additional guidance. It has been suggested, for example, that payday loans contribute to a "cycle of debt" that keeps borrowers from building wealth. Research specifically discounts this phenomenon, as detailed in the previously cited 2009 Elliehausen study. Dr. Elliehausen's study found that "few payday loan customers considered payday loans as a debt trap," and reported that only three percent of payday borrowers expressed dissatisfaction with their payday loan because of concerns about the difficulty of getting out of debt.

Further, CFSA Best Practices limit rollover loans, which is when a customer pays the fee only, and extends the loan. In fact, rollover loans are prohibited unless explicitly allowed by state law. Where state law allows rollovers, our Best Practices limit rollovers to four (4) or the state limit, whichever is less.

If a customer is unable to pay back a loan within the arranged timeframe, our members will work with them to find the best ways to deal with their individual situation and the repay the loan in full. In addition, CFSA's Best Practices include an Extended Payment Plan (EPP). Unique in financial services, the CFSA EPP, where allowed by law, offers customers more time to repay a loan, usually four extra pay periods, without additional fees or interest. As long as a customer does not default on the EPP, the lender will not pursue additional collection measures. Applying for the EPP does require that the borrower return to the lender – to the storefront or online – and sign a new agreement. Additionally, many of our members also have close working relationships with credit counseling agencies in their communities. The bottom line is that our members go to great lengths to make sure that their borrowers are successful.

Under our Best Practices, members may not pursue criminal prosecution against a customer if a check is returned. If it becomes necessary and appropriate, our members, like any other type of lender, may turn an account over to a licensed collection agency.

The effectiveness of CFSA's Best Practices is reflected in the number of consumer complaints filed against payday lenders, compared to other lending institutions. The Federal Trade Commission's 2012 Consumer Sentinel Network Data Book reported only 476 complaints against payday lenders, compared to 62,315 against mortgage companies, 8,013 against finance companies, and 3,448 against banks and credit unions. We ascribe this low complaint rate to several factors. Customer satisfaction with our product is extremely high, but perhaps more importantly, we have been successful at working with state regulators to incorporate our Best Practices into state law and to familiarize borrowers with their rights and obligations, and with the consumer-friendly nature of our services.

The Federal Government's Role in Protecting Payday Loan Borrowers

CFSA knows from experience that educated borrowers are our members' best customers, and that access to clear, consistent, unbiased information benefits both the lender and the borrower. Inconsistency in the application of standards and the delivery of information across state lines can lead to confusion and abuse.

The federal government can help protect payday loan borrowers by improving the consistency with which federal rules and regulations are applied to similar short-term, small-dollar products, regardless of the provider's organizational structure or business model. Many short-term, small-dollar credit options, such as title loans, installment loans, deposit advance loans, and overdraft protection services, are offered by both banks and non-bank institutions. These very similar products and services, however, are not necessarily regulated in the same manner. We hope that the Consumer Financial Protection Bureau will work toward regulating like products in a like manner, as that type of consistency will reduce confusion and improve understanding among consumers who depend on these products.

CFSA members work continuously and consistently with state legislators and regulators to ensure that laws and regulations keep pace with advances in lending products and technology, and with changes in the economy. We are proud to provide an essential service in the communities we serve, and we seek to do so in a responsible manner. We welcome the opportunity to discuss our business, our experiences in the serving the short-term credit needs of millions of American consumers as well as the important safeguards our members have put in place for those that we serve.

Thank you for this opportunity to testify. I welcome any questions you may have.

The CHAIRMAN. This committee is not assaulting payday loans. I stated very clearly in the opening comments that there is a need for those kind of advance payments. It is the cases that this committee is interested in of the egregious examples of abuse and where someone is paying 300 percent interest when a State's law says that the max is 36 percent interest. Then we have an interest in seeing that those kind of practices are stopped.

You also bring up very cogently and timely the fact that we are going to have another creature out there to try to protect seniors from, and that is the online offshore kind of lending. We have been involved in some of that offshore scam stuff that is going on among seniors. So we want to work with you, Mr. Shaul.

Mr. Hunt, tell us, as CEO of the Consumer Bankers Association, what can we do.

I am going to stop right here. It is 3:40. All across Capitol Hill, there is now a moment of silence for Officer Jacob Chestnut and Detective John Gibson, killed 15 years ago in the line of duty.

[Moment of silence observed.]

And thank you all very much.

Okay. Mr. Hunt, you are the CEO of the Consumer Bankers Association. Tell us what you think is the problem and how can we go about correcting it with your members.

STATEMENT OF RICHARD HUNT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONSUMER BANKERS ASSOCIATION

Mr. HUNT. Sure. Thank you very much, and good afternoon to you, Mr. Chairman and Ranking Member Collins and members of the committee.

I am President of the Consumer Bankers Association. We represent the retail section of a bank. We appreciate the opportunity to be here today.

Unfortunately, 75 percent of today's consumers in this economy live paycheck to paycheck, meaning many times they need help to pay their mortgage or rent, hospital bills, or an automobile repair. When an existing customer walks into one of our banks, we can do one of two things. We can help them or we can turn our back on them.

If we try to assist, and remember, we only have six banks in this country that offer a deposit advance product—we represent four of those six—if we try to assist them and they qualify, they have the option to use something called a deposit advance product. It is important to highlight for this committee, this product is a short-term line of credit. It is not a loan. It has been widely used by consumers to meet their short-term liquidity needs. It is a very popular product.

A deposit advance is absolutely not a payday loan. Banks do not participate in any payday lending, as the costs and terms are very different.

Deposit advance products are consumer driven and driven by demand. One can eliminate the product, but unfortunately, cannot eliminate the demand. We try and do everything we can to keep customers in a heavily regulated entity, such as we are. In many instances, deposit advance product is one-half the cost of a traditional payday loan and much cheaper than that versus other industries such as pawn shops and unregulated online lenders.

There are very stringent requirements that must be met for one to receive a deposit advance product. A customer must be in good standing with a bank. That means they have an established relationship with their bank from two to six months, no extensive negative actions against their account, and have a history of recurring direct deposit.

If the customer qualifies for this product, they must then review the bank's transparent and easy to understand disclosure, which includes fee structure details, an agreement to pay off the balance of this line of credit with the next direct deposit, and importantly, each bank clearly highlights and discloses to the consumer this is a short-term product. Then, and only then, will a customer receive access to a deposit advance product.

I would like to point out, our four banks do not spend one penny marketing this product. Of the four banks, three percent participation of all checking account holders. Fifteen percent of those three percent are seniors.

So a quick review. There are 7,000 banks in this country. Only six banks present this product. Only three percent of the account holders participate in a deposit advance product, and 15 percent are seniors. So it is 15 percent of the three percent are seniors.

Customers must review the terms and disclosure each time they access this line of credit.

These four banks have worked with regulators, customers, and consumer groups to improve this product to make it as transparent and less costly as possible. Over the years, we have changed our product to include cooling off periods, installment repayment options, lower credit amounts, and lowered the cost. We also do not charge for any late fee a customer may have.

The other option we have when a customer walks into the bank wanting assistance is to turn our back on that customer and tell them the most heavily regulated industry in the country cannot help you in your time of need, in a time where the number of underbanked and unbanked customers are rapidly increasing. We do not think this is in the best interest of the consumer.

If we do not choose to help them, they have several choices. They can go to the traditional online payday lending, which is expensive, the pawn shop, which is even more expensive, or, as the Wall Street Journal pointed out recently, they will turn to the Tony Sopranos, rest in peace, of the world. That is the most expensive alternative.

One thing you may have seen over the last couple of weeks is something we called regulatory olympics in this country. There are now four regulators, numerous States, and now this body overseeing this product. We understand. We appreciate the jurisdiction all may have. However, this is an inefficient and ineffective way to regulate. In this town, we call it regulatory olympics. We think it fits the situation well.

We urge another cooling off period. Let us let the CFPB conduct its comprehensive analysis before any agency takes further action.

I would like to close with a quote from a prominent member of banking, the newly confirmed Director of the CFPB, Richard

Cordray, who said, and I quote, “I want to be clear about one thing. We recognize there is a need and demand in this country for emergency credit.” January 19, 2012. We align ourselves with that comment.

We want to improve this product. Any suggestions you may have will be taken seriously. We want to make sure customers are happy with their banks.

With that, Mr. Chairman, I will yield for any questions you may have.

[The prepared statement of Mr. Hunt follows:]

CBA | CONSUMER BANKERS ASSOCIATION

The Voice of the Retail Banking Industry

July 24, 2013

TESTIMONY OF RICHARD HUNT PRESIDENT & CEO, CONSUMER BANKERS ASSOCIATION

BEFORE THE UNITED STATES SENATE SPECIAL COMMITTEE ON AGING

"PAYDAY LOANS: SHORT-TERM SOLUTION OR LONG-TERM PROBLEM?"

1225 Eye Street, NW, Suite 550 ♦ Washington, DC 20005 ♦ 202-552-6382

Chairman Nelson, Ranking Member Collins and members of the Committee, thank you for the opportunity to discuss the short-term liquidity needs of American consumers and bank deposit advance products. My name is Richard Hunt and I am President and CEO of the Consumer Bankers Association ("CBA").[1]

Currently, an estimated 76% of all Americans live paycheck to paycheck.[2] The economy has remained stagnant leaving consumers with less cushion for emergencies, strained credit scores, and fewer credit options, making access to reasonably priced short-term liquidity products all that more important. Various entry-level credit products exist to meet a wide range of needs, including traditional credit cards, personal loans, and other forms of credit. Unfortunately, many consumers do not qualify for them. In response, some banks have chosen to offer a deposit advance product to meet their customers' need and demand for short-term, small-dollar credit.[3]

Deposit advance products, offered today by only six banks, serve a critical short-term, small-dollar credit demand for consumers who do not qualify for traditional credit products. These products are not loans, they are lines of credit ("LOC") repaid automatically from a recurring direct deposit. While individual products vary, the maximum amount advanced is limited to the lesser of a cap (typically $500) or a percentage of the average recurring payment (e.g. 50 percent). Deposit advances providers usually charge a clear, easily understood fee based on a percentage of the loan.

[1] The Consumer Bankers Association ("CBA") is the only national financial trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation on retail banking issues. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the industry's total assets.

[2] *Short On Savings, Americans Still Feeling Positive* - Bankrate.com - http://www.bankrate.com/finance/consumer-index/americans-still-feeling-positive.aspx?ic_id=Top_Financial%20News%20Center_link_1

[3] Banks offer these products under different names and with different features. For simplicity's sake, we will refer to them as Deposit Advance Products in this testimony.

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Executive Summary

- Deposit advance products are small-dollar lines of credit available only to bank customers with established checking account relationships in good standing. They are not payday loans. These products incorporate features such as maximum loan size and cooling off periods to protect consumers from reliance on the product.

- There is high consumer demand for viable short-term, small dollar credit. Deposit advance products are designed to safely, quickly and conveniently meet this demand. Consumers understand and like bank deposit advance products. These products have received positive customer feedback and carry few complaints.

- Deposit advance products do not have a disparate impact on seniors. Total customer usage corresponds roughly with the population of seniors in the United States.

- Deposit advance products have been offered by depository institutions for many years and are intensely regulated for consumer protection and safety and soundness concerns. The risks to consumers and supervised institutions recently cited by federal prudential regulators are overstated and regulatory coordination is strongly urged moving forward. Deposit advance products do not present safety and soundness risks to the institutions that offer them. These products have built in controls to limit use, are not actively marketed, and offer clear and conspicuous disclosures.

In testimony before a House Subcommittee, Senator Elizabeth Warren, then the Special Advisor to the Secretary of the Treasury for the Consumer Financial Protection Bureau ("CFPB"), said, "consumers want to know the costs up-front and don't want to be blindsided by hidden fees, interest rate changes, or payment shocks. Informed decision-making allows consumers to drive the financial marketplace so that providers offer products that meet consumer needs and preferences."[4] As outlined in our testimony today, CBA believes the banks offering deposit

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[4] Testimony of Elizabeth Warren, Special Advisor to the Secretary of the Treasury for the Consumer Financial Protection Bureau - Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs, Committee on Oversight and Government Reform United States House of Representatives, Tuesday, May 24, 2011 -

advance products have adhered to these words in the strictest sense by providing reasonably priced products with highly transparent terms, meeting the demand of U.S. consumers.

Discussion

Deposit advance products are heavily regulated and carefully designed to ensure strong consumer safeguards at reasonable prices. Most notably, deposit advance products have safely served consumer demand for many years under intense regulatory scrutiny; one product having been in existence for nearly two decades. As such, these products have been scrutinized again and again for consumer protection and safety and soundness concerns by numerous state and federal banking regulators. Banks have responded by working with regulators to ensure products that are best suited for public offering.

Bank-offered deposit advance products serve an important function: they help keep consumers from being pushed out of the heavily regulated banking system and into more expensive and often less and inconsistently regulated alternatives such as traditional payday loans, pawn brokers, title loans and other sources of short-term, small-dollar lending. Additionally, without reasonable alternatives, consumers will pay higher prices for short-term liquidity or may face increased delinquency, late payment, nonsufficient fund, and returned check fees.

One of the advantages of bank-offered deposit advance products is they are typically cheaper than other alternatives. For example, for a $100 loan repaid over a 30 day period, the average cost of a payday loan is $15.26, some of course are much higher.[5] Even at the highest end, the cost of a bank deposit advance product for the same amount is only $10, with some as low as $7.50.

More providers in the marketplace and efficient and consistent regulation will ensure greater competition and innovation, which ultimately will increase protections and lower costs. Overly

http://www.consumerfinance.gov/speeches/testimony-of-elizabeth-warren-before-the-subcommittee-on-tarp-financial-services-and-bailouts-of-public-and-private-programs/

[5] Community Financial Services Association of America - *Cost of Offering Payday Loans* (2009) - http://cfsaa.com/our-resources/short-term-credit-alternatives/cost-of-offering-payday-loans.aspx.

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prescriptive restrictions on bank-offered deposit advance products will lead to less competition and an increase in prices[6] - something not in the best interests of consumers.

Consumer demand is clear: Bank customers consistently register high satisfaction rates for deposit advance products. At a field hearing held by the CFPB on January 19, 2012 in Birmingham, Alabama, Director Richard Cordray remarked, "I want to be clear about one thing: We recognize that there is a need and a demand in this country for emergency credit."[7] This statement rings more true today than ever. Consumers demand access to short-term, small-dollar alternatives, often using the service as a cash flow management tool. They appreciate the product's convenience when coupled with a deposit account and recognize the value in utilizing services offered by their bank of choice. Consumers speak very highly of the product, registering testimonials like "I'm very thankful for [deposit advance]... It has helped me through some rough times... I hope this survey doesn't mean they are considering ending this program," and "[deposit advance] has made my life a lot easier...there have been several times where I have found myself in a bind, but was able to make ends me[e]t because of [deposit advance]."

In 2009, Professor Todd Zywicki of George Mason University published a paper addressing the disadvantages consumers will experience should overly restrictive bans be put on payday lending.[8] In his report, Zywicki writes, "[consumers] use payday lending to deal with short-term exigencies and a lack of access to payday loans would likely cause them substantial cost and personal difficulty, such as bounced checks, disconnected utilities, or lack of funds for emergencies such as medical expenses or car repairs. As such, having banks compete in this space will serve to benefit the consumer by better serving their short-term liquidity needs."

Crippling the ability of banks to offer deposit advance products will not solve the underlining problem that creates the need for them, and consumer demand will not diminish. CBA urges

[6] According to study conducted the Center for Financial Services Innovation entitled *A Fundamental Need: Small-Dollar, Short-Term Credit* (2008), continued market competition and product innovation would be advantageous in expanding small-dollar, short-term lending and may ultimately help lower the cost of these products for both providers and consumers.

[7] CFPB - In The Matter of: *A Field Hearing on Payday Lending,* page 19, Lines 9 -12.

[8] *The Case Against New Restrict ions on Payday Lending,* Todd Zywicki, George Mason University (2009).

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lawmakers and regulators to give strong consideration to the possible unintended adverse impacts on consumers when contemplating actions that would affect or eliminate the ability of banks to offer deposit advance products. There is significant acknowledgement by banking regulators and advocacy groups of the market demand and a need for short-term, small dollar lending products.

Deposit Advance Products vs. Payday Loans – A Comparison

It is important to note bank-offered deposit advance products are not payday loans. Deposit advance products are lines of credit, which are products available to qualified bank customers. While some refer to these as "payday loans" their product features are very different in a number of ways. Critics, some media, consumer groups and policy makers often incorrectly associate bank-offered deposit advance products with certain traditional payday lending options, with little or no distinction as to how bank-offered product features allow for greater consumer protection and better customer pricing.

CBA believes it is important to explain bank-offered deposit advance products in order for members of this committee to have an accurate understanding of how they work, their products features, how consumers use them to manage their cash flow and how these are different than traditional payday loan products.

Eligibility

The most important distinction between deposit advance products and payday loans is the relationship that exists between the customer and the bank. A consumer in need of a short-term, small dollar loan cannot walk into a bank and immediately qualify for a deposit advance LOC. These are not stand-alone products as the customer must have a checking account with the bank.

More importantly, they could not walk into a branch and open a checking account and have access to a deposit advance product that same day or even in the first month. The handful of CBA member banks offering this product all require a period of time in which the customer has had a checking account in good standing before they are even eligible to add the deposit advance feature to their checking account. This allows banks to monitor the customer to determine they

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have the cash flow to qualify for the LOC and have been able to maintain their account for some period of time (2 to 6 months or longer) without any negative actions.

The maintenance of this relationship is of the utmost importance to a bank. Without a positive banking experience, customers would look elsewhere to meet their financial needs and banks would not only lose the opportunity to service the customer's short-term liquidity needs, but also the chance to establish or maintain a long-term banking relationship.

Product Feature Protections

Unlike many payday loans, bank deposit advance products have built-in controls designed to limit use of the product. These controls include limits on credit amounts, automatic repayment through a linked depository account and "cooling" periods, all designed to keep customers from relying too heavily on the product and to ensure the customer's ability to repay.

Also, it is important to note that banks are some of the most highly regulated business entities in the country. Unlike most payday lenders, banks are under the constant scrutiny of many different regulators, some of which have a permanent presence within the companies they supervise. Additionally, banks need to take into account all applicable federal and state laws as well as banking regulations when developing products and services. Banks do this whenever they are developing new products. To ensure compliance for all products and services, the banks that currently offer deposit advance products have regular exams and audits and have been working with their regulators over the years to develop deposit advance products and make consumer-friendly adjustments to their features.

There are additional important distinctions between deposit advance products and payday loans, all of which are designed to strengthen customer relationships through valuable services that consumers demand, including:

Account Security

Bank-offered deposit advance products offer customers greater account security. With these products, customers do not have to provide sensitive bank information to third-party financial

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service providers, opening the door to the possible compromise of sensitive financial information. Accordingly, all personal account information is kept in-house, providing a significant security advantage to non-depository services.

Clear Disclosure

Banks strongly support and adhere to strict clear and conspicuous disclosures for all financial products and services that assist consumers in making informed decisions about managing their finances. All product terms are disclosed clearly and are fully transparent to customers prior to product use. At a minimum, all deposits advance providers are bound by applicable federal laws, and the customer is typically required to sign a separate, detailed terms and conditions document to activate a deposit advance line of credit. Additionally, bank providers clearly and repeatedly disclose to their customers that deposit advance products can be an expensive form of credit that is designed for short-term borrowing needs and not long-term use. Customers also are regularly reminded that other credit alternatives, if applicable, may be cheaper and better suited to meet their financial needs.

Banks offering deposit advance products continue to provide consumers with clear disclosures needed to calculate and understand their product of choice. In surveys conducted by banks, customers overwhelmingly indicated they fully understand the terms of use for the product including pricing, repayment schedules and duration. For example, one bank's survey of its pilot product asked customers on a scale from 1-10 how clear explanations were regarding how an advance is calculated and how and when it is to be repaid. The overall score for the program was 9.13 out of a possible 10, giving all term and pricing explanations a "very clear" ranking.

Loan Size Limitations

All depository institutions currently offering deposit advance products have limits on the amount a consumer may borrow. Although it varies from bank to bank, advances generally are limited to the lesser of a specific amount or a percentage of the total amount of a customer's monthly direct deposits. These limits ensure the customer has money for other monthly expenses after the advance is paid. In contrast, payday loans are not based on or repaid through a pre-existing deposit relationship and payday lenders do not consider whether a particular loan will completely deplete a consumer's monthly income.

Cooling Off Periods

All bank-offered deposit advance products impose a mandatory cooling-off period to ensure customers do not depend on the product to meet their monthly financial needs. These periods are imposed to ensure deposit advance products are used for the intended purpose, namely, short-term liquidity. To manage the risk that the consumer will become reliant, a customer typically will be able to access a deposit advance product for a limited period of time at the end of which they are required to repay the outstanding balance or completely stop using the product. Other usage limits are tied to excessive overdrafts and sustained negative checking account balances.

Pricing

Deposit advance products often are criticized for their costs when considering the size of the credit extended. However, in order for any product to be sustainable, it must be delivered in a cost-effective manner for both the provider and the customer. Previous small dollar lending programs, such as those suggested by the FDIC,[9] have not been widely adopted by the industry because the costs to administer the programs outweigh the revenues and, hence, are not sustainable.

Most importantly, the fees associated with deposit advances products are typically lower than those charged by traditional payday lenders.[10] Most deposit advance products are priced based on a percentage of the amount advanced and do not include additional costs to the consumer such as application fees, annual fees, over-limit fees, rollover or re-write fees and late payment fees.

Level Playing Field

[9] FDIC's Small-Dollar Loan Pilot Program - 2008

[10] Deposit advance products carry less consumer costs than traditional payday loans. According to the Consumer Financial protection Bureau ("CFPB"), the median fee for traditional payday lenders was $15 per $100. In fact some payday lenders charge close to $20 per transaction. For bank-offered deposit advance products, a typical fee per $100 is $10 or less.

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Bank-offered deposit advance products have recently become the focus of proposed supervisory guidance by federal regulators. The Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") have issued nearly identical proposals for supervisor guidelines, and the CFPB has issued a white paper that raises the prospect of future action. As for the actions of the OCC and FDIC (collectively the "Agencies"), the impact of their proposals, if adopted, would severely constrain banks' ability to offer deposit advance products and assist their customers.

While the proposals claim to be based on safety and soundness concerns, the Agencies fail to provide any clear evidence to support their claim. Banks have offered these products for many years, including one for nearly two decades. During this time the products have yielded positive reactions from regulators and demonstrated that close working relationships between banks and their supervisors can result in services meeting consumer's needs. CBA believes that using safety and soundness as the basis for market intervention without clear evidence of risk or careful consideration of the consequences to consumers is a bad precedent and contrary to the policy objective of the prudential regulators to support development of innovative, fair and transparent financial products and services by insured financial institutions.

Title X of the Dodd–Frank Act created the CFPB to specifically address issues of consumer protection surrounding financial products. To ensure equal protections across all financial products and services, the CFPB's authority to promulgate consumer protection rules extends to all providers of financial services and products including depository and non-depository institutions (e.g. payday lenders) – authority that the prudential regulators do not have. Accordingly, *only the CFPB can ensure that consistent rules are applied across the entire financial services industry.* Unilateral action by the OCC or FDIC is contrary to Congressional intent in creating the CFPB and directing that agency to regulate consumer financial services whether offered by banks or nonbanks. Absent across-the-board standards, consumers will be pushed into services that offer fewer protections and come at significantly greater costs. Indeed, even within the realm of federal prudential banking supervision, banks of different charters will apply inconsistent standards with regards to deposit advance products.

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As evidenced by its recent study,[11] the CFPB is in the process of collecting and analyzing sizable data on payday loans and deposit advance products. The goal of this effort is to develop a clear understanding of how consumers use these products. The CFPB's initial findings do not draw any conclusions as to what, if any, consumer protection issues exist, and we believe the study should be completed before any inferences about deposit advance products are made. Further, the CFPB's findings thus far do not consider the benefits of these products, which have been discussed in various reports.[12] CBA believes more work is needed to fully understand the complexity of this market, and we urge Congress and the federal prudential regulators to allow the CFPB to continue its analysis of all relevant data and complete a cost-benefit study before implementing new rules or guidance that could be detrimental to consumers.

Deposit Advance Products Pose No Safety and Soundness Concerns

As previously mentioned, the OCC and FDIC have prefaced their proposed guidelines of deposit advance products on safety and soundness concerns. However, there is little evidence to support the premise that these products pose any safety and soundness risks to the banks that offer them. It is important to note some banks have offered deposit advance products for many years with little or no safety and soundness concerns, and we are unsure as to the basis for the Agencies' concerns over institutional safety and soundness. Close regulatory examination of these products has yielded relatively positive results and, importantly, demonstrated that close working relationships between banks and regulators can result in the development of prudent and fair products. Moreover, as discussed below, bank-offered deposit advance products involve materially less risk of harm to consumers than similar products offered by non-depository providers.

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[11] *Payday Loans and Deposit Advance Products, A White Paper of Initial Data Findings*. Consumer Financial Protection Bureau (April 24, 2013).

[12] *See, An Analysis of Consumer's Use of Payday Loans*, Gregory Elliehausen, Division of research and Statistics, Board of Governors of the Federal Reserve System (2009) – Survey results of consumer use of payday lending indicated that most customers used payday loans as a short-term source of financing. *Also see, Payday Lenders: Heroes or Villains?* Adair Morse, Graduate School of Business, University of Chicago (January 2007) - An assessment of the impact of payday lenders on disaster-struck communities concluded communities struck by natural disasters are more resilient and their community welfare improves as result of the availability of payday advances. *Also see, Payday Holiday: How Households Fare after Payday Credit Bans*. Donald P. Morgan and Michael R. Strain (2008) - An assessment of states with payday lending bans concluded that consumer financial problems saw significant increases when compared to states without similar restrictions.

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Reputational Risk

There is little evidence of consumer dissatisfaction with bank-offered deposit advance products. To the contrary, consumer satisfaction with these products is often very high with below normal complaint rates. For example, in one bank's recent survey of deposit advance customers, 90 percent of respondents rated their overall experience with the product as "good" or "excellent". In another survey by a different bank, the customer satisfaction rating ranked higher for the bank's deposit advance product than any other product offered by that bank.

In yet another recently conducted customer survey, one bank found more than 96 percent of customers said they were "satisfied" or "extremely satisfied" with their deposit advance. In addition to high overall customer satisfaction, 92 percent of customers of the bank agreed it was important to have the ability to advance from their next direct deposit with 94 percent of customers preferring the service to be offered by their bank.

Accordingly, complaint levels for deposit advance products are extremely low across the board. One bank offering the product registered just 41 complaints over the course of a year, representing just .018 percent of all active users of that bank's deposit advance product. This percentage equates to roughly one in every 5,500 users. Whether taken together or considered separately, the high customer satisfaction ratings and low levels of customer complaint for deposit advance products refute claims that these products pose significant reputational risk.

Credit Risk

Deposit advance products have been around for many years, most notably through one of the most challenging economic cycles in recent history, and losses remain within an acceptable risk tolerance. Even if default rates were high, which they are not, there would be little to no credit risk as these products represent a very small percentage of any given bank's total lending portfolio.

Legal risk

Banks need to take into account all applicable federal and state laws as well as banking regulations when developing products and services. Banks do this whenever they are developing new products. To ensure compliance for all products and services, banks have regular exams and audits. CBA believes that deposit advance products carry no greater legal risk than any other product or service. As discussed, deposit advance products rank high in customer satisfaction including high ratings for transparency and ease of use.

Underwriting

The OCC, FDIC and others have expressed the view that banks currently offering deposit advance products do not typically analyze the customer's ability to repay the advance and assert banks base their decisions to grant deposit advance credit solely on the amount and frequency of customer deposits, not on the traditional underwriting that characterizes lines of credit. In their respective proposals, the OCC and FDIC suggest this lack of underwriting results in consumers repeatedly taking out advances they are unable to fully repay, creating a debt cycle the Agencies refer to as the "churning" of loans. The Agencies have proposed underwriting expectations for supervised banks designed to ensure deposit advance products are consistent with consumer eligibility and criteria for other bank loans. These criteria should ensure credit can be repaid according to the product terms, while allowing the borrower to meet typical and recurring necessary expenses.

Under the proposals, a bank would be required to monitor the consumer's use of a deposit advance products and repetitive use would be viewed as evidence of weak underwriting. To comply with the guidance, policies relating to the underwriting of deposit advance products must be written and approved by the bank's board of directors and must be consistent with a bank's general underwriting and risk appetite. Providers are also expected to document a sufficient customer relationship of no less than six months prior to providing a deposit advance to the consumer. The guidance would further prohibit consumers with delinquencies from eligibility. The bank must also analyze the customer's financial capacity with these products, including income levels and deposit inflows and outflows in addition to applying traditional underwriting criteria to determine eligibility.

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CBA believes the approach taken by the proposed guidelines is flawed for several reasons. First, the proposals would require banks to use traditional underwriting and, in addition, overlay a cash flow analysis. Such analysis is not well suited to a deposit advance product and would increase the cost to offer it. Requiring a bank to complete a cash flow analysis on the customer's checking account, involves mapping all recurring inflows against all outflows of a single checking account to determine a borrower's financial capacity. This analysis assumes that non-recurring inflows are not legitimate forms of income and also assumes all outflows are non-discretionary. This type of analysis is not used for other credit underwriting in the ordinary course of business because a bank is not able to assess its predictive power, which is a key aspect of safe and sound underwriting practices.

Second, the proposed guidelines are flawed is they assume consumers use their checking accounts to build reserves or savings as opposed to using them as transactional accounts, an assumption that is contrary to the very purpose of the account. Accordingly, even a high income consumer with no debt and a very high credit score may not qualify under the proposed guidelines as checking accounts are not typically where consumers keep excess funds.

Third, the application of traditional underwriting would require banks to pull consumer credit reports to assess a customer's ability to repay. Under the proposals, banks would need to make credit report inquiries at least every six months to ensure a customer continues to have the ability to repay all advances made. This process of making multiple inquiries could have a detrimental effect on a one's credit score and, in turn, would cause, not prevent, harm to the customer by possibly limiting access to other forms of credit.

Accordingly, the proposals would impose more stringent underwriting standards on deposit advance products than on any other bank product today. If the guidelines are adopted as proposed, very few consumers would be eligible and it would be nearly impossible for banks to offer these products. Deposit advance products are hybrid products combining elements of depository payments and lending, thus requiring new and innovative models of evaluation. The proposals do not take into account the hybrid nature of the product and lean too far in the direction of classifying it as a traditional credit product.

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CBA firmly believes the proposals will effectively result in killing the product and will steer consumers away from the banking system to non-depository alternatives such as traditional payday lenders, title loans, pawn shops and others that are more expensive and offer far fewer consumer protections. We believe these consumers will face other burdens such as over-drafting their account, delaying payments that could result in late fees and detrimental hits to their credit score, or foregoing needed non-discretionary expenses.

In a 2011 report,[13] the FDIC noted, "Participation in the banking system…protects households from theft and reduces their vulnerability to discriminatory or predatory lending practices. Despite these benefits, many people, particularly low-to-moderate income households, do not access mainstream financial products such as bank accounts and low-cost loans." The FDIC continues to note, "These households may incur higher costs for transaction and credit products and services, be more vulnerable to loss or struggle to build credit histories and achieve financial security. In addition, households that use non-bank financial services providers do not receive the full range of consumer protections available through the banking system." We agree.

Deposit Advance Myths

There are claims that bank-offered deposits advance products carry the same consumer risks as traditional payday loans. In addition to the distinctions between the products we have previously noted, we offer the following observations in response to several of these specific accusations.

- *Seniors make up a disproportionate amount of deposit advance borrowers.*

Deposit advance products **do not** have a disparate impact on seniors. In fact, CBA has found that seniors make up a small percentage of customers using the product. Additionally, seniors that use the product, often use it less frequently than younger users.

[13] FDIC, *National Survey of Unbanked and Underbanked Households* (September 2011) - http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf

CBA members show deposit advance use by seniors to average in the range of 15%. This number is no higher than for any other bank-offered service or product. Additionally, the ratio of seniors to total population should be considered. According to 2010 U.S. Census data[14], the population of the U.S. for those eligible for social security benefits (62 and over) is 16.2%, exemplifying that deposit advance use by seniors correlates roughly with the population of all customers having access to the product.

It also is important to note that a report from the Center for Responsible Lending ("CRL") claimed one-quarter of all "payday" borrowers are Social Security recipients; however, CRL's report utilized a sample size of only 66 respondents of which 17 received Social Security. A sample size so small clearly is not indicative of all deposit advance users and holds no statistical significance.

- *Bank deposit advance products carry an annual percentage rate (APR) that averages 225 to 300 percent.*

Media and consumer groups often point to what would appear to be a high APR for deposit advance products. An APR is a single percentage number that represents the actual yearly cost of funds over the term of a loan. Since the duration of deposit advance products is only a fraction of a full year, applying an APR provides an inflated percentage that misrepresents the products true cost. It is akin to booking for a hotel room for one night and being given the costs of the room for the full year.

Bank-offered deposit advance products are structured as LOCs and utilize flat fees based on total amounts advanced to determine a finance charge. Under the provisions of Regulation Z, banks that use a flat fee based on a percentage of the amount borrowed for open-ended extensions are not required to disclose an APR. CBA believes this is a more appropriate finance charge calculation that more accurately informs the customer of the cost of an amount advanced.

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[14] 2010 U.S. Census - http://www.census.gov/prod/cen2010/briefs/c2010br-03.pdf (page 2, Table 1).

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- *The median bank deposit advance user took out 13.5 loans in 2011 and spent at least part of six months during the year in bank payday debt. Over a third of borrowers took out more than 20 loans, bringing the mean number of loans per borrower to 19.*

Again, deposit advance products are lines of credit and using "days with a balance" is incorrect. Nor is it the right approach to consider "number of loans" as some customers only take small installments (i.e. $20) at a time, not the max. It is helpful to think of this in the context of how consumers use other LOCs such as credit cards. Customers often use their credit cards to take multiple small dollar advances/purchases and they pay in full or not (consumer choice). It is not uncommon to use many times per month, and in every month of the year. Many statistics simply look to see if a customer used the service (made at least one advance during a month), which is not the same as a customer taking a single "loan" for a one-time need.

Consumers do in fact use deposit advance products for small dollar advances as needed and there is significant value in an open-end LOC structure. Advances are immediately available in a customer's checking account (no time needed for a loan application, fees associated with loan, funding, deposit made and credited, etc.). As such, an advance may be taken proactively to avoid an overdraft fee. For example, two checks may post at the end of a given day – in absence of an advance, the customer would be assessed two overdraft fees instead of paying a much smaller fee for the cost of an advance to cover the checks.

- *Bank payday borrowers are two times more likely to incur overdraft fees than bank customers as a whole.*

To make the assumption that users of deposit advance products incur more overdraft fees due to their use of the service would imply absolute causality – that the use caused the overdraft. However, one would have to ask other questions to get the bigger picture. For example, how many overdrafts were avoided by using the deposit advance? How much did the customer save by avoiding late fees, over limit fees, etc.? Was the customer afforded the ability to purchase necessities? CBA believes the total customer experience should be taken into account before assuming unsupported conclusions of causality.

Conclusion

Moving forward, Congress, regulators and financial institutions need to build the right foundation to provide short-term consumer credit. Any legislative or regulatory action that impairs the ability of depository institutions to provide deposit advance products ultimately will result in steering consumers to less consumer friendly alternatives to fund their short-term liquidity needs. CBA appreciates the opportunity to provide testimony on this important issue and we welcome the opportunity to work with the Committee and others to ensure consumers have access to the best possible financial products and services available. I welcome the opportunity to answer any questions you may have.

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The CHAIRMAN. Well, some of the suggestions were made by Mr. Shaul, which I would encourage you to share with your member banks.

Mr. HUNT. Sure.

The CHAIRMAN. Instead of the three alternatives that you listed, installment loans for up to two weeks, extended pay plan so they would not get into the cycle on a limited income, such as Social Security that Ms. Smith made. So we will discuss that later.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Shaul, today in your testimony, you gave a number of constructive suggestions for tightening the regulation of payday lenders. That seems very much at odds with the tone that your organization took when you sent a comment letter to the CFPB on its white paper on payday loans, and I am going to read specifically what your organization said.

You wrote, "The tone, conclusions, and specific language within the report seem aligned with the type of rhetoric that more often comes from advocacy groups that are not always driven by facts but rather are driven by agendas and unsupported anecdotal information."

I am trying to reconcile your constructive approach today and at least conceding the need for codifying best practices, taking steps to clean up the industry, with your indictment of the paper done by the CFPB on payday loans.

Mr. SHAUL. Perhaps I can help you, Senator. The indictment of the white paper is not an indictment of the Bureau or those who work within it. I should say that we were surprised by its timing because the data collection was not complete, a fact that they themselves acknowledge.

We were disturbed by the methodology because I think, as our critique would show, it gives an unrealistic and unwarranted sample to those who are frequent users of the product as opposed to taking the body of those who use the product across the whole field, the whole field of users.

And then, perhaps most importantly, there is a speculation on consumer welfare that is a part of the end of the paper which draws no factual research to support it.

Now, it is important to say a number of things. First, we recognize that the Bureau is here to stay and we wish to cooperate with it. As a matter of fact, one of the great disappointments here was, as you can imagine, in a trade association, it is not always easy to convince the members to give up their data to a regulatory agency. We took that step, and it was not an easy one to convince our members to do. Therefore, when we found that though the data was not complete, the conclusions had been reached, it was a moment of some seriousness within the trade association.

Secondly, we do feel, and we have seen it here today, and this is such a disappointment to me, I thought that when I took this position, the one thing that would be extremely helpful was to do or have at my disposal research that would be extremely useful in getting at how many on a spectrum of 100 customers are really led into a poverty situation—into a greater poverty situation by their use of the loan, how many are well served, how many are left neutral. I do not find that research.

Moreover, as you have seen today, there is a dispute about the research. In my judgment, the one place in which that research can be conducted in a way that neutrally will affect all parties and where there will be a respect for it is within the Bureau.

Senator COLLINS. Well, what advocacy groups that are not driven by facts are you referring to?

Mr. SHAUL. I thought that the Pew paper was not—the Pew research paper was not a well-done paper, and I would be happy to augment my statement with some detailed criticism.

Senator COLLINS. Mr. Shaul, I am just curious, were you involved in drafting the Dodd-Frank bill which created the Bureau?

Mr. SHAUL. Yes, in its later stages, I was, but I was not involved in the creation of the Bureau itself.

Senator COLLINS. Did you support the creation of the Bureau?

Mr. SHAUL. Yes.

Senator COLLINS. Do you support increased disclosure requirements for lenders such as Mr. Wright and I discussed, so that they know the actual dollar amount that they are going to end up paying?

Mr. SHAUL. Not only do I support greater disclosure, but one of the first things I did in January of this year as a part of a staff effort was to revise our disclosure to say that the payday loan is denominated or marked as a short-term loan. Experience shows that many borrowers use it longer than that.

I think if you read our disclosure, it is a very comprehensive thing as it is now. I would say most——

Senator COLLINS. Does it say the amount that the consumer is going to have to pay back, or does it just give the interest rate——

Mr. SHAUL. It gives the APR and it depends——

Senator COLLINS. Well, the APR is pretty hard for people to calculate——

Mr. SHAUL. Right.

Senator COLLINS [continuing]. If you do not give them the amount the way you get with a mortgage disclosure.

Mr. SHAUL. I am with you on greater disclosure and I would go one step further. It is not just greater disclosure, but it is also a form of education that we need for people in this sector of the economy so that they really understand what they are getting into.

So I am completely open to greater disclosure and I think we have done a great deal on it. And I think your suggestion about denominated dollars is one that I would be happy to discuss with my membership, yes.

Senator COLLINS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Warren.

Senator WARREN. Thank you very much, Mr. Chairman.

So, Mr. Hunt, I heard you say most emphatically that deposit advance is not payday lending. So, I just want to go over the specific example we have here from Ms. Smith. She says an installment loan was not available, that she asked for it and could not get it. Partial payment was not available. Once she had taken this out, she had to come up with all of the money, which is, I think, how it usually works with payday. That she rolled this over, Ms. Smith, did you say 67 times?

Ms. SMITH. Sixty-three times.

Senator WARREN. Sixty-three times over the space of five years. By my calculation, just back of the envelope, I think it is about 200 percent annual interest that she paid. She was given this when she had—evidently, it was verified that she would have a Social Security check coming in every month, which means, in effect, repayment was virtually guaranteed.

Ms. SMITH. They took it.

Senator WARREN. They took the money out——

Ms. SMITH. I did not——

Senator WARREN [continuing]. Did not even wait for someone to show up with a check. And it was all handled electronically, so there was no need even to have a storefront and a clerk to process this.

So, I understand ways in which it is more effective than a payday loan, but what I do not understand is your statement about how this is not a payday loan, so maybe you could just explain that better to me.

Mr. HUNT. Sure, Senator Warren. Sure. Thank you very much. I appreciate the question. As you know, Senator, we cannot get into the specifics of an individual case for privacy matters. I do not know the exact relationship between the witness and the bank in question. We cannot ask those questions.

I would tell you generically and from a 30,000-foot standpoint, you do have an opportunity for installment loans.

Senator WARREN. I am sorry, Mr. Hunt——

Mr. HUNT. You do have an opportunity——

Senator WARREN. Let me stop right there. Are you saying that Ms. Smith misunderstood Wells Fargo when she asked for an installment loan and was told that she could not get it?

Mr. HUNT. I do not know what transpired between two individuals. I do not even know when it was. I am just telling you today——

Senator WARREN. Ms. Smith?

Ms. SMITH. It is a matter of record that they forgave my loan about a month ago when I went in and asked for an installment loan.

Senator WARREN. Mr. Hunt?

Ms. SMITH. They said they were not equipped to do that.

Mr. HUNT. Senator Warren, I am just going to tell you, Wells Fargo today offers an installment loan, that if a person cannot meet their needs on the next direct deposit, they have an opportunity to have an installment loan. Now, when that happens——

Senator WARREN. Mr. Hunt, I am just saying to you, we have Ms. Smith here saying that that is not so.

Ms. Borne, did you want to weigh in?

Ms. BORNE. I just wanted to point out that the installment option that Wells Fargo has and that other banks making payday loans have are notoriously hard to obtain. For example, Wells, even after having changed its policy, still requires the borrower to be in debt for three consecutive months before they can qualify for an installment plan.

Another bank only lets you get an installment plan if you ask for it by calling the bank before you take out the loan. So once you actually have the loan, no installment option. This is consistent with the experience in the storefront arena, where the extended payment plan that Mr. Shaul mentioned has notoriously low pick-up rates. In other settings, the industry has admitted that it is a lot less profitable and they do not want borrowers doing it.

Senator WARREN. Thank you, Ms. Borne.

Mr. Hunt, I am still trying to understand how the deposit advance is not a payday loan.

Mr. HUNT. Well, I will tell you how exactly that is not a payday loan. One, you have to have an established relationship with the bank. We have to have a history with the bank. You cannot just walk into a bank and receive a deposit advance product. You have to have a history of a direct deposit, as well. And you cannot have any negative consequences happen to your bank. That is our form of underwriting.

Senator WARREN. So——

Mr. HUNT. That is completely different.

Senator WARREN. So let me——

Mr. HUNT. And the cost——

Senator WARREN. Let me make sure I understand this, then.

Mr. HUNT. The costs are completely different.

Senator WARREN. Let me understand, make sure I understand this, Mr. Hunt.

Mr. HUNT. Sure.

Senator WARREN. So you only want to do these loans for your established customer base when, in the case like Ms. Smith, when you know that you are going to have effectively a 100 percent chance of repayment here, and that is how you distinguish yourself from being a payday loan?

Mr. HUNT. That is one of the ways we distinguish ourself. I think it is a positive thing, we have an established relationship with our customer. I think it is a positive thing that only certain people qualify to get a deposit advance product. I think it is a positive thing that we charge half of what a payday lender charges. I think those are positive bodies. I think it is also positive, Senator Warren, that we keep people within the regulated entity and not the under-regulated. I think we can all agree we are one of the most heavily regulated industries.

Senator WARREN. Mr. Hunt, I see that I am out of time, but if I might, Mr. Chairman——

The CHAIRMAN. You can——

Senator WARREN. No, no, I just want to say here that to describe yourselves as being part of a heavily regulated entity when it is the case that by her direct testimony we have someone here who received loans that were rolled over for five years. She paid an average of 200 percent interest on a loan that cost the bank very little to administer, since it was electronic, and was effectively 100 percent guaranteed that the bank would be repaid.

So I appreciate that the bank is a regulated entity, but I am afraid I just cannot understand the distinction between how deposit advance has somehow improved Ms. Smith's life over that of going to a storefront, where she could have also gotten a payday loan.

So, thank you. Thank you, Mr. Chairman.

Mr. HUNT. Do I get a chance, Mr. Chairman, to respond?

The CHAIRMAN. Of course.

Mr. HUNT. Okay, great. Thank you very much.

As you know, Senator Warren, banks offer cooling off periods, so if a customer has this product for five to six months, they are shut off. For one solid month, they cannot access their line of credit. It is up to the customer, then, to say, hey, I need this line of credit once again.

The customer also, Ms. Warren, Senator Warren, has an extensive process for application, something you have always been in favor of, easy and transparent disclosures. So if you apply for a deposit advance product, you will see right here it says that deposit direct advance is a line of credit designed for short-term borrowing needs. It says the service is expensive. You have to understand the fees. Advances are automatically deposited into the checking account. Advances will automatically be repaid from your checking account. And on and on and on.

Senator WARREN. Mr. Hunt——

Mr. HUNT. And the customer has to voluntarily sign off on this.

Senator WARREN. Mr. Hunt, I am afraid what I was looking for here is how your product—I just started with your statement that a deposit advance is not a payday loan——

Mr. HUNT. It is not.

Senator WARREN [continuing]. And that is what I am trying to understand——

Mr. HUNT. It is not a loan.

Senator WARREN [continuing]. And you are telling me—you are telling me that there are extensive paperwork that you had her sign off on, you had Ms. Smith sign off, and actually, Ms. Smith is shaking her head no. Ms. Smith?

Ms. SMITH. It was all done online, point and click, and——

Senator WARREN. So I am back in my original position. If the concern we have is about a product that is designed to ensnare people in repeat loans over time so that it is possible to extract from them 200 percent interest, then it seems to me that Ms. Smith is describing such a product from Wells Fargo.

Ms. SMITH. May I make a statement?

Senator WARREN. Of course, Ms. Smith. I am sorry, Mr. Chairman.

[Laughter.]

Sorry, Mr. Chairman.

Ms. SMITH. I do not quite understand where he said that I was eligible. I walked into the bank and asked for a small loan. They said they did not have them, but they had a service called a direct deposit advance. The only thing that made me eligible was I had a Social Security check in there that they could just take the money out. I did not have to buy a stamp in five years to mail it in. I was never late. I was never defaulted.

Senator WARREN. Thank you, Ms. Smith.

Mr. HUNT. And just to finish up, I did make a mistake when I said sign off. In today's terminology, that also means you check off a box. Much like you do with iTunes, you can do services now online, as well. And it is true that many of our banks do this. But it is the same principle. You still have to check off on these boxes to do it. And again, this is a voluntary item that the customer chooses to do, and you do have to meet certain requirements in order to get this product.

Senator WARREN. Yes, Mr. Hunt, I think you are right. It is the same principle.

The CHAIRMAN. There are customers and there are customers, and some of your customers, probably a good percent of them, do not know all the different products that are offered by a bank, and maybe that is one of the responsibilities of a bank, to present to them all the alternatives, particularly when it comes to a senior citizen that is on just Social Security and depends on that check for everything.

Now, for the life of me, I cannot understand why your member banks would want to take the negative aura that is created by these kinds of circumstances that Ms. Smith has testified to, and there have been others that have been mentioned here today, in order to insist on a technical point of this or that. The bank ought to be helping the customer and we are going to follow up on this.

Senator Donnelly.

Senator DONNELLY. Thank you, Mr. Chairman.

And, Ms. Smith, it was a pleasure to have you stop by the office this morning. Thank you very much.

Did you ever discuss your situation with anyone at Wells in regards to paying it back in installments?

Ms. SMITH. Just recently.

Senator DONNELLY. Okay.

Ms. SMITH. I did not think I had any choice. It was not an option for me.

Senator DONNELLY. Okay. Mr. Hunt, from the way these loans are repaid, would you agree they—or lines of credit, as you put it—would you agree they are fairly minimal risk?

Mr. HUNT. Minimum risk for the customer or minimum risk for the bank?

Senator DONNELLY. For the bank.

Mr. HUNT. Yes, only because——

Senator DONNELLY. If there is direct deposit.

Mr. HUNT. I do, only because of the requirements you have to meet before a person gets access to a deposit advance product. We have done our homework on the customer.

Senator DONNELLY. Okay. And now, the average amount the bank is paying for the money—a lot of savings accounts are one percent now, somewhere in that neighborhood. Say the average rate that the bank is paying for their funds, one percent, maybe two percent. How is 36 percent not a fair interest rate on these deposits?

Mr. HUNT. Yes. So, Senator, as you well know, we do not charge interest rate or APR. It is a fee. It is a fee for service for people who need this assistance. And I think it is very simple in the disclosure. It says it is $7.50 for every $100, $2 for $20, $1.75 for $20. So it is not interest rate. I concur with Senator Collins' statement——

Senator DONNELLY. So your fee rate——

Mr. HUNT. It is a fee rate.

Senator DONNELLY [continuing]. Comes out to be 200 percent a year.

Mr. HUNT. Well, it depends, sir. It depends if you are doing it over a two-day loan. Is it a 35-day loan—I am sorry, line of credit? It depends on the line of credit. It is a fee for it.

Senator DONNELLY. Yes, Ms. Borne. Thank you for raising your hand.

[Laughter.]

Ms. BORNE. If I could just interject quickly on this, so the fee per $100 that the banks charge is a finance charge. It is a charge in exchange for credit. Through a loophole by which the banks claim that their loans are open-end, they are not currently disclosing an APR, but an APR is the best way to compare the cost of credit across credit products.

The studies have shown that they average 225 to 300 percent in APR terms, and even the CFPB, when it looked at deposit advance recently in its report, it did use APR as a manner of comparing the cost of bank payday loans to loans by other lenders.

Mr. HUNT. And I would just say about APR, I think they are the most confusing item out there. The Fed, when they were looking at overdraft services, dismissed using APR because, A, they could not explain it, and B, customers could not understand it.

Senator DONNELLY. Well, it gives you a fairly ballpark idea what you are paying for——

Mr. HUNT. Well, I will tell you this. You are about to vote on a student lending bill and the Federal Government does not put an APR on Federal student loans because they know they cannot explain it nor can it be understood, either. And these are lines of credit, not for the whole year. There is nothing annual about a line of credit——

Senator DONNELLY. Well, it is simple math, though. Here is the fees, or whatever you want to call it. You know, you can call it a motorcycle or a motorsickle. You can call it about anything you want.

Mr. HUNT. Right.

Senator DONNELLY. And one of the things you commented on, you said you want to make this the least costly possible for Ms. Smith. And I guess I would say, if you look at this product that comes out 200-plus percent, are you meeting that goal?

Mr. HUNT. I think any time we meet the goals of the customer, and this is a demand-driven product——

Senator DONNELLY. Well, but the goal——

Mr. HUNT. It is two for 20——

Senator DONNELLY [continuing]. But you said the least costly possible way to do it.

Mr. HUNT. I am sorry. Say that again, please.

Senator DONNELLY. You had mentioned in your statement the least costly possible way to do it.

Mr. HUNT. Sure. Sure. And we think the charges—the line of credit fees that we charge are very competitive.

Senator DONNELLY. Well, I——

Mr. HUNT. And I will tell you, sir——

Senator DONNELLY. I do not disagree, I mean, in terms of other products for those people. But is it not profitable enough for these banks to, instead of here is your fee for this money, to use a 36 percent interest rate, or 37, or 35, or 34? I mean, they are paying one percent for the money.

Mr. HUNT. Well, Senator, I am not going to get into a debate whether we should use percentages or fees. We think, for the customer, it is much easier to understand it is $2 for every $20, or $10 for every $100.

And I would tell you, if you really want to have competition, why do we not encourage banks to get into this process for more competition and have people stay in the regulated industry? The worst thing we can do is increase the underbanked numbers and unbanked numbers. We get criticized, sir, for having people pay their lines of credit on time. I think that is wrong.

Senator DONNELLY. I am not criticizing you. I am just asking you. Do you think that it is appropriate for some of the most respected banking names to be making 200 percent plus off of their customers?

Mr. HUNT. First off, I do not accept that it is 200 percent because it is a line of credit. It is not a loan. If we were charging 200 percent for a home mortgage, I am with you.

Senator DONNELLY. No, that is——

Mr. HUNT. That is too much.

Senator DONNELLY. You know——

Mr. HUNT. But this is not a loan. This is a line of credit.

Senator DONNELLY. You know that is not what we are talking about. I mean, this is a woman who paid, on average, 200 percent plus. You can call it a fee. You can call it whatever you want. But that is about what the extra funds that were paid on this averaged out to for the amount that was loaned. And all I am asking is, in regards to the institutions that are doing this, do you not think they could do better?

Mr. HUNT. I really do not think we ought to get in the business of price setting. We saw what happened on——

Senator DONNELLY. I am not asking you to set prices.

Mr. HUNT [continuing]. I mean, that has gotten worse.

Senator DONNELLY. I am just asking you, do you not think they can do better than having fees and such add up to over 200 percent plus on the money?

Mr. HUNT. Again, Senator, I am not trying to be difficult, but we do not charge a percentage. It is a line of credit that the customer must pay off before they have an opportunity to have another line of credit. This is their choice.

Senator DONNELLY. I——

Mr. HUNT. It has to be reasonable. It has to be proportionate. There are UDAP violations if we are taking advantage of a customer. We work with regulators all the time on this product and other products, as well.

Senator DONNELLY. My time is up, Mr. Chairman. I will pass—no, I guess the question is reasonable. We have different views on what is reasonable.

Mr. HUNT. Sure. Thank you, though.

Mr. SHAUL. Mr. Chairman, may I correct myself?

The CHAIRMAN. Please.

Mr. SHAUL. I am unable to exit the office without a brain trust behind me and my brain trust, I am sure, after hearing from some of our members, wants to make clear that our disclosure does include a dollar amount as well as an APR. So I misspoke to Senator Collins.

The CHAIRMAN. How is that different from Mr. Hunt's? He—you represent the Community Financial Services Association and Mr. Hunt represents the Consumer Bankers Association.

Mr. SHAUL. Correct.

The CHAIRMAN. So yours does have that——

Mr. SHAUL. We have an APR.

The CHAIRMAN. APR——

Mr. SHAUL. And then we have an actual dollar amount that is paid, as well.

The CHAIRMAN. And your members, Mr. Hunt, do not?

Mr. HUNT. Ours is a line of credit. It is not a loan. And we show $2 for $20, $10 for $100, however you want to slice and dice it. It is clear. It is transparent. It is up front.

The CHAIRMAN. Well, let me ask you, how does someone—and chime in, Senator Donnelly, if you have any other questions—how does someone who is on Social Security ever get out from under this loan when the whole amount must be paid back out of their next Social Security check?

Mr. HUNT. Yes, Mr. Chairman, I appreciate the question very much on it. It is a great debate. Do we have people pay this loan—this line of credit back immediately or do we let them finance it over months? I thought in this country it was always better to pay off your debt, and now we are getting in trouble for having consumers pay off their debt. They have to pay off that line of credit before they get access to another.

Now, hearing from consumers, hearing from regulators, hearing from members of Congress, some of these banks have now said, okay, even though we do believe a person should pay this off as they agreed to, we are going to give them the option to pay longer, over three to four months' period of time. But, if we give them the opportunity, we are not going to allow them to access their line of credit.

So we get criticized for asking people to pay their agreement on time and then we get criticized for making them have a longer opportunity, as well. So we give them the best. We can say, you are going to get paid—you are going to have to pay this off at your next direct deposit or an extension. The choice is now yours.

The CHAIRMAN. If they have that choice.

Mr. HUNT. That is correct. But remember, now, before they get a line of credit——

The CHAIRMAN. We have an example here with Ms. Smith that she did not have that choice. She was never told that.

Mr. HUNT. Every consumer has a choice not to extend the line of credit. They also cannot get another line of credit, sir, until they pay that line of credit off. It has to be paid off before they get access to another line of credit.

The CHAIRMAN. Well——

Mr. HUNT. And a cooling off period, sir.

The CHAIRMAN. Here is what I do not understand. Banks like their customers to think that they are there to help them as financial advisors. What is the best product for you? Now, if you know that someone on Social Security, that the whole amount is going to be paid the next time they get their Social Security payment, and you know that is what they are living on, would that not trigger the bank to say, this might not be the right product for you, that there is a different product?

Mr. HUNT. So, Mr. Chairman, we have a right and responsibility to give the facts to the consumer. We always tell them through financial literacy there may be less expensive products. It is clear as day in the disclosures that this is an expensive product, that it must be paid back, and it will be paid back with the next direct deposit, assuming it was reoccurring, and they must qualify for it.

We are not going to be the parents of customers. We think they have the right to choose the product they so desire. If we present it in a clear and transparent manner, back that up with financial literacy that we do—we text people, we mail people, we do everything but fly a helium balloon over saying there could be less expensive items—we do everything we can to make sure we act in a responsible way for the consumer. But at the end of the day, sir, it is up to the consumer to choose which product they want to have.

Some of the biggest criticisms we receive from people who use this product is why is there a cooling off period, when we have done everything we have been taught from the second grade to pay off our debt, and here we go, paying off our debt, and you are taking something away from us. And it is a very popular product until that occurrence happens, sir.

The CHAIRMAN. Mr. Shaul, did all of this advance payment thing, did this really start when the use of electronics and electronic payments—of which almost all Social Security payments now are made by electronic payment instead of by paper checks, therefore, it is an easy thing for the banks to access to pay off the advance payment—did all of this just start when Social Security started making electronic checks?

Mr. SHAUL. I do not think so, Senator. I mean, what had been the traditional mode before that was that we would take a check that would be deposited on the payday and often—in nearly all instances—the person would be called in advance to be sure that the check would be good. Within the bank itself, I suspect the situation would be different because they would have accurate knowledge of the high and low points of the account at all times.

The CHAIRMAN. This committee has a responsibility to the elderly and the senior citizens of this country, and I want to ask both of you—Ms. Borne, as well—if we have a system like this, are we not setting up Social Security recipients to fail? What do you think, Ms. Borne?

Ms. BORNE. You know, I think I would just point out that, as has already been remarked on here today, it is very unlikely that a Social Security recipient on a fixed income is going to be able to repay an expensive loan in full in two weeks. It is extremely likely they will end up in a long-term cycle of debt and that that cycle will leave them worse off than they were before they ever took out their initial loan.

Mr. SHAUL. If I may, Senator——

The CHAIRMAN. Please.

Mr. SHAUL [continuing]. Three points. As I have indicated, the percentage of our borrowers who are senior citizens actually is less than their average across the population.

The second point is, it is true that there is a danger here, no question about it. If you track expenditures of those who are elderly, they tend to be more fixed than those who are younger because their aspirational goals and so on are a little less. But the danger is a real one, no question about it.

I think it goes to this question that I feel strongly about that is a difficult one for us to do, both in terms of profitability and also in terms of the customer himself. Part of underwriting has to be to look at the person's condition in detail. And, obviously, if you are doing underwriting and you are looking at a Social Security recipient, you have a different case than if you were looking at someone who has a wide variety of incomes.

The CHAIRMAN. That is exactly right, and what is the risk to the bank when there is a guaranteed Social Security payment coming in the next month? And that has got to be taken into account here.

Mr. SHAUL. Yes. That is different from our storefronts, of course, but I grasp the point that it is not different in the sense that if that person has written us a check and so forth, we are in the same position in that sense.

The CHAIRMAN. Do you all have any further questions?

Mr. HUNT. Senator, if I can just add on to that——

The CHAIRMAN. Yes, please.

Mr. HUNT. We do not want an unhappy customer. That is not good for the banking institution. It is not good for the bank. We want to do everything we can to make sure the customer receives the right product at the right price with the right disclosures.

The CHAIRMAN. I believe that you believe that.

Mr. HUNT. Yeah.

[Laughter.]

The CHAIRMAN. But, Mr. Hunt, you have got some unhappy customers and you have got some unhappy Senators who represent those unhappy customers——

Mr. HUNT. And, Mr. Chairman, I——

The CHAIRMAN [continuing]. That are trying to straighten this thing out.

Mr. HUNT. And we want to help them if there is some—but I would tell you this, sir. The vast, vast, vast customers, seniors, pay off their obligation. They do it. I do not want people to think that seniors are not paying it or they cannot. The vast majority are doing it. They are——

The CHAIRMAN. That is not the question here, and in terms—again, I just repeat myself. In terms of risk to the bank, what risk is there? You have got the Social Security. As long as there is the United States Social Security Administration, you have got that coming in.

So, I want to thank everybody. It has been a good discussion. I do not want you two to think that we picked on you, even though we have.

[Laughter.]

Mr. HUNT. And probably will again.

The CHAIRMAN. Not if we get this thing straightened out.

Mr. HUNT. We look forward to working with you.

The CHAIRMAN. Well, that is going to depend on really what you do, go back to your member banks, and I see some of them out here in the audience, some of them that are dear friends of mine. And I want you all to address this, because this is not right on what has been testified here today.

Ms. Smith.

Ms. SMITH. I just have one thing to say to some of his comments about paying off your debt. Someone asked me recently, why did you not just take your money out of Wells Fargo and go somewhere else? What would they do to you? And there is not probably much they could do to me because I do not have anything to take. They could harass me a long time with credit, you know.

But I did come from the generation of where you do pay your debts and that is why I stayed and allowed this to continue, because I did owe the debt. I did make the loan. And I did pay it. They took it. So, I am a little insulted about that, you know, because I could have done that.

The CHAIRMAN. You know, you mentioned that you are part of that generation. Let us hope that that passes to every generation.

Ms. SMITH. Yes.

The CHAIRMAN. We are a nation of laws. That is what sets us apart from other countries on the face of Planet Earth, is that we respect the rule of law. Now, we just need to make sure, and I am looking at the CFPB and I am looking at the FS—I cannot even say it, there are so many acronyms—Federal Deposit Insurance Corporation—I am talking about the Comptroller of the Currency and others—to make sure that the laws are being effectively administered. And then if there is inadequacy in the law, we need to know about it so that we can address that through the making of laws.

Well, it has been a robust discussion. I want to thank everybody. And I would suggest that we have, as a result of this discussion, I suggest that the financial community be proactive on a going forward basis. And I would ask you all to provide all disclosures for each of your banks offering these products to this committee by the close of business next Wednesday.

I want to continue to encourage the FDIC and the OCC to move forward with the guidance that they have proposed and finalize those rules to protect the consumers, such as we have heard today. Some of us on this committee have already filed a public comment in support of the work that is being done by the FDIC as well as the OCC.

And so for all of you who have been very patient and participated in this robust discussion, thank you and the meeting is adjourned.

[Whereupon, at 4:24 p.m., the committee was adjourned.]

APPENDIX

Opening Statement of Chairman Bill Nelson
Senate Special Committee on Aging: Payday Loans: Short-term Solution or Long-term Problem?
July 24, 2013

Good afternoon, everyone. Thank you for being here today as we discuss payday loans and other short-term lending products, and how they impact seniors and their Social Security income.

The marketplace for these products has evolved rapidly in the last several years. For some time, we have been aware of these storefront payday lenders, where people can bring a paystub or proof of income into the store and get an advance on their next paycheck, while paying a very high premium in fees for the privilege.

Opening Statement of Chairman Bill Nelson
Senate Special Committee on Aging: Payday Loans: Short-term Solution or Long-term Problem?
July 24, 2013

But now there are additional players in this market. We've got online lenders and even big banks offering seniors these short-term loans. The Center for Responsible Lending just released a report showing that one in four users of the bank payday loan known as a deposit advance is a Social Security recipient.

Opening Statement of Chairman Bill Nelson
Senate Special Committee on Aging: Payday Loans: Short-term Solution or Long-term Problem?
July 24, 2013

I want you to think about how the math works on this, or in most cases, how it doesn't work for seniors with a fixed income and fixed expenses. Seniors take one of these deposit advances out because they can't make ends meet or have some sort of emergency – health issues, car problems, you name it. Then when their next Social Security check arrives, that amount they borrowed, plus these very high fees, are automatically deducted before the money even hits their bank account.

So how do these seniors get through the month when they still have all the same expenses, but their income is cut – potentially in half – for the whole month? The answer in most cases is that they borrow again and again. Some people even borrow from a variety of different sources, from storefronts, banks and online lenders.

Take the case of Annette Smith, who has traveled here from California to tell us just how hard it is to get out from under this cycle of debt. She took out a $500 loan about five years ago and in the time since has gone back to her bank 63 times to secure a deposit advance, paying out a total of around $3,000 in fees.

Or consider the story of Donna Johnson, a grandmother of three from Ocoee, Florida, who managed to break a two-year payday loan debt trap only after receiving insurance money associated with her husband's death.

We are grateful to Ms. Smith for being here today to talk about her financial struggle. And we also thank the regulators for joining us to talk about why they are considering stepping into this market. This is a critical time for these products, and we want to hear from the Consumer Financial Protection Bureau and the Federal Deposit Insurance Corporation about what they have seen from these loans and the regulatory power they have to protect consumers.

One thing is clear: millions of Americans with poor or no credit have a need for money in emergencies. But how can we make sure that the products available to these people, especially the seniors, won't trap them in a cycle of debt? We have brought all the parties involved here this afternoon to see how we can answer this question.

While everyone agrees payday lending and deposit advance products are expensive forms of short-term credit and borrowing, we must ensure they are properly overseen with adequate consumer protections and safeguards against predatory leading.

We have two excellent panels of witnesses today. I thank you all for being here, and look forward to hearing from each of you.

Opening Statement
Senator Susan M. Collins
Special Committee on Aging

"Payday Loans: Short-Term Solution or Long-Term Problem?"

July 24, 2013

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Mr. Chairman, thank you for holding this hearing to examine the impact of "payday" loans on American consumers, and for assembling such a comprehensive group of witnesses to share their views with the Committee. I am particularly pleased that the Committee will be hearing from Eric Wright, a staff attorney with the Maine Bureau of Consumer Credit Protection. Since the Bureau was established in 1975, it has earned a well-deserved reputation as a leader in the field of consumer protection. Some two decades ago, I had the privilege of overseeing the Bureau when I served as Commissioner of the Maine Department of Professional and Financial Regulation.

Payday loans are typically unsecured "close-ended," small-dollar amount loans of short duration, with high up-front costs. Repayment of the loan is typically structured as a single "balloon payment" tied to the borrower's next paycheck or some other regular source of income.

Payday loans are usually made without "underwriting" – in other words, without a credit check or other attempt to determine the borrower's ability to repay. In years past, the borrower would simply give the lender a check to be cashed on the borrower's next payday, which explains why this kind of financial arrangement came to be known as a "payday" loan. Today, it is more likely the borrower will authorize the lender to draw funds directly out of the borrower's savings or checking account on a pre-set date.

Studies show that payday loans are relied upon by low and moderate income consumers who need the short-term flexibility that these loans provide, or who have bad credit and cannot get a traditional bank loan or credit card. According to a study by the Federal Reserve, two-fifths of all households considered “underbanked” have used payday loans, and most of these households have done so in the past year. By contrast, only 1 in 20 “fully banked” households has ever taken out a payday loan.

While payday loans can provide consumers with a way to get cash quickly when they need it, the high borrowing costs built into the loan fees can make it difficult or impossible for low-income borrowers to repay them. Too often, borrowers who get trapped in a cycle of debt are then subjected to aggressive – even abusive – collection practices by some payday lenders.

For many years, the Maine Bureau of Consumer Credit Protection was able to protect my constituents from the worst of these abuses, largely because Maine law tightly regulates unsecured consumer debt, and requires lenders who wish to provide these products to register with the State and abide by statutory limits on fees and interest rates. For these reasons, Maine's experience with

payday lenders differs from that of other states. "Storefront" payday lenders have not been a problem in Maine, as they have been elsewhere. Banks, also, are not a source of abusive payday loans in Maine. In fact, Will Lund, the long-time Superintendent of the Maine Bureau, has told me that the Bureau has never fielded a consumer complaint over a payday loan where the lender was a state- or federally licensed bank.

But that does not mean that Mainers can't be victims of abusive payday loan practices. With the advent of the Internet, on-line and off-shore lenders have direct access to Maine

consumers, and not a day goes by when the Bureau doesn't get a call from a victim of an unscrupulous on-line lender who has trapped the consumer into paying off a loan that was never legal to offer in Maine in the first place.

I understand that on-line payday loans still make up a minority of the total payday loan volume nationally, but as the CFPB noted in its recent white paper, on-line payday lending is growing rapidly, and may eventually overtake storefront lending. This raises troubling issues, since on-line lenders typically get authorization from their borrowers to draw funds directly from their bank accounts. Since

so many of the abusive payday loans affecting Maine consumers were made by on-line lenders, I am particularly interested in the witnesses' views on these types of loans.

Again, Mr. Chairman, thank you for calling this important hearing.

<u>Questions for Mr. David Silberman, Associate Director for Research, Markets, and Regulation, Consumer Financial Protection Bureau, from Senator Wyden:</u>

1. Installment Loans – What tools does CFPB have in regards to pursuing installment loans, and specifically, the installment loan practices of World Finance/World Acceptance Corporation? What is the agency's urgency in pursuing installment loans?

Response

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) granted the Consumer Financial Protection Bureau (Bureau) authority to implement and enforce federal consumer financial law across the market for consumer financial products and services. The Dodd-Frank Act provides the Bureau with a number of tools that may be applicable to the installment lending market, including enforcement, supervision, and rulemaking.

Consumer installment loans are generally unsecured, closed-end loans with relatively small balances. While some depository institutions offer loans with a similar structure, there is also a market of non-depository installment lenders. This non-depository market is distinct from the bank "signature" loan market by its storefront-based distribution and servicing model. These storefront signature loans are generally fully amortizing in substantially equal payments, though in practice they are frequently refinanced or renewed at least once before they are fully repaid. These loans usually do not require that a borrower provide a post-dated check or an ACH authorization as collateral.

The Bureau is responsible for enforcing federal consumer financial law (including the Consumer Financial Protection Act's prohibition on unfair, deceptive, or abusive acts or practices) and the Military Lending Act. Installment lenders fall within the Bureau's enforcement authority, which generally includes anyone who offers or provides a consumer financial product or service and anyone who provides a material service to those persons in connection with the offer or provision of a consumer financial product or service.

Additionally, the Bureau's supervisory authority extends to some installment lenders, including where an installment lender is engaged in payday lending. The Bureau may supervise non-depository companies of all sizes in the residential mortgage, payday lending, and private student lending markets. For other markets, the Bureau may gain supervisory authority over "larger participants" by promulgating a larger participant rule for the specified market. To date, the Bureau has finalized "larger participant" rules on the debt collection and consumer reporting markets and published a proposed "larger participant" rule on the student loan servicing market.

The Bureau also has the authority to supervise any non-depository company that it has reasonable cause to determine has engaged or is engaging in conduct that poses risks to consumers with regard to consumer financial products or services. Such conduct may involve, for example, potentially unfair, deceptive, or abusive acts or practices, or other acts or practices that potentially violate federal consumer financial law. The Bureau must base such determinations on consumer complaints or on information from other sources, which may include judicial opinions or administrative decisions. In June 2013, the Bureau established procedural rules for exercising this supervisory authority.

Through the regulatory process, the Bureau may promulgate substantive rules implementing federal consumer financial laws that apply to installment lenders, such as the Truth in Lending Act, and the Consumer Financial Protection Act, including the prohibition on unfair, deceptive, or abusive acts or practices. Additionally, the Bureau is working closely with the Department of Defense, as a consulting agency, to ensure that the Military Lending Act protects servicemembers and their dependents.

The Bureau seeks to protect consumers across the entire small dollar credit market, and we are moving swiftly to address potential harms. We recognize that installment loans are a possible substitute for other forms of high-cost credit, including the payday and deposit advance loans that were the topic of our April 2013 white paper. To the extent that consumers may experience injury in the installment lending market resulting from violations of laws within our authority, we will take appropriate action to ensure consistent implementation and enforcement of the applicable laws across the small dollar credit marketplace.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

CA 13-7

April 25, 2013

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO STATE MEMBER BANKS:

SUBJECT: Statement on Deposit Advance Products

Applicability to Community Banking Organizations: This guidance applies to all state member banks, including those with $10 billion or less in consolidated assets.

The Federal Reserve is issuing the attached policy statement, *Statement on Deposit Advance Products*, to emphasize to state member banks the significant consumer risks associated with deposit advance products in light of the Consumer Financial Protection Bureau's April 24, 2013 white paper entitled "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings."[1] State member banks are expected to consider the risks associated with deposit advance products, including potential consumer harm and the potential for elevated compliance risk, when designing and offering such products.

Federal Reserve Banks are asked to distribute this letter and the accompanying guidance to state member banks, as well as to supervisory and examination staff. Questions on the attached guidance should be directed to Carol Evans, Assistant Director, at (202) 452-2051; or Amy Henderson, Managing Counsel, at (202) 452- 3140. In addition, questions may be sent via the Board's public website.[2]

Sincerely,

Sandra Braunstein

Attachment: Statement on Deposit Advance Products

[1] http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf

[2] See http://www.federalreserve.gov/apps/contactus/feedback.aspx.

STATEMENT ON DEPOSIT ADVANCE PRODUCTS

The Board of Governors of the Federal Reserve System (Board) is issuing this statement to emphasize to state member banks the significant consumer risks associated with deposit advance products in light of the Consumer Financial Protection Bureau's (CFPB) April 24, 2013 white paper entitled "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings."[1]

Background

A deposit advance product is a type of short-term, small-dollar credit product offered by depository institutions to consumers with a deposit account or reloadable prepaid card. The depository institution allows a customer to obtain an advance on expected future deposits. Such advances and any associated fees are generally required to be repaid when the next deposit occurs.

The CFPB white paper sets forth the CFPB's initial data findings regarding the costs and patterns of deposit advance product usage by consumers. In particular, the CFPB white paper raises concerns about the significant costs associated with sustained repeat usage of deposit advance products. On April 25, 2013, the CFPB issued a press release indicating that it sees significant consumer risks and that the CFPB expects to use its full authorities to provide protections to consumers once it completes further analysis of the short-term, high-cost loan market later this spring.

Potential Risks Associated with Deposit Advance Products

The Board encourages state member banks to respond to their customers' small-dollar credit needs with products that meet this demand in a responsible manner. However, state member banks should take into consideration the significant risks associated with deposit advance products, including potential consumer harm and the potential for elevated compliance risk when designing such products.

In designing and offering deposit advance products, state member banks must comply with all applicable federal laws and regulations, including but not limited to requirements under the Truth in Lending Act (TILA), the Electronic Fund Transfer Act (EFTA), the Truth in Savings Act (TISA), and the Equal Credit Opportunity Act (ECOA). In addition to these laws, institutions must act in accordance with Section 5 of the FTC Act, which prohibits unfair or deceptive acts and practices (UDAP), and Section 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which prohibits unfair, deceptive, or abusive acts or practices. Depository institutions must also comply with state laws and regulations.

The prohibition against UDAP applies broadly to every stage of the deposit advance product, including marketing, servicing, and collections. The Board expects institutions to analyze the legal risks of any deposit advance products before offering such products. The Board expects Federal Reserve examiners to thoroughly review any deposit advance products offered by supervised institutions for compliance with Section 5 of the FTC Act, as well as other applicable laws.

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[1] http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf

State member banks that rely upon outside vendors to offer deposit advance products remain responsible for compliance with applicable laws and regulations. Inadequate management or oversight of third-party vendors by depository institutions presents additional consumer and compliance risks. In addition, fee sharing or similar arrangements that create an incentive for third party vendors to increase product usage create particular risk in connection with deposit advance products given that they may lead vendors to encourage inappropriate sustained usage of such products by consumers. Accordingly, the Board expects institutions to develop procedures to closely monitor vendor practices and outcomes. State member banks should mitigate and manage such risks, consistent with applicable regulations and guidance, in connection with the design and marketing of any deposit advance products that they might offer.

APRIL 24, 2013

Payday Loans and Deposit Advance Products

A WHITE PAPER OF INITIAL DATA FINDINGS

cfpb Consumer Financial Protection Bureau

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1. Introduction

During the past year, the Consumer Financial Protection Bureau (CFPB) has engaged in an in-depth review of short-term small dollar loans, specifically payday loans extended by non-depository institutions and deposit advance products offered by a small, but growing, number of depository institutions to their deposit account customers. This review began with a field hearing held in Birmingham, Alabama in January 2012. At that event, CFPB Director Richard Cordray noted that "the purpose of th[e] field hearing, and the purpose of all our research and analysis and outreach on these issues, is to help us figure out how to determine the right approach to protect consumers and ensure that they have access to a small loan market that is fair, transparent, and competitive." Director Cordray went on to state that "[t]hrough forums like this and through our supervision program, we will systematically gather data to get a complete picture of the payday market and its impact on consumers," including how consumers "are affected by long-term use of these products."[1]

Both at the field hearing and in response to a subsequent request for information, the CFPB heard from consumers who use these products.[2] On one hand, some consumers provided favorable responses about the speed at which these loans are given, the availability of these loans for some consumers who may not qualify for other credit products, and consumers' ability to use these loans as a way to avoid overdrawing a deposit account or paying a bill late. On the other hand, consumers raised concerns such as the risk of being unable to repay the loan while still having enough money left over for other expenses, the high cost of the loan, and aggressive debt collection practices in the case of delinquency or default.

These discussions and submissions underscore the importance of undertaking a data-driven analysis of the use of these products and the longer-term outcomes that borrowers experience. Because Congress authorized the CFPB to supervise both depository and non-depository institutions, over the past year we have been able to obtain data from a number of market

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[1] The full transcript of Director Cordray's speech is available at http://www.consumerfinance.gov/speeches/remarks-by-richard-cordray-at-the-payday-loan-field-hearing-in-birmingham-al/.

[2] Comments received in response to this request for information are available for review at http://www.regulations.gov/#!searchResults;rpp=25;po=0;s=cfpb-2012-0009.

participants that offer either deposit advance products or payday loans. At the same time, the CFPB has been conducting an in-depth review of overdraft products and practices, which some consumers may also use to meet financial shortfalls. The CFPB plans to issue a preliminary report based on the results of that study shortly.

This white paper summarizes the initial findings of the CFPB's analysis of payday loans and deposit advances. It describes the features of typical payday loan and deposit advance products. The paper then presents initial findings using supervisory data the CFPB has obtained from a number of institutions that provide these products.[3] The analysis reported here reflects considerations needed to preserve the confidentiality of the institutions that provided the information used in this paper.

The CFPB has a statutory obligation to promote markets that are fair, transparent, and competitive. Consequently, this white paper has two primary purposes. First, we seek to provide information that may facilitate discussion of policy issues around a shared set of facts. Second, we seek to provide market participants with a clear statement of the concerns our analysis raises.

The CFPB recognizes that demand exists for small dollar credit products. These types of credit products can be helpful for consumers if they are structured to facilitate successful repayment without the need to repeatedly borrow at a high cost. However, if the cost and structure of a particular loan make it difficult for the consumer to repay, this type of product may further impair the consumer's finances. A primary focus is on what we term "sustained use"—the long-term use of a short-term high-cost product evidenced by a pattern of repeatedly rolling over or consistently re-borrowing, resulting in the consumer incurring a high level of accumulated fees.[4]

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[3] The CFPB considers all supervisory information to be confidential. Consistent with CFPB's rules, the data findings presented in the white paper do not directly or indirectly identify the institutions or consumers involved. See CFPB's final rule on the *Disclosure of Records and Information*, 12 C.F.R. § 1070.41(c).

[4] For purposes of this white paper, sustained use is not measured only by the number of loans that are taken by a consumer over a certain period of time, but the extent to which loans are taken on a cousecutive or largely uninterrupted basis. For example, one consumer who takes out six loans in a year may do so on a sporadic basis, paying back each loan when due, and taking significant breaks between each use. Another consumer might also have taken out six loans, but sequentially with little or no break between periods of indebtedness. The latter scenario would be more indicative of sustained use than the former.

The findings reported in this white paper indicate that these risks exist for a sizable segment of consumers who use these products.

2. Overview of Payday Loans and Deposit Advances

Given the general similarities in structure, purpose, and the consumer protection concerns these products raise, this paper provides a parallel analysis of payday loans and deposit advances.[5]

Payday loans offered by non-depository institutions and deposit advances offered by certain depository institutions are generally marketed as a way to bridge unexpected financial shortfalls between paychecks, receipt of benefits, or other sources of income. The products provide ready access to funds for a short period of time with very limited underwriting. Rather than charging a periodic interest rate which would generate a dollar cost that depends on the amount of time the debt is outstanding, payday and deposit advance lenders charge a set fee that is based upon the amount borrowed and does not vary with loan duration. [6]

Payday loans are typically structured with a single balloon payment of the amount borrowed and fees, timed to coincide with the borrower's next payday or other receipt of income. Loans are repaid at the storefront or—in the event the borrower does not return to the storefront—repayment may be initiated by the lender by presenting the consumer's personal check or effecting a pre-authorized electronic debit of the consumer's deposit account.[7]

Deposit advances are offered by a small number of depository institutions to certain deposit account holders who have recurring electronic deposits, such as a direct deposit of their

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[5] The descriptions of payday loans and deposit advances provided in this section reflect market research and do not imply that the CFPB has necessarily approved or critiqued any particular aspects of the features or operation of these products from a regulatory or supervisory standpoint.

[6] Some states have minimum loan durations as part of their payday lending laws. Depository institutions offering deposit advances may have internal policies that affect the minimum amount of time an advance is outstanding.

[7] Originally offered only by storefront lenders, these loans are now increasingly offered online. Online payday loans are discussed in more depth at the end of Section 2.1 on payday loans, but are not the focus of this white paper.

paycheck, to their accounts.[8] Like payday loans, deposit advances are typically structured as short-term loans. However, deposit advances do not have a predetermined repayment date. Instead, deposit advance agreements typically stipulate that repayment will automatically be taken out of the borrower's next qualifying electronic deposit. Deposit advances are typically requested through online banking or over the phone, although at some institutions they may be requested at a branch.

Despite the general similarities between payday loans and deposit advances, particularly in the consumer protection issues they raise, there are significant differences in delivery costs and credit risk as those products are typically structured today.

Available data indicate that storefront payday lenders have significant fixed costs associated with customer acquisition and with the operation of retail storefront locations.[9] Although storefront lenders generally require borrowers to provide a personal check or debit authorization, both the credit extensions and loan repayments typically take place at the storefront. There is less available information regarding the costs of offering a deposit advance product. However, the product is offered only to existing customers and is an automated feature of a deposit account, akin to linking a deposit account to a line of credit.

Payday lending also involves somewhat greater credit risk than a deposit advance. The payday lender is dependent upon information it can obtain from the borrower or from external sources to assess the borrower's likelihood of repayment. With deposit advance, the depository institution has insight into the customer's flow of funds over a period of time before extending eligibility to the customer. Furthermore, similar to standard overdraft coverage, depository institutions can immediately debit incoming funds (certain electronic deposits in tbe case of deposit advances) to obtain the repayment of an advance, before paying other transactions that occur on the same day. Payday industry data indicate loss rates of around 5% of loan

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[8] We use the term "depository institution" throughout this white paper to generally refer to both banks and credit unions. "Deposit account" refers to checking accounts offered by a bank and share draft accounts offered by a credit union.

[9] For a more detailed discussion of storefront payday economics, see Flannery, Mark, and Katherine Samolyk, *Scale Economies at Payday Loan Stores*, Proceedings of the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition (May 17, 2007).

originations for large storefront lenders.[10] Initial analysis of loan charge-off rates on deposit advances conducted by the CPFB in connection with this study suggests that deposit advance loss rates are lower than those reported for storefront payday loans.

The features and operation of these two products are discussed separately in more detail below.

2.1 Payday Loans

As just explained, a payday loan is typically structured as a closed-end single payment loan with a due date that coincides with the borrower's next payday or receipt of other income. Because the due date is timed in this manner, the loan term is typically two weeks. However, the term could be shorter for consumers who are paid on a weekly basis or longer for those receiving income once a month. Variants of this model exist, including open-end lines of credit and longer-term loans (which may be repayable in installments). The structure of these variations may be driven by state law or other factors.

A consumer obtaining a payday loan at a storefront location must either provide a personal check to the lender or an authorization to electronically debit her deposit account for the loan amount and associated fee. Although the check or authorization essentially serves as a form of security for the loan, the borrower usually agrees to return to the storefront when the loan is due to make repayment in person. If the consumer does not return to the storefront when the loan is due, a lender has the option of depositing the consumer's check or initiating an electronic withdrawal from the consumer's deposit account.

Cost. The cost of a payday loan is a fee which is typically based on the amount advanced, and does not vary with the duration of the loan. The cost is usually expressed as a dollar fee per $100 borrowed. Fees at storefront payday lenders generally range from $10 to $20 per $100, though loans with higher fees are possible. Variations often reflect differences in state laws setting

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[10] For example, one payday trade association notes that "[n]inety five percent of loans are repaid when due..." See Community Financial Services Association of America, *Myth v. Reality*, available at http://cfsaa.com/aboutthepaydayindustry/myth-vs-reality.aspx.

maximum allowable fees. A fee of $15 per $100 is quite common for a storefront payday loan, and would yield an APR of 391% on a typical 14-day loan.

Eligibility. Many states set a limit on payday loan size; for example, $500 is a common loan limit. In order for a consumer to obtain a payday loan, a lender generally requires the consumer to present identification and documentation of income, and have a personal deposit account. Lenders generally do not consider a consumer's other financial obligations or credit score when determining eligibility; however, some lenders use specialty credit reporting firms to check for previous defaults on payday loans and perform other due diligence such as identity and deposit account verification. No collateral (other than the check or electronic debit authorization) is held for the loan.

Repayment. Storefront payday loan contracts generally require borrowers to return to the storefront to pay the loan and associated fee by the due date. If a borrower is unable to repay the full amount, the lender may give her the option to roll over the loan balance by paying a fee, usually equal to the original finance charge, in order to extend the loan until her next payday. If the lender is unwilling or—because of restrictions in state law—unable to directly roll over a loan, the borrower may instead repay the full amount due and then quickly take out a new loan.

Limits on Sustained Use. Historically, payday lending has been largely governed by state law, often through specific legislation that modifies a state usury law in order to permit payday lending. Hence, payday lenders are required to comply with varying laws in each state in which they are located. In states in which payday lending is permitted, laws often include provisions that attempt to limit sustained use, such as: (1) restrictions on the number of times a loan can be rolled over, (2) requirements to offer extended payment plans, (3) cooling-off periods between loans that are triggered after a period of time indebted or number of transactions conducted, (4) limits on loan size based on monthly income, and (5) limits on the number of loans that can be taken over a certain period of time. Individual lenders and trade associations may also adopt their own policies and best practices.[11]

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[11] For example, one trade association whose membership includes storefront payday lenders, the Community Financial Services Association (CFSA), has adopted a set of best practices that include limits on roll overs and the availability of an extended payment plan. See *CFSA Member Best Practices*, available at http://cfsaa.com/cfsa-member-best-practices.aspx. Another trade association that also serves storefront payday lenders, the Financial Service Centers of America (FISCA), has adopted a similar code of conduct for extending credit. See *FISCA Code of*

Online Payday Lending

While not the subject of the findings of this white paper, the CFPB is separately analyzing the use of online payday loans. Online payday loans still make up a minority of the total loan volume; however, the online channel is steadily growing and some industry analysts believe it may eventually overtake storefront loan volume.[12] Variations on the loan structure, such as online payday installment loans and open-end lines of credit, are becoming more common.

In the online lending model, a consumer completes a loan application online and provides an authorization for the lender to electronically debit her deposit account. Other payment methods such as remotely-created checks or wire transfers may also be used. The loan proceeds are then deposited electronically into the consumer's deposit account. On the due date, the lender submits the debit authorization to the consumer's depository institution for repayment. Alternatively, the loan might be structured to provide for an automatic roll over, in which event the lender will submit a debit authorization for the fee only. If an online loan is set up to roll over automatically, the borrower must proactively contact the lender a few days before the electronic withdrawal is to occur to indicate that they wish to pay off the loan in full.

Online loans tend to be offered with fees equal to or higher than storefront loans. According to two industry reports, some of the key cost drivers for online payday lending are the cost of customer acquisition, often done by purchasing leads from lead generators, and loss rates which are reportedly higher for online loans than for storefront payday lending.[13]

Conduct in Offering Access to Credit, available at http://www.fisca.org/Content/NavigationMenu/AboutFISCA/CodesofConduct/FiSCAPDACodesofConduct/default.htm.

[12] For example, some payday lending industry reports contain discussions of growth trends and loan volume projections. See, e.g., Stephens Inc. *Payday Loan Industry Report* (June 6, 2011) and JMP Securities' *Consumer Finance: Online Financial Services for the Underbanked* (Jan. 9, 2012).

[13] Cost drivers for the online payday lending industry are also discussed in the Stephens Inc. and JMP Securities reports, referenced in n. 12.

2.2 Deposit Advances

Deposit advances are lines of credit offered by depository institutions as a feature of an existing account. The product is available only to those consumers that receive electronic deposits on a recurring basis. Some institutions provide eligible consumers the option to sign up for this product; at other institutions, the feature is automatically provided to eligible consumers. When an advance is requested, funds are typically deposited into the consumer's account as soon as the advance is processed, subject to certain limitations on availability for use. Because advances will be repaid automatically when the next qualifying electronic deposits are made to the consumer's account, there is no fixed repayment date at the time the advance is taken. In the event an outstanding advance is not fully repaid by incoming electronic deposits within 35 days, the consumer's account will be debited for the amount due, even if this results in the associated deposit account being overdrawn.

Cost. Like payday loans, the fees associated with deposit advances typically do not vary with the time that the consumer has an outstanding loan balance. The fees are typically disclosed to consumers in terms of dollars per amount advanced. For example, the cost may be described as $2 in fees for every $20 borrowed, the equivalent of $10 per $100. Unlike a payday loan however, the repayment date is not set at the time of the advance and will vary depending on timing and amount of electronic deposits. Hence the fee cannot be used to calculate an APR for the advance at the time the credit is extended.

Eligibility and Credit Limit. A consumer is eligible for a deposit advance if she has a deposit account in good standing which has been open for a specified period and has a history of recurring electronic deposits above a minimum size. Individual depository institutions may impose additional eligibility criteria. Accounts can become ineligible for additional deposit advances for a number of reasons, such as a lack of sufficient recent electronic deposits or excessive overdrafts and non-sufficient funds (NSF) transactions.

Credit limits on the deposit advance product are generally set as a percentage of the account's monthly electronic deposits, up to a certain limit. For example, some depository institutions permit the deposit advance to be the lesser of $500 or 50% of the direct deposits from the preceding statement cycle. The advance limit does not include any associated fees that may be charged for the advance.

The depository institution relies on past electronic deposit history to anticipate the level of deposits that will likely be available as the source of repayment. It typically does not consider the consumer's overall outstanding debt service burden and living expenses. Like payday loans, traditional credit criteria are not used to determine eligibility.

Depository institutions that offer this product generally notify account holders that they are eligible to take advances through online alerts. An eligible consumer can initiate an advance online, via automated voice-assisted phone services, or—at some institutions—in person at a branch.

Repayment. Typically, repayment of an outstanding deposit advance balance is automatically debited from the consumer's account upon receipt of the next incoming qualifying electronic deposit. Qualifying electronic deposits used to repay advances can include recurring deposits (such as salary or government assistance or benefits) as well as one-time payments (such as a tax refund or expense reimbursement from an employer).

Generally, the depository institution captures repayment of advances and fees from the incoming electronic deposit before the consumer can use those funds for other expenses. If that electronic deposit is less than the outstanding deposit advance balance, institutions will typically collect the remaining balance from subsequent electronic deposits.

If an advance and the associated fee are not completely repaid through subsequent electronic deposits within 35 days, the depository institution may execute a forced repayment from the consumer's deposit account for the amount due, even if this causes the account to become overdrawn.

As with payday loans, there are variations of the typical deposit advance product. Some allow consumers to repay the loan through a series of installments over a period longer than 35 days. These repayment options may carry additional costs and restrictions.

Limits on Sustained Use. State-chartered depository institutions operate subject to state law, but, as currently structured, the deposit advance product does not meet the definition of payday lending contained in most state laws, and federally chartered institutions are not generally subject to such legislation. Consequently, it appears that depository institutions typically do not consider such laws in setting the features of deposit advance products. Most programs set limits on the number of consecutive months a consumer can use deposit advances. However, the amount of borrowing needed to trigger a cooling-off period or other mechanism to limit use varies across institutions.

Interplay with Overdraft. Because deposit advance and overdraft are both services tied to a deposit account, there is potential for various interactions between these products. Depository institutions frequently consider a consumer's overdraft and NSF activity when assessing continued eligibility for deposit advance.

If account balances are depleted, consumers may use a deposit advance to cover debits before those transactions are posted and thereby avoid incurring overdraft fees. However, if a consumer's account is already overdrawn when she takes a deposit advance, the advance proceeds are automatically applied to pay off the negative balance resulting from the overdraft and any associated fee first, with the remainder available for her use. In addition, a consumer's account may become overdrawn from a forced repayment on day 35 if there are insufficient funds in the account to cover the repayment. If this insufficient fund situation occurs, a consumer may be charged overdraft or NSF fees on subsequent items presented to the account.

3. Initial Data Findings

The CFPB's avenues of inquiry related to the use of payday loans and deposit advances include loan and borrower characteristics, usage patterns, and outcomes that are correlated with certain patterns of use. While our data do not represent all consumers using these products, our findings are an accurate representation of how these products are used by a sizable share of borrowers in the marketplace.

The following discussion provides initial data findings on consumer usage of storefront payday loans[14] and deposit advances.

3.1 Payday Loans

For our study of payday loans, we obtained data from a number of payday lenders to create a dataset of all payday loans extended by each lender for a minimum 12-month period. Information in the data allows us to identify the loans that were made to the same consumer at a given lender, but not to the same consumer across lenders. [15]

Our findings are derived from a subset of consumers in the full dataset. The sample consists of consumers who have a loan in our dataset in the first month of a 12-month period and then tracks usage across this timeframe. We limit our analysis to this subset of consumers because one focus of our analysis is sustained use, and consumers that we initially observe later in the data can only be followed for a more limited time. The start and end dates of lenders' 12-month

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[14] As noted before, while the analysis in this white paper does not include any online payday loan usage, we plan to conduct a similar analysis of that market.

[15] Our sample consists of all loan activity conducted by an individual consumer at a given lender during the 12-month time period. A borrower may obtain loans from more than one payday lender; however, this analysis does not control for such cross-lender activity and thus potentially underestimates per-consumer usage. The impacts of cross-lender borrowing may be evaluated in subseqnent empirical work. In addition, because we are analyzing results for individuals rather than households, we cannot determine whether other household members are using payday loans or have other relevant income that is not observed.

data reporting varies, which mitigates concerns about seasonality effects. Overall, the study sample consists of a total of approximately 15 million loans generated by storefronts in 33 states.[16]

3.1.1 Loan Characteristics

The median amount borrowed by consumers in our sample was $350. Loan amounts are often limited by state law, with a common maximum loan size of $500, though some states have lower or higher limits. Individual lender credit models may also influence loan amounts offered. The mean loan size was $392, signaling that there are more consumers with loan sizes substantially above the median than substantially below. Most loans in our sample cluster around $250, $300, and $500.

The payday loans we analyzed were single payment loans with a repayment scheduled to occur on the borrower's payday (or when they are scheduled to receive other regular sources of income). We found a median loan term of 14 days, and a mean loan term of 18.3 days.[17]

While payday loans are generally characterized as two-week loans, and we observed a significant number of loans with a 14-day loan duration, there are several explanations for the longer mean loan duration. One reason is state law, which can dictate minimum loan terms and other features.[18] In addition, loan due dates are impacted by the frequency at which consumers receive income, since due dates are generally set to align with a borrower's payday. We have data for a subset of our sample on the frequency with which consumers received income, which is illustrated in Figure 1 below. While over half of the consumers we observed were paid twice per

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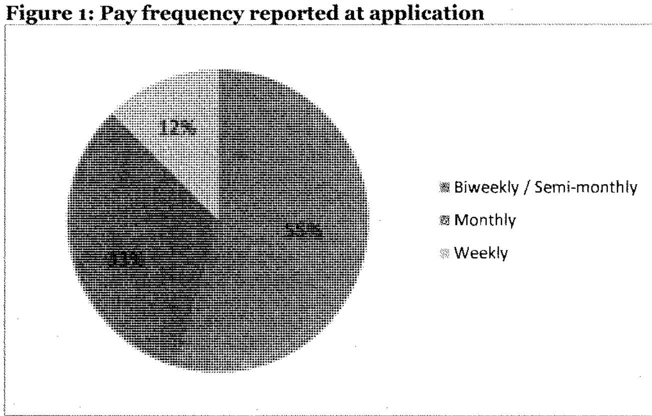
[16] Our sample does not include loans structured at origination to be repayable in installments over a longer period of time, such as those offered in Colorado. Colorado requires a minimum six month loan term. See Colorado Deferred Deposit Loan Act, 5-3.1-103.

[17] Loan duration is defined as the contractual duration when available. When contract duration is unavailable, duration is based on the date the loan was repaid. Average duration changes very little if loans for which contractual duration is unavailable are dropped from the sample.

[18] For example, if a consumer who is paid every two weeks takes out a payday loan three days before her next payday in a state with a minimum seven day loan term, her loan would not come due at that time. Rather, it would be scheduled for a subsequent payday, perhaps 17 days later.

month (thus receiving 24 paychecks per year if paid semi-monthly or 26 paychecks if paid bi-weekly), one-third of consumers were paid monthly.

Figure 1: Pay frequency reported at application



Most states with payday lending storefronts set a maximum fee per $100 borrowed that lenders may charge, which typically ranges between $10-20 per $100. A few states have higher or no limits, while others employ a sliding scale, depending on loan size.[19] The median fee we observed in our sample was $15 per $100. Table 1 provides a summary of mean and median loan amounts, fees per $100, duration, and APR for the loans in our sample.

[19] An example of a state with a sliding scale fee schedule is Michigan, where a fee of $15 is assessed on the first $100 borrowed, then $14 on the second $100, $13 on the third $100, and so on. See Michigan Deferred Presentment Service Transaction Act § 487.2153.

Table 1: Summary of loan characteristics

	Mean	Median
Loan amount	$392	$350
Fee per $100	$14.40	$15
Duration	18.3 days	14 days
APR	339%	322%

Note: Summary statistics should not be interpreted as reflective of the characteristics of an "average" loan. Individual data findings for average loan amount, fee, duration, and APR are calculated separately and do not relate to one another. For instance, the loans in our sample have a median cost of $15 per $100. This would equate to a fee of $52.50 on the median $350 loan. In this example, the borrower would owe $402.50 to be repaid on her due date. The APR on that particular loan with a median duration of 14 days would be 391%.

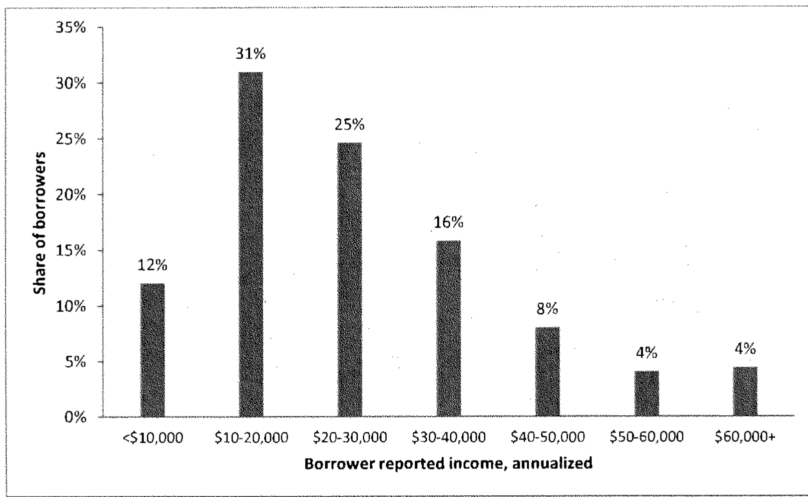
3.1.2 Borrower Income

Here, we examine the income that consumers document as part of the application process in order to qualify for a loan, and the source of that income.[20] Storefront payday borrowers in our sample have income that is largely concentrated in income categories ranging from $10,000-$40,000 on an annualized basis.[21]

[20] Consumers typically provide a recent pay stub, recent deposit account statement, or other information to document income as part of the application process.

[21] Our dataset includes information on the amount and frequency of income that can be used to calculate an annualized figure for each borrower in our sample. Because the source of this income information could be a paystub or deposit account statement, it may be net income after taxes and other items have been deducted. The income data reported in this section is only available for a sub-set of lenders in our sample.

Figure 2: Distribution of income reported at application



Note: Annualized income based on pay period amount and pay frequency reported at the time of payday application.

The median income is $22,476, although a quarter of horrowers have income of $33,876 or more.

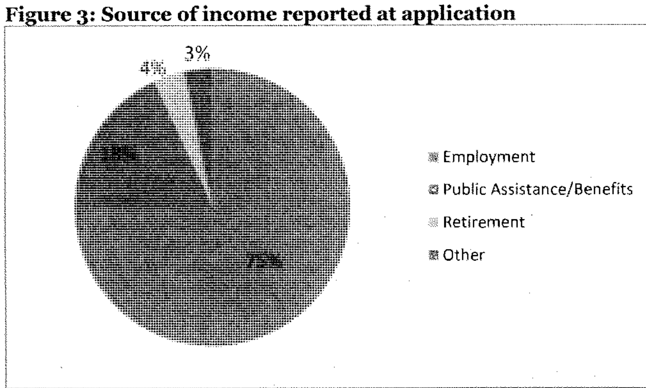
Table 2: Borrower income reported at application

Mean	$26,167
25^{th} percentile	$14,172
Median	$22,476
75^{th} percentile	$33,876

It is important to note that income used in this analysis may not reflect total household income. Other income may be present in the household if the borrower receives income from more than one source or another person in the household also has an income source.

We also observed the source of this income. Three-quarters of consumers in our sample were employed either part- or full-time. A significant share of consumers—nearly 1 in 4—reported either some form of public assistance or other benefits (18%) or retirement funds (4%) as an income source.

Figure 3: Source of income reported at application

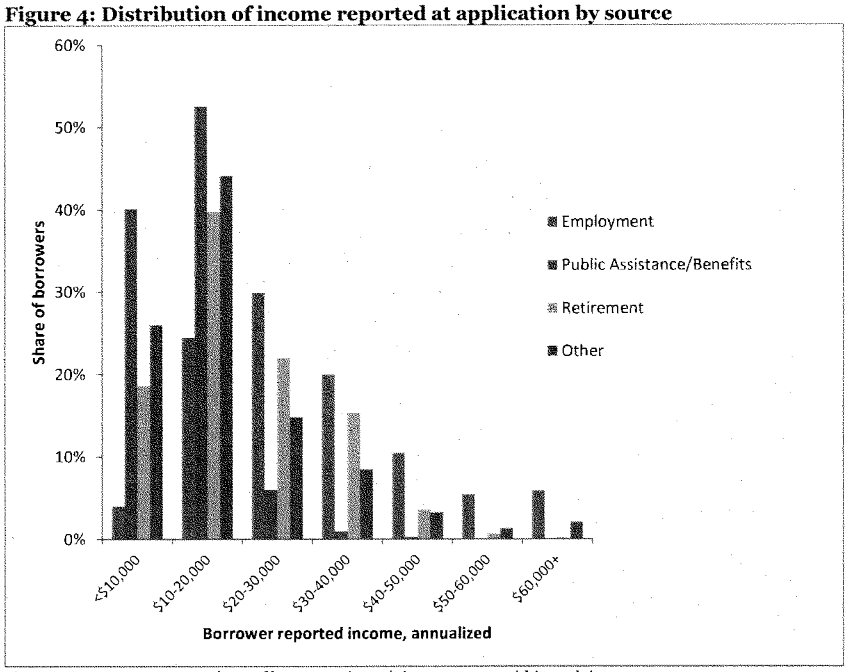


Reported government assistance or benefit income received by the consumers in our sample consists largely of Social Security payments (including Supplemental Security Income and Social Security Disability Insurance),[22] unemployment, and other federal or state public assistance.[23] These payments are usually of a fixed amount, typically occurring on a monthly basis. As shown in Figure 4 below, borrowers reporting public assistance or benefits as their income source are more highly concentrated towards the lower end of the income range for the payday borrowers in our sample.

[22] Supplemental Security Income (SSI) payments are to qualified adults and children with disabilities and people who are 65 years or older with limited income and resources. Social Security Disability Insurance payments are to persons with disabilities who have paid enongh employment taxes to the Social Security Trust Fuud.

[23] It is possible that some benefit payments from private sources such as employer-provided disability benefits may also be captured in this category.

Figure 4: Distribution of income reported at application by source



Note: Percentages represent share of borrowers in each income range within each income sonrce category.

3.1.3 Intensity of Use

One of the primary goals of our analysis is to understand payday loan usage patterns. This section provides preliminary findings on the extent to which consumers in the study sample used this product during the 12-month study period and on the patterns of that use.[24] In order

[24] Loan usage patterns are based on our sample borrowers who take out a loan in the initial month of a lender's dataset. Usage is theu tracked for a total of 12 months. These results thus reflect the subsequent experiences of a representative set of consumers whose loan usage would include the first month of the study sample. Therefore, our analysis does not reflect a given lender's portfolio over the course of a calendar year, since the lender would also have

to report usage levels consistently across borrowers, we consider loans and any rollovers of existing loans as separate transactions. For example, a consumer who takes out one loan and rolls it over once is considered to have two transactions (or loans) for purposes of this white paper. Similarly, a consumer who takes a loan, pays it back, and opens a new loan would also be considered to have two transactions.

Figure 5 below shows the distribution of loan use across consumers in our sample. Usage is concentrated among those consumers in our sample with 7 or more transactions in the 12-month study period. Nearly half (48%) of borrowers had more than 10 transactions over this same time period; of these, 29% (14% of all borrowers) had over 20 transactions. In contrast, 13% of borrowers had 1-2 transactions and another 20% had 3-6 transactions over the 12-month period. These consumers had a relatively low intensity of use.[25]

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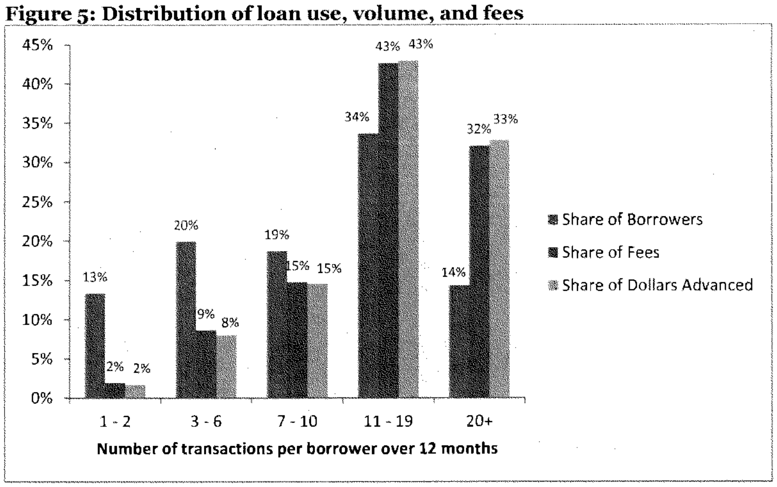
loan volumes and revenues derived from borrowers who do not take loans in the first month. Two factors may cause the usage statistics in our sample to show somewhat more intense usage than analyses based on all loans made in a calendar year. First, high-intensity borrowers are more likely to be sampled based on usage in a given month than low-intensity borrowers. Second, we exclude borrowers whose initial loan in the 12-month study period occurs after the initial month in the lender's sample, since their usage cannot be tracked over a full 12 months.

[25] Usage rates include borrowers who default and may become ineligible for future payday loans. For instance, some share of borrowers who take out a single payday loan may have this low amount of usage because they never paid their loan back and, as a result, were not provided additional credit by that lender in our 12-month study period.

Figure 5: Distribution of loan use, volume, and fees



The figure also shows the distribution of loan volume and loan fees across consumer usage groups. Three-quarters of all loan fees generated by consumers in our sample come from those with more than 10 transactions during this period. In contrast, loan fees generated by consumers who borrowed six or fewer times over 12 months make up 11% of the total for this sample of borrowers.[26]

Overall, the median consumer in our sample conducted 10 transactions over the 12-month period and paid a total of $458 in fees, which do not include the loan principal.[27] One quarter of borrowers paid $781 or more in fees.

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[26] As described in n. 24 above, these data differ from what would be observed in a lender's overall portfolio over a one-year period.

[27] An important policy question here is the benefit the consumer receives, in the form of credit extended, in return for the fees paid. As shown in Figure 6 in a subsequent section, many new loans are taken out within the same day a previous loan is repaid or shortly thereafter; therefore, it is arguable that these transactions should not be treated as new extensions of credit for this purpose.

Table 3: Number of transactions and total fees paid over 12 months

	# transactions	Total fees paid
Mean	10.7	$574
25th percentile	5	$199
Median	10	$458
75th percentile	14	$781

Since payday loans can be made for varying durations based on consumers' pay cycles, the frequency at which consumers received income may impact the number of transactions they conducted. Consumers paid on a more frequent basis may have the ability to take more loans over a certain period of time than others paid fewer times per year. The number of transactions conducted by a consumer can also be impacted by state law, which may cap the number of loans made in a given year or mandate cooling-off periods.[28] Because of this, we also examined the number of days in the 12-month study period that consumers were indebted. This provides a uniform measure for consumers with different use patterns, pay frequencies, and loan durations.

We find that consumers in our sample had a median level of 199 days indebted, or roughly 55% of the year. A quarter of consumers were indebted for 92 days or less over the 12-month study period, while another quarter was indebted for more than 300 days. The length of time a consumer is indebted is driven by three factors: (1) the number of transactions they conduct; (2) the number of days until each loan is due; and—to a much lesser extent—(3) whether that consumer has delinquent loans that remain outstanding beyond the contractual due date.

Table 4: Number of days and share of the year indebted

Mean	196	54%
25th percentile	92	25%
Median	199	55%
75th percentile	302	83%

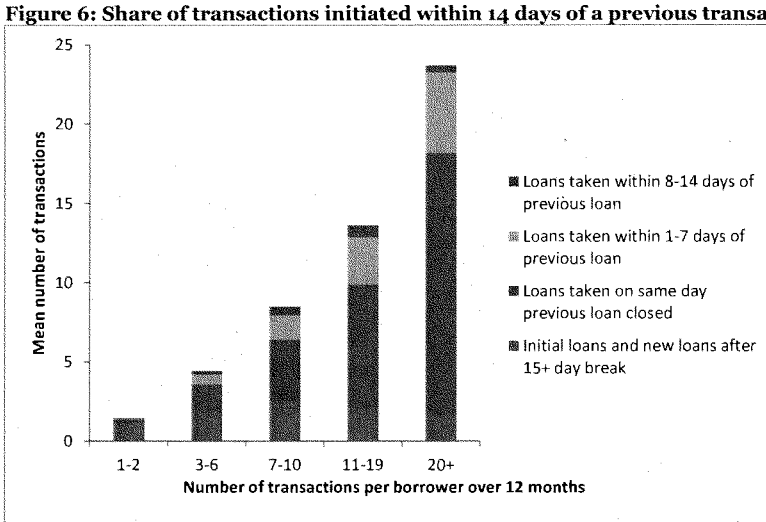
[28] Some states have laws that would restrict maximum usage, such as an eight loan per year limit in Washington, a minimum loan duration of two pay cycles in Virginia, and mandated cooling-off periods after a certain amount of usage in Oklahoma and Virginia.

3.1.4 Sustained Use

Of particular importance to our analysis is the timing of the use of payday loans and whether we observe patterns of sustained, rather than sporadic, use. A pattern of sustained use may indicate that a borrower is using payday loans to deal with expenses that regularly outstrip their income. It also may indicate that the consumer is unable to pay back a loan and meet her other expenses that occur within the same pay period.

To shed light on this issue, we evaluate the distribution of borrowing patterns across consumer usage groups. This allows us to observe the share of transactions that are consistent with a pattern of sustained use, defined as transactions which occurred either the same day a previous loan was closed or soon after. Figure 6 below classifies consumers into five groups based on the number of transactions they conducted over the 12 month period. For each group, we can observe what share of transactions conducted by these consumers are the initial loans or loans after a break in indebtedness of at least 15 days. Likewise, we can observe the share of transactions that occurred shortly after a previous loan was closed—either the same day, within 1-7 days, or within 8-14 days.

Figure 6: Share of transactions initiated within 14 days of a previous transaction



Note: The total height of each bar represents the mean number of transactions a borrower in each usage category conducted over 12 months. The height of each sub-category represents the mean number of transactions per consumer in the 12-month period that were conducted on the same day, within 1-7 days, or within 8-14 days of the close of a previous loan, as well as a sub-category that represents initial loans and new loans opened 15 days or longer after a previous loan was repaid.

The vast majority of loans made to consumers with 1-2 transactions in the 12 month period were either initial loans or loans taken after a 15 day or longer break. By definition, all borrowers with a single transaction would meet these criteria since they only took an initial loan.

For those consumers taking out more than two loans during the 12 month period, an increasing share were attributable to transactions that are taken out on a sustained basis; that is, within 14 days of the prior loan. Transactions taken by consumers with 3-6 loans in the 12 month period were about evenly split between continuous loans and loans that are either the initial in our study period or taken out after a 15 day or longer break after closing the previous loan.

The majority of transactions conducted by consumers with at least 7 transactions a year were taken on a nearly continuous basis. Most frequently, these new transactions were opened within a day of a previous loan closing. We discuss the significance of these findings in the final section of this paper.

3.2 Deposit Advances

For our study of deposit advances, we gathered data from a number of depository institutions. Some of these data are used here to describe outcomes for consumers during a 12 month study period. Since deposit advance eligibility typically depends on recent electronic deposit history, NSF and overdraft activity, and previous deposit advance use, a consumer's eligibility can fluctuate over time. Consumers included in this analysis had accounts that were either: (1) eligible to take an advance during the first month of the study period or (2) eligible during subsequent months if they had been eligible sometime during the quarter prior to the beginning of the study period.[29] Consumers with accounts opened after the beginning of the study period and accounts that became newly eligible later in the study period were excluded. Based on these criteria, an equal number of accounts were randomly selected for each institution; hence the outcomes reported here can be thought of as averages across institutions, rather than outcomes for the underlying population of accounts that satisfied these criteria.[30] This sampling methodology was used so that patterns measured below cannot be attributed to any specific institution.

About half of the institutions' consumer deposit accounts were eligible for deposit advances. Our sample contains more than 100,000 eligible accounts, with roughly 15% of accounts having at least one deposit advance during the study period. We compare deposit advance users and consumers who are eligible for—but did not take—any advances, as well as deposit advance users with varying levels of use.

[29] The data obtained by the CFPB covers a period longer than the study period and thereby enables us to observe eligibility prior to the start of the study period.

[30] The analysis of the deposit advance product presented in this paper draws on information collected through the supervisory process, aggregated to preserve the confidentiality of individual institutions.

3.2.1 Loan Characteristics

The median size of an individual advance was $180. However, consumers can take out multiple advances in small increments up to their specified credit limit prior to repaying outstanding advances and associated fees out of the next electronic deposit. Thus, merely observing the size of an individual advance without considering the number of advances taken before repayment may not fully capture the extent of borrowing.

To provide a more meaningful representation of loan characteristics, we also analyzed each "advance balance episode," defined as the number of consecutive days during which a consumer has an outstanding deposit advance balance. The median average daily balance of all advance balance episodes was $343, which is larger than the $180 median advance. This reflects the tendency of some consumers to take multiple advances prior to repayment.

To measure the duration and APRs associated with incremental deposit advance use or repayments from multiple deposits, we again used the concept of advance balance episodes. Each advance balance episode has a well-defined duration and average daily outstanding balance that can be used to measure an APR, given total advance fees that are a fixed percent of advances extended during the period.[31]

We took this approach to measuring APRs in dealing with consumers who take incremental advances prior to the receipt of the next electronic deposit and with advances that are repaid out of successive electronic deposits credited to the account at different dates. When a consumer takes multiple advances prior to a given incoming electronic deposit, each is subject to the same fee measured as a percent of the advance amount. However, each advance will have a different duration (measured as the number of days until repayment) and, therefore, a different APR. Similarly, when an incoming electronic deposit is insufficient to fully repay an outstanding deposit advance balance, segments of the advance repaid at a different dates will have varying durations (and, again, different APRs).

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[31] This fee-based APR calculation is solely intended to facilitate comparisons between payday loans and deposit advances for the purposes of this white paper and should not be relied upon for any other purpose. When disclosing APR, lenders must comply with currently applicable legal requirements.

The median duration of advance balance episodes in our sample was 12 days. Using this duration, we can calculate an APR for different fees that may be charged for an advance. For example, a typical fee is $10 per $100 borrowed.[32] This fee would imply an APR of 304% given a 12-day duration. A hypothetical lower fee of $5 per $100 advanced would yield an APR of 152%, while a hypothetical higher fee of $15 per $100 advanced and would yield an APR of 456% with the same 12-day term. Thus, the APR will vary significantly depending on the duration of a particular advance balance episode and the fee charged by an individual institution.

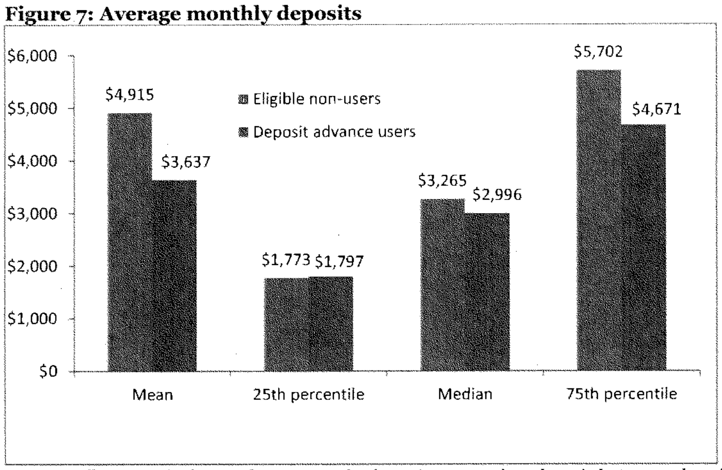
3.2.2 Consumer Account Characteristics

While we did not directly observe the total income of consumers who use deposit advances in our sample, we did observe deposits to their accounts. We can also measure other account characteristics in our data, such as average daily balances, and how consumers transact from their accounts. An important part of our analysis was to compare how these types of account activity differ for consumers who use advances and for consumers who are eligible for deposit advances but do not use the product ("eligible non-users"). In general, these findings are measured on an average per-month basis for the months that the deposit account was open during the study period.

Consumers in our study sample who took deposit advances had a median of just under $3,000 in average monthly deposits. While monthly deposits are not necessarily indicative of, or directly comparable to, monthly income (deposits can reflect money transferred into an account from other sources), average monthly deposits do reflect available resources. As compared to eligible non-users, consumers taking deposit advances tended to have slightly lower average monthly deposits.

[32] This fee is expressed in slightly different ways depending on the institution, such as $2 per $20 borrowed, or $1 per $10 advanced, but is the equivalent to a $10 fee for every $100 borrowed.

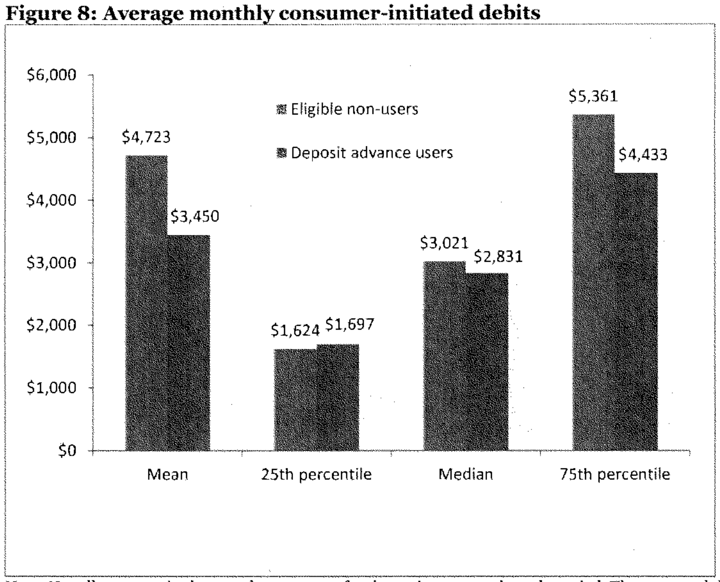
Figure 7: Average monthly deposits



Note: Not all accounts in the sample were open for the entire 12-month study period. Average deposits were measured for months during which the accouut was open.

Consistent with lower deposits to the account, deposit advance users also tended to have a lower volume of payments and other account withdrawals than eligible non-users.

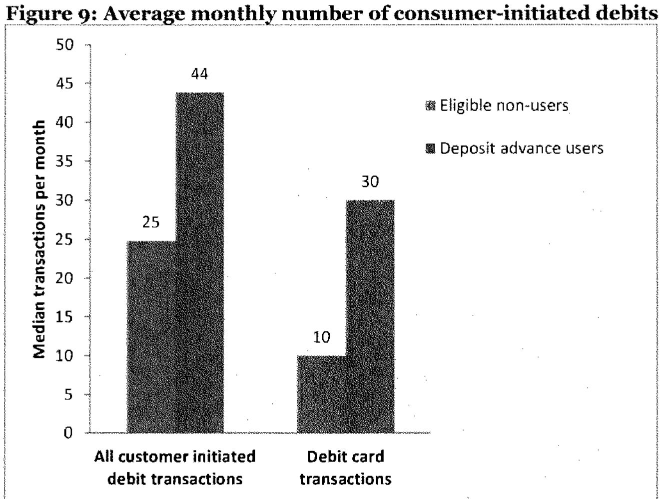
Figure 8: Average monthly consumer-initiated debits



Note: Not all accounts in the sample were open for the entire 12-month study period. The average dollar volume of consumer-initiated debits was measured for months during which the account was open.

However, deposit advance users tended to conduct a larger number of account transactions than eligible non-users, particularly debit card transactions.

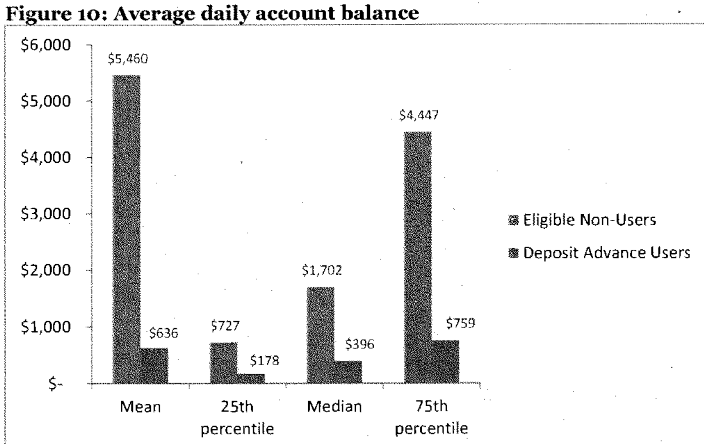
Figure 9: Average monthly number of consumer-initiated debits



Note: Not all accounts in the sample were open for the entire 12-month study period. The average number of consumer-initiated debits per month is measured for months during which the account was open.

Deposit advance users tended to have much lower average daily balances than eligible non-users. This suggests that deposit advance users have less of a buffer to deal with financial shortfalls (balances reported here include deposit advances that have been credited to a consumer's deposit account).

Figure 10: Average daily account balance



Note: Not all accounts in the sample were open for the entire 12-month study period. The average daily account balance for each account is measured for days during which the account was open.

3.2.3 Intensity of Use

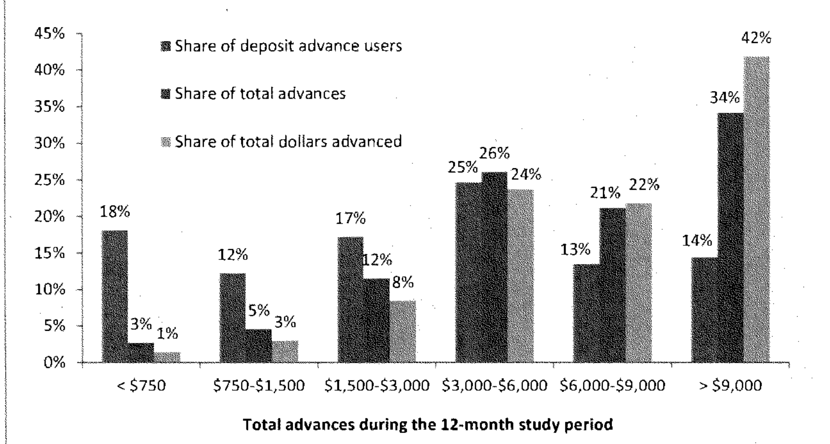
To better understand how consumers in our sample use deposit advances, we first present information on the number of advances taken and total dollar amount advanced during the study period, as well as the number of advance balance episodes deposit advance users have over the 12-month study period.

As previously explained, because consumers can take multiple advances up to their specified credit limit with repayment out of the next electronic deposit, measuring the number of advances is not necessarily an accurate means of measuring the intensity of use. For example, a consumer who takes out two advances each of $50 on successive days is not necessarily using the product more intensely than a consumer who takes out a single advance of $100. To assess intensity of use in light of the incremental nature of some consumers' use of the deposit advance product, we classify accounts in terms of the total dollar volume of advances taken during the 12-month study period rather than the number of advances that were extended.

As with payday borrowers, we found that a significant share of deposit advance borrowers took a sizable volume of advances during the 12-month study period. On the one hand, 30% of all borrowers in our sample had total advances of no more than $1,500; which we refer to as light to moderate annual use of the deposit advance product. On the other hand, more than half of deposit advance users in our sample took advances totaling more than $3,000. Further, more than a quarter (27%) of deposit advance borrowers took advances totaling more than $6,000 over 12 months, and more than half of this group (14% of the total population of deposit advance borrowers) took advances in excess of $9,000.

The two highest usage groups accounted for 64% of the total dollar volume of advances and more than half (55%) of the total number of advances extended. In contrast, the borrowers who used $1,500 or less in advances during the same time period accounted for less than 10% of the total dollar amount and number of advances.

Figure 11: Distribution of loan use and volume



Note: Each account is classified by the dollar volume of deposit advances taken during the 12-month study period. Not all accounts in the sample were open for the entire study period.

Table 5 illustrates that higher deposit advance usage during the 12-month period tends to reflect borrowers' frequent, as well as larger, advances.

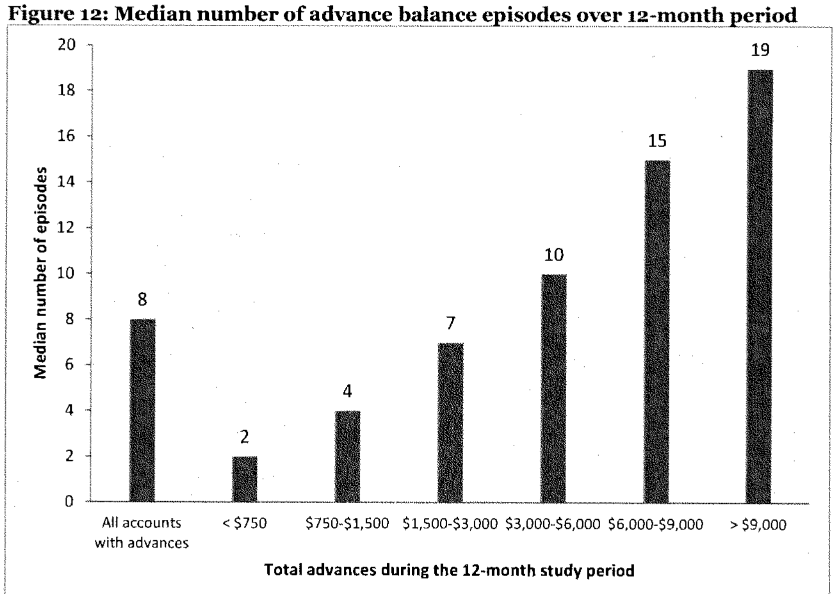
Table 5: Median amount per advance and median number of advances

		Amount use groups					
	All account with advances	<$750	$750-$1,500	$1,500-$3,000	$3,000-$6,000	$6,000-$9,000	>$9,000
Median amount per advance	$180	$100	$100	$100	$160	$200	$200
Median number of advances	14	2	6	11	17	26	38

Note: Each account was classified by the dollar volume of deposit advances taken during the 12-month study period. Not all accounts in the sample were open for the entire study period.

As discussed in a previous section, we also measure use in terms of each advance balance episode—defined as the period of time in which a consumer has an advance outstanding. We found that the median number of episodes for all advance users in our study sample is eight per year. This varied from a median of just two episodes for the lowest use group to a median of 19 episodes for the highest use group.

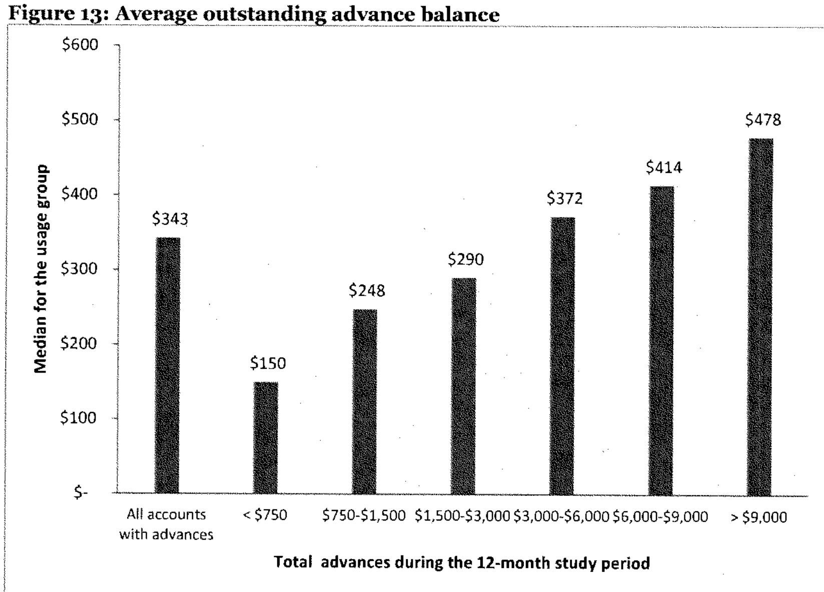
Figure 12: Median number of advance balance episodes over 12-month period



Note: An advance balance episode is defined as a period during which the account holder had an outstanding deposit advance balance. An advance balance episode may involve more than one advance or more than one repayment. Not all accounts in the sample were open for the entire 12-month study period.

Higher usage during the 12-month study period also reflected larger outstanding balances during advance balance episodes. For the lowest usage group, the median average daily advance balance was $150, while for consumers in the two highest usage groups, average daily balances of advance balance episodes tended to exceed $400.

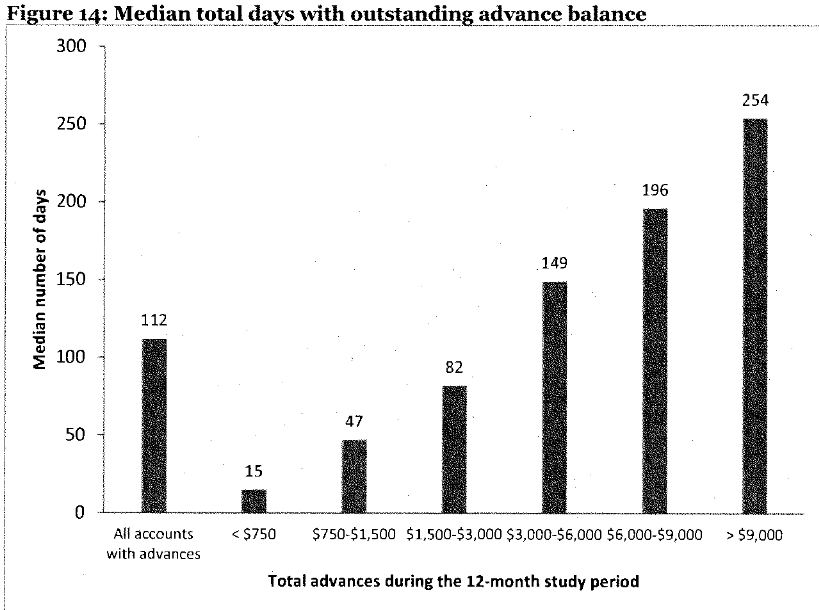
Figure 13: Average outstanding advance balance



Note: An average daily balance is computed for each period during which an account holder has an outstanding deposit advance balance. Not all acconnts in the sample were open for the entire 12-month study period.

We also measured the total number of days that each consumer in our sample was indebted by using the duration of each advance balance episode. Consumers in our sample were indebted for a median of 112 days (31% of the year), with the number of days generally increasing with the total volume of advances taken. Consumers taking more than $3,000 in advances during the 12-month study period tended to be indebted for more than 40 percent of the year.

Figure 14: Median total days with outstanding advance balance



Note: Median number of days with outstanding advance balances during the 12 month-study period; not all accounts in the sample were open for the entire 12-mouth study period.

It is important to note that because we are analyzing consumers based on their eligibility for the deposit advance product, reported usage patterns are not directly comparable to those analyzed for payday borrowers that were included in the sample only if they had taken a loan in the first month of the study period. The deposit advance usage patterns measure usage by consumers who were eligible to use the product at the beginning of the sample period, but some consumers who used the product may not have done so until later in the year. Neither the payday loan nor the deposit advance findings capture any continuing use after the 12-month period analyzed. Usage patterns for both products also reflect use that ends because a consumer does not repay the loan and hence, the account is charged off.

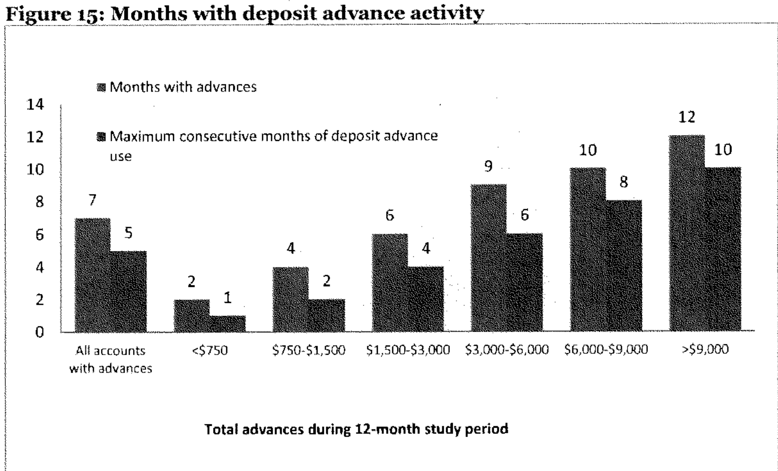
3.2.4 Sustained Use

In addition to examining the advance activity of consumers during the 12-month period, we also analyze whether that indebtedness (measured in terms of advance balance episodes) occurred on a sustained, nearly uninterrupted basis.

We examined the total number of months in which each consumer in our sample took deposit advances and the longest number of consecutive months that advances were used. The median number of months in which a consumer had outstanding advance balances was seven; however consumers with $1,500 or less in annual advances typically had outstanding advances in four or fewer months while consumers with over $3,000 in annual advances typically had outstanding advances in 9 or more months, and at least six consecutive months during the 12-month period we examined here. It is important to note that that not all consumers were eligible to take deposit advances in every month of the study period so breaks in usage may be attributable to other factors.[33]

[33] For example, some accounts closed before the end of the study period. And, while most accounts were open for the entire period, many consumers were not eligible to take deposit advances for the entire year. In addition to other criteria that affect eligibility, variations also reflect policies requiring cooling-off periods after a specific period and/or intensity of use. Cooling-off policies are reflected in a reduction in amount of time that heavy advance users are eligible during the 12-month study period, compared to otherwise similar consumers with less usage. As intended, cooling-off policies set an upper bound on the number of months consumers can take advances.

Figure 15: Months with deposit advance activity

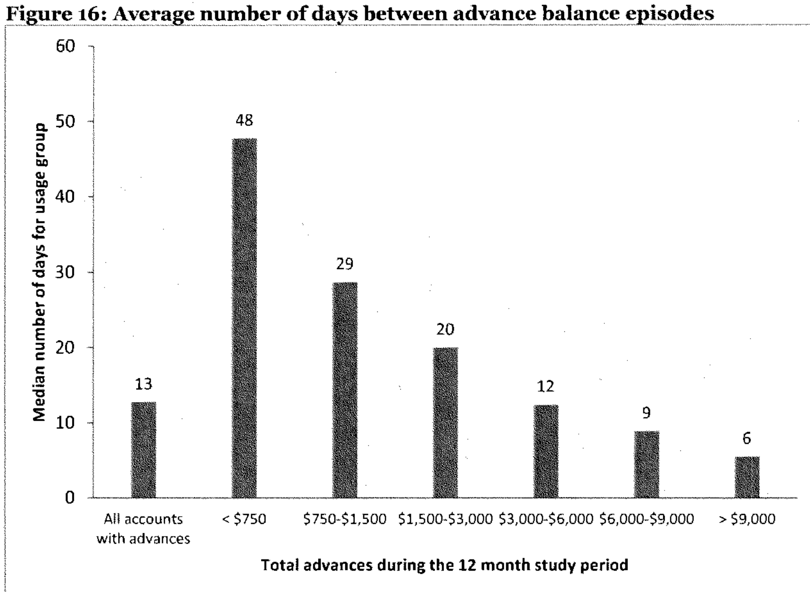


Note: Not all accounts in the sample were open for the entire 12-month study period.

Likewise, to determine whether advances are used with little break in between, we can observe the average number of days between each consumer's advance balance episodes using the dates that each deposit advance episode begins and ends.

Among consumers in our sample with more than one advance balance episode, the median number of days between advances was 13. Consumers who had the least use also had longer breaks between usage; for example, those consumers in the lowest usage group who had more than one advance episode had a median of 48 days between these uses of deposit advance. This break declined markedly among consumers with higher levels of use. Borrowers in the highest three usage groups tended to have 12 or fewer days between advance balance episodes.

Figure 16: Average number of days between advance balance episodes



Note: The average number of days between a consumer's advances is calculated for each account with at least two advances during the 12-month study period; not all accounts in the sample were open for the entire 12-month study period.

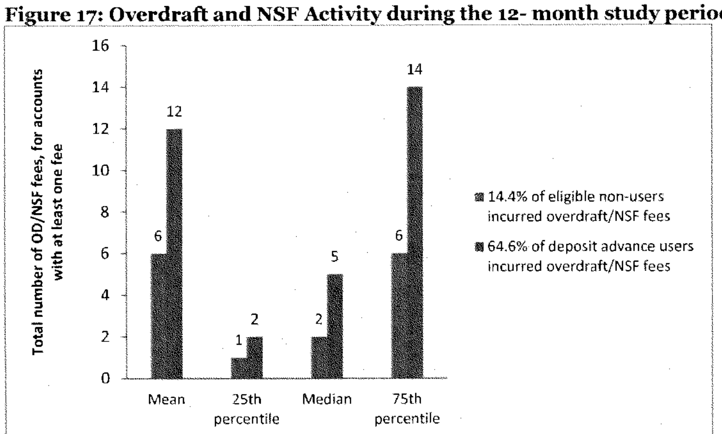
3.2.5 Deposit Advance Use and Overdraft/NSF Activity

In addition to offering deposit advance, the depository institutions in our analysis may also provide overdraft coverage. Overdraft fees may be assessed when a depository institution pays items even though the consumer does not have sufficient funds in her account (or in another account which the consumer has linked to the deposit account). If, instead of paying the item, the bank elects to return it as an unpaid NSF item, a fee may also be charged.

Some institutions market deposit advances as a way for consumers to avoid overdraft fees when they do not have sufficient funds in their accounts to cover transactions. However, deposit advances are typically not offered as a form of "overdraft protection" that would automatically cover non-sufficient funds items up to a consumer's deposit advance limit. A consumer taking a deposit advance to add funds to her account balance must estimate the amount of funds needed to cover transactions that have not yet cleared as well as future transactions that will occur before the next deposit.

We found that deposit advance users in our sample of accounts were much more likely to have incurred an overdraft or NSF fee during the 12-month study period than eligible non-users. Notably, we found that while just 14% of eligible non-users incurred an overdraft or NSF fee during the 12 montb study period, 65% of those consumers who used deposit advances had overdraft or NSF activity. Deposit advance users who incurred an overdraft or NSF fee typically incurred a greater number of fees than eligible non-users with at least one overdraft or NSF fee.

Figure 17: Overdraft and NSF Activity during the 12- month study period



Note: For each account with at least one NSF or overdraft fee, total fees reflect all overdraft and NSF fees incurred by the account during the study period. However, not all accounts in the sample were open for the entire 12-month study period.

Consumers with greater deposit advance usage during the study period were more likely to have had overdraft or NSF transactions. Over four out of five consumers in the two highest usage groups had at least one overdraft or NSF.

Table 6: Deposit advance usage and overdraft/NSF fees during the 12 month-study period

		<$750	$750-$1,500	$1,500-$3,000	$3,000-$6,000	$6,000-$9,000	>$9,000
Accounts in deposit advance usage group with OD/NSF fees		45%	57%	63%	71%	82%	83%
Number of OD/NSF fees for accounts in usage group with any OD/NSF fees	Mean	7	9	10	13	17	16
	25th percentile	1	2	2	2	3	3
	Median	3	4	4	5	7	7
	75th percentile	7	9	11	14	19	18

Note: For each account with at least one overdraft or NSF fee, total fees reflect all overdraft and NSF fees incurred by the account during the study period. However, not all accounts in the sample were open for the entire 12-month study period.

Among consumers with overdraft or NSF activity, the total number of these items tended to increase with deposit advance usage. Among the four-fifths of consumers in the two highest usage groups with overdraft or NSF items, the median number of items was seven. However, a quarter of deposit advance users in our sample in the two highest usage groups with overdraft or NSF items had 18 or more.

4. Conclusions and Implications

Payday loans and deposit advances are both structured as products designed to meet short-term credit needs, with the full amount borrowed due at the next payday in the case of payday loans and due as soon as sufficient qualifying electronic deposits are received (but no later than 35 days) in the case of deposit advances.

It appears these products may work for some consumers for whom an expense needs to be deferred for a short period of time. The key for the product to work as structured, however, is a sufficient cash flow which can be used to retire the debt within a short period of time.

The data presented in this study suggest some consumers use payday loans and deposit advances at relatively low to moderate levels. Thirteen percent of payday borrowers in our sample took out only 1-2 loans over the 12-month period, and about one-third took out six loans or less. A similar share of deposit advance users (30%) took no more than a total of $1,500 in advances over the same period of time.

However, these products may become harmful for consumers when they are used to make up for chronic cash flow shortages. We find that a sizable share of payday loan and deposit advance users conduct transactions on a long-term basis, suggesting that they are unable to fully repay the loan and pay other expenses without taking out a new loan shortly thereafter. Two-thirds of payday borrowers in our sample had 7 or more loans in a year. Most of the transactions conducted by consumers with 7 or more loans were taken within 14 days of a previous loan being paid back—frequently, the same day as a previous loan was repaid. Similarly, over half of deposit advance users in our sample took out advances totaling over $3,000. This group of deposit advance users tended to be indebted for over 40% of the year, with a median break between advance balance episodes of 12 days or less.

We did not analyze whether consumers who use these products more heavily turned to a payday loan or deposit advance initially because of an unexpected, emergency expense or because their regular obligations outstripped their income. Nor have we analyzed what other strategies a consumer might employ, other products she might use in lieu of a payday loan or deposit advance, or the possible consequences or trade-offs associated with these choices. What appears clear, however, is that many consumers are unable to repay their loan in full and still meet their other expenses. Thus, they continually re-borrow and incur significant expense to repeatedly carry this debt from pay period to pay period. For both products, the high cost of the loan or advance may itself contribute to the chronic difficulty such consumers face in retiring the debt.

It is unclear whether consumers understand the costs, benefits, and risks of using these products. On their face, these products may appear simple, with a set fee and quick availability. However, the fact that deposit advances do not have a repayment date but rather are repaid as soon as qualified deposits are received adds a layer of complexity to that product which consumers may not effectively grasp. Moreover, consumers may not appreciate the substantial probability of being indebted for longer than anticipated and the costs of such sustained use. To the extent these products are marketed as a short-term obligation, some consumers may misunderstand the costs and risks, particularly those associated with repeated borrowing.

In addition, the current repayment structure of payday loans and deposit advances, coupled with the absence of significant underwriting, likely contributes to the risk that some borrowers will find themselves caught in a cycle of high-cost borrowing over an extended period of time. As we have seen, payday loans are generally required to be repaid at the consumer's next payday and deposit advances are repaid out of ensuing electronic deposits, typically derived from wages or other regular source of income. These products are represented as being appropriate for consumers who (1) have an immediate expense that needs to be deferred for a short period of time and (2) will have a sufficient influx of cash by the next pay period to retire the debt – and to pay the significant borrowing costs. Yet, it does not appear tbat lenders attempt to determine whether a borrower meets this profile before extending a loan. Lenders may instead rely on their relative priority position in the repayment hierarchy to extend credit without regard to whether the consumer can afford the loan. This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses. Other structural and usage characteristics may also play a material role in harms experienced by consumers.

Our findings thus raise substantial consumer protection concerns. The CFPB intends to continue its inquiry into small dollar lending products to better understand the factors contributing to the sustained use of these products by many consumers and the light to moderate use by others. We will analyze the effectiveness of limitations, such as cooling-off periods, in curbing sustained use and other harms. Separately, we are analyzing borrowing activity by consumers using online payday loans.

The CFPB recognizes its responsibility to implement Federal consumer financial laws to ensure that "markets for consumer financial products and services are fair, transparent and competitive." The CFPB is also authorized to "prescribe rules ... identifying as unlawful unfair, deceptive or abusive acts or practices in connection with ... the offering of a consumer financial product or service" (among other rulemaking authority) and to act to prevent covered persons or service providers (as defined in title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act) "from committing or engaging in" such acts or practices.[34] The potential consumer harm and the data gathered to date are persuasive that further attention is warranted to protect consumers. Based upon the facts uncovered through our ongoing work in this area, the CFPB expects to use its authorities to provide such protections.

[34] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. X, 124 Stat. 1376 (2010). See sections 1021(a), 1031(a), and 1031(b).

FEDERAL DEPOSIT INSURANCE CORPORATION
6714-01-P

Proposed Guidance on Deposit Advance Products

AGENCY: The Federal Deposit Insurance Corporation (FDIC).

ACTION: Proposed guidance with request for comment.

SUMMARY: The FDIC is proposing guidance on safe and sound banking practices and consumer protection in connection with deposit advance credit products.

DATES: Comments must be submitted on or before [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES:

- Mail: Written comments should be addressed to Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Delivery: Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
- Agency Web site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comment on the agency Web site.
- E-mail: You may also electronically mail comments to comments@fdic.gov.
- Public Inspection: Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E–1005, Arlington, Virginia 22226, between 9:00 a.m. and 4:00 p.m. (EST), Monday to Friday.

FOR FURTHER INFORMATION CONTACT:

Luke H. Brown, Associate Director, Supervisory Policy, (202) 898-3842; Rae-Ann Miller, Associate Director, Risk Management Policy, (202) 898-3898; Surya Sen, Section Chief, Supervisory Policy, (202) 898-6699; Ardie Hollifield, Senior Policy Analyst, Supervisory Policy, (202) 898-6638; or Louis Bervid, Senior Examination Specialist, Risk Management Policy, (202) 898-6896

SUPPLEMENTARY INFORMATION:

I. Introduction

The Federal Deposit Insurance Corporation (FDIC) is proposing supervisory guidance to clarify the FDIC's application of principles of safe and sound banking practices and consumer protection in connection with deposit advance products. This proposed guidance details the principles that the FDIC expects FDIC-supervised financial institutions to follow in connection with any deposit advance product to address potential reputational, compliance, legal and credit risks. The FDIC expects institutions to apply the principles set forth in this guidance to any deposit advance product they offer.

II. Description of Guidance

A deposit advance product is a small-dollar, short-term loan that a depository institution (bank) makes available to a customer whose deposit account reflects recurring direct deposits. The customer is allowed to take out a loan, which is to be repaid from the proceeds of the next direct deposit. These loans typically have high fees, are repaid in a lump sum in advance of the customer's other bills, and often do not utilize fundamental and prudent banking practices to determine the customer's ability to repay the loan and meet other necessary financial obligations.

The FDIC continues to encourage banks to respond to customers' small-dollar credit needs; however, banks should be aware that deposit advance products can pose a variety of safety and soundness, compliance, consumer protection, and other risks. The FDIC is proposing guidance to ensure that any bank offering these products does so in a safe and sound manner and does not engage in practices that would increase credit, compliance, legal, and reputation risks to the institution.

III. Guidance

The text of the proposed Supervisory guidance on deposit advance products follows:

FDIC PROPOSED GUIDANCE ON DEPOSIT ADVANCE PRODUCTS

The Federal Deposit Insurance Corporation (FDIC) is proposing supervisory guidance to depository institutions (banks) that offer deposit advance products. This guidance is intended to ensure that banks are aware of the significant risks associated with deposit advance products. The guidance also supplements the FDIC's existing guidance on payday loans and subprime lending.[1] Although the FDIC encourages banks to respond to customers' small-dollar credit needs in a responsible manner and with

[1] FDIC Financial Institutions Letter FIL-14-2005, "Guidelines for Payday Lending," (*Guidelines for Payday Lending*) (February 25, 2005); FDIC Financial Institutions Letter FIL-50-2007, "Affordable Small-Dollar Loan Guidelines," (June 19, 2007); FDIC Financial Institutions Letter FIL-9-2001, "Expanded Guidance for Subprime Lending Programs" (*Subprime Lending Guidance*), jointly signed by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the FDIC, and the Office of Thrift Supervision (OTS) (January 31, 2001).

reasonable terms and conditions, deposit advance products pose a variety of safety and soundness, compliance, and consumer protection risks to banks.[2]

Background: A deposit advance product is a type of small-dollar, short-term credit product offered to customers maintaining a deposit account, reloadable prepaid card, or similar deposit-related vehicle at a bank. The bank provides a credit feature that allows the customer to take out a loan in advance of the customer's next direct deposit. The advance is based on the customer's history of recurring deposits. Typically, the advance is offered as an open-end line of credit. While the specific details of deposit advance products vary from bank to bank, and also may vary over time, those currently offered incorporate some or all of the characteristics described below.

Cost. The cost of the deposit advance is typically based on a fee structure, rather than an interest rate. Generally advances are made in fixed dollar increments and a flat fee is assessed for each advance. For example, a customer may obtain advances in increments of $20 with a fee of $10 per every $100 advanced. The cost of the deposit advance can be more expensive than other forms of credit, such as a credit card, or a traditional line of credit.

Eligibility, Loan Limits and Ability to Repay. Typically, a customer is eligible for a deposit advance if the deposit account has been open for a certain period of time and the customer receives recurring deposits. Banks typically require a minimum sum to be directly deposited each month for a certain period of time in order for the borrower to be eligible for a deposit advance loan. Currently, some banks permit a recurring deposit as low as $100.

[2] This guidance on Deposit Advance Products does not apply to banks' overdraft lines of credit. Overdraft lines of credit typically do not have repayment characteristics similar to deposit advance products.

The maximum dollar amount of the advance is typically limited to a percent or amount of the recurring monthly deposit. For example, some banks permit the deposit advance to be the lesser of $500 or 50 percent of the scheduled direct deposits from the preceding statement cycle, rounded up to the nearest $10. The advance limit does not include the fee associated with the advance. In addition, some banks will allow the advance even if the customer's account is currently overdrawn. Some banks also permit a customer to exceed the advance limit, at the bank's discretion.

Typically, the bank does not analyze the customer's ability to repay the loan based on recurring debits or other indications of a need for residual income to pay other bills. The decision to advance credit to borrowers, based solely on the amount and frequency of their deposits, stands in contrast to banks' traditional underwriting standards for other products, which typically include an assessment of the ability to repay the loan based on an analysis of the borrower's finances.

Repayment. Repayment is generally required through an electronic payment of the fee and the advance with the next direct deposit. Typically, the bank is paid first before any other transactions are paid. In some cases, a bank will apply a time limit on how soon it will take the fee and the advance from the direct deposit, but the time limit is minimal, usually one or two days. If the first deposit is insufficient to repay the fee and the advance, the repayment will be obtained from subsequent deposits. If the deposits are insufficient to repay the fee and the advance within a certain time period, typically 35 days, then the bank executes a forced repayment by sweeping the underlying deposit account for the remaining balance. Unlike a payday lender, the bank has automatic access to the underlying deposit account. In some cases, borrowers may be able to access program features that allow for a longer repayment period than 35 days; however, this is not usually allowed.

If the deposit account funds are insufficient to repay the fee and the advance, then the account goes into overdraft status. Some banks will charge an overdraft fee based on the deposit advance overdrawing the account. Other banks will only charge overdraft fees based on any subsequent transactions that overdraw the account.

Although the deposit advance limit is based on an amount or percentage of the monthly deposit, the repayment can be based on a shorter time period. For example, if a customer receives direct deposits of $500 every other Friday from her employer, her monthly direct deposit would be $1000. Under the typical bank's advance limit, she could receive an advance of $500 with a fee of $50. If she obtains the deposit advance on the Thursday before her payday, then the bank will obtain repayment on Friday. The bank will take the entire $500 paycheck. In addition, the customer will still owe $50 in principal because the deposit was only sufficient to pay the $50 fee and $450 in principal. Assuming the customer has no other source of income, the customer will need to rely on savings to pay bills until the next paycheck. At the next paycheck, the bank will take the remaining $50 in principal and the customer will have $450 to pay all outstanding bills.

Some banks have implemented alternative repayment methods that provide more flexibility to the customer. For example, some banks will permit repayment to extend through to the second direct deposit if the first direct deposit falls below a specific dollar threshold. In addition, some banks allow payment by mail rather than electronic transfer, but may charge a fee for this option. Finally, some banks offer an installment loan option, but may also charge an additional fee or may only offer this option if the customer cannot repay the advance and fee from the monthly deposits.

Repeat Usage Controls. Banks often have repeat usage limits that trigger a "cooling off" period during which the customer cannot take out a deposit advance, or the credit limit is reduced. For example, some banks may prevent an advance for 35 days if the borrower has used the service at least once each month in the previous six-month period. However, the customer can resume use of the product after the 35-dayperiod is completed. Other banks may prevent an advance for one full billing cycle if the customer borrows the entire amount of the advance each month in the previous six months. However, the customer can avoid this limit by taking out something less than the maximum advance.

Marketing and Access. Banks market deposit advance products as intended to assist customers through a financial emergency or to meet short term needs. These advances, however, are typically not included with the bank's list of available credit products, but are instead listed as a deposit account "feature." Customers are alerted to the availability of the products by a reference on their account statement or a "button" or hot link on their personal account webpage, but it is not clear that the customer is made equally aware of less expensive alternatives.

SUPERVISORY CONCERNS OF DEPOSIT ADVANCE LOANS

Although the FDIC encourages banks to respond to customers' small-dollar credit needs, deposit advance products pose supervisory risks. These products share a number of characteristics seen in traditional payday loans, including: high fees; very short, lump-sum repayment terms; and inadequate attention to the consumer's ability to repay. As such, banks need to be aware of these products' potential to harm consumers, as well as elevated safety and soundness, compliance, and consumer protection risks.

The combined impact of an expensive credit product coupled with short repayment periods increases the risk that borrowers could be caught in a cycle of high-cost borrowing over an extended period of time. Specifically, deposit advance customers may repeatedly take out loans because they are unable to fully repay the balance in one pay period while also meeting typical recurring and other necessary expenses (e.g., housing, food, and transportation). Customers may feel compelled to take out another loan very soon thereafter to make up for the shortfall. This cycle is referred to as the "churning" of loans and is similar to the practice of "loan flipping" that the OCC, the FDIC and the Board, have previously noted to be an element of predatory lending.[3] Though deposit advance products are often marketed as intended for emergency financial assistance, and as unsuitable for meeting a borrower's recurring or long term obligations, the FDIC believes the product's design results in consumer behavior that is frequently inconsistent with this marketing and is detrimental to the customer.

To address concerns that certain borrowers become dependent on deposit advance products to meet their daily expenses (as evidenced by their repeated borrowings), certain lenders now require borrowers who have taken out a specified number of deposit advance loans within a certain time frame to wait for a specified period before they are eligible to take out a new loan. However, the FDIC is concerned these "cooling-off" periods can be easily avoided and are ineffective in preventing repeated usage of these high-cost, short-term loans.

[3] *Subprime Lending Guidance* jointly signed by the OCC, the Board, the FDIC and the OTS (January 31, 2001).

Weak underwriting increases the risk that the borrower's account may become overdrawn and result in multiple overdraft fees when subsequent transactions are presented for payment. Some banks assess overdraft fees when the automatic repayment of the deposit advance loan causes the associated account to reflect a negative balance.

Safety and Soundness Risk

Credit Risk: Borrowers who obtain deposit advance loans may have cash flow difficulties or blemished or insufficient credit histories that limit other borrowing options. The high aggregate cost of numerous and repeated extensions of credit that may be a consequence of this product further increase credit risk. Lenders that offer deposit advance loans typically focus on the amount of the borrower's monthly deposit for underwriting purposes. Failure to consider whether the income sources are adequate to repay the debt while covering typical living expenses, other debt payments, and the borrower's credit history presents safety and soundness risks.

Numerous and repeated extensions of credit to the same individual may be substantially similar to continuous advances and subject the bank to increased credit risk. While re-aging, extensions, deferrals, renewals, and rewrites of lending products can be used to help borrowers overcome temporary financial difficulties, repeated re-aging credit practices can cloud the true performance and delinquency status of the portfolio.[4]

Relying on the amount of the customer's incoming deposits without consideration of expected outflows does not allow for a proper assessment of the customer's ability to

[4] *See* the Federal Financial Institutions Examination Council Uniform Retail Credit Classification and Account Management Policy, Federal Register Vol. 65, No. 113, June 12, 2000. This policy is addressed more fully in the "Credit Quality" section.

repay the loan and other necessary expenses. This failure to properly assess the borrower's financial capacity, a basic underwriting principle, increases default risk.

Reputation Risk: Reputation risk is the risk arising from negative public opinion. Deposit advance products are receiving significant levels of negative news coverage and public scrutiny. This increased scrutiny includes reports of high fees and borrowers taking out multiple advances to cover prior advances and everyday expenses. Engaging in practices that are perceived to be unfair or detrimental to the customer can cause a bank to lose community support and business.

Legal Risk: The significant risks associated with deposit advance lending products may subject institutions to the risk of litigation — both from private lawsuits and regulatory enforcement actions.

Third-Party Risk: Banks remain responsible and liable for compliance with all applicable laws and regulations, even for the activities of a third party.[5] The FDIC is aware of banks working with third parties to develop, design and service the deposit advance product. The existence of third-party arrangements may, when not properly managed, significantly increase institutions' legal, operational and reputation risks. Some of the risks are associated with the underlying activity itself, similar to the risks faced by a bank directly conducting the activity. Other potential risks arise from or are heightened by the involvement of a third party, particularly if the third party will receive a portion of the fees. Consequently, third-party arrangements may expose the bank to regulatory action and affect the institution's ability to establish new or service existing customer relationships.

Compliance and Consumer Protection Related Concerns

[5] *See* FDIC FIL 44-2008, "Guidance for Managing Third-Party Risk" (June 6, 2008).

Deposit advance products must comply with all applicable federal laws and regulations, some of which are outlined below. State laws also may be applicable, including usury laws and laws on unfair or deceptive acts or practices. It is important that banks have their deposit advance products reviewed by counsel for compliance with all applicable laws prior to implementation. Furthermore, although the guidance below outlines federal laws and regulations as of the date this guidance is published, applicable laws and regulations are subject to amendment. In addition, statutes and regulations will have different applications depending on how a deposit advance product is structured. Banks offering deposit advances should carefully consider whether and how these laws and rules will apply to the particular version of a deposit advance product they are providing. Accordingly, banks should monitor applicable laws and regulations for revisions and to ensure that their deposit advance product is fully compliant. Federal laws and regulations applicable to deposit advance products include, but are not limited to, the following:

The Federal Trade Commission Act (FTC Act): Section 5 of the FTC Act prohibits unfair or deceptive acts or practices (UDAP).[6] The FDIC enforces this section pursuant to its authority in Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818.[7] An act or practice is unfair where it: (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered. An act or practice is deceptive if: (1) there is a representation, omission, or practice that misleads or is likely to mislead a consumer; (2) the consumer's

[6] 15 U.S.C. §§ 45(a) and (n).
[7] Joint Board and FDIC guidance on "Unfair or Deceptive Acts or Practices by State-Chartered Banks" (March 11, 2004).

interpretation is reasonable under the circumstances; and (3) the misleading representation, omission, or practice is material.

Deposit advance products may raise issues under the FTC Act depending upon how the products are marketed and implemented. Any FTC Act analysis will be dependent on the facts and circumstances in a particular matter.

The prohibition on UDAP applies not only to the product, but to every stage and activity, from product development to the creation and rollout of marketing campaigns, and to servicing and collections. For example, marketing materials and disclosures should be clear, conspicuous, accurate and timely; and should fairly and adequately describe the terms, benefits, potential risks and material limitations of the product.

Truth in Lending Act (TILA): TILA and Regulation Z require creditors to provide cost disclosures for extensions of consumer credit.[8] Different rules apply to Regulation Z disclosures depending on whether the loan is an open- or closed-end credit product. Banks should ensure the product's disclosures comply with the applicable requirements. TILA advertising rules for open-end credit require that, if an advertisement states any periodic rate that may be applied, it must state the rate as an Annual Percentage Rate, using that term.[9] Similarly, TILA advertising rules for closed-end credit require that, if an advertisement states a rate of finance charge, it must state the rate as an Annual Percentage Rate, using that term.[10]

Electronic Fund Transfer Act (EFTA): A program that involves the use of electronic fund transfers must meet the applicable disclosure and other requirements of

[8] 15 U.S.C. 1601 *et seq.* TILA is implemented by Regulation Z, 12 CFR 1026.
[9] *See* 12 CFR § 1026.16(b)(1).
[10] *See* 12 CFR § 1026.24(c).

EFTA and Regulation E.[11] EFTA requires disclosures,[12] prohibits creditors from mandating that loans be repaid by "preauthorized electronic fund transfers,"[13] and allows borrowers to withdraw authorization for "preauthorized fund transfers."[14]

Truth in Savings Act (TISA): A program that involves a consumer's deposit account must meet the disclosure requirements of TISA and Regulation DD.[15] Under TISA, deposit account disclosures must include the amount of any fee that may be imposed in connection with the account and the conditions under which the fee may be imposed.[16] TISA also prohibits institutions from making any advertisement, announcement, or solicitation relating to a deposit account that is inaccurate or misleading or that misrepresents their deposit contracts.[17] TISA disclosures enable consumers to make informed decisions about their deposit accounts at depository institutions. A consumer is entitled to receive TISA disclosures at account opening, when the terms of the consumer's account are changed, and when a periodic statement is sent.

Equal Credit Opportunity Act (ECOA): Under ECOA and Regulation B, creditors are prohibited from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction.[18] This prohibition applies to deposit advance products. The creditor's discretion, for example in the application of eligibility requirements, loss

[11] 15 U.S.C. 1693 *et seq.* The EFTA is implemented by Regulation E, 12 CFR 1005.
[12] *See, e.g.,* 12 CFR §§ 1005.7, 1005.8, and 1005.9.
[13] *See* 12 CFR § 1005.10(e).
[14] *See* 12 CFR § 1005.10(c).
[15] 12 U.S.C. 4301 *et seq.* TISA is implemented by Regulation DD at 12 CFR § 1030 for banks and federal savings associations.
[16] *See* 12 CFR § 1030.4(b)(4).
[17] *See* 12 CFR § 1030.8.
[18] 15 U.S.C. 1691 *et seq.* ECOA is implemented by Regulation B, 12 CFR Part 1002. ECOA prohibits discrimination on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that all or part of the applicant's income derives from a public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

mitigation options and fee waivers, may raise fair lending risk.[19] Steering or targeting certain customers on a prohibited basis toward deposit advance products while offering other customers more favorable credit products may also raise fair lending risk. Additionally, providing different product terms or conditions and different servicing or loss mitigation options to similarly situated customers on a prohibited basis may also violate ECOA.

In addition to the general prohibition against discrimination, ECOA and Regulation B contain specific rules concerning procedures and notices for credit denials and other adverse actions. Regulation B defines the term "adverse action," and generally requires a creditor who takes an adverse action to send a notice to the consumer providing, among other things, the reasons for the adverse action.[20]

SUPERVISORY EXPECTATIONS

Deposit advance lending presents significant consumer protection and safety and soundness concerns, irrespective of whether the products are issued by a bank directly or by third parties. The FDIC will take appropriate supervisory action to prevent harm to consumers, to address any unsafe or unsound banking practices associated with these products, and to ensure compliance with all applicable laws. Examinations will focus on compliance with applicable consumer protection statutes and potential safety and soundness issues.

Examiners will assess credit quality, including underwriting and credit administration policies and practices. In addition, examiners will assess the adequacy of

[19] *See* Interagency Fair Lending Examination Procedures (August 2009) at 9-13.
[20] *See* 12 CFR §§ 1002.2(c) and 1002.9.

capital, reliance on fee income, and adequacy of the allowance for loan and lease losses. Compliance with applicable federal consumer protection statutes, management's oversight, and relationships with third-parties will also be assessed.

Credit Quality: The Uniform Retail Credit Classification and Account Management Policy (Retail Classification Policy) establishes guidelines for classifying consumer loans, such as deposit advance loans, based on delinquency, but also grants examiners the discretion to classify individual retail loans that exhibit signs of credit weakness, regardless of delinquency status. An examiner also may classify consumer portfolios, or segments thereof, where underwriting standards are weak and present unreasonable credit risk.

Deposit advance loans often have weaknesses that may jeopardize the liquidation of the debt. Borrowers often have limited repayment capacity. Banks should adequately review repayment capacity to assess whether borrowers will be able to repay the loan without needing to incur further deposit advance borrowing.

Deposit advance loans that have been accessed repeatedly or for extended periods of time are evidence of "churning" and inadequate underwriting. Banks should monitor for repeated or extended use, as will be discussed in greater detail in the discussion of underwriting expectations below.

Underwriting and Credit Administration Policies and Practices: As part of the credit quality review, examiners will assess underwriting and administration policies and practices for deposit advance loan products. Eligibility and underwriting criteria for deposit advance loans, consistent with eligibility and underwriting criteria for other bank loans, should be well documented in the bank's policy. The criteria should be designed to assure that the extension of credit can be repaid according to its terms while allowing the borrower to continue to meet typical recurring and other necessary expenses such as food, housing, transportation and healthcare, as well as other outstanding debt obligations. Additionally, criteria should ensure that borrowers can meet these requirements without needing to borrow repeatedly. Institutions should maintain appropriate criteria to prevent churning and prolonged use of these products. Underwriting for deposit advance products should occur prior to opening such accounts and should be monitored on an on-going basis. Repetitive deposit advance borrowings indicate weak underwriting and will be criticized in the Report of Examination and then taken into account in an institution's rating.

Bank policies regarding the underwriting of deposit advance loan products should be written and approved by the bank's board of directors, and consistent with the bank's general underwriting standards and risk appetite. Factors a bank should address in its written underwriting policies for deposit advance products include, but are not necessarily limited to, the following:

- The Length of a Customer's Deposit Relationship With the Bank. Banks should ensure that the customer relationship is of sufficient duration to provide the bank with adequate information regarding the customer's recurring deposits and expenses in order to prudently underwrite deposit advance loans. The FDIC will consider sufficient duration to evaluate a customer's deposit advance eligibility to be no less than six months.
- Classified Credits. Customers with any delinquent or adversely classified credits should be ineligible.

- Financial Capacity. In addition to any eligibility requirements, the bank should conduct an analysis of the customer's financial capacity including income levels. Underwriting assessments should consider the customer's ability to repay a loan without needing to borrow repeatedly from any source, including re-borrowing, to meet necessary expenses. The financial capacity assessment should include:
    - An analysis of the customer's account for recurring deposits (inflows) and checks/credit/customer withdrawals (outflows) over at least six consecutive months. Lines of credit of any sort, including overdrafts, and drafts from savings should not be considered inflows. In reviewing customers' transactions to determine deposit advance eligibility, the bank should consider the customers' net surplus or deficit at the end of each of the preceding six months, and not rely on a six-month transaction average.
    - After conducting the above described analysis, determine whether an installment repayment is more appropriate.
- Cooling Off Period. Each deposit advance loan should be repaid in full before the extension of a subsequent deposit advance loan, and banks should not offer more than one loan per monthly statement cycle.[21] A cooling off period of at least one monthly statement cycle after the repayment of a deposit advance loan should be completed before another advance may be extended in order to avoid repeated use of the short-term product.[22]

[21] The Interagency "Expanded Guidance for Subprime Lending Programs" (2001) states that loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged, in this case the borrower's direct deposit, are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent.
[22] The FDIC, in its 2005 *Guidelines for Payday Lending*, directs institutions to ensure that payday loans are not provided to customers who had payday loans outstanding at any lender for a total of three months during the previous 12 months. FDIC-supervised institutions should apply this requirement to any deposit advance program using for

- Increasing Deposit Advance Credit Limits. The amount of credit available to a borrower should not be increased without a full underwriting reassessment in compliance with the bank's underwriting policies and in accordance with the factors discussed in this guidance. Additionally, any increase in the credit limit should not be automatic and should be initiated by a request from the borrower.
- Ongoing Customer Eligibility. As part of their underwriting for this product, banks should, no less than every six months, reevaluate the customer's eligibility and capacity for this product. Additionally, banks should identify risks that could negatively affect a customer's eligibility to receive additional deposit advances. For example:
    - Repeated overdrafts (establish/set a certain number during a specified number of months).
    - Evidence that the borrower is overextended with respect to total credit obligations.

Capital Adequacy: Higher capital requirements generally apply to loan portfolios that exhibit higher risk characteristics and are subject to less stringent loan underwriting requirements. Loans exhibiting subprime credit characteristics are higher risk loans and may require higher levels of capital.

Over-Reliance on Fee Income: Fees associated with deposit advance products should be based on safe and sound banking principles. Institutions should monitor for any undue reliance on the fees generated by such products for their revenue and earnings.

example, state payday lending databases or incoming checks or Automated Clearing House transactions to known payday lenders.

Adequacy of the Allowance for Loan and Lease Losses (ALLL): Examiners will assess whether the ALLL is adequate to absorb estimated credit losses within the deposit advance loan portfolio. Examiners will also determine whether banks engaged in deposit advance lending have methodologies and analyses in place that demonstrate and document that the level of the ALLL is appropriate.

Consumer Compliance: Banks should implement effective compliance management systems, processes and procedures to appropriately mitigate risks. Examiners will review a bank's program with respect to deposit advance products for compliance with applicable consumer protection statutes and regulations, including TILA, EFTA, TISA, ECOA, and Section 5 of the FTC Act.

Management Oversight: Examiners will assess bank management's ability to administer a deposit advance loan program and board oversight of the program. Furthermore, examiners will determine whether bank management has established controls and implemented a rigorous analytical process to identify, measure, monitor, and manage the risks associated with deposit advance loans. The bank's compliance management system should ensure continuing compliance with applicable federal and state laws, rules and regulations, as well as internal policies and procedures.

Banks should maintain adequate oversight of deposit advance programs and adequate quality control over those products and services to minimize exposure to potential significant financial loss, reputation damage, and supervisory action. Management should provide the appropriate oversight and allocate sufficient qualified staff to monitor deposit advance programs. Results of oversight activities should be reported periodically to the financial institution's board of directors or designated committee, including identified weaknesses, which should be documented and promptly addressed.

Third-Party Relationships: Because third-party relationships are important in assessing a bank's overall risk profile, the FDIC's primary supervisory concern in reviewing a bank's relationships with third parties is whether the bank is assuming more risk than it can identify, monitor, and manage. Management should allocate sufficient qualified staff to monitor for significant third-party relationships, excessive usage by borrowers, and excessive risk taking by the bank. Therefore, examiners will review the risks associated with all material third-party relationships and activities together with other bank risks. In certain high risk situations, examiners may conduct on-site third-party reviews under specific authorities granted to the FDIC.

RESPONSIBLE PRODUCTS TO MEET SMALL-DOLLAR CREDIT NEEDS

The FDIC recognizes the need for responsible small-dollar credit products among consumers. A number of banks are currently offering reasonably priced small-dollar loans at reasonable terms to their customers. The FDIC's 2007 *Affordable Small-Dollar Loan Guidelines* (Guidelines) encourage insured institutions to offer small-dollar loan products that have affordable, reasonable interest rates with no or low fees and payments that reduce the principal balance of the loan.[23] The Guidelines indicate that if structured properly, small-dollar loans can provide a safe and affordable means for borrowers to transition away from reliance on high-cost debt products. The FDIC conducted a two-year case study from 2007 to 2009 that demonstrated that safe and affordable small-dollar

[23] *See* FDIC Financial Institutions Letter FIL-50-2007, "Affordable Small-Dollar Loan Guidelines," (June 19, 2007).

lending is feasible for banks and resulted in a template of important elements for such lending.[24] The FDIC encourages banks to continue to offer these products, consistent with safety and soundness and other supervisory considerations, and encourages other banks to consider offering such products as well. Properly managed small-dollar loan products offered with reasonable terms and at a reasonable cost do not pose the same level of supervisory risk as deposit advance products.

[24] FDIC, "FDIC Model Safe Accounts Pilot Final Report", (April 2012).

[THIS SIGNATURE PAGE RELATES TO THE DOCUMENT ENTITLED "PROPOSED GUIDANCE ON DEPOSIT ADVANCE PRODUCTS."]

Dated at Washington, D.C., this 25th day of April, 2013.
Federal Deposit Insurance Corporation.

_//signed//______________________________
Robert E. Feldman,
Executive Secretary

Feature Article:

A Template for Success: The FDIC's Small-Dollar Loan Pilot Program

Introduction

The Federal Deposit Insurance Corporation's (FDIC) two-year Small-Dollar Loan Pilot Program concluded in the fourth quarter of 2009. The pilot was a case study designed to illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products such as payday loans and fee-based overdraft programs.[1] This article summarizes the results of the pilot, outlines the lessons learned and the potential strategies for expanding the supply of affordable small-dollar loans, and highlights pilot bank successes through case studies.

Since the pilot began, participating banks made more than 34,400 small-dollar loans with a principal balance of $40.2 million. Overall, small-dollar loan default rates were in line with default rates for similar types of unsecured loans. A key lesson learned was that most pilot bankers use small-dollar loan products as a cornerstone for building or retaining long-term banking relationships. In addition, long-term support from a bank's board and senior management was cited as the most important element for programmatic success. Almost all of the pilot bankers indicated that small-dollar lending is a useful business strategy and that they will continue their small-dollar loan programs beyond the pilot.

A Safe, Affordable, and Feasible Template for Small-Dollar Loans

The pilot resulted in a template of essential product design and delivery elements for safe, affordable, and feasible small-dollar loans that can be replicated by other banks (see Figure 1). While each component of the template is important, participating bankers reported that a longer loan term is key to program success because it provides more time for consumers to recover from a financial emergency than the single pay cycle for payday loans, or the immediate repayment often required for fee-based overdrafts.

Figure 1

A Safe, Affordable, and Feasible Template for Small-Dollar Loans

Product Element	Parameters
Amount	$2,500 or less
Term	90 days or more
Annual Percentage Rate (APR)	36 percent or less
Fees	Low or none; origination and other upfront fees plus interest charged equate to APR of 36 percent or less
Underwriting	Streamlined with proof of identity, address, and income, and a credit report to determine loan amount and repayment ability; loan decision within 24 hours
Optional Features	Mandatory savings and financial education

Source: FDIC

FDIC Chairman Sheila C. Bair has expressed a desire to determine how safe and affordable small-dollar lending can be expanded and become more of a staple product for all banks.[2] Pilot banks have demonstrated that the Safe, Affordable, and Feasible Small-Dollar Loan Template is relatively simple to implement and requires no particular technology or other major infrastructure investment. Moreover, adoption of the template could help banks better adhere to existing regulatory guidance regarding offering alternatives to fee-based overdraft protection programs.[3] Specifically, this guidance suggests that banks should "monitor excessive consumer usage (of overdrafts), which may indicate a need for

[1] See previous articles on the Small-Dollar Loan Pilot Program, "An Introduction to the FDIC's Small-Dollar Loan Pilot Program," *FDIC Quarterly* 2, no. 3 (2008), http://www.fdic.gov/bank/analytical/quarterly/2008_vol2_3/2008_Quarterly_Vol2No3.html; and "The FDIC's Small-Dollar Loan Pilot Program: A Case Study after One Year," *FDIC Quarterly* 3, no. 2 (2009), http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_2/smalldollar.html.

[2] See opening comments from FDIC Chairman Sheila C. Bair at the December 2, 2009, FDIC Advisory Committee on Economic Inclusion Meeting, at http://www.vodium.com/MediapodLibrary/index.asp?library=pn100472_fdic_advisorycommittee&SessionArgs=0A1U0100000100000101.

[3] "Overdraft Protection Programs, Joint Agency Guidance," Financial Institution Letter, February 18, 2005, http://www.fdic.gov/news/news/financial/2005/fil1105.html.

Table 1

Small-Dollar Loan Pilot Program Participants

Bank	Location	Total Assets ($000s)	Number of Branches
Amarillo National Bank	Amarillo, TX	2,792,382	16
Armed Forces Bank	Fort Leavenworth, KS	862,852	52
Bank of Commerce	Stilwell, OK	93,672	3
BankFive	Fall River, MA	708,545	13
BankPlus	Belzoni, MS	2,144,987	61
BBVA Bancomer USA*	Diamond Bar, CA	139,327	25
Benton State Bank	Benton, WI	45,780	3
Citizens Trust Bank	Atlanta, GA	387,130	11
Citizens Union Bank	Shelbyville, KY	715,927	18
Community Bank of Marshall	Marshall, MO	98,478	6
Community Bank - Wheaton/Glen Ellyn	Glen Ellyn, IL	340,628	4
The First National Bank of Fairfax	Fairfax, MN	27,539	1
Kentucky Bank	Paris, KY	676,239	15
Lake Forest Bank & Trust	Lake Forest, IL	1,816,422	8
Liberty Bank and Trust Company	New Orleans, LA	423,624	24
Liberty National Bank	Paris, TX	245,262	3
Mitchell Bank	Milwaukee, WI	73,623	5
National Bank of Kansas City	Overland Park, KS	708,191	6
Oklahoma State Bank	Guthrie, OK	43,228	4
Pinnacle Bank	Lincoln, NE	2,538,702	57
Red River Bank	Alexandria, LA	795,889	16
State Bank of Alcester	Alcester, SD	94,263	1
State Bank of Countryside	Countryside, IL	913,111	6
The Heritage Bank	Hinesville, GA	982,012	32
The Savings Bank	Wakefield, MA	417,081	9
Washington Savings Bank	Lowell, MA	164,724	3
Webster Five Cents Savings Bank	Webster, MA	559,762	8
Wilmington Trust	Wilmington, DE	9.609,666	44

Source: FDIC.

Note: Data as of fourth quarter 2009.

*BBVA Bancomer USA merged into Compass Bank (Birmingham, AL) in September 2009. Data shown are the latest available for BBVA, as of June 30, 2009.

alternative credit arrangements or other services, and inform consumers of these available options" that could include small-dollar credit products.

Background

The Small-Dollar Loan Pilot Program pilot began with 31 banks, and several banks entered and exited as the pilot progressed. The pilot concluded with 28 participating banks ranging in size from $28 million to nearly $10 billion (see Table 1). The banks have more than 450 offices across 27 states. Before being accepted into the pilot program, banks had to submit an application, describe their programs, and meet certain supervisory criteria.[4] About one-third of the banks in the pilot had existing small-dollar loan programs at the time of their applications, while the rest instituted new programs in conjunction with the pilot. The FDIC anticipated that most programs would be consistent with the Affordable Small-Dollar Loan Guidelines (SDL Guidelines), but it offered banks some flexibility to encourage innovation.[5]

The pilot was a case study and does not represent a statistical sample of the banking universe. Pilot bankers provided some basic information about their programs each quarter.[6] Some data, such as number and volume of loans originated, were relatively straightforward to obtain and aggregate. To obtain more subjective or

[4] "An Introduction to the FDIC's Small-Dollar Loan Pilot Program" described pilot program application parameters. See footnote 1.

[5] FDIC, "Affordable Small-Dollar Loan Guidelines," news release, June 19, 2007, http://www.fdic.gov/news/news/press/2007/pr07052a.html. The primary product features described in the guidelines included loan amounts up to $1,000, payment periods beyond a single paycheck cycle, annual percentage rates below 36 percent, low or no origination fees, streamlined underwriting, prompt loan application processing, an automatic savings component, and access to financial education.

[6] The information collection request complied with the Paperwork Reduction Act; it did not include account-level information, in accordance with the Right to Financial Privacy Act. See the *Federal Register* citation at http://www.fdic.gov/regulations/laws/federal/2007/07notice June7.html for a description of the information collection process.

otherwise difficult-to-quantify information, the FDIC held periodic one-on-one discussions and group conference calls with bank management.

The pilot tracked two types of loans: small-dollar loans (SDLs) of $1,000 or less and nearly small-dollar loans (NSDLs) between $1,000 and $2,500. Data collection was initially concentrated in the SDL category, in accordance with the SDL Guidelines. Data collection was expanded for the NSDL category after the first year of the pilot, when some bankers relayed to the FDIC the importance of these loans to their business plans. In particular, they indicated that some of their customers needed and could qualify for larger loans and that these loans cost the same to originate and service as SDLs, but resulted in higher revenues. Some bankers conducted only SDL or NSDL programs, and some conducted both types. In this article, the terms "small-dollar lending" and "small-dollar loans" refer to banks' overall programs, regardless of which category of loan they originated.

Pilot Results

During the two-year pilot, participating banks made more than 18,100 SDLs with a principal balance of $12.4 million and almost 16,300 NSDLs with a principal balance of nearly $27.8 million (see Table 2). As of the end of the pilot in fourth quarter 2009, 7,307 SDLs totaling $3.3 million and 7,224 NSDLs totaling $9.2 million were outstanding. Quarterly origination volumes were affected by seasoning of newer programs, periodic changes some banks made to their programs, banks exiting and entering the pilot, seasonality of demand, and local economic conditions.

Loan Volume

Table 3 shows loan volume data for fourth quarter 2009 by originator size. Because several banks with long-standing programs had disproportionately large origination volumes, results for banks originating 50 or more loans per quarter were isolated from the rest of the group to prevent skewing the loan volume. Interestingly, several banks with new programs produced enough volume to move into the large originator category.

Smaller originators made, on average, 10 SDLs in fourth quarter 2009, compared with 9 SDLs in the third quarter, 13 SDLs in the second quarter, and 15 SDLs in the first quarter. Smaller originators made, on average, 11 NSDLs in fourth quarter 2009, versus 18, 13, and 13 loans in the third, second, and first quarters of 2009, respectively.

Table 2

Small-Dollar Loan Pilot Program Cumulative Statistics

	SDL Originations		NSDL Originations	
	Number	Amount ($)	Number	Amount ($)
1Q08	1,523	1,013,118	1,617	2,696,996
2Q08	2,388	1,495,661	1,918	3,202,358
3Q08	2,225	1,502,456	2,113	3,651,934
4Q08	2,210	1,492,273	2,033	3,434,906
1Q09	1,650	1,079,999	1,745	2,943,952
2Q09	2,229	1,553,296	2,389	4,135,785
3Q09	2,928	2,135,767	2,178	3,744,603
4Q09	3,010	2,168,295	2,301	3,972,694
Total	**18,163**	**$12,440,864**	**16,294**	**$27,783,227**

Source: FDIC

Loan Characteristics

While the application process did not preclude open-ended credit, all banks in the pilot offered only closed-end installment loans. Basic loan characteristics, such as interest rates, fees, and repayment terms, did not vary between large and smaller originators. Therefore, there is no distinction made for origination volume in the fourth-quarter loan characteristics data shown in Table 4.

Loan terms remained fairly consistent from quarter to quarter. For example, the average loan amount for SDLs was approximately $700, and the average term was 10 to 12 months. The average loan amount for NSDLs was approximately $1,700, and the average term was 14 to 16 months. Average interest rates for both types of loans ranged between 13 and 16 percent, and the most common interest rate charged was 18 percent. About half of the banks charged an origination fee (the average fee was $31 for SDLs and $46 for NSDLs), and when this fee was added to the interest rate, all banks were within the targeted 36 percent annual percentage rate.

Loan Performance

The delinquency ratio for SDLs climbed to 11 percent in fourth quarter 2009 from a relatively stable rate of about 9 percent for much of 2009.[7] The fourth quarter increase in SDL delinquencies is attributed largely to adverse economic conditions in bank communities. The delinquency ratio for NSDLs has also been high, though somewhat volatile, again due to adverse local economic conditions. As of fourth quarter 2009, the NSDL delinquency ratio was 9.4 percent compared with 10.9 percent in the third quarter, 6.4 percent in the second quarter, and 6.6 percent in first quarter 2009. Delin-

[7] Delinquency refers to loans 30 days or more past due.

Table 3

Small-Dollar Loan Pilot 4Q09: Origination Data by Program Size

	Number of Banks Reporting	Total	Average	Minimum	Maximum
Loans up to $1,000 (SDLs)					
All Banks					
# of Notes	22	3,010	111	1	1675
Note Volume	22	$2,168,295	$98,559	$500	$1,140,660
Banks Originating Fewer Than 50 Loans					
# of Notes	15	146	10	1	26
Note Volume	15	$99,880	$6,659	$500	$15,800
Banks Originating More Than 50 Loans					
# of Notes	7	2,864	409	51	1,675
Note Volume	7	$2,068,415	$337,437	$38,700	$1,140,660
Loans over $1,000 (NSDLs)					
All Banks					
# of Notes	12	2,301	192	1	1,151
Note Volume	12	$3,972,694	$331,058	$1,200	$1,942,837
Banks Originating Fewer Than 50 Loans					
# of Notes	7	78	11	1	38
Note Volume	7	$135,064	$19,295	$1,200	$64,868
Banks Originating More Than 50 Loans					
# of Notes	5	2,223	445	109	1,151
Note Volume	5	$3,837,630	$767,526	$193,355	$1,942,837

Source: FDIC.

Table 4

Small-Dollar Loan Pilot 4Q09: Summary of Loan Characteristics

	Number of Banks Reporting	Average	Minimum	Maximum
Loans up to $1,000				
Loan amount	22	$724	$445	$1,000
Term (months)	22	12	2	24
Interest rate	22	13.09%	4.00%	31.90%
Non-zero fees	9	$31	$8	$70
Loans over $1,000				
Loan amount	12	$1,727	$1,200	$2,070
Term (months)	12	15	10	24
Interest rate	12	13.99%	4.00%	33.53%
Non-zero fees	6	$46	$15	$70

Source: FDIC.

quency ratios for both SDLs and NSDLs are much higher than for general unsecured "loans to individuals." According to the FDIC Call Report, delinquency ratios for those loans were 2.5 percent in fourth quarter 2009, 2.6 percent in the third quarter, 2.4 percent in the second quarter, and 2.5 percent in the first quarter.

However, charge-off ratios for SDLs and NSDLs, although climbing, are in line with the industry average. For SDLs, the final, cumulative charge-off ratio was 6.2 percent as of fourth quarter 2009 versus 5.7 percent in the third quarter, 5.2 percent in the second quarter, and 4.3 percent in the first quarter.[8] These compare with ratios of 5.4 percent, 5.4 percent, 5.3 percent, and 4.9 percent for unsecured "loans to individuals,"

[8] Cumulative charge-off ratios for SDLs are calculated from the beginning of the pilot period.

according to fourth, third, second, and first quarter 2009 Call Reports, respectively.

The cumulative charge-off rate for NSDLs, at 8.8 percent, is higher than for SDLs and general unsecured loans to individuals.[9] However, the charge-off rate for these larger loans compares favorably with other types of unsecured credit. For example, the charge-off rate for "credit cards" on bank balance sheets was 9.1 percent as of the fourth quarter 2009 Call Report, and defaults on managed credit cards exceeded 10 percent throughout 2009.[10] Performance statistics of loans originated during the pilot show that while small-dollar loan borrowers are more likely to have trouble paying loans on time, they have a default risk similar to those in the general population.

Lessons Learned

Best practices and elements of success emerged from the pilot and underpin the Safe, Affordable, and Feasible Small-Dollar Loan Template. In particular, a dominant business model emerged: most pilot bankers indicated that small dollar loans were a useful business strategy for developing or retaining long-term relationships with consumers. In terms of overall programmatic success, bankers reported that long-term support from a bank's board and senior management was most important. The most prominent product elements bankers linked to the success of their program were longer loan terms, followed by streamlined but solid underwriting.

Long-Term, Profitable Relationship Building Was Predominant Program Goal

About three-quarters of pilot bankers indicated that they primarily used small-dollar loans to build or retain profitable, long-term relationships with consumers and also create goodwill in the community. A few banks focused exclusively on building goodwill and generating an opportunity for favorable Community Reinvestment Act (CRA) considerations, while a few others indicated that short-term profitability was the primary goal for their small-dollar loan programs.[11]

Program and product profitability calculations are not standardized and are not tracked through regulatory reporting. Profitability assessments can be highly subjective, depending on a bank's location, business model, product mix, cost and revenue allocation philosophies, and many other factors. Moreover, many of the banks in the pilot are community banks that indicated they either cannot or choose not to expend the resources to track profitability at the product and program level.

Nevertheless, as a general guideline, pilot bankers indicated that costs related to launching and marketing small-dollar loan programs and originating and servicing small-dollar loans are similar to other loans. However, given the small size of SDLs and to a lesser extent NSDLs, the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products.

Board and Senior Management Support Was Most Important Element Related to Program Feasibility

According to interviews with pilot bankers, several overarching elements directly affect the feasibility of small-dollar loan programs. Banks indicated that strong senior management and board of director support over the long term is the primary factor in ensuring the success of small-dollar loan programs. They also cited the importance of an engaged "champion" in charge of the program, preferably with lending authority, significant influence over bank policy decisions, or both. One of the champion's key challenges was to convince branch staff, local loan officers, or similar personnel to promote the small-dollar loan product among the bank's many products and services.

Location was also linked to program feasibility. Banks with offices in communities with large populations of low- and moderate-income, military, or immigrant households tended to benefit from greater demand for small-dollar loan products. Banks in rural markets with few nonbank alternative financial services providers also benefitted from limited competition for SDL and NSDL products.

Banks, particularly those in suburban locations with less demand at the branch level, cited the importance of strong partnerships with nonprofit community groups to refer, and sometimes qualify, potential borrowers. These partnerships were especially useful for fostering word-of-mouth advertising for their small-dollar loan products.

[9] The cumulative charge-off ratio for NSDLs was calculated only for fourth quarter 2009 because data regarding NSDL charge-offs were not collected until 2009. The cumulative ratio for NSDLs is calculated from the beginning of 2009.
[10] "Credit Card Charge-Off Rate on the Rise Again," *Washington Post*, December 30, 2009. This article reports the results of Moody's Investor Service's Credit Card Index.
[11] The extent to which a bank's small-dollar loan program may be subject to positive CRA consideration is described in the "Affordable Loan Guidelines." See footnote 3.

While some banks used mass media, Web page links, and targeted promotional efforts, word of mouth emerged as the dominant form of advertising for small dollar loans, particularly for established programs.

Longer Loan Term and Streamlined but Solid Underwriting May Have Been Key Performance Determinants

Pilot bankers indicated that a longer loan term was critical to loan performance because it gave consumers more time to recover from a financial emergency than a single pay cycle for payday loans, or the immediate repayment often required for fee-based overdrafts. Several banks experimented with relatively short loan terms, largely in an attempt to mimic the customer's experience with payday lenders. For example, as described in the text box on page 39, Liberty Bank in New Orleans, Louisiana, initially required that loan terms coincide with three paycheck cycles, but found that borrowers often could not repay the loans on time and returned to the bank for multiple renewals.[12] To avoid the cycle of continuously renewed "treadmill" loans, Liberty Bank extended loan terms to a minimum of six months. For the pilot overall, a 90-day loan term emerged as the minimum time needed to repay a small-dollar loan.

Underwriting processes varied somewhat among pilot banks and were streamlined compared with other loans, but bankers reported that some basic elements were important in minimizing defaults. Notably, most pilot banks required a credit report to help determine loan amounts and repayment ability and to check for fraud or recent bankruptcy. Few banks used credit scoring in the underwriting process, but those that did had low minimum thresholds, such as a Fair Isaac Corporation (FICO) score in the low to mid-500s. In addition to the credit report, all pilot banks required proof of identity, address, and income.

Virtually all of the pilot banks could process loans within 24 hours, and many processed loans within an hour if borrowers had the proper documentation. Banks tended to have strong opinions about the merits of centralized versus decentralized loan approval processes, based on the bank's size and business model, but no clear link to performance under either method emerged. About three-fourths of banks offered borrowers the option of automatically debiting payments, and some provided interest rate discounts to encourage borrowers to choose this payment method. It is difficult to draw empirical conclusions about the effect of automatic payments on performance because not all borrowers chose this option. Nevertheless, pilot bankers in general believed that automatic repayments can improve performance for all credit products, not just small-dollar loans.

Pilot Bankers Had Mixed Views on Optional Linked Savings and Financial Education

As part of the pilot application process, the FDIC specifically sought to test whether savings linked to small-dollar credit and access to financial education would improve loan performance, and ultimately, build a savings cushion to reduce future reliance on high-cost emergency credit. Cumulatively, pilot banks reported opening more than 4,000 savings accounts linked to SDLs with a balance of $1.4 million. These numbers are likely understated because of the limited ability of some banks to track this information.

On the surface, it appears that default rates for loans made under programs featuring savings and financial education are lower than for programs without those features. To illustrate, about one-half of pilot banks required or strongly encouraged SDL customers to open savings accounts linked to SDLs.[13] About 80 percent of the SDL funds originated during the pilot were made by banks that offered and encouraged, but did not require, a linked savings account. The cumulative charge-off rate on SDLs was 6.4 percent at banks with optional linked savings versus 11.4 percent at banks that did not feature linked savings as part of their programs. Slightly more than 10 percent of SDL funds were originated by banks that required linked savings accounts; these banks had the lowest cumulative charge-off rate during the pilot period, at just 1.6 percent.

Almost one-half of pilot banks strongly encouraged or required formal financial education. Because many of the largest SDL programs had educational components, more than 90 percent of SDLs were made by banks that featured education as part of their lending programs. The cumulative SDL charge-off rate was 5.7 percent where financial education was featured compared with 12.0 percent where it was not.

Given the limited sample size and variances in the program requirements and other features, it is unclear

[12] Financial institutions, companies, community groups, and other organizations mentioned in this article are for illustration only. The FDIC does not endorse any individual organization or specific products.

[13] Performance data for linked savings and financial education components are limited to SDLs, as data for NSDLs were not collected until later in the pilot, which limited their usefulness.

whether linked savings or formal financial education directly affected loan performance. Moreover, it is uncertain whether these factors reduced future reliance on high-cost credit, particularly since reducing reliance on credit is a long-term goal that may extend beyond the pilot period and it is difficult to track based on data available to banks. Anecdotally, some pilot bankers indicated that some small-dollar loan borrowers subsequently used linked savings or financial management skills in positive ways.

All of the pilot bankers recognized the importance of both savings and financial education, but perhaps the most interesting finding regarding program design was the difference in opinion among bankers about the effectiveness of requiring or even strongly encouraging these features. Some bankers felt that linked savings and formal financial education must be hardwired into the small-dollar loan product to break the cycle of high-cost lending. Others believed that requiring extra features for a loan complicates the process and can drive an already stressed consumer to the ease of the payday lending process; these bankers thought that financial education counseling should be provided during the application process.

Small-dollar loan programs at two of the pilot banks—BankPlus in Belzoni, Mississippi, and Liberty Bank and Trust Company, of New Orleans, Louisiana—illustrate these differences in opinion. BankPlus required both formal education seminars and a significant savings component to qualify for its small dollar loan program (see text box on page 38). The bank strongly believed that these components were the driving factor in minimizing defaults and rehabilitating small-dollar loan customers with problematic credit histories into what it believes will be future mainstream banking customers.

On the other hand, Liberty Bank and Trust Company believed that its program's initial formal financial education and linked savings requirements introduced an unwanted level of complexity for borrowers already facing a financial emergency (see text box on page 39). Liberty reported a surge in loan demand when it removed these requirements. A common theme that Liberty and other banks cited was the importance of informal financial education and counseling as part of the loan closing process. For many small-dollar loan consumers, obtaining a loan from a bank is an exciting and sometimes life-changing event, and part of relationship building is capitalizing on a teachable moment—explaining the importance of repaying the loan—when the loan is delivered.

Strategies to Scale Small-Dollar Loans

Banks other than those in the pilot provide small-dollar loans, but it is likely that most banks do *not* offer these loans.[14] Pilot bankers and other banks that have started or have expressed interest in starting a small-dollar loan program indicated that the primary obstacles to entry are the cost of launching and maintaining the program and concerns about defaults. The strategies described below could help overcome these obstacles and increase the supply of small-dollar loans.

Highlight Facts about Existing Models

A straightforward way to encourage more banks to offer small-dollar loans is to emphasize the facts about successful programs. The key facts are that safe, affordable, and feasible small-dollar lending does occur in mainstream financial institutions; that small-dollar lending can be part of a cornerstone for creating profitable relationships; and that defaults on these loans are in line with other types of unsecured credit. Indeed, other small-dollar loan programs have reported loan performance results similar to those of the pilot.

For example, the Pennsylvania Credit Union Association's Credit Union Better Choice program reported an approximate 5 percent default rate as of third quarter 2009.[15] This program was launched in early 2007 in partnership with the Pennsylvania Credit Union Association and the State Treasurers' Office, and about 80 credit unions are currently participating. The maximum loan amount is $500, the maximum fee is $25, and the maximum interest rate is 18 percent. The loan term is 90 days, and financial counseling is offered but not required. At disbursement, an amount equal to 10 percent of the loan is placed in a mandatory savings account.

In another example, the country's largest microlender, ACCION Texas, also indicated its loss rate is about

[14] The FDIC Survey of Banks' Efforts to Serve the Unbanked and Underbanked, published in December 2008 (http://www.fdic.gov/unbankedsurveys/), included a question regarding whether banks offer small-dollar loans. However, the response to this question was materially skewed, apparently by widespread misinterpretation by banks that believed small-dollar loans included standard overdraft lines of credit. This question will be clarified in subsequent survey efforts.

[15] Data regarding the Better Choice Program were reported to the FDIC Committee on Economic Inclusion on December 2, 2009, http://www.vodium.com/MediapodLibrary/index.asp?library=pn100472_fdic_advisorycommittee&SessionArgs=0A1U0100000100000101. See also the Better Choice Program Web site at http://www.pacreditunions.com/betterchoice.html.

5 percent.[16] Its maximum loan amounts are higher, up to $100,000, and the average amount is about $10,000, but 75 percent of its loans are for $1,500 or less. ACCION Texas's active portfolio was $24 million as of third quarter 2009, and loans are targeted to Latina women seeking to start or expand small businesses. Most applicants do not have a credit history, and the average FICO score is 575.

The FDIC has taken steps to highlight the facts about the small-dollar loan pilot program by releasing program results and lessons learned, as well as setting forth the Safe, Affordable, and Feasible Small-Dollar Loan Template. In addition, the FDIC has been discussing the pilot and template in speeches and public forums with a number of groups, including banks; other regulators; policymakers; academics; nonprofit, community, and philanthropic groups; and innovators in the small-dollar lending area.

Study Creation of Pools of Nonprofit Funds or Government Operating Funds to Serve as "Guarantees" for Safe Small-Dollar Loan Programs

Several existing small-dollar loan programs feature "guarantees" in the form of loan loss reserves or linked, low-cost deposits provided by government bodies or philanthropic groups. These guarantees provide important assurances to banks that are interested in offering small-dollar loans but are concerned about the costs of doing so.

For example, pilot bank Wilmington Trust in Wilmington, Delaware, originates small-dollar loans solely to clients of West End Neighborhood House (WENH), a social services nonprofit organization. WENH screens applications, performs loan underwriting (based on bank-approved criteria), and provides a full range of counseling and social services for prospective borrowers. In addition, all of the loans are fully guaranteed by WENH and backed by a loan loss reserve funded by grants and donations from other program partners.[17]

In another example, as part of the Better Choice Program, the Pennsylvania State Treasurers' Department has established a loan guarantee pool whereby $20 million in state operating funds are deposited in a corporate federal credit union and receive a market rate of return. The difference between that rate and the corporate credit union's earnings on the deposit is used to fund a loan loss reserve pool. Participating credit unions can apply to the pool to have up to 50 percent of their losses offset. While it is not a guarantee fund per se, the Pennsylvania Credit Union Association helps offset the cost of entry into small-dollar lending by paying for traditional advertising for credit unions that wish to enroll in the Better Choice Program.

In addition to guarantee programs, opportunities may exist to create larger and more broadly available guarantees. For example, recently proposed legislation would amend the Community Development Banking and Financial Institutions Act of 1994 to provide financial assistance to help defray the costs of operating small-dollar loan programs.[18] Elements of the Safe, Affordable, and Feasible Small-Dollar Loan Template were incorporated into this proposed legislation.

Encourage Partnerships

Pilot bankers and other successful small-dollar lending programs reported that partnerships with community groups were crucial to the success of their programs. Among other things, these partnerships can serve as an incentive to banks by providing client referrals and the opportunity for other parties to share in program costs. In some instances, the partnerships are direct and one-on-one relationships, such as the Wilmington Trust and WENH partnership described above. Other models, such as the state and local "Bank On" campaigns, use broad-based coalitions and strategies, which often include the provision of short-term emergency credit, to increase access to the financial mainstream.[19]

The Alliance for Economic Inclusion (AEI) is the FDIC's national initiative to establish coalitions of financial institutions, local policymakers, community-based and consumer organizations, and other partners in 14 markets across the country to bring unbanked and underserved populations into the financial mainstream. The focus is on expanding basic retail financial services, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, and asset-building programs, to underserved populations. The number of AEI members

[16] Ibid. See also ACCION Texas's Web site at http://www.acciontexas.org/.

[17] The partnership between Wilmington Trust and WENH was profiled in "The FDIC's Small-Dollar Loan Pilot Program: A Case Study after One Year," page 38. See footnote 1. See also WENH's Web site at http://www.westendnh.org/financial-management-services/# for more information about the program.

[18] S. 3217, 111th Cong. § 1206 (2010).

[19] See the National League of Cities Web site for a general description of Bank On campaigns at http://www.nlc.org/ASSETS/7E6FA32D3A364733B3172E44618A0CE3/IYEF_BankOnOnePagerFinal_4-10.pdf.

nationwide is 967, and 35 banks offer or are developing small-dollar loan programs.[20]

Study Feasibility of Safe and Innovative Small-Dollar Loan Business Models

The relationship-building small-dollar loan model is as costly to originate as other, larger loans because of the "high-touch" nature of the loan delivery process. Emerging technologies and delivery channels could reduce handling costs and, potentially, credit losses.

For example, employer-based lending is an emerging model whereby loans are delivered through the workplace as an employee benefit, like medical insurance or 401(k) plans. Banks or credit unions could process loans using employment information as a proxy for most of its underwriting criteria. That is, the employee's name, address, social security or tax identification number, salary, and length and status of employment would already be known, potentially reducing or eliminating the time a bank employee would spend gathering that information. Moreover, payments would be made automatically from payroll deduction, and features such as financial education screens and required savings could be factored into the loan origination process.

There are no large-scale examples of employer-based lending, but some organizations are experimenting with the concept. For example, Employee Loan Solutions (ELS) is a start-up company that has a patented process for delivering closed-end installment loans as an employee benefit.[21] According to ELS, underwriting costs would fall to virtually zero because of an automated process with no consumer interaction. Defaults also would be limited through automated payroll deduction for payments. While ELS has not had any practical application of its process yet, there are a few operating examples of employer-based small-dollar lending.

In July 2009 the Commonwealth of Virginia launched a pilot program, the Virginia State Employees Loan Program (VSELP), to deliver loans to state employees through its payroll system.[22] The program does not involve any state funds, and loans are funded by the Virginia Credit Union. An Internal Revenue Code §501(c) 3 nonprofit organization called the Virginia State Employee Assistance Fund (VSEAF) provided a $10,000 guarantee to fund a loan loss reserve. Previously, the VSEAF was being used for direct emergency aid to state workers, and the VSELP provided a way to leverage those funds to assist more employees who might need emergency funds.

VSELP loans are for amounts up to $500, and terms are up to six months with an interest rate of 24.99 percent. Loans are also conditioned on taking a short computer-based financial education course and passing a ten-question financial education quiz. After about three months, more than 2,000 VSELP loans had been originated with a cumulative balance of over $1 million; this represented about 2 percent of Virginia's 100,000 state employees who were using the loans. According to the Commonwealth of Virginia, borrowers are disproportionately minority, female, and low-income.

E-Duction is a for-profit company that offers open-ended loans through employers with credit lines delivered through MasterCard®. The maximum loan amount is 2.5 percent of annual pay, which, for example, would be $1,000 for an employee earning $40,000 per year.[23] There is no interest rate; rather, the company charges an annual fee, which as of late 2009 was $36 to $40 per year. Equal payments are made through payroll deduction over two to six months, depending on the type of expense. The company has been in business since 2002 and reports that it has about 18,000 accounts. According to E-Duction, about two-thirds of its borrowers earn between $20,000 and $40,000, and more than half have been employed for five or more years. Their average FICO score is 568.

Several pilot banks have been experimenting with innovative program features. For example, as described in the text box on page 40, Lake Forest Bank & Trust, of Lake Forest, Illinois, began working with a local municipality to offer small-dollar loans to city workers. These loans are structured along the terms of the bank's standard small-dollar loan but are repaid through automatic payroll deductions. As described on page 41 Mitchell Bank, Milwaukee, Wisconsin, created a unique low-cost financial education aspect to its loan program in which borrowers sign a pledge that they will not incur another payday loan during the term of their Mitchell Bank loan.

[20] Some of the AEI member banks offering small-dollar loans are also in the pilot. See the FDIC's Web site at http://www.fdic.gov/consumers/community/AEI/index.html for more information about the AEI.

[21] Information regarding Employee Loan Solution's proposed business model was reported to the FDIC Committee on Economic Inclusion on December 2, 2009.

[22] Ibid. See also the State of Virginia's Web site for more information about the loan program at http://www.dhrm.virginia.gov/vaemploan/.

[23] Ibid. See also e-Duction's Web site at http://www.e-duction.com/html2.0/index.html for more information.

Consider Ways That Regulators Can Encourage Banks to Offer Affordable and Responsible Products and That Small-Dollar Loan Programs Can Receive Favorable CRA Consideration

Pilot bankers and others have reported that a more flexible regulatory environment could encourage more banks to offer small-dollar loans. The SDL Guidelines and the pilot application process indicated that small-dollar loan programs can already receive favorable consideration for CRA purposes. However, several pilot bankers believe that small-dollar lending should receive more emphasis in CRA examinations, even if the program is relatively small. The FDIC is reviewing this suggestion and other types of regulatory and supervisory incentives to encourage small-dollar lending.

Conclusion

The FDIC small-dollar loan pilot program, conducted between December 2007 and December 2009, demonstrated that banks can offer alternatives to high-cost, emergency credit products, such as payday loans or overdrafts. The pilot resulted in a Safe, Affordable, and Feasible Small-Dollar Loan Template that other banks can replicate. Loans originated under the program have a default risk similar to other types of unsecured credit. Small-dollar loan programs can be an important tool in building and retaining customers, can be eligible for favorable CRA consideration, and could help banks' consistency with regulatory guidance regarding offering customers alternatives to fee-based overdraft protection programs. The FDIC continues to work with the banking industry, consumer and community groups, nonprofit organizations, other government agencies, and others to research and pursue strategies that could prove useful in expanding the supply of small-dollar loans.

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Financial Education, Savings, and Small-Dollar Lending at Work for Public Servants

BankPlus
Belzoni, Mississippi

BankPlus is a $2.1 billion institution headquartered in Belzoni, Mississippi. In addition to its main office, the bank has 61 branches throughout northwest, central, and southeastern Mississippi. BankPlus operates in a largely nonmetropolitan environment; of the bank's four designated assessment areas, only one is in a metropolitan statistical area (Jackson). The bank's business strategy of placing branches near businesses may provide banking services to residents of rural, sparsely populated environments who commute to work. For example, BankPlus operates a branch inside the Nissan plant in Canton, Mississippi.

The bank learned that there was a strong need for a small-dollar loan program after it opened branches in Jackson. As a result of the bank's community outreach and partnerships, it soon discovered that many local residents had not received financial education and, as a result, were unaware of the high costs of using alternative financial services. The bank studied the predominate users of payday loans in the local community and found that public servants such as teachers, firefighters, and police officers were particularly vulnerable to a cycle of high-cost lending.

The bank launched its CreditPlus program in April 2008. CreditPlus is a small, short-term loan product designed to encourage participants to break the cycle of high-cost debt while developing a regular savings plan. BankPlus opens a new checking and savings account for those approved for a CreditPlus loan. One-half of the loan proceeds are deposited into an interest-bearing personal savings account, and these funds are "on hold" until the loan is repaid. The bank encourages participants to use the remaining loan proceeds to eliminate outstanding debts to alternative financial services providers.

BankPlus reported that the educational component has been the "key to [the program's] success." Consumers must complete a three-hour seminar based on the FDIC's Money Smart financial education curriculum before they can apply for a small-dollar loan.* Owing to the popularity of the seminars, the bank capped registrations at 50 people per class. In fourth quarter 2009, the bank held 21 seminars and reached 667 people. Slightly more than half (51 percent) of those who attended the financial education workshops came to the bank for a small-dollar loan.

CreditPlus applicants also receive one-on-one credit counseling so they can better understand their credit report at the time of application. Bank staff also encourages CreditPlus customers to save 10 percent of their income each pay period through electronic transfer from the checking account into the savings account.

CreditPlus loans range from $500 to $1,000, and all are closed-end with a 12- or 24-month term (the average being 21 months). The interest rate is fixed at 5 percent. No fees are charged, and proof of recurring income (for at least 60 days), identity, and address is required. A credit report is obtained as part of the underwriting process, but the bank does not require a particular credit score. Rather, those with a FICO score above 500 receive a $1,000 loan, while those with a FICO score below 500 receive a $500 loan. If the customer's documents are in order, a loan can be underwritten in less than one hour after the financial education workshop is completed. The bank conducted training for loan officers so that the underwriting process could be decentralized and made in the community.

BankPlus joined the pilot in 2009 and originated 610 SDLs in fourth quarter 2009. At the conclusion of the pilot, 1,404 SDLs with a cumulative balance of about $1 million were outstanding. Only 58 SDLs totaling $34,000 were 30 days or more delinquent at the end of the pilot. The bank's cumulative charge-off rate during the pilot period was 1.8 percent.

Bank management indicated that SDLs are not profitable on a stand-alone basis but can help establish customer relationships and improve the bank's community, which benefits the bank over the long term. According to Senior Executive Vice President and President–South Region Jack Webb, "We see CreditPlus as an investment in the future—it is about building a relationship over the long term. Financial education improves habits, and the change of habits improves the future of customers." One of many success stories the bank cites is of a customer who had bad credit, received a CreditPlus loan, improved her credit score by making timely repayments, and was later able to qualify for a mortgage through BankPlus and become a first-time homebuyer.

* See the FDIC's Web site at http://www.fdic.gov/consumers/consumer/moneysmart/ for more information on Money Smart.

Product Simplification Leads to Small-Dollar Loan Success

Liberty Bank and Trust Company New Orleans, Louisiana

Liberty Bank and Trust Company is a minority-owned $424 million bank headquartered in New Orleans, Louisiana. Liberty has 24 branches in six states. Ten branches are in New Orleans; four are in Baton Rouge; one is the New Orleans suburb of Harahan, Louisiana; and one is in Opelousas, Louisiana. The bank has two branches each in Jackson, Mississippi; Detroit, Michigan; and Kansas City, Kansas. It also has one branch in Kansas City, Missouri; and one in Houston, Texas. Most of the small-dollar loans made by Liberty are originated out of the New Orleans and Kansas City, Missouri, branches. With the exception of the Harahan branch, all of Liberty's branches are in urban areas, and most of the branches are in low- and moderate-income neighborhoods.

The bank did not have an active small-dollar loan product when it applied for the FDIC pilot. In its initial application, the bank cited providing affordable "anti-payday" loans to the qualified public, attracting new clientele, and increasing future cross-selling opportunities as its objectives for offering small-dollar loans. The pre-launch, conceptual product outlined in its application was called the Payday Assistance Loan. It featured a $300 to $1,000 line of credit, a $15 initial saving deposit, a $15 refundable financial literacy course fee, a $10 processing fee, a 17.99 percent interest rate, and a three-payment term structure incorporating a $15 savings deposit into each payment. The financial literacy fee was to be refundable upon completion of a literacy class within 30 days of application.

By the launch of the bank's small-dollar loan program in April 2008, the Payday Assistance Loan had been rebranded as the Liberty Bank Fast Cash Loan. The Fast Cash loan required a minimum FICO score of 525, the opening of a Liberty checking account with direct deposit, deposit of 9 percent of the loan amount into a Liberty savings account, completion of a 90-minute financial literacy course, and a $4.50 application fee. The loan had an 18 percent interest rate and was payable in three installments commensurate with the borrower's paycheck schedule. The minimum loan size remained $300, while the maximum was increased to $2,500. If all required customer documents were provided at the time of application, the Fast Cash approval process, featuring localized underwriting authority in most cases, was designed to take 15 minutes on average. A complete application consisted of the applicant's two most recent pay stubs, most recent mortgage statement, utility bills, and proper identification.

In response to customer needs, Liberty refined the Fast Cash program over the remaining quarters of the pilot. According to Kelly Dixon, Liberty Bank's manager of E-commerce, the savings component proved too complicated for potential borrowers. Thus, it was dropped before the end of 2008. Similarly, potential borrowers viewed the financial education requirements as too burdensome, and the bank modified them to allow customers to take out and repay two Fast Cash loans before completing a literacy class to qualify for a third loan. The three-payment term structure was dropped in favor of 6- to 12-month terms for loans up to $1,000 and 18-month terms for loans up to $2,500, to give borrowers more time to repay. Also, the small-dollar loan approval process was centralized and the underwriting guidelines were made more flexible. Rates on Fast Cash loans are 18 percent and fees are $4.50.

After implementing the program refinements, Liberty originated more SDL and NSDL loans in the first quarter of 2009 than it had in the previous three quarters combined. Liberty's marketing efforts initially included media advertising, point-of-sale displays, Web site advertising, and dissemination of information at local churches. As the pilot progressed, Liberty came to rely more on word of mouth and the dissemination of brochures at gatherings to market the program.

Subsequently, the Fast Cash program continued to evolve. By November 2009, the financial education component had been dropped altogether. The program was modified to accommodate more credit history "glitches," such as payment problems due to medical issues, job losses, hourly employment cutbacks, unexpected spikes in expenses affecting household budgets, and divorce, and to give greater consideration to borrowers using small-dollar loans to support educational purposes or to military families. According to Liberty Bank and Trust's Executive Vice President Howard Brooks, "We needed more flexibility to avoid pushing our low- and moderate-income consumers to high-cost-debt products such as payday loans. In particular, our customers told us that they don't have the time or the resources to fulfill mandatory financial literacy or savings requirements." He believes that the modifications to the Fast Cash program allowed Liberty Bank and Trust to be of greater service to its communities.

During the pilot, Liberty originated 102 SDLs and 82 NSDLs. In all, Liberty originated approximately $217,000 in small-dollar loans during the pilot. The bank did not report any charge-offs, and its 30-day delinquency rate was about 5.60 percent. The bank reported a positive net income on small-dollar loans.

Innovating to Build Profitable Relationships

Lake Forest Bank & Trust
Lake Forest, Illinois

Lake Forest Bank & Trust is a $1.8 billion institution headquartered in Lake Forest, Illinois, in the northern suburbs of Chicago. In addition to the main office, the bank has seven branches throughout the state. It is owned by the Wintrust Financial Corporation holding company, which also owns 14 other banks serving the Chicago, Illinois, and southern Wisconsin metropolitan areas.

To expand the bank's community reinvestment activities, Lake Forest initiated a small-dollar lending program in late 2008. The program was designed to meet the FDIC's Guidelines on Affordable Small-Dollar Loans, and the bank joined the ongoing pilot program in fourth quarter 2008. All seven of the bank's branches offer the small-dollar loan product. Lake Forest has encouraged its sister banks—which, including Lake Forest, have 84 branches—to offer the product as well, and many have started their own programs. Although Lake Forest was a relatively late entrant into the pilot program, the program has grown quickly, from 5 loans originated in its first quarter of participation to 51 in the final quarter of the pilot.

Lake Forest's small-dollar loans range from $250 to $1,000. One of the most successful changes the bank made to its program over the past year has been reducing the minimum loan amount to accommodate borrowers who did not need large amounts of credit. The bank charges a fixed interest rate of prime plus 5 percent, which has hovered around 8.5 percent since it implemented the loan product, with no fees. Interest rates are reduced by 0.25 percent if the borrower chooses to use auto-debit payments or payroll deduction. Loans must be repaid within 24 months, but are paid off in 18 months, on average. The underwriting process allows for loan decisions within 24 hours at the branch level. There are no minimum credit score requirements. While the bank initially required a minimum credit score, it found this requirement was an obstacle for too many applicants. Underwriting processes now consist of completing the application for credit, which collects information on employment history, income, assets, and debts. A credit report is also ordered to help determine the borrower's ability to repay.

Since joining the pilot program, Lake Forest has made more than 100 SDLs for nearly $86,000. Forty-four loans had been paid off by the end of 2009. With just one loan delinquent and 11 loans charged off by fourth quarter 2009, the bank reports that losses on the SDL product are no higher than those on other consumer loans. In addition to the positive effect the SDL program has had on community development, the bank has been able to earn a small profit on the loans and intends to develop long-term relationships with performing SDL borrowers.

Lake Forest is also involved in several innovative approaches to its small-dollar lending. In fourth quarter 2009, the bank began working with a local municipality to offer workplace-based loans to city employees to reduce their reliance on payday loans and other alternative financial services. City workers can get a loan application directly from their employer, can fax the complete application to the bank, and will go in to the bank only to close the loan. The loans are structured along the terms of the bank's standard small-dollar loan but are repaid through automatic payroll deductions.

In addition, the bank is working with the State of Illinois on the Micro Loan Program and was the first bank approved by the state as a lender under this program. This program is designed to provide affordable capital to credit unions and community banks so they can make micro loans to low-income residents who might otherwise turn to payday lenders. If a bank is accepted into the program, the Micro Loan Program will deposit up to $250,000 at a reduced rate at the bank for one year. These funds are then used to make loans to borrowers. The bank plans to work on modifying its product to meet the state guidelines, and the state program will become a subset of the small-dollar loan program.

While these partnerships are successful in providing loan prospects for the bank, the majority of the small-dollar loan borrowers come from outside of these relationships. Lake Forest consistently advertises the small-dollar loan in a community newspaper, which is the biggest driver of applications. Program information and the loan application are also available on the bank's Web site, which is becoming a more important channel for applicants. Also, the bank's successful track record with the program is generating positive word of mouth that is reaching increasing numbers of potential borrowers.

A Pledge to Break the High-Cost Lending Cycle

Mitchell Bank
Milwaukee, Wisconsin

Mitchell Bank is a $74 million institution headquartered in Milwaukee, Wisconsin. In addition to the main office, the bank has four branches. The bank's main office and branches are located in communities with concentrations of Latino and low- and moderate-income households.

Mitchell Bank's small-dollar loan program was new when the pilot began in February 2008. The bank's goals for the program were to provide consumers with an alternative to high-cost credit, build multiple account relationships, and provide opportunities for financial education. Initially, loans were offered only to existing customers who had had an account for six months or more and also had a Social Security number. In 2009, Mitchell Bank relaxed the existing customer requirement but required borrowers who were new customers to open a Mitchell Bank deposit account and to have their payroll or benefits check direct deposited into the account. Because of its large immigrant customer base, the bank also altered its program requirements to allow customers who had only an Individual Taxpayer Identification Number (ITIN) to apply for a loan.

Loans range from $300 to $1,000, although loans up to $2,500 may be made on a case-by-case basis. The interest rates range from 15 to 22 percent, depending on the borrower's credit score; the average rate is about 19 percent. Each loan application requires a credit report. Generally, the bank requires borrowers to have a minimum FICO score of 570 but will extend loans to those below that threshold if the borrower agrees to a single financial counseling session. An $8 fee is charged to cover the cost of the credit report. Loan terms range from 6 to 12 months, with an average of 9 months. In addition, borrowers must have a minimum income of $1,000 per month and are required to provide Mitchell Bank with two months' evidence of payroll or other recurring income.

A unique aspect of Mitchell Bank's program is that borrowers must sign a pledge that they will not incur another payday loan during the term of their Mitchell Bank loan. The bank also requires that the borrower set aside 10 percent of loan proceeds in a savings account that is restricted until the loan is paid. The interest rate on the savings account is three times higher than Mitchell Bank's regular accounts to encourage small-dollar loan customers to add to savings and avoid future reliance on short-term credit. The bank also offers a 2 percent discount for customers who agree to have payments automatically debited from their accounts.

The bank made 84 SDLs and one NSDL during the pilot, with cumulative balances of about $56,000. Eight loans were charged off. The bank found that a borrower's status as an existing customer (versus a new customer) had little effect on loan performance. However, the lack of credit history, as opposed to a poor credit history, *was* correlated to performance. Of the eight loans charged off, six were ITIN loans whose borrowers, for the most part, had no credit score. Mitchell Bank also reported that loans that became 30 days delinquent were frequently charged off. Management attributed the correlation between late payments and default to state laws that limit the penalty for late charges.* Recent collection efforts have resulted in recovery and payment of three of the previously charged-off loans, and the bank anticipates collecting on several more.

In terms of successful program components, Mitchell Bank reported that extended loan terms significantly reduced the incidence of repeat customers. Several customers have taken two loans per year (the bank's maximum), but all have paid as agreed. The program also provides for a discount on subsequent loans if initial loans performed as agreed. Mitchell Bank indicated that the savings component was well received by consumers and resulted in substantial savings balances. Sixty-two percent of savings accounts opened by loan customers remained open at the end of the program, and most were active. Most accounts are in the $250 to $300 range, but several accounts are in the five-figure range. Overall, Mitchell Bank reported that its small-dollar loan program was profitable and met the emergency credit needs of the community it serves. Mitchell Bank plans to continue to offer small-dollar loans and will continue to develop and refine its program.

* The Wisconsin Consumer Act (§422.203(1) Wis. Stats.) limits late charges to the lesser of 5 percent of the payment or $10. A late charge may be assessed only once on an installment, however long it remains in default. A borrower who misses a $30 installment payment on a small-dollar loan will be charged a $1.50 penalty.

CFSA℠

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA

A COMMUNITY OF RESPONSIBLE LENDERS

BEST PRACTICES FOR THE PAYDAY ADVANCE INDUSTRY

CFSA Members must abide by the following Best Practices:

1. FULL DISCLOSURE. A member will comply with the disclosure requirements of the state in which the payday advance office is located and with federal disclosure requirements including the Federal Truth in Lending Act. A contract between a member and the customer must fully outline the terms of the payday advance transaction. Members agree to disclose the cost of the service fee both as a dollar amount and as an annual percentage rate ("APR"). A member, in compliance with CFSA guidelines where they do not conflict with applicable federal, state or local requirements, will further ensure full disclosure by making rates clearly visible to customers before they enter into the transaction process.

2. COMPLIANCE. A member will comply with all applicable laws. A member will not charge a fee or rate for a payday advance that is not authorized by state or federal law.

3. TRUTHFUL ADVERTISING. A member will not advertise the payday advance service in any false, misleading, or deceptive manner, and will promote only the responsible use of the payday advance service.

4. ENCOURAGE CONSUMER RESPONSIBILITY. A member will implement procedures to inform consumers of the intended use of the payday advance service. These procedures will include the placement of a "Customer Notice" on all marketing materials, including all television, print, radio and on-line advertising, direct mail and in-store promotional materials.

5. ROLLOVERS. Members shall not allow customers to rollover a payday advance (the extension of an outstanding advance by payment of only a fee) unless expressly authorized by state law, but in such cases where authorized the member will limit rollovers to four (4) or the state limit, whichever is less.

6. RIGHT TO RESCIND. A member will give its customers the right to rescind, at no cost, a payday advance transaction on or before the close of the following business day.

7. APPROPRIATE COLLECTION PRACTICES. A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member's practice in this area.

8. NO CRIMINAL ACTION. A member will not threaten or pursue criminal action against a customer as a result of the customer's check being returned unpaid or the customer's account not being paid.

9. ENFORCEMENT. A member will participate in self-policing of the industry. A member will be expected to report violations of these Best Practices to CFSA, which will investigate the matter and take appropriate action. Each member company agrees to maintain and post its own toll-free consumer hotline number in each of its outlets.

10. SUPPORT BALANCED LEGISLATION. A member will work with state legislators and regulators to support responsible legislation of the payday advance industry that incorporates these Best Practices.

11. EXTENDED PAYMENT PLAN*. Each member will provide customers who are unable to repay a payday advance according to their original contract the option of repaying the advance over a longer period of time. Such an extended payment plan will be offered in compliance with any requirement in state law to provide an extended payment plan or, in the absence of such a requirement in state law, in compliance with the Best Practice "Guidelines for Extended Payment Plans." A member will adequately disclose the availability of the Extended Payment Plan to its customers in compliance with any requirement in state law for such a disclosure or, in the absence of such a requirement in state law, in compliance with the Best Practice "Guidelines for Extended Payment Plans."

12. INTERNET LENDING. A member that offers payday advances through the Internet shall be licensed in each state where its payday advance customers reside and shall comply with the disclosure, rollover, rate, and other requirements imposed by each such state, unless such state does not require the lender to be licensed or to comply with such provisions, or the state licensing requirements and other applicable laws are preempted by federal law.

13. DISPLAY OF THE CFSA MEMBERSHIP SEAL. A member company shall prominently display the CFSA Membership Seal in all stores to alert customers to the store's affiliation with the association and adherence to the association's Best Practices.

SUPPLEMENTAL GUIDELINES FOR MEMBER COMPANY IMPLEMENTATION OF CFSA BEST PRACTICES ARE INCORPORATED HEREIN BY REFERENCE AND ARE AVAILABLE UPON REQUEST.

** LAWS IN SOME STATES DO NOT PERMIT IMPLEMENTATION OF CFSA'S EXTENDED PAYMENT PLAN (EPP). CFSA IS WORKING WITH REGULATORS IN THESE STATES TO OBTAIN APPROVAL OF CFSA'S EPP AND WITH LEGISLATORS TO PROMOTE ITS ADOPTION INTO STATE LAW*

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CFSA[SM]

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA

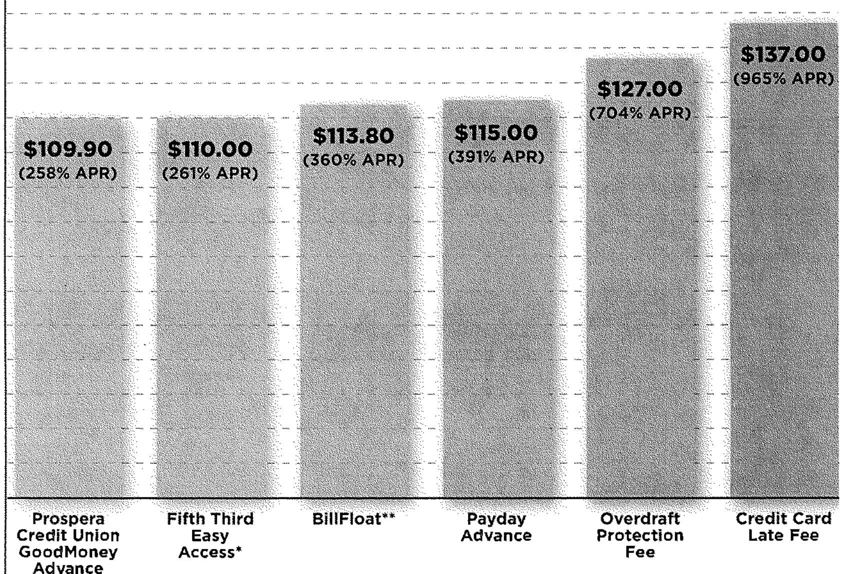
A COMMUNITY OF RESPONSIBLE LENDERS

A COST COMPARISON.

Stacking up the payday advance against short-term market alternatives.

Millions of Americans require the use of a small dollar, short-term loan—whether they are experiencing a financial setback or are in recurring need. Though the credit options in the market seem relatively expensive, restrictions on these products do not eliminate consumer demand.

SHORT-TERM CREDIT OPTIONS FOR A 14-DAY $100 LOAN



*BillFloat loans have 30-day terms, resutling in a 168%

(P) 888.572.9329 (F) 703.684.1219 (E-MAIL) INFO@CFSAA.COM (WEB) CFSAA.COM

Check Into Cash of South Carolina, Inc.

Fee Schedule

Cash Needed	Fee Amount	Check Amount	Annual Percentage Rate*
$\$\ 50^{00}$	$\$\ 7^{50}$	$\$\ 57^{50}$	391.07%
$\$\ 75^{00}$	$\$11^{25}$	$\$\ 86^{25}$	391.07%
$\$100^{00}$	$\$15^{00}$	$\$115^{00}$	391.07%
$\$125^{00}$	$\$18^{75}$	$\$143^{75}$	391.07%
$\$150^{00}$	$\$22^{50}$	$\$172^{50}$	391.07%
$\$175^{00}$	$\$26^{25}$	$\$201^{25}$	391.07%
$\$200^{00}$	$\$30^{00}$	$\$230^{00}$	391.07%
$\$225^{00}$	$\$33^{75}$	$\$258^{75}$	391.07%
$\$250^{00}$	$\$37^{50}$	$\$287^{50}$	391.07%
$\$275^{00}$	$\$41^{25}$	$\$316^{25}$	391.07%
$\$300^{00}$	$\$45^{00}$	$\$345^{00}$	391.07%
$\$325^{00}$	$\$48^{75}$	$\$373^{75}$	391.07%
$\$350^{00}$	$\$52^{50}$	$\$402^{50}$	391.07%
$\$375^{00}$	$\$56^{25}$	$\$431^{25}$	391.07%
$\$400^{00}$	$\$60^{00}$	$\$460^{00}$	391.07%
$\$425^{00}$	$\$63^{75}$	$\$488^{75}$	391.07%
$\$450^{00}$	$\$67^{50}$	$\$517^{50}$	391.07%
$\$475^{00}$	$\$71^{25}$	$\$546^{25}$	391.07%
$\$500^{00}$	$\$75^{00}$	$\$575^{00}$	391.07%
$\$525^{00}$	$\$78^{75}$	$\$603^{75}$	391.07%
$\$550^{00}$	$\$82^{50}$	$\$632^{50}$	391.07%

* Based on a fourteen (14) day advance with one (1) payment.

Your One Stop Money Shop

If you are unable to repay a deferred presentment transaction when due, you are eligible to request one extended payment plan in a twelve month period.

We will access the deferred presentment transaction database to verify whether you are eligible to enter into a transaction. The information related to a new transaction must be entered into the database.

Customer Notice: Payday advances should be used for short-term financial needs only, not as a long-term financial solution. Customers with credit difficulties should seek credit counseling.

THE
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July 22, 2013

By Electronic Delivery

RE: Statement of The Pew Charitable Trusts to the Senate Aging Committee Hearing: *Payday Loans: Short-term Solution or Long-term Problem?*

Ladies and Gentlemen:

The following statement provides a short summary of research findings about payday lending from The Pew Charitable Trusts. Pew is a non-profit, research-based organization and our interests include providing research and analysis to help ensure a safe and transparent marketplace for consumer financial services. Pew's safe small-dollar loans research project focuses on conducting research that identifies the needs, perceptions, and motivations of those who use payday, deposit advance, and similar loan products, as well as the impacts of market practices and potential regulations. We have been studying this issue closely for more than two years. Our research includes a unique, nationally representative telephone survey of payday loan borrowers and more than a dozen focus groups with borrowers across the country.

We have published two reports so far in our *Payday Lending in America* series, available at www.pewtrusts.org/small-loans. Our website also includes helpful summaries and animated videos explaining what payday loans are, who uses them, and why.

Payday loans offer small amounts of cash ($375 on average) to people who have an income source and a checking account. In exchange, lenders take a fee ($55 on average at a storefront) and the right to take payment directly from the borrower's checking account on his or her next payday, when *payment in full* is due. Payday loans are available from stores, online lenders, and a small number of national and regional banks.

Pew's research demonstrates that those who borrow short-term, small-dollar loans routinely struggle to keep up with living expenses, and most often they use the loans to pay rent, utility bills, and other routine obligations (as opposed to spreading the cost of purchases over time, which is a more traditional use of credit). Repeat borrowing is the norm because customers who seek payday loans to help service other debts and obligations cannot afford lump-sum repayments. And so they repeatedly pay fees to renew or re-borrow for five months of the year, paying $520 in fees on average.

Repeat borrowing is also necessary for lenders, who could not stay in business if the average customer paid off the loan within just a few weeks.[1] Lenders offer these loans to almost anyone with a checking account and a source of income—without assessing the borrower's ability to repay the loan—in exchange for the right to take full repayment from the borrower's checking account on his or her next payday. This unusual ability to collect payment before the customer pays other bills such as rent or utilities is what allows payday lenders to thrive even as they make loans to borrowers who cannot afford them.

Key Findings from Pew's *Payday Lending in America* Series of Reports

Pew has published two reports in this series so far (July of 2012 and February of 2013). Additional publications will follow.

- Twelve million people use payday loans annually. The average loan size is $375.
- Although payday loans are characterized as a short-term solution for unexpected expenses, the opposite is true. The average borrower is in debt for five months during the year, spending $520 in interest to repeatedly re-borrow the loans. Sixty-nine percent of first-time borrowers used the loan for recurring bills, while just 16 percent dealt with an unexpected expense.
- Most payday loan borrowers have trouble meeting monthly expenses at least half the time.
- Payday loans are unaffordable. The average borrower can afford to pay $50 per two weeks to a payday lender, but only 14 percent can afford the more than $400 needed to pay off the full amount of these non-amortizing loans.
- Forty-one percent of borrowers have needed a cash infusion, such as a tax refund or help from family or friends, to pay off a payday loan.
- If payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions.
- In states that enact strong legal protections, the result is a large net decrease in payday loan usage. Rates of online borrowing are similar in states with payday loan storefronts and those with none.
- Payday loans do not eliminate overdraft risk. A majority of borrowers overdraft as well.

[1] Robert DeYoung and Ronnie J. Phillips. Federal Reserve Bank of Kansas City Economic Research Department, "Payday Loan Pricing," (2009). http://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf. See also Stephens Inc., "Payday Loan Industry" (2011).

- A majority of borrowers say payday loans take advantage of them, and a majority also say they provide relief.

- By almost a 3-to-1 margin, borrowers favor more regulation of payday loans.

In sum, Pew's research shows that payday loans unrealistically require lump-sum repayments that far exceed most borrowers' financial capacity. The predictable result is that customers are unable to repay the loans and meet their other financial obligations, resulting in prolonged periods of renewing or re-borrowing. The product poses significant risk of harm to consumers, and it is based on a business model that is highly inconsistent with sound lending practices.

Thank you for addressing this important issue. Our statement concludes with the attachment on the following page, showing the demographics of payday loan borrowers based on Pew's nationally representative survey.

Sincerely,

Nick Bourke
Director, Safe Small-Dollar Loans Research Project
nbourke@pewtrusts.org
www.pewtrusts.org/small-loans

attch: 1

PAYDAY LOAN BORROWER DEMOGRAPHIC SNAPSHOT

Demographic	Percentage of All Payday Borrowers	Percentage of All American Adults
Renters	58	35
Homeowners	41	65
Single	24	31
Living with partner	14	N/A*
Married	33	50
Separated/divorced	25	13
Widowed	4	6
Full-time employed	49	59**
Part-time employed	13	
Unemployed	14	6
Disabled	8	N/A*
Retired	8	23
Homemaker	5	6
Student	3	5
Income <$15,000	25	13
Income $15,000 to under $25,000	24	11
Income $25,000 to under $30,000	11	
Income $30,000 to under $40,000	13	25**
Income $40,000 to under $50,000	8	
Income $50,000 to under $75,000	10	19
Income $75,000 to under $100,000	5	12
Income $100,000+	1	21
White (non-Hispanic)	55	64
African American (non-Hispanic)	23	12
Hispanic	14	16
Other race/ethnicity	6	8
Ages 18-24	12	13
Ages 25-29	16	9
Ages 30-34	12	9
Ages 35-39	11	9
Ages 40-44	13	9
Ages 45-49	11	10
Ages 50-54	10	10
Ages 55-59	5	8
Ages 60-64	5	7
Ages 65-69	3	5
Ages 70+	3	12
Parent	38	30
Non-parent	62	70
<High school	16	15
High school	38	29
Some college	31	30
College	11	16
Postgrad	3	9
Male	48	49
Female	52	51

This table describes the demographic characteristics of payday loan users overall, based on responses to Pew's survey. For example, 58 percent of all payday loan users rent (as opposed to own) their homes. For more on the survey, see the Methodology.

NOTES: All payday borrower data come from payday borrowers identified through 33,576 interviews conducted from August through December 2011 on behalf of Pew's Safe Small-Dollar Loans Research Project.

All comparative data except for employment status come from the Census Bureau's 2010 Decennial Census, the 2006–2010 American Community Survey 5-Year Estimates, and the 2008–2010 American Community Survey 3-Year Estimates. Employment status data come from a three-month average (March, April, and May 2012) of the NBC News/*Wall Street Journal* Survey, a nationally representative monthly telephone survey.

Data may not equal 100 percent due to rounding or because respondents declined to answer.

Marital status is based on residents 15 years of age and older. Educational attainment is based on adults 25 to 64 years of age. Other data, including Pew's survey data, represent adults 18 years of age and older.

*N/A Certain data were unavailable and/or are not comparable to Pew's survey.

**The Census uses slightly different income and employment categories in its survey.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; U.S. Census Bureau; NBC News/*Wall Street Journal* Survey.

Source: The Pew Charitable Trusts, "Who Borrows, Where They Borrow, and Why" (July 2012), at Appendix A. Available at: www.pewtrusts.org/small-loans. Note: Approximately 12 million people use payday loans annually.

Online Lenders Alliance

Statement for the Record
By Lisa McGreevy, President and CEO
Senate Special Committee on Aging
Payday Loans: Short-term Solution or Long-term Problem?
July 23, 2013

Mr. Chairman,

The Online Lenders Alliance, and its member companies, thank the Committee members for the opportunity to provide you with information about our industry. We look forward to working with you in the future to ensure that consumers are fully informed and fairly treated.

The Online Lenders Alliance (OLA) is a professional trade organization representing the growing industry of companies offering consumers small, short-term loans online since 2005. OLA member companies abide by a list of Best Practices and Code of Conduct to ensure that customers are fully informed and fairly treated.

OLA supports the efforts by the CFPB's Office of Older Americans to protect senior Americans from financial abuse and works closely with its member companies to ensure that they make credit available to all persons consistent with laws that protect this vulnerable population against discrimination, fraud and other abuse.

It is against the law and industry best practices to discriminate against any consumers based on their age. An analysis of over 1.8 million customers proves seniors are not disproportionately applying for or receiving small dollar loans from internet lenders.

According to a study by Microbilt, a leading credit bureau for underbanked and consumers with limited credit history, the average age of consumers borrowing from online lenders is 44. Additional analysis of the Microbilt study shows that of the 1.8 million customers from April 2012 to March 2013 only 10.33% were 55 to 65 years old with 4.33% over 65.

The most recent census data indicates that 11.8% of the U.S. population is between 55 and 65, and 13.0% of the U.S. population is over the age of 65. These statistics clearly show that seniors are comparatively underrepresented among the customers of online lenders.

OLA members do not target any specific group. Online lenders market their loan products over the Internet, and, as such, borrowers seek us out, rather than the other way around.

Online Lenders Alliance

Thank you, Mr. Chairman for allowing me to submit this statement on behalf of OLA's members. Our Alliance stands ready to provide you and your members with information about our industry and the customers who are increasingly using our products.

crc

CALIFORNIA REINVESTMENT COALITION

July 23, 2013

U.S. Senate Committee on Aging
Senator Bill Nelson, Chairman
G31 Dirksen Senate Office Building
Washington, DC 20510

Re: Oversight Hearing on July 24, 2013, "Payday Loans: Short-term Solution or Long-term Problem?"

Dear Chairman Nelson and Respected Committee Members,

Thank you very much for conducting a hearing on the effect of payday lending on seniors. We urge you to support strong laws and regulations that eradicate this industry and encourage instead, affordable small dollar loans that are responsibly underwritten, payable over time like most bank loans, and offered at reasonable interest rates that are not predatory or excessive.

The California Reinvestment Coalition is a non-profit coalition of over 300 organizations from across all of California. We advocate for financial services practices and policies that respond to the needs of low income households, communities of color and other economically and politically marginalized communities in California. California, one of the fastest growing state and already home to over 12% of our nation's residents, has a senior population that is expected to grow twice as fast as any other segment of society. Unfortunately, we also have a very aggressive payday lending industry, including storefront lenders, internet lenders and two of the five national banks that provide payday loans.

We recently submitted comments to the Office of the Comptroller of the Currency and the Federal Deposit Insurance Commission urging them to adopt proposed guidelines for banks that provide these loans. The deposit advances sold by Wells Fargo and US Bank, so far the only two bank providers in California, wreak havoc on people already on difficult financial footing. Their products work exactly like ill-reputed payday loans while being exempt from any existing payday regulations. We believe that the guidance provided by the OCC and the FDIC provides the minimum considerations that banks must apply when providing these products.

We ask this Committee on Aging to support the proposed guidelines offered by the OCC and the FDIC. Anyone living on a limited income, including seniors, and especially those receiving only Social Security as their income, are particularly vulnerable to these products. As currently structured, few customers can afford the full payment by next deposit requirement without coming into a windfall of cash or enjoying a rare reprieve in basic expenses. The full- and-fast payment requirements of these products sets up customers for cycles of repeat borrowing that drive them into debilitating debt. One Wells Fargo

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customer, Annette Smith, a 69 year old Social Security recipient, got stuck in a cycle of deposit advances of $500 from Wells Fargo every month for five years, costing her $3,000 in fees which she paid using her $1,200 monthly Social Security benefits.

Bank payday loans are particularly dangerous to seniors who might never walk into a storefront payday lender's office, or apply for a loan with unfamiliar and unregulated entities online. Banks are also dangerous because only they have direct access to the accounts of those who get Social Security electronically deposited as is now mandated for most Social Security recipients.

We applaud the OCC and the FDIC for this first strong step, and support immediate adoption and enforcement of these guidelines. Below are our recommendations for reforming these practices and making banks a resource for seniors, not a source of financial abuse.

Banks should restrict eligibility for these products.

Wells Fargo and US Bank customers become eligible for advances after meeting only the barest of eligibility requirements. All they must have is an account for six months and a source of income that is directly deposited at least monthly. These standards fall absurdly below the eligibility standard that the banks require for every other form of credit. There is no consideration for ability to repay, such as by looking to cash flow or average monthly balances. Monthly balances are currently required to receive as little as a fee waiver. Minimum eligibility should require an average monthly surplus at the end of each of the preceding six months of an amount sufficient to either cover the cost of paying the advance all at once or over time.

These products should be underwritten.

Neither Wells Fargo nor US Bank currently assess the customer's ability to pay, in full, the amount advanced and fee without endangering other financial obligations. Instead, they impose a so-called "credit limit" suggestive of an assessment of risk that the customer can repay. It is no such thing.

Rather, the policies ensure that the bank will receive enough of a deposit to cover immediate withdrawal of principal and fee by the bank, regardless of the customer's other financial obligations. US Bank's "credit limit" is half of the customer's monthly direct deposits, up to $500, such that a person receiving $1200 a month could be advanced $500. Wells Fargo's "credit limit" is half of the average monthly direct deposit, also up to $500, such that a person who receives two direct deposits a month totaling $1,200, could be advanced $300 while a person who receives one monthly direct deposit of $1,200 could be advanced $500.

Neither bank looks at all at the customer's other financial obligations because they are first in line to be paid by virtue of their reach directly into the customer's account. This "first in line" approach is not underwriting. It ensures repeat borrowing, causing the customer to take another advance, for the very reason that the customer cannot in fact afford to both pay the advance and her other financial obligations.

Banks should look at the customer's ability to repay while simultaneously meeting existing and predictable recurring and necessary expenses such as food, housing, transportation and healthcare, as well as other outstanding debt obligations. If a customer will not be able to meet all of their basic needs without needing to borrow repeatedly, the loan terms, including advance limits and repayment periods, should be adjusted accordingly.

Payment terms should reflect prudent underwriting.

Wells Fargo and US Bank's deferred deposit advances currently work exactly like payday loans: customers must repay the amount advanced, plus a fee, upon their next deposit whether in 24 hours or a month. Neither bank allows the first-time borrower to pay in installments. US Bank provides no installment option at all and will deduct the full amount owed, or as close to it as possible, even if that means the customer has no funds left for other needs. Wells Fargo requires customers to have taken advances in three consecutive statement periods or have an outstanding balance of more than $200 before being allowed to pay in installments.

These terms favor the bank's interest in fee revenue at the expense of the customer's ability to repay successfully without borrowing again and going further into debt. The banks merely exploit their direct reach into the account before other creditors, leaving the customers with no choice but defaulting on other obligations or taking out another advance.

Instead, repayment terms should align with existing standards for loans and lines of credit. Customers should expect to pay regular amounts to cover a portion of principal, fees or interest charge over a predictable period of time, such as every other week or every month. This would allow the customer to budget and pay all debt obligations safely, including the bank's advance.

Banks should not encourage or exploit back to back advances.

Both US Bank and Wells Fargo emphasize that advances are for short-term use only, that they are not designed for long-term use. They both impose "cooling off" periods after advances in consecutive statement periods: Wells after six and US Bank after nine. These policies do not work. The banks simply make multiple advances in one statement period, such that the last advance is paid back the second statement period, and the subsequent consecutive advance falls in the third statement period. Voila: consecutive monthly advances with a skipped statement period in between.

Instead, the banks should not make advances until at least one statement cycle after the customer has paid the last advance. This is the only way to prevent the cycle of borrow, payment, fee, borrow, payment fee month after month.

Banks should characterize advances as credit products and stop marketing them as bank account features.

Both Wells Fargo and US Bank market advances as account features. The online prompts for requesting an advance are on webpages designed for account management and next to frequently used basic features such as checking balances. By comparison, both banks market credit card and other credit options using tabs and prompts that clearly marked and take the customer to an obviously different section of the online banking site.

Customers should be able to compare advances against other credit options side by side on the bank website. Standard disclosure rules should apply such as stating the Annual Percentage Rate. In California, storefront payday lenders are required to state APRs. Banks should be required to do no less.

Banks should not be relying on fees from these products.

The OCC and the FDIC should examine the fee revenue generated by advances. High revenue reflective of repeat borrowing should indicate poor underwriting, inappropriate payment terms, inadequate disclosures of costs, lax eligibility standards, or all of the above. Significant fee revenue from areas with high concentrations of low income households or of people who are African-American, Latino, Asian or another racial or ethnic minority should trigger an investigation for violations of the Fair Lending and Equal Credit Opportunity Acts.

Conclusion

CRC has already heard banks threaten to stop offer any form of small dollar credit if these guidelines are adopted, thereby pushing customers to more expensive storefront lenders. These are the same disingenuous scare tactics that storefront payday lenders use, threatening to close up shop and leave customers vulnerable to more expensive internet and tribal lenders. To all them we say: good riddance.

None of these products, including bank deposit advances as currently structured, resemble the small dollar loans that customers actually need. We support the OCC and the FDIC recommendation that banks should offer reasonably priced small-dollar loans at reasonable terms to their customers, which if structured properly, can provide a safe and affordable means for borrowers to transition away from reliance on high-cost debt products that do not appropriately serve their needs.

With great appreciation for the hard work of tending to the needs of seniors, we thank you for the opportunity to submit these comments.

Sincerely,

Andrea Luquetta

Andrea Luquetta, Esq.
Policy Advocate