November 29 , 2012

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RE: Wells Fargo CRA Examination, Comments on Payday Loan Product

We write to urge that Wells Fargo's direct engagement in payday lending have a significant negative impact on its upcoming Community Reinvestment Act (CRA) evaluation because, as the OCC has recognized, payday lending harms consumers—often families CRA is especially intended to ensure that banks serve.

CRA's objective is to ensure that financial institutions meet the banking needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods and individuals.[1] This legal obligation is considered a *quid pro quo* for the valuable public benefits financial institutions receive, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window.[2]

In contradiction to this obligation, Wells Fargo makes payday loans. The bank calls its product a "direct deposit advance service," but it is structured just like a loan from a payday loan storefront, carrying a high-cost (averaging 270% in annualized interest)[3] combined with a short-term balloon repayment (averaging just 10 days).[4] In its own advisory letter addressing payday lending, the OCC notes that "payday loans" are "also known as 'deferred deposit advances.'"[5]

For customers with direct deposit of wages or public benefits, Wells Fargo will advance the pay in increments for a fee of $7.50 per $100 borrowed.[6] The bank deposits the loan amount directly

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[1] 12 U.S.C. 2901 *et seq*.

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

[3] Center for Responsible Lending, "Big Bank Payday Loans," CRL Research Brief, July 2011, *available* at http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[4] *Id.*

[5] OCC Advisory Letter, AL 2000-10, Payday Lending, http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf; FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005 [hereinafter OCC Advisory Letter on Payday Lending.]

[6] 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 [hereinafter Wells Fargo Agreement].

into the customer's account and then repays itself the loan amount, plus the fee, directly from the customer's next incoming direct deposit.[7] If direct deposits are not sufficient to repay the loan within 35 days, the bank repays itself anyway, even if the repayment overdraws the consumer's account,[8] triggering more costs through overdraft fees.

CRA requires that banks serve communities' credit needs,[9] but the data show that these short-term, high-cost loans do the opposite, leading to repeat loans that not only leave borrowers' needs unmet but leave them affirmatively worse off than before the lending began.

Non-bank payday borrowers routinely find themselves unable to repay the loan in full plus meet their expenses for the next month without taking out another payday loan. CRL's 2009 analysis of loan-level storefront data found that, of loans made to repeat borrowers, *94 percent* were opened within one month of the borrower's previous loan.[10] Thus, the large majority of all payday loan volume is the result of trapped borrowers being churned, effectively to repay their original payday loan, rather than an effective response to a need.[11]

Our analysis of actual checking account activity finds the cycle of repeat loans occurs with bank payday loans as well: *On average, bank payday borrowers are in debt for 175 days per year. The typical borrower takes out 16 bank payday loans within twelve months, with many borrowers taking out 20 or even 30 or more loans within one year*.[12]

Wells Fargo has not presented to us or others, to our knowledge, any data inconsistent with our findings—no data indicating that its payday product does not result in repeat, high-cost loans.[13]

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[7] *Id.* The bank has recently altered the terms of the program to allow for a "daily expenses buffer" whereby the first $100 of a direct deposit will not be used for repayment. This small change does not alter the fundamental structure of the product—very high cost with very short-term balloon repayment—that leads to a long-term cycle of debt.

[8] *Id.*

[9] 12 U.S.C. 2901.

[10] Leslie Parrish and Uriah King, *Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76 Percent of Total Volume,* Center for Responsible Lending, 7/9/09, available at: http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

[11] *Id.* The study found that 76 percent of all payday loans were generated by borrower churn. Researchers arrived at this estimate by excluding the following loan categories from the total volume of payday lending: loans made to borrowers who take out a single loan in a year, initial loans made to borrowers with more than one loan in a year, and subsequent loans made to repeat borrowers that are not opened during the same pay period in which the previous loan was repaid.

[12] "Big Bank Payday Loans." Borrowers remain in this cycle of debt despite "protections" banks have in place like "installment options" and "cooling-off periods," which, as with storefront payday lending, simply do not stop the cycle of repeat loans.

[13] To the contrary, Wells Fargo has on occasion acknowledged the problem of repeat use: "Many [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken." Wells Fargo insider quoted in David Lazarus, *120% rate for Wells' Advances*, San Francisco Chronicle, Oct. 6, 2004.

Rather, the distinctions it has offered to distinguish its product from other payday loans have been superficial. The bank has said that its borrowers must have an established relationship with the bank and recurring direct deposit.[14] An established relationship does not change that the loan is a payday loan. And that the bank has access to the customer's next direct deposit better illustrates a key *similarity* with storefront payday loans, where the lender has access to the borrower's post-dated check.

The bank also often notes that the product is intended for emergencies and not for long-term use.[15] Again, this is a common claim of the payday lending industry, even as the industry acknowledges that profitability depends on long-term use.[16]

Moreover, the "protections" Wells Fargo points to—no rollovers,[17] cooling-off periods,[18] and payment plans[19]—do not stop the cycle of repeat loans; instead, the very existence of these

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[14] *See, e.g.*, Donna Fuscaldo, *Direct deposit loans: ready cash, high fees*, Bankrate, Nov. 16, 2011 (quoting Richele Messick, spokesperson for Wells Fargo).

[15] *See, e.g.*, Fuscaldo, *id.* ("While Messick says the bank makes it clear this is an expensive form of credit, she says there is a need for this product because it's designed to help customers through an emergency situation. 'It's not intended to solve longer-term financial needs,' Merrick says").

[16] The Community Financial Services Association (CFSA), the payday industry trade association, states the following on its website: "A payday advance is designed to provide short-term financial assistance. It is not meant to be a long-term solution" (http://cfsaa.com/what-is-a-payday-advance/is-a-payday-advance-appropriate-for-you.aspx, last visited November 29, 2012). Yet payday lending industry representatives have often acknowledged that repeat borrowers are extremely important to them. Several examples are cited in Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are only proven payday lending reform*, Center for Responsible Lending (Dec. 13, 2007), at 11-12, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf: "A note about rollovers. We are convinced the business just doesn't work without them" (Roth Capital Partners, First Cash Financial Services, Inc., Company Update, July 16, 2007); "We saw most of our customers every month—a majority came in every month" (Rebecca Flippo, former payday lending store manager, Henrico County, VA); "This industry could not survive if the goal was for the customer to be 'one and done.' Their survival is based on the ability to create the need to return, and the only way to do that is to take the choice of leaving away. That is what I did" (Stephen Winslow, former payday lending store manager, Harrisonburg, VA). Industry researchers and analysts have noted the same: "The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers" (Michael Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly*, Vol. 17, No. 1 (February 2003); "We find that high-frequency borrowers account for a disproportionate share of a payday loan store's loan and profits… the business relies heavily on maximizing the number of loans made from each store" (Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf).

[17] The bank has noted that it does not technically allow "rollovers," where one loan is repaid directly with the funds of another. But state law provisions supported by the payday lending industry have long prohibited technical rollovers of payday loans while allowing back-to-back loans, where the borrower pays off the loan but then borrows back their payment with another payday loan either immediately or within a few days—a distinction without a difference. *See, e.g.*, Jennifer Bjorhus, *Report Rips Banks on Payday Loans*, Star Tribune, April 17, 2012 ("San Francisco-based Wells Fargo said another key difference is that, unlike with payday lenders, it doesn't roll over or extend the advances. Instead, the amount is automatically repaid with the customer's next direct deposit, whenever that is.") For the payday industry trade association's endorsement of limits on rollovers, *see* "Best Practices for the Payday Advance Industry," CFSA, *available at* http://cfsaa.com/cfsa-member-best-practices.aspx.

"protections" is indicative that the product creates a debt trap. The payday lending industry trade association's endorsement of such "protections,"[20] even as they acknowledge that their profitability depends on long-term use of the product,[21] is only further proof that these "protections" do not stop the cycle of debt.

Thus, there is no question that Wells Fargo's product is indeed a payday loan: Though it may be "also known as a deferred deposit advance" as the OCC noted in 2000,[22] it is structured like a payday loan and it results in the same long-term cycle of debt.

Numerous studies have shown that, far from meeting consumers' needs as CRA requires, the debt trap caused by payday lending has serious negative consequences for borrowers, including higher rates of bank account closures,[23] delinquency on other debts,[24] and even bankruptcy.[25] And payday lending has a particularly adverse impact on African Americans and Latinos, as a disproportionate share of payday borrowers come from communities of color.[26] For a more

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[18] Wells Fargo's "cooling off" period, which currently requires a one-month period without a loan after six consecutive months with a loan, allows borrowers to be in payday loans eleven out of twelve months in the year. Wells Fargo Agreement, *supra*; *see* Pamela Yip, *Banks' 'deposit-advance' loans just another name for payday lending*, The Dallas Morning News, Nov. 25, 2012 (quoting Wells Fargo spokesperson Richele Meddick: "If a customer uses this service for six consecutive statement cycles, we ask them to take a break because we don't want them to use this for a long period.")

[19] Wells Fargo'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 for three consecutive months and have at least $300 outstanding. Wells Fargo Agreement, *supra*.

[20] CFSA Best Practices, *supra*.

[21] *See* footnote 17, above.

[22] OCC Advisory Letter on Payday Lending.

[23] *See*, *e.g.*, Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School, 12/3/08, *available at* www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf.

[24] One study found that once credit card users began borrowing from payday lenders, they became 92 percent more likely to become delinquent on their credit card payments. Sumit Agarwal, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?*, Federal Reserve Bank of Chicago, Vanderbilt University Law School, and University of Pennsylvania, 1/13/09, *available at* http://www.nber.org/papers/w14659. In addition, a study comparing low- and middle-income households in states with and without access to payday lending found that those who could gain access to payday loans were more likely to have difficulty paying bills or to have to delay medical care, dental care, and prescription drug purchases. Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, Kellogg School of Management, Northwestern University, 1/3/09, *available at* www.kellogg.northwestern.edu/faculty/melzer/Papers/realcosts_melzer_07.02.09.pdf.

[25] Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania, 10/10/08, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

[26] Limited data on the race and ethnicity on payday borrowers have been collected. For example, a June 2008 California Department of Corporations survey found that, although they represent about one-third of the overall state population, over half of California payday borrowers are African American and Latino. *See* California Department

detailed account of Wells Fargo's payday loan product, the long-term cycle of high-cost debt it creates, and the harms payday loans inflict on borrowers, please see our 2011 comment letter to the OCC on its proposed guidance addressing deposit-related credit products, attached to this letter.[27]

The OCC has long expressed concern about payday lending generally, and in particular about the repeat loans payday lending generates. Its 2000 payday lending guidance cautioned that payday lending "can pose a variety of safety and soundness, compliance, consumer protection, and other risks to banks."[28] It highlighted concerns about multiple renewals, noting that "renewals without a reduction in the principal balance . . . are an indication that a loan has been made without a reasonable expectation of repayment at maturity."[29] And it cited the agency's general guidance on abusive lending, which identifies "loan flipping, i.e., frequent and multiple refinancings" as a characteristic of abusive lending.[30]

Around the time it issued this 2000 guidance, the OCC inspected the four national banks that were partnering with storefront payday lenders and brought enforcement actions in each case to terminate those partnerships.[31]

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of Corporations, "Payday Loan Study (Updated June 2008)," *available at* http://www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf. Moreover, researchers using a database of a large Texas-based payday lender found that African Americans (who make up 11 percent of the total adult population) made up 43 percent of payday borrowers and Latinos (who make up 29 percent of the total adult population) made up 34 percent of payday borrowers. See Table 1 of Skiba and Tobacman. *Do Payday Loans Cause Bankruptcy?*, *supra*. In addition, a survey conducted by Cypress Research Group for the payday lending industry found a disproportionate share of borrowers were African American; however, the survey did not find that Latinos made up a disproportionate share of payday borrowers. *See Payday Advance Customer Satisfaction Survey*, Cypress Research Group, May 2004.

This disproportionate share is even more significant because African Americans and Latinos are much less likely to have a checking account than whites—a basic requirement of getting a payday loan—which would lead one to believe that the concentration of payday lenders should be lower than in white neighborhoods. The Federal Reserve's Survey of Consumer Finances found that 19.4 percent of non-white households do not have a bank account, compared with less than five percent of whites. See Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore. *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances.* Federal Reserve Bulletin, February 2006.

[27] *See* Comments of Center for Responsbile Lending, Consumer Federation of America, and National Consumer Law Center (on behalf of its low-income clients), to the OCC on its proposed guidance on depos-trelated consumer credit products, Aug. 8, 2011, pp. 4-5 , 7-35, *available at* http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/comments-to-occ-on-overdraft-08092011.html.

[28] OCC Advisory Letter on Payday Lending.

[29] *Id.*

[30] OCC AL 2000-7 on Abusive Lending Practices. *See also* OCC AL 2002-3 on Predatory and Abusive Lending Practices.

[31] OCC, Annual Report, Fiscal Year 2003, p. 17. *See also*, Jean Ann Fox, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," Consumer Federation of America, March 30, 2004 at 17

More recently, the OCC testified before Congress that payday lending is categorically "unsafe and unsound and unfair to consumers"[32] and that the profitability of payday loans "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt."[33] The agency further noted the importance of the protections that the Military Lending Act (MLA) provides members of the military and their dependents by "restricting the cost and terms of . . . *abusive credit products*"[34]—a protection that Wells Fargo's payday lending product grossly undermines, including with branches operating directly on military bases.[35]

Historically, the effectiveness of CRA has been limited because its primary enforcement mechanism, the rating system, has been inflated. It has been too easy for institutions to receive positive ratings notwithstanding harmful lending practices. The FDIC's payday lending guidelines explicitly address CRA concerns raised by payday lending, cautioning that "payday loans to individuals who do not have the ability to repay, or that may result in repeated renewals or extensions and fee payments over a relatively short span of weeks, do not help to meet credit needs in a responsive manner."[36] We urge the OCC to do the same. We urge the agency to refuse to condone payday lending by Wells Fargo directly, just as it refused to allow banks to make payday loans through partnerships. We urge you to give CRA the meaning it was intended to have, by ensuring that making payday loans—a product that the agency has determined is unfair to consumers—has a significant negative impact on Wells Fargo's CRA rating.

Thank you for your consideration of our comments. If you would like to discuss them further, please do not hesitate to contact us.

Sincerely,

Center for Responsible Lending
National Consumer Law Center (on behalf of its low-income clients)

cc: Mr. Barry Wides, Deputy Comptroller for Community Affairs

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

[33] *Id.*

[34] *Id.* at 5 (emphasis added).

[35] Wells Fargo operates on the following bases: Fort Benning (GA), Fort Gordon (GA), Joint Base McGuire-Dix-Lakehurst (NJ), Holloman AFB (NM), Kirtland AFB (NM), Minot AFB (ND), Fort Jackson (SC), Shaw AFB (SC), Fort Bliss (TX), and Hill AFB (UT). Jean Ann Fox, *The Military Lending Act Five Years Later*, Consumer Federation of America (May 29, 2012) at 55, *available at* http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf.

[36] FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005.