



OCC AND FDIC GUIDANCE ON SUPERVISORY CONCERNS AND EXPECTATIONS REGARDING DEPOSIT ADVANCE PRODUCTS

The Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”) (collectively, “the agencies”) each recently issued final supervisory guidance titled *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products* (“Guidance”), which describes the agencies’ expectations for deposit advance products.¹ A deposit advance product is a type of small-dollar, short-term credit product offered to customers who maintain a deposit account, reloadable prepaid card, or similar deposit-type account at a bank.²

The Guidance is intended to ensure that banks are aware of the potential credit, reputation, operational, legal, compliance, and other risks associated with deposit advance products. The Guidance supplements each agency’s existing guidance on payday lending and on subprime lending.³

The OCC and the FDIC expect the financial institutions that they supervise to apply the principles of safe and sound banking practices and consumer protection set forth in the Guidance to any deposit advance products they offer. The OCC and the FDIC will take appropriate supervisory action to address any unsafe or unsound banking practices associated with these products, to prevent harm to consumers, and to ensure compliance with applicable laws.⁴

The Guidance describes supervisory concerns with deposit advance loans, safety and soundness risks, and compliance and consumer protection-related concerns and expectations. A key element of the Guidance provides that a bank’s underwriting and credit policies should ensure that the consumer can repay a deposit advance loan, including fees, according to its terms while paying for typical recurring expenses for food, housing, transportation,

health care, and other outstanding debts.⁵ Among other factors, a bank should reevaluate the customer's eligibility and financial capacity for a deposit advance loan at least every six months.⁶ Both the OCC and the FDIC consider that a bank's failure to assess a consumer's ability to repay a deposit advance loan presents safety and soundness risks.⁷

Another key element of the Guidance is a "cooling off period," which provides that a customer's deposit advance loan, including fees, should be repaid in full before a bank extends another such loan to the customer, and a bank should not offer more than one loan per monthly statement cycle.⁸ A customer should have a cooling off period of at least one monthly statement cycle after the repayment of a deposit advance loan before the bank extends another advance to prevent repeat use. These provisions are designed to address the agencies' concerns that customers can become dependent on deposit advance products to meet their daily expenses and that current practices for cooling off periods are ineffective at preventing repeat usage of high-cost and short-term deposit advance products for long-term borrowing needs.⁹

The OCC and the FDIC distinguish deposit advance products from small-dollar credit products. The agencies encourage banks to offer small-dollar credit products to their customers at reasonable terms in a manner consistent with safety and soundness and other supervisory considerations, stating that small-dollar credit products do not present the same level of supervisory risk as deposit advance products, which share a number of characteristics seen in traditional payday loans such as high fees, very short lump-sum repayment terms, and inadequate attention to the consumer's ability to repay the loan.¹⁰ Following a two-year study of small-dollar lending, the FDIC concluded that safe and affordable small-dollar lending is feasible for banks.¹¹

The Board of Governors of the Federal Reserve System ("Federal Reserve Board") has not issued Guidance to state-chartered member banks that is as comprehensive and detailed as the OCC and FDIC Guidance. On April 25, the Federal Reserve Board issued a Statement on Deposit Advance Products ("Statement") to emphasize to state-chartered member banks the significant consumer risks associated with deposit advance products in light of publication

by the Consumer Financial Protection Bureau ("CFPB") on April 24 of a white paper titled *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings*. The white paper's "key finding: payday loans and deposit advance products can become debt traps for consumers."¹² According to the Federal Reserve Board's Statement, 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.¹³ Additionally, as with the OCC and FDIC Guidance, the Federal Reserve Board's Statement requires state member banks to comply with all applicable federal and state laws and regulations and holds state member banks accountable for closely monitoring third-party vendor practices and outcomes.

The CFPB has authority to examine and regulate nonbank payday lenders and large banks, thrifts, and credit unions with more than \$10 billion in assets. The CFPB published examination procedures for short-term, small-dollar lending, commonly known as payday lending, in January 2012. On September 17, 2013, the CFPB released guidelines to examiners regarding identification of consumer harm and risks related to violations of the Military Lending Act ("MLA") when supervising payday lenders.¹⁴ The CFPB indicated that the agency is committed to ensuring compliance with the MLA, including the 36 percent cap on annual percentage rates.¹⁵ The CFPB has not issued guidance comparable to the OCC's and FDIC's Guidance, nor has it promulgated a regulation covering payday lending. The most recent CFPB semiannual regulatory agenda indicates that the CFPB "has been engaged in extensive research and analysis concerning payday loans, deposit advance products, and bank overdraft programs..."¹⁶

SUPERVISORY EXPECTATIONS IN THE OCC AND FDIC GUIDANCE

Deposit advance lending raises substantial safety and soundness and consumer protection concerns whether conducted directly by a bank or by a third party, according to the Guidance. For these reasons, OCC and FDIC examinations will focus on potential safety and soundness issues and compliance with applicable consumer protection laws.

The Guidance states, “It is important that a bank’s deposit advance products be reviewed by counsel for compliance with all applicable laws prior to implementation.”¹⁷

Examiners will focus on the following topics, each of which is described below in order:

- Credit Quality
- Underwriting and Credit Administration Policies and Practices
- Capital Adequacy
- Over-Reliance on Fee Income
- Allowance for Loan and Lease Losses
- Consumer Compliance
- Operational Risk and Third-Party Relationships
- Board and Management Oversight

A bank’s failure to adhere to the factors in the Guidance could be the basis for supervisory action up to and including an administrative enforcement order and fine. The principal supervisory expectations, factors, and admonitions in the Guidance follow.

Credit Quality. Examiners have discretion to classify adversely individual loans that exhibit signs of credit weakness regardless of delinquency status and may classify adversely consumer portfolios or portions of such portfolios in which underwriting standards are weak and present unreasonable credit risk.

- A bank should adequately review a customer’s repayment capacity to evaluate whether the customer will have the ability to repay the loan without additional deposit advance borrowing.
- A bank should monitor for repeated or extended use of deposit advance products. Deposit advance loans that are accessed repeatedly or for extended time periods may be indicative of the customer’s inability to repay and inadequate underwriting.

Underwriting and Credit Administration Policies and Practices. Examiners will evaluate a bank’s underwriting and administration policies and practices as part of the credit quality review.

- A bank should have well-documented eligibility and underwriting criteria that ensure that the customer can repay the loan, including all fees and expenses, according to its terms while continuing to pay typical recurring and other necessary expenses such as those for food, housing, transportation, health care, and other borrowing.
- Eligibility and underwriting criteria should ensure that customers are able to meet these requirements without the need for repeat borrowing.
- While a bank may decide to review a customer’s credit report in evaluating financial capacity or ongoing eligibility for a deposit advance product, a bank is not expected to review a customer’s credit report for purposes of determining ability to repay.
- A bank should maintain criteria that prevent churning and prolonged period of use of deposit advance products.
- Underwriting for deposit advance products should occur before the product is obtained and should be monitored on an ongoing basis.
- Repeat borrowings may indicate weak underwriting and be subject to criticism in a bank’s Report of Examination and considered in a bank’s examination rating.
- A bank should have written underwriting policies for deposit advance loan products that are approved by the bank’s board of directors and consistent with the bank’s general underwriting standards and risk appetite. The factors addressed by a bank’s written underwriting policies include:
 - The length of a customer’s deposit relationship with the bank: The agencies will consider no less than a six-month time period to be sufficient to assess a customer’s eligibility for a deposit advance loan.
 - Classified credits: A customer who has delinquent or adversely classified loans with the bank should be ineligible for a deposit advance product.
 - Financial capacity: A bank should conduct an evaluation of the customer’s financial capacity, including income. The financial capacity assessment should include:
 - An analysis of the customer’s account for inflows (recurring deposits) and outflows (checks, credit, and customer withdrawals) over at least a six-month consecutive time period. Lines of credit, including overdrafts, and drafts from savings should not be considered inflows.

- A bank should determine whether an installment repayment is more appropriate for the customer based on the results of the above analysis.
- **Cooling off period:** A bank should not extend a subsequent deposit advance loan until the customer has paid the prior deposit advance loan in full, together with all applicable fees, and a bank should not offer more than one loan per monthly statement cycle. A customer should have a cooling off period of at least one monthly statement cycle after the repayment of a deposit advance loan before the bank extends another advance to prevent repeat use of the short-term product.
- **Increasing deposit advance credit limits:** A bank should not increase a customer's available credit amount without a full underwriting reassessment in accordance with the bank's underwriting policies and the factors described in the Guidance. Credit limit increases should be initiated only by customer request.
- **Ongoing customer eligibility:** A bank should reassess the customer's eligibility and capacity for a deposit advance loan no less than every six months, and it should identify risks that may negatively affect a customer's eligibility such as where a customer is overextended regarding total credit obligations or has repeat overdrafts. A bank should monitor for repeat usage and if alternative credit arrangements are needed, the bank should inform customers of available options.

Capital Adequacy. Generally, higher capital requirements apply to loan portfolios with higher-risk characteristics, and loans with subprime credit characteristics are higher-risk loans that may require higher capital levels.

Over-Reliance on Fee Income. The fees charged for deposit advance products should be based on safe and sound banking principles.

A bank should monitor for any undue reliance for its revenue and earnings on the fees it generates from deposit advance lending.

Allowance for Loan and Lease Losses ("ALLL"). The agencies' examiners will assess the adequacy of a bank's ALLL to absorb estimated credit losses attributable to the deposit advance loan portfolio. The examiners will also determine whether a bank has methodologies and analyses that demonstrate and document that the bank's ALLL is appropriate.

Consumer Compliance. Deposit advance products must comply with all applicable federal laws and regulations and certain state laws may also apply. A bank should monitor applicable laws and regulations for revisions and to ensure that its deposit advance products remain compliant.

The agencies' examiners will assess a bank's program for deposit advance products and lending for compliance with applicable consumer protection statutes and regulations, including the Truth in Lending Act, the Electronic Funds Transfer Act, the Truth in Saving Act, the Equal Credit Opportunity Act, and section 5 of the Federal Trade Commission Act prohibiting unfair or deceptive acts or practices.

Operational Risk and Third-Party Relationships. A bank is responsible for ensuring that processes, systems, and internal controls are appropriate for the delivery of deposit lending products to the customer in a safe and sound manner and in compliance with applicable laws and regulations, whether delivered by the bank or a third party. The agencies' examiners will review the risks associated with all material third-party relationships and activities. In high-risk situations, examiners may conduct on-site third-party reviews in accordance with the agencies' legal authorities.

Oversight by the Board of Directors and Management. The agencies' examiners will assess the adequacy of oversight by a bank's board of directors and the ability of a bank's management to carry out a deposit advance program. Examiners will assess whether bank management has established controls and carried out a rigorous analytical process to identify, measure, monitor, and manage risks associated with deposit advance products.

- A bank should maintain adequate oversight and quality control to minimize exposure to financial loss, reputation damage, and supervisory action.
- A bank's compliance management system should ensure compliance with applicable federal and state laws, rules and regulations, and internal policies and procedures.
- A bank's management should provide appropriate oversight and sufficient qualified personnel for monitoring of deposit advance programs.
- Oversight activities should be reported periodically to a bank's board of directors or designated committee of the board. Reports to the board of directors or a designed committee of the board should include weaknesses that have been identified, which a bank should address promptly.

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ENDNOTES

- 1 *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products*, Department of the Treasury, Office of the Comptroller of the Currency, 78 Federal Register 70624 (November 26, 2013) ("OCC Guidance") and *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Product*, Federal Deposit Insurance Corporation, 78 Federal Register 70552 (November 26, 2013) ("FDIC Guidance").
- 2 A definition of "deposit advance" appears at 78 Federal Register 70625 (OCC) and 78 Federal Register 70553 (FDIC). Footnote 3 of each agency's Guidance explains that the Guidance does not apply to banks' overdraft lines of credit because overdraft lines of credit generally do not have repayment characteristics that are similar to deposit advance products (OCC Guidance, p. 70623; FDIC Guidance, p. 70553).
- 3 OCC Advisory Letter AL 2000-10, *Payday Lending* (November 27, 2000); OCC Bulletin 2001-6 and FDIC Financial Institutions Letter FIL-9-2001, *Expanded Guidance for Subprime Lending Programs*, jointly signed by the OCC, FDIC, Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision (January 31, 2001); FDIC Financial Institutions Letter FIL-14-2005, *Guidelines for Payday Lending* (February 25, 2005); and FDIC Financial Institutions Letter FIL-50-2007, *Affordable Small-Dollar Loan Guidelines* (June 19, 2007).
- 4 OCC Guidance, p. 70628; FDIC Guidance, p. 70556.
- 5 OCC Guidance, p. 70629; FDIC Guidance, p. 70556.
- 6 OCC Guidance, p. 70629; FDIC Guidance, p. 70557.
- 7 *Id.*
- 8 Each Guidance refers to the interagency *Expanded Guidance for Subprime Lending Programs* (2001), for the proposition that a loan to a borrower who does not have the capacity to repay the loan according to its terms from a source other than the pledged collateral (which, for a deposit advance loan, means the capacity to repay from the borrower's direct deposit), is generally considered unsafe and unsound and would be criticized as imprudent in the Report of Examination for a bank. OCC Guidance, p. 70629, footnote 25; FDIC Guidance, p. 70557, footnote 25.
- 9 See OCC Guidance, p. 70627; FDIC Guidance, p. 70554.
- 10 OCC Guidance, pp. 70627, 70630; FDIC Guidance, pp. 70554, 70557-70558.
- 11 See *FDIC Model Safe Accounts Pilot Final Report*, FDIC (April 2012). This FDIC study was conducted from 2007-2009.
- 12 See "The CFPB Finds Payday Loans and Deposit Advances Can Trap Consumers in Debt, Sustained Use of Loans Raises Consumer Protection Concerns," CFPB Press Release (April 24, 2013); In the press release, CFPB Director Cordray stated, "This comprehensive study shows that payday and deposit advance loans put many consumers at risk of turning what is supposed to be a short-term emergency loan into a long-term expensive debt burden." The CFPB White Paper can be accessed at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.
- 13 *Statement on Deposit Advance Products*, Board of Governors of the Federal Reserve System, CA Letter 13-7 (April 25, 2013).
- 14 The CFPB examination procedures for short-term, small-dollar lending, including the recent amendments related to loans to servicemembers, may be accessed at http://files.consumerfinance.gov/f/201309_cfpb_payday_manual_revisions.
- 15 See "CFPB Lays Out Guidelines for Protecting Servicemembers in the Payday Lending Market: CFPB Watching for Military Lending Act Violations in its Examinations of Payday Lenders," CFPB Press Release (September 17, 2013).
- 16 CFPB Semiannual Regulatory Agenda, RIN 3170-AA40, Fall 2013.
- 17 OCC Guidance, p. 70627; FDIC Guidance, p. 70555.

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