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TESTIMONY OF

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Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
U. S. HOUSE OF REPRESENTATIVES

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Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, my name is Barry Wides and I am the Deputy Comptroller for Community Affairs of the Office of the Comptroller of the Currency (OCC). In this position, I oversee the Community Affairs Department which supports the OCC's mission to ensure the banks we regulate provide fair access to financial services and fair treatment of customers. The Community Affairs Department is specifically focused on supporting national banks and federal savings associations ("banks and thrifts") in their efforts to be leaders in providing consumer credit and retail services to underserved communities and individuals.

I would like to take the opportunity to thank the Subcommittee for inviting the OCC to testify regarding consumer credit and the types of products that are available to meet the small dollar credit needs of a spectrum of borrowers. My testimony will first discuss a number of credit products that banks and thrifts offer their customers and provide details on some specific initiatives. Next I will describe how consumer credit is underwritten and the OCC's regulatory and supervisory framework for banks and thrifts that offer consumer credit products. Finally, my testimony will discuss how consumer lending is evaluated under the Community Reinvestment Act (CRA) and the OCC's activities to encourage banks and thrifts to address the financial services needs of unbanked and underbanked consumers.

Consumer Credit Products

Banks and thrifts play a crucial role in providing credit to consumers in communities across the nation. With $617.7 billion in credit card and other revolving debt plans outstanding, banks and thrifts provide the lion's share of unsecured consumer lending in the U.S.[1]

[1] Amount held by national banks and federal savings associations as of June 30, 2011. "Other Revolving Plans" is defined as all extensions of credit to individuals for household, family, and other personal expenditures arising from prearranged overdraft plans and other revolving credit plans not accessed by credit cards.

Consumer credit offered by banks and thrifts comes in many forms—unsecured and secured credit cards, term consumer installment loans, and lines of credit linked to checking accounts. Overdraft protection lines of credit can also help meet immediate temporary financing needs.

Credit cards play a critical role in providing households with access to credit with a flexible repayment schedule. The FDIC's "Survey of Bank Efforts to Serve the Unbanked and Underbanked" found that about one-third (36 percent) of banks offer consumer credit cards.[2] In addition to being used to pay directly for items, many credit cards also offer consumers the option to obtain a cash advance through an ATM or by writing a check that draws on the credit card.

Credit cards serve customers with a wide range of credit profiles and bear either fixed or adjustable interest rates. Periodic payments based on a percentage of the outstanding balance are required, but a customer can carry an outstanding balance up to the credit limit. Lack of an established banking relationship does not preclude a borrower from being approved for a credit card.

Secured credit cards are another alternative that many banks and thrifts offer to consumers who have damaged credit or have not yet established credit. Customers agree to hold a set amount of funds in a collateral account, such as a savings account, money market account, or certificate of deposit. The financial institution then provides a secured credit card up to the amount held in that account, which offers a customer the features, convenience, and security that traditional unsecured credit cards provide. The consumer makes monthly payments and can carry an outstanding balance on the secured card at interest rates comparable to prevailing unsecured credit card rates. If the consumer fails to make payments as agreed, the financial institution may offset the outstanding debt from the collateral account.

Once the secured card holder establishes a history of good payment performance, which banks typically set between 12 and 18 months, the customer is generally eligible to apply for an unsecured credit card. With good payment performance, some issuers might reduce the collateral amount prior to the time when a consumer may graduate to an

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[2] The survey results were released on February 5, 2009. For complete results, see http://www.fdic.gov/unbanked surveys/.

unsecured product (i.e. from one dollar in collateral for each dollar of credit offered to 50 cents for each dollar of credit offered). Also, banks and thrifts report customers' on-time payment performance to credit bureaus, which helps the consumer to build a credit history for a broader set of credit products as well.

In 2004, the OCC took the lead in preventing unfair and deceptive practices in connection with secured credit cards. Guidance was issued that cautioned national banks to avoid charging fees and costs that consumed much of the credit extended.[3] The guidance also recommended practices for banks to follow when marketing secured credit cards. Important reforms were also enacted into law by Congress as part of the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, so that in the first year, fees on a secured credit card may not exceed 25 percent of the account credit limit.

Some banks and thrifts offer customers an unsecured, open-end line of credit. Usually this line of credit is offered as a revolving account where the consumer can request additional draws up to the credit limit and make monthly payments to reduce the balance. A line of credit may be linked to a checking account, so that if a customer overdraws the account, funds are automatically transferred from the line of credit to cover the negative balance in the checking account. A 2008 FDIC study found that 50.1 percent of the banks participating in the study offered an overdraft line of credit program.[4]

Banks and thrifts also offer unsecured installment consumer loans—where the borrower receives the loan proceeds at origination and repays the loan in installments over a set time period. The FDIC survey on the unbanked and underbanked found that closed-end unsecured personal loans for amounts under $5,000 were offered by approximately two-thirds (69 percent) of the respondents. Turn-around time for originating these loans is generally quick, which is a critical element when competing against non-depository institution lenders. However, credit underwriting standards expected of insured depository institutions can be a barrier for some customers.

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[3] OCC Advisory Letter 2004-4.

[4] FDIC Study of Bank Overdraft Programs, November 2008, at page 5. See http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf

Unsecured and secured installment loans are also offered by banks and thrifts that partner with retailers selling big ticket items, such as. large appliances, building supplies, and autos. The consumer applies for the loan at the retail store or car dealership, a credit report is ordered, and the bank underwrites and funds the loan, which is also serviced by the bank as installment payments are made.

Initiatives to Serve the Credit Needs of the Underserved

Studies have shown that low- and moderate-income individuals use credit products offered by alternative financial service providers more frequently than the population at large. Many consumers use this type of credit product to address emergency needs. Research conducted by the Consumer Federation of America shows that less than 30 percent of low-income households and less than half of moderate-income households have at least $500 in emergency savings.[5] Credit history is a significant barrier to mainstream credit for many. Reportedly 25.5 percent of the U.S. population have FICO scores below 599, and 9.5 percent have FICO scores between 600 and 649.[6]

Banks and thrifts have undertaken a number of initiatives to address unbanked and underbanked segments of the market that have traditionally relied on non-bank financial services providers to meet their credit needs. Some of these efforts are highlighted in the discussion that follows.

Many community banks and thrifts make traditional installment loans using flexible underwriting to address the specific credit needs of their communities. For example, for many years, Fraternity Federal Savings and Loan in Baltimore has offered its depositors small dollar consumer loans between $100 and $3,000. Repayment schedules are customized to match the borrower's ability to repay, and range from six months to five years. Interest rates vary depending on market rates, the amount of the

[5] Understanding the Emergency Savings Needs of Low- and Moderate-Income Households: A Survey-based Analysis of Impacts, Causes, and Remedies, Consumer Federation of America, November 2008, at http://www.consumerfed.org/elements/www.consumerfed.org/file/Emergency_Savings_Survey_Analysis_Nov_2008.pdf.

[6] Source: FICO, April 2010.

loan, and the term. There are no application fees. Automatic repayment from the deposit account can also be set up. No additional loans are permitted until prior loans are paid in full.

Beverly Bank and Trust, NA in Chicago, offers a small dollar loan program that serves borrowers with credit blemishes. The bank only uses manual underwriting for this loan program, reviewing the past two years of the applicant's credit history to evaluate payment performance, calculating the debt-to-income ratio for open trade accounts, and verifying income sources. In making its loan decision, the bank will evaluate any mitigating circumstances that might have contributed to harming the applicant's credit. If an applicant does not qualify for this loan program, the bank offers an alternative to help a customer rebuild credit. The bank provides an installment loan and its proceeds are invested in a certificate of deposit. With timely repayment of the loan, this approach is designed to help borrowers re-establish or improve their credit.

Some banks no longer offer unsecured consumer loans with installment repayment terms, but do provide credit cards allowing cash advances or offer lines of credit. Other large banks offer small dollar, open end lines of credit tied to checking accounts that are geared to customers who do not qualify for the bank's traditional suite of unsecured credit offerings. These programs are offered to bank customers who have recurring direct deposits into their account. Key Bank, NA, a large regional bank, rolled out a small dollar loan program geared to consumers who do not qualify for their traditional unsecured loan offerings. The bank offers its checking account customers a credit line that allows repayment over as long as five years. The interest rate is equivalent to credit card rates, payments are manageable, and advances can be transferred to a checking account at no cost. The consumer can also opt to allow automatic overdrafts to cover a negative balance in the checking account for a fee.

Other small dollar loan initiatives are being developed in conjunction with the Bank On Cities initiative whose programmatic goal is to eliminate barriers to entering the financial mainstream.[7] Bank On Cities is a program begun by the National League of Cities that offers a template for banks, community groups, and local government agencies

[7] More details regarding the Bank On Cities program may be found at http://www.nlc.org/find-city-solutions/iyef/family-economic-success/asset-building/bank-on-cities-toolkit.

to work together to reach out to unbanked and underbanked individuals who are using high-cost financial services and provide them with access to mainstream banking products. A number of cities, including large urban areas, have participated in this initiative. Common barriers that prevent these consumers from doing business with banks and thrifts include minimum balance requirements, monthly service charges, penalty fees or overdraft fees, and poor past performance with bank accounts. Banks and thrifts that participate in Bank On Cities initiatives strive to overcome these barriers by partnering with trusted community organizations that provide budgeting and financial counseling services. Products designed by banks and thrifts for these consumers include prepaid debit cards, savings options, direct deposit, and small dollar loans.

FDIC's Small Dollar Loan Pilot

Five national banks also participated in the FDIC's Small Dollar Loan Pilot, conducted in 2008 and 2009, the objective of which was to test how small dollar loans performed and whether these loans could be profitably originated in a safe and sound manner.[8] The five national banks that participated in this pilot originated approximately one-third of the loans made under the initiative. Four out of the five national banks had previously realized the need for a small dollar product in their communities and had been offering such a product when the FDIC pilot was initiated.

The pilot evaluated closed-end installment loans that offered amounts of up to $2,500 with terms longer than 90 days and interest rates at or below 36 percent (including origination and upfront fees). The pilot banks set their own underwriting policies and processes. While these processes tended to be more streamlined compared to other types of consumer lending to keep origination costs low, basic underwriting procedures such as evaluating credit reports and requiring proof of identity, address, and income were retained because they were deemed essential to managing credit risk on a safe and sound basis.

[8] The five national bank participants were Liberty National Bank (TX), Amarillo National Bank (TX), Armed Forces Bank, N.A. (KS), The First National Bank of Fairfax (MN), and National Bank of Kansas City (MO). The 28 banks participating in the pilot originated approximately 34,400 small dollar loans with a total principal balance of $40.2 million.

Participants concluded that these products served as a vehicle for building or retaining long-term banking relationships. The metrics reported by national banks fell well in line with the pilot's findings, with their product performance consistent with the figures reported from the pilot in terms of the cost, terms, and default rates associated with small dollar lending.[9]

In designing their small dollar loan programs, national banks went beyond the conventional underwriting process. From the outset, national banks adopted a "high touch" approach where, in addition to credit and income verification, the loan officer generally provided counseling for the customer or referred them to other nonprofit counseling resources.

In the underwriting evaluation, loan officers often took into consideration extenuating circumstances, such as temporary unemployment and medical expenses. Bankers evaluated debt-to-income ratios, bill payment behavior, and the customer's account management skills. Flexibility in setting loan terms helped loan officers to tailor loans to meet the customer's needs and ability to repay. And in cases where the loan became delinquent, the banks employed prompt follow-up and modification strategies to make sure the customers could bring the loan current and return to a positive payment performance.

Moreover, a special effort was made to help the customers move away from short-term financial solutions to longer term, more stable financial management—often in conjunction with financial counseling organizations and programs. National bankers repeatedly mentioned cases where individuals, who became customers through the small dollar loan program, built better credit and, over time, went on to use more traditional credit products, such as car loans, credit cards, and mortgages.

Underwriting Consumer Credit

For some individuals, access to traditional types of unsecured credit is limited, available only through labor intensive underwriting that is higher cost, or is entirely unavailable for those with significant credit issues. There are many reasons for this. A

[9] See "A Template for Success: "The FDIC's Small-Dollar Loan Pilot Program," FDIC Quarterly, Volume 4, No. 2, 2010.

younger individual or recent immigrant may not yet have established a credit history or has only started to do so. Previous late payment, repossession action, bankruptcy, or foreclosure may have damaged an individual's credit score. Unforeseen circumstances such as divorce, death of a family member, disability, high medical bills, or unemployment can threaten financial stability even for those who have previously maintained excellent credit.

Underwriting processes to evaluate a potential borrower's ability to repay can range from a review that evaluates a credit report or credit score and confirms identity to more in-depth underwriting procedures. Additional requirements may include calculation of a consumer's debt-to-income ratio;[10] verification of employment and income, social security number or individual taxpayer identification number; length of employment and residence at a current address; and whether the consumer is a renter or homeowner. The financial institution may also evaluate the quality of the banking relationship—how the customer has managed a checking account or whether the applicant is a current customer.

With near-instantaneous access to a consumer's credit information, quick turn-around times for underwriting loans are possible. The FDIC survey on the unbanked and underbanked noted that 80 percent of banks could originate small dollar loans in less than 24 hours, and 97 percent funded the loans in less than 48 hours. However, if a potential borrower has credit blemishes, a loan officer may need to take a more hands on approach and interview the customer to determine if there are mitigating circumstances. A financial institution may choose to approve a loan if credit problems occurred due to temporary unemployment or high medical expenses, as long as it is clear that the customer has otherwise properly managed credit and is now on better financial footing and has the capacity to repay the loan. This type of evaluation takes extra time and effort and is more costly than a customer scenario that doesn't include those issues.

New scoring models and databases have also been developed to evaluate "thin file" consumers who have not established a sufficient credit history, but who have shown that they are capable of managing recurring bills such as rent payments, utilities, and car

[10] Lenders are now required by the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, Pub. Law No. 111-24, which amends the Truth in Lending Act to evaluate the ability of the consumer to make the required payments under the terms of the account before opening a credit card account or increasing a credit limit on an existing account.

insurance, and that they are employed or have the resources to repay credit. Increasingly, alternative payment data are being compiled by credit bureaus and data warehouses. Companies have also developed new alternative credit scoring models that cover 60 to 90 percent of consumers with no or thin traditional credit.[11]

Regulatory and Supervisory Framework for Consumer Credit Products

Consumer credit products are subject to a variety of laws and regulations that are designed to ensure that consumers receive fair, unbiased treatment, and receive appropriate disclosures regarding the terms and conditions governing credit-related products. These include the various provisions of the Truth in Lending Act, the Fair Housing Act, and the Equal Credit Opportunity Act. Historically, rulemaking authority for consumer-credit related products has resided with the Board of Governors of the Federal Reserve System.

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Consumer Financial Protection Bureau (CFPB) is given rulemaking authority over certain federal consumer financial laws and is given jurisdiction for the supervision and enforcement of those laws for depository institutions with total assets of $10 billion or more. The OCC continues to be responsible for monitoring compliance with these laws by banks and thrifts with assets under $10 billion, and will also continue to examine and assess the risks these products may present to overall safety and soundness of banks and thrifts of any size.

The OCC's core mission is to assure the safety and soundness of the institutions subject to our jurisdiction and to ensure that those institutions support fair access to financial services and fair treatment of their customers. We carry out this mission through our on-going supervisory activities. Through these activities we evaluate banks' and thrifts' compliance with applicable laws, regulations, and supervisory requirements, and we assess whether they have adequate risk management systems, controls, and capital to support the size, scope, and complexity of their activities. Where we find weaknesses or violations, we direct management to take appropriate and timely corrective

[11] "Credit Scoring in Volatile Times," Vantage Score, June 29, 2009, http://www.vantagescore.com/docs/American_Banker_Insert_9-28-09.pdf.

action. Examiners do not tell bankers which loans to make or deny. However, they will assess whether such loans have been prudently underwritten and, with respect to consumer credit products, comply with all applicable consumer protection laws and regulations.

To provide consistency and continuity in our supervision, we organize our supervision programs around a common framework and national perspective that is then supplemented by the hands-on knowledge of our examiners. Our supervision by risk framework establishes a common examination philosophy and structure that is used at all national banks. This structure includes a common risk assessment system (RAS) that evaluates each bank's risk profile across eight risk areas – compliance, credit, interest rate, liquidity, operational, price, reputation, and strategic – and assigns each bank an overall composite safety and soundness rating and individual component ratings on the bank's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risks using the interagency Uniform Financial Ratings System (informally known as CAMELS) and an overall compliance rating using the interagency Uniform Interagency Consumer Compliance Rating System. We also have examination handbooks with examination procedures tailored to specific products and activities, including Retail Lending, Credit Card Lending, and interagency examination procedures for Fair Lending, Truth in Lending, and other consumer-related compliance laws. Specific examination activities and supervisory strategies are tailored to each bank's risk profile. These strategies are updated and approved annually. While tailored to each individual bank's risk profile, they also incorporate key agency supervisory priorities for the coming year. Given the volume and complexity of the literally hundreds of thousands of transactions that flow through the banking system, it is not feasible to review every transaction in each bank, or for that matter, every single product line or bank activity in each supervisory cycle. As a result, specific examination activities and supervisory strategies are tailored to each bank's risk profile. These strategies are updated and approved annually. While tailored to each individual bank's risk profile, they also incorporate key agency supervisory priorities for the coming year.

To reflect the different expectations for controls and risk management between large and small banks, our bank supervision programs and core examination procedures to determine a bank's RAS and CAMELS ratings are aligned across two primary lines of business: Midsize and Community Bank Supervision, and Large Bank Supervision.

Our community bank supervision program is built around our local field offices located in over 60 cities throughout the U.S. Every community bank is assigned to an examiner who monitors the bank's condition on an on-going basis and who serves as the focal point for communications with the bank. The frequency of our on-site examinations for community banks follows the statutory provisions set forth in 12 USC 1820(d), with on-site exams occurring every 12 to 18 months. The scope of these examinations is set forth in the OCC's Community Bank Supervision handbook and requires sufficient examination work and transaction testing to complete the core assessment activities in that handbook, and to determine the bank's RAS, CAMELS, and compliance ratings. On-site activities are supplemented by off-site monitoring and quarterly analyses to determine if significant changes have occurred in the bank's condition or activities. Each of our districts that oversee our community and mid-size bank programs has one or more lead examiners with specialized expertise in retail credit and consumer compliance issues. These examiners, along with our Washington, D.C. policy and legal staffs, serve as resources for our examination staff on complex issues that may arise in evaluating consumer credit products.

Our large bank program is organized with a national perspective. It is centralized and headquartered in Washington, D.C., and structured to promote consistent uniform coordination across institutions. As part of our large bank supervision program, we maintain on-site resident examination staff that conduct on-going supervisory activities and targeted examinations of specific areas of focus. This process allows the OCC to maintain an on-going program of risk assessment, monitoring, and communication with bank management and directors. Our resident large bank staff includes specialists and lead experts in retail credit and consumer compliance issues.

Community Reinvestment Act (CRA)

The CRA encourages banks and thrifts to offer needed credit products to low- and moderate-income individuals. The bank regulatory agencies' CRA guidance explicitly acknowledges the importance of small dollar loans as a means of serving the credit needs of the community. Programs that provide small, unsecured consumer loans in a safe and sound manner (i.e., based on the borrower's ability to repay) and with reasonable terms are one example specifically cited as a lending activity that is likely to be responsive in helping to meet the credit needs of many communities.[12]

Favorable CRA consideration may be given to loan programs that include a financial education component for consumers to help them avoid unfair or otherwise unsuitable products, as well as lending programs that feature reporting to consumer reporting agencies or that transition low- and moderate-income borrowers from loans with higher interest rates and fees to lower-cost loans. Reporting to consumer reporting agencies gives borrowers the opportunity to improve their credit histories and thereby improve their access to more competitive credit products.

Banks and thrifts may also receive positive CRA consideration for qualified investments in financial intermediaries, such as Community Development Financial Institutions, community loan funds, low-income credit unions and others, allowing these partners to offer credit to low- and moderate-income individuals.[13]

Banks and thrifts may also receive positive CRA consideration for providing credit counseling to low- or moderate income individuals—either directly or though affiliates or third parties if the services will help the institution meet the credit needs in its community.[14] For example, an institution that contracts with a community organization to provide counseling and help low- or moderate-income customers build a good credit profile or repair their credit as part of the institution's small dollar loan program may receive consideration for that indirect activity under the CRA service test.

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[12] See §II.22(a)—1 of the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, pages 11654-11655.

[13] See §II.12(t)—4 of the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, page 11652. Qualified investments include, but are not limited to, investments, grants, deposits, or shares in or to financial intermediaries (including Community Development Financial Institutions (CDFIs), Community Development Corporations (CDCs), minority- and women-owned banks and thrifts, community loan funds, and low-income or community development credit unions) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development..."

[14] See §II.12(i)—3 and §II.24(e)—1 in the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, pages 11650 and 11661.

Engagement by OCC Community Affairs

OCC's Community Affairs staff engage in a variety of activities to encourage banks and thrifts to address the financial services needs of unbanked and underbanked consumers. We maintain on-line resources and develop publications for bankers, industry associations, and community groups highlighting "best practices" in providing mainstream banking products and services to address the needs of consumers utilizing check cashers, payday lenders, and other alternative financial services providers. These publications and resources include:

- Transaction Accounts Products Targeting the Unbanked Web-Resource[15]
- Financial Literacy Web Resource Directory[16]
- Financial Literacy Update Electronic Newsletter[17]
- Bank Savings Incentive Programs Fact Sheet[18]
- Individual Development Accounts *Insights* Report[19]

Community Affairs staff work with the other bank regulatory agencies to conduct dozens of conferences and seminars around the country each year to highlight these "best practices" and for bankers to hear first hand from practitioners on how best to implement programs, such as small dollar loan initiatives. The OCC's District Community Affairs Officers also are involved in bringing bankers together with local governmental agencies who are spearheading Bank On Cities initiatives around the country. As previously noted, these Bank On Cities initiatives, which are active in approximately 100 cities, seek

[15] http://www.occ.gov/topics/community-affairs/publications/article-archives/archive-transaction-account-products.html

[16] http://www.occ.gov/finlit

[17] http://www.occ.gov/topics/community-affairs/publications/index-ca-publications.html#flu

[18] http://www.occ.gov/static/community-affairs/fact-sheets/bank-savings-incentive-programs-fs.pdf

[19] http://www.occ.gov/static/community-affairs/insights/2005-25a.pdf

to help unbanked consumers utilize the services of banks offering a range products that address the specific banking needs of this clientele.

Conclusion

Access to credit plays a vital role in our communities. The OCC supports efforts by national banks and federal savings associations to be leaders in their communities by offering products and programs that meet a spectrum of credit needs in a safe, sound, and sustainable manner.