

#### **IV. *Dodd-Frank Act Title XII: Improving Access to Mainstream Financial Institutions***

##### **A. Introduction**

The Dodd-Frank Act (“Dodd-Frank”) was signed into law by President Barack Obama on July 21, 2010.<sup>1</sup> Title XII, “Improving Access to Mainstream Financial Institutions,” was included and passed as part of Dodd-Frank for the primary purpose of increasing and improving the access of low- and moderate-income families to mainstream financial institutions.<sup>2</sup> Its stated purpose is to “to encourage initiatives for financial products and services that are appropriate and accessible for . . . Americans who are not fully incorporated into the financial mainstream.”<sup>3</sup> The decision to include Title XII was in response to what was viewed as the lack of financial access to mainstream financial institutions and, perhaps more importantly, was tailored to combat predatory payday loan lending by offering low-cost, small-dollar loans.<sup>4</sup> Title XII purports to accomplish its primary purpose through three programs.<sup>5</sup> Participation in these programs is not mandatory for financial institutions.<sup>6</sup> The Treasury Secretary (“Secretary”) has authority to implement every aspect of the programs detailed in Title XII via regulation issuance.<sup>7</sup>

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<sup>1</sup> *July, 21, 2010: Dodd-Frank Act Signed into Law & SEC Commissioners Approve Amendments to Form ADV, Part 2*, July 21, 2010, <http://www.foleyhoag.com/NewsCenter/Publications/Alerts/Investment-Adviser/Foley-Adviser-072110.aspx>.

<sup>2</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, <http://financetrain.com/dodd-frank-act-title-xii-improving-access-to-mainstream-financial-institutions/> (last visited Feb. 23, 2011).

<sup>3</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions*, <http://www.gibsondunn.com/publications/Documents/Dodd-Frank-TitleXII.pdf> (last visited Feb. 23).

<sup>4</sup> Andrea Kovach, *Payday Lenders Beware: Financial Reform Law Promotes Alternative Small Dollar Loans*, HUFFINGTON POST, July 28, 2010, [http://www.huffingtonpost.com/andrea-kovach/payday-lenders-beware-fin\\_b\\_662745.html](http://www.huffingtonpost.com/andrea-kovach/payday-lenders-beware-fin_b_662745.html).

<sup>5</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>6</sup> *Id.*

<sup>7</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions*, *supra* note 3.

The first program is “Expanded Access to Mainstream Financial Institutions.”<sup>8</sup> Under this program the Secretary has the authority to establish a variety of incentives aimed at enabling low- and moderate-income individuals to establish accounts in an insured depository institution that are appropriate to meet their needs.<sup>9</sup> The second program is “Low Cost Alternatives to Small-Dollar Loans.”<sup>10</sup> It authorizes the Secretary to establish “multiyear demonstration loan programs” that provide low-cost loans as an alternative to payday loans.<sup>11</sup> The third program is “Grants to Establish Loan-Loss Reserve.”<sup>12</sup> This program directs the Community Development Financial Institutions Fund to provide grants for community development financial institutions and other depository institutions for the purpose of enabling them to create a loan-loss reserve fund that would mitigate the costs of a “small-dollar loan program.”<sup>13</sup>

### **B. History of the Limited Access and Predatory Lending Problem**

Title XII was devised and included in Dodd-Frank to address a perceived lack of access to mainstream financial institutions for low- to moderate-income individuals by combating predatory payday loan lending.<sup>14</sup>

Pre Dodd-Frank, most small-dollar loans available by financial institutions across the country were payday loans.<sup>15</sup> Payday loans are short-term, have high interest rates, and were “designed as a last resort for those finding themselves in financial dire straits.”<sup>16</sup>

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<sup>8</sup> *Id.*

<sup>9</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>10</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions*, *supra* note 3.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> Kovach, *supra* note 4.

<sup>15</sup> *Alternative Small Dollar Loans in Illinois: Creating Sound Financial Products through Regulation and Innovation*, Nov. 2009, <http://www.illinoisassetbuilding.org/wp-content/uploads/2009/11/asdlbrieffinal.pdf> (last visited Mar. 3, 2011).

<sup>16</sup> Gareth Marples, *The History of Payday Loans—A Necessary Evil?*, THEHISTORY OF.NET, Sept. 11, 2008, <http://www.thehistoryof.net/history-of-payday-loans.html>.

Payday loans are considered to operate outside of the mainstream financial sector and instead are distributed to consumers through a system of storefront retailers.<sup>17</sup> Payday loans have been controversial and are recognized as a form of predatory lending.<sup>18</sup> Predatory lending occurs when institutions and lenders grant consumers loans using a variety of “predatory” tactics including lending at exorbitant interest rates that are not based on a reflection of the consumer’s credit history but rather on the consumer’s race or “national origin,” “[k]nowingly” lending “more money than a borrower can afford to repay,” and charging “fees for unnecessary or nonexistent products and services.”<sup>19</sup> Payday lenders often charge highly exorbitant rates and reports of annual percentage rates reaching 400% and higher are not uncommon.<sup>20</sup> In recent years, politicians and consumer advocacy groups have heavily criticized payday loans.<sup>21</sup> It therefore makes sense that Title XII, which seeks to provide more access to the mainstream financial sector for low- to moderate-income individuals, is focused on combating payday loans.<sup>22</sup>

### C. “Expanded Access to Mainstream Financial Institutions”

The first of the three programs outlined in Title XII, “Expanded Access to Mainstream Financial Institutions,” authorizes the Secretary to create a variety of “multiyear” grants, programs, agreements, and other initiatives in order to enable individuals with low- to moderate-incomes to open accounts in depository institutions that are federally insured and to improve access to these accounts on

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<sup>17</sup> *Id.*

<sup>18</sup> *What Does the Dodd-Frank Financial Reform Bill Mean for Payday Lenders?*, <http://www.financialservicesreview.com/what-does-the-dodd-frank-financial-reform-bill-mean-for-payday-lenders/> (last visited Mar. 3, 2011).

<sup>19</sup> *Don’t Be a Victim of Loan Fraud*, <http://www.hud.gov/offices/hsg/sfh/buying/loanfraud.cfm> (last visited Mar. 3, 2011).

<sup>20</sup> *What Does the Dodd-Frank Financial Reform Bill Mean for Payday Lenders?*, *supra* note 23.

<sup>21</sup> *Alternative Small Dollar Loans in Illinois: Creating Sound Financial Products through Regulation and Innovation*, *supra* note 20; Marples, *supra* note 21.

<sup>22</sup> Kovach, *supra* note 4.

terms that are reasonable for those individuals.<sup>23</sup> Financial institutions that wish to participate or receive a grant must file an application with the Secretary.<sup>24</sup> Grants will be awarded in the amount necessary for the grant program's operation.<sup>25</sup>

Only "eligible entities" are permitted to participate in these programs.<sup>26</sup> These eligible entities include federally insured depository institutions, community development financial institutions, 501(c)(3) (nonprofit) organizations, state, local or tribal government entities, and partnerships or joint ventures comprised of any of these institutions.<sup>27</sup> If one of these entities does choose to participate in one of these programs it has the option of providing a variety of services to low- and moderate-income individuals including loans with small-dollar values as well as financial education and counseling.<sup>28</sup>

#### D. "Low Cost Alternatives to Small-Dollar Loans"

This section of Title XII authorizes the Secretary to create a variety of grants, agreements, and other initiatives for eligible entities to give consumers the option of low-cost, small loans that serve as alternatives to payday and other more expensive small-dollar loans.<sup>29</sup> All loans made as part of this program must be made on reasonable terms and conditions and in line with reasonable lending practices.<sup>30</sup> Title XII does not outline the standard for "reasonable" but the implication is that the terms and conditions will be more reasonable than those that accompany payday loans, which often charge interest

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<sup>23</sup> *Id.*; Promontory Financial Group, *Executive Summaries of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, available at <http://www.promontory.com/assets/0/78/110/202/c70a257c-88bf-4adb-8393-d9ae65e9f9e2.pdf>.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>27</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions*, *supra* note 3; *What is a 501(c)(3)?*, <http://www.501c3.org/start-a-nonprofit/what-is-a-501c3.html> (last visited Mar. 3, 2011).

<sup>28</sup> *Id.*

<sup>29</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>30</sup> *Id.*

rates higher than 100 percent.<sup>31</sup> Prior to the passing of Title XII of Dodd-Frank, the consumers affected by this program only had the option of receiving high cost loans.<sup>32</sup>

This part of Title XII was passed to create incentives for financial institutions to provide low-cost and small-dollar loans to consumers as alternatives to payday loans.<sup>33</sup> Instead of attempting to regulate payday lenders, which charge high costs, Title XII endeavors to establish financial incentives for institutions to offer reasonably priced small-dollar loans through the utilization of loan loss reserve funds, various grants to increase financial education and access and technical assistance funding.<sup>34</sup> Title XII sought to provide alternatives to payday loans because it is well recognized that payday loans are used to exploit consumers by predatory lenders.<sup>35</sup> In general, institutions that offer payday loans take advantage of disadvantaged consumers, promote easy credit, and charge short term loan interest rates that are wildly exorbitant, the combination of which effectively traps these “individuals in an endless debt spiral.”<sup>36</sup> According to Joan Lok, a specialist with the Federal Deposit Insurance Corporation (“FDIC”), the “predatory cash advance industry continually bombards the airwaves with promises of easy money, and finds fertile ground among those who are struggling financially.”<sup>37</sup> She further states that, due to the current economic climate and recession, “the lack of alternatives to these fast cash lenders” means that “the need for responsible loan programs is greater than ever.”<sup>38</sup> She highlights that therefore it was important for alternatives to payday loans to be made available.<sup>39</sup> This is exactly what this program of Title XII provides for.<sup>40</sup>

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<sup>31</sup> *What Does the Dodd-Frank Financial Reform Bill Mean for Payday Lenders?*, *supra* note 23.

<sup>32</sup> *Id.*

<sup>33</sup> Kovach, *supra* note 4.

<sup>34</sup> *Id.*

<sup>35</sup> *Helping the Poor Avoid Predatory Lenders and a Cycle of Debt*, WASH. POST, May 21, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/05/21/AR2010052103306.html>.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions*, *supra* note 3.

The effectiveness of this program has been tested.<sup>41</sup> FDIC ran a two-year pilot program, ending in the fourth quarter of 2009, which was comprised of 28 participating banks making more than 34,400 small-dollar loans having a more than \$40 million principal balance, all accompanied with an APR of 36% or lower.<sup>42</sup> Three of the banks that participated in the study were headquartered in Illinois.<sup>43</sup> They were Community Bank—Wheaton/ Glen Ellyn, Lake Forest Bank & Trust, and State Bank of Countryside.<sup>44</sup> Of those banks, the Lake Forest Bank & Trust made a marginal profit on the small-value loans and any losses it experienced on them were not higher than losses incurred by alternative consumer loans.<sup>45</sup> Despite the highlighted results being focused on a limited number of banks in one state, Illinois, commentators have interpreted the results of this study to be positive signs of a program that they believe can be successful nationwide.<sup>46</sup>

#### E. “Grants to Establish Loans”

Title XII amends the Community Development Banking and Financial Institutions Act.<sup>47</sup> It does so by allowing the Community Development Financial Institutions Fund to “make grants to community development financial institutions . . . and any other federally insured depository institution with a primary mission to serve targeted investment.”<sup>48</sup> However, community development financial institutions and other institutions that do receive a federal grant must offer direct loans, “but they may be used to help recapture a defaulted loan made under the small-dollar loan program and may be used to employ a fiscal agent for their normal service.”<sup>49</sup> Additionally, the Community Development Financial Institutions Fund must offer technical assistance grants to community development financial institutions and “other

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<sup>41</sup> Kovach, *supra* note 4.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions, supra* note 3.

<sup>48</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions, supra* note 2.

<sup>49</sup> *TITLE XII: Improving Access to Mainstream Financial Institutions, supra* note 3.

depository institutions, which may be used for technology, staff support, and other costs associated with establishing a small-loan program.”<sup>50</sup>

The purpose of this program is to assist community financial institutions mitigate the costs of running small-dollar loan programs by supplying the amount necessary for them to create loan loss reserve funds.<sup>51</sup> The fear of defaults is a primary concern cited by financial institutions that have shown interested in creating a small-dollar loan program.<sup>52</sup> According to commentators, it is therefore crucial to structure the eligible loan programs in a manner that produces products that are appropriate, safe, and reasonable for consumers.<sup>53</sup> Title XII purports to attempt this.

#### **F. Potential Problems with Implementation of Title XII**

Despite its stated purpose of attempting to improve access to mainstream financial institutions for low- to moderate-income individuals and to achieve this in part by combating predatory lending, Title XII will face pitfalls that may prove fatal to its mission.<sup>54</sup> Strangely enough, other parts of Dodd-Frank itself are the source of these pitfalls and have the potential to both restrict access to mainstream financial institutions for low- to moderate- income individuals and to increase the amount of consumers that seek payday loans.<sup>55</sup>

The Durbin Amendment to Dodd-Frank was passed in July 2010 and gave the Federal Reserve “regulatory power over the interchange fees banks can charge business owners every time a debit card is used in their stores.”<sup>56</sup> The Federal Reserve has stated that

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<sup>50</sup> *Id.*

<sup>51</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>52</sup> Kovach, *supra* note 4.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> Todd Zywicki, *Dodd-Frank and the Return of the Loan Shark*, WALL ST. J., Jan. 4, 2011, <http://online.wsj.com/article/SB10001424052748704735304576058211789874804.html>.

<sup>56</sup> Odysseas Papadimitirou, *The Durbin Amendment Will Make You Give Up Your Debit Card*, BUSINESS INSIDER, Dec. 14, 2010, <http://www.businessinsider.com/the-durbin-amendment-will-make-you-give-up-your-debit-card-2010-12>.

soon the interchange rate will be cut approximately 90 percent from its present rate.<sup>57</sup> According to some commentators this will likely heavily benefit “big-box retailers” and other businesses but unfortunately will have an extremely negative effect on consumers and low-income Americans will be negatively affected the most.<sup>58</sup> Many banks have already stated that in light of the Durbin Amendment they will be reducing benefits provided to cardholders and establishing maintenance fees for accounts.<sup>59</sup> Many low-income consumers will not be able to afford these fees and will be unable to qualify for certain services, such as free checking under the new regulations.<sup>60</sup> Their only option will be either to find a way to pay the higher fees or to exit the banking system.<sup>61</sup> The Durbin Amendment, therefore, seems to severely limit Title XII’s stated goal of increasing access to mainstream financial institutions for low- to moderate-income individuals.<sup>62</sup>

Dodd-Frank created the Bureau of Consumer Financial Protection (“CFPB”) with the purpose of providing consumers with the information necessary to make prudent financial decisions.<sup>63</sup> Under Dodd-Frank, one of the CFPB’s responsibilities will be the enforcement of the 2009 Credit CARD (Card Accountability Responsibility and Disclosure) Act (“CARD”).<sup>64</sup> CARD placed “new federal limits on how credit-card issuers can price and adjust interest rates” in an effort to shield consumers from “exploitative credit-card” companies that limit “penalty fees” and “interest-rate adjustments.”<sup>65</sup> Unfortunately, according to some commentators, CARD will exacerbate the financial situation of those Americans that it intends to protect by driving consumers to payday lenders and forcing some

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<sup>57</sup> Zywicki, *supra* note 56.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> Bureau of Consumer Financial Protection (CFPB), <http://www.treasury.gov/initiatives/Pages/cfpb.aspx> (last visited Mar. 3, 2011).

<sup>64</sup> *The Dodd-Frank Wall Street Reform and Consumer Protection Act is Good for America’s Small Businesses*, Oct. 2010, <http://www.treasury.gov/initiatives/wsr/Documents/Fact%20Sheet%20-%20Good%20for%20America's%20Small%20Businesses,%20Oct%202010%20FINAL.pdf> (last visited Mar. 3, 2011).

<sup>65</sup> Zywicki, *supra* note 56.

consumers to exit the banking system.<sup>66</sup> CARD drives consumers to payday lenders because while it limits interest rate adjustments, its practical implication “[f]or many Americans” is “higher interest rates, an increase in other fees, and reduced credit limits.”<sup>67</sup> Furthermore, commentators argue that the group hurt the most by CARD is low-income consumers, the exact group of Americans that Title XII and CARD purport to protect.<sup>68</sup> This is because, under CARD, these lower-income consumers do not have a high enough credit rating to qualify for credit cards anymore and are therefore forced to lend from payday lenders that charge interest rates significantly higher than credit card companies.<sup>69</sup> Therefore, the enforcement of CARD by the Dodd-Frank-created CFPB seems to severely frustrate Title XII’s primary purpose of improving access to mainstream financial institutions for low- to moderate-income Americans as well as its goal of combating predatory lending. It is strange that Title XII and the Durbin Amendment are both part of Dodd-Frank because while one attempts to increase access to mainstream financial institutions for low- to moderate-income individuals, the effect of the other seems to be the restriction of that access.<sup>70</sup>

It appears that while Title XII takes steps in the right direction to increase access and participation of low- to moderate-income individuals in the mainstream financial sector and to combat predatory payday loans, that there is a very good chance it will not be effective. In an attempt to remedy different aspects of America’s financial system, portions of Dodd-Frank other than Title XII seem to frustrate Title XII’s stated goals. As one commentator remarked, “[C]ongress can pass all the laws it wants, but it can’t repeal the law of supply and demand . . . .”<sup>71</sup>

### G. Conclusion

Title XII of Dodd-Frank seeks to provide initiatives for mainstream financial institutions to provide “financial products and

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<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2. Marples, *supra* note 21.

<sup>71</sup> Zywicki, *supra* note 56.

services” to “millions of Americans who are not fully incorporated into the financial mainstream.”<sup>72</sup> In doing this, it also seeks to combat payday loans.<sup>73</sup> Because Title XII attempts to bring low- to moderate-income individuals into the mainstream financial sector, its priority is to curb payday loans.<sup>74</sup> By providing that the Secretary can approve grants for loan-loss funds, Title XII encourages alternatives to payday loans.<sup>75</sup> Some commentators are optimistic about the incentives that Title XII provides for institutions to create alternatives to payday loans.<sup>76</sup> A recent study has shown that Title XII’s measures have been effective thus far in Illinois.<sup>77</sup> However, other commentators note that while Title XII purports to increase access for low- to moderate-income individuals and to provide alternatives to payday loans, other portions of Dodd-Frank cause these individuals to flock to payday lenders and in some cases, to exit the mainstream financial sector altogether.<sup>78</sup> It therefore seems that Dodd-Frank has an internal tension that may result in Title XII not achieving its stated purpose.<sup>79</sup>

Dodd-Frank was passed recently so it is hard to tell thus far whether or not Title XII has been effective in incorporating low- to moderate-income individuals into the mainstream financial sector or in combating predatory lending. The opinions from commentators and experts have been split.<sup>80</sup> However, as some commentators have noted, the current economic climate makes the need for “responsible loan programs,” such as the ones Title XII purports to establish, “greater than ever.”<sup>81</sup>

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<sup>72</sup> *Dodd Frank Act—Title XII: Improving Access to Mainstream Financial Institutions*, *supra* note 2.

<sup>73</sup> Kovach, *supra* note 4.

<sup>74</sup> Kovach, *supra* note 4.

<sup>75</sup> Kovach, *supra* note 4.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> Zywicki, *supra* note 56.

<sup>79</sup> *Id.*

<sup>80</sup> Kovach, *supra* note 4; Zywicki, *supra* note 56.

<sup>81</sup> *Helping the Poor Avoid Predatory Lenders and a Cycle of Debt*, *supra* note 37.

<sup>82</sup> Student, Boston University School of Law (J.D. 2012).