CENTER FOR RESPONSIBLE LENDING

February 2, 2007

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990
VIA EMAIL: supervision@fdic.gov

Re: Draft Guidelines on Small-Dollar Loans

Dear Mr. Feldman:

The Center for Responsible Lending (CRL) appreciates the opportunity to comment to the Federal Deposit Insurance Corporation on its proposed guidelines for affordable small-dollar loans.[1]

We commend the FDIC for its leadership in defining the key elements of responsible small-dollar loans, and encouraging banks to develop products that meet the need for affordable consumer credit. That need is most acute among financially vulnerable individuals, whose recourse to costly payday and overdraft loans has tended to exacerbate rather than alleviate their indebtedness. The "debt trap" effect of payday lending has been borne out by our research showing that the payday industry relies heavily on recurrent borrowers for its $4.6 billion in annual revenue. Some 90 percent of its income is from individuals who take out five or more loans a year; 62 percent from people with 12 or more loans a year.[2] "Bounce" protection overdraft lending has had similar consequences for cash-strapped account holders: some 71 percent of overdraft fees, which can top $2 for each dollar borrowed, are paid by just 16 percent of overdraft users.[3, 4]

---

[1] CRL is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices, and by promoting responsible lending and access to fair terms of credit for low-wealth families. CRL is an affiliate of Self-Help, which also includes a credit union and a loan fund. Self-Help has provided more than $4.5 billion in financing to enable over 50,000 low-wealth borrowers in 47 states buy homes, build businesses, and strengthen community resources. Self-Help Credit Union is the nation's largest community development credit union, with some $260 million in assets. CRL's affiliation with Self-Help provides CRL with important insight into lenders' needs and responsibilities to communities.

[2] Uriah King, Leslie Parrish, Ozlem Tanik, *Financial Quicksand*, Center for Responsible Lending (Nov. 30, 2006).

[3] Lisa James & Peter Smith, *Overdraft Loans: Survey Finds Growing Problem for Consumers*, Center for Responsible Lending, Issue Paper No. 13 (Apr. 24, 2006).

[4] Eric Halperin, Lisa James, Peter Smith, *Debit Card Danger*, Center for Responsible Lending (Jan. 25, 2007).

PO Box 3638, Durham NC 27702-3638 • 302 W. Main Street, Durham NC 27701 • Phone 919.313.8500 • Fax 919.313.8595
910 17th Street NW, Suite 500, Washington DC 20006 • Phone 202.349.1850 • Fax 202.289.9009
1330 Broadway, Suite 604, Oakland CA 94612 • Phone 510.379.5000 • Fax 510.893.9300
www.responsiblelending.org

Small-dollar consumer credit should buttress financial security by offering individuals the prospect of debt reduction that will lead to improved creditworthiness and the opportunity to accumulate reserves that can be leveraged to build wealth. But high cost, impossibly short-term credit depletes assets, leaving borrowers teetering on the brink of insolvency where they clutch at the evanescent stability of loan after loan. Hopefully, the guidelines now proposed by the FDIC will promote sound lending practices and somewhat limit the reach of loan products that plunge consumers into profound debt.

We believe that according banks favorable Community Reinvestment Act (CRA) consideration for responsible small-dollar loan products will create an inducement to innovate in the consumer credit arena. This will hopefully counterbalance, at least in part, the financial incentive that currently drives the growth of overdraft and payday-type lending. Clearly, CRA credit on its own will likely be inadequate to produce a rapid sea change in short-term lending practices. But at the outset, it may catalyze the development and introduction of affordable credit products that, once on the market, will gain momentum as banks realize their profitability, as well as benefits associated with attracting and retaining customers. Furthermore, it is entirely fitting for banks to receive CRA credit for launching products that promise significant benefits for consumers in the communities they serve.

We would like to offer several observations about the proposed guidelines. First, it is worth emphasizing that a loan cannot truly serve consumer credit needs unless it contains a comprehensive package of the features identified in the guidelines. For example, a loan structured to be repayable in amortizing installments over a fixed period will not be affordable if the interest rate is excessive. A loan that carries a reasonable interest rate will be transformed into a high-cost product by the simple addition of ancillary membership, origination or other fees.

The proposed guidelines list the essential characteristics of a responsible small-dollar loan program, but they fail to point out that these features work in concert, not in isolation, and are only effective in the aggregate. That is not to say that every responsible small loan program must contain the full slate, although a program that did would be virtually assured to be responsive to consumer needs. The interest rate cap is indispensable to affordability and, therefore, must be present in every program. But beyond this, it is the mix of features and their interaction that is important.[5] While we would agree that lending parameters should remain sufficiently flexible to encourage innovation in product design, failure to consider the desired end product holistically could result in programs that meet the letter but not the spirit of the guidelines. Under such circumstances, a bank might qualify for CRA credit for lending that meets certain of the specifications listed, but results in a product that is predatory in application because one or another essential ingredient is missing.[6]

---

[5] An example of a small-dollar loan product that meets affordability criteria but does not incorporate every element identified by the proposed guidelines is the North Carolina State Employees' Credit Union (NCSECU) Salary Advance Loan, which provides up to $500 for 31 days at 12 percent APR with no fees. This product, which has been successful both for borrowers and the lender (CEO Jim Blaine has described it as "the most profitable loan we have"), is not repayable in installments.

[6] Car title loans in some states would fit this profile: reasonable terms such as minimal underwriting, installment repayment and incremental principal reductions that do not result in a responsible product because the interest rate is 360 percent.

Second, we agree that affordable interest rates, limits on fees, amortization, installment payments, streamlined applications, risk-based underwriting, maximization of technology and automated processes are crucial elements of a responsive small-dollar loan program. But two key characteristics are barely mentioned: minimum loan term and renewal limits. Establishing a minimum closed-end loan term would eliminate the debt trap risk associated with a truncated repayment period that forces a borrower to renew, extend, or rollover the loan, thereby incurring additional interest and fee charges. The guidelines do not address closed-end loan terms at all, and suggest merely a "reasonable timeframe" for repayment of open-end credit.

While it is impossible to designate an ideal term that would be appropriate for all loan amounts and borrower circumstances, it is reasonable to consider a minimum period that is short enough to ensure profitability for banks but long enough to give borrowers "a meaningful opportunity to repay debt" without requiring more credit. We strongly recommend a minimum loan term of 90 days. This would give borrowers the added security of earning as many as six paychecks from which to make installment payments and cover necessary living expenses at the same time. In addition, we suggest inserting the following explanatory language: "The term must be of a length that a borrower can pay it off and still meet all financial obligations without incurring additional extensions of credit."

Third, and closely related to the minimum loan term, is the problem of protracted indebtedness resulting from frequent renewals and serial extensions of credit. The proposed guidelines caution banks that "excessive renewals … are signs that the product is not meeting the borrower's credit needs." This admonition may not be effective in limiting the risk of unduly burdensome debt to both the bank and borrower because it neither defines "excessive" nor advises banks on what actions or product adaptations to consider that would achieve conformity with regulatory expectations.

The Payday Lending Guidance cites "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" as an example of payday lending that is inconsistent with the CRA.[7] The Overdraft Guidance instructs banks to "monitor customer use of products such as fee-based overdraft programs and, when usage becomes excessive, offer or refer a customer to a more suitable product."[8] Presumably, the small-dollar loan guidance is intended to ensure that this "more suitable product" is available and provides a meaningful alternative to high-cost credit. It should, therefore, instruct banks to comply with standards established for overdraft and payday lending. As the Payday Lending Guidance suggests, banks should not receive CRA credit for keeping customers in loan products that are trapping them in debt.

Fourth, we commend the FDIC's emphasis on consideration of a borrower's ability to repay when deciding whether and how much credit to extend. It is imperative that banks adhere to sound underwriting practices that are sufficient to determine a borrower's income and obligations, while expeditious enough to make credit available in a timely manner. We would emphasize that, in this regard, all underwriting criteria are not equal. Of course, as the FDIC points out, proof of recurring income is imperative, as is an assessment of outstanding debt (which is not mentioned in the guidelines). But consideration of FICO score, for example, which

---

[7] FDIC Payday Lending Programs Revised Examination Guidance, FIL-14-2005 (Mar. 14, 2005).
[8] Joint Guidance on Overdraft Protection Programs, FIL-11-2005 (Feb. 18, 2005).

among other things is an indication of debt-to-income ratio, would almost certainly pose a barrier for the very consumers who would benefit most from these products – those who are credit impaired or lack documented credit histories entirely. Furthermore, individuals who could reduce their debt burden by refinancing at lower cost and on better terms should not be barred by traditional underwriting considerations from access to responsible credit products. It may be worth noting this in the final guidelines.

Fifth, we applaud the FDIC's suggestions for complementary program features such as a savings component to lessen future reliance on credit, collaboration with other institutions to augment lending capacity and quality, and financial education for borrows experiencing financial stress. Such examples of creative problem solving and strategic alliances have already proved successful in extending the range and effectiveness of short-term consumer credit.[9] As advantageous as such enhancements may be for borrowers and banks alike, however, they are no substitute for the core features that make a loan truly affordable. CRA credit should be reserved for lending that is intrinsically responsive to consumer needs, and should only be considered for additional non-essential features when these are used to augment the benefits of a product that is already fundamentally sound

Finally, while we are aware that most banks have severed their third-party relationships with payday lenders, this is not universally true, nor are such affiliations prohibited. We believe that a bank that offers a responsible small-dollar loan product should not be entitled to favorable CRA consideration if it is also partnered with a payday lender or with any other entity for the purpose of furnishing credit that is predatory in nature (including "plastic" payday). Engaging in such activity would amount to a "robbing Peter to pay Paul" arrangement that is incompatible with the expressed purpose of the CRA.

In conclusion, we appreciate the opportunity to comment on the FDIC's Draft Affordable Small-Dollar Loan Guidelines and again commend the FDIC for its leadership on this important issue. If you have any questions or would like more information, please do not hesitate to contact Jillian Aldebron at 202-349-1868 or by email at jillian.aldebron@responsiblelending.org.

Sincerely,

Michael Calhoun
President, Center for Responsible Lending

Jillian Aldebron
Policy Counsel, Center for Responsible Lending

[9] For example, the NCSECU salary advance program incorporates a savings component that automatically deducts 5 percent of the loan amount and deposits it in a savings account meant to provide the borrower with a buffer against future financial need. In addition to the $33.6 million in avoided finance costs generated by this salary advance program, credit union members have put aside $8 million in savings through this mandatory savings feature. State Employees Credit Union Press Release: SECU's Alternative Program saves Salary Advance Members $2.8 million each month, February 22, 2006.