FINANCIAL SERVICE CENTERS OF AMERICA, INC.
A NATIONAL TRADE ASSOCIATION

Via Email (supervision@fdic.gov)
February 2, 2007

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990

Re: FDIC Guidelines on Affordable Small-Dollar Loans

Dear Mr. Feldman:

On behalf of the Financial Service Centers of America ("FiSCA"), thank you for giving us this opportunity to comment on the draft guidelines on small-dollar loans ("SDL") developed by the Federal Deposit Insurance Corporation ("FDIC"), which seek to encourage banks to offer customers affordable SDLs.

FiSCA is the national trade association representing an expanding industry of more than 6,500 community financial service centers throughout the United States. FiSCA members form a well established and growing alternative to traditional banks and other financial institutions for a large and increasing segment of the American public. Our members serve customers from all walks of life, including urban communities and the under-banked, groups that the federal banking agencies, including the FDIC, have stressed as being underserved by traditional financial institutions.

FiSCA's members provide important financial services including check cashing, money orders, bill payment services, wire transfers as agents of regulated money transfer companies, and small, short-term loans, such as payday advances ("PDAs") and installment loans. Our members serve hundreds of thousands of customers, who use our member locations for the advantages that we provide, including: convenience, instant liquidity, quality service, and access to simple and affordable small-dollar, short-term credit.

As illustrated by a survey of FiSCA member organizations conducted in 2006 by Dr. Patricia Cirillo, Ph.D. of Cypress Research Group, customers are overwhelmingly satisfied with their financial experience at our member locations. For example, 92% of those surveyed rated the overall monetary value of products and services as either 'excellent,' 'very good,' or 'good,' ratings that most banks envy. More importantly, the survey paints a very clear picture of a financially-savvy consumer who understands the costs associated with using a financial service center and the products and services offered. The survey also accurately portrays that our customers have a firm grasp on how best to manage their money and are making sound financial decisions, based on their specific circumstances.

As discussed below, FiSCA supports the FDIC initiative encouraging banks to offer affordable SDLs. We believe that increased competition in the small-dollar, short-term credit market, which includes, *inter alia*, PDAs, pawn loans, auto loans, NSFs and overdraft charges, will be to the benefit of consumers, as it will provide consumers with an additional small-dollar, short-term credit option. Ultimately, FiSCA believes that financially savvy consumers, after considering factors including cost, convenience, service, and simplicity of the transaction, will choose the financial product that best serves his/her credit needs.

A. Emergence of Payday Advances

As a prerequisite to obtaining a PDA, a customer must demonstrate that he/she is gainfully employed and maintains an active checking account. Thus, the PDA customer already has a relationship with the mainstream banking community. Despite already having that customer relationship, most traditional financial institutions have chosen not to offer small-dollar, short-term loans. Some FDIC member banks participated in "rate exportation" programs, under which the banks made the loans and the location's operator functions exclusively as the bank's agent. FiSCA consistently has supported the availability of rate exportation programs, as they provide additional competition within the industry. However, because of a shift in the FDIC policy in 2006, the rate exportation model is no longer available for banks.

The emergence of the PDA industry resulted from a void in the marketplace for a financial product that satisfied the short term credit needs of consumers. Until the early 1990s, a substantial number of Americans lacked access to small denomination credit because many traditional lenders, such as banks and other financial institutions, did not offer such loans. Traditional lenders had abandoned the small loan market because the cost of processing the transactions, the risk related to those transactions and the limitations on interest rates, made small, short-term lending unattractive and unprofitable for lenders.

Rather than offering SDLs, most traditional financial institutions instead chose to aggressively pursue NSF fees, resulting annually in billions of dollars of profits for the banking industry. More recently, over the past decade banks have added other revenue generating consumer products, most notably, overdraft protection. Like NSF fees, overdraft protection has resulted in billions of dollars of revenue for banks. These bank programs compete directly with payday lending, often with much higher fees and much less disclosure. As the FDIC's January 28, 2003 analysis of payday lending observed, bank overdraft protection programs "exhibit characteristics similar to payday lending programs." In actuality, NSF fees and overdraft charges typically result in a greater expense to consumers. Despite prior guidance by the FDIC on customer over-usage of fee-based overdrafts programs, which required financial institutions to monitor customer use of overdraft privileges, banks continue to boast record profits as a result of overdraft charges and NSF fees.

As noted in a 2001 study of the PDA industry conducted by Gregory Ellihausen, Ph.D. of the Credit Research Center at the McDonough Business School of Georgetown University ("Georgetown Study"):

> The cost structure of the consumer finance industry is such that operating costs increase less than proportionately with loan size [citations omitted]. In other words, companies producing larger loans have lower costs per dollar of credit than companies producing smaller loans. Thus, for a given interest rate, larger loans are more profitable than smaller loans (Georgetown Study, at 1).

The Georgetown Study concludes this is one of the principal reasons that small loan companies abandoned making SDLs of under $500 and even $1,000; instead, choosing to focus their business models on more profitable, large consumer loans and fee-based products.

The effect of the traditional lenders' decision to withdraw from the market for small, short-term loans to consumers was devastating because many consumers were dependent on those types of loans when financial emergencies arose. Quite naturally, the void created by traditional lenders deserting consumers in need of small amounts of credit was filled by financial service centers and other entities who recognized there continued to be a strong demand for small dollar, short-term credit by individuals who did not have access to conventional sources of credit.

In response to the clear market demand, pre-existing businesses, such as check cashers, added PDA to their already expanding product line in states where it was legally permitted. The usage of PDA grew rapidly, as consumers, with no other low-cost options, discovered that financial service centers offered a viable option for their credit needs. Over the years, the industry has evolved into a legitimate source of credit throughout much of the country. Perhaps nothing is more illustrative of the acceptance of PDAs into the financial mainstream than the steady wave of legislation, regulating the industry, enacted over the course of the past decade.

B. The Importance of Preserving Customer Choice

Unlike overdraft protection, consumers always <u>choose</u> to enter into PDA transactions. This choice is typically made because PDAs often represent the best available alternative, as decided by the consumer. In other words, if a consumer decides to apply for a PDA, she/he does so because the individual has determined that alternative is most suitable for that individual's needs and makes the most sense. The consumer knows her/his financial situation better than anyone else. The consumer's right to choose is best validated through a full, clear disclosure about the product. FiSCA members have always favored complete disclosure about the costs and other terms of a PDA transaction. We recommend that similar disclosures be made by banks offering SDLs in order to allow consumers the opportunity to make an informed decision.

C. The Cost of Offering PDAs and SDLs

The PDA industry is often criticized for charging interest rates that are in the triple digits. These individuals focus their attention on an imputed "annual percentage rate" ("APR") derived from the transaction even though no PDA transaction is ever intended to extend for a year. Utilizing an APR calculation to determine the cost is an ineffective method of analyzing pricing on a small dollar, short-term credit product. In order for APR to be a reliable calculation, a traditional two week PDA would have to be rolled over 26 times. Applying the same calculation method to overdraft charges would similarly result in triple digit APR rates and, in some instances, a quadruple digit APR.

FiSCA does not believe in judging any particular financial product or service, but instead thinks the focus should be on the abundantly clear demand for small-dollar, short-term credit and full disclosure of its costs. While the FDIC has undertaken the initiative to encourage its member banks to offer affordable SDLs, we are skeptical of banks' willingness to forgo billions of dollars in profits from NSFs and overdraft protection to offer SDLs at between 12% and 36% APR with no or low fees, which, among other things, utilizes basic underwriting and provides for principal reduction.

As candidly set forth in the comments submitted by First Bank & Trust, 36% is an arbitrary and unrealistic APR ceiling which will deter banks from competing with PDA providers. The PDA industry knows first-hand that SDLs in any form closely resembling a traditional PDA cannot be made with an APR cap anywhere near 36%. This fact is supported by the FDIC's own research. In 2005, the FDIC's Center for Financial Research studied the costs and pricing associated with payday lending. The FDIC study concluded, "[w]e find that fixed operating costs and high loan loss rates justify a large part of the APR charged on payday advance loans." Considering the FDIC's own research suggests that a 36% APR is an unprofitable rate for PDAs and, presumably, SDLs, we are concerned that FDIC member banks following the guidelines will market "affordable" SDLs which are loaded with origination fees, penalties and other inconspicuous fee generating features.

As anecdotally noted in First Bank & Trust's comments, the North Carolina State Employee Credit Union ("NCSEU"), a credit union highly praised by FDIC Chairwoman Sheila Bair for offering affordable SDLs, "enjoys payday loan-like returns generated on their overdraft protection." Moreover, First Bank & Trust's experience with NCSEU reveals "accounts with NCSEU show repeat usage of overdraft privileges each month without limitation." We assume that the FDIC's guidelines are not intended to achieve this type of result. We strongly believe that the cost of any SDLs offered should conspicuously disclose all costs associated with the loan in order to allow consumers' adequate opportunity to weigh cost and other factors important to that borrower before choosing what small-dollar, short-term credit alternative makes the most financial sense.

D. FiSCA Questions Directly Linking a Savings Component to SDLs

While FiSCA supports the intent of the proposed guidelines to encourage financial institutions to structure SDL programs that include a savings component, we have reservations about directly linking a savings account to the amount borrowed. As stated in the draft guidelines, the FDIC envisions consumers setting aside a percentage of the amount borrowed in a designated savings account as a pledge against the loan. Assuming a consumer had to set aside 5% of the amount borrowed in a savings account as security, the consumer would be forced to borrow more money than needed to satisfy this requirement. For example, a consumer who needs $500 for a particular emergency would have to borrow $525 and consequently pay more interest on the higher amount borrowed. While a savings component linked to an SDL would have the appearance of promoting wealth building, in reality, it would only increase banks' profitability by allowing them to collect interest on a higher amount.

Rather than linking a savings component to an SDL, FiSCA believes building wealth by saving should be encouraged independently, similar to that which FiSCA members have offered their costumers. In 2005, FiSCA partnered with NetSpend Corporation of Austin, Texas, to launch the All-Access National Savings Program ("Savings Program"), a first-of-its-kind savings product based on an interest-bearing, federally insured account linked to a prepaid debit card. The interest rate on the Savings Program is currently 3%, which is well above the market rate of interest for low balance accounts. The Savings Program provides access to millions of Americans who do not have savings accounts. The Savings Program is offered for free to all new and current NetSpend prepaid debit cardholders who originate their accounts through a FiSCA member check cashing location. There is no minimum deposit to enroll in the program, no minimum monthly balance to maintain, and no monthly service fee. As of December 31, 3006, approximately 5,700 FiSCA member locations were offering the Savings Program and, in a little more than one year, 2 million customer accounts have been opened.

E. The Effect of Giving CRA Credit as Reward to Banks Offering SDLs

While the FDIC indicates that favorable CRA credit will be given to those financial institutions that offer SDLs consistent with the FDIC's proposed guidelines, in reality, this should have very little effect on CRA ratings, as most banks already receive at least a satisfactory rating. For example, of all the banks that the FDIC supervises, only 15 banks in 2006 received less than a satisfactory CRA rating. As such, it is anticipated banks will have little incentive to offer SDLs consistent with the FDIC's model guidelines.

F. Conclusion

Again, we thank the FDIC for the opportunity to comment with respect to this issue. As noted above, FiSCA supports the FDIC's efforts to encourage banks to offer SDLs at rates not higher than 36%, so long as the SDLs are not linked to overdraft charges and/or other penalties. Assuming banks are willing to offer SDLs under these conditions, we believe that increased competition in the small-dollar, short-term credit market will be to the benefit of consumers, who will decide for themselves which financial product best meets their credit needs. Lastly, FiSCA believes that the FDIC should re-visit its position with respect to rate exportation, which has proven previously to be an effective and preferred method for banks, in conjunction with PDA providers, to offer PDAs.

Please contact the undersigned if you should require any further information.

Thank you.

Very truly yours,

Gerald Goldman
General Counsel
Financial Service Centers of America, Inc.