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The Center for
Financial Services Innovation

An Affiliate of ShoreBank Corporation

February 2, 2007

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments / Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC, 20429
supervision@fdic.gov

Dear Mr. Feldman:

On behalf of the Center for Financial Services Innovation, I want to commend the FDIC for taking a leadership role in encouraging banks to be innovative in meeting the short-term, small-dollar credit needs of both their current customers and other underserved consumers. On this issue, there can be no uncertainty about the significant demand for small-dollar loans. Rather, what is lacking is a supply of well-priced, properly-structured products.

We appreciate the opportunity to comment on the FDIC's Affordable Small-Dollar Loan Guidelines issued December 4, 2006. Overall, we believe the guidance strikes the right balance between innovation and risk mitigation, and we agree with the proposed provisions. However, we believe more needs to be done to provide consumers with the right information to make a meaningful choice among short-term loan options. Specifically, we question whether APR is the appropriate disclosure standard for loans that are almost always of a duration of 30 days or less.

Double-digit interest rates in excess of 36 percent APR can provoke community outrage, yet over the course of a month, what may seem like an overly high interest rate may generate a relatively small cost to the consumer. For instance, an APR of 60 percent for a $500 loan repaid in 30 days costs the consumer only $25, or 5 percent of the loan proceeds. This scenario represents a much better deal for the consumer than the typical payday loan, which generally costs $10 to $15 for every $100 borrowed (at least $50 for a two-week $500 loan), if not more. Likewise, this scenario seems reasonable when compared with a typical bounced check fee of $17 to $35 for each check bounced, no matter what the amount.

Using APR as the standard for short-term loans not only increases the difficulty for the consumer of understanding the loan's true costs, but also compounds the reputational risk that banks face in offering such products. Further, the APR standard leads to finger pointing between various segments of the financial services industry over whose products are more or less expensive, obscuring the real issue. As research has demonstrated, the biggest problem with traditional payday loans is not necessarily the underlying price of a single loan, but the structure. By requiring repayment in full after only two or four weeks, payday loans can cause a toxic cycle of debt at an ultimate cost that far outweighs the original loan amount.

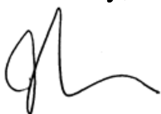
Having a standard by which to judge comparably the cost of short-term, small-dollar loans, regardless of what they are called, is critical for consumers. A better standard might be the total cost of the loan, including both interest and all fees, as a percentage of the total proceeds. This standard reflects the calculation a consumer might actually make in choosing among different options, and makes it easier to compare a short-term loan to the cost of a bounced check. The cost of a payday loan is already frequently described as the dollar cost per $100 borrowed, which is a variation of this standard. Moreover, such a standard takes into consideration any and all fees assessed, as opposed to the APR alone, which might not be representative of the total cost.

A dramatic change like the one proposed here is not without its challenges, and it raises several critical questions. First, to which loans would this standard apply? Given the typical loan sizes and durations currently available in the marketplace, applying the standard to loans of $1,000 or less and with a duration of 31 days or less would seem to cover the right product set.

Currently, most payday loans are closed-end loans. It would be important to prevent the standard from being used to justify high costs on longer-term loans that are simply a series of 30-day loans rolled over, renewed, or paid back and immediately taken out again. The State of Illinois dealt with this issue by creating a new 56-day repayment period with no additional interest charges for borrowers who have trouble repaying their loans. Another option would be to require lenders to convert loans that cannot be repaid within 31 days to a longer-term installment loan subject to the more traditional APR standard. It would also be necessary to create a similar standard—with safeguards—for small open-ended credit.

We recognize that creating a new standard for measuring the cost of a loan is a bold and complicated undertaking. To be truly successful, the new standard would need to be coupled with other legislative and regulatory requirements to ensure that short-term, small-dollar loans are being provided responsibly. This seems like an opportune time to begin the discussion, both because of the significant amount of national attention to the issue of short-term loans, and because of the Federal Reserve's ongoing review of Regulation Z. In absence of a substantive discussion about the appropriate standard by which to disclose pricing, eye-popping APRs will continue to divert the dialogue from the important conversations about product structure and consumer pathways to longer-term financial prosperity.

Sincerely,



Jennifer Tescher

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