February 2, 2007

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

Re: Draft Guidelines on Small-Dollar Loans

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the FDIC's proposed guidelines designed to encourage banks to offer affordable small-dollar loan products in a responsible, safe and sound manner.

ICBA Comments - Overview

Information to help community banks develop and explore products for untapped markets is always welcome. ICBA appreciates the FDIC's efforts and interest regarding availability of affordable small-dollar loan products. Clearly, there is a demand for small-dollar finance, as demonstrated by the explosive growth in payday lending. ICBA welcomes the opportunity to work with the FDIC to help community banks meet this demand in a safe and sound way by further refining the model. However, individual banks should be able to adapt the guidelines to their particular market and business plan. This will allow banks to achieve the FDIC's goal of developing "safe and sound small-dollar credit programs [that] provide customers with credit that is both reasonably priced and profitable for the institution."

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than $876 billion in assets $692 billion in deposits, and more than $589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

There seems to be a misperception that community banks do not currently offer small-dollar loans. Community banks offer products and services that meet the proposed criteria when appropriate and within safety and soundness guidelines. Although not offered as special programs, community banks extend small-dollar unsecured loans to customers, generally using the bank's existing underwriting criteria. ICBA members offer special small-dollar credits, some as low as $500, with low interest rates and no annual fee and with a six to 12-month repayment period. And, community banks often offer overdraft protection plans that allow consumers to access needed funds at minimal fees.

ICBA recommends several key steps to help banks expand affordable small-dollar loans for consumers. The first step is to understand which consumers will benefit from special small-dollar loan programs. Understanding the market is critical to designing products and services to meet the needs. To overcome the barriers that prevent payday loan customers from using banks, it will be important to better understand who they are, why they use payday lenders instead of banks, and what risk profile they present.

Second, existing barriers that prevent banks from offering these loans more broadly must be identified and addressed. Anecdotal evidence suggests small-dollar loans are not profitable and so benefits also need to be clearly specified.

As acknowledged by the FDIC in the proposal, many of these loans can be considered subprime. Community banks often avoid the subprime market due to increased costs, close regulatory scrutiny, adverse publicity and inherent credit and reputation risk. Therefore, regulatory treatment of these loans, and examiner attitudes, are also important to address.

Finally, to be fully successful, this should be an interagency effort. Discussions that include all the banking regulators – perhaps through the FFIEC – may help address some of the barriers that deter community banks from small-dollar loans. For example, if streamlined underwriting is permitted, clearly understood guidelines for bankers – and examiners – will be needed.

Affordable, Responsible Loans for the Military

The FDIC proposal parallels separate efforts to develop special affordable loans for members of the military, in part due to a provision in the John Warner National Defense Authorization Act for Fiscal Year 2007 (the Act) that caps loans to members of the military and their dependents at 36%.

ICBA has recommended the Department of Defense adopt narrow interpretations for "consumer credit" and seriously consider exempting FDIC-insured depository institutions from the Act's restrictions to ensure servicemembers have continued access to affordable and responsible credit products offered by community banks.

For the FDIC's proposed small-dollar loan guidelines, though, a broad interpretation of the Act would bar many of the features recommended in the guidelines. For example, if the Department of Defense broadly applies the Act's restrictions, it will be impossible for banks to offer servicemembers and their dependents loan products that rely on direct debit or that are tied to a savings account, key facets of the FDIC proposal.

The Proposed Guidelines

The FDIC believes small-dollar loan programs can be offered by banks to tap into underserved and potentially profitable markets by attracting customers with minimal or no banking relationships while also helping consumers avoid or transition away from high-cost debt. As an incentive, banks that offer these products may be eligible for favorable CRA treatment. The proposed guidelines address affordability, streamlined underwriting and financial education. Although the FDIC recognizes that many of these programs will be targeted to customers with poor or limited credit histories, i.e., those who would be characterized as subprime borrowers, the agency stresses that banks with programs that do not exceed 25% of Tier 1 capital need not have additional capital or robust monitoring and portfolio analysis usually required for subprime lending programs.

To help make products affordable, lenders are encouraged to structure loans to amortize the principal balance over a reasonable timeframe. Interest rates on the loans should reflect risk but still be affordable. To maintain a reasonable annual percentage rate (APR) and cover administrative and other expenses, an origination fee that bears a direct relationship to origination costs might be assessed. The loans should have minimal or no annual fees, membership fees, advance fees or prepayment penalties. And, lenders should avoid excessive renewals. Sound underwriting should focus on the borrower's ability to repay the loan. Since the loans will be small and must meet needs for quick availability, banks may make credit decisions with streamlined underwriting for existing customers using "very basic information," such as proof of recurring income. The FDIC believes automation can help reduce costs while voluntary pre-authorized debit programs can be used to ensure timely repayment.

The FDIC also recommends including a savings component to help borrowers establish assets and avoid continued reliance on small-dollar loans. Where permitted by state law, the savings account could serve as collateral. The proposal also recommends banks explore working with other organizations, both for-profit and non-profit, to develop and implement special small-dollar loan programs through grants, referrals from community organizations, or alliances with alternative service providers. And finally, the guidance stresses improving financial literacy to help consumers reduce reliance on costly short-term credit.

Community Banks Offer Small Dollar Loans

As noted above, many community banks already offer small-dollar loans for their customers, although not through a separate formal program. Generally, these are offered as part of the bank's normal lending to existing customers, such as through their credit card programs. Other community banks offer small-dollar installment loans for a reasonable fee to cover costs, structured with a nominal interest rate, e.g., from 10% to 18%, and a set minimum initial principal balance for the loan such as $200, $1,000 or $1,500. Some community banks offer single payment small-dollar loans for 90 days, 6 months or even up to one year. In most cases, these loans are approved using the same underwriting procedures used for other consumer loans. The borrowers tend to be established customers of the bank, and some banks set a specific minimum credit score for approval, e.g., 625. And, where the bank deems it appropriate, special exceptions may be made to permit small-dollar loans. Overall, though, the programs vary depending on the unique circumstances and market area served by the bank.

Community banks that do not offer small dollar loans report that the cost for offering them can be prohibitive or that they have not experienced sufficient demand.

Small-Dollar Loan Program. While community banks offer small dollar affordable loans as part of their existing lending programs, an informal survey of ICBA members found mixed interest in special small-dollar loan programs. Community banks without such programs might find a special program appealing to attract customers who currently resort to payday lenders or finance companies. However, there is a reluctance to establish special small-dollar loan programs. Community banks believe the costs would outweigh any potential benefits to a special program or avoid subprime lending and believe most consumers attracted to these loans would be subprime borrowers. And, community banks are concerned that a special small-dollar loan program would encounter increased examiner scrutiny and questioning, leading to higher compliance costs.

ICBA believes that to overcome this resistance, successful guidance would need to be clear and easily followed. For example, the guidelines would need to clearly spell out what is needed for "streamlined underwriting" for bankers – and examiners, such as review of a credit report, a credit score or established customer relationship. In addition, supervisors should consider permitting a minimum fee without regard to principal balance as well as possible adjustments to Truth-in-Lending Act disclosures (a streamlined or abbreviated approach.

Attracting New Customers. Community banks believe a successful small-dollar loan program might be useful to attract new or retain existing customers. Depending on the market, some community banks have found small-dollar loans can be a special niche product to attract customers, especially where there is little competition for this type of loan. One possible approach for a successful small-dollar loan program could be through partnering with a local employer that has a sufficient number of employees likely to use the program, where the bank bundles various products, including small-dollar loans.

Community Reinvestment Act (CRA) Credit. If the banking agencies allow special CRA credit for small-dollar loan programs, community banks might find it more appealing to offer special products. Clear parameters that would lead to CRA credit might be sufficient in certain circumstances to overcome the perceived risks and potential losses from these products. However, CRA credit alone would not be likely to convince a bank to undertake a special small-dollar loan program.

Loan Features

Origination Fee and Interest Rate. The proposal recommends a "reasonable" origination fee to allow the bank to cover costs. It is important to recognize that not all community banks have clear figures for what it costs to underwrite individual consumer loans, for various reasons. In some instances, the cost to develop such specific information would far outweigh the benefits of the analysis needed to derive the figure.[2] Community banks that have developed estimates report varying figures. For example, it might cost $20 to process the loan if the bank uses an automated underwriting system with an additional $30 in administrative costs to handle the loan for a total of $50. Other community banks estimate it can cost from $40 to $75 for processing an individual consumer loan, but costs can run as high as $150 to $175, depending on the individual bank. However, it may be necessary to separate this fee from the annual percentage rate (APR) calculation.

The proposal suggests the interest rate for an affordable small-dollar loan should be 36% or less, a rate that reflects the cap in the Defense Authorization Act. Many community banks that currently offer small-dollar loans to consumer customers charge a simple interest that is less than 36%. ICBA recommends the final guidance clarify that 36% is the simple interest rate since fees or other charges could cause the 36% to easily be exceeded, especially for a small principal amount. For example, an origination fee calculated into APR could produce an APR that would seem excessive[3] and that would be strongly resisted by consumer groups. However, without being able to recover costs, community banks are less likely to offer a special loan product.[4]

<u>Underwriting</u>

ICBA agrees with the FDIC recommendation for streamlined underwriting. To be profitable, processing must be quick and simple yet still meet requirements for sound and profitable loans. ICBA recommends that the FDIC include examples and recommendations for when to require a credit report or credit score and what steps to consider when a customer has little or no credit history or a blemished credit. For example, community banks often have established relationships with customers where a credit report may not be necessary.[5] But where there is little or no established customer relationship, this can be high-risk lending where further steps are needed to underwrite the loan, such as income verification or a credit report. Therefore, additional guidance would be helpful, especially for non-customers.

The guidelines also should be flexible. Alternatives can be used to determine the risk level for a small dollar consumer loan. However, community bankers report that FDIC examiners have criticized use of utility or rent payment history as insufficient to

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[2] Some community banks operate on the premise that any small-dollar loan should be treated as a "loss leader" and therefore the costs are not relevant.

[3] The smaller the principal balance, the greater the impact of an origination fee on the APR, a problem ICBA raised with the Department of Defense with respect to rules under the Defense Authorization Act.

[4] For example, $500 amortized over one year with monthly payments at 24% would only produce interest income of $67.32, making it uneconomical for the bank to offer the loan.

[5] Some community banks question to what extent they can rely on credit report information. The Federal Reserve and the Federal Trade Commission are analyzing the accuracy and completeness of credit reports for a report to Congress required by the Fair and Accurate Credit Transactions Act.

make an underwriting decision.[6] The ability to use alternatives to credit report data will need to be addressed, especially if the goal is to reach underserved consumers who often have minimal or no credit history. These are elements that the FDIC should incorporate into the final guidelines to ensure this flexibility can be used for small-dollar loans.

The proposal suggests automated underwriting can help reduce the costs of processing small dollar loans, but many community banks do not currently use software or systems that allow automated underwriting. Therefore, the purchase and installation of these systems must be factored into the costs associated with a small-dollar loan program. If demand or usage is minimal, these costs make the installation of special automation uneconomical. And, consumer groups often question whether automated underwriting programs use inappropriate factors in developing the algorithms used. Therefore, ICBA recommends that the FDIC acknowledge automated underwriting may not always provide a useful solution.

Quick Turnaround. One of the key elements of the proposed guidelines is quick turnaround for processing loan applications, something consumers find appealing with payday loans.

The proposal suggests existing checking account information can facilitate processing. While information from a checking account relationship with the bank might be sufficient, it may not be enough in all circumstances. For example, if the checking account has only recently been opened there may not be enough information on which to base a lending decision. Also, not all banks obtain credit report information when opening a checking account. If that becomes an additional requirement or is perceived as additional information needed to open a checking account, it would add to the cost and time needed to open checking accounts. Moreover, information solely from a checking account relationship could be misleading. For example, checking account behavior would not necessarily indicate how that same individual repays outstanding loans.

Even though rapid processing is a feature of payday lending, payday lenders are not required to use the same underwriting factors that community banks must use for safety and soundness reasons. The distinctions between banks and payday lenders are critical, especially how they are supervised, are important factors. Payday lenders are not held to the same high standards – or supervisory expectations – as banks. Examiner requirements for sufficient information to underwrite a loan may be one barrier that prevents community banks from offering special small dollar loan programs. Therefore, ICBA recommends that the final guidance explain how and when streamlined underwriting and other factors can be used to expedite loan processing – and when more extensive procedures are needed to ensure the loan is made in a safe and sound way.

Direct Debit. The FDIC proposal recommends banks encourage customers to voluntarily use direct debit to repay small-dollar loans. Many community banks currently offer a direct debit option for repaying consumer loans. To encourage customers to elect this option, community banks may offer a discount on the loan or

[6] Many community banks report examiners exhibit a tendency to apply guidelines as hard and fast rules and not as parameters that allow discretion in application.

waive processing fees.[7] The option provides customer convenience and helps develop a positive relationship with the customer. However, for smaller institutions with limited volume, processing of direct debits may not be cost effective. This is a business decision which should be left to the discretion of the bank. Therefore, ICBA recommends the FDIC acknowledge that direct debit may not be practical for all community banks or in all situations.

Savings Component

The proposed guidelines recommend combining the loan with a savings account. Some existing programs offer loans where a small percentage of each loan payment is deposited in a savings account to encourage consumers to build assets. However, an informal survey of ICBA bankers found that few offered a savings account tied to a loan. While steps that encourage consumers to save deserve closer consideration, ICBA members have found there is little customer demand for such a feature. Therefore, ICBA recommends the FDIC help educate the public and bankers about the value of encouraging savings through a small-dollar loan program, especially since savings allow consumers to be less dependent on short-term loans.[8]

Savings Account as Collateral. Where permitted by state law, the proposal recommends a savings account serve as collateral for the loan, a step many community banks currently offer. While some community banks are reluctant to use a savings account as collateral due to the ease with which funds can be withdrawn, many are willing to allow consumers to pledge certificates of deposit as collateral.

The proposal also suggests restricting withdrawals from the savings account to ensure assets accumulate. While the bank might be able to do so while the loan is outstanding, placing restrictions on the savings account after the loan has been paid may present other problems. For example, it places the bank in the awkward position of determining which withdrawals are acceptable. It also threatens to create a fiduciary relationship between the bank and the consumer that may not be appropriate and places risks and responsibilities on the bank that it may not be equipped to handle and for which it is not compensated. Therefore, ICBA recommends that any restrictions only be imposed with caution and careful balancing of the risks and liabilities involved.

Matching Funds Programs. The proposal also recommends banks explore matching-funds programs to encourage savings. In our informal survey, no community banks offer such a program, in part because costs to administer a matching funds program are believed to outweigh the benefits. Community bankers also believe these programs also present high risks. While some community banks offer limited matching funds through high school educational programs, e.g., $5.00 per account, most found little public interest in matching fund programs. ICBA recommends the FDIC, working with other interested parties, take steps to increase banks' awareness of matching funds programs, facilitate partnerships between banks and organizations that help fund these

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[7] Since direct debit can reduce processing costs, the bank passes along the cost savings to the customer.

[8] Existing financial literacy programs are a step in the right direction and can help consumers understand the importance and benefits of savings.

programs, and take other steps to increase the visibility and usefulness of the programs for banks and the general public.

Collaboration with Other Organizations, Financial Education and Counseling

The FDIC recommends banks consider partnering with other organizations to offer affordable small-dollar loans. Currently, ICBA members participate in a variety of programs, through partnerships or participation offered through local schools, economic or rural development cooperatives, Federal Home Loan Banks, and Habitat for Humanity.

ICBA members believe financial education is extremely important and take appropriate steps to offer it in their communities, especially through partnerships with local schools or senior centers. As a trade association, ICBA supports and promotes financial literacy programs, especially those that help underserved, disadvantaged and emerging markets. ICBA partners with government, nonprofit, and private-sector entities in promoting financial literacy programs to community banks to use in their communities, including the FDIC Money Smart program. ICBA also offers a variety of consumer training resources and brochures for our members to use to help educate consumers. In addition, to help community banks develop financial literacy programs, ICBA participates in the Jump$tart coalition, the Wall Street Journal's Classroom Edition program, Operation Hope, and MyMoney.gov. The FDIC can further help promote these efforts by facilitating training and information for bankers and facilitating partnerships with local community groups.

While community banks may not have formal counseling programs for consumers, ICBA members report they provide training for staff and are always available to help customers with financial questions. As one community banker put it, "Of course we offer financial counseling personally on a daily basis. It's what we do as community bankers. It's not a structured program, but the access and professional advice to customers and friends of the bank is always constant."

Conclusion

ICBA appreciates the FDIC's efforts to help community banks tap into unserved markets. However, it is important that policymakers recognize that many community banks already offer the types of services contemplated by the proposed guidance, although without setting up specialized programs. Community banks make these loans without segregating them from normal consumer lending programs. ICBA believes this is a competitive market where additional regulatory requirements could add to the costs for banks and their customers, creating additional barriers to small dollar consumer lending by community banks. If banks exit this line of business, it will provide even more fertile environment for non-bank lenders to make these loans. Therefore, to facilitate the lending contemplated by the proposal will require a clear understanding of barriers and costs.

ICBA agrees with the FDIC that financial literacy is an important component to overcome reliance on small-dollar loans and strongly encourages the FDIC to continue to promote and expand programs like MoneySmart that can be used by banks and others. ICBA also strongly encourages the FDIC to work in collaboration with the other financial agencies on financial literacy programs, either through the FFIEC or through Treasury's Financial Literacy and Education Commission. ICBA looks forward to working with the FDIC to help promote programs such as MoneySmart and other financial literacy efforts. And, since financial literacy is critical, ICBA urges the FDIC to take steps to facilitate banks use of financial literacy training programs as well as facilitating partnerships between interested third parties and banks.

Thank you for the opportunity to comment. ICBA looks forward to working with the FDIC to address the barriers to expanding affordable small dollar loan opportunities for community banks, to help consumers become good bank customers and to help community banks tap into new markets.

If you have any questions or would like additional information, please contact the undersigned by telephone at 202-659-8111 or by e-mail at robert.rowe@icba.org.

Sincerely,

Robert G. Rowe

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