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1 February 2007

Mr. 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 American Bankers Association is pleased to submit our comments on the Federal Deposit Insurance Corporation's ("FDIC") proposed guidelines to state-member banks, released 4 December 2006, regarding small-dollar loan products that are both affordable to customers and yet safe and sound investments for banks. The FDIC notes in the proposed guidelines, "Because such products are in great demand, the FDIC would like to raise awareness that some institutions have found ways to offer them in a cost-effective, safe and sound manner that is responsive to customer needs."

ABA strongly supports the FDIC's efforts to encourage prudently designed affordable small-dollar loans, and we appreciate the principles presented in the model offered by the proposed guidelines. We also pledge our continued cooperation with the FDIC in these efforts.

We understand that the FDIC guidelines are presented as a model, placing on the table the kind of elements of small dollar lending that could make it attractive to customers and to banks. We recommend that any final document make this exemplary nature clear, so that no one would reach the mistaken conclusion that a federal agency is endeavoring to design specific commercial banking products. We take the principles in the proposal very seriously and find their presentation to be extremely helpful to the work of our member banks to broaden our ability to meet customer lending needs.

As we approach the practical issues that need to be overcome in broadening access to small dollar loan products, we have identified a number of challenges. The first relates to Section 670 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. 109-364, Section 670, "Limitations on Terms of Consumer Credit Extended to Servicemembers and Dependents" (hereafter, "Payday Lending Law"). In addition, there are the challenges posed by the unique risks and costs

associated with these types of loans. We are confident that working together these challenges can be addressed.

Specific Recommendations

1. Convert the Guidelines to Illustrations of CRA Options.

To make clear the role of the guidelines as a model rather than a detailed regulatory requirement, we suggest the document be relabeled, for example, "Exploring Innovative Small Dollar Loans: Illustrating CRA Options." We also suggest that the Community Reinvestment Act (CRA) aspect be stressed by placing it in the beginning of the document rather than at the end.

2. Hurdles Presented by the Payday Lending Law.

Next, there are potential, serious difficulties in reconciling the specifics of the proposed guidelines with the Payday Lending Law. Until the uncertainties surrounding how this law will be interpreted and applied are resolved, it will have a chilling effect on banks' efforts to design affordable small-dollar loans, whether for military or civilian customers.

While the Payday Lending Law applies specifically to military personnel and their spouses and dependents, unless there is a clear and practical system for depository institutions to identify and verify eligibility under that law, as a practical matter, this provision of law will overshadow any efforts to develop small loan products. Moreover, even if there were a clear and practical way for banks to distinguish between military and civilian customers, few if any depository institutions will wish to design products for the general public but exclude military personnel and their families from such products.

The specific provisions of the Payday Lending Law, if applied to depository institutions, will prohibit or restrict important terms and features the proposed guidelines appear to encourage. These legal restrictions, coupled with the severe penalties for noncompliance, will potentially inhibit depository institutions from pursuing efforts to design the products envisioned by the proposed guidelines.

For example, the proposed guidelines advise depository institutions to use savings accounts as security for the loan, thus reducing the risk of nonpayment while encouraging customers to begin to build their financial assets. Indeed, at the FDIC's forum, *Affordable, Responsible Loans for the Military* held 6 December 2006, representatives of various depository institutions offering alternatives to payday loans indicated that the savings account component was a critical one. Not only does it provide security for the loan in the event of a default, making the program more attractive for depository institutions to offer, but it also encourages customers to

develop a savings habit so that they have a cushion in the event of unexpected expenses and thus avoid the need to resort to payday lenders. However, the Payday Lending Law prohibits using as security any "method of access" to a bank account. Thus, this important savings feature might not be an option under the Payday Lending Law were it to be applied to insured depository institutions.

In addition, under the Payday Lending Law, the new, "all-in" annual percentage rate ("APR") cannot exceed 36%. However, applying an APR model designed for very different kinds of loans can be a misleading and bad fit when applied to the lending programs envisioned in the FDIC's proposed guidelines. A variety of routine and customary factors may make it difficult for small-dollar loans, which are typically very short term, to meet this test when calculated as may be envisioned under the new law. The fixed costs of making and maintaining any loan, the small amount of the loan, and the typically short term of such loans will artificially inflate the APR, potentially so that it exceeds a nominal *annual* rate of 36%. Consider, for example, a $5 dollar fee on a $200 dollar loan. If made for a year, that would be little more than 2%; but if the loan were intended for one or two weeks, an annual percentage rate calculation could easily jump beyond the limits in the new law. In addition, the normal risks associated with any unsecured loan will compound this pressure on the APR.

The Payday Lending Law also prohibits refinancing a loan with the same creditor. This means that beneficial refinancings and also work-out loans, for example, would no longer be an option, presenting another impediment to offering affordable small-dollar loans, especially ones that target, as the FDIC expects, "customers who have poor or limited credit histories, or who would otherwise be characterized as subprime borrowers." The hope would be that such customers will develop better credit histories and more financial experience and resources and qualify for more favorable credit products. Application of the Payday Lending Law to insured depository institutions could prevent them from offering such services to the very people who need the help and are ready to move on to the next level.

Finally, uncertainties about the role direct debit repayments can play in such loans could potentially inhibit the use of the FDIC's model. The proposed guidelines advise "voluntary" direct debit to repay the loan. At the FDIC's forum, *Affordable, Responsible Loans for the Military,* depository institutions describing their small-dollar affordable loans stressed the important role of the direct debit component of their programs. However, the uncertainties about the application of the Payday Law's prohibition against mandatory direct debit will inhibit development of small-dollar affordable loans until it is resolved.

3. Financial Risks and Costs of Small Dollar Loans.

In addition to the Payday Lending Law considerations, the ability to design any affordable small-dollar loans will be significantly influenced by the unique risks and costs associated with these types of loans. By definition, small dollar loans are relatively expensive to offer because the fixed costs of providing and servicing the loan may not be covered by the small amount of interest generated by a small loan and other minimal fees. In addition, the loans may be riskier because they may not be secured and because, as the FDIC anticipates, some of those applying will have "poor or limited credit" histories," or "would otherwise be characterized as subprime borrowers."

The proposal observes, "The goal of safe and sound small-dollar credit programs is to provide customers with credit that is both reasonably priced and profitable for the institution." In addition, the FDIC in the proposal notes that the purpose of the guidelines is "to encourage financial institutions to offer small-dollar credit products that are affordable, yet safe and sound." And of course, safety and soundness of banks is of paramount concern to the agency that insures the deposits made in those banks. We believe that working with the FDIC we can develop affordable small loan programs that recognize that costs and risks are significant components in any program that is to be feasible and sustainable over time for any particular depository institution.

Conclusion.

ABA is eager to continue to work closely with the FDIC to raise awareness about the need for affordable small-dollar loans and the means for depository institutions to offer them in a safe and sound manner. We believe that the proposed guidelines are an important initiative and a good start to these important discussions; we pledge our best efforts to work together with the FDIC and other banking regulators to address the challenges before us. We look forward to continuing the dialogue on this important issue.

Sincerely,

Nessa E. Feddis