STATEMENT BY

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HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

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I commend the subcommittee for conducting this hearing on the important issue of access to credit for cash-strapped consumers and small businesses. I wish I were able to participate in the hearing in person and would appreciate my written statement being made part of the record.

I am former Chairman of the Federal Deposit Insurance Corporation; Senior Managing Director & Global Head of Financial Institutions for FTI Consulting; and Chairman of Fifth Third Bancorp. The opinions I express are my own and do not necessarily reflect the views of these organizations.

I appreciate Congressmen Luetkemeyer and Baca taking the time to fashion an innovative approach to increasing the flow of small loans to individuals and businesses. As reported in the "findings" of their bipartisan bill, studies by the FDIC and others "have shown that roughly half of all American families . . . are literally living paycheck-to-paycheck." I think we can all agree that we need more education in financial literacy, and we need more stable sources of credit.

I believe the proposed Consumer Credit Access, Innovation, and Modernization Act's creation of optional federal chartering for non-bank

lenders is an innovative approach that could yield many benefits. It's difficult for me to see a downside to the bill.

The legislation would create an optional federal charter for non-depository lenders at the Office of the Comptroller of the Currency, which has chartered national banks for 150 years. The legislation instructs the Comptroller to focus on the "true cost" of the loan product rather than the annual percentage rate (APR) and facilitates the offering of short-term lending products best suited to the needs of borrowers, beyond payday lending.

I have long been critical of interest-rate ceilings that restrict or effectively prohibit short-term personal loans from banks and non-bank lenders. While the APR provides useful information to consumers when comparison shopping for loans, it is inappropriate to use it to cap interest rates on short-term lending.

Hearing about a 390% APR for a payday loan, for example, is at first blush jarring. But after thinking about it more carefully, one recognizes the value proposition. The APR on a payday loan is much lower than the APR on a typical fee for a bounced check or for a late mortgage or credit card payment, or the fee for getting your electricity turned back on after it has been cut off due to late payments. The loan fee is definitely much less than the lost income when you can't get to work because you can't afford to get your car repaired. These are typical of the choices facing customers who take out a short-term loan.

The plain truth is that tens of millions of people from all walks of life decide their best option is to do business with non-bank, short-term lenders. The terms are very easy to understand – you borrow $200 and you pay back $230 two weeks later. Critics claim this amounts to predatory lending, a charge I don't understand. The loans are unsecured and if you default, there is not much the lender can do except not grant another loan. The lender cannot evict you from your house or take your car. It's not economic for the lender to even file a collection suit.

The legislation addresses directly the criticism that payday loans are never really repaid – just renewed over and over. I believe this criticism is blown out of proportion, particularly in comparison to other types of borrowing. The high APRs and short maturities on payday loans make it impossible to keep the rollover game going for very long, in contrast to credit card and other revolving debt.

In any event, to the extent rollover loans are a problem, it is largely because state regulatory barriers effectively prohibit lenders from offering borrowers more suitable options, such as installment loans, which most lenders would very much like to do. As John Berlau of the Competitive Enterprise Institute noted in a recent paper, "In California, a nonbank lender can make a payday loan in the maximum amount of $300 or an installment loan in the minimum of $2,500. This leaves a big gap in the middle."

The Luetkemeyer-Baca legislation will help bridge this gap by allowing safe, regulated and innovative loans to flow across state lines and benefit consumers and small businesses. It will do so without exposing taxpayers to any risk, as these federally chartered and regulated, short-term lenders will be required to raise their capital and funding entirely from private sector sources without the benefit of any federal guarantee.

The financial record of non-bank short-term lenders over recent decades has been impressive in good times and bad. Short-term lending is relatively risky, but the risks are ameliorated due to diversification in the portfolio, and the risks are priced into the fee structure. It is quite feasible to maintain high loan loss reserves and strong capital against short-term loans and achieve good returns if the short-term lender is an efficient operator.

Reducing unnecessary regulatory barriers will increase competition for bank and non-bank lenders and will foster sustainable sources of credit for consumers and small businesses. This will in turn stimulate economic growth and job creation. The Luetkemeyer-Baca bill appears to be an important step in the right direction and deserves a fair hearing and serious consideration.