AN EXAMINATION OF THE AVAILABILITY OF CREDIT FOR CONSUMERS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

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AN EXAMINATION OF THE AVAILABILITY OF CREDIT FOR CONSUMERS

Thursday, September 22, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:31 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Renacci, Royce, McHenry, Pearce, Westmoreland, Luetkemeyer, Huizenga, Canseco, Grimm, Fincher; Maloney, Gutierrez, Watt, Hinojosa, McCarthy of New York, Baca, Miller of North Carolina, Scott, Meeks, and Carney.

Chairwoman CAPITO. This hearing will come to order. Close the doors there.

I would like to thank the Members for being cooperative and the witnesses for starting early this morning. The Oversight and Investigations Subcommittee has a very important hearing in this room at 2 p.m., and we need to move through this hearing as expeditiously as possible so that they can have enough time to complete their hearing.

We are also likely to have a series of votes around 1 p.m., and it is my intention to try to wrap up the hearing when those votes are called. That said, I would like to remind Members to try to abide by the 5-minute rule when questioning witnesses so all Members will have sufficient time to ask questions.

The financial crisis and economic downturn have left many Americans with fewer financial resources. Furthermore, some Americans have lost their jobs and suffered significant reductions in their standard of living. Many have exhausted their savings and are now seeking new financial products to help them get through these difficult times.

While many of us will weather the storm and regain our financial footing, those who have struggled may have fallen out of the banking system or are teetering on the edge. Today's hearing will give members of the Financial Institutions and Consumer Credit Subcommittee a better understanding of the ongoing innovation of financial products to meet the demand for credit.

Our first panel of regulator witnesses will provide us with an assessment of programs that financial institutions offer for borrowers seeking lower-dollar loans. Our second panel will provide members of the subcommittee with an overview of entrepreneurship and innovation in dealing with new financial products as well as the necessary safeguards to make sure that these products are safe for the consumer.

We need to foster innovation in the creation of new financial products to meet our consumers' needs. There should be diverse product offerings for consumers so that they can best tailor the products to their needs.

This product expansion is critical to consumers' ability to gain—to regain, in some cases—and maintain financial stability and to access the credit products they need. It is my hope that this hearing will provide Members with the information necessary to make informed decisions about ways to expand credit availability for the underserved.

I would like to now recognize the ranking member, the gentlelady from New York, Mrs. Maloney, for the purpose of making an opening statement.

We experienced some technical difficulties at the beginning of Mrs. Maloney's statement.]

Mrs. MALONEY. —particularly not only from government in the first panel, but the second panel, on many in the private sector that are exploring short-term credit options and other ways to provide credit to the underbanked. According to a recent study, this segment is approximately 55 million people, or 24 percent of all households in America, and this population has grown by approximately 12 percent over the last 4 years, in large part due to the economic crisis.

Even those who do have checking accounts at traditional banks often face credit challenges. In fact, research from the Bureau of Economic Research tells us in their recent report—I find this an astonishing statistic—that about half of all Americans would not be able to come up with $2,000 in 30 days for emergencies. I would say this is, then, an emergency that government faces.

Whether they use payday lenders, check cashers, or simply seek to borrow money from their friends and families, these consumers tend to feel that their banks can't provide them with the money they need to fill the financial void that they face. And in many cases, banks are not willing to give this type of loan to a customer. So they seek services outside of their banks, where there is often a greater likelihood of predatory practices.

We know that the population of people seeking these types of short-term credit products is growing in this uncertain economy, where the unemployment rate has been over 9 percent for some time. I have always supported consumer choice, whether it be in the area of credit cards, overdraft protection, check cashers, or any other form of short-term loans. I believe that as long as the prices are clear, the risks are clear, and that consumers are on a level playing field with their financial institutions, then they should be empowered to make decisions about their finances that are right for them and their families.

I was very happy to learn about the National Credit Union Administration's short-term loan product for credit unions, and that the FDIC pilot project enabled a small number of banks to offer a low-dollar loan product. This is important that you are looking in these directions.

But the problem is that consumers say the reason they seek a short-term loan as opposed to a loan from their bank is because the payday loan, or the check cash, or whatever it is, is fast and easy to obtain, and often these loans do not require a credit check.

I look forward to hearing from the regulators on our first panel whether they think the loan products that their banks offer could be a viable alternative. I also would like to hear from them what they are doing for check cashers, because many are telling me that they can't get any cooperation from a bank. I know that in the great State of New York, there is only one bank that will cooperate with check cashers, and—even though they will check the credit of the people and ensure the credit of the people they are looking at.

I really do feel that this is a huge, huge problem. There are many unbanked and underbanked citizens in our country, and we need to figure out how we can help them become banked, either through an alternative low-term project in the government, in the government banks—or the government-regulated banks—or in the other alternative areas.

And I would like to raise to the OCC, these alternative areas are not regulated. Maybe the OCC should regulate this area too, or what are your ideas of how this should be approached?

In any event, I compliment the chairwoman for focusing on this. Regrettably, it is a growing problem in our country.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Westmoreland for 1 minute for an opening statement.

[Technical difficulties.]

Mr. WESTMORELAND. —for this hearing, and despite the Administration's assurances that 2010 would be a recovery summer, consumers are still struggling to gain access to credit. This is particularly true in Georgia, where the proliferation of bank failures and burdensome regulations from this Administration further hindered bank's abilities to lend to creditworthy borrowers.

Now, banks are expanding to offer nontraditional financial products to consumers because regulations have increased costs and limited banks' ability to charge customers for these services. I am especially concerned about Federal regulators regulating profit over regulating the product. This is particularly true of recent OCC guidance, issued June 8, 2011.

And I look forward, Madam Chairwoman, to hearing the testimony today from these witnesses.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Gutierrez for 3 minutes for an opening statement.

Mr. GUTIERREZ. Thank you very much.

And I want to thank you and the ranking member. I support the work these regulatory agencies are doing to encourage banks to offer safe and sensible loan products to underserved borrowers.

I am also interested in innovations and really helping families get out of the debt cycles and build good credit. I consider this a very important issue, and one for which I want to explore solutions, and how will we address the potential abuses that exist just before us?

Big banks—the same banks that we bailed out—are not offering products that look very familiar to anyone looking at them and fighting abusive and predatory lending practices. Wells Fargo—I just got this from the Internet—Wells Fargo has something called "direct deposit advance," and U.S. Bank has "checking account advance."

While these offers may sound interesting and pretty innocent, they may not be all they seem to be. They are charging fees and interest rates that work out to almost 120 percent APR or more, and that looks pretty much like a payday loan to me.

They are writing terms that they say can take their payout straight from their next direct deposit. Sounds like a payday loan to me.

And guess what? If you can't pay it off at the end of the month, they are going to go to your account and debit your account, and if the money doesn't exist, you get an overdraft fee from U.S. Bank and Wells Fargo.

I don't know about the rest of you, but I am paying attention, because I thought the payday industry was the ugly little brother duckling that the big banks always frowned upon. But it appears that after we bailed them out, and they took us to the brink of disaster that is exactly where they want to take many of their customers today.

I hope we check into these products and use enforceable standards created by a new consumer protection agency, which I hope we stop tying the hands of.

Thank you so much.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Luetkemeyer for 2½ minutes for an opening statement.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

As unemployment hovers above 9 percent, and the economy remains stagnant, the American people continue to suffer. Traditional financial institutions are facing a sizeable wave of new regulations and have, in some cases, turned to increased fees to help weather the financial storm.

Regardless of who or what is to blame, the simple truth is that some low- and middle-income Americans are being forced out of depository institutions. They are more frequently turning to alternative sources of capital.

Twenty-five percent of American households have difficulty obtaining credit from traditional sources, and 55 percent of our citizens have trouble pulling together $2,000 to deal with an emergency. We seem to continue to work against the non-depository institutions despite the fact that they are regulated, have high customer satisfaction, and serve a population that others are not interested in or able to serve.

If we want to get serious about helping those with limited access to credit, we need to consider novel concepts that include a wide variety of institutions. We are beginning to do this, but must continue to make progress. To take the FDIC's small-dollar loan pilot program, this is just one example of a new initiative that could ultimately lead to wider access to credit.

Most institutions that have participated have viewed it—some of them have viewed it as a success, and did so because it gave them an opportunity to build relationships with customers. Without that connection, financial institutions have no reason to do a small-dollar, short-term loan that might be needed to pay a medical bill or a car payment that allows the American public to get well, get educated, or get back to work.

We can improve upon this program by consenting to the formation of partnerships between banks and non-banks, which I believe would encourage increased access to credit and stronger consumer protections. The economy isn't improving. Our constituents continue to suffer.

It is time for our government to work together and identify innovative ways to foster cooperation and advance this conversation. Hopefully, today's hearing will provide a forum to do just that.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Baca for 2 minutes for the purpose of an opening statement.

Mr. BACA. Thank you very much, Madam Chairwoman, and anchor for our third-base team, as well as our ranking member, as well.

Today, we are here to discuss the credit crisis and how it impacts the unbanked and underbanked population in this country. With all the attention the near-collapse of Wall Street received, relatively little attention has been given to the population of minority and underbanked and unbanked communities.

These individuals and families are struggling with high unemployment and limited options as to where to go for credit.

A recent study by the National Bureau of Economic Research found that one quarter of Americans would be unable to come up with $2,000 in 30 days if they had financial emergencies. So, you have to put yourself in that kind of a situation.

Another 19 percent would have to rely on short-term credit products in order to come up with the cash. This population is no longer just the poor. It is the middle-class families fighting to pay their bills, mortgages, and educational costs for their kids, and knowing that they need a $2,000 loan and can't get it anywhere else.

Today's banks are not serving the underserved consumers and are not supporting the innovation that we need in the market. In this situation, where can these individuals go? Some Members may choose to focus on the subset of the short-term loans—payday loans, what they feel are the danger of this product.

But payday loan providers do not offer $2,000 loans. It would be a disservice to the people in need of credit to focus on these products alone.

If close to half of Americans cannot come up with $2,000 on their own in 30 days, the problem is much bigger than just payday loans. We need to discuss short-term products and how they can help.

We need to create an environment for safe but effective financial innovation that at the end will provide more access to people who need it. This year, I have introduced H.R. 1909, the Federal Financial Services and Credit Companies Charter Act of 2011.

Chairwoman CAPITO. The gentleman's time—

Mr. BACA. May I have 30 seconds?

Thank you very much, Coach.

The goal of the legislation is to provide access to short-term products and safe, transparent—instead of reinventing the wheel, the bills work with what we have. Let us create Federal charter incorporated products. I realize that we have a lot to discuss and I look forward to hearing the testimony of the individuals today, and hopefully they will consider my bill, as well, in that, and that is the FFSCC Charter Act.

Thank you.

Chairwoman CAPITO. Thank you.

Mr. Canseco, for 1 minute for an opening statement.

Mr. CANSECO. Thank you, Chairwoman Capito, for holding this meeting.

Federal Reserve Chairman Ben Bernanke has as much as said that credit is the lifeblood of our economy. And based on a recent FDIC survey which shows millions of American families are unable and limited in their ability to access credit, and to quote my colleague, Mrs. Maloney, who stated and quoted the National Bureau of Economic Research that found that half of American families could not raise $2,000 in an emergency if they needed to.

This is truly a daunting problem that threatens the future of American prosperity. To correct this, Congress should focus on fostering a vibrant and competitive financial services industry—one that provides ample choices for consumers and allows borrowers mobility from one type of lending product to the next.

Unfortunately, the recent legislation and the hundreds of regulations that they mandate will restrict credit to even more and more Americans and disallow low- and moderate-income families access to traditional banking systems and other sources of credit. I look forward to hearing the testimony of the witnesses today.

Thank you, and I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Scott for 2 minutes for an opening statement.

Mr. SCOTT. Thank you very much, Madam Chairwoman.

I think the statistics point out clearly this great need. Right now, only 17 percent of banks consider it a priority to really get into the communities and serve the unbanked areas.

We are now in a very difficult economic time, with soaring unemployment. These unbanked individuals are not generally financially irresponsible. For example, there are those who have been unemployed for at least 4 months and are looking for work, and they have dried up their savings; there are those who are young adults who have limited access to liquidity due to various circumstances but realize the value in saving money where possible—they need access to credit.

Additionally, there are those who receive an hourly wage from often more than one job, who are just trying to hold on and find steady employment, with the economy hovering at 10 percent unemployment—and that is being very generous when you count those who have given up work. So we have an opportunity here. We have a responsibility to make sure we have a fair, level playing field.

One size does not fit all. There is room for payday lenders; there is room for small industrial loan companies; there is room for pawn shops. All play a very vital role.

And as we move forward with regulations we have to make sure that the one thing that is paramount is that our consumers deserve choices that fit their very serious economic circumstances at this time.

With that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Fincher for 1 minute for the purpose of an opening statement.

Mr. FINCHER. Thank you, Madam Chairwoman.

The poor state of this economy is hurting those the most who have the least. In an era of 9.1 percent unemployment, access to credit is tighter than it has ever been.

However, in my home State of Tennessee, there is a way to get credit that requires no credit score and has provided thousands of Tennesseans with funds to pay for emergencies and life's other problems. These lenders in Tennessee have satisfied a unique demand in the marketplace that banks and other financial institutions cannot fill.

Low-dollar lenders provide short-term, low-dollar loans, far below the amount that a person can borrow from the bank without a credit check. These loans offer another immediate option to many consumers who have low credit or no credit at all.

I look forward to hearing the testimony today from the witnesses, and I yield back.

Thank you.

Chairwoman CAPITO. Thank you.

I would like to thank the Members for their opening statements, and now I would like to introduce our first panel of witnesses for the purpose of giving a 5-minute opening statement.

We have your written testimony.

Our first witness is Mr. Barry Wides, Deputy Comptroller for Community Affairs, Office of the Comptroller of the Currency.

Welcome, Mr. Wides.

STATEMENT OF BARRY WIDES, DEPUTY COMPTROLLER FOR COMMUNITY AFFAIRS, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. WIDES. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, I appreciate the opportunity to appear on OCC's behalf to discuss consumer credit and the types of products that national banks and Federal savings associations are making available to meet small-dollar credit needs.

National banks and Federal savings associations provide the lion's share of unsecured consumer lending in the United States, with over $600 billion in credit card and other revolving debt outstanding. Consumer credit comes in many forms: unsecured and secured credit cards; term consumer installment loans; and lines of credit linked to checking accounts.

Many banks and thrifts offer credit cards that provide households with a crucial source of credit and a flexible repayment schedule. Lines of credit which are widely offered are frequently tied to checking accounts and can be set up automatically transfer funds to cover overdrafts. Most banks and thrifts also have unsecured consumer loan products, where the borrower makes installment payments over a set period of time.

But there are many factors that may limit a borrower's access to traditional types of credit. Some prospective borrowers may have yet to establish a credit history or may only have a limited credit record.

For other prospective borrowers, previous late payments, repossession action, bankruptcy, or foreclosure may have damaged their credit score. And some consumers are just unaware that the better credit products for which they would qualify are available.

However, a growing number of banks and thrifts recognize that there are ways for these customer segments to be underwritten safely and soundly. And many banks and thrifts have taken initiatives to provide products tailored to the needs of these customers.

My written testimony highlights examples of small-dollar loan products offered by banks and thrifts and shows that much is being done to improve access to credit. Many banks and thrifts use high-touch manual underwriting when making a loan decision, which allows them to consider mitigating circumstances such as temporary unemployment or emergency medical expenses. This approach is prudent as long as the customer has otherwise managed credit and has the capacity to repay the loan.

Other banks offer products such as secured credit cards to help borrowers reestablish or improve their credit. And new scoring models are helping to automate underwriting for thin-file customers. This not only lowers costs for low-margin small loans, but also allows rapid decisioning and expedited disbursement of funds.

The bank regulatory agencies' Community Reinvestment Act guidelines specifically acknowledges the importance of small-dollar loans as a means of serving the credit needs of the community. Programs that provide small, unsecured consumer loans based on the borrower's ability to repay and with reasonable terms are eligible for positive CRA consideration.

Loan programs that feature reporting to consumer reporting agencies or include a financial education component also may be favorably considered. And banks and thrifts may receive positive CRA consideration for qualified investments in financial intermediaries that offer small-dollar programs.

The OCC's community affairs staff engage in a variety of activities to encourage nationally chartered banks and thrifts to address consumer credit needs. We educate by communicating best practices through online resources and publications. We also work with the other bank regulatory agencies to conduct dozens of seminars each year where bankers hear firsthand from practitioners about how best to implement constructive programs, such as small-dollar loan initiatives.

The OCC works actively in partnership with the National League of Cities Bank On initiative to expand banking opportunities for unbanked and underbanked individuals. Under this initiative, banks and thrifts are offering low-cost checking with no minimum balance requirements, prepaid debit cards, and small-dollar loans with the support of counseling organizations who provide budgeting and financial counseling assistance.

I would like to conclude by reemphasizing that the OCC firmly supports efforts by national banks and Federal savings associations to be leaders in their communities. The OCC's guidance and supervision encourages our regulated institutions to offer products and programs that meet a spectrum of credit needs in a safe, sound, and sustainable manner.

Thank you for the opportunity to appear before you today, and I look forward to your questions.

[The prepared statement of Deputy Comptroller Wides can be found on page 156 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Robert Mooney, the Deputy Director for Consumer Protection and Community Affairs at the Federal Deposit Insurance Corporation.

Welcome, Mr. Mooney.

STATEMENT OF ROBERT W. MOONEY, DEPUTY DIRECTOR, CONSUMER PROTECTION AND COMMUNITY AFFAIRS, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. MOONEY. Thank you for inviting me to testify on options available to consumers in need of small-dollar, short-term credit. Expanding the availability of mainstream financial services in general, and affordable small-dollar loans in particular, is a priority at the FDIC.

A generation or so ago, it was not uncommon for banks to make small, unsecured loans to individuals. However, over time a series of product and technological innovations in the competitive landscape of banking contributed to a decline in the number of banks offering small loans and an increase in alternative credit providers offering more costly credit products.

The FDIC began reviewing whether banks could feasibly offer alternatives to high-cost, short-term credit in the context of military personnel, whose financial problems can collectively affect the readiness of our Armed Forces. In December 2006, we held a conference titled, "Affordable, Responsible Loans for the Military: Programs and Prototypes," where attendees, including military banks, representatives from the Department of Defense, community groups, and others developed a template for an affordable, small-dollar loan program.

In June of 2007, to encourage more banks to offer these loan products, the FDIC issued its Affordable Small-Dollar Loan Guidelines. The guidelines encourage affordable prices, reasonable loan terms, streamlined underwriting, and suggest linking a savings component and financial education to short-term loan products.

In February 2008, the FDIC launched a 2-year small-dollar loan pilot program to determine the feasibility of banks offering small-dollar loans as an alternative to high-cost emergency credit such as payday loans or fee-based overdraft programs. The pilot concluded in 2009. Twenty-eight volunteer banks participated with total assets ranging from $27 million to $10 billion, and with almost 450 branches in 27 States.

Banks made 34,400 loans with a principal balance of just over $40 million. While delinquencies on the loans tended to be higher than for unsecured consumer loans in general, charge-offs were in line with those other loans.

The pilot has resulted in a model, or template, of product elements for a safe, affordable, and sustainable small-dollar loan. Product elements include loan amounts of $2,500 or less, loan terms of 90 days or more, APRs of 36 percent or less, and low or no fees. Elements also include streamlined but solid underwriting, and optional savings and financial education components.

The template is simple and replicable.

Most pilot bankers indicated that these loans were a useful business strategy for developing or retaining profitable, long-term relationships with customers. The most prominent product element bankers linked to the success of this program was a loan term longer than just a few pay cycles to give consumers time to repay the loan. And perhaps most importantly, the pilot shows that banks can offer affordable small-dollar loans in a manner that suits their business plans and is fair to consumers.

Going forward, the FDIC is working with the banking industry and others to support strategies that expand the supply of small-dollar loans. These strategies include highlighting the successful features of the pilot and other small-dollar loan models, such as we are all doing here today; and encouraging broad-based partnerships among banks, nonprofits, and others to design and deliver small-dollar loans, including the use of new technologies and business models.

The FDIC is also engaged in a number of related initiatives, such as our Model Safe Accounts pilot, where we hope to demonstrate affordable savings and transaction accounts; Money Smart, our comprehensive financial education curriculum; our Alliances for Economic Inclusion that we have in 14 markets around the country; and our unbanked and underbanked surveys and other consumer research.

In conclusion, like all of us, underserved consumers need to cash their paychecks, pay bills, and save for the future with products that are safe, affordable, and easy to understand. They also need to access reasonably priced credit to buy a home or car, pay for their children's education, and of particular relevance to this hearing, to meet unexpected short-term financial needs.

The FDIC looks forward to the day when affordable small-dollar loans become a staple product at all banks, helping American families address their short-term credit needs in a safe, reliable, and financially sound manner.

Thank you.

[The prepared statement of Deputy Director Mooney can be found on page 139 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Mooney.

Our final witness on this panel is Mr. David Marquis, who is the executive director of the National Credit Union Administration.

Welcome.

STATEMENT OF DAVID M. MARQUIS, EXECUTIVE DIRECTOR, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

Mr. MARQUIS. Good morning, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. NCUA appreciates the invitation to testify about the availability of credit for the underbanked—that is, people who have a savings account but who also use alternative financial services.

In recent years, credit unions have outperformed banks in lending overall. Between December 2007 and June of 2011, credit union loans have expanded by about 6 percent while credit contracted for the rest of the economy.

Of note, low-income credit unions, which focus on providing services to individuals in communities more likely to have underbanked populations, have performed even better. Lending at these particular institutions grew by about 14 percent.

In passing the Federal Credit Union Act nearly 80 years ago, Congress decided that credit unions have a mission of meeting the credit and savings needs of consumers, especially people of modest means. NCUA therefore has considerable experience facilitating the ability of credit unions to meet the financial needs of the underbanked.

NCUA works to help the underbanked obtain credit in three principal ways: by facilitating the availability of loan products; by expanding credit union access to members in underserved communities; and by offering assistance to credit unions focused on providing service to the underbanked.

To facilitate the availability of credit for the underbanked, the NCUA finalized its small loan program last September. The rule provides a viable, consumer-friendly, lower-cost alternative for credit. With strong consumer protections, the rule balances increased risk and access to affordable, fully-amortized credit that is faster and easier to qualify for as compared to more traditional lending products.

Since its introduction, the product has gained growing market acceptance and enhanced the availability of short-term credit. At the end of June, 343 Federal credit unions reported more than 33,000 small loans averaging just over $412 each and just under 21 percent interest rates, which is significantly lower than the triple-digit interest rates often charged by payday lenders.

To further expand credit union access to unbanked households, NCUA also revised its rules in June. These changes ease regulatory burdens on credit unions seeking lower-income credit union designation.

Additionally, NCUA continues to promote access to credit by approving applications allowing credit unions to add underserved areas for their field of memberships.

To provide additional assistance to credit unions, NCUA operates the Community Revolving Loan Fund. Congress created this fund to provide low-interest loans and grants to support low-income credit unions' efforts like improving financial literacy, providing financial education, creating new products, and preventing foreclosures and expanding overall access to credit.

In May, NCUA issued a proposed rule to eliminate outdated procedures and increase transparency. When finalized, NCUA anticipates that the reduction of regulatory burden will increase loan demand and enhance the availability of basic financial service in low-income communities.

The committee has also requested ideas to increase the availability of sustainable, affordable credit options for underbanked households. In this regard, NCUA has several suggestions.

First, current law only permits multiple common-bond credit unions to serve underserved areas. Allowing other types of credit unions to add underserved areas would promote improved access to basic financial services, loan products, and wealth-building opportunities.

Second, Congress could permit credit unions to serve any adjacent geographic area meeting economically distressed criteria like poverty and unemployment without regard to CDFI fund's more restrictive conditions than NCUA's local community requirements.

Finally, focusing more broadly on job creation and economic growth, the passage of the bipartisan Small Credit Union Lending Enactment Act, sponsored by Congressman Royce and Congresswoman McCarthy, would also increase access to credit. The bill would enable credit unions to prudently make safe, well-underwritten member business loans more frequently, supporting economic growth and job creation.

If enacted, NCUA will act quickly to implement the strong safety and soundness regime called for in the bill by writing new rules and remaining vigilant in our supervision effort programs.

In sum, NCUA recognizes the real need to expand access to credit for the underbanked. As a result, the agency has long sought to enhance the availability of credit, increase access to potential members, and assist credit unions. NCUA also stands to work with the committee on any future legislative efforts to increase access to credit.

Thank you, again, for the opportunity to discuss these important issues. I look forward to your questions.

[The prepared statement of Mr. Marquis can be found on page 116 of the appendix.]

Chairwoman CAPITO. Thank you very much.

And I am going to go ahead and begin the questioning.

My question is in relation to the interchange issue that we had earlier in the year on the debit and credit—or, it was the debit cards, and some of the push-back from the financial institutions was because of the loss of revenue in that area, that they were going to be eliminating some credit card rewards. But also, some, I think, have started to assess monthly charges for a banking account, a checking account with the financial institutions, and some people—the folks that we are talking about today are—my fear was that they would just drop out of the banking system because of the—you know $10 a month is a significant amount of money here.

Are you finding with the institutions that you regulate that they are losing customers in this economic range and that maybe developing a short-term, low-dollar loan program is a way to get them back into the banking systems? Is that something that is working?

Mr. WIDES. One of the banks that we actually highlighted in my testimony was KeyBank, in Cleveland, Ohio. They have actually, as a large bank, developed a very aggressive strategy for going after the unbanked. They have check cashing within their branch locations; they offer remittance services; and as I mentioned in my testimony, they recently rolled out a small-dollar product for customers who didn't qualify for the bank's other unsecured credit products. And this credit product that they developed is geared toward individuals who have thin credit files or are reestablishing credit.

And I would say that KeyBank is an example of a national bank that has actually developed a strategy to affirmatively go after this clientele, and they do offer the kinds of products that you mentioned, the low-cost products that provide a slimmed-down set of offerings for consumers.

I can't speak to the other question in terms of whether the interchange rules have or have not had an effect yet. But we do see promising signs of banks seeing the unbanked as a market that is worth going after.

Mr. MOONEY. I would briefly add that in the FDIC's survey of banks 2 years ago relative to their activities in underserved markets, banks that responded said that about 73 percent of those were aware of the increased demand in low- and moderate-income areas and underserved areas, and they considered that to be an important market. However, only 18 percent of those banks prioritized it as a market that they would go into, which is why the FDIC started Alliances for Economic Inclusion. In 14 different markets, we brought together banks, nonprofits, and public officials to talk about ways to reach into these underserved neighborhoods and develop products that are useful to them, including small-dollar loans.

Our pilot program showed that the banks who found that loan program to be the most profitable were those that targeted low- and moderate-income areas, targeted the military—targeting the individuals who otherwise don't have free and ready access to the financial system.

Chairwoman CAPITO. In regards to your pilot program, the original participants in that program, are they still offering those—

Mr. MOONEY. It is a good question.

Chairwoman CAPITO. —products?

Mr. MOONEY. We began with 31 banks that started the program. We ended the program 2 years later with 28 banks. Most of those banks, we believe, are still in the program; we haven't surveyed them recently.

But we are very encouraged by the fact that an additional 50 banks who are members of our Alliances for Economic Inclusion have either started to offer a small-dollar loan program or are developing a program to initiate in the very near future. I was just at a meeting of military banks, and the military banks that were part of the program continue to offer the program and consider it very important.

Chairwoman CAPITO. Let me ask a quick question, because I only have a little bit of time left. I have heard kind of veiled references to qualify, qualify, qualify. How does a person qualify? Is it your credit score? And can you qualify, is a question I would have?

So, just briefly, if somebody would like to address that?

Mr. WIDES. Sure. I would say mostly they are looking at the credit profile; they may use the credit score, but if the borrower does not have a credit score because of a thin file, they are beginning to use alternative data sources that look at utility payment, rent payment, and other public file characteristics.

They also do a debt-to-income ratio capacity, and for credit card lending, under the Card Act, in fact, a capacity analysis is required.

Mr. MOONEY. It is important that the underwriting be very streamlined and very fast.

Chairwoman CAPITO. Yes, I am thinking that somebody who needs a $2,000 loan for whatever, it is usually something that is pretty crucial to them; it is not to go on vacation. And timeliness is extremely important.

Mr. MOONEY. Our pilot banks turned those around within 24 hours, some very quickly. Remember, they are serving their own customers, so—

Chairwoman CAPITO. Right.

Mr. MOONEY. —they do know them.

Chairwoman CAPITO. Right.

All right. Thank you.

Mrs. Maloney?

Mrs. MALONEY. Thank you.

And in response to your question on the Card Act—the Credit Card Bill of Rights, which I authored and worked on for 4 years and which passed this body with strong bipartisan support, the Pew Foundation found that bill alone saved consumers over $10 billion last year by stopping unfair abusive practices, such as raising rates retroactively on balances for no reason at all.

I think the answer to that is if a bank is raising and charging fees, go to a different bank. Go to a community bank. Go to a credit union. They all provide the same service.

And shop around. In many cases the interest rate is much, much lower at some banks than at other banks. So consumers should, if they are getting unfair fees, cancel their account and move to another bank that is providing what they feel is fair service.

I feel that this is a truly important issue about addressing the unbanked, and one of the reasons that many people think that financial institutions are not providing it is that there are often not branches in low-income neighborhoods. But a report that was issued in 2008 from the New York City Department of Consumer Affairs on Financial Empowerment found that a fundamental mismatch between the products being offered and the population's real need was the primary reason why lower loans and products were not getting out to the unbanked.

And then the areas that we do have services—and I will note one that is active in the community I represent, which is money service businesses—they cannot get banks to work with them. So we really have to get this system to work better, and I wrote the OCC several times and inquired, was the OCC cracking down on banks that were working with MSBs? The banks in my district said that they would not offer services to MSBs because the OCC was telling them not to, that they were going to rate them differently.

I just want to say that I did put in a bill on self-certification of the MSBs, that if they comply with the Bank Secrecy Act and the anti-money laundering statutes, the bill makes strict penalties for MSBs that in any way are not up to their statements, and banks are not held liable for MSB activities. And the banking associations did not oppose this bill; they found it fine. But they are afraid of regulators hitting them hard if they cooperate with some of these alternative areas that are out there.

So I think that banks have choices, and they are going to be able—they have the choice to go to what product they feel meets their business model, and we should recognize that and honor that. We are in a free enterprise system.

But also, these new alternatives that are coming up, I believe we should help them regulate them—they are unregulated; they would like to be regulated, and maybe the OCC should start regulating them and working on ways they can work with the financial systems that already exist to get the credit out to the communities. What I am hearing many of my constituents say is, "We are seeing banks that are too-big-to-fail and too-big-to-give-any-credit."

So they are really important banks. They are international. They are serving the world, but they are not serving communities and they are certainly not serving the unbanked and underserved.

I will just throw that out as a question: Would the OCC be open to creating a unit that would oversee or regulate these new entities and look at ways to encourage the existing banking system—credit unions, financial institutions—to work with them to get the credit out? We don't have to reinvent the wheel. There are many people who are out there trying to help in that particular field.

So my question is really to the OCC.

Mr. WIDES. You raise very important points, and I would like to address a couple of them. Number one, the Consumer Financial Protection Bureau will have the authority and does have the authority to regulate the check cashers, payday lenders, and it probably would require legislation to move that function back under the OCC. As it relates to the money services businesses, there are issues that have been raised in that context relative to anti-money laundering, and I am not an expert on all of that, but we are aware of the issues that have been raised about some of the money service businesses not being able to get access to the services of banks because of the concern of the bank regarding the anti-money laundering.

Mrs. MALONEY. My time has expired. I look forward to meeting with you on this issue. FINRA came out in support of the bill and the whole area that looks at that area in our economy, so I think it is a challenge that we need to look at. And on the CFPB, we are having trouble getting a Director in there so that they can really get started.

So anyway, my time has expired.

Mr. WIDES. I would be happy to work with you.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Renacci for 5 minutes for questioning.

Mr. RENACCI. Thank you, Madam Chairwoman.

And thank you all for testifying today. My concern is, again, the underbanked and the unbanked represent 14 percent, or 230 million adults in our country, and I am trying to get an understanding as to how we can better serve those individuals.

Mr. Mooney, in some of your comments, you said that the 2-year pilot program was simple and replicable. My question is, was it successful in the sense that, were the banks profitable?

And one of your other comments was that you started out with 31 and went to 28. I would really like to hear how many banks are doing it now.

Mr. MOONEY. Congressman, thank you. You hit on two very key points relative to the pilot program.

The banks that participated in the program considered it to be successful for them because they realized that over time, they were able to develop longer-term relationships with customers they already had or were new customers who would become profitable over the long term and the long run. The banks that participated in the program, we started with 31; we ended the program with 28 banks. You have to remember that this period of time, 2008 and 2009, was one of the most financially troubled. There was such turmoil in the financial marketplaces that it would not have been unusual for a couple of banks to join and then drop out, depending on their circumstances.

But at the end of the pilot program 28 of those banks continued to offer the small-dollar loan program. They considered it an important part of their product mix.

What we can do—

Mr. RENACCI. How many—

Mr. MOONEY. —we will look for—I am sorry—

Mr. RENACCI. I was going to say, how many today?

Mr. MOONEY. We will find that out. We haven't done a survey of those institutions recently; we will be happy to do that for you.

[The following information was received from Mr. Mooney for the record:

Number of banks in the pilot program: 28.
Number of banks continuing to offer SDLs: 24.
Number of banks no longer doing so: 3.
Number of banks merged into another bank: 1.]

Mr. RENACCI. It is very difficult to determine the success. And a lot of times—I was in business for 28 years, and I have only been in Congress for 9 months.

Sometimes, I think people in the real world out there don't connect with what you are saying here today, because I have talked to the banks and I have talked to some of the underbanked. They can't get the money. They can't borrow the money today.

And I have talked to some of the banks. I have had meetings for the last 6 weeks with small banks and community banks, and they are not going toward these programs. They don't feel they are profitable; they feel they are overregulated already; and they have problems in doing it because of all the other regulations.

So it would be very helpful—and hopefully after today's hearing, if you could get back to me and tell me, out of the 31 that started, how many are still going forward? I would appreciate that information.

Mr. Marquis, on the 343 credit unions you mentioned in your testimony who would report small loans on their call reports since the announcement of the small-loan rule, can you tell me how many are still participating and still following through with these type of programs?

Mr. MARQUIS. That is the current data as of June, so that is the number of credit unions that are actually participating as of June of this year. And so far on their balance sheets, they have $14 million. Plus, these are small-dollar loans, so the total dollars won't add up to a lot.

And no one is saying, at least the evidence so far, that anyone is having any big issues with that issue. It is a high-volume issue, requires some human resources, but we gave them some flexibility to manage within that.

And of course, they have to be a member for at least for a month to participate in this program, and the goal here is then to get them into the other financial products so they can stay a member of a credit union and also build a credit history so they can better get access to financial resources later on.

Mr. RENACCI. And again, I guess just all three of you can maybe just comment on this: There are other alternatives to the banking or credit union opportunities, and I guess my question is, I was talking to some regulators last night who had said, "They are going to charge too many fees and they are going to charge too many interest rates," and my comment was, as long as the consumer understands and is fully disclosed and totally gets it and up-front—if somehow they could get all the information and say, "I understand it," don't you believe that consumers should have all options available to them—banks, credit unions, and any other option available to them, as long as they are fully disclosed and they understand the consequences?

Mr. Wides?

Mr. WIDES. We certainly favor full disclosure. We believe that consumers have choices, as you pointed out. Certainly, the OCC has not issued any guidelines which would preclude a bank from offering a particular product or service that would meet the needs of the unbanked.

Mr. MOONEY. I would say that the FDIC's concern is not over the non-banks and what they are offering as much as it is over what banks are offering. We believe that banks have the capacity and the existing infrastructure to affordably offer small-dollar loans and some other products as well: 7,500 institutions exist across the country; 7,000 of those are supervised by the FDIC; 5,500 of those are banks that have less than $1 billion in assets; and about 4,400 or so have assets of less than $250 million.

These community banks have shown and have a proven track record of meeting whatever the real credit needs of their local communities are, and they have done a good job. We would like to encourage those institutions to begin offering, once again, affordable, small-dollar loans as an option for their community members.

Mr. RENACCI. Thank you all.

Chairwoman CAPITO. Thank you.

Mrs. McCarthy, for 5 minutes for questions?

Mrs. MCCARTHY OF NEW YORK. Thank you.

And thank you to the witnesses.

I happen to be very interested in financial literacy, with my colleague here, Mr. Hinojosa, and we have been working on it not only in the Education & the Workforce Committee, but also here on this particular committee. So while you have the opportunity—and I guess, I will go to Mr. Mooney and Mr. Marquis—to go into the underserved areas, for those that you offer credit, are you also teaching them financial literacy, how to get out of debt, how to build up their savings, how to have more sustainable credit and everything else like that?

Mr. MOONEY. Thank you, Mrs. McCarthy. At the FDIC, we offer the Money Smart financial education program, and we promote that. It is available free of charge; it is not copyrighted. Banks, nonprofits, and others are offering it. Right now, our numbers indicate 2.75 million Americans have taken some portion of that course.

Financial education is fine as far as it goes, but it doesn't go far enough unless it results in a safe, sound, and profitable banking relationship, but also one that is affordable. We conducted a longitudinal survey of our Money Smart students 2 years ago to find out if there was an actual change in behaviors as a result of taking the course. In this Gallup survey, we interviewed people before they took the course, after they took the course, and a year later to see if behaviors changed. The good news is that those individuals started to budget for the first time and adhere to a budget; they saved more; they shopped around for financial services; and they paid their bills on time. This is terribly important proof to banks that this is a market which is very profitable and a good one for them. We encourage banks to not only offer financial education, but then open accounts for these folks.

Mrs. MCCARTHY OF NEW YORK. Mr. Marquis?

Mr. MARQUIS. Thank you.

We put on several workshops for the small credit unions to help them do financial literacy. We also have the CDRLF fund that Congress has given money to that allows us to give technical grants to help credit unions put on literacy programs.

And we have added almost 1,700 underserved areas to credit unions over the years. Right now, only multiple-bond credit unions can add underserved areas. We could go further if we could have other credit unions add those areas.

We also have economic development specialists. They are not really examiners who examine. There are 15 of them and they go only to small credit unions to help them produce programs that better the educational needs of their membership at a credit union.

Mrs. MCCARTHY OF NEW YORK. Mr. Marquis, also, being that you are in the underserved area, and I understand you have outreach programs, but what products do you offer that are the most successful? Plus, how do you handle those customers who go into default? How do you work with them?

Mr. MARQUIS. Every credit union does it a little bit differently. Delinquency sometimes tends to be a little higher in our small credit unions.

Over the decades we have learned, as examiners, how to deal with that. Just because they skip some payments, they usually make their payments over time, especially on the low-dollar amounts. There are different ways to look at that. A credit score is not the only way to evaluate a loan.

A lot of low-income people have other ways to make income. We look at what their character is; we look at how they pay their other bills. And over time, they establish a relationship with the credit union and the credit union learns who those members are, and over time they understand how they get in trouble from time to time over short periods of time, and they learn to work with their members.

But every credit union is a little different. They just have to learn how to manage their delinquency in a prudent way to maintain safety and soundness.

Mrs. MCCARTHY OF NEW YORK. Thank you.

With that, I yield back my time.

Chairwoman CAPITO. Thank you.

Mr. Luetkemeyer, for 5 minutes for questions?

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Mr. Mooney, in your testimony you make a comment that you are studying the creation of pools and nonprofit or government funds to serve as guarantees for small-dollar loans. Can you explain that program just a little bit for me, please?

Mr. MOONEY. Yes. We are familiar with different government programs. For example, the State of Maryland has one, I believe, and the State of Virginia, whereby funds are either made available to guarantee these types of loans, and in those particular cases, we have seen them involving State employee programs partnering with either a credit union or a bank. In Illinois, for example, there was a bank in Lake Forest that actually partnered with a local city, and they were part of our small-dollar loan program, to offer small-dollar loans through the City's payroll department.

Mr. LUETKEMEYER. Are these States where they normally don't have any small-dollar lending authority, or are these in competition with existing—

Mr. MOONEY. That is a good question. I don't know what the answer to that is.

Mr. LUETKEMEYER. Quite frankly, I am kind of concerned from the standpoint that if you get the government involved in guaranteeing loans again, we have found that this has been kind of a disaster in the housing situation, where you had two separate programs that have come through this committee—the one was a 95 percent loss; the other we spent $40 million for, I think, 11 loans, or something like that, which is a disaster.

And now, we are looking at something like that again. If private enterprise is willing to take that risk, and we have entities out there that are willing to do this, why are we even looking at this unless it is a State where we don't have that authorization?

Mr. MOONEY. You raise a good point. I think that is worth considering.

Mr. LUETKEMEYER. Okay. Along those lines, with regards to the small-dollar pilot program that you had, I know one of the folks testified here recently when we were discussing it with them, and

I had the FDIC in my office and we discussed it thoroughly, that some of the folks who participated in the program and were supportive of it did it because it helped them with their CRA rating—Community Reinvestment Act. And I can understand that is—because that is basically what CRA does. It tries to get you into other areas they believe are underserved.

So, Mr. Wides, do you think this is a pretty good way to go to help with the CRA rating? Would you be supportive of that if you had a bank that wanted to do this?

Mr. WIDES. Yes. We have had a number of banks let us know that CRA was a main driver for them getting involved. But what we found was after they got involved with the program, they actually found that it was a way of attracting new customers and a way of providing a service that they could do.

They didn't say that it was profitable, but they said that it was manageable, in terms of the costs that they incurred. And they did find efficiencies, and this was something we had talked about earlier, that they had found ways to more efficiently process them, and I think that there is a lot of knowledge-sharing around that.

Mr. LUETKEMEYER. I had some discussions with some of the banks in my district recently, and what is the normal time that it takes to get a CRA rating once the examination has been completed?

Mr. WIDES. I would have to get back to you. I think it would depend on the size of the institution and—

Mr. LUETKEMEYER. Can you give me a rough estimate—a month, 2 months, 6 months, 10 months?

Mr. WIDES. I would have to get back to you. I would like to—

Mr. LUETKEMEYER. Do you think 3 years is a little out of line?

Mr. WIDES. I would say for a community bank, yes. For a very large bank, that would probably be the sort of the outset of how long it could take.

Mr. LUETKEMEYER. Normally, you have those exams about every 2 years, do you not?

Mr. WIDES. Large banks would have an exam every 3 years, roughly; a community bank every 5 years, assuming they have good CRA performance.

Mr. LUETKEMEYER. I am a former regulator. I don't quite think that is where we are going, but I will let you get away with that.

I really think that when we are looking at 3 years, and you are getting to the point where you are getting into the next exam, I think we have missed the boat. So, I think we need to take a look at our processes and procedures to make sure we get back to where we are going to be so we can get these banks to where they can actually go out, because what you are doing is hindering them from being able to expand, put in new branches, buy additional banks, and in doing that, now we are exactly where we are at today with this, from the standpoint we are hurting the ability of people to get credit and be able to access financial services.

So I am very concerned about that, and I would love to continue the discussion with you on that off to the side.

I am kind of curious, also, I know in the pilot project, one of the things that you discussed was the terms of the loan. I know that in discussing it again, with the FDIC folks, the successful folks who had the program had larger amounts than what normal payday loans are, and it extended the terms out longer as a result of that.

Do you think that is something that can be worked on with regards to a new pilot program, and perhaps have the FDIC engaged with the small lending—small-dollar folks? Why would you not include them in your pilot program? Right now, it is only the banks. Why do you not include the small-dollar folks in the program?

Mr. MOONEY. We certainly encourage partnerships for banks with others, but at the same time, the FDIC chose to focus on the banks that it supervises relative to involvement in the pilot program, as well as banks that it insures. What we want to do primarily, Congressman, is to encourage a large number of institutions with a large branch network to begin to think about offering this type of affordable credit to their communities.

Mr. LUETKEMEYER. I had discussions with your comrades. They made a statement that they are not prohibited from doing that. I assume that is—

Mr. MOONEY. Correct. They are not prohibited from doing that. But again, for the pilot program our focus was on those institutions that we insure and supervise.

Mr. LUETKEMEYER. Thank you very much.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Gutierrez?

Mr. GUTIERREZ. Thank you very much.

To Mr. Mooney and/or Mr. Wides, I understand that there are guidelines, but some mainstream banks are still offering loans that have the same pitfalls as payday loans. What is the FDIC or the OCC doing to prevent financial institutions from offering predatory services? Please, either one of you can begin.

Mr. Mooney?

Mr. MOONEY. Congressman, thank you for raising this issue. It is important to us during our examination process to ensure that consumers are treated fairly and that the products and features are fully disclosed.

We are also concerned about bank partnerships with third parties that may be engaging in activities that do not comply with consumer protection laws and regulations. Certainly, a focal point of our exams is on current deceptive acts and practices.

To that end, the FDIC issued particular guidance to financial institutions it supervises on the risks inherent—

Mr. GUTIERREZ. Because of the clock, unfortunately, there was a minute between the answer part of your answer and part of my question. So, what do you think?

Mr. MOONEY. I think most of our banks don't show much risk in terms of offering products that are that troublesome.

Mr. GUTIERREZ. They don't show any risk—

Mr. MOONEY. Nonetheless—

Mr. GUTIERREZ. What do you think about the consumer?

Mr. MOONEY. Oh, the consumer—

Mr. GUTIERREZ. Do you think this is a good deal for the consumer to walk into Wells Fargo or U.S. Bank and take out a—what is the—do you think these are essentially payday loans?

Mr. MOONEY. I would have—

Mr. GUTIERREZ. Have you examined these loans?

Mr. MOONEY. I think your points certainly indicate that there may be problems with them, and I would certainly pay attention to your views.

Mr. GUTIERREZ. Okay. Could you please look at these loans—

Mr. MOONEY. Of course.

Mr. GUTIERREZ. —and evaluate these loans, and maybe get back to us? Because I am going to read it, and it says, "The direct deposit advance service offers a temporary source of credit when you need help managing unexpected or emergency expenses. As a Wells Fargo consumer checking customer you qualify for up to $500 with advances directly linked to your direct deposit on your checking account. The credit service advance access to your next electronically deposited paycheck or recurring deposit of $100 or more."

I think that if you looked at an advertisement for a payday loan, it would read almost exactly the same way. And the terms are almost—they are going to offer you 20—it is 120 percent APR if you don't pay it, right? You can pay it all back, so you get a one-time fee.

But if you don't pay it, they allow you to extend the loan, and extend the loan, and extend the loan up to 6 months. And then there is a cooling-off period, but they don't stop charging you interest on the loan; they just don't allow you to take any more money.

These are all the same pitfalls. You have examined the payday industry. You know something about the payday industry, don't you, Mr. Mooney?

Mr. MOONEY. I think that your points relative to the features that you discuss are worth looking at. We have always shared the concerns about consumers who are in desperate need of cash getting to the right products.

Mr. GUTIERREZ. And I guess my only point is, in the past they would always say, "These are not FDIC-regulated institutions. These are payday loans. These are institutions outside the regulatory sphere."

But these are within the regulatory sphere of the FDIC, and how it is that—anyway, Mr. Wides?

Mr. MOONEY. Your points are well made and well taken.

Mr. GUTIERREZ. OCC?

Mr. WIDES. Yes. We are aware of those concerns. Those concerns led us, actually, to issuing proposed guidelines back in June regarding the appropriate safety and soundness and consumer protection that should be provided with these types of products.

We have received about 14,000 comments. The comment period closed last month. And we are looking at the various comments and certainly will take into account the various types of concerns that you raise today as we look toward finalizing this guidance.

Mr. GUTIERREZ. I understand the functioning that you have. But that is why I was always fighting for a consumer protection agency, someone whose purpose is to look specifically at these kinds of loans.

And I have to tell you that I sit here and I keep hearing about how it is that the Fed and the government is just—first there was the $700-plus billion bailout that maintained it; now they are coming back with these kinds of loans. And then it is FDIC-insured, and we all know that things have been going well, but they could go badly.

We back them up, but they are not backing us up. And I hope the two of you take a close look at this so that we don't fall into this kind of exploitation of our American taxpayer.

Thank you.

Chairwoman CAPITO. Thank you.

Mr. Pearce, for 5 minutes?

Mr. PEARCE. Thank you, Madam Chairwoman.

The richness of what we are doing here today is amazing. We are hearing the testimony of how the government is advising people who are broke to borrow more money.

If there is anything that the government knows how to do, that is it. We are borrowing 42 percent of every dollar that we spend, and in fact, we can't borrow that much so we actually printed 70 percent of the money that we borrowed last year.

So I hope next, you give printing lessons to those people who can't afford to get more loans. Let's keep the continuity going here.

It would also be interesting to see if you talked to the largest payday lender in history—that would be the IRS. They have extraordinarily high interest and penalties, and they just keep going no matter what, as long as you don't pay, and so many times the interest and penalty are far greater, and it basically looks like a payday loan to me, what the IRS is doing. So I hope that at some point, your agencies will drift off into those oversights.

Mr. Mooney, I am interested in your small-dollar loan pilot program. New Mexico's average income is about $29,000, and we have Indian reservations where the unemployment is running in the 30 percent range. I notice that none of the banks in that list come from New Mexico.

What are the criteria for choosing those banks?

Mr. MOONEY. First of all, it is entirely voluntary. They had to be well managed and well run. We looked for a variety of institutions across the country of different asset sizes and different business strategies, but they had to actually apply and volunteer for the program.

Mr. PEARCE. Okay. Now, you mentioned that the default rate is 3 to 4 times on these loans.

Mr. MOONEY. That is right.

Mr. PEARCE. Do these customers pay more interest? Do they have other requirements?

Mr. MOONEY. I am not aware that there was, in most cases, an interest adjustment relative to delinquencies, but most of those delinquencies were brought up to current status during—

Mr. PEARCE. Would you all look with suspicion if banks actually charged more interest to people who default at a higher rate?

Mr. MOONEY. No. In fact, in this program we wanted to conduct a feasibility study. We wanted to find what the impact was on banks and we wanted to give them enough flexibility so that they could innovate. That would include the rates and fees they charge.

I should point out, about half of the banks that participated did not charge additional fees, but half did. Although for all of them, the total cost of the loan was still less than 36 percent APR.

Mr. PEARCE. Just an observation, I think if we—let's say that we started a stock fund that was going to fund the kind of loans that you are talking about today—all three of you—and we gave priority to Members of Congress who are telling banks how to loan their money and how to run their business, I suspect you wouldn't get one Member of Congress who would buy the preferred stock to lend people money who may or may not pay back where the chances of not getting your money back.

So what we are engaged in here today is noble, but also it is highly suspicious. It is one of the reasons businesses are having very great difficulty making it. When we are faced with 9 percent unemployment, we are spending a lot of effort in an area which I don't think any one of us would put our money into that.

Would you invest in a stock like that, Mr. Mooney, if you were given the opportunity to put your own money into a stock that would go in and lend to people who have a history of not repaying?

Mr. MOONEY. I—

Mr. PEARCE. You don't have to answer that. I am asking—

[laughter]

I just thought it would be interesting to pitch it out there.

Anyway, just—I do get the richness, and I understand what we are talking about, but at some point, if you don't have any money you probably shouldn't be borrowing too much more, and if we would learn that method in the Federal Government, we might get our credit rating back instead of having it downgraded even worse.

But I yield back my time, Madam Chairwoman.

Chairwoman CAPITO. The gentleman yields back.

Mr. Watt?

Mr. WATT. Thank you, Madam Chairwoman.

I actually came not expecting to ask any questions, but because I actually thought this hearing was more about something slightly different, and I wanted to find out what was going on with reevaluation of collateral, but this is a different category of borrowers we are talking about. But I am, kind of like Mr. Pearce, surprised that—maybe from a slightly different perspective, but we are here bragging about a pilot program that has an annual percentage rate of 36 percent, and last time I checked most of these banks were borrowing money from the Fed at zero percent.

I assume, based on what all of you have testified, including the credit union, Mr. Marquis, that all of these people go through some credit qualification. It sounds like they pay back their loans. They might not pay them on time.

Why are we bragging about—and then I heard Mr. Wides say that now we want to give them CRA credit for loaning money to somebody at 36 percent interest that they got at zero percent interest. I am having a little trouble figuring this out, so maybe you all can help me, because I don't think we ought to be—I am like Mr. Pearce. I don't think we ought to be loaning money to people who can't pay it back.

But if an assessment has been made of their credit and they are going to pay it back I don't think we ought to be charging them 36 percent annual percentage rate on money that the lender got for zero percent. And this is not—and I don't think the FDIC ought to be bragging about a pilot program that has a 36 percent annual percentage rate on. So help me understand what I am missing here.

Mr. MOONEY. Congressman, thank you for that point. I want to clarify that in the pilot program, no institution charged more than a 36 percent APR; many institutions charged far less. Some were charging 10, 12, or 15 percent interest. It doesn't speak to your point—and an important point—about the funds they use to lend to those individuals or the interest rate that they pay to borrow those funds.

But I think what we tried to do during this pilot program was to encourage institutions to offer fair, responsible, and affordable interest rates, so that they could afford to repay over a reasonable period of time. And that is what we think those institutions did do.

Mr. WATT. $1,000, $360 in interest if I keep it for 1 year? I am missing something.

Mr. MOONEY. Some actually were charging lower interest rates. The 28 institutions' experience was different. We didn't want to see them—

Mr. WATT. Mr. Pearce might change his mind about investing in that—that is a pretty good return, if somebody is actually paying the loan back. And then I get on his side of the equation. If they are not going to pay the loan back, then I am not sure why we are encouraging them to borrow.

So, I am just frustrated, I guess, as a lot of the borrowers out there are, and it is not unique to the people in this category of borrowing. It goes on up the line. It goes on up the line.

Mr. MOONEY. During the pilot, some banks in the pilot—and we encouraged them to do this—offered a savings component on the repayment of the loan, so a portion of the payment would go into a savings account so they wouldn't have to borrow again, so they would have a financial cushion, a small amount of savings to meet emergency credit needs.

So I think, Congressman Pearce and Congressman Watt, your points relative to the fact that some people may not be able to afford to borrow responsibly but should begin saving to develop that cushion if they can is a point well taken.

Mr. WATT. Thank you.

Madam Chairwoman, I yield back.

Chairwoman CAPITO. Mr. Westmoreland, for 5 minutes?

Mr. WESTMORELAND. Excuse me, I would like to ask the OCC and the FDIC, are you allowing Georgia banks to offer any of these products?

Mr. MOONEY. We would encourage banks to consider offering these products anywhere, yes.

Mr. WIDES. The OCC supervised five national banks that participated in the pilot. None of those five banks were located in Georgia, although if a bank in Georgia wanted to offer a product along the lines of the FDIC's program, we would not have a supervisory objection assuming it had appropriate safety and soundness controls.

Mr. WESTMORELAND. Have any of the Goergia banks asked to do this?

Mr. MOONEY. In the pilot program we had, I believe, two Georgia banks that were part of the program.

Mr. WESTMORELAND. And so none of them were approved?

Mr. MOONEY. I believe that they were part of the program, and I could check that for you. I don't know if they were or were not national banks, but they were FDIC-insured banks, if that is what you are asking.

Mr. WESTMORELAND. Do you tell these banks how much to charge for these type of loans—this credit? Anybody?

Mr. MOONEY. Either of us? No, we did not. We asked that they be affordably priced. We showed them the guidelines where we had a maximum of 36 percent APR. But we wanted to promote flexibility and innovation in the pilot program, Congressman, so that the banks had a free hand to analyze their costs and decide what their charges and fees would be.

Mr. WIDES. For the five national banks that participated in the FDIC's pilot, they developed the guidelines themselves. In fact, four of the five national banks that participated in the FDIC's pilot had offered this product prior to the FDIC announcing its pilot. I spoke to one community banker in Texas who told me that they had been offering this product for 20 years, that this is part of the bread-and-butter business of lending in this small community in Texas.

So, the OCC did review the terms under which the banks were offering it, did not engage in any way in terms of the terms or features and monitored with the bank to make sure that the performance was done in a safe and sound manner.

Mr. WESTMORELAND. Is the Consumer Financial Protection Bureau going to regulate these banks that are doing that, or are you all going to continue to regulate them, as far as consumer protection?

Mr. WIDES. The Consumer Financial Protection Bureau has direct supervisory responsibility for banks over $10 billion in assets as it relates to certain consumer protection laws. So for the five banks that participated in the pilot that were national banks, none of those banks had assets over $10 billion, so the OCC would continue to supervise all aspects of those banks' operations, including this pilot.

Mr. WESTMORELAND. And, Mr. Marquis, let me ask you a question: Under the options that you got for increasing access, you talk about going into underserved areas and offering, I guess, your products, or—and it says that you would also be able to participate in a community development financial institutions fund. Is that correct?

Mr. MARQUIS. Many credit unions participate in the Community Development Loan Fund Program. I think we have let low-income credit unions borrow about $54 million over the past several years, and it also gives them access to technical development funds or grants.

Mr. WESTMORELAND. Isn't that just a taxpayer guarantee on those loans?

Mr. MARQUIS. On the loans, they—we have never had a loss on one of those loans. They have always been paid back. There has never been a delinquency on one of those loans.

Sometimes, we require matching funds if we think the credit union is distressed a little bit, but that has never produced a loss to that fund. The technical development grant is roughly $1.2 million appropriated by Congress every year. That is—

Mr. WESTMORELAND. I understand, but my question was, are these loans guaranteed by the taxpayer?

Mr. MARQUIS. I guess they are guaranteed by the taxpayer to the extent, though, that if we had to liquidate one of those credit unions, they are protected by—they have access to all the balance sheet assets first, so in all likelihood, the share insurance fund would absorb that loss, not the taxpayer.

Mr. WESTMORELAND. Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Baca, for questions?

Mr. BACA. Thank you, Madam Chairwoman.

Mr. Mooney, in your testimony you detailed a small-dollar loan program and how it was constructed and operated during the last 2-year period in 2008 to 2009. You urged that the pilot project provide a template for safe and affordable small-dollar products.

You argue that banks offer these products in a way that meets the business needs, and I want to follow up in a question there. If these programs have been successful, then why do only 26 percent of the institutions in the country offer these products? That is question number one. And surely this can't be enough institutions to meet the needs of the 50 percent of the Americans who have trouble raising a $2,000 loan in 30 days, especially considering the pilots only took place in 27 States.

Mr. MOONEY. Those points are well made, Congressman, and that is precisely why we engaged these institutions in the pilot program. We wanted to demonstrate that banks should consider offering these products to their customers. We wanted to find out whether or not they would be profitable, whether or not institutions would consider offering them on their own.

What we found out was that banks did consider the long-term relationships that they develop with these customers to be profitable, and that was the primary reason why they engaged in the program.

We also wanted to produce a model that would be replicable—that we could encourage other institutions to consider. The fact is that banks have the infrastructure currently in existence and the capacity to make these relatively small-dollar loans available to their customers.

Most of the customers of payday lenders and alternative lenders have checking accounts with insured financial institutions. We think it is important that those institutions consider serving them in helping to meet their needs as well.

Mr. BACA. Some of these loans could go up—you stated earlier, or I heard the figure—up to 36 percent interest, is that correct?

Mr. MOONEY. Some did go up there, but there was a variety of interest rates. Banks were able to set their own. But all of them were offering interest rates and—

Mr. BACA. So actually, the 36 percent interest rate is even higher than that when someone is late in payment, which means they are paying a lot more, aren't they?

Mr. MOONEY. They could be if there was an additional late charge, yes.

Mr. BACA. So versus an uncharted bank or someone else that offers a $2,000 loan for "X" amount of dollars means that they are actually paying a lot less than someone who is charging 36 percent interest rate plus late payment. Is that correct?

Mr. MOONEY. I am not sure of that.

Mr. BACA. You are pretty sure it is correct. It would be higher when you take in the total percentages that someone would pay in the interest rate, now they have a late payment, now the payments are a lot higher so when you calculate that—and you borrowed only $2,000. I don't know how you can do that.

But let me ask another question: You said that—earlier I heard you make a statement that it would take—for someone who wanted to borrow some money, it would take maybe $2,000 or less—I will use that figure. It could take up to 24 hours turnaround time. Is that correct?

Mr. MOONEY. Yes. Most of the banks in the pilot try to make the decision within 24 hours.

Mr. BACA. So what happens if you have an emergency and you need to fix your vehicle, and you need 4 tires, you had some maintenance, and you needed a $2,000 loan, and what—you have to wait 24 hours for a response?

Mr. MOONEY. That is right.

Mr. BACA. So that means you are out of luck, you lose your job possibly, because someone may say, hey, you didn't have a vehicle in an emergency. So that is a problem that we have because you have 24 hours turnaround when you can go somewhere else and obtain a loan and get it and take care of the emergency that is there.

So I have a question. I have problems with that 24-hour period because that is quite a long time because then you have to turn around and do the credit check on the individuals, and of course you are only going to give it if they establish credit, have good credit, and have a history in that area, so that presents some problems.

Let me ask another question: In recent years—this is to the entire panel—the Federal Government and the Federal regulators have begun to allow banks and credit unions to offer small-dollar loans to underserved populations. However, it seems that these efforts have fallen drastically short when compared with the actual problem. Then I ask, why would the government need to continue using these programs when it seems that we have the tools in the private sector to build upon and expand?

To any of the panelists?

Mr. MOONEY. Thank you for that. This is one of the reasons why the FDIC has promoted the small-dollar loan pilot program.

We asked banks to volunteer to offer these programs. They are not underwritten in a way that would pose a risk to the taxpayer. There are no Federal guarantees involved; we wanted just private sector involvement and we wanted to see if they would work without that kind of assistance. I think we showed that they can do this, or at least the institutions who participated helped us draw that conclusion.

Chairwoman CAPITO. Thank you.

Mr. Grimm, for 5 minutes?

Mr. GRIMM. Thank you, Madam Chairwoman.

Mr. Mooney, you are on a roll so I am going to kick it over to you. It is my understanding that many of the non-depositories have developed quite a bit of expertise, I would say even efficiencies, in making and servicing loans to a higher-risk consumer who typically cannot qualify for a small loan and other credit products that are out there at depository institutions.

Are there any conditions under which you believe that a qualified non-depository lender should be allowed to partner or otherwise work with the depository banks to provide innovative small loans and other credit products?

Mr. MOONEY. Banks have always partnered with third parties for a variety of reasons, including to obtain computer services that they provide; and to provide nonfinancial and other financial services, including loans. There are risks involved. We would warn institutions to be careful of those risks and to manage that third party relationship carefully.

Risks would include operational risks, credit risks, reputational risks, and the like. But if the bank is involved in activity that is legal with a third party, and they are closely monitoring and managing the actions and activities of that third party, and if they have the capacity to do that and do it well, then we would consider them in compliance with our guidance on third party risk. So I would say that is a possibility, yes.

Mr. GRIMM. Okay. Thank you.

Mr. Marquis, under the Credit Union Administration—under their regulations, you mentioned that interest charged to consumers is limited but you don't say what exactly that is. Can you tell me what the limit on interest rates is?

Mr. MARQUIS. Yes. Overall, the interest on credit unions is set by statute, except for in certain circumstances that we can do these pilot programs at 18 percent. In this particular program, we have allowed the credit unions to charge up to 28 percent provided that we don't have rolling loans where the consumer doesn't have the capacity to repay. So we are trying to make this an alternative to payday lending and an opportunity to establish credit at a financial institution to better be able to get credit in the future.

So far in this program, that has been outstanding. For a year, the average interest rate that credit unions did end up charging came out to 21 percent.

Mr. GRIMM. Thank you. Under the small-amount loan rule, I think it is called, you list several requirements for the program, from loan amounts to application fees. Why were these chosen, specifically? Why would you limit a consumer who pays exactly on time or early, even—some pay early—from using the product more than 3 times in a rolling 6-month period?

Mr. MARQUIS. The only time that goes into effect is when a credit union wants to charge that extra interest rate in the small credit union program up to the 28 percent, and a consumer who has been a member for a long time in good standing with the credit union, there is nothing to stop the credit union from lending to them continuously on a revolving loan program. This is just to get people who have not participated in the credit union to establish a history with the credit union and to improve their credit histories.

And these loans are not predatory. We want to make sure that the member does, in fact, have the capacity to repay, so we said you can make 3 loans over a rolling 6-month period, but you can't add a fee to it if you extend the loan term, and you can only charge a $20 fee or less in order to implement the loan.

Mr. GRIMM. Okay. Thank you.

I just wanted to say that there are certainly a lot of underserved communities. Access to credit, I think, is something that is a problem throughout the entire United States and throughout just about every community.

And with the current state of our economy and the fact that many, what we have considered stable, middle-class homes that always paid their bills on time, are obviously having trouble right now. Take Staten Island, in Brooklyn, where we just got hit by a hurricane. Those who traditionally always made their bills, they are out of work and they have an emergency—literally an emergency.

I am just going to tell you, people are going to find ways to get through that emergency. We need to make sure that they have that access.

With that, I yield back. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Scott, for 5 minutes?

Mr. SCOTT. Thank you.

This has been a fascinating hearing. I have been grappling with how to approach the situation from my knowledge. We have an issue here that involves two basic groups, and we are trying to get an answer that I think kind of ignores that fact.

First of all, we have the unbanked and we have the underbanked. And I don't see how the pilot program that we are talking about—that you were talking about—can even approach the bigger part of this problem, which is the unbanked.

According to a recent study by one of our accounting firms, KPMG, there are 33 million unbanked, and the unbanked are those individuals who have absolutely no relationship with a bank. They have no account; they have nothing. So how can we even begin to approach the program?

And then the other issue is, banks basically are high-profit, low-risk, and with stricter regulatory forms that we are placing on them due to the recent crisis we have had, they are tightening their underwriting requirements, making it even more difficult. So it seems to me that a part of this hearing should be to take a look at and see—for example, let me just get, for the record, do each of you agree that there is very serious and very great opportunity and room in all of this for the alternatives, like payday lenders, pawn shops, cash checking services, that really apply to the need of easy, quick access to these 33 million, and the fact that can these financial institutions really even begin, given their structure, to really, really address this issue?

Now, the underbanked certainly has some possibility here. They have a relation with the bank. They just have low credit ratings.

So I want to sort of find out find out first—am I right about this? Is this a—

Mr. MOONEY. Yes. We conducted our unbanked and underbanked survey, and we found out when we surveyed banks that 73 percent surveyed were aware of needs in low- and moderate-income and underserved areas, but only 18 percent prioritized the need to develop those products and services. That is why we decided to focus on and encourage and find different ways that banks can help to meet those needs.

In 14 MSAs around the country, we have gone to the trouble to establish Alliances for Economic Inclusion. Many hands make light work, and many partners can help address this particular problem that you outlined so well. We have over 1,000 partners nationwide in these 14 alliances. Over 300 banks are part of that, and each of those meet on a regular basis locally to identify areas of need, to identify underserved customers, and try to figure out new ways to provide affordable financial services to those individuals.

We think that it is our job to continue to encourage banks to do that. Banks have the capacity, Congressman; they have the infrastructure already in place to begin offering these products. The expenses, the overhead—all of that is already in place. What we would like to see them do is to help meet the needs of those particular residents in their community as well.

Mr. SCOTT. Let me just ask your response to some of the potential barriers that are faced with. Does consumer confusion about what types of acceptable forms of identification are required to open a bank account—just that one fact, does that discourage some of the consumers from using the financial institutions?

Mr. MOONEY. We have learned in our partnerships with nonprofits—who work face to face daily counseling consumers—that can be a cause of concern. Nonetheless, in those partnerships that I talked about and these alliances, banks are finding new ways to satisfy those identification requirements and to make consumers feel more comfortable when they are actually opening these accounts and engaged in those transactions.

Mr. SCOTT. And what about the holding period for clearing checks? Because the problem which you have here is there are many people in these emergency situations who need it quickly; they need it now, and that is why they go to some of the alternatives. Can these banks fix their situations in terms of the holding period?

Chairwoman CAPITO. The gentleman's time has expired. Thank you.

Mr. SCOTT. Thank you. I am sorry.

Chairwoman CAPITO. Mr. Fincher, for questions?

Mr. FINCHER. Thank you, Madam Chairwoman.

Last week, I was looking into the financial situation we find ourselves in as a country, and I was looking at the average credit card debt per household in the country was about $7,000, something like that, and it just was unbelievable how much debt we have as a country, but also personally how much debt we have. And as we are listening to the testimony today—and I really appreciate the input—there is a level of personal responsibility that we all have in the country, and we must go back to that, that the government isn't the answer-all. We need to do our part.

A couple of questions.

Mr. Wides, for you first. You recently proposed guidance on payday loan alternatives that covers disclosures, costs, and usage, but did not impose specific requirements or limitations. Why did the OCC decide to use guidance that lacks specifics?

Mr. WIDES. Thank you, Congressman.

It is principle-based guidance. It is trying to lay out what our safety and soundness expectations are for national banks and Federal savings associations, in recognizing that there are needs for consumer protections, as well.

The guidance is out in proposed form. The comment period closed back in early August. We are reviewing a significant number of comments relative to that guidance.

We have received comments from some commenters who have raised the concern that you have raised, that perhaps there should be specificity on that point. But at the same time, we received comments on the opposite point of view, as well. So we are looking at all the comments and working through that, and trying to come up with an appropriate outcome.

But I can't really go into much more in terms of our guidance, because it is still in proposed form.

Mr. FINCHER. How long will it take, do you think?

Mr. WIDES. I really can't give you an idea at this point, unfortunately. The comment period closed last month. As I mentioned earlier, we received about 14,000 comments. It was an area of great interest by consumer groups, as well as financial institutions and major trades, so unfortunately, I can't really give you a timeline.

Mr. FINCHER. Mr. Mooney, there is a need for short-term, low-dollar loans, particularly in my State of Tennessee. However, based on what I have heard today and what I see at home, banks are not meeting this need. So in your opinion, why should banks be getting involved if they don't seem to be interested while there is private—the free market private sector already meeting this need?

And then, the last part, to Mr. Marquis, how are banks ever going—or credit unions—going to be able to serve people who don't have credit?

Mr. MOONEY. Congressman, thank you. While the business strategy of different banks may vary, and not all banks may be seeking to meet a retail market need, most banks do. Banks are chartered by States and the Federal Government to do business, to serve their communities, to meet their financial needs.

While we would like to see all banks offering this type of product to meet this important need in many communities—we are encouraging as many as possible to actually do that. They are there. They have the offices; they have the employees; they are paying the overhead. And it may make sense for them, in terms of their overall business strategy. At least for those where it does make sense, we would like to see them do more.

Mr. MARQUIS. On a safety and soundness basis, you obviously don't want to have a consumer get into a debt spiral. You don't want to cause more harm, as they say.

So you want to establish credit history for that consumer by making them crawl before they walk, in terms of establishing credit history. Credit unions are not in business to make a profit. They make a profit only to establish adequate capital levels for their institutions.

The more credit unions can establish relationships in underserved communities, and have better access to underserved communities, the more capacity they will have to step up and help them establish a positive credit history.

Mr. FINCHER. Thank you, guys. I appreciate it.

I yield back.

Chairwoman CAPITO. Thank you.

Mr. Carney, for 5 minutes?

Mr. CARNEY. Thank you, Madam Chairwoman, and thank you for having this—what Mr. Scott characterized as a very fascinating hearing today. I have to agree with that characterization. Confusing as well, as we heard Members on both sides of the aisle talk about the need to provide services and credit for the unbanked, the underbanked, and yet, they are concerned about predatory lending rates.

The question was asked, is this the appropriate venue for traditional banks? I think the answer is "yes." The answer I heard was "yes." I would like to hear the answer from the OCC to that question, because obviously the credit unions are doing it, so they must feel it is an appropriate—but I didn't hear anything from the OCC about whether this is an appropriate space for regular banks, if you will, for your banks.

Mr. WIDES. Yes, if it is subject to safety and soundness guidelines.

Mr. CARNEY. So that seems to be the question, on the balance between safety and soundness and what are affordable or reasonable rates. And how do you—how do we do that? How do we settle on what is predatory and what is not?

I was a little surprised to hear the credit union rates, frankly, were as high as they were. If you added profit onto that, that would put it into the 30 percent range. Your average, I guess, was 20 percent, so maybe not into the 30 percent range.

I heard my colleague up here express concern about 38 percent. How do the banks, or how do—what is your role as regulators in that process in determining what is predatory or not in this space?

Anybody?

Mr. WIDES. There is no rule or regulation or statute that establishes a maximum interest rate for a federally chartered thrift or national bank.

Mr. CARNEY. So they could charge whatever would be acceptable in the market?

Mr. WIDES. They are also underwriting a credit risk here—

Mr. CARNEY. Sure.

Mr. WIDES. —and we expect them to be prudent in terms of underwriting the credit risk to a borrower who has sufficient repayment capacity. That seems to be, I think, the real issue in terms of the interest rate that is charged is, what is that borrower's repayment capacity? What is the default rate? What is the loss rate that you suffer on a given borrower—

Mr. CARNEY. So some assessment of the loss ratio is going to be part of the pricing, right? That is fairly obvious. And then I guess the administrative costs of making low-dollar, short-term cash available to consumers. Is that—

Mr. WIDES. Yes. That is correct.

Mr. CARNEY. —fair?

Mr. WIDES. Yes.

Mr. CARNEY. But we don't seem to have, on a political level, a good handle on what is acceptable, I guess. Rates that have been mentioned here in this hearing today have struck some people on both sides as kind of unacceptable. How do we—as Members who come here to represent our constituents and our districts—look at that question of what is affordable, what is predatory, and what is acceptable? I guess it depends on our particular philosophy of banking and the marketplace.

Do you have any views of that from a regulatory perspective or from a credit union perspective?

Mr. MARQUIS. You have to balance safety and soundness with the issue of establishing the credit for someone who may have ruined their credit over time for whatever the reasons are, and you have to bring them back onboard in terms of mainstream financial services. But it is a higher volume business, and it has a higher cost.

We have to balance that with making sure the financial institutions don't cause harm to themselves by building out those portfolios too big. Delinquency tends to be higher; charge-off tends to be higher. So it doesn't take many loans to offset and reduce that 20 or 30 percent interest rate to be something in the negative category, if you are not careful.

Mr. CARNEY. That is how you get at your 21 percent average without a profit being part of that, right?

Mr. MARQUIS. So far. And we have allowed them to charge up to 28 percent, and up until now, they haven't had to do that. They are crawling before they walk and trying to manage that business and determine where the break-even points are in that business.

Mr. CARNEY. Really quickly, there was some mention earlier about debit interchange and the Card Act. Do you have any impression or any idea of the unintended consequences of, say, the Card Act, in terms of access to credit for the underserved consumer?

Mr. MARQUIS. I am not sure the two subjects are exactly related, but at the end of the day, financial institutions, especially credit unions, are not in business to make a profit, but they have to build adequate capital. There are only several ways to make money: you can charge more interest on loans; you can break even on fee structures or charge a little more for fees; you can reduce your costs of funds; and you can reduce your expenses.

At the end of the day, those are all finite things that you have to balance out in terms of what does it take that organization in their business model to come out at the end of the day that they are not losing money.

Mr. CARNEY. Thank you.

I see my time has expired.

Chairwoman CAPITO. Thank you.

Mr. Hinojosa, for questions?

Mr. HINOJOSA. Chairwoman Capito, thank you for holding this important and very timely hearing. I commend all that you and

Ranking Member Maloney do to improve the financial literacy rates of all those residing in the United States.

Before I ask my questions, I think all of us here today should be aware of some of the following facts. I will just give three or four.

First, 25 percent of households in the United States, or close to 30 million households with approximately 60 million adults, are unbanked. So I have concerns of that group, just as Congressman Scott gave earlier.

Second, 3 in 10 adults in the United States, or more than 68 million individuals, report they have no savings. And only 24 percent of those adults in the United States are now saving more than they did a year ago because of the current economic climate.

Third, I learned that 28 percent, or nearly 64 million adults, admit to not paying all of their bills on time. So it seems to me that personal financial literacy education is essential to ensure that individuals are prepared to manage money, credit, and debt.

My first question I want to direct to Comptroller Barry Wides and to Deputy Director Robert Mooney. What are each of you and the entities you regulate doing to bank the unbanked, move the underbanked entirely into the mainstream financial services system, and what are you doing to reign in those predatory lenders that we are talking about, such as the check cashers and others that charge excessive interest rates?

Mr. WIDES. Thank you, Congressman. The OCC is very involved with the national financial literacy efforts of the Financial Literacy and Education Commission. I am the agency's representative to that Commission.

One of the more interesting, and I think promising, initiatives in financial literacy and inclusion of the unbanked is the Bank On initiative, sponsored by the National League of Cities, in which the Treasury Department and the banking regulatory agencies are partners with this effort. The way that initiative is working is that cities around the country are coming up with a template of a basic banking product that would be offered in conjunction with financial literacy through local nonprofits.

And what the banking regulators are doing is collaborating with these cities that are sponsoring these initiatives to bring the bankers to the table to see if they can offer a product in these markets that would be geared toward an unbanked individual. In many instances, it involves second chance checking accounts for people who might have previously been banked but left the system due to high fees or inability to manage an account. So these initiatives do involve a financial literacy component, and—

Mr. HINOJOSA. Let me interrupt you. If those initiatives were implemented and they were able to have them open up a bank account, would they be covered under the FDIC just like anybody else on that $250,000?

Mr. WIDES. Oh yes, yes. These are full bank accounts with FDIC—

Mr. HINOJOSA. The reason I ask you—and I am glad to hear you say yes, because one of the things that many of our immigrants have is that they are afraid of not being able to get their money out, number one; number two, that banks may fold up and that they will lose their money, like they did in—back during the

1940s—1930s to 1940s. So I don't blame them for learning from their parents and their grandparents about those experiences.

And we just have too many people who could benefit by being banked. I would like to hear your answer.

Mr. MOONEY. Congressman Hinojosa, thank you. The FDIC is very much aware of what you just stated, and first of all, we also want to recognize your leadership in the financial literacy field.

Mr. HINOJOSA. Thank you.

Mr. MOONEY. Our Money Smart program has been updated—the financial education program—to include issues related to Federal Deposit Insurance. We embarked on a public service campaign—a national public service campaign in several different languages—to build public confidence, in particular in our minority and immigrant communities as to the importance of FDIC-insured accounts, not only that they are safe and insured up to $250,000, but that we provide uninterrupted access to their financial accounts and the financial services in the event of a possible bank failure, and we have done that. Also, with that insurance and with those bank accounts come consumer protections.

Economic inclusion, as you state, is important, and the FDIC, several years ago, embarked on a campaign to establish Alliances of Economic Inclusion, and we have done this in 14 different MSAs around the country, everywhere from Boston, to Baltimore, to the Black Belt area of Alabama, to Los Angeles, to Southern Texas, to Chicago, and the list goes on. In those communities, Congressman, we brought together banks—all the banks—nonprofits, and public officials to figure out new ways to reach the underserved in several ways: one, by offering affordable savings and checking accounts as well as affordable small-dollar loans; and two, possibly in many of these markets, affordable foreign remittance services. And in addition to small business lending, we also encourage the use of financial education programs—programs that will result in the opening of accounts for those who are underserved, in particular in some of the immigrant markets that you have talked about.

More than 1,000 organizations and banks are part of that initiative, and we are finding very, very positive results in each of those.

Chairwoman CAPITO. Thank you.

The gentleman's time has expired.

Mr. HINOJOSA. I like your response.

And, Madam Chairwoman, I want to comment that I have visited Federal Reserve Banks and others that have materials in eight languages, but are the banks actually getting any pushback from either community leaders or elected officials because we are doing it in languages other than English?

Chairwoman CAPITO. If you could answer briefly, because we need to—

Mr. MOONEY. I am not aware of that. In fact, our translated services are very popular with banks.

Mr. HINOJOSA. Thank you.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Mr. Miller, for 5 minutes? Do you have any questions for this panel?

Mr. MILLER OF NORTH CAROLINA. I do, for the OCC.

I am sorry. As the Chair noted, I have just kind of sprinted in, but I am curious about your military lending program. One of the great triumphs of consumer protection is what we have done in the last decade for servicemembers. There is a series of articles, or maybe just one big article in the New York Times about the abuse of servicemembers. Many of them were fresh out of high school, living independently for the first time, and they were being gouged by lenders just off the base, obviously targeting them at a very vulnerable stage of their lives.

There was legislation introduced to do something about it, and the industry—the lenders who were doing it—succeeded in getting that postponed and having the military conduct a study. The study came back more strongly than they could possibly have imagined, and the commanders talked about how it was affecting their readiness, how was it affecting their troops, how it was affecting their security clearances, how they were unprepared because they were not sleeping at night or because all they could think about was how much debt they were under. And Congress set a cap of 36 percent.

My understanding is that, what are functionally the equivalent of payday loans are now being offered to the military and have been designed in a way to avoid that Federal limitation on interest for our military. Is that correct? Are there loans being made to our military with a closed end or open end that exceed 36 percent?

Mr. MOONEY. I am not aware of FDIC-supervised banks that are involved in anything approaching that. In fact, we held a conference where we highlighted the need for affordable lending to the military in 2006, and we partnered with the Department of Defense and military banks. And, actually, as a group at that conference, they developed a small-dollar loan template which would provide an alternative to high-cost payday lending and other lending that had been plaguing the military, as you have outlined.

That template led to the FDIC's small-dollar loan pilot program, where small-dollar loans were being offered—

Mr. MILLER OF NORTH CAROLINA. What is the effective interest rate on those loans?

Mr. MOONEY. In our pilot program, for the 28 banks that ended the program, the average rate charged was between 14 and 16 percent. The most common was 18 percent. We asked banks not to charge more than a 36 percent APR, and most charged well under that.

Mr. MILLER OF NORTH CAROLINA. Are there any loans being made to servicemembers, whether open- or closed-end, that presumably would be subject to the statute, that might not be, where the interest rate does exceed the amount allowed by Congress in 2006—36 percent per annum?

Mr. MOONEY. We examined banks for compliance with those rules and I am not aware that there are any exceptions, but we could look into that. I don't think that would be an issue with banks primarily.

Mr. MILLER OF NORTH CAROLINA. Would you support or oppose legislation that would make it clear that those lending programs are subject to a 36 percent cap?

Mr. MOONEY. I think the FDIC would have to review that. I wouldn't be able to comment on it today.

Mr. MILLER OF NORTH CAROLINA. Okay.

The Center for Responsible Lending made several observations about today's hearing and suggested that any loans that the OCC required to comply with certain criteria, certain minimum standards that they repaid in affordable installments, and that there be a cooling-off period between installments, between borrowing, to prevent the repetitive use, which is one of the great evils of payday lending, that they be reasonably priced and that the cost of credit be expressed as the interest rate and not as penalties or fees where the borrower frequently has no idea what they are getting into—they understand an interest rate; they may not understand when they are being hit by penalties and fees—that they be based upon—that there be an ability to repay requirement for any lender, and that they not be paid through an automatic set-off against the customer's deposits, which they said effectively is a wage garnishment and really prevents the consumer from very effectively being able to contest the amount being charged.

Do those seem like reasonable limitations? Do you support those limitations?

Mr. WIDES. We are very, very aware of the concerns that have been raised by the Center for Responsible Lending and other consumer groups about these types of products. All I can say is that we have received over 14,000 comments, many of which are very, very similar to the types of issues that you have just identified, and we are sifting through those comments now, as I mentioned that the comment period closed last month. But we are very aware of those issues and concerns as we look at determining how we move forward with this guidance.

Chairwoman CAPITO. The gentleman's time has expired, and I believe that concludes all of the questions for this panel.

I want to thank you all. You have given very, very excellent testimony.

I would like to request unanimous consent to submit the following letters into the record: the National Association of Federal Credit Unions, and VantageScore. Without objection, it is so ordered.

And I will dismiss the first panel and call up the second panel.

Mr. RENACCI. [presiding]. At this time I would like to call up our second panel of witnesses. I will introduce them individually for the purpose of giving a 5-minute opening statement.

The first, Ms. Gerri Guzman, is the executive director of the Consumer Rights Coalition.

STATEMENT OF GERRI GUZMAN, EXECUTIVE DIRECTOR, CONSUMER RIGHTS COALITION (CRC)

Ms. GUZMAN. Thank you.

To the chairwoman and members of the subcommittee, I want to thank you for including us in this conversation. Your work and ours impacts the daily lives directly of consumers, so we should be working together to first do no harm, and then improve both their circumstances and their options.

I am Gerri Guzman, the executive director of the Consumer Rights Coalition, or CRC. CRC is a nonprofit consumer-based organization dedicated to ensuring that Americans have increased access to credit.

I am here today on behalf of more than 200,000 of our members who are consumers of alternative or nonbank financial services. Our members have traditional bank accounts, but they don't always have a financial safety net. They want to preserve and expand access to a full range of short- and intermediate-term credit options and other basic financial services.

Millions of Americans, as you know, are coming up short. They are struggling to make ends meet for several months at a time or they are dealing with a financial shock like a reduction in work hours, a medical emergency, or a broken down car or appliance.

Millions of consumers don't have rainy day savings accounts to get them to the next paycheck or manage the unexpected. They may not have credit available on their credit cards or family to turn to for a few hundred dollars in order to get through a tough time.

As stated in studies by other panelists, the previous, in addition to those reports, there was a second study that found that 64 percent of Americans don't have $1,000 on hand in case of emergency. If these consumers choose to go to a traditional bank for a loan, the vast majority of traditional banks and credit unions could not give them a typical $300 loan needed, to say nothing of $1,000 or $2,000.

As a result, today almost 20 million Americans are turning to nonbank financial products, like check cashing, installments, payday, and pawn loans. The alternative to traditional banks is quickly becoming the mainstream.

I know firsthand that traditional bank products don't always offer a realistic solution for people without a significant financial cushion to help absorb the unexpected. I relied on a payday loan when I was in danger of losing my home. It was simple, transparent, less expensive than bouncing a check or making a late payment, and I knew that it would not further damage my credit rating.

Short- and intermediate-term loans are easily and conveniently available from alternative lenders in some States. Unlike most traditional banks, stores are located in minority neighborhoods. They are open at times the services are needed and the process is understandable, quick, and easy. Employees are likely to speak the language of the local residents, and in addition, these short-term loans will not ruin people's credit ratings like bouncing a check or failing to make a payment would.

Short-term credit options are currently regulated at the State level, and regulations vary in many States: the fees; the types of loans; the terms that are offered. Research from the Federal Reserve and others indicates that States that have eliminated or restricted credit options have actually done more harm than good.

For example, when the State of Washington restricted the number of loans an individual could take out, regulators found that it had the effect of driving consumers to more expensive options, further damaging their credit. Studies also found that consumers in North Carolina, Georgia, and Oregon were hurt by payday loan bans that drove them to bounce more checks, incur more late fees, and ultimately file more personal bankruptcies.

Unfortunately, I hear from consumers all the time that they no longer have access to short-term credit because of restrictions in their States. They are now spending more on overdraft, bounced check, late fees, and in many cases banks are threatening to close their accounts.

The fact is that people will always come up short. If access to one product is eliminated consumers will seek out another. And unfortunately, at times it is not a viable option that works for their household.

Seventy-three percent of banks are aware of the significant unbanked or underbanked populations in their market, but less than 18 percent of banks have identified expanding services to this group. In listing the reasons why, they list profitability issues, regulatory barriers, and fraud concerns.

A few banks are, however, beginning to compete in the small-dollar, short-term lending market. This is very good. The more options, the better. That will allow my consumers to make choices, weigh out those options, and certainly, ultimately choose the option that is best for their household.

Laws need to further change, though, to open up the market to more competitors. We would like to see nonbank financial service providers already trusted in the communities throughout the United States have the opportunity to provide more and better credit services to underserved communities.

All Americans need responsible credit options in order to build personal financial records, healthy credit ratings, move up to the traditional banking system, and ultimately build their own personal wealth and wealth for their neighborhoods and communities.

Thank you.

[The prepared statement of Ms. Guzman can be found on page 72 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness will be Melissa Koide, vice president of policy, Center for Financial Services Innovation.

STATEMENT OF MELISSA KOIDE, VICE PRESIDENT OF POLICY, CENTER FOR FINANCIAL SERVICES INNOVATION (CFSI)

Ms. KOIDE. Thank you, Chairwoman Capito, Vice Chair Renacci, and Ranking Member Maloney. I am Melissa Koide, the vice president of policy at the Center for Financial Services Innovation. On behalf of CFSI, I appreciate the opportunity to be here today as a witness.

CFSI, for those of you who may not know us, is a nonprofit organization in its 8th year of providing leadership, research, and insights on the financial services needs of underbanked consumers. Our vision is to see a strong, robust, and competitive financial services marketplace where the diversity of consumers' needs are met with a variety of financial products and services that are transparent and reasonably priced.

We believe well-structured products can help consumers address their short-term credit needs and also build positive credit histories, which we all realize are not only critical for long-term asset goals, but more immediate needs: employment; housing; and insurance. In 2008, we conducted a study—a nationally representative study—and found that almost one-third of unbanked or underbanked consumers had borrowed for short-term needs in the prior 12 months.

While the reasons for their borrowing varied, over a third cited the need to pay bills and to manage their expenses as their motivation for seeking out the credit. This result suggests that in addition to helping address emergency expenses, which we typically think about when we think about small-dollar credit, that credit is being used as a method to manage expenses, smooth income at times. And that is especially relevant in today's context.

Looking at the supply side of small-dollar credit, we pay quite a bit of attention to some of the innovations in this area. Over the past half-decade, we have seen a handful of new and modified products that are emerging to better meet the demands of consumers with more consumer-friendly structures.

Examples of these innovations include products that offer flexible loan terms, that use a variety of data to better underwrite and assess consumers who may have insufficient or poor credit histories, that link credit with other products and services, including transaction products and savings, and that also offer credit products intentionally to help consumers build or repair their credit records.

But even with these promising trends, there are significant challenges to the growth of well-designed, small-dollar credit products, and there is without question concerns about products that are in the market today. Many, if not most of today's products are short-term, often with repayment due in a matter of weeks or when the next paycheck arrives. Many products draw the full repayment directly from the consumer's account, which on the one hand, we recognize helps to reduce the likelihood of default, but on the other hand, leaves some consumers with little left except the option to borrow again.

Regulatory scrutiny of the product is warranted, but we also need additional research to shed light on how these products can be designed to avoid overindebtedness and to help consumers successfully manage their credit while also ensuring product sustainability.

On the supply side, it is important, also, to call out the challenges that are constraining the growth of high-quality products. Those challenges include capital constraints, depending on the type of provider. They include regulatory inconsistency as well as regulatory uncertainty. It also includes negative stigma associated with the products themselves, and insufficient underwriting in order to assess risk.

I think with a few ground rules and a level of regulatory consistency, we will see more and better small-dollar credit products emerge that help consumers safely access credit, reduce the price, and allow for product diversity and innovation.

With respect to our policy recommendations, we believe policymakers should support the Consumer Financial Protection Bureau, as it is the appropriate Federal regulator to create and ensure consistent rules and balanced rules that take into consideration both the consumers using the products and the providers offering them, and that would be regardless of the type of provider that is offering the credit, looking at both the banks and the nonbanks across-the-board. As the Federal consumer protection regulator that will have rule-writing authority over consumer protection rules, and for many providers, supervision and enforcement authority over those providers, the CFPB will develop a deep knowledge about the range of small-dollar credit lenders and the products as well as a rich understanding about the consumers who are using these products.

This, I believe, will lead to more informed roles that are coordinated across the Federal regulators as well as the State regulators that are responsive to the different business models and that are deeply attuned to the consumers using the products.

It is also worth noting the CFPB's mission, which I think we tend to sometimes forget or not necessarily focus on. As defined in the Act, the CFPB is explicitly required to recognize its duty to ensure consumers have access to financial products and services. It also, of course, has the duty to ensure that those products are fair, transparent, and competitive.

Before I conclude, I would like to also point out that we offer a set of consumer protection recommendations detailed in our written testimony that we think will help to ensure that these products, regardless of the type of provider, are prudently provided, that they are manageable for the consumer, and that they are helping consumers meet their short-term needs.

Thank you, Chairwoman Capito, Vice Chair Renacci, Ranking Member Maloney, and the other subcommittee members. I look forward to your questions.

[The prepared statement of Ms. Koide can be found on page 74 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Ryan Gilbert, chief executive officer, BillFloat, Inc..

Welcome.

STATEMENT OF RYAN GILBERT, CHIEF EXECUTIVE OFFICER, BILLFLOAT, INC.

Mr. GILBERT. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, good morning. My name is Ryan Gilbert and I am the CEO of BillFloat, based in San Francisco, California. It is a distinct honor to be here today speaking before you as an immigrant who has been in America for 13 years, discussing the issue of consumer credit.

Our company was founded in 2009 with the backing of PayPal, Silicon Valley venture capital firms, and angel investors. We represent a new generation of financial services providers that embrace technology and innovation to offer consumers hope.

Customers come to BillFloat when they need more time to pay recurring monthly bills. The majority are mothers balancing a tight family budget.

Our short-term credit products can only be used to pay bills. This includes cable bills, utility bills, phone, or insurance bills, the exact kind of sorely needed short-term credit options that have been abandoned by many banks.

We offer our services in partnership with some of the largest billers in the country. These companies offer BillFloat to their customers as an alternative to late fees and service interruption.

Central to our product model is our belief in alternative data, including customers' bill payment experience, cash flow, borrowing habits, and household expenditures. We are raising the technology bar with new algorithms that evaluate the consumers' ability to afford these products and to offer safe, feasible credit alternatives to consumers whose best option often is high-interest, short-term loans or simply not paying their bills.

Meanwhile, the too-big-to-fail banks are, simply put, too scared to lend.

A recent Federal Reserve Bank of New York report cited that $1.1 trillion of consumer credit has been removed from the market since Q3 of 2008 to Q2 of 2011. This retraction of credit flies in the face of initiatives from many Federal agencies, including the FDIC, to maintain access to loans and other viable financial products for underserved consumers.

At the same time, demand for consumer credit has grown significantly, influenced by several trends, including a population increase and declining household income. We have heard often today of the recent paper from the National Bureau of Economic Research that found that almost half of the Americans surveyed considered themselves to be financially fragile. These consumers responded that they could not access $2,000 to cover a financial emergency, even if given a month to do so.

The simple truth is that underserved consumers face a bleak landscape when a sudden expense derails even a responsible family budget. We do feel that there is hope.

BillFloat represents a new breed of financial services provider that includes either start-up companies, like Kabbage, and On Deck Capital, which make loans to small businesses also suffering from a lack of credit; Square, out of San Francisco, that enables the long tail of merchants to be able to access merchant processing infrastructure, previously the domain of large, established corporations. And we share technology and market-driven approaches that are highly consumer-centric.

None of us are asking for Federal funding, loan guarantees, or any other handouts. There is, however, one thing this subcommittee could do, and that would be to consider H.R. 1909, introduced by your colleague, Representative Joe Baca. This bill, the FFSCC Charter Act of 2011, would establish a much-needed platform for financial services innovators to flourish and serve the underserved, and I believe this will have an immediate and hugely positive impact for many Americans and the economy as a whole.

Today, one of the most difficult challenges facing any financial services innovator is accessing the critical banking infrastructure needed to deliver our service. We are frequently beholden to banks to market our products, from credit offerings to prepaid cards. It has been our collective experience, however, that the same banks that are not serving underserved consumers are not supporting technology and financial services innovators.

With the charter, there will be a platform for nonbank providers to operate nationally. The pro-consumer requirements of the bill are very, very clear, including clear standards for credit disclosure, account access, financial literacy, and the breadth of product offerings.

There is also a mission that each charter-holder will have to observe, which is to provide an array of financial services to the underbanked, and unbanked, and consumers with low credit scores. And most important, non-delivery of these services will mean noncompliance. I haven't seen too many terms like that in many bills.

I think consumers have spoken clearly. They want access to convenient service from trustworthy sources, and by removing reliance on third-party banks and enabling national business and operating plans, many of these service providers can thrive and offer safe, affordable, and more convenient alternatives as opposed to overdraft protection, high interest loans, and credit card late fees.

Once again, I appreciate the opportunity to speak with you today, and I would be very happy to answer your questions. Thank you.

[The prepared statement of Mr. Gilbert can be found on page 66 of the appendix.]

Chairwoman CAPITO. Thank you very much.

Our next witness is Mr. Michael Grant, president, National Bankers Association.

Welcome, Mr. Grant.

STATEMENT OF MICHAEL A. GRANT, PRESIDENT, NATIONAL BANKERS ASSOCIATION

Mr. GRANT. Thank you very much, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. First, Madam Chairwoman, I owe you an apology. At the end of my statement, you have been downgraded from "Madam Chair" to "Mr. Chairman," so I want to apologize for that.

And second, I have to leave after this statement because I have another prior engagement I have to make. Thank you very much to the whole committee.

I represent the National Bankers Association. It is a consortium of minority banks in the country, and those who have studied our organization and the banks that we represent know that we are representing the heart of this problem that we are having in our country. The urban areas of our country were hardest hit by this ongoing financial crisis, so we are super sensitive to the issue that we are discussing today.

Specifically, I would like to address the subcommittee's desire to better understand credit products that are available for consumers who cannot always access more traditional financial institutions' products and services.

In a nutshell, the underbanked and the unbanked, usually with low to moderate incomes, continue their historical struggle to access credit for a number of reasons. The number one reason is that many of these individuals create such high risk for lending institutions that they do not meet the minimum underwriting requirements imposed by the regulators of traditional financial institutions.

Madam Chairwoman, I picked one of our banks as an example of how these banks are trying to address this problem of providing credit for folks in the low- to moderate-income range, and actually, we chose Citizens Trust Bank of Atlanta, Georgia. It is kind of a microcosm. It is an urban area, and the unemployment rate is high, and so forth and so on.

And basically, in 2008 the bank tried to implement this small-dollar loan program to see how it would work in 11 branches and three different markets: in Atlanta; Columbus; and in Birmingham. Although the bank's intention was to meet the pressing economic needs of the consumers in this market, a 13 percent default rate rendered the program a costly failure.

With comparative lenient underwriting criteria, the bank sought to help consumers with housing payments or car payments or other financial needs with small loans that ranged from $500 to $1,500. At the beginning of the program, the following underwriting criteria were established: a score—a FICO score of only 500; allowed a higher debt-to-income ratio, along with a $48 document preparation fee, which was financed into the loan document; 12-month same residence; credit report could not have outstanding liens or judgments; allowed for collection items on the report; must provide 6 months' income from the same employer; 2 years discharged from bankruptcy that is Chapter 13; no Chapter 7 bankruptcy was allowed.

The result was still a 13 percent default rate, which was subtracted from the bank's loan loss reserves. Today, the bank provides this small-dollar program in only one of its branches, and the requirements are now more rigid. Interestingly enough, that branch is in Green County, Alabama, one of the poorest counties in America. The default rate is near zero.

The only recommendation I would like to make today, Madam Chairwoman, is that if Regulation E were modified to allow banks to debit borrowers' bank accounts, the bank's risk would be mitigated and borrowers would probably act more responsibly. Having direct deposit accounts would also help to ensure that lenders could make timely payments.

But the largest issue, Madam Chairwoman, and subcommittee members, is the issue of the cost of risk, and I haven't heard that kind of analysis today. How can we decide whether it is predatory lending or banks—how can we decide whether a loan—the cost of that loan—is excessive if someone hasn't done the calculus to decide, how do you cover high risk, you know? If you want to make a loan to someone who has very poor credit and maybe has not had a history of being consistently employed for more than a year at a time, we need to find out—we know the need is great. The credit needs of the poor are great.

But we have to be fair and say, listen, what constitutes excessive? The cost of these loans can be very high. So the committee could wrestle with the issue of what constitutes excessive payment for these loans, and I think we could get to the heart of the issue.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Grant can be found on page 70 of the appendix.]

Chairwoman CAPITO. Thank you very much.

Our next witness is Dr. Kimberly Manturuk—did I say that correctly?

Ms. MANTURUK. It is "Manturuk."

Chairwoman CAPITO. "Manturuk"—with a name like "Capito," you would think I would get that right—research associate, University of North Carolina Center for Community Capital.

Welcome, Doctor.

STATEMENT OF KIMBERLY R. MANTURUK, RESEARCH ASSOCIATE, UNIVERSITY OF NORTH CAROLINA CENTER FOR COMMUNITY CAPITAL

Ms. MANTURUK. Thank you.

Good afternoon, Chairwoman Capito, Ranking Member Maloney, and distinguished members of the subcommittee. I am Kimberly Manturuk, from the Center for Community Capital at the University of North Carolina in Chapel Hill, and I am honored to have the opportunity to share some thoughts and research on credit options available to underbanked and unbanked American households.

This hearing comes at a time when families of all income levels are struggling with financial insecurity and need all the help they can get rebuilding their financial lives. North Carolina has long been at the forefront of promoting a financial services environment in which both consumers and lenders prosper, and our center has developed a body of research on credit options available. In addition to summarizing this research, I will also discuss several emerging and innovative products that meet consumer demand for credit in ways that are both affordable and sustainable.

First, our research indicates that most lower-income families have multiple options available when facing an immediate financial shortfall. Very few families rely on a single coping strategy alone.

Among people who use credit to handle their emergencies, mainstream products such as credit cards and bank loans were used more commonly than alternative products, such as pawn shop loans or auto title loans. The use of multiple options suggests an elaborate level of management where consumers are layering in resources in some order of preference. However, it also suggests that none of these products are currently fully meeting consumer needs.

Second, we have found that consumers who do use alternative credit products were attracted to them because the loans were private, fast, and above all, easy to obtain. People cited the short application process, lack of a credit check, and guaranteed acceptance of such loans.

When we asked former payday loan borrowers whether they thought they would have been able to get a loan if there had been a credit check, they generally thought not. However, there was also overwhelming agreement that these products did not sufficiently meet their needs.

In our research with payday loan borrowers, we found strong support for small-dollar credit with a lower interest rate. The former payday loan customers we spoke to, including those who wanted to retain the option to take such loans, wanted a lower APR, a longer amortizing repayment term, as well as limits on renewals and the amounts borrowed.

Current industry best practices do not begin to approach the requirements that our focus group's participants wanted. There are, however, some emerging products in the small-dollar consumer credit space which offer reasonable terms and conditions while retaining profitability for lenders. I would like to conclude today by highlighting a few of these products.

First, a product called FlexWage works with employers to give workers access to a payroll card with a linked salary advance feature, an alternative to the traditional payday loan. Through the WageBank product, the company makes available wages that have been earned but not yet paid.

Customers are charged a flat convenience fee for the pre-disbursement of earned wages. There is no loan, and therefore, nothing to repay.

For consumers who need to borrow more than their already earned wages, Workers Choice USA allow employees to borrow up to 50 percent of their monthly salary at a competitive interest rate. The lender remains profitable because there are low underwriting costs associated with this loan since most of the borrower's information has already been verified by the employer. Repayment is done via payroll deduction over time and there is no cost to the employer to offer these loans.

Finally, in 2001 the North Carolina State Employee's Credit Union introduced a 12 percent APR product called the salary advance loan. Over the past 10 years, the credit union has made over 5 million loans and lent a total of over $2 billion. They have had an average annual charge-off or bad debt expense of less than 1 percent. The credit union calculates that it is saving members an average of $33.6 million per year in payday loan fees.

In conclusion, our research indicates that there is strong demand for small-dollar consumer credit that is ill-served by existing products, such as payday loans, credit cards, or bank loans. Consumers want credit that is affordable, repayable, and closed-ended.

This promise is found in the FDIC's affordable small-dollar loan product guidelines, issued in June 2007, which calls for FDIC-supervised financial institutions to promote consumer credit products with an APR not to exceed 36 percent and amortizing repayments. The guideline also recommends underwriting for ability to repay, incorporating a savings component in the product, working with other organizations, and providing an avenue for financial education.

We encourage lawmakers to promote policies which encourage these types of loans as well as to continue to encourage lenders, particularly non-depository institutions, to better leverage emerging technologies to increase consumer access to low-cost credit options.

Thank you for your time.

[The prepared statement of Dr. Manturuk can be found on page 82 of the appendix.]

Chairwoman CAPITO. Thank you.

And our final witness is Ms. Ida Rademacher, vice president, policy and research at CFED, which stands for Corporation for Enterprise Development.

Welcome.

STATEMENT OF IDA RADEMACHER, VICE PRESIDENT, POLICY AND RESEARCH, THE CORPORATION FOR ENTERPRISE DEVELOPMENT (CFED)

Ms. RADEMACHER. Thank you.

Thank you, Chairwoman Capito, and thank you, Ranking Member Maloney, and members of the subcommittee. On behalf of the Corporation for Enterprise Development, I appreciate, as well as the others here, the opportunity to present testimony today on this important subject.

The Corporation for Enterprise Development, or CFED, is a 32-year-old economic nonprofit that fosters social innovations to build wealth in low-income communities and for low-income families. We see access to high-quality credit as a fundamental tool in the effort to help households build wealth, but it is a tool that must be used with great care and with great intention, and the overwhelming majority of evidence in recent years shows that while there are many, many fundamental barriers to financial wellbeing that American families are struggling with today, some of the research on debt-to-income ratios shows that access to credit is actually not probably the top priority barrier that families are struggling with in this case. In fact, the proliferation of alternative credit products and accumulated debt is actually a large part of the problem.

Even a cursory review of recent data on the status of the American household balance sheet puts us—there is perspective—puts some perspective on this issue. Simply put, Americans are unemployed, underemployed, and overleveraged. We have a consumer credit problem in this country for sure, but a lot of the problem is inadequate access to high-quality and affordable credit, not credit in general.

We are literally drowning in debt. Just last week, the company CardHub.com published its Q2 2011 Credit Card Debt Study, showing that consumers accumulated $18.4 billion in new debt in the second quarter of 2011. That was a 66 percent increase over the same quarter in 2010, and a 368 percent increase over the same period in 2009.

Couple this information with what we know about the increasing ratio between household debt and income. Economist Edward Wolff discussed the explosion of debt-to-income ratios in his most recent analysis of household economics. Middle-income households' debt-to-income ratios were about 67 percent back in the mid-1980s; they rose to 100 percent debt-to-income ratios in 2001; and in 2007, they were at 157 percent.

He further concluded that the debt buildup, to Ms. Koide's point, was for normal consumption, not enhanced consumption. And findings from the 2009 FINRA Financial Capabilities Study, administered by the Financial Industry Regulatory Authority Investor Education Foundation substantiates the finding, with nearly half of survey respondents reporting facing difficulties covering monthly expenses and paying bills. And the majority of respondents didn't have any type of rainy day funds set aside for financial emergencies.

With inadequate incomes and inadequate savings, the only option for millions of Americans is to turn to credit alternatives to finance basic consumption, but our own analysis of consumer credit scores suggest that over 60 percent of those consumers have subprime credit scores, so the credit product options that are available are often sub-optimal, and the most vulnerable households who can least afford additional financial burden end up paying a premium for access to the credit they need simply to make ends meet.

The ultimate lens through which we think we should be looking at any financial product or policy is relatively intuitive and straightforward: Does the product help a consumer improve their financial situation long-term or does it make their financial situation worse? A growing body of evidence shows that many of the short-term alternative credit products that are available in the market for cash-strapped consumers today with either thin credit files or no or low credit scores don't pass this fundamental principle of "do no harm."

Less than 2 percent of payday loans—according to recent research by the Center for Responsible Lending—went to borrowers with the ability to repay in the first cycle of getting that loan. And in fact, the executive director of TitleMax himself, in testimony, stated that the average customer with a car title loan renews that loan 8 times.

CFED's Assets and Opportunity Initiative provides some in-depth information at the State and local levels on the kinds of policies that can help households increase financial stability and build and protect assets. We support the regulation of short-term consumer lending products. Small-dollar installment loans, when responsibly regulated, can be a very safe product, but we recommend capping the interest rate charged on loans, such as payday loans, car title lending, and small-dollar installment loans.

To date, 10 States have banned or capped all three types of predatory loans I just mentioned. That includes the short-term lending and basic consumer protection laws. Fourteen States do not effectively regulate any of the three predatory loan products. And nine States include short-term lending in their basic consumer protection laws. All other States protect consumers against some, but not all types of short-term loan products.

So what can and should the Federal Government do? I will just leave you with three broad recommendations to consider. CFED feels these would go a long way toward helping families truly regain their financial footing.

First, protect consumers from financial products that exacerbate financial distress. We absolutely support the Consumer Financial Protection Bureau's mandate in that regard.

Second, help families save. Credit and emergency savings are actually substitutes at this level of the household, so helping families learn how to save and incentivizing that savings gives them another option when emergencies happen.

Finally, help families build good credit. I will finish where I started: The quality of credit available to families is all-important. We do believe that with full file reporting, as many as 120 million consumers could build and improve their credit score, and we should really help to end the regulatory uncertainty and provide permission to utility and telecom companies to report on-time payment to credit reporting agencies, to that end.

Thank you for your time.

[The prepared statement of Ms. Rademacher can be found on page 151 of the appendix.]

Chairwoman CAPITO. Thank you.

I am going to begin the questioning with Mr. Gilbert. How does an individual customer find out about BillFloat? Is it on the Internet, or—

Mr. GILBERT. Thank you for the question. They are able to access us through our Web site at BillFloat.com, but our strongest point of messaging is through the billers themselves.

Chairwoman CAPITO. So that would be the utilities, or the—

Mr. GILBERT. The phone companies, insurance companies, the existing entities that have relationships with these customers who get the phone call in the call center to say, "My bill is due today or in a week. I won't be able to pay it on time. Can I get more time to pay?"

And they will often get a response from the call center reps that, "We are not in that business. You have to go and find credit from someone else." Now, with BillFloat as a payment option in those workflows, at least there is a solution that the utility companies know comes from a reputable company with terms and conditions that are very clear to consumers.

Chairwoman CAPITO. Do you have any challenges offering services across State lines?

Mr. GILBERT. Certainly, it is a challenge. We are dependent on banks, based on their license and regulations, and also State laws for direct lending we are doing ourselves. Compliance across State lines means that we have to increase our costs of goods for product, which does impact our product overall.

Chairwoman CAPITO. So if you forward somebody's power ill—say it is $300—then do they pay you within the 30-day period, what interest do you charge, and—

Mr. GILBERT. Our product is a 30-day product. We charge an interest rate of 36 percent APR based on the standards put forth from the FDIC small-dollar loan template, which we use as a guideline for our business as well.

Chairwoman CAPITO. Are there other competitors in this space with you? I am sure there are.

Mr. GILBERT. I believe consumers have a lot of credit options that they could access in order to pay bills. No one has taken credit options specifically to address this problem of bill payment.

What drove us into this space was the data point in the 2009 FDIC study which showed that 47 percent of the times consumers get high-dollar loans, it is to pay bills. So we took the approach, "Let us build a product to help bill payment."

Chairwoman CAPITO. I am interested in the innovation because I think all of you all have remarked that to have a competitive marketplace in this arena is extremely important for the consumer to make sure that they can—hopefully give them some sort of reasonable rates and reasonable parameters for them to be able to pay this back.

I have a question for Ms. Koide. You mentioned the CFPB in terms of regulating these products, and how important that you feel that is. But, for instance, we just had the FDIC testify that they are regulating in some of this space, too. Do you think that there is any—not conflict there, so much as a potential for, “They are regulating, so we don’t need to look?”

Ms. KOIDE. Excellent question. I think right now it has been interesting to see how the regulators are stepping out and focusing on certain products, under the auspices of safety and soundness, even if it looks like a consumer protection matter or a consumer protection matter under the auspices of safety and soundness. I think those things are inextricably linked; it is hard to pull them apart.

I think the fact that we don’t have a CFPB that is in full standing with a Director in place right now leaves a bit of a void, and so I am encouraged to see the regulators focus on some of these products and realize that there is more that needs to be done to understand what is underneath them and what are the products that are coming out.

I also realize that having this new bureau, once it is fully standing, is going to create another regulator that is going to take positions. I think it has been very explicit in the sort of formation of the CFPB and many of the discussions that have happened around it how critical it is going to be that the entity is conferring, developing rules, guidance, best practices in coordination with the other regulators, because I think you are hearing innovation talked about a lot here. What is underneath a lot of that is that it is not just one entity that is a part of the provision of the services; it is, perhaps, a depository who sits in the back and does the processing or provides the capital, that there are other players in that product offering, and we have to have a regulatory system that recognizes that complexity and coordinates around it.

Chairwoman CAPITO. But at the same time, I think some of the barriers that were talked about by one of the witnesses is capital—the regulatory inconsistency. I am not sure we are solving this problem, but I will move on.

I am really curious to know, and I wanted to ask the other panel this—this will be my final question; I am back to the Internet again—we know that financial literacy is extremely important, but we know that Internet access and capabilities has really grown exponentially, and certainly with the generation behind me, it will be a way of life for all. How do you see that as—do you see that as a plus or a minus for the underbanked and unbanked population, in terms of trying to reach capital? And I will ask the three of you all over there.

Ms. GUZMAN. I think consumers are demanding more options based on convenience and accessibility. We find that, of course, like you, Madam Chairwoman, the younger generation is using strictly technology. They are using their phones as their checking account; they are wiring money via an iPhone.

However, other options need to be available because there are different markets, nonbank as well as traditional banking. And then, of course, we need to look at the variety of products and ensure that at all times, our consumers are protected. I think all these will make the availability of access to cash when we need it just more convenient and available so that people don’t find themselves spiraling out of control when it comes to their finances and maintaining their obligations.

Chairwoman CAPITO. I am going to move on, because I am kind of violating my own rule here.

So, Mrs. Maloney?

Mrs. MALONEY. Thank you. This hearing certainly points out that the unbanked population is growing, the need is growing, and the challenge is there. Quite frankly, I was not aware of the FDIC's model program or the OCC's efforts in this area, and the programs that came forward today, such as BillFloat, FlexWage, salary advance on credit cards, and other things that you talked about.

I think at the very least, this committee or some regulator should get out where all these programs are so consumers can know where they are to go for these services. I think that there is a growing need; there is no question about it.

And there have been several legislative proposals that have been put forward, one, actually, by my colleague, Mr. Baca, today—I was not aware of it until he told me about it today—which would create optional Federal charters for nonbank financial institutions. And under this proposal, the OCC would be the principal regulator and State laws in the area would be preempted.

Can the members of the panel comment on the merit of this proposal? Anyone? All of you? We will start at this end and go down the line.

Ms. Rademacher?

Ms. RADEMACHER. Yes, thanks. So, I think, as I mentioned, States are—

Mrs. MALONEY. I can't hear you.

Ms. RADEMACHER. Thank you. States are, in terms of this policy space, out in front addressing these issues. A lot of them are on the ground seeing what is happening with consumers in the short-term lending space.

I think it would be a real shame for a Federal charter process to create a way around some of—create a new type of ceiling that is actually, perhaps—and I don't know the details of it—if it is lower than where the States have already gone to protect their citizens, I think that would be something that we would want to look at very closely before we said much. I do think that to the point of coordinating efforts, understanding that this is a very complex marketplace and growing more complex every day, being able to coordinate and regulate with some consistency and open communication is imperative, so a sense of some piece of this moving back to the OCC but actually serving in a space where there are multiple types of financial institutions, it raises some questions for me, and I would want to look at that more closely.

I certainly think that, at the very least, nothing that happens should preempt the places where States have gone with some of the ways they are trying to protect their consumers at the State level.

Mrs. MALONEY. Ms. Manturuk?

Ms. MANTURUK. Thank you.

We haven't done any research specifically looking at preemption effects or what they would be in the consumer credit space. I can say, within North Carolina we have a long tradition of pretty rigorous regulation of consumer credit, and there is pretty strong research evidence that the regulations that we have in place right now are meeting consumers' demands.

We just finished doing some research looking at finance company lending, which is subject to an 18 percent cap above a certain level and a 36 percent cap at $3,000 and below. And our research found that industry in North Carolina, with the current regulations, is profitable for lenders and is also meeting consumer demand. So I would have to agree that any regulation which would preempt what we already have that is working for us would be something to think very carefully about.

Mrs. MALONEY. Ms. Guzman?

Ms. GUZMAN. I like the idea of having a balance for consumers of a regulated option that protects consumers, offering more expanding access to options that work for them and allowing them to make choices for their own household. Unfortunately, well-intended legislation in States has had very adverse outcomes for my consumers. I constantly hear, especially in the States where they have regulated—put a ban or a cap on the amount of times, etc.—that they have been forced to use the more expensive bank option that has negatively impacted their credit, which is what they are trying to avoid to begin with. They are trying to get back on their feet.

And so, I have to really question some of the regulations in some States, and certainly at this time we are looking at the Federal Government to help us protect our consumers, yet expand options. Thank you.

Mrs. MALONEY. Mr. Gilbert?

Mr. GILBERT. Thank you, Congresswoman.

One of the biggest challenges that I have in running my business is getting banks to work with me in order to offer my products. When colleagues back in the startup world heard that I was going to be testifying this morning, they started inundating me with e-mails about my bill. I responded to them, "It is not my bill." I heard about this bill for the first time back in May, and I think it is a great bill because it can allow entrepreneurs to get on with their business.

I also believe that uniformity will be very much helpful to consumers, and that uniformity can be achieved in a way that is also very respectful of the rights of States and State caps.

Mrs. MALONEY. My time has expired, but if you would like to give your point of view, Ms. Koide?

Ms. KOIDE. Thank you. I would.

I absolutely recognize the need to get banks to play more with the nonbanks. It has to happen, because these are volume businesses and they need volume to be able to affect the price.

I completely recognize the need for coordination among the regulators. I need to read the bill again; it has been about a year- and-a-half since I looked at it. But I don't know that adding another regulator in the mix of regulators is ultimately going to get us what we need.

Mrs. MALONEY. Then, how do you force some institutions to work with these independents to provide this?

Ms. KOIDE. I also wanted to say that I think we absolutely need uniformity and clarity of the rules across the different types of products. I think that emphasis from Congress on the regulators—this new bureau, once it does get up and running, is going to be working with the other regulators to create joint guidances, for instance, on what good consumer protections look like.

I need to look further at the bill, but I would pause on that.

Chairwoman CAPITO. Thank you.

Mr. Renacci, for 5 minutes?

Mr. RENACCI. Thank you, Madam Chairwoman.

And thank you to all of the individuals participating today.

There is a little bit of confusion for me because we do have a problem. We are hearing that there are a number of underbanked individuals who need these type of loans.

And then we had the regulators in earlier who were saying we had pilot programs, but when I questioned whether they were working, they said they don't have a conclusion as to whether they are working because we don't have the numbers. So hopefully, I will get some numbers that will show whether they are working.

Mr. Grant testified that banks are having issues with the profitability of these loans, so it tells me that—and then, of course, I have had discussions with many banks who have said that it is very difficult to manage these loans and make a profit on these loans. So we have a need and we have to be able to provide for that need.

So I would question, first, Ms. Guzman. With the States getting away from some of these types of short-term lenders and short-term loans, and not wanting them, do you have any research as to where these individuals are going when there is an emergency and they need the cash?

Ms. GUZMAN. The only research I have is, being that our mission and our actions are driven through our consumer feedback, is the feedback from our consumers. And they tell us they are forced either to more expensive options, such as bouncing a check. In almost all cases, their credit was negatively impacted.

And basically, ultimately they have lost their housing, they have had their utilities turned off, they have lost child care, which is critical for some of our single heads of households. It has just become basically a nightmare. It restricts options.

And, they somehow feel very slighted, considering they are hard-working Americans who pay their taxes, and yet they don't have the choices that they need because government has restricted them.

Mr. RENACCI. I have seen somewhere—I can't find it here—but I even saw that some were going offshore, doing whatever is necessary to get the dollars.

Ms. GUZMAN. Absolutely. Unregulated offshore lenders always find their way to our consumers, unfortunately.

I would just hate to see something that is not regulated on any level make its way to our consumers. We certainly want the options to be expanded and the access to be there, but we want to make sure our consumers are protected, also.

And choice seems to be the number one thing that is mentioned. They feel a sense of pride in being able to weigh out choices and choose the option that works best for their homes and their families.

Mr. RENACCI. Mr. Gilbert, are these some of the individuals who would be the profile of your typical customer?

Mr. GILBERT. Yes. Our typical customer is a female head of household, probably age 35, with children, one person in the household working, and an income in the $45,000 to $65,000 range. In our consumer studies, choice is the number one objective or the number one goal for these consumers.

But trust comes in right there. These organizations need to be very, very clear about who they are to their customers so trust can be earned and maintained.

Mr. RENACCI. Do you have any competition from small banks or community banks?

Mr. GILBERT. I wish we did have a lot more. We have been working very, very hard with a number of community banks, particularly in the State of California.

The challenge that they are finding, because they are insured by the FDIC, is I often receive a message that there is no space for small-dollar lending, really, in an insured deposit system. Safety and soundness of the banks is really the overarching concern when looking at these types of programs.

But we continue to push on, because I am quite sure that soon enough, we will find the right bank. I also believe that some federally chartered credit unions could be the right partners for us over time.

Mr. RENACCI. Can you give me an idea of what your default ratio is?

Mr. GILBERT. We are seeing a default ratio of approximately 10 to 12 percent for first-time consumers and 5 to 8 percent for returning customers.

Mr. RENACCI. Okay.

Ms. Rademacher, you made the comment—you had some good conclusions. The problem I had with your conclusions was they would be for somebody who was not in trouble, who was not in an emergency situation, does not have the need today for those dollars.

What would you say for those people? Where should they go? Because your conclusions are, we need to teach people that they need less debt; we need to find financial institutions with better interest rates.

All of those things are great when you don't have an emergency. But these people are coming up with emergency situations, which we all could have in life. What are your thoughts on that and where should they go?

Ms. RADEMACHER. Sure. No, it is a great point, and I actually knew that there would be a number of people talking about some of the alternatives that I might have cited myself. So I didn't spend as much time talking about where they can go today.

In addition to the innovation in the marketplace, as with some of the folks who are here on the panel, there are a lot of cities and States trying to innovate, as well. They recognize that you cannot just create parameters around the conditions of emergency loan products without making sure that there are alternatives available in this space. That is where the Virginia small-dollar loan pilots are coming from.

There is certainly a lot of evidence, I think, from the work that has been done in North Carolina as well, with the profitability for a credit union, on the large scale, with the kinds of emergency loans that can be offered safely and relatively affordably to people in crisis already in existence, but do need to be promoted there.

I think that the—

Mr. RENACCI. I am running out of time, but just one really quick question: So you believe that as long as they were regulated properly, some of these nonfinancial institution providers of short-term loans would be a working solution?

Ms. RADEMACHER. Yes. I think to the points made here, capping the interest rate, capping the amount of churn that can happen, or the amount of rollover that needs to happen, understanding the needs of both the consumer and the marketplace for a sustainable product is paramount.

Mr. RENACCI. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Baca?

Mr. BACA. Thank you, Madam Chairwoman.

Ms. Guzman, there has been limited effort by the Federal Government to tap into the market and allow federally regulated institutions to offer products to underbanked and unbanked populations, and we are still seeing a large number of consumers still limited to this option, and I appreciate your personal story that you told earlier.

In your opinion, what has held back the Federal programs from reaching out to these people who clearly still need access to credit? And then, I want to follow up with another question, if I can, and what are the obstacles in place that have limited the private nonbank lenders from reaching all of the people who need credit?

Ms. GUZMAN. First, it is a simple answer. Banks are the only answer. That is what we are literally being told. My consumers are being told, if you don't deal with a main banking institution, you have no options. So, they go to alternative financial services that are working very well for them.

I understand from my colleagues in the banking industry, they don't really care about my consumers that use alternative—that is not their job. That is not the business they are in. They are in the business of—

Mr. BACA. Why don't they care? Why do they say that they don't care?

Ms. GUZMAN. Because they are held accountable to a board of directors for whom the bottom line demands a profitability, and these are high-risk people who, for any reason—

Mr. BACA. But these are people in need of an emergency loan. Is that correct?

Ms. GUZMAN. Yes. Or sometimes it is not just an emergency. Someone loses a job or has a cut in hours or a cut in pay for a period of time, maybe 5, 6 months—it is not something anyone intends to do or I think does out of lack of responsibility. Everybody enters into their commitments well-intended.

The problem with regulations, while they are well-intended, is no one is asking consumers what they need. The intentions are done.

I am a local school board member, so I do this also. I make decisions for my constituency based on what I feel is in their best interest. However, often State laws and other laws are made that are actually hindering consumers from being able to manage their finances in their household because their options are limited and they are forced to do something that creates a larger problem.

I think sometimes—

Mr. BACA. That is because, also, the credit card—there is a credit card option, but the credit card option then means that it is a higher interest rate, as well. Isn't that correct?

Ms. GUZMAN. Absolutely. And I have a video of my consumer testimony I would be willing to share with all the committee and send to your offices that shows that the Credit Card Act negatively impacted many consumers by dropping consumers who had good-standing credit down to a $1,000 minimum. That didn't give them very many options to keep cash flowing in an emergency or during a period of time when they have a tough time making ends meet.

They certainly want, again, more access to choices so they can identify their problem and choose the option that works for them and their household. That is pretty much what we want them to do so that at some point, they can work their way up to traditional banking, and own a home, and acquire the American dream.

Mr. BACA. My next question is for Mr. Gilbert.

Everyone is saying that competition and innovation is the key to coming up with answers to the problems. What are the biggest problems for these nonbank lenders to expand and fill these needs that 50 percent of the Americans need—and I will say 50 percent of the Americans needs—and can the current patchwork of the State regulations allow for this?

Mr. GILBERT. I think the biggest challenge, Congressman—and thanks for the question—is finding the right platform to conduct business. For innovators, before one rolls out a full, complete program across millions of consumers and potentially multi-States, we always try to consider pilot programs, much like the FDIC spoke about, and I think it could be very enabling if there were pilot initiatives under any of the agencies, or perhaps the purview of the Bureau, to enable true pilots.

We can learn a lot from the pilots if they are run on reasonable terms and over a reasonable period of time. And for me, I describe reasonable as at least 2 years—the first year to get it up and running, and the second year to get the data and continue reporting.

I think, also, the patchwork of State laws is something that we have to appreciate and live with in the United States, but also respect the need for uniformity. The cost of compliance can bring down even the most successful business.

As an entrepreneur, many will ask me, "Why are you in financial services?" I could be in social networking, or sell widgets online. This is a challenge, and that is why we are standing up to the challenge.

Thank you.

Mr. BACA. Thank you very much.

I know that my time is going to expire, so I will yield back the balance of my time.

Chairwoman CAPITO. Thank you.

Mr. Westmoreland for 5 minutes?

Mr. WESTMORELAND. Thank you, Madam Chairwoman.

Ms. Koide—I am not really good with names—where does your company get its operating funds from?

Ms. KOIDE. We get our funding from a variety of sources. We are an organization that began with funding from the Ford Foundation. Our president, 10 years ago, when there was so much focus on access to credit and realization that there are these consumers who are out there who we don't really understand what drives their choices and the products that they use, she sought out funding from the Ford Foundation in order to do a pretty comprehensive study to understand those consumers with the objective and appreciation that ultimately scale solutions reside in the market.

So we began with funding from the Ford Foundation, and we have significant funding from other national philanthropic funders. We also have resources that are generated through roundtables that we hold. We also hold an annual conference each year for underbanked innovators. So it is a range of sources.

Mr. WESTMORELAND. No Federal, though? No grants?

Ms. KOIDE. No Federal money, no.

Mr. WESTMORELAND. And, Ida—I am going to call you that, rather than destroy your name, but—I am assuming that you get your funding from private sources, also?

Ms. RADEMACHER. We do. Primarily, the model is we have about 80 percent of our funding from philanthropic sources.

We do have some new Federal contracts. We are partnering right now with the Department of the Treasury to build out some of the basic tools and data for the financial access types of initiatives that are happening in communities around the country—somebody mentioned Bank On initiatives. So we are doing a number of things with that at the moment.

We are creating estimates at the local level for unbanked and underbanked based on the FDIC's data. We are looking across the financial institutions to look at what it means to be sustainably engaged in this work—what is the kind of—

Mr. WESTMORELAND. Okay. That is fine. I just wanted to know about the—

Ms. RADEMACHER. That is where I am from, yes.

Mr. WESTMORELAND. I found your testimony pretty interesting. I come from a construction background, and I actually have seen people in dire need of $200, $300, $400, $500. You can see it in their eyes; I have seen it.

And you said that one of the things that you think the ultimate test was, is does this product help consumers improve their financial situation or does it make the situation worse? Then, you go on to talk about the no credit, low credit, whatever. And then you talk about the amount of interest that somebody should be capped, as far as charging.

Would staying out of jail be something that would help the financial situation or hurt the financial situation?

Ms. RADEMACHER. That would obviously help. I am not saying that we should—I think the whole point of what I was trying to say and what I—we have continued to say is that it is an unfortunate situation we find ourselves in in America right now, that people have to choose between immediate urgency and—

Mr. WESTMORELAND. No, ma'am. I couldn't agree with you more. But if you were counseling somebody, would you tell them that it is going to be better to go to jail than to borrow $300 from somebody? Would you tell them it is going to be better to pay $30 in an insufficient check fund to cover a $5 check?

Are those some of the things that you would weigh when you are looking at financial responsibility?

Ms. RADEMACHER. Yes. I had this conversation, preparing this testimony, with my sister, about her experiences with short-term lending and where she has been for very similar reasons, the choices she has made. Nobody can knock the choices somebody makes in an urgent place. They—

Mr. WESTMORELAND. —to make choices in life, but you have to do it, so—

Ms. RADEMACHER. Yes. She wishes she didn't have to make them, and she hopes in the long run she has opportunities so she can get out of that trap.

Mr. WESTMORELAND. I understand. But a lot of people find themselves in the situation where they can't, and what I have found is that somebody who really needs $400, they are going to either borrow it from somebody who is licensed, they are going to borrow it from somebody who may do physical harm to them if they don't pay it back at a very large interest rate, or they are going to break into somebody's house or car or steal something to go pawn to get the money.

So I think there is a place for some of these financial or nonfinancial institutions, whatever you want to call them, that really go into some of these areas to locate, to service the needs where a lot of people don't. And so when I read your testimony, I just felt that it was very, very interesting that you are weighing what it is in the financial balance, but in real life, a lot of those people weigh that every day between going to jail, not going to jail, being able to go to work, or not being able to go to work.

Thank you very much.

Chairwoman CAPITO. Thank you.

Mr. Meeks, for 5 minutes?

Mr. MEEKS. Thank you, Madam Chairwoman.

And let me just say, Mr. Westmoreland, I actually concur. My own life experiences tell me that you are absolutely correct.

There are a number of individuals out there who are not just considering their financial situation or their financial health, they are thinking about survival. They are thinking about, "How do I make it to the next day? How do I keep my family intact?"

They are not thinking about, "Oh, I have to have a FICO score of 700, and I have to make sure that my financial situation is in order." They are not there.

They are saying, "How can I live to make it another day, keeping my family together?" And they have these options that they have to choose from.

Now, personally, my point of view is if they had more options on a legal way, then they will be able to make better choices. But if we limit the options that they have—because guess what? If you happen to have the 750 credit score and a lot of money, you have a lot of options. The options are limited for those who do not.

And for them, when you talk to—my family back then, if you talk to them and you ask them, or folks are telling them, "Get your financial life in order," when they are trying to get their life in order for the next day, they say, you have to be out of your mind.

And if you go to a bank whose interest is not that consumer, that is not their interest. That is not who they are going to—they are bored with—get them off the board of that is what they were focused on.

So to me, if there is a group of individuals or businesses that says, "Okay, we want to compete for this unbankable population. We think that it is viable. We think that we could make some money doing it. But we think that we can compete for this population," the people who I know that are in that situation will say, "Thank you. You understand my needs. Give me some options of people who want me because they know that I am struggling every day to make it."

I have somebody—I won't say who—on my staff who has been trying to get a $500 loan to fix their car so they can go to work. They have gone to bank after bank after bank. The banks won't give them the money.

Finally, I know someone who gave them the money so they can get back and forth to work. But if they had institutions that were competing for them—but guess what? We talk about the interest rates. I think even in that population, that competition would draw the interest rates down if you had as many people as you could that would be going after them, that is how you bring the rates down.

They would be competing for them just as people in the other end. What do they do to get people with money to bank in their banks? They lower the rates. They give you free checking. They find ways to try to entice you in to them because that is the customer that they want.

It is the same thing on the bottom end. There is no difference for those who have been on the bottom, it is just that nobody has been competing for them. And I think it would be wrong for us that if we have institutions that now want to compete for that business to say, "Nope. You can't do it. We are going to regulate you out of the business; we are going to end it because you are bad. You can't do it."

And in essence, you are saying to those people, "You can't exist."

I do financial literacy in my district all the time, and we do need to teach and educate folks. But in order for them to be able to advance into the sphere of financial literacy, they first have to survive. So if they allow them to survive and then teach them financial literacy, then hopefully one day they will have some money to lend to others and compete. They can go from one end of competition to the other end of competition, because that is what this is really all about if you live the life.

I have been there. I have been there, believe me. And so, I don't just speak from theory; I speak from very real life.

I had these questions and I know I took up my time, so I will stop there. I had a bunch of questions, but you just hear this stuff, and because it is so close to me, I just had to make these comments.

But I want to thank all of you for being here, and I look forward to working with you.

Thank you, Madam Chairwoman, for this hearing.

Chairwoman CAPITO. Thank you.

Mr. Luetkemeyer, for 5 minutes?

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

And I thank all of the panel for being here today, and I certainly thank Mr. Meeks for his passionate words there. I think that we are all here to try and find a way to help those who need some help with access to credit.

That is what this is all about today, and I think we need to find a way to structure this environment so that people can have access to it, and structure it in a way that they can afford whatever alternatives they pick, yet allow the business climate to be able to fund itself, make enough money so that it can continue that service. We are all looking for that balance; we are all looking to help these folks. And it is the give and take, and it is the struggle we are with here.

So I know Mr. Meeks and Mr. Westmoreland made some great points.

Quick question for Ms. Manturuk: In your testimony, your research says that you show that there was no real impact on the abolition of small-dollar lending in North Carolina, yet the Federal Reserve of New York published a study, and also, according to my information, the Federal Reserve Bank of Kansas City published something in the Economic Review that said whenever the payday loans were banned in Georgia and North Carolina, households bounced more checks, complained more to the FTC about lenders and debt collectors, and filed Chapter 7 more often than households in other States where payday lending was permitted.

Can you tell me what the difference is between the studies?

Ms. MANTURUK. I read that study probably a couple of years ago, so I am a little bit rusty on it. My recollection was that study didn't account for macro-level economic changes that might have changed in the before and after climate.

Our research was aimed at actually talking to people who were former payday borrowers themselves, and getting their impacts and their evaluation of the impact it had on their lives, and that is where we derived the finding. Interestingly, when we targeted people who lived in communities where there had been a proliferation of payday lenders, most of them did not even realize that the option was gone, which, I think, speaks to the fact that this really wasn't something that was important in their financial lives.

When we focused exclusively on people who were former borrowers themselves, though, they overwhelmingly said that they felt that they were grateful that the option was gone. One of the more interesting things, as one customer told us, is that not having what she considered to be a negative option had actually prompted her to change the way she managed her money on a regular basis.

Mr. LUETKEMEYER. That is interesting. They were glad it was gone. That is curious.

One of the things—I used to be the chairman of the Financial Services Committee in Missouri, and we instituted a lot of new rules and regulations with regard to payday loans, title loans, small-dollar loans. And one of the things that we did was put it in what I call the "Fed box." I am a banker, and on your housing forms you have a disclosure box, or we call it the "Fed box" a lot of the time. It discloses all the interest rates, and the origination fees, and any other fees that are in this that are there.

I know that is what we did with regards to the forms there in Missouri, and I was just kind of curious, in your experience do you see any consumers that shop the rates? Do they shop for rates at all?

Ms. Guzman?

Ms. GUZMAN. Absolutely. And their method of shopping is by walking into a bank or a credit union and being told, "No. We don't have a product that fits your needs," or actually being told they can apply for an option and then not qualifying for it for a multitude of reasons.

Unfortunately, this becomes very humiliating and very degrading. And then, when they look at their other options in other locations, they find that it will work for them.

I don't think there is much—you don't need too much common sense, and my consumers certainly have great common sense—they are short on funds, but not on common sense—that you need your money today but they are going to hold your check for 3 days at the bank that has your account. Naturally, you are going to go to a check casher. The same thing goes for access to funds.

Mr. LUETKEMEYER. That is kind of interesting, because we haven't heard a lot of testimony today that has been a negative about the small-dollar loan folks, but I know when I was the chairman, because I oversaw that area, I would constantly check with the regulators and see once if there were a lot of complaints filed. And it was interesting to see that there were fewer complaints filed against small-dollar loan lenders than the banks themselves—

Ms. GUZMAN. Yes.

Mr. LUETKEMEYER. —which tells you that they are delivering a good service at prices that are competitive, that it is a service that people want.

And I noticed in your testimony, Ms. Guzman, you were talking about how they want more choices that help them get credit back for themselves. And we had a lady who testified in this committee at a hearing recently—several months ago—that she used it as a way to get back her regular credit so that she could get back and actually be able to go buy a house and start a business.

And so while it may not be for everybody, it certainly fills a gap for those who need some quick access to cash in small amounts.

So with that, thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I think that concludes our hearing, and I want to thank all the panelists from the second panel. You were very great witnesses, with very good information.

The Chair notes that some Members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that said, the hearing is adjourned.

[Whereupon, at 12:52 p.m., the hearing was adjourned.]

A P P E N D I X

September 22, 2011

Prepared Statement for the Record

Ryan Gilbert
CEO, BillFloat, Inc

Hearing on
"An Examination of the Availability of Credit for Consumers"

Before the
HOUSE FINANCIAL SERVICES COMMITTEE
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE

September 22, 2011

Chairwoman Capito, Ranking Member Maloney and members of the subcommittee, good morning.

My name is Ryan Gilbert and I'm the Chief Executive Officer of BillFloat, based in San Francisco, California. It's an honor to speak with you today on the availability of credit for consumers.

Our company was founded in San Francisco in 2009 with the backing of PayPal and leading Silicon Valley Venture Capital and angel investors. We employ 41 full time and part time staff, at offices in San Francisco, Dallas and Chicago. BillFloat has a singular vision – to develop alternative consumer finance products that are simple to understand, fairly priced, and place consumers on a graduation path to financial stability and flexibility.

New generation of financial services providers

We represent a new generation of financial services providers that embraces technology and innovation to offer everyday consumers hope.

Customers come to BillFloat for assistance when they need more time to pay their monthly bills. The majority are mothers tasked with balancing the family budget and paying monthly bills.

We've developed a short-term consumer loan platform for payments with a purpose. Loan proceeds can only be used to pay bills – for example cable, utility, phone, or insurance bills. Our products range from 30 to 60 day terms, and we plan to offer longer-term repayment options in the future. We've designed these financial products to help consumers get past short-term cash flow impairments and maintain good standing with their monthly services providers. Non-payment of recurring bills results in significant impediments for most American families – loss of communication services, power, heating or insurance coverage. This is exactly the kind of short-term, small dollar credit solution that has been abandoned by many banks – yet is sorely needed by consumers to make ends meet.

We offer our services in partnership with some of the largest billers in the country, including two of the top five cellular phone service providers. We help these companies offer their customers an alternative to late fees and service interruption, maintain their credit rating, and continue a mutually beneficial relationship.

Most noteworthy has been the repayment performance of our customers, and their ability to get back on a firm financial footing after receiving support from BillFloat. Recent data shows that 97% of customers successfully paid billers with their own good funds after relying on BillFloat in the previous month. We successfully supported these customers during their cash flow crunch, and they responsibly returned to a more stable financial relationship with their biller.

Central to our product model is a belief in alternative data, including consumers' bill payment experience, cash flow, lending habits and household expenditures. As technology innovators, we have focused on developing new ways to assess a consumer's ability to afford alternative financial products and offer safe, feasible credit alternatives to consumers whose best option is often high interest short-term loans.

We also strive to determine the prudent amount of credit that a consumer requires. Our approach can be summarized as 'Less is More'. Our offers reflect a consumer's current financial situation and only provide the consumer an amount of credit based on his ability to repay. This approach has the positive impact of reducing the amount of credit the consumer accepts, and the total cost of credit.

Strong, growing consumer demand for financial services alternatives

Over the last two years, some dynamics of the consumer credit market have become abundantly clear to us. The defensive posture of the 'too big to fail' banks has led to a large number of consumers having their financial liquidity decimated. The 'too big to fail' banks are today, simply put, 'too scared to lend' to worthy consumers, due to the higher costs and risks associated with serving non-prime consumers.

According to a recent Federal Reserve Bank of New York report, approximately $1.1 trillion of consumer credit has been removed from the markets from the third quarter of 2008 to the second quarter of 2011.This retraction of credit to consumers hurts the overall economic recovery and flies in the face of initiatives from Federal agencies, such as the FDIC, to maintain access to loans and other viable financial products for under-served consumers.

At the same time, demand for consumer credit has grown significantly, influenced by several demographic and socioeconomic trends, including an overall increase in the population and stagnant to declining growth in the household income for under-served customers. A recent research paper by the National Bureau of Economic Research found that almost half of the Americans surveyed reported that they were financially fragile, and felt that they could not gain access to $2,000 to cover a financial emergency, even if given a month to do so. This is incredible when you consider the short-term lending market in the United States represented approximately $40 billion in loan volume in 2010, according to Government Accountability Office estimates.

What also makes this so troubling is that not just thousands, but many millions of hard-working middle-income Americans are being relegated to second class economic status through no fault of their own. While we all take "cashless" e-commerce transaction systems for granted, consumers without good funds or good credit cannot make a payment online, and, without cash for an in-person payment, they are likely to resort to non-payment as a the only "viable" option.

We do feel there is hope, however.

Federal charter, not federal funding

BillFloat represents a new breed of financial services provider. Start-up companies like BillFloat, Kabbage, Obopay, OnDeck Capital, and PayNearMe, epitomize "can do" American ingenuity at its finest. We share a technology and market-driven approach that is highly consumer-centric. We never exploit our customers, or take them for granted. And our products offer under-served, yet financially responsible, middle-income consumers reasonable fees, transparent terms, and the professional support of personnel that are compassionate and straightforward in their dealings with them.

We are not asking for any federal funding, loan guarantees or any other handouts. We're backed by our country's energetic and forward-looking community of venture capital and angel investors who have invested over $1.6 billion in 231 privately held financial services companies since 2008, according to The Money Tree Report published by PricewaterhouseCoopers and the National Venture Capital Association.

There is, however, one thing this subcommittee could do, and that would be to consider H.R. 1909 introduced by your colleague, Representative Joe Baca. This bill, the FFSCC Charter Act of 2011, will establish a much needed and welcome platform on which financial services innovators will be encouraged to flourish and serve the under-served. I believe this will have an immediate and hugely positive impact for everyday American consumers, and the economy as a whole.

Today, one of the most difficult challenges facing any financial services innovator is accessing the critical banking infrastructure needed to offer a new service. We are frequently beholden to banks to bring to market any of the comprehensive array of alternative finance solutions demanded by under-served consumers – from credit products to prepaid cards.

It has been our collective experience, however, that the same banks that are not serving under-served consumers are not supporting technology and financial services innovators either. Of the thousands of banks in the United States, fewer than ten have made an active and concerted effort to support start-up innovation efforts, and none of these banks are the household names that consumers rely on every day.

Pro-innovation, pro-consumer

The FFSCC Charter Act will establish a clear platform for non-bank providers to launch and operate their service nationally. I also believe the pro-consumer requirements of the bill that will hold all Federal Financial Services and Credit Companies to clear standards for credit disclosure, account access, financial literacy and breadth of product offerings are critically important.

The Charter Act further provides that each charter holder shall "have a primary mission of providing a comprehensive array of financial services to the under-banked, unbanked, and consumers with low credit scores." Non-delivery of much needed services will mean non-compliance.

Finally, we have heard consumers clearly. They want access to fast and convenient credit from reputable and trustworthy sources. By removing reliance on third party banks and enabling national business and operating plans, innovative service providers chartered under the FFSCC will have the opportunity to present consumers with new credit options that are safer, more affordable and more convenient alternatives than overdraft protection on bank accounts, high interest loans, late payments on credit cards, and banks' insufficient funds policies.

Once again, I greatly appreciate the opportunity to speak with you today. I would be very happy to answer your questions.

Thank you.

Statement of Michael A. Grant
President
National Bankers Association

Before the
Subcommittee on Financial Institutions and Consumer Credit
September 22, 2011

First, I would like to thank Chairman Capito, Ranking Member Maloney and the entire subcommittee for the privilege of addressing a matter of grave concern to all who are witnessing – first hand – the devastating impact of our nation's on-going financial crisis.

Specifically, I would like to address the subcommittee's desire to better understand credit products that are available for consumers who cannot always access more traditional financial institution products and services.

In a capsule, the under-banked and the unbanked, usually in low-to-moderate income neighborhoods, continue their historical struggles to access credit for a number of reasons. The number one reason is that many of these individuals create such high risks for lending institutions that they do not meet the minimum underwriting requirements imposed by the regulators of traditional financial institutions. A classic example of what happened when one of our banks, Citizens Trust Bank of Atlanta, Georgia, attempted in 2008 (at the beginning of the financial meltdown) to advertise – in the three markets that it served – the availability of the Small Dollar Loan Program is described below.

Although the bank's intentions was to meet pressing economic needs of consumers in its market, a 13% default rate rendered the program a costly failure. With comparatively lenient underwriting criteria, the bank sought to help consumers with house payments or car note payments or other financial needs with small loans ranging from $500 - $1,500 max.

At the beginning of the program, the following underwriting criteria were established:

- A credit score of 500;

- Allowed a higher debt to income ratio (along with a $48 document preparation fee, which was financed into the loan document);
- 12-month same residence;
- Credit report could not have outstanding liens or judgments;
- Allowed for collection items on their report;
- Must provide 6 months income from same employer;
- Two years discharged from bankruptcy (chapter 13);
- No chapter 7 bankruptcy allowed.

The result was still a 13% default rate which was subtracted from the bank's loan loss resources. Today, the bank provides this small dollar loan program – with more rigid requirements – in only one of its eleven branches (Green County, Alabama). This is one of the poorest counties in America. But the default rate is near zero.

The only recommendation I would make today is that if Regulation E were modified to allow banks to debit borrowers' bank accounts, the bank's risks would be mitigated and borrowers would probably act more responsibly. Having direct deposit accounts would also ensure lenders that timely payments could be made on small dollar loans.

The largest issue looming over this discussion, Mr. Chairman, is: How should public policy address the inescapable problem of risk? If we are to balance the equation associated with lending and borrowing to high risk consumers, how do we determine what constitutes a reasonable cost of that risk?

Thank you, Mr. Chairman, for your time.

Michael A. Grant
President
National Bankers Association

CONSUMER RIGHTS COALITION

Testimony before the Subcommittee on Financial Institutions and Consumer Credit

Provided by Gerri Guzman, Executive Director, Consumer Rights Coalition

September 22, 2011

Hello, my name is Gerri Guzman and I am the executive director of Consumer Rights Coalition, or CRC. CRC is a non-profit consumer-based organization dedicated to ensuring that Americans have increased access to credit.

I appreciate the opportunity to be here today on behalf of more than 200,000 of our members who are consumers of alternative, or non-bank, financial services. Our members have traditional bank accounts, but they don't always have a financial safety net. They want to preserve and expand access to a full range of short and intermediate-term credit options and other basic financial services.

Millions of Americans are coming up short. They're struggling to make ends meet for several months at a time or they're dealing with a financial shock like a reduction in work hours, a medical emergency or a broken down car or appliance.

Millions of consumers don't have a rainy day savings account to get them to their next paycheck or to manage the unexpected. And they may not have credit available on their credit cards or family to turn to for a few hundred dollars in order to get through a tough time.

A recent study reported in the *Wall Street Journal* found that half of Americans would not be able to access $2,000 in a month if they needed to. A second study found that 64% of Americans do not have $1,000 on hand in case of emergency.

If these consumers chose to go to a traditional bank for a loan, the vast majority of traditional banks and credit unions could not give them the typical $300 loan needed, to say nothing of $1,000 or $2,000. As a result, today almost 20 million Americans are turning to non-bank financial products—like check cashing, installment, payday and pawn loans. The "alternative" to traditional banking is quickly becoming the mainstream.

I know firsthand that traditional bank products don't always offer a realistic solution for people without a significant financial cushion to help absorb unexpected expenses. I relied on a payday loan when I was in danger of losing my home. It was simple, transparent, and less expensive than bouncing a check or making a late payment. And, I knew it wouldn't damage my credit rating.

Short and intermediate-term loans are easily and conveniently available from "alternative" lenders in some states. Unlike most traditional banks, stores are located in minority neighborhoods, open at times the services are needed and the process is understandable, quick and easy. Employees are likely to speak the language of local residents. In addition, these short-term loans will not ruin borrowers' credit ratings; bouncing a check or failing to pay bills would.

CONSUMER RIGHTS COALITION

Short-term credit options are currently regulated at the state level. Regulations vary state by state regarding the amount, the fees, the types of loans and the terms that may be offered.
Research from the Federal Reserve and others indicates that states that have eliminated or restricted credit options have done more harm than good.

For example: When the state of Washington restricted the number of loans an individual could take out, regulators found that it had the effect of driving consumers to more expensive, unregulated online lenders. Studies also found that consumers in North Carolina, Georgia, and Oregon were hurt by payday loan bans that drove them to bounce more checks, incur more late payment penalties, and file for more personal bankruptcies.

Unfortunately, I hear from consumers all the time who no longer have access to short-term credit because of restrictions in their states. They are now spending more on overdraft, bounced check and late bill fees and their credit is suffering. And as a result, their banks are threatening to close their accounts.

The fact is people will always come up short from time to time. If access to one product is eliminated, consumers will seek out another. And it will likely be a more expensive and credit-damaging option. The bottom line is that people need options, the information to compare those options and the ability to make their own decisions.

It is becoming increasingly clear that traditional banks are not a realistic option for a large and growing portion of Americans. Seventy-three percent of banks are aware that significant unbanked and/or under banked populations are in their market areas, but less than 18 percent of banks identify expanding services to unbanked and/or underbanked individuals as a priority in their business strategy.

When asked to rank the challenges banks face in serving or targeting unbanked and/or underbanked individuals, banks list "profitability issues" first, followed by "regulatory barriers," and "fraud concerns." It is not surprising that such banks do not provide adequate services to underbanked consumers.

A few banks are, however, beginning to compete in the small dollar, short term lending market. That's a very good thing. Consumers will benefit if there are more companies offering more services which will bring prices down, provide more choices, and greater innovation.

But, laws need to change in order to open up the market to more competitors. We would like to see non-bank financial service providers—already trusted in so many communities throughout the U.S.—have the opportunity to provide more and better credit services to underserved communities.

All Americans need access to responsible credit options in order to build strong financial records and healthy credit ratings, move up into the traditional banking system, and, ultimately build personal and community wealth.

CFSI Center for Financial Services Innovation

Written Testimony of
Melissa Koide, Vice President of Policy, Center for Financial Services
House Subcommittee on Financial Institutions and Consumer Credit

An Examination of the Availability of Credit for Consumers

September 22, 2011

Thank you, Chairman Capito, Vice Chair Renacci, and Ranking Member Maloney. On behalf of the Center for Financial Services Innovation, I appreciate the opportunity to participate as a witness before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit on the matter of underbanked consumers' access to credit. We appreciate the Subcommittee's attention to the state of consumers' access to credit, particularly in this economic environment.

I am the vice president of policy for the Center for Financial Services Innovation. CFSI is a national nonprofit organization, in its eighth year of providing national leadership, research, and insights on the non-mortgage, retail financial services needs of underbanked consumers. We conduct consumer and industry research to develop a broad understanding of consumers in this segment and the products offered to them. We hold twice-yearly roundtables with large and small financial services providers and nonprofits to develop and advance products and strategies for serving underbanked consumers. Each year we bring together over 500 representatives from the financial services sector, including innovators, nonprofits, and policymakers, to spotlight how innovation, partnerships, and public policy can improve financial services for underbanked families. We provide grants to nonprofits that are building underbanked consumers' financial capability through the marriage of financial education and products and technology.

Finally, we develop and champion federal policy to spur financial product innovation and market competition and address impediments to access to high-quality financial services. We believe that effective public policy must protect consumers from harmful products and practices; ensure that consumers have access to safe and affordable products and services; and ensure that providers operate safely and soundly. Our vision is to see a strong, robust, and competitive financial services marketplace, where the diversity of consumer transaction, savings, and credit needs are met by a range of providers offering clear and transparent products and services at reasonable prices.

My testimony will provide insights on the small-dollar credit marketplace and recommendations for public policy. These comments are based on our consumer research and our observations of market practices. We pay particular attention to consumers' need for small-dollar credit and emerging product innovations with the potential to extend wide-scale credit access to underbanked consumers, responsibly and affordably. We believe that well-structured credit products can help consumers address short-term credit needs and build positive credit histories, critical for employment, insurance, and housing, as well as for longer-term asset building. We believe quality credit is marketed transparently and priced fairly, and that it is affordable and structured to support repayment without creating a cycle of repeat borrowing.

The State of Underbanked Consumers and Small-Dollar Credit

CFSI research focuses on unbanked and underbanked consumers and the ways that the financial services industry meets, or could meet, their needs. We define "unbanked" consumers as those without a checking or savings account, while "underbanked" consumers may have one or both accounts but also use alternative financial services such as check cashers or payday lenders. In a 2009 study assessing the size and make-up of the unbanked and underbanked population, the FDIC found that 30 million American households—approximately one in four—are either unbanked or underbanked. Compared to the general population, these households are more likely to be classified as low to moderate income. The FDIC found that approximately two-thirds of unbanked and underbanked households had annual incomes below $50,000, roughly the median income of all American households.[1]

In 2008, prior to the FDIC study, CFSI conducted a nationally representative survey of unbanked and underbanked consumers to gauge their numbers and explore their preferences, behaviors, and challenges related to financial services. We found that almost one-third of unbanked or underbanked consumers had borrowed for small-dollar needs in the prior 12 months, and that they borrowed from a variety of sources, including rent-to-own centers, pawnshops and payday lenders, as well as from friends, family, and financial institutions. While the reasons for their most recent borrowing varied, over a third cited the need to pay bills and basic living expenses as their motivation for seeking out credit.[2] This suggests that, in addition to helping address unexpected emergencies, unbanked and underbanked consumers use credit to manage expenses, perhaps in the face of volatile or unpredictable incomes.

A lack of sufficient credit history or a damaged credit profile can often serve as an impediment to qualifying for high-quality credit products. Our survey found that as much as 75 percent of the unbanked and underbanked population had credit scores that would be considered subprime or lacked enough credit history to generate any score at all. For these households, credit providers such as payday lenders and pawnshops may be one of few options available in today's marketplace to meet a credit need.

In the current economic environment, there have been signs that an increasing number of households may be in a similar position, unable to access high-quality credit products. Millions of households have suffered foreclosures or bankruptcies that likely damaged their credit profile. The sustained period of high unemployment has created additional financial challenges for Americans, and middle-class incomes have stagnated, as indicated by the 2.3 percent decline in the median income in 2010.[3] At the same time, banks rapidly tightened lending standards for credit cards and consumer loans following the financial crisis in an attempt to protect and rebuild their portfolios.[4]

With this widening access gap caused by declining credit profiles and elevated underwriting standards, an increasing number of households appear to be finding it difficult to access good credit

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[1] *FDIC National Survey of Unbanked and Underbanked Households*, Federal Deposit Insurance Corporation (December 2009); and *Income, Poverty, and Health Insurance Coverage in the United States: 2010*, U.S. Census Bureau (September 2011).

[2] *Underbanked Consumer Study*, Center for Financial Services Innovation (June 2008–February 2009), http://cfsinnovation.com/publications/list/CFSIUnderbankedConsumerStudy.

[3] Employment statistics from the U.S. Department of Labor; income statistics from the U.S. Census Bureau.

[4] Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices.

options and are turning to alternative credit providers in the face of limited options. Our belief that this transition is taking place has been bolstered by estimates of growth in payday loan volume during 2010. It is also supported by the FDIC Underbanked Survey, which found that 43% of payday loan borrowers say they use alternative credit because it is easier to qualify for a payday loan than a bank loan. In the coming months, we will launch a new study to better understand the profile of today's small dollar credit borrowers, the factors that influence consumers' product choices, and the implications of those decisions.

Promising Small-Dollar Credit Product Developments

Beginning in 2009, consumer credit levels dropped for seven consecutive quarters, declining 6.6 percent in all.[5] This change resulted from retraction on the part of both credit providers, who tightened lending standards and charged off delinquent balances, and consumers, who increased their savings and debt repayments during the recession. The main driver of the trend was a substantial drop-off in revolving debt, which is typically associated with credit cards, the most common mainstream option for meeting small-dollar loan needs.

Revolving debt posted its first increase in several years in the most recent fiscal quarter. But amid softness in the credit card market, a variety of providers, both in and out of the financial mainstream, have been offering new and existing small-dollar loan products. A few new and modified products have emerged over the past five years to meet the demand for small-dollar credit, with some focused on consumers who lack access to more traditional credit products. A handful of banks and nonbank providers have been developing offerings with promising product structures, terms, and features that make it more viable to serve the underserved market. Described below are some innovations designed to better guide customers toward successful repayment and improved financial outcomes:

- **Offering flexible loan terms that allow customers to choose a repayment plan that fits their budget.** By either offering installment loans or providing the option for installment payments, some providers are allowing customers to spread out their debt service payments, making payments lower than they would be with loans requiring a single, short-term repayment. Customers may find the lower payments easier to fit into their regular budgets.

- **Gathering and analyzing a variety of customer data to improve the ability to underwrite credit for consumers with insufficient or poor credit history.** Certain providers are demonstrating a level of sophistication in analyzing customer data—generated internally and purchased from outside sources—to develop ways to underwrite customers who do not qualify for mainstream credit sources.

  In the case of new credit products linked to transaction products (e.g., checking accounts and prepaid cards), providers can monitor customers' cash inflows and outflows and use the information as a cost-effective way to gauge ability to repay. To date, this practice has largely been limited to setting credit lines at a percentage of customers' paychecks or direct deposit payments, which may not be sufficient to tell whether a consumer will be able to repay a loan without needing to borrow again soon. However, further refinements in using transaction data to assess customers' financial profile may lead to efficient and effective underwriting that lowers costs for providers while giving customers loans they can afford.

[5] G.19 release, Federal Reserve Board G.19 (September 8, 2011).

- **Creating new and more efficient platforms to handle the application process, the distribution of funds, and customer interactions to reduce operations costs.** By leveraging technology and interfacing with customers online, providers are finding ways to offer credit products more efficiently and reduce the costs of operating a loan program relative to models that rely on physical distribution and in-person customer interactions.

- **Linking credit offerings with other financial products, particularly those that facilitate savings.** This practice allows loan providers to establish broader and potentially more profitable relationships with customers. As many of these emerging products are geared toward underserved consumers, some providers are offering their small-dollar loan products as part of a larger suite of financial services, such as check cashing and remittance services, that meet the target customer's needs. Particularly promising are those that link credit products with savings accounts, often by folding contributions to a savings account into installment payments. This link can help customers establish savings to manage future cash shortages and benefit providers by potentially generating collateral for outstanding loans.

- **Using small-dollar credit as a tool to help consumers build or repair their credit.** A number of credit unions, banks, and nonprofit organizations have designed loan programs specifically to give consumers an opportunity to generate positive credit history, improve their credit profile, and qualify for mainstream loan products. Although we have not seen any one provider achieve significant scale with such a program, and many require a subsidy to operate, anecdotal evidence suggests such programs can facilitate credit building.

- **Using mobile technology to provide financial information relevant to borrowing decisions.** Many financial services providers now allow customers to access information about their transaction accounts (e.g., current balances) through their mobile phones. For credit products linked to transaction accounts, using the mobile channel to provide account information or send messages about the consequences of borrowing could help ensure that customers make informed credit decisions—critical in the wake of foreclosures, unemployment and other economic challenges.

Some providers have developed or adopted these innovations in an attempt to create a viable and sustainable small-dollar loan product for the underserved market. In particular, practices that leverage technology to increase operational efficiency and reduce credit losses have shown promise as a means to improve the business case for small-dollar loans. Other innovations, such as credit-building loans and loan-loss reserve programs, can benefit consumers by positioning them for successful repayment and offering opportunities to access high-quality credit products in the future. These two categories of innovation highlight what we see as the primary challenge of designing small-dollar loans: creating products that are profitable for providers and also safe, responsible, and useful for consumers. While the innovations and practices highlighted represent promising approaches, some also come with concerns and challenges that still need to be addressed.

Challenges to the Expansion of Responsible Small-Dollar Credit

While many new and emerging products and trends suggest promise for those in need of small-dollar credit, there are significant challenges to the growth of responsibly designed small-dollar credit, and critical concerns remain with many such products in the market today. Many if not most of today's products are short-term, often with full repayment due in a matter of weeks, or when the next paycheck arrives. Some products draw the full repayment directly from the consumer's deposit account, which on one hand is a means to gauge income and reduce the likelihood of default, but on the other may leave the consumer little income to live on. While such short-term credit products may be manageable for some consumers, for others the rapid repayment may make repayment impossible. As a result, some consumers are launched into cycles of debt, where they can repay a loan only by borrowing again.

Regulatory scrutiny of the products is warranted, and better consumer protections as well as additional research are needed to shed light on how small-dollar credit products can be designed to avoid rollovers and over-indebtedness, and help consumers manage the credit and build good credit histories.

Policymakers and small-dollar credit providers must find the right balance between product sustainability and ensuring affordability, while protecting consumers in ways that do not overly constrict product offerings. At some level, restrictions that are too tight on providers could make it unviable to offer small-dollar loans to the underserved, causing regulated companies to exit the market and leaving consumers without access to above-ground consumer credit. Conversely, placing too little emphasis on consumer protections leaves open the door for unaffordable and abusive products. A strong base of research and careful analysis of the dynamics in the evolving small-dollar loan market, along with the careful and consistent application of consumer protections, will be essential.

While more work is necessary to ensure responsible product design, it is also important to call out challenges that appear to constrain wide-scale availability of high-quality small-dollar credit. Those factors include capital constraints for certain lenders, regulatory inconsistency and uncertainty, negative stigma associated with small-dollar credit providers, and insufficient underwriting methods that inadequately assess risk. These factors, coupled with the financial crisis, have made it especially challenging for smaller providers to access the needed capital to scale up their businesses and achieve a sizeable volume.

Policy Recommendations

Based on our consumer research and the developments emerging in the market, we offer the following suggestions for policymakers to address both consumers' and providers' need for clarity and certainty with respect to consumer protections in the small-dollar credit marketplace. These recommendations will help to define the safeguards and ensure they are consistently applied across the range of small-dollar credit products and providers. With a few ground rules and a level of regulatory consistency, more and better small-dollar credit products will emerge that we believe will help consumers safely access credit, push down prices, and allow for product diversity and innovation.

First, policymakers should support the Consumer Financial Protection Bureau, as it is the appropriate federal regulator to create and ensure consistency and balanced rules for consumers and providers alike, regardless of the type of entity providing the credit product.

As the federal consumer protection regulator with rule writing, supervision, and enforcement authority over many if not most bank and nonbank credit products, the CFPB will develop considerable knowledge about the range of small-dollar credit lenders and products. And as defined in Title 10 of the Dodd-Frank Financial Reform and Consumer Protection Act, the CFPB's mission is to enforce federal consumer financial laws consistently to ensure that all consumers have access to markets for consumer financial products and services and that those products and services are fair, transparent, and competitive.[6] We believe the statute and the approach that those leading the bureau have taken will result in a rich understanding of consumers using these credit products as well as a comprehensive picture of the full range of small-dollar credit providers. This, we believe, will lead to informed rules that are responsive to different financial services business models and better attuned to the needs and risks for consumers.

Part of the CFPB's mandate is to ensure efficient and effective coordination with the other federal regulators as well as state regulators. Regulatory coordination and, to the extent possible, regulatory consistency with other federal and state regulators is critical for a safe and reasonably priced financial services market. An uneven regulatory environment causes an uneven playing field, making financial products and services confusing and risky for consumers. An uncoordinated regulatory environment also allows for inconsistencies and inefficiencies in the production, marketing, and selling of financial products and services, particularly when more than one regulated party is involved.

The current regulatory unevenness has contributed to skepticism and distrust of the nonbank sector. It has also hampered market competition, as some providers have sought to leverage the differences between state and federal regulation for their own advantage. Once the CFPB's nonbank authority is in place, it will level the playing field with its ability to write, examine for, and enforce federal consumer protection rules covering both banks and nonbanks. The resulting regulatory consistency will create a policy environment that better supports innovation and enables a diverse financial services marketplace to thrive. One of the most important steps the CFPB can take to improve the quality of practice in the nonbank financial services sector is to coordinate supervision with the other federal and state regulators. This would include shared policy goals, common rules, joint exams, and coordinated guidance. Despite the additional effort required, we believe a coordinated approach would bring benefits to consumers and providers, such as cost and price reductions, product advances, and greater consumer access.

Second, as the federal regulator that will have authority over the range of financial products and services, the CFPB should develop and implement consumer protection rules that will ensure safeguards for consumers across the range of small-dollar credit products and providers.

We offer some consumer protection recommendations to make sure small-dollar credit, regardless of type or provider, is prudently provided, manageable, and helps consumers meet short-term financial needs while building positive credit records.

- **Encourage lenders of all types to assess the consumer's ability to repay and successfully manage the credit product.** While many consumers clearly value convenience and the ease of a

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[6] "The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive." H.R. 4173, 111th Congress: Dodd-Frank Wall Street Reform and Consumer Protection Act, Title X, Subtitle B, GovTrack.us (database of federal legislation), 2009.

credit application process that is not predicated on extensive underwriting or a good credit record, lenders should be encouraged to assess the consumer's ability to succeed with the loan, which may mean examining information in addition to the record of prior credit or deposit activity. While there are a myriad of ways lenders can assess a consumer's ability to successfully manage the loan, we recommend regulators study and encourage lenders to assess a consumer's ability to pay using such metrics as whether the consumer used one loan to pay off another loan; what the consumer's debt burden is beyond the loan; how much of the next income deposit or paycheck is being advanced; and what will remain in the consumer's account (in the case of a deposit advance product) to cover other living expenses after the payment is made. While performing this fuller analysis may affect the amount and the price of credit offered to consumers, this type of underwriting will help to ensure that the programs are safe for consumers.

- **Encourage lenders to structure the credit to reduce the likelihood of cycling debt.** The length of the loan, the number of repayments, and the amount borrowed each affect the likelihood of the consumer's success with the loan product. While short-term loans may be manageable for some consumers, products with very short terms are problematic for others. Based on recent trends and practices by small-dollar credit innovators who are testing new product structures, good practices to encourage safe use of small-dollar credit would entail: providing the option for longer repayment periods; providing the option to pay back the loan with multiple payments, rather than just one; calibrating the amount of the credit to reflect a consumer's ability to repay; and starting the credit extension with small amounts that can grow larger as the consumer shows success with the product. We believe these changes will better ensure repayment and avoid defaults, thus helping consumers maintain credit access.

- **Encourage lenders, particularly banks that offer multiple forms of credit, to routinely assess credit use and offer products that are most appropriate and affordable.** Ideally, providers would frequently review consumers' use of credit products and help them find the products that best fit their needs and are most affordable. For some consumers in need of small-dollar credit, products with longer terms and multiple repayment structures, such as installment loans or secured or unsecured credit cards, may be more appropriate than single-payment, shorter-term credit, and many consumers may already qualify for those products.

- **Prevent overuse of small-dollar credit products.** Heavy use of small-dollar credit may indicate a consumer's financial distress. If the provider has taken steps to offer credit with longer terms, multiple repayments, grace periods, or other affordable credit products, and the consumer still cannot repay the credit without having to borrow again, a good practice would be to require meaningful cooling-off periods, allow the consumer to repay the existing credit in manageable installment payments, and encourage the consumer to seek assistance in financial management, potentially through partnerships with reputable credit counseling agencies.

- **Clarify disclosure requirements for all pertinent information.** Lenders should give consumers information about their loans, including the amount, the due date, the reporting of payments to the credit bureaus, and the price and any fees that could be incurred. Terms should be clear, simple, and tested for understandability. The lender ideally also should inform consumers about their prior credit use and provide information about the long-term costs of using the credit product repeatedly.

Finally, policymakers should encourage lenders to design credit products to help customers succeed with the products and build positive credit histories.

- **Help consumers build their credit by reporting repayment activity to the major credit bureaus.** For some consumers, a small-dollar credit product is the only credit option. Others may have access to different types of credit, but their credit may be blemished. In either case, repayment activity on the responsibly designed credit product, if it is reported, can be an important way for the consumer to build or rebuild a positive credit record. Providers offering small-dollar credit should design their products to not only report payment activity, but also to make sure that the reports are successfully incorporated in consumers' credit records.

- **Incorporate financial capability tools into small-dollar credit products.** Well-informed, financially capable consumers are critical for an effective financial services market. Some small-dollar credit products are being developed that provide consumers with resources and features to track and manage credit, build savings, and establish a positive credit history. While these practices are not yet widespread, they are important, positive developments that policymakers can and should encourage.

Thank you, Chairman Capito, Vice Chair Renacci, and Ranking Member Maloney. I hope these insights and recommendations prove useful as you seek to ensure underbanked consumers have access to products that are responsibly designed and easy for all consumers to use safely. I look forward to your questions.

Testimony of Dr. Kimberly R. Manturuk

Center for Community Capital

University of North Carolina at Chapel Hill

Before the Subcommittee on Financial Institutions and Credit for Consumers

United States House of Representatives

Hearing on

An Examination of the Availability of Credit for Consumers

September 22, 2011

Good morning Chairman Bachus, Ranking Member Frank and distinguished members of the subcommittee. I am Kimberly Manturuk from the Center for Community Capital at the University of North Carolina at Chapel Hill. I am honored to have the opportunity to share some thoughts and research on credit options available to underbanked American households. This hearing comes at a time when families of all income levels are struggling with financial insecurity and need all the help they can get in rebuilding their financial lives. For over a decade, the Center for Community Capital has conducted research and analysis into the transformative power of capital on the economic health of households and communities in the U.S. Our in-depth analyses help policymakers, advocates and the private sector find sustainable ways to expand economic opportunity to more people, more effectively.

I will draw particularly on several recent studies our center has conducted. Two of these were commissioned by the NC Commissioner of banks, as North Carolina has been at the forefront of promoting a financial services environment where both lender and consumer can prosper. Our first study evaluated the credit needs of North Carolina working families after payday lending was de-authorized in the state. The second study examined the costs and benefits of consumer installment lending, once the primary source of credit for working families in the US. This study was commissioned to explore how the state's longstanding consumer finance law could best balance the profitability of the lenders with the needs of consumers. A third body of our research examines the overall financial attitudes and preferences of low income consumers from the standpoint of savings, debt and money management.

In my remarks, I will summarize the findings of this body of research on credit options available to lower-income households. I will also discuss several emerging or innovative credit products that meet consumer demand for credit in affordable and sustainable ways. On the basis of the study findings, I will present policy recommendations for improving financial conditions for underbanked households. Attached to this written testimony is the complete text of one of our studies on this topic.

First, I will highlight our top findings and policy implications:

1. We find that most lower-income families have multiple options available when facing an immediate financial shortfall. Very few families rely on a single form of credit.
2. Families express a clear preference for lower-cost, sustainable options when seeking credit. However, these options can be inconvenient or time-consuming to access. In our view, policymakers should consider ways to encourage lenders, particularly non-depository institutions, to better leverage technology to increase consumer access to low-cost credit options.
3. Several emerging developments in the consumer credit landscape highlight how credit products can be structured to meet consumer demand for affordable credit while remaining profitable for lenders.

Research on Credit Options for Underbanked Households

I will start by providing an overview of the landscape of small-dollar consumer credit in North Carolina before presenting the findings from our Center's research in this area. In 1997, the North Carolina General Assembly exempted loans under $600 from the North Carolina Consumer Finance Act which capped the interest rate on such loans at 36%. This resulted in significant expansion of the small-dollar consumer credit industry in North Carolina. They majority of these loans were made by payday lenders who made loans around $300 for a two-week time period. In 2000, lenders in North Carolina made a total of 3.5 million loans to just over 413,000 customers[1].

In 2001, the North Carolina legislature allowed the small-dollar loan exemption to expire, effectively ending the availability of payday loans in the state. Some lenders continued to operate through partnerships with out of state banks, but by 2006 all remaining lenders entered in to agreements with the state Attorney General's office and ceased operating in the state[2].

Managing Financial Shortfalls

In 2007, the North Carolina Office of the Commissioner of Banks asked researchers at the Center for Community Capital to evaluate the impact that ending payday lending in the state had on the credit options available to lower-income and traditionally underbanked residents[3]. We sought to determine whether households had sufficient options to deal with financial shortfalls or income disruptions, and how those options compared to payday loans. To accomplish these objectives, we conducted two types of analysis. First, we conducted a survey of 400 lower-income North Carolinians about financial shortfalls their households faced, and how they managed these shortfalls when they occurred. We conducted this survey in the three metropolitan areas of North Carolina that previously had the highest concentration of payday loan companies. Second, we conducted two focus groups of former payday borrowers to understand their experiences with payday lending, and the impact payday de-authorization had on their ability to manage financial shortfalls.

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[1] North Carolina Commissioner of Banks (NCCOB). 2000. *Annual report of check cashing businesses licensed under article 22 of chapter 53 of the North Carolina general statutes fact sheet*. Raleigh, NC: NCCOB.

[2] North Carolina Attorney General (NC A.G.) Press Release. March 1, 2006. *Payday Lending on the Way Out in North Carolina: AG Cooper says major payday lenders agree to stop loans.*

[3] Full text of the report available at http://www.ccc.unc.edu/abstracts/1107_NorthCarolina.php.

The majority of my comments today will focus on findings from a sub-sample of respondents who reported having experienced a financial shortfall, and therefore possibly a need for consumer credit, in the prior three years. Three-fourths of the people we surveyed said they had used multiple options to handle their most recent financial shortfall. Most people used their savings, paid an expense late, or borrowed from friends or family members, among other things. Among people who used credit to handle the shortfall, mainstream products such as credit cards and bank loans were used more commonly than fringe products such as pawn shop loans or auto title loans. The use of multiple options suggests an elaborate level of management, where consumers are layering in resources in some order of preference.

We used reasonable assumptions of cost to categorize the alternatives as "no or low cost" (borrowing from friends and family, using savings, borrowing from retirement, receiving charity, taking an employer loan, taking a bank loan), "moderate cost" (using a credit card, taking a finance company loans), and "high cost" (bounced check, pawn shop loan, payday loan, auto title loan, tax advance loan). We did not include the unknown and highly variable options, which includes bankruptcy, debt negotiation, and not paying or paying late. Regardless of how many options used, the most commonly used options were no- or low-cost, especially if one considers that 40% of no- or late-pay events also carried no financial cost. The exception was those who relied on four or more options to meet their financial need. For this group, high-cost options out-numbered moderate-cost options driven by a relative increase in bounced checks and decrease in credit card use.

Based on these findings, we conclude that lower-income households are aware of multiple credit options when facing a financial shortfall. Furthermore, people demonstrate a general preference for lower-cost credit products. However, people often rely on multiple sources of funds when faced with a financial shortfall which suggests that none of the available options are fully meeting consumer needs.

Fairness and Satisfaction Scores

We asked study participants to rate the fairness of each credit product they had used in the prior three years to handle a financial shortfall. We also asked them to rate how satisfied they were with the product. Both scores were on a scale from one to five. Bank loans received the highest fairness score and scored among the most satisfying. The highest satisfaction score went to finance company loans, and the lowest to pawnshops. This is consistent with a study by MarketSearch[4] in which respondents also gave finance companies the highest satisfaction ranking and pawnshops the lowest among several "alternative financial services." While we can only conjecture as to why, it is worth noting that finance company loans, most loans against retirement savings, and certain bank loans are the only amortizing, closed-end options on the list. This suggests consumer demand for credit products that include a clear path for repayment. The products with the lowest satisfaction scores were open-ended products such as credit cards, pawn shop loans, and payday loans.

Focus Group Research

In the course of our research, we also conducted two focus groups in Charlotte, NC. For both groups, we recruited former and current payday loan customers. Our objective was to find out what their credit

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[4] MarketSearch Corporation. 2007. *North Carolina Office of the Commissioner of Banks consumer banking and finance study.*

needs were and what types of products met their needs. All participants were attracted to payday loans for the same reason: The loans were private, fast, and above all, easy to obtain. People cited the short application process, no credit check, and the guaranteed acceptance. When asked whether they would have been able to get a payday loan if there had been a credit check, they generally thought not.

Participants also expressed a need for small-dollar credit. Many participants said they doubted that a bank or finance company would be willing to lend them only a couple hundred dollars. Along similar lines, people also expressed reservations that they would be welcomed at a bank and felt that bank employees looked down on lower-income customers.

However, there was overwhelming agreement that payday lending as it had existed in North Carolina was not meeting these consumers' credit needs. People felt that, in order to meet their needs, they wanted credit products that offered a lower interest rate and a longer repayment schedule with installment payments. The former payday loan customers we spoke to, including those who wanted to retain the option, wanted a lower APR and longer, amortizing repayment terms as well as limits on renewals and amounts borrowed. Some of these changes would fundamentally alter the nature and economics of payday loans. Industry "best practices"[5] do not begin to approach the requirements our focus group participants wanted.

Emerging Developments in Consumer Credit

The most widely-used credit product across all households is a credit card. As of 2009, 63% of North Carolina residents had used a credit card within the prior two years[6]. In spite of their widespread use, many customers report being dissatisfied with credit cards because the interest is compounding and it is not clear how much the customer must pay each month to retire the debt. On the other hand, banks and credit unions offer credit products with fixed terms and a clear repayment schedule. However, underbanked consumers often do not qualify for such loans. When looking at loans by credit score quintile, for example, only 6% of loans made to people in the lowest quintile came from a bank or credit union[7]. The result is that many underbanked consumers turn to alternative financial services to meet their credit needs. However, it is clear from our research at the Center that many of these so-called fringe credit options available to underbanked households such as payday loans or pawn loans do not meet the needs of most consumers.

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[5] The trade association, the Community Financial Services Association of America (CFSA), requires its members to abide by a set of best practices. These can be found on their website, www.cfsa.net/industry_best_practices.html. As of October 1, 2007, the list included: full disclosure including fees and APRs, compliance with the law, truthful advertising, encouraging consumer responsibility, limiting rollovers to lesser of 4 or the state limit, a one-day right of recision, using legal collection practices, not threatening or pursuing criminal action against customers for nonpayment, self-policing, supporting balanced legislation, offering extended repayment plans to customers who are unable to repay under their original contract, a special best practices for loans to active duty military customers, offering internet loans only in states where licensed and in compliance with that state's laws unless those laws are federally preempted, and display of the membership seal.

[6] The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly, available at http://www.nccob.gov/Public/docs/Financial%20Institutions/Consumer%20Finance/NCCOBReport_Web.pdf

[7] Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit, Board of Governors of the Federal Reserve System, August 2007. Available at http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/default.htm

There are some emerging products in the small-dollar consumer credit space, however, which offer reasonable terms and conditions while retaining profitability for lenders. I'd like to conclude my testimony by highlighting a few of these products.

FlexWage[8] works with employers to give workers access to a payroll card with a linked salary-advance feature, an alternative to the traditional payday loan. Through its WageBank product, the company makes available wages that have been earned but not yet paid. Customers are charged a flat convenience fee for the "predisbursement" of earned wages. There is no loan, and nothing to repay. The funds are distributed on a Visa-branded prepaid card to the employee.

For consumers who need to borrow more than their already-earned salary, Workers Choice USA[9] allows employees to borrow up to 50% of their monthly salary at a competitive interest rate. The lender remains profitable because there are very low underwriting costs associated with these loans since most of the borrower's information has been previously verified by the employer. Repayment is done via payroll deduction and there is no cost to the employer to offer these loans. Our research indicates that there is customer demand for employer-based lending of this type.

In 2001, the North Carolina State Employee's Credit Union (SECU) introduced a 12% APR product called the Salary Advance Loan (SALO). With more than 1.3 million members, SECU is the nation's second largest credit union[10]. Typical SALO borrowers earn less than $25,000 per year and have low account balances and low credit scores. Renewal rates are high, with two-thirds of SALO customers taking out a SALO every month, so SECU requires the borrower to deposit 5% of every new SALO into a savings account. Over the past ten years, SECU has made over five million loans and lent a total of over two billion dollars. They have had an average annual charge-off, or bad debt expense, of just 0.19%; and $8 million of accumulated savings account balances. SECU calculates it is saving members $33.6 million a year in payday loan fees[11].

Our research also provides evidence that low income households need better tools for smoothing income and positioning themselves to deal with financial ups and downs through saving. However, underbanked families generally lack access to affordable savings products to prepare for rainy days; standard bank savings accounts typically cost more in monthly fees than modest balances can earn in interest. Nor do they often have access to employer-based retirement savings – especially those with matching employer contributions, and to the many savings-related tax benefits that flow to more affluent households. Yet our research and the work of others affirms that low income families have a high desire to save and, when given the right tools and institutions, will do so.

Over the past two years, we have evaluated $aveNYC, a program in New York City designed to help lower-income families save part of their tax refund. Through the course of this research, we found that 90% of lower-income households said saving money was important to them as a way to prepare for emergencies. However, 80% said unexpected expenses made it difficult to save and 87% said all their

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[8] Details about the FlexWage product can be found on their website at http://www.flexwage.com/.
[9] Details about WorkersChoice USA can be found on their website at http://www.workerschoiceusa.com/overview.asp
[10] National Credit Union Administration (NCUA) *2007 Directory of Federally Insured Credit Unions* (http://www.ncua.gov/data/directory/2007/CUDirectory07.pdf).
[11] Stegman 2007 and State Employees Credit Union (SECU). 2006. Press Release. *SECU's Alternative Program Saves Salary Advance Members $2.8 million each month.* February 22, 2006.

money went towards paying expenses. In spite of these barriers, almost 90% of people who signed up for the savings program were able to save for a full year or more, and many reported feeling more confident and secure in their financial situation because they had money saved[12].

In conclusion, our research indicates that there is a strong demand for small-dollar consumer credit that is ill-served by existing products such as payday loans, credit cards, or bank loans. Consumers want credit that is affordable, repayable, and close-ended. This promise is found in the Federal Deposit Insurance Corporation's (FDIC) Affordable Small-Dollar Loan Products Guidelines issued in June 2007, which calls for FDIC-supervised financial institutions to promote consumer credit products with an APR not to exceed 36% and amortizing payments[13]. The guidance also recommends underwriting for ability to repay, incorporating a savings component into the product, working with other organizations, and providing an avenue for financial education. We encourage lawmakers to promote policies which encourage these types of loans, as well as continue to encourage technological innovation in the development of consumer credit products.

[12] Details about the $aveNYC program can be found at http://www.nyc.gov/html/ofe/html/poverty/save.shtml.
[13] Federal Deposit Insurance Corporation (FDIC). 2007. *Affordable small-dollar loan products final guidelines.* FIL-50-2007. June 19. http://www.fdic.gov/news/news/financial/2007/
fil07050.html.

North Carolina Consumers after Payday Lending:

Attitudes and Experiences with Credit Options

November 2007

Prepared for the North Carolina Commissioner of Banks

Center *for* Community Capital
Research and analysis on the transformative power of capital

UNC COLLEGE OF ARTS & SCIENCES

The Center for Community Capital at the University of North Carolina at Chapel Hill is the leading center for research and policy analysis on the transformative power of capital on households and communities in the United States.

The Center's in-depth analyses help policymakers, advocates and the private sector find sustainable ways to expand economic opportunity to more people, more effectively.

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Executive Summary

The UNC Center for Community Capital undertook this study at the request of the North Carolina Office of the Commissioner of Banks to assess the household credit market since the closure of payday lending stores in North Carolina in 2006.

Researchers were asked to determine:

- What effect has the end of storefront payday lending had on low- and middle-income households?
- Do residents have adequate options to deal with financial hardships?
- What options are most commonly used, and how do they compare to payday loans?
- Are North Carolina residents worse off or better off without payday lending?

The Center conducted two phases of consumer research:

1. A survey of 400 low- and middle- income North Carolinians about financial shortfalls their households faced, and how they managed these shortfalls when they occurred.
2. Focus groups of former payday borrowers to understand their experiences with payday lending, and the impact payday de-authorization had on their ability to manage financial shortfalls.

Researchers concluded that the absence of storefront payday lending has had no significant impact on the availability of credit for households in North Carolina. The vast majority of households surveyed reported being unaffected by the end of payday lending. Households reported using an array of options to manage financial shortfalls, and few are impacted by the absence of a single option—in this case, payday lending.

More than twice as many former payday borrowers reported that the absence of payday lending has had a positive rather than negative effect on their household. The ban on payday lending has made no difference to most, and helped more households than it has harmed.

Payday borrowers gave first-hand accounts of how payday loans are easy to get into but a struggle to get out of. These borrowers universally agreed that the cost of payday loans was excessive.

Nearly nine out of ten households surveyed think that payday lending is a bad thing. This overwhelming negative view of the product did not vary significantly for households that had experienced a financial shortfall.

Phase I: Consumer Survey

The goal of the consumer survey was to learn how low- and middle-income households manage financial shortfalls, particularly now that storefront payday lending is not available. Proponents of payday lending have argued that without access to payday loans, low- and moderate-income households would struggle in the face of financial crises or turn to more onerous options. We wanted to explore householders' actual experiences. What resources do they use in the event of financial shortfalls? Were they obtaining payday loans via the Internet, crossing state lines perhaps, or using more costly alternatives?

Sample Selection and Survey Methodology

The Center's objective was to survey people who may have been most likely to consider obtaining a payday loan prior to closure of payday loan stores. In North Carolina, payday borrowers generally had a household income below $50,000.[1] To qualify for a payday loan, they also had to have a checking account and be employed. We limited our sample to households making no more than $45,000 per year, with a regular source of income and a checking account in the past three years, and where the primary wage earner was not a full-time student.

We contacted households in three urban areas—Charlotte, Raleigh, and Fayetteville—that had among the highest number of payday lending stores when the practice was allowed. Charlotte, North Carolina's largest city, is close to the border of South Carolina, where payday lending is still legal. Raleigh, the state capital, is more centrally located in the state. Fayetteville, in eastern North Carolina, is home to the Fort Bragg military base and had a high level of payday loan stores per capita before the ban.[2] Previous data indicates there is a significant, positive relationship between the number of payday stores in one's neighborhood and the likelihood of taking out a payday loan.[3] Therefore, we targeted our calls to zip codes where there had been the most payday lending stores.

The survey was conducted in the spring of 2007 using random-digit dialing to call phone numbers within the three target areas, in English only, giving us a random cluster sample of lower-income, English-speaking, urban residents of North Carolina who have (or recently had) a bank account. At the beginning of the 10 to 15-minute survey, we told people we were conducting a survey about how people use credit and manage expenses; we did not use incentives. The cooperation rate was a low 7.79%, primarily because we were unable to contact anyone at many of the numbers called.[4] The refusal rate was 38.21%; the majority of those declined before we gave them any information about the survey, so we have no basis to believe bias was introduced by refusals. Our overall contact rate was 46.86%, and we completed 401 interviews.[5]

Survey Findings

We differentiated the interviewees between those who had a recent financial crisis and those who had not. The first group, 159 respondents, reported they were unable to meet household expenses or had a financial need that they could not pay with their regular household income. The second group, 240 respondents, reported not having had a financial crisis in the previous three years that they could not handle with their regular income.

Table 1 below presents descriptive statistics on these groups. Though random cluster sampling should assure us of a representative sample, when compared to all households earning less than $45,000, our sample includes fewer White and Hispanic households and more Black households, probably attributable to the neighborhood focus and English-only survey. Most significantly, our sample includes substantially fewer married households than expected. Likely due to the study being conducted via telephone during a short period of time, our sample includes more widowed respondents than expected since they are more likely to be retired and easier to contact quickly by telephone. To ensure that the distribution of marital status within our data set did not compromise the representativeness of our findings, we weighted the sample to mirror the overall population attributes for marital status and found almost identical responses for the data presented in Table 2.[6] For more details on this analysis, see the endnote (6). The distribution pattern is an artifact of the survey delivery method and is unrelated to our sample selection criteria. Moreover, it did not affect the findings related to awareness and attitudes about payday lending.

Table 1: Descriptive Statistics

	All respondents (N=401)		Had financial crisis (N=159)		No recent financial crisis (N=240)	
	Freq	Percent [1]	Freq	Percent [1]	Freq	Percent [1]
Male	132	32.9%	52	32.7%	80	33.3%
Female	269	67.0%	107	67.3%	160	66.7%
Own home	281	70.6%	92	57.9%	188	78.3%
Rent home	106	26.6%	60	37.7%	46	19.2%
No children at home	335	84.0%	116	72.9%	217	90.4%
1 or more children	64	16.0%	42	26.4%	22	9.6%
1 Adult in household	231	58.0%	87	54.7%	143	59.6%
2 Adults in household	146	36.7%	59	37.1%	86	35.8%
3 + Adults in household	21	5.2%	11	6.9%	10	4.2%
Receive any government income	127	31.7%	35	22.0%	92	38.3%
Income Less than $10,000	43	12.0%	18	11.3%	25	10.4%
Income $10,000 to under $20,000	75	21.0%	40	25.2%	34	14.2%
Income $20,000 to under $30,000	109	30.5%	45	28.3%	64	26.7%
Income $30,000 to under $45,000	130	36.4%	45	28.3%	84	35.0%
Single, never married	119	30.0%	55	34.6%	64	26.7%
Married or living with a partner	104	26.3%	43	27.0%	60	25.0%
Divorced or separated	69	17.4%	36	22.6%	33	13.8%
Widowed	104	26.3%	23	14.5%	80	33.3%
White, Non-Hispanic	225	57.1%	75	47.2%	149	62.1%
Black, Non-Hispanic	151	38.3%	76	47.8%	74	30.8%
Hispanic	5	1.3%	0	0.00%	5	2.1%
Asian	3	0.8%	2	1.26%	1	0.4%
Other Race	10	2.5%	5	3.14%	5	2.1%
Has a credit card	293	73.1%	97	61.0%	195	81.3%
Gone over credit card limit	29	9.2%	22	19.6%	6	3.0%
Denied credit	50	12.6%	37	23.6%	13	5.5%
No savings account	83	21.0%	46	29.1%	36	15.3%
<2 months expenses in savings	106	34.4%	66	60.0%	40	20.2%

[1] Within-category percents do not sum to 100 because some people elected not to answer all questions

There are some significant differences between the two groups.[7] People who had experienced a financial crisis in the prior three years were more likely to:

- Rent their home
- Not have a credit card
- Have gone over the credit limit if they had a credit card
- Have been denied credit or not received as much credit as requested
- Not have a bank or credit union savings account
- Have less than two months of living expenses in savings
- Be divorced

Payday Lending is Not Missed

We asked about the termination of payday lending in the state (see Table 2). Most respondents—three out of five—were not even aware that payday lending is no longer allowed in the state. The exception was former payday borrowers of whom 60% were aware of North Carolina's ban on payday lending.[8]

The vast majority of households surveyed—more than three out of four—said the elimination of payday lending had no effect on their household. This percentage declined only slightly for those families that experienced financial distress (71%) or who had been payday borrowers in the past (68%).

The overwhelming majority of households—almost nine out of ten—said payday lending was a "bad thing."[9] This strong negative rating held true for households that had experienced a financial hardship or had borrowed from a payday lender in the past.

Respondents who felt they were better off without payday lending well out-numbered those who thought they were better off with it. For the full sample, twice as many respondents said the absence of payday lending has had a positive effect on their household than said it has had a negative effect. The 159 respondents who actually experienced a recent financial shortfall—arguably those most likely to consider a payday loan and miss its availability—had responses similar to the overall survey population. Notably, the ratio of positively-affected households to negatively-affected households was highest in this group—more than 3-to-1. Likewise, former payday loan borrowers generally felt the absence of payday lending to be a good thing, rather than a bad thing. (While a sample size of 23 former payday loan customers is insufficient to draw conclusions of statistical significance, it is notable that the numbers follow a pattern similar to the full sample and to the sub-sample of those who had experienced a financial shortfall.) In short, the responses suggest that former payday customers do not, on the whole, have a different view of payday lending than other respondents to the survey.

Table 2: Payday Lending Attitudes and Experiences

	Full Sample Freq.	Full Sample Percent	Financial Shortfall Freq.	Financial Shortfall Percent	Former Customers Freq.	Former Customers Percent
Aware that payday lending is not allowed in North Carolina	155	39.6%	66	42.0%	14	60.9%
Not Aware	236	60.4%	91	58.0%	9	39.1%
	N=391		N=157		N=23	
Think payday lending was						
A Bad thing	286	88.3%	114	87.0%	17	73.9%
A Good thing	38	11.7%	17	13.0%	6	26.1%
	N=324		N=131		N=23	
Prohibiting payday lending has *no effect* on my household	287	77.2%	107	71.8%	15	68.2%
Positive effect	58	15.6%	32	21.5%	5	22.7%
Negative effect	27	7.3%	10	6.7%	2	9.1%
	N=372		N=149		N=22	

See endnote (6) for results using weighted samples.

Households are hardest hit by shocks to income and expense

The findings presented in the remainder of this section apply only to the subsample of 159 participants who reported experiencing at least one financial shortfall in the past three years (unweighted).[6] Of these, 142 were able to identify the factors that contributed to the **most recent time** they had a shortfall (see Table 3). For most (60%), the financial crisis resulted from a combination of factors rather than from one single event. The single most common cause was an illness or some other medical expense, followed by transportation expense. Conceivably, these top two causes have a compound effect of both increasing household expense and decreasing income (if illness or transportation impedes ability to work). Tied for third place was loss of income and home repairs.

Table 3: Reasons Given for Most Recent Financial Shortfall

Reason	Frequency	Percent [1]
Illness, disability or some kind of medical expense	70	49%
Car repair or other transportation-related costs	53	37%
Home repairs	42	30%
A loss of income due to a job loss or cutback	42	30%
A major household appliance purchase	18	13%
Tuition or other school-related expenses	12	8%
Regular expenses exceeding income	11	7%
Other income or expense shocks[2]	8	5%
Other[2]	4	3%

[1] Percents do not sum to 100 because respondents could select multiple options
[2] "Other income and expense shocks" include such events as death or divorce, apartment fire, loss of child support, need to pay property taxes. "Other" includes spending on vacation travel, entertainment-type purchases, gambling, and friends.

People Use Multiple Options to Handle Shortfalls

We asked these 159 respondents whether they had used any of a series of options during periods of financial shortfall. To learn more about specific behaviors, we also asked them to reflect on the *most recent* financial crisis in particular.

Our research revealed important information about how people handle financial emergencies. The most common option, over the last three years and most recently, was to pay the expense late or not to pay (see Table 4). Of those who obtained funds to pay the expense, most relied on credit cards, savings, or friends or family members. Bank loans and bank overdrafts were other frequent options.

Most people used more than one strategy. The 159 respondents used more than 500 options in the last three years and just over 300 options in their latest shortfall alone. About a quarter of respondents said they used only one or none of the options over the previous three years, indicating that around three-fourths of those surveyed are familiar with a range of credit options.

Eight percent used payday loans in the prior three years. Storefront payday lending ended in North Carolina roughly one year prior to our survey. Though some lenders offer Internet payday loans in this state, these are subject to North Carolina law as well, regardless of the lender's location.[10]

Table 4: Number of respondents who used each option in previous three years

	For all shortfalls in past three years		During most recent shortfall specifically	
Option	Freq.	Percent who used [1]	Freq.	Percent who used[1]
Did not pay/paid the expense late	82	52%	68	43%
Used money from a savings account	70	44%	53	33%
Obtained money from friends/family	67	42%	47	30%
Used a credit card/cash advance	62	39%	33	21%
Took out a bank loan/line of credit	44	28%	19	12%
Bounced checks/used overdrafts	36	23%	16	10%
Borrowed from insurance/retirement	26	16%	14	9%
Received money from church/charity	21	13%	12	8%
Obtained a pawnshop loan	17	11%	9	6%
Loan from finance company	15	9%	5	3%
Sought bankruptcy protection	15	9%	6	4%
Received a payday loan	13	8%	6	4%
Received tax refund advance	10	6%	5	3%
Borrowed from employer	9	6%	4	3%
Obtained loan from auto title lender	9	6%	1	1%
Entered debt negotiation	9	6%	3	2%

[1] Percents do not sum to 100 because respondents could select multiple options

These findings are roughly consistent with a survey of the general population in March and April of 2007.[11] Among those 500 households surveyed, 8% reported using a finance company, 7% taking out a tax refund anticipation loan (RAL), 4% borrowing from a payday lender, and 3% pawning an item in the prior two years.

The most frequent strategy survey respondents used was to skip paying an expense or to pay it late, but it was rarely the only strategy. Of the 68 people who skipped a payment or paid late, only 9 said that was the only thing they did. The remaining 59 people used a median of three options. The use of multiple options suggests an elaborate level of management, where consumers are layering in resources in some order of preference.

Table 5 shows the distribution of options people used to address their most recent financial shortfall. In the Options rows, the numbers are the number of people selecting that option. For example, of the 32 people who used 3 options the last time they had a financial shortfall, 25 paid an expense late or skipped paying it.

Table 5: Options used during most recent financial crisis

# Options Used	1		2		3		4	
# of People	44		35		32		20	
Total options used	44		70		96		>80	
Options:	# times used	Percent of options used	# times used	Percent of options used	# times used	Percent of options used	# times used	Percent of options used
Pay late/not pay	9	20%	16	46%	25	78%	18	90%
Family/ friends	8	18%	14	40%	11	34%	14	70%
Savings	8	18%	13	37%	22	69%	10	50%
Credit Card	5	11%	10	29%	11	34%	7	35%
Bank Loan	5	11%	6	17%	6	19%	2	10%
Bounced Checks	1	2%	2	6%	5	16%	8	40%
Charity	2	5%	2	6%	3	9%	5	25%
Retirement	3	7%	3	9%	3	9%	5	25%
Payday Loan	2	5%	1	3%	-	-	3	15%
Finance Company	1	2%	1	3%	-	-	3	15%
Pawn Shop	-	-	1	3%	3	9%	5	25%
Bankrupt	-	-	-	-	4	13%	2	10%
Auto Title Loan	-	-	-	-	1	3%		0%
Tax Advance	-	-	-	-	1	3%	4	20%
Debt Negotiation	-	-	1	3%	1	3%	1	5%
Employer Loan	-	-	-	-	-	-	4	20%

Note: Percentages represent the number of people in each column who selected a given option

More than half of those who used multiple options used their own savings as one option (45 out of 87). Only those using 3 or more options turned to bankruptcy, and only those using 4 or more chose employer loans. Payday loans were not among the most common choices.

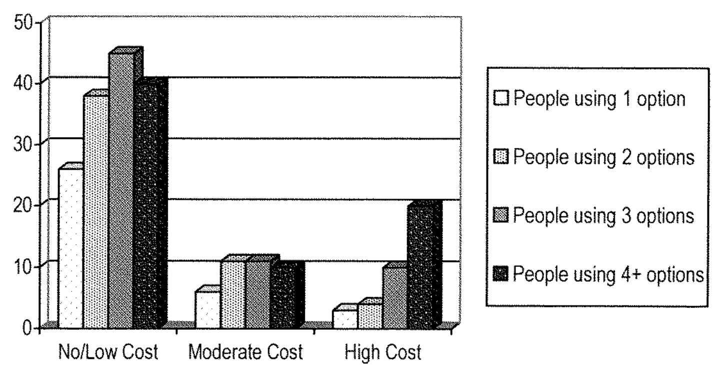
Cost Is a Factor in Selecting Options

We used reasonable assumptions of cost to categorize the alternatives as "no or low cost" (friends and family,[12] savings, retirement, charity, employer loan, bank loan), "moderate cost" (credit card, finance company loans), and "high cost" (bounced check, pawn, payday, auto title, tax advance). We did not include the unknown and highly variable options, which includes bankruptcy, debt negotiation, and not paying or paying late.

The cost of not paying or paying late was too variable to categorize. Fifty-nine of the no- or late-payers were willing to talk about their experiences of paying bills late. About 40% of these said they incurred no cost, but rather negotiated the payment over time, simply paid late, received phone calls, or had no consequences at all. Ten percent had utilities disconnected, went without a prescription medication, or had a damaged credit rating. The remaining half incurred late fees and charges, including eight respondents who said their bill was turned over to a collection agency or that they faced repossession or bankruptcy.

After separating responders by the number of options they used, we analyzed whether any group was more likely to select higher-cost options (see Chart 1). For all groups, the most commonly used options were no- or low-cost, especially if one considers that 40% of no- or late-pay events also carried no financial cost. The exception was those who tapped many sources, where high-cost options out-numbered moderate-cost options (driven by a relative increase in bounced checks and decrease in credit card use.

Chart 1: Number of options used in each cost category, by number of options respondent used in most recent financial crisis *(excluding no-/late-pay, bankruptcy and debt negotiation)*



Most people need more than $300

Table 6 shows the amounts people borrowed, by option. We used $300 as the dividing line, since this was the maximum allowable payday loan in North Carolina when the practice was authorized. Overall, the most popular amounts to borrow from a single source were from $100 to $299 and from $1,000 to $2,999.[13]

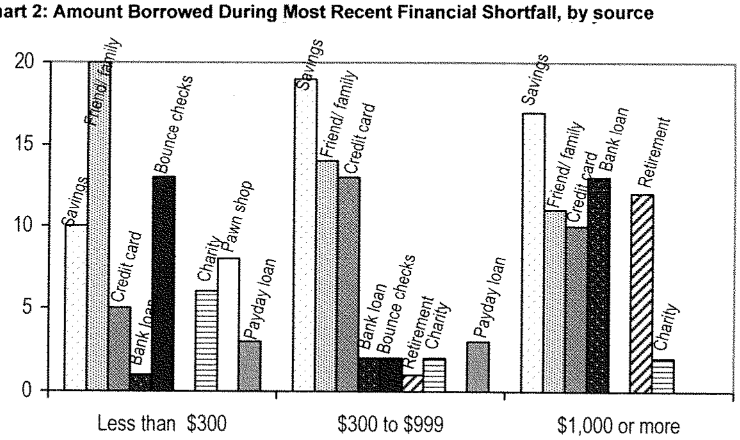
After not paying, the most common borrowing option people tapped was taking money from savings, which occurred regardless of amount of funds needed. The next most common option was to borrow from friends and family, who tended to provide somewhat smaller amounts though could still be generous. Responders across the board used credit cards but most often in the $300 to $500 range, while bank loans were the most popular resource in the high-dollar categories. Bounced checks and pawnshops were almost exclusively limited to small amounts. While only six people reported obtaining a payday loan to cover their most recent shortfall, half borrowed above $300. Of those who obtained a loan from a finance company, four out of five borrowed over $1,000. Likewise, three out of five who received a tax advance loan borrowed over $1,000, probably driven by the total amount of their refund. Pawn shops and employer loans were used exclusively below $300 while retirement and finance companies were never used for less than $300.

Table 6: Amounts Borrowed, by Source

	Less than $100	$100 to $299	$300 to $499	$500 to $999	$1,000 to $2,999	$3,000 to $9,999	$10,000 or More	Total
Savings	2	8	11	8	10	5	2	46
Friend/ family	7	13	9	5	9	2		45
Credit card	2	3	8	5	3	4	3	28
Bank loan	-	1	2	-	4	7	2	16
Bounce checks	5	8	2	-	-	-	-	15
Retirement	-	-	-	1	7	3	2	13
Charity	2	4	1	1		1	1	10
Pawn shop	5	3	-	-	-	-	-	8
Payday loan		3	2	1	-	-	-	6
Finance company	-	-	-	1	3	1	-	5
Tax advance	-	-	1	1	3	-	-	5
Employer loan	1	2	-	1	-	-	-	4
Auto title	-	-	-	1	-	-	-	1
Total	24	45	36	25	39	23	10	202

Chart 2 illustrates the nine most common options used by size (including the top five for each size category). When borrowing less than $300, the top five options are friends or family members, bounce checks, savings, pawning items, and charity. For loans between $300 and $999, people mostly rely on savings, friends and family, and credit cards. For amounts over $1,000, the top five options include those same three sources plus bank loans and retirement assets.

Chart 2: Amount Borrowed During Most Recent Financial Shortfall, by source



While people commonly borrowed less than $300, most people obtained funds from multiple sources. Only 15 of the 159 people polled used just one small-dollar option; 12 more used multiple options each of which was less than $300; while we do not know the cumulative amount obtained, ***at most***, only a quarter of the people could have needed only $300. (For this purpose, we treated no- or late-pay as a small amount). The three-quarters who we know needed more than $300 were evenly divided between those using a single over-$300 option, those using two or more over-$300 sources, and those mixing small and large amounts.

People prefer finance companies and bank loans; credit cards must be endured

We asked respondents who had used a particular option during their most recent financial shortfall two questions:

1) How fair and reasonable were the terms?
2) How satisfied were they with the option?

Table 9 presents the fairness score and satisfaction score for various credit options where the respondent turned to an institution and obtained assistance at a cost.[14] Scores range from 5 (very fair or satisfied) to 1 (very unfair or dissatisfied). These scores are the mean values for each option.

Bank loans received the highest fairness score and scored among the most satisfying. The highest satisfaction score went to finance company loans, and the lowest to pawnshops. In the MarketSearch study mentioned earlier, respondents also gave finance companies the highest satisfaction ranking and pawnshops the lowest among several "alternative financial services." While we can only conjecture as to why, it is worth noting that finance company loans, most loans against retirement savings, and certain bank loans are the only amortizing, closed-end options on the list.

We also asked people how likely they were to use various options in the future if they needed to borrow $300. The last column in Table 9 presents the percentage of people who said it was "somewhat likely" or "very likely" they would use a particular option in the future. The alternative response was "not likely." This question was asked of the full sample of 401 respondents.

Table 9: Fairness and Satisfaction Scores

	N	Fairness Score	Satisfaction Score	Satisfied-fair gap	Likely to use in the future
Take out a bank loan/line of credit	19	3.79	3.72	-0.07	39%
Borrow from employer	4	3.75	3.50	-0.25	4%
Enter debt negotiation	3	3.67	3.33	-0.34	15%
Borrow from insurance/retirement	14	3.57	3.64	0.07	16%
Bounce checks/use overdrafts	16	3.50	3.37	-0.13	8%
Loan from finance company	5	3.40	3.80	0.40	14%
Seek bankruptcy protection	6	3.17	3.33	0.16	9%
Obtain a pawnshop loan	9	3.14	2.56	-0.58	7%
Receive an early tax refund advance	5	3.00	3.20	0.20	Not asked
Receive a payday loan	6	2.83	3.33	0 50	4%
Use a credit card/cash advance	33	2.82	2.75	-0.07	29%

Although there was some correlation between fairness and satisfaction, satisfaction scores differed from fairness scores for several options. The "satisfied-fair gap" measures this difference. A large positive figure suggests that borrowers derived satisfaction over and above their perception of fairness; For example, finance companies had the highest satisfaction score but a middle-ground fairness score and payday loans had the highest such gap, with a satisfaction score well above its low fairness score. Conversely, a large negative number suggests customers were dissatisfied for reasons beyond their sense of (un)fairness; thus, people who obtained pawnshop loans did not think the terms were particularly unfair but were less satisfied than all other respondent groups.

There tended to be less difference between the satisfaction and fairness scores of the most frequently used options—bank loans, borrowing against retirement, bounced checks, and credit cards. Notably, the most-used option, credit cards, had poor scores on both measures. Respondents saw credit cards as less fair than pawnshops, overdrafts, or bankruptcy—in short, everything but auto title lenders—and neck and neck with payday lenders. On the satisfaction scale, credit cards ranked below auto title lenders and payday lenders and above only pawnshops. Despite these scores, respondents cited credit cards as the second most likely source they would use to borrow $300 in the future.

Our survey found that the overwhelming majority of low- and moderate-income families do not miss payday lending, and that most families use multiple avenues to handle financial hardships. Generally speaking, we found that households more frequently choose lower-cost options to deal with hardships and preferred term loans from banks and finance companies to credit cards and other sources of credit.

Phase II: Focus Groups–A Closer Look at Payday Borrowers

We also wanted to learn more about the experiences of people who had, at some point in the past, turned to a payday lender to make ends meet. We wanted to know more about the circumstances leading to their decision to take out a payday loan, their experiences as a borrower, their reaction to the shuttering of payday lending stores, and how they view their options to manage financial shortfalls.

Prior Research

Payday borrowers represent an estimated 5% of the United States population (Stegman 2007). They typically are from lower- to middle-income households and are more likely to be younger, female, divorced, or separated. Borrowers are also more likely to be high school educated but less likely to have graduated from college. Minorities are over-represented, even after controlling for a number of socioeconomic factors. By definition, payday loan borrowers are banked but often carry small balances.[15]

"What most borrowers have in common is significant credit constraints, including poor and impaired credit histories."[16] Payday borrowers are about four times more likely to have filed for bankruptcy[17] but there is some evidence that payday borrowing may contribute to bankruptcy.[18]

Payday borrowers are more likely to spend a greater share of their income on consumer debt payments, to revolve credit card balances, be at or near credit limits, and have been turned down for credit or been offered less than the amount requested than the general population.[19] While close to 25% have used a pawnshop, virtually none report considering a pawnshop as an alternative to their most recent loan.[20]

Although in general payday loan borrowers are experienced users of credit, there is mixed evidence as to how well they grasp the terms of payday debt. Generally, survey respondents knew the dollar fee per $100 borrowed but were much less clear on the APR. In one study, 96% of respondents could report the finance charge per $100 borrowed, but only 16% could report an APR, and 60% of those were probably wrong, including 41% who reported an APR below 30%.[21]

Industry-funded surveys report that three-quarters of respondents say they were satisfied with the experience.[22] Users report most satisfaction with the application process and the ability to refinance or renew and most dissatisfaction with cost. Far and away, the single most important reason for using a payday loan was speed and ease. Only 9% said they had no other alternative and only 1% cited greater privacy. Advertisement has the biggest influence on choosing the first payday loan, ahead of referral.[23]

Focus Group Participants

We conducted two focus groups of 10 people each, both held in Charlotte, North Carolina. The participants were all ages and included young, single people, married people with children, divorced parents, and grandparents. Sixty percent of the participants were white, 40% were black, and about 60% were women. Jobs included technician, security guard, and clerical, warehouse, and manufacturing workers. All except three participants, who said their unemployment was temporary, were working full-time. All participants were former or current payday loan customers. Some had taken their last payday loan more than two years previously, prior to payday loans becoming legally unavailable in North Carolina. However, some participants had taken out recent loans, either in South Carolina or over the Internet. Two participants reported taking out a payday loan within the previous month, and one of these was still outstanding.

We divided the participants into two groups: infrequent users of payday loans (five or fewer loans over the previous five years) and frequent users (more than five loans). In North Carolina, when payday lending was authorized, around half of all payday customers took out five or fewer loans, but they generated only 15% of the total loan volume.[24] Customers who took out six or more loans provided the majority of loan volume (85%). There was some blurring of the distinction between our two focus groups, because some participants reported few loans but actually rolled them over a number of times. In their minds each constituted a single, separate loan, although these were actually a series of repeat transactions. In fact, very few participants reported paying off their loan at its first due date. Between the infrequent and frequent payday borrowers, we found some stark differences in attitudes and experiences but some common sentiments.

Focus Group Findings

The opinions we present from these focus groups represent the consensus or majority opinions expressed by participants. Whenever significant variation exists, we present the range of opinions and beliefs expressed. Italicized phrases and remarks in quotations are direct quotes.

A few points are consistent across the spectrum of participants:

- All agreed they had paid what they considered to be an excessively high price for the loan.
- In spite of many reported difficulties, all but one person did pay off the loan.
- They universally called for a more viable credit option for borrowing a small amount of money.

General Views on Payday Lending

The motivations and experiences of infrequent payday loan customers vary significantly compared to frequent users. For example, we started the discussion with a general question, "When I say 'payday loan' what do you think of?" Responses from infrequent borrowers included:

- "Quick way to get money"
- "Money for emergencies"
- "Extra money between paychecks"

More frequent borrowers had very different answers. The first person to speak answered, "Rape…you are down, desperate, need money, and so you go to borrow, and you keep doing it over and over and over again." Other responses included:

- "Addiction"
- "You go in to more debt"
- "When it's due, when you have to repay it…then you take out another"

Why People Go To Payday Lenders

The majority of focus group participants reported that they initially took out a payday loan because they experienced a financial shock, either an unexpected loss of income or extra expense (we call this "setback" driven). These setbacks included car repairs, job loss, reduced work hours, medical bills, annual car insurance payments, or unexpected expenses incurred by a child.

Four of the twenty participants were what we term "lifestyle borrowers;" they used payday loans for non-essential expenses, such as gambling, vacations, or expensive restaurant meals. In general, lifestyle borrowers took out more payday loans more frequently than setback borrowers; all were in the frequent user category.

Occasional borrowers used payday loans to pay for unexpected costs, such as car repairs or medical bills, while many frequent borrowers used payday loans to pay necessary but expected expenses such as housing. Some frequent borrowers viewed payday loans as a kind of supplemental income.

As one participant put it: *"I knew I'd screwed up after I got out; I blame myself."* Overwhelmingly, participants did not blame the lender or the loan but rather themselves for their situation. Most participants were glad they were no longer payday loan borrowers, that they had "learned a lesson," and that they were making efforts to avoid taking another payday loan.

Awareness of Payday Loan Terms

As expected, knowledge about payday loan terms and conditions varied greatly. Everyone agreed on the basic steps of obtaining a loan and the requirement to pay it back in a few weeks (see Appendix). Most also knew that they could roll-over or renew a loan for two additional weeks by paying the fee again. But many participants did not know how to compare the costs and terms of a payday loan to other credit products.

Among infrequent users, understanding varied widely. Several said they did not understand the interest rate, or that they only realized the cost of the loan after they got home. One said that after reflecting on the loan, she felt "like I sold my soul to the devil." On the other hand, several other infrequent borrowers said they understood the interest rate at the time of the loan and accepted the terms. Some participants felt that payday loans were less expensive than pawnshop loans, while others felt pawnshops were the better deal.

The more frequent users had a better understanding of the costs associated with payday loans. Several said they had read the fine print and knew that the APR was in the 400% range. Their attitude was they needed the money. The interest rate, fees, and repayment terms were just features they had to accept rather than features to consider when making a decision. One participant captured what many voiced: "Your mind, it is set; I need the money now…you don't think about the afterwards." Another said, "It is when you have to pay it, that's when you think about it."

Easy to Get In...

"It was quick and easy...real easy."
All participants were attracted to payday loans for the same reason: The loans were private, fast, and above all, easy to obtain. People cited the short application process, no credit check, and the guaranteed acceptance. When asked whether they would have been able to get a payday loan if there had been a credit check, they generally thought not.

"The paperwork was simple. They didn't ask a lot of questions."
Many people also said they appreciated the discretion of a payday loan. One person said that with a payday loan, "there is no family drama;" another said it enabled him to "hide my head." This was a common theme—payday loans could be obtained without family members or bankers finding out; however, participants also reported that the payday loan companies contacted their employers before making the loan. Others said that payday loan companies did not report to credit bureaus, so taking a loan would not affect their credit.

"I didn't have to go through much to get it. I mean, I was in and out of there in about thirty, thirty-five minutes."
Participants said they preferred payday loans because they were faster to get than other loans. For one person, the payday loan shop was "right down the street." A few who got their loans

over the phone or the Internet said the money was in their checking account within one to 24 hours. Some participants said their payday loan company offered them another loan without requiring another application.

"Small amounts"
Many were attracted by the fact that they could borrow small amounts. They felt that lenders such as banks or finance companies would not be willing to loan them only a few hundred dollars.

"The guy I did my business with at that one place, he did not look like your typical lounge lizard."
Finally, several participants mentioned that payday lending shop employees were friendly and personable. This did not necessarily influence their decision to take out a payday loan, but it made them feel more comfortable about doing so. They noted the cleanliness of the stores and the fact that employees remembered their names. Payday loan employees were "non-judgmental," many participants said, while bank employees looked down on low-income people.

*"They always offered me more." "If you need money in the first place and they say, 'Well, here's what you **really** can do', quite naturally your eyes see that."*
Most people borrowed more than they had initially intended to borrow. Many participants told how they ended up getting a larger loan because payday loan employees told them they could. For example, according to one participant, an employee might say, 'Just in case something comes up behind that, you might need more.' One woman said, "You get a little extra," and another added, "To blow."

"I was like 'what? I can do that again? Really? Oh, okay, let me take it back out.'"
Some focus group participants said the loan representative made loans available to previous customers even if they didn't ask for one. One woman said she got e-mails from the Internet loan shop she used letting her know she could get another loan; others got phone calls. Some customers also were offered a small incentive for making referrals.

"Nice people...yea, as long as you came back and paid it off after two weeks and then took out your next one. They're happy you're not one of the ones they have to chase down... I'd always be back so they always liked me."

...But Hard to Get Out

"I even get them calling me asking 'would you like to extend your loan?' and my answer was always 'why yes, I would!'"
Participants were quick to point out that payday features they liked were outweighed by negatives, and sometimes the positives turned into negatives: "It's *too* easy." Several explained that payday loans' easy access became a problem when they started taking out loans on a regular basis. One man said, "Every two weeks I have to run down and get another [loan] before they close. It became a part of my life, until I realized I was paying $45 every two weeks. Then it started to come to me."

"I get happy, but then I realize I'm probably perpetuating the problem...Then reality sets in... I've put myself in another bind again."
Most customers also said that the payday loan delayed rather than resolved the financial problem that led them to take out the loan, or resolved it in favor of another problem. While many reported feeling extreme relief, almost euphoria, upon receiving the loan, they also said reality set in as payday neared. Frequent customers especially said that two weeks later, when the loan was due, their financial situation had not changed and they did not have the money to cover the loan. At first they thought of a payday loan as income or extra money, but later they realized that rather than adding to their income they had just "killed one bill with another." Almost all agreed it was easy to get trapped in a payday loan.

"It is really easy. You just go down and give them another $30 and you have another two weeks to pay it back."
This was a typical response to the question, "Did you find it easy to pay off your loan?" In fact, participants' comments implied that it is very easy to *not* repay a payday loan and instead pay another fee and delay payment for two weeks. They told of lenders giving them grace periods or "holding their check" past the due date to give them time to renew.

"It became a habit."
Focus group participants generally felt that payday loans have some appealing features but that these are outweighed by high fees and a short repayment period. Frequent borrowers said when they took out their initial loan they believed they could pay it back within two weeks, but most rolled over that initial loan several times. Some took as long as a year to finally pay it off.

"I don't know anybody who knew how to work it right, to use it for the main purpose it is set up to be."
Only two of the twenty participants said the payday loan had truly resolved their problem. One man said payday loans improved his situation because he used the money to continue taking out his girlfriend without her knowing he spent much of his income on gambling. The other said the loan's onerous terms had taught him a lesson and led him to fundamentally change his financial management.

Paying off

"I started calculating. I'll never get out of it. If you're already struggling, you'll never come out of it."
One frequent borrower explained, "If you borrow $300 and pay back $45, and you're going in there two times a month, at the end of the year that's $1,180 in interest and you still owe $300. That's what woke me up—$1,180. You could use that for something a lot more important."

"You see yourself in a hole."
Participants said they saw payday loans as a "quick fix." One said it become "more of a burden than a convenience." Four frequent borrowers got money from other sources to pay off their payday loans, including pawnshops, friends and family, and a bank overdraft that was subsequently converted to an installment loan.

"I would come down a level each time I'd go until I paid it all."

When pressed, most said it had been difficult to pay back their loans. Several people said that once they realized how much the cycle cost them, they paid off by "easing out," taking consecutively smaller loans. Others took part-time jobs or cut back on spending.

"The interest rate is already outrageous."
Customers felt strongly that the cost was excessive. All except one participant reported paying off every payday loan they took, and they did not see that they posed such a risk as to warrant the fees they were charged, particularly when they had a long track record of paying on time. One contrasted the price of a payday loan to the cost of cashing a check and felt the difference was not justified. Participants found several aspects of payday loans burdensome: They wanted lower interest rate caps and longer repayment schedules with installment payments. Many said they would prefer being able to receive a loan from their employer.

End of Payday Lending

"Thank you Jesus! Yes! Now I can't do it anymore!"
We asked participants if they were aware that payday lending is no longer allowed in North Carolina, and most were. When asked if this was a hardship, both groups had an immediate and strong common reaction: "No, no, no; I think that's a *good* thing!" Another woman said, "They're there basically to rob people that need money...they're the devil!" Most participants were glad they no longer had the temptation.

However, when asked more abstractly whether "people" should have the right to take a payday loan, all but two agreed that they should. This apparent contradiction highlights the conflict between people's desire to be protected from what they view as unfair business practices, and their deep sense of independence and accountability. One man voiced this faint praise: "You're an adult. You signed the contract. They put their terms there. I think it's shady that they allow it to be that high. They're preying on people on hard times... But they should be allowed to have a business."

Participants reported using several different credit alternatives, though no single alternative was widely used. Seven used overdrafts, a few patronized pawnshops, and two took out auto title loans. One resorted to "EZ lease," in which, she explained, she provided the lender with post-dated checks and serial numbers on several appliances in exchange for cash at a steep finance charge, on terms that earned the comment, "There are worse things." Two lifestyle borrowers used Internet payday lenders. For the most part, those using South Carolina payday lenders had always used South Carolina lenders.

Others had developed lower-cost strategies. "It aggravated me that I was stupid enough to not ask someone in the family to lend me the money," one said. And another has learned how to negotiate with bill collectors instead of taking on more new bills.

Some were managing without debt, by changing their spending habits, taking on another job or more hours, or simply doing without. "I'd rather stay home," one person said. One person had used payday loans to smooth cash flow in her insurance billing business, because her clients, who were doctors, were often slow to pay. She now requires them to pay on time.

Many participants appealed for small-dollar credit options that could ease, rather than increase, financial strain in difficult times. Their attitudes about regulation displayed a lack of clarity about what was and wasn't regulated but also some faith in the capacity of appropriate regulation to protect them. These 20 current and former payday borrowers have much the same views as those expressed by respondents in a much broader survey of North Carolinians' perceptions of financial services: "Findings also identify uncertainty and mixed opinions relative to the state's banking regulations ...however, findings identify clear support for regulations and opportunities to strengthen them even more."[25]

Focus Group Conclusion

Experts in behavioral economics argue that situational factors, such as daunting complexity, conveniences or minor obstacles, influence of peers overriding expert advice, can lead us all to make sub-optimal decisions. Because financially constrained individuals have less room for error, poor financial choices—even if driven by apparently modest factors—can have make-or-break consequences.[26] The Consumer Credit Research Foundation found that "simplifications" are an important part of the appeal of payday loans,[27] and our focus group participants echoed that point. The themes of speed, ease, and convenience resound throughout the research and our focus groups, which may partly explain why payday lending appeals to certain consumers, and why, at the same time, it is not sorely missed.

Conclusion

Our research introduces the experiences and opinions of low- and moderate-income North Carolinians and former payday loan users into the debate over consumer protection in the credit market. Most surveyed households consider themselves better off or unaffected by the closing of payday loan stores in North Carolina. The demand for consumer credit remains, but households currently handle financial hardships in a variety of ways. Low- and middle-income households experience financial shortfalls largely because of circumstances beyond their control and typically borrow more than $300 to pay their debts. By and large, they are willing to contribute from their own assets and work with service providers, and they manage and repay a range of debt sources. Thus, in our analysis, the policy decision to ban payday lending was effective because it was a net benefit to households and does not appear to have materially curtailed the availability of credit for these households.

In focus groups, former payday borrowers reported receiving payday loans quickly, easily, and with little review of their ability to repay. Few were able to pay off the easy-to-obtain loans in the timeframe they had expected. Frequent users--those who generated the preponderance of payday transactions--were more likely to abuse the product and borrow repeatedly. Payday loan customers, even those who want to retain the option, wanted a lower APR and longer, amortizing repayment terms, as well as limits on renewals and amounts borrowed. Some of these changes would fundamentally alter the nature and economics of payday loans. Industry "best practices"[28] do not begin to approach the requirements our focus group participants want.

Addressing the Demand for Small and Affordable Consumer Loans

The North Carolina State Employee's Credit Union (SECU) introduced a 12% APR product called the Salary Advance Loan (SALO) in January 2001. With more than 1.3 million members, SECU is the nation's second largest credit union.[29] Typical SALO borrowers earn less than $25,000 per year and have low account balances and low credit scores. Renewal rates are high, with two-thirds of SALO customers taking out a SALO every month, so SECU requires the borrower to deposit 5% of every new SALO into a savings account. In the first five years, SECU reported more than a million loans to more than 50,000 customers; an average annual charge-off, or bad debt expense, of just 0.27%; and $8 million of accumulated savings account balances. SECU calculates it is saving members $33.6 million a year in payday loan fees.[30]

One researcher points out that "depository institutions are able to profitably offer payday loan alternatives...whether they have the will to do so remains to be seen."[31] In our survey, 12% of households experiencing a shortfall took out bank loans, which they ranked as the most fair and second most satisfying source of credit. On the other hand, 10% of households used overdraft loans or bounce protection. Several focus group participants used overdraft loans and viewed the fairness of the charges negatively, particularly when they overdrew their accounts by small amounts: "You're just minus fifty cents, they pop you for twenty-five dollars." Thus, bank products offer both a promise and a potential shortcoming.

This promise is found in the Federal Deposit Insurance Corporation's (FDIC) Affordable Small-Dollar Loan Products Guidelines issued in June 2007, which calls for FDIC-supervised financial institutions to promote an alternative debt product that features affordable rates (with an APR not to exceed 36%) and amortizing payments. The guidelines stress that "excessive renewals of a closed-end product, or the prolonged failure to reduce the outstanding balance on an open-end loan, are signs that the product is not meeting the borrower's credit needs." The guidance also recommends underwriting for ability to repay, incorporating a savings component into the product, working with other organizations, and providing an avenue for financial education. Institutions that pursue such practices can qualify for Community Reinvestment Act credit.[32]

Another bank product, the ubiquitous credit card, was strongly disliked. Respondents in our survey used credit cards more than any other interest-bearing debt product, but the only service rated less satisfying than credit cards was pawnshop and the only one considered less fair was the auto title loan. Similarly, focus group participants were afraid of being misled by credit card companies. These findings are consistent with recent developments: While Congress considers credit card reform legislation,[33] many financially distressed homeowners are falling behind in mortgage payments while keeping their credit cards in good standing.[34] Because the technology, flexibility, and cost structure of the credit card business holds the potential to offer a simple, fair, and repayable debt product, it is particularly regrettable that credit cards received such low marks for satisfaction and fairness.

Finance companies appear to be picking up some business formerly served by payday lenders. Although only a few financially distressed survey respondents named finance companies as a source of credit, finance companies outranked all other options in terms of satisfaction. A tiered rate system allows North Carolina finance companies to charger higher interest rates on the first $600 to $1,000 loaned. Loans under $600 are capped at a maximum of 36%.[35] Payday lenders say they cannot be profitable at that level, but as part of an overall business model that includes larger loans this appears to generate a reasonable return for finance companies. In 2006, North Carolina's 597 finance company offices made 32,586 loans under $600, representing 7% of their borrowers. The average balance was $481. The number of loans under $600 made by finance companies has grown each year since 2002 and is up 37% in four years.[36]

This research suggests that North Carolina households do not miss payday lending and have an array of other strategies to manage financial shortfalls. However, demand remains for alternative sources of small, affordable consumer loans. Our research suggests that payday lending did not fulfill this demand, as few people miss it now that it's gone and most of those affected by the ban consider themselves better off now. What the focus groups want is a product with a lower rate, longer repayment schedule, and installment payments—all core features in the FDIC's Affordable Small Dollar Loan Guidelines. The Office of the North Carolina Commissioner of Banks and others should continue efforts to encourage such products.

Payday Lending Overview

Today's payday lending is a modern version of a practice once known as "salary lending," which dates from the 1800s. By 1907, at least 20% of Americans owed money to salary lenders, with many trapped in what was called "chain debt." Eventually, the excesses of the high-cost credit industry led to the term "loan shark," passage of bankruptcy laws, the emergence of credit unions, and the passage of small loan laws by individual states.[1]

North Carolina's experiment with modern payday lending began in 1997, when lawmakers exempted the practice from the state's small loan usury rules. Except for the period from October 1997 through August 2001, North Carolina's Consumer Finance Act limits the APR on loans under $600 to 36%.[2]

A payday loan is a small, short-term loan on the order of $300 for two weeks made in exchange for a postdated check or withdrawal authorization for the cash received plus fees.[3,4] A composite of loans made in North Carolina in 2000 illustrates a "typical" transaction: The median $244 loan had a median fee of $36 and the majority of loans were due within 8 to 14 days, resulting in a median annual percentage rate (APR) of 419%.[5] A shorter term raises the APR.

According to the industry's trade association, the payday lending industry makes $40 billion in transactions a year.[6] At $15 per $100 borrowed, that amounts to some $6 billion in fees paid by borrowers.[7] While payday loans are available over the Internet, most payday lending is conducted through storefronts, either in stand-alone payday lending stores or in related businesses, such as check cashers and pawnshops. Two years ago, there were more payday lending and check cashing locations nationwide than McDonalds, Burger Kings, Wal-Marts, JC Penneys, Targets, and Sears combined.[8] As more states allowed payday lending, the business evolved from private, local operators to a more organized industry, with a number of large chains controlling a growing share of the market.

Obtaining a payday loan is quick and easy. Payday lenders generally do not check credit reports, and the money is made available almost immediately. But paying off the loan in a fortnight can prove more challenging. Numerous studies show that most borrowers have problems repaying the loans and that re-borrowings (or "roll-overs") are common.[9] The Center for Responsible Lending, a consumer advocacy

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[1] Peterson, Christopher L. 2004. *Taming the sharks. Towards a cure for the high-cost credit market.* Akron, OH: The University of Akron Press.

[2] N.C.G.S. § 53–15. North Carolina Consumer Finance Act. Raleigh, NC: North Carolina General Assembly.

[3] Other terms for payday lending include "deferred deposit" or "deferred presentment" loan.

[4] See Consumer Federation of America http://www.paydayloaninfo.org/index.cfm for additional details.

[5] Stegman, Michael A and Robert Faris. 2003. Payday Lending: A business model that encourages chronic borrowing. *Economic Development Quarterly* 17(1): 8-32. Sage Publications.

[6] Community Financial Services Association of America (CFSA) http://www.cfsa.net/about_payday_advance.html); Accessed September 28, 2007.

[7] While limits vary from state to state, with some states having no limit on payday lending fees charged, fifteen dollars per $100 is a "typical fee" according to King, Uriah, Leslie Parrish and Ozlem Tanik. 2006. *Financial Quicksand: PDL sinks borrowers in debt with $4.2 b in predatory fees every year.* Durham, NC: The Center for Responsible Lending.

[8] Karger, Howard. 2005. *Short changed, Life and debt in the fringe economy.* San Francisco, CA: Berrett-Koehler Publishing.

[9] It is common practice for borrowers unable to extinguish the debt with regular cash flow to push off repayment. These borrowers may simply extend the loan, or do a "back to back" by paying off the old loan and getting another

group, calculates that just 1% of payday loans go to people who take out one loan a year and pay it back on schedule, while 60% go to borrowers who take out more than 12 loans a year; nationwide, the average payday borrower pays $793 to borrow $325.[10] Despite the fact that North Carolina law set out to prevent roll-overs, [11] in 2000, the average North Carolina payday borrower got more than eight loans (from the same store). In that same year, 18% of customers used the same lender more than once per month, and 7% took 20 or more loans from the same lender in the course of a year. [12]

When a borrower does not pay off or extend the payday loan, the lender withdraws funds from the borrower's bank account. If bank funds do not cover the withdrawal, the borrower faces probable bounced check charges along with negative bank history reports, often the very things the borrower was trying to avoid by going to the payday lender in the first place. In 2000, 6% of checks written by North Carolinians to secure payday loans were returned (NSF), but lenders recovered 69% of these amounts and collected more than $2 million in additional fees for NSF checks. Net charge offs were less than 2% of loans advanced.

In 2000, the peak year for which records were kept, the payday loan industry in North Carolina made 3.5 million loans to 413,214 customers, or almost 7% of the state's adult population, assuming that each customer only used one store.[13] But many borrowers go to multiple lenders simultaneously to borrow above statutory limits, or use one payday lender to pay off another. One nationwide survey found that almost half of respondents had used at least two different payday lenders in the prior year, and that 35% of those paid off one lender with an advance from another.[14] If this pattern held in North Carolina, the total number of customers overstates the true customer base by at least 50%.

Ultimately, North Carolina became the first state to close down a once legal payday lending industry. The state allowed the law that authorized payday lending to sunset in 2001. Some payday lending chains continued to operate under partnerships with out-of-state banks, arguing that this arrangement exempted them from North Carolina laws. The North Carolina Attorney General prosecuted one of these chains, Advance America, and the North Carolina Commissioner of Banks ruled against Advance America's continued payday lending in the state. On March 1, 2006, the remaining chains entered consent agreements with the Attorney General, and all stores operated by out-of-state chains were eliminated.[15] Internet payday lending in the state is also subject to North Carolina law, even if the offer comes from outside the state.[16]

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immediately or very soon, sometimes after a legally mandated "cooling off" period. State laws vary with regard to these practices. See Stegman and Faris 2003 for review of studies of payday loan usage.

[10] King, Parrish and Tanik 2006.

[11] An act to regulate check cashing businesses, S.L. 1997-391 Senate Bill 312, General Assembly of North Carolina. (1997).

[12] North Carolina Commissioner of Banks (NCCOB). 2000. *Annual report of check cashing businesses licensed under article 22 of chapter 53 of the North Carolina general statutes fact sheet.* Raleigh, NC: NCCOB. In 2000 in North Carolina, there were 3,469,917 loans made to 413,214 customers for an average of 8.4 loans per customer per store.

[13] Ibid.

[14] Elliehausen, Gregory and Edward C. Lawrence. 2001. *Payday advance credit in America: An analysis of customer demand.* Washington, D.C.: Credit Research Center, McDonough School of Business, Georgetown University.

[15] North Carolina Attorney General (NC A.G.) Press Release. March 1, 2006. *Payday Lending on the Way Out in North Carolina: AG Cooper says major payday lenders agree to stop loans.*

[16] Fox, Jean Ann and Anna Petrini. 2004. *Internet Payday Lending: How High Priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections.* Washington, D.C.: Consumer Federation of America.

Endnotes

[1] IO Data Corporation. 2002. *North Carolina payday advance customer study: Public report.* Salt Lake City, UT. Prepared for Community Financial Services of America.
[2] One population well represented in North Carolina and receiving special attention from payday lenders, consumer advocates, and policy makers is military families. The state houses five military bases, all in eastern North Carolina, and has the third-largest active military population in the country (Press Release from office of Representative G.K. Butterfield, January 26, 2007 http://www.house.gov/list/press/nc01_butterfield/01262005butterfield onarmedservices.html. Accessed July 5, 2007). In 2006, the Department of Defense reported that payday lenders targeted military personnel because of their youth, inexperience with money management, low savings, steady income, and independence, in addition to the military culture's emphasis on "financial responsibility." The report further found that predatory consumer loans undermine troop morale and readiness and called for policies to protect military families (U.S. Department of Defense. 2006. *Report on predatory lending practices directed at members of the armed forces and their dependents.*). In response, Congress capped rates on consumer loans to military families at 36%, effectively prohibiting payday lending (Welch, William M. 2006. Law caps interest on 'payday advances' to service members. *USA Today.com*, October 1, http://www.usatoday.com/news/ washington /2006-10-17-paydayloans_x.htm. Accessed September 25, 2007), and the Department of Defense issued its final rule on August 31, 2007 (see 32 CFR Part 232 Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule http://a257.g.akamaitech.net/ 7/257/2422/ 01jan20071800 edocket.access.gpo.gov/2007/07-4264.htm).
[3] Stegman, Michael A and Robert Faris. 2003. Payday lending: A business model that encourages chronic borrowing. *Economic Development Quarterly* 17 (1):8-32.
[4] We used standard AAPOR formulas, which are available from the authors upon request.
[5] The Center acknowledges Clark and Chase Research of Charlotte, North Carolina, which conducted the survey data collection and facilitated the focus groups.
[6] We compared our sample and the subsample of 159 borrowers having a financial shortfall with overall demographic characteristics for households earning below $45,000 a year in the three MSA's using Integrated Public Use Microdata Series (IPUMS) data for 2006:

	IPUMS 3 MSAs	Full Sample	Shortfall Subsample
Married	45%	26%	27%
Separated/divorced	13%	17%	23%
Widowed	6%	26%	15%
Single	36%	30%	34%
HH w/ children	28%	16%	26%
No children	72%	84%	73%
Own home	69%	71%	58%
Rent home	31%	27%	38%
White	68%	57%	46%
Black	23%	38%	48%

To assess the possibility of bias resulting from the under-representation of married households, the sample was re-weighted to mirror the overall population (this also increased the weight of households with children). We then measured the results for the data shown in Table 2 (awareness of end of payday lending and attitudes toward payday lending) and obtained virtually identical awareness and attitudinal measures using the weighted sample as we did for the unweighted sample with married respondents weighted at 1.73, separated/divorced at .73, widowed at .23, and single at 1.2:

	Full Sample		Shortfall Subsample	
	Unweighted	Weighted	Unweighted	Weighted
Aware payday lending is not allowed	40%	41%	42%	42%
Not Aware	60%	59%	58%	58%
A Good thing	12%	12%	13%	12%
Think payday lending was *A Bad Thing*	88%	88%	87%	88%
Prohibiting payday lending had *no effect* on household	77%	78%	72%	72%
Positive effect	16%	16%	21%	22%
Negative effect	7%	7%	7%	6%

We conclude that the marital status distribution of our sample did not affect the responses to these critical questions.

[7] Chi-square tests significant at the p<.05 level

[8] A sample size of 23 former payday loan customers is insufficient to draw conclusions of statistical significance. However, from a descriptive standpoint it is notable that the numbers follow a pattern similar to the full sample and to the sub-sample of those who had experienced a financial shortfall.

[9] The survey simply asked, "When they were allowed, do you think payday lenders were a good thing or a bad thing?," without qualifying in any way what was meant by good or bad. Respondents were also given the option of "neither," "not sure," or "refused." These were not counted here because we could not know whether they didn't understand the question, had no opinion, or had an opinion that was "unsure."

[10] Fox, Jean Ann, and Anna Petrini. 2004. *Internet payday lending How high priced lenders use the Internet to mire borrowers in debt and evade state consumer protections*. Washington, D.C.: Consumer Federation of America.

[11] MarketSearch Corporation. 2007. *North Carolina Office of the Commissioner of Banks consumer banking and finance study*. This survey was conducted by MarketSearch for the North Carolina Commissioner of Banks to gage consumer perceptions of financial services and the role of the Office of the Commissioner of Banks.

[12] All the people who received money from friends or family members reported that the money was either a no-interest loan or a gift.

[13] This does not include the 68 people who reported that they did not pay an expense or paid it late, although those people essentially borrowed from the service provider or company to which they owed money. We did not collect data as to the total amounts that went unpaid. In thirteen cases, people were not sure of amounts borrowed and in three, they refused to say.

[14] Options such as using savings or receiving money from family/friends are not represented in the table.

[15] See Stegman, Michael A. 2007 Payday lending. *Journal of Economic Perspectives* 21(1):169-190 for a review of research findings.

[16] Stegman and Faris 2003, 9

[17] Stegman 2007

[18] Skiba, Paige Marta, and Jeremy Tobacman. 2007. Measuring the individual-level effects of access to credit: evidence from payday loans. Working paper.

[19] Elliehausen, Gregory, and Edward C. Lawrence. 2001. *Payday advance credit in America: An analysis of customer demand*. Washington D.C.: Credit Research Center, McDonough School of Business, Georgetown University.

[20] In Skiba and Tobacman's 2007 analysis of 145,000 applicants for payday loans from a Texas payday/pawn shop chain over a four year period, a quarter of all the payday applicants also used the lender's pawn services, but once an applicant obtained the first payday loan, the likelihood of using the pawn services fell by almost half, while those who were denied were more likely to pawn. Those who pawned did so with some repetitiveness, but not as much as the payday borrowers and for far smaller amounts (4.5 times at an average of $88 versus 8.8 times for the payday customers). More than half of all pawn loans ended in default. But those who received payday loans were more likely to declare bankruptcy within two years of receiving their first payday loan. Although there is some anecdotal evidence that payday lending has cut into the pawnshop business, research to date suggests that there is limited overlap between pawn customers and payday borrowers. The Texas study 25% overlap likely captured the "upper bounds," since the enterprise provided both products under one roof. Elliehausen and Lawrence (2001) found that 23% had pawned in the previous five years, but that less than 1% had considered pawning before obtaining their most recent advance. Likewise, virtually none of the North Carolina payday borrowers surveyed by Io Corporation even considered using a pawn shop, and fewer than 3% considered a car title loan.

[21] In Elliehausen and Lawrence (2001), 78% of respondents reported receiving APR information, and only 20.1% of those could report what APR was disclosed.
[22] The share of customers who said they were satisfied in various surveys is 75% (Elliehausen and Lawrence 2001), 75% (IO Data Corporation 2002), and 77% (Cypress Research Group. 2004. *Payday advance customer satisfaction survey*. Shaker Heights, OH. http://www.cfsa.net/customer_demand.html. Accessed July 3, 2007).
[23] Cypress Research Group 2004, Elliehausen and Lawrence 2001, Io Data Corporation 2002.
[24] North Carolina Commissioner of Banks (NCCOB). 2000. *Annual report of check cashing businesses licensed under article 22 of chapter 53 of the North Carolina general statutes fact sheet*. Raleigh, NC: NCCOB.
[25] MarketSearch 2007, 11
[26] Bertrand, Marianne, Sendhil Mullainathan and Eldar Sharif. 2006. Behavioral economics and marketing in aid of decision making among the poor. *American Marketing Association*. 25(1): 8-23.
[27] Brown, William O., Jr., David W. Findlay, Thomas E. Lehman, Michael T. Maloney, James W. Meehan Jr. 2004. *Payday lending: A practical overview of a growing component of America's economy*. Consumer Credit Research Foundation, 2 Available at http://www.cfsa.net/downloads/payday_lending.pdf.
[28] The trade association, the Community Financial Services Association of America (CFSA), requires its members to abide by a set of best practices. These can be found on their website, www.cfsa.net/industry_best_practices.html. As of October 1, 2007, the list included: full disclosure including fees and APRs, compliance with the law, truthful advertising, encouraging consumer responsibility, limiting rollovers to lesser of 4 or the state limit, a one-day right of recision, using legal collection practices, not threatening or pursuing criminal action against customers for non-payment, self-policing, supporting balanced legislation, offering extended repayment plans to customers who are unable to repay under their original contract, a special best practices for loans to active duty military customers, offering internet loans only in states where licensed and in compliance with that state's laws unless those laws are federally preempted, and display of the membership seal.
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[35] N.C.G.S. § 53–15. North Carolina Consumer Finance Act. Raleigh, NC: North Carolina General Assembly.
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STATEMENT OF

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EXECUTIVE DIRECTOR
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"AN EXAMINATION OF THE AVAILABILITY OF CREDIT FOR CONSUMERS"

BEFORE THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

THURSDAY, SEPTEMBER 22, 2011

I. Introduction

Chairman Capito, Ranking Member Maloney, and Members of the Committee, the National Credit Union Administration (NCUA) appreciates the opportunity to testify before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit. At this hearing, the Subcommittee has asked NCUA to comment on the availability of credit products for consumers who cannot or do not always access more traditional products and services offered by mainstream financial institutions like banks, thrifts, and credit unions. As detailed in this testimony, NCUA and the credit union system have a long track record of facilitating access to credit for disadvantaged populations.

This testimony addresses the issues and questions raised in the Subcommittee's invitation. First, this testimony will provide a general overview of the credit union system and the requirements of the Federal Credit Union Act to serve people of modest means. Second, the statement will offer some general observations about the prevalence of unbanked and underbanked households.

Third, this testimony will highlight the three principal ways—availability, access, and assistance—that NCUA seeks to help the unbanked and underbanked to obtain credit. Specifically, NCUA strives to:

- Facilitate the availability of consumer-friendly alternative financial services products, such as through the agency's Short-term, Small Amount loan rule;
- Expand the access to credit unions for consumers in low-income communities and underserved areas; and
- Provide assistance to credit unions serving low-income communities through loans and grants offered by the Community Development Revolving Loan Fund administered by the agency.

Fourth, this testimony will briefly review some other ways that NCUA has recently sought to help consumers to make better and smarter decisions with their money. Finally, pursuant to the invitation, this statement will outline some potential steps that the federal government could consider taking to increase access to affordable and sustainable credit options for the unbanked and underbanked.

II. Overview of NCUA

As a prudential regulator, NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. Consumer protection is also a top priority for the agency. NCUA performs these important public functions by chartering, regulating, and examining all federal credit unions (FCUs), participating in the supervision of federally insured, state-chartered credit unions in coordination with state regulators, and insuring federally insured credit union members' accounts. In its statutory role as the administrator of the National Credit Union Share Insurance Fund,[1] NCUA presently provides oversight and supervision to 7,239 federally insured credit unions, representing more than 91 million members.[2]

The Federal Credit Union Act states that credit unions have a mission to meet the credit and savings needs of consumers, especially people of modest means. NCUA assists credit unions in fulfilling their statutory mission of promoting savings and meeting the credit needs of consumers by facilitating the availability of consumer-friendly products, reviewing applications to increase credit unions' presence in underserved communities, and offering technical assistance, loans, and grants to low-income credit unions (LICUs)[3] to expand services and improve operations.

[1] Created in 1970 by P L 91-468 (Title II of the Federal Credit Union Act), the NCUSIF was amended in 1984 by P.L. 98-369 The Fund was established as a revolving fund in the U.S Treasury under the management of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state-chartered credit unions that request insurance.
[2] Approximately 150 state-chartered credit unions are privately insured and are not subject to NCUA's oversight. The term "credit union" is used throughout this statement to refer to federally insured credit unions.
[3] A 1970 amendment to the Federal Credit Union Act provided a framework for designating LICUs. LICUs are those credit unions that predominately serve persons with incomes falling below qualifying thresholds.

In November 2009, NCUA created the Office of Consumer Protection (OCP) to demonstrate the importance of consumer protection, segregate consumer protection and consumer compliance responsibilities from those involving safety and soundness, raise the profile of the consumer protection function, and assign dedicated resources to this aspect of NCUA's mission. OCP has overall responsibility for consumer protection and chartering programs and policies.

OCP consists of two divisions. The Division of Consumer Compliance and Outreach is responsible for consumer compliance policy, programs, and rulemaking; fair lending examinations; interagency liaison for consumer protection and compliance issues; member complaint call center; financial literacy programs; and ombudsman duties. The Division of Consumer Access is responsible for new federal credit union charters, charter conversions, Field of Membership expansions, bylaw amendments, and low-income designations.

OCP also represents NCUA on the Financial Literacy and Education Commission, where agencies collaboratively work to study the accessibility of mainstream financial services for the underserved. Additionally, OCP is continuing work under an interagency collaboration with the U.S. Department of Education and Federal Deposit Insurance Corporation (FDIC) to promote savings and financial access among school-age and college students.

III. Assessment of the Unbanked and Underbanked Population

The Subcommittee has asked NCUA to identify and detail some of the economic challenges facing underbanked borrowers seeking to access credit in today's economy. NCUA has not defined the terms "unbanked" or "underbanked" in its rules and regulations. In general, "unbanked" refers to individuals without an account at a depository institution, and "underbanked" refers to individuals with accounts at depository institutions who also rely on non-depository providers for financial services and products.

The *2009 Survey on the Unbanked and Underbanked*[4] by the FDIC offers important insights into the state of access to credit in the United States. Specifically, the survey finds that an estimated 9 million U.S. households are unbanked and that an additional 21 million households are underbanked. In all, an estimated 60 million adults reside within these households. In prior congressional testimony,[5] NCUA has further noted that low-income consumers most commonly use transactional and short-term credit products provided by alternative financial providers to address their immediate financial needs.[6]

The U.S. economy runs on credit, and disruptions in the availability of credit contribute to especially painful contractions. The recent global economic contraction is no exception. The availability of credit tightened for many households in the months immediately following the collapse of our financial markets. In late 2008, more than two-thirds of banks reported tightening standards for non-mortgage loans to individual borrowers, including credit card and non-credit card borrowing, and nearly three-quarters of banks reported tightening standards for mortgage borrowing.[7] The same groups found to be more likely to be unbanked—non-whites, less educated, and young—are also the groups that have been hit hardest during the recent recession.

For example, from December 2007 to the present, unemployment rates for non-whites have risen by more than those for whites. Similarly, the unemployment rate for individuals with less than a high school diploma rose 6.6 percentage points compared to 4.9 percentage points for individuals with only a high school diploma between December 2007 and August 2011, and 4.4 and 2.2 percentage points for individuals with some college or a college diploma, respectively. Unemployment rates have increased more for younger age groups than older age groups over the same period.[8]

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[4] See http://www.fdic.gov/householdsurvey/executive_summary.pdf

[5] See statement on "Financial Services in Disadvantaged Communities" by the Honorable JoAnn M. Johnson, Chairman, National Credit Union Administration, March 1, 2007, at http://www.ncua.gov/NewsPublications/News/speeches/2007/Johnson/Testimony07-0301.pdf.

[6] "Banking the Poor" by Michael S. Barr, University of Michigan Law School – A Working Paper Prepared for the Brookings Institution Center on Urban and Metropolitan Policy, July 2003, p. 6.

[7] Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices, June 2008 and September 2008

[8] Bureau of Labor Statistics.

Throughout the recent severe financial downturn and subsequent recovery, U.S. credit unions have outperformed banks in providing access to credit. Between December 2007 and June 2011, credit union loans expanded by about 6 percent.[9] During this same timeframe, total bank lending declined by approximately 7.5 percent.[10]

The number and lending capacity of LICUs, which focus on providing services to individuals and communities more likely to have unbanked and underbanked populations, have also expanded during the past several years. As more credit unions have received LICU status, the LICU system has more than doubled in assets and lending and nearly doubled in members. In 2003 there were 963 LICUs with $15.2 billion in assets, $9.9 billion in loans and 3.2 million members. As of June 30, 2011, there were 1,118 LICUs with $44.3 billion in assets, $27.2 billion in loans and 6.1 million members.

Even holding the population of LICUs constant, over the period since the financial crisis started these credit unions generally expanded and increased loan growth faster than non-LICU credit unions. Loans at LICUs grew by more than twice the rate of loans at other credit unions, 14 percent versus 6 percent, during this period. Notably, real estate lending by LICUs grew by 29 percent versus 12 percent at other credit unions.[11]

IV. Availability, Access and Assistance

All consumers—whether unbanked, underbanked, or fully banked—want financial services and products that are affordable, accessible and focused on their needs. The costs for transactional and short-term credit products offered by many non-traditional financial providers are often quite high and, in many cases, can exacerbate low-income consumers' economic distress. The challenge for traditional financial institutions like

[9] NCUA calculations based on Call Report data
[10] NCUA calculations using data for total loans and leases for all institutions from FDIC Statistics on Depository Institutions online reports.
[11] NCUA calculations based on Call Report data

credit unions is to make these products accessible and affordable to low-income consumers in a safe-and-sound manner.

NCUA has long worked with the credit union industry—and within the confines of the Federal Credit Union Act and consumer protection laws such as the Truth in Lending Act—to make viable financial products and services more accessible and affordable to low-income and unbanked or underbanked households. Some key aspects of NCUA's regulations include:

- NCUA limits the interest rate FCUs can charge for loans or lines of credit.
- In January 2007, NCUA began permitting FCUs to offer money transfer instruments, including international and domestic electronic fund transfers and check cashing services, to anyone in the Field of Membership.
- Credit unions have developed a number of alternative loan products, known as credit builder loans, people-helping-people loans and micro loans to further meet the needs of their members. Each of these products represents market-driven, practical attempts at providing consumer-friendly credit alternatives for unbanked and underbanked communities.

As noted earlier, NCUA seeks to expand access to credit to the unbanked and underbanked population through three ongoing initiatives—facilitating the availability of consumer-friendly products like the agency's Small Loan rule, expanding the access of credit unions to potential members through LICU designations and underserved area additions, and providing assistance to small credit unions and LICUs, primarily with grants, loans and training administered by NCUA's Office of Small Credit Union Initiatives.

Promoting Credit Availability through the Small Loan Rule

Many underbanked households choose payday lenders and pawnshops over banks and credit unions because of convenience and a general fear and distrust of financial institutions. These underbanked households also often turn to alternative financial services providers because of the ease in qualifying for a loan.

NCUA has long encouraged FCUs to identify prudent ways to meet their members' small-loan needs. NCUA issued a guidance letter in July 2009[12] encouraging FCUs to find financially sound ways to provide their members with alternatives to the high-cost lending practices of some other financial services providers. This letter highlights the potential benefits of a well-designed, small-loan program. The guidance also reminds FCUs of compliance responsibilities and risks associated with this type of lending program.

NCUA believes that the ability to offer small loans helps FCUs fulfill their statutory mission to promote savings and meet the credit needs of consumers, particularly those of modest means. Specifically, FCUs offering such loans provide their members with responsible, reasonable credit access alternatives to potentially high-cost payday loans, title loans, and pawnshops. Individuals needing short-term credit are often underbanked or have problematic credit histories. Lacking access to traditional, longer-term lending products, they often turn to alternative providers, like payday lenders, for their short-term cash needs. These payday lenders often charge exorbitant fees, resulting in triple-digit interest rates.

To facilitate greater availability of small loans and to offer the unbanked and underbanked within a credit union's Field of Membership the availability to obtain a consumer-friendly short-term loan, the NCUA Board recently reviewed the agency's existing regulatory structure. This review recognized that many FCUs could not provide their members with a reasonable alternative to traditional payday loans due to regulatory limitations. Therefore, last year the NCUA Board considered a proposal to provide FCUs with a regulatory structure under which they could offer a responsible alternative to payday loans to members in a safe-and-sound manner. The NCUA Board

[12] See Letter to Federal Credit Unions on "Payday Lending" (09-FCU-05) at http //www.ncua gov/Resources/09-FCU-05 pdf

finalized the Short-term, Small Amount Loan (Small Loan) rule, in September 2010. The rule became effective October 25, 2010.

Credit unions participating in this program may offer Small Loans to members at an interest rate up to 28 percent per year or 10 percentage points higher than the current interest rate ceiling for FCUs. The NCUA Board permitted a higher interest rate on Small Loans to account for the increased risk associated with this type of lending and to make it cost effective for FCUs to offer this product.

To offer Small Loans with this higher interest rate, FCUs must follow the other requirements of the rule. These requirements simultaneously ensure that members receive access to a reasonable and responsible product, as well as protect the safety and soundness of the credit union. These Small Loan requirements include:

- A principal of not less than $200 or greater than $1,000;
- A minimum maturity term of one month and a maximum maturity term of six months;
- No more than three Small Loans in any rolling six-month period to any one borrower, and no more than one Small Loan at a time to a borrower;
- No Small Loan rollovers, except to extend the loan term without additional fees for extending credit;
- Full amortization of the Small Loan;
- A minimum length of membership requirement of at least one month; and
- An application fee to all members applying for a new Small Loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed $20.

To protect safety and soundness, FCUs offering Small Loans must also self-impose a limit on the aggregate dollar amount of Small Loans made, up to a maximum of 20 percent of the FCU's net worth. For example, if an FCU had 10 10 percent net worth it would be limited to the total dollar amount of Small Loans of not more than 2 percent of assets. Participating FCUs must also implement appropriate underwriting guidelines to minimize risk.

The Small Loan rule offers some best practices to implement a Small Loan program, too. For example, when considering a Small Loan program, an FCU should consider both the potential benefits to a member's financial well-being and the higher risk associated with this type of lending. The guidance additionally encourages an FCU to develop a Small Loan program that improves participating members' financial health, perhaps by incorporating a savings component, offering financial literacy education, and reporting members' positive payment history of Small Loans to credit bureaus. This last aspect, in particular, helps members to repair problematic credit histories, enabling those members to begin using more mainstream financial products.

In the year since the adoption of the Small Loan rule, many FCUs have implemented programs or adjusted existing programs to meet the need of their members for short-term loans at reasonable rates. As of June 30, 2011, 343 FCUs reported Small Loans on their Call Reports. At that time, they reported having originated more than 33,000 Small Loans year-to-date, with an aggregate balance of almost $14 million. The average amount of these loans stood at just under $413 and the average interest rate for a Small Loan was 20.76 percent, significantly lower than the triple-digit interest rates often charged by payday lenders.

By prudently expanding access to credit, the Small Loan rule has gained market acceptance and expanded the availability of credit during its first year. In accordance with text accompanying the rule, NCUA plans to evaluate the success of the Small Loan rule within the next eight months. This review will analyze data collected on Call Reports to determine if changes are needed to ensure the rule accomplishes the purpose it was designed to fulfill. NCUA is committed to keeping this product properly scoped and to protecting consumers.

Expanding Access to Members through Approvals of LICU Designations and Underserved Areas

Since their inception in the United States more than a century ago, credit unions have served as a financial resource for consumers.[13] Individuals who have been able to join a credit union have experienced tangible financial benefits from membership in these not-for-profit financial cooperatives.

Despite efforts by credit unions to improve financial service access for the unbanked and underbanked, the largest obstacle to greater access to credit union products is the legal constraint on credit union membership. Not every consumer may join a credit union because credit unions can only accept members who are in "designated" Fields of Membership. In the cases of low-income communities and underserved areas, the unbanked and underbanked often have even more limited opportunities to access credit. NCUA, therefore, seeks to expand access to credit for the unbanked and the underbanked by reviewing and approving LICU designations, and considering and granting underserved area applications by FCUs with a multiple common-bond charter.

A 1970 amendment to the Federal Credit Union Act provided a framework for designating LICUs. For the purpose of implementing the amendment, Congress directed NCUA to define "low income." NCUA's definition of a low-income individual is either someone who earns 80 percent or less than the total median earnings for individuals, or someone whose family income is at or below 80 percent of the median family income as established by the U.S. Census Bureau.

NCUA continues to make aggressive efforts to educate FCUs about the benefits of the low-income designation. As a result, the number of LICUs has increased from 645 credit unions at year-end 2000 to 1,118 as of June 30, 2011. Today, 15.44 percent of credit unions are LICUs, representing 4.7 percent of the assets in credit unions. LICUs

[13] A group of Franco-American Roman Catholics formed the first credit union in the United States in New Hampshire in 1908, and the Commonwealth of Massachusetts enacted the Nation's first credit union chartering statute in 1909.

also presently have 6.1 million members and a combined Field of Membership of 68.1 million potential members.

Over the years, NCUA has initiated a number of programs focused on assisting LICUs. These initiatives provide increased opportunities for FCUs to diversify their membership profile and to assist low-income designated and small credit unions as they manage their operations.

The number of LICUs continues to generally increase as more credit unions become aware of the benefits of the designation. To help more credit unions to establish their qualification as a LICU, the NCUA Board at its meeting on June 17, 2011, approved a revised rule that reduces regulatory burdens for FCUs seeking the low-income designation. Specifically, the rule change provides FCUs interested in obtaining a low-income designation with an option of demonstrating that they are a qualifying institution using a random sample of members' incomes. The agency believes this change will assist FCUs serving pockets of poverty within areas generally considered as not meeting the low-income requirements. Enabling more FCUs to obtain the low-income designation will make it easier for unbanked and underbanked households to access credit.

In addition to approving applications for LICU designations, NCUA expands access to credit for the unbanked and underbanked by authorizing certain FCUs to add underserved areas to their Fields of Membership. Specifically, with the enactment in 1998 of the Credit Union Membership Access Act,[14] NCUA received the authority to approve, for multiple common-bond credit unions, expansions enabling them to serve members that reside in underserved areas. For an area to be "underserved," the area must be a local community, qualify as an investment area as defined in the Community Development Banking and Financial Institutions Act of 1994,[15] and be underserved by other depository institutions.

[14] P.L. 105-219
[15] P.L. 103-325

Through this initiative, NCUA helps credit unions provide access to financial services to members of modest means and unbanked communities. From 2010 through July 31, 2011, 30 multiple common-bond FCUs added 36 underserved areas to their Fields of Membership. These additions provided access to financial services to more than 3.5 million people. Since 2000, NCUA has approved 1,684 underserved area additions covering 161 million people.

As a condition of obtaining an underserved area addition to the Field of Membership, FCUs must have a facility in the underserved area. This facility requirement is indicative of an FCU's commitment to providing affordable financial services to people in underserved areas. Since the NCUA Board adopted guidance in 2008,[16] the agency has also required credit unions to discuss in their application packages the unmet needs they intend to address after receiving approval to serve underserved areas. Some recent examples of how FCUs will address unmet needs include:

- Serving as a viable alternative to a proliferation of non-traditional financial service providers, such as check cashing firms, title loan providers, and payday lenders;
- Offering small-dollar emergency loans; and
- Serving those with poor credit histories through "second chance" loan and share draft products.

Just as LICUs increase access to credit for the unbanked and underbanked, FCUs with underserved areas also increase the availability of credit. As the table below indicates, multiple common-bond FCUs that have added underserved areas (UA) tend to be more proactive, when compared to all federally insured credit unions (FICUs), in offering services designed to benefit the unbanked and underbanked.

[16] See NCUA Interpretive Ruling and Policy Statement 08-1.

Credit Product Offered	Number of FCUs with UAs	Percent of Total		Number of FICUs	Percent of Total
Real Estate Loans	578	83.77%		4,620	63.93%
Risk Based Loans	572	82.90%		4,173	57.74%
Overdraft Protection/Courtesy Pay	480	69.57%		2,972	41.12%
Overdraft Lines of Credit	440	63.77%		3,176	43.95%
Share Secured Credit Cards	296	42.90%		2,076	28.73%
First Time Homebuyer Program	150	21.74%		669	9.26%
Pay Day Loans	75	10.87%		522	7.22%
Refund Anticipation Loans	29	4.20%		127	1.76%

In sum, NCUA's efforts to facilitate the ability of FCUs to obtain low-income designations and to add underserved areas has increased the availability of credit and access to credit for unbanked and underbanked households.

Offering Financial Assistance to LICUs

A third way by which NCUA assists the unbanked and underbanked to obtain credit involves the use of loans and Technical Assistance Grants (TAGs) to LICUs. NCUA's Community Development Revolving Loan Fund (CDRLF) shows that, with a small amount of financial assistance, FCUs serving low-income communities can play a significant role in providing needed financial services to those communities.

NCUA has administered the CDRLF since 1986. Within NCUA, the Office of Small Credit Union Initiatives serves as the administrator of the CDRLF. All administrative costs associated with the program are borne by the agency's Operating Fund, thus maximizing the availability of appropriated funds to support the important work of LICUs. The overall objectives for the CDRLF and its operating principles are outlined in Part 705 of NCUA's Rules and Regulations.

A proposed rule, approved by the NCUA Board in May 2011 for public comment, would modify and streamline the operations of the CDRLF. NCUA anticipates the proposed rule changes will increase loan demand due, in part, to lower interest rates and reduced regulatory burdens on participating credit unions. The changes will also enhance the availability of basic financial services for low-income households, including the unbanked and underbanked.

Since its inception, the CDRLF has granted loans totaling $54 million and TAGs totaling $12 million. In 2010, NCUA approved 283 of the 438 grant applications submitted, awarding TAGs to 210 credit unions totaling $1.4 million. As of mid-year 2011, NCUA awarded 67 TAGs totaling approximately $265,000 for the year. These awards occurred within one month of receiving the FY 2011 appropriation.

At the end of 2010, the 67 CDRLF outstanding loans totaled $5.5 million. Currently, the loan interest rate is 1 percent and is the lowest rate allowed by NCUA Rules and Regulation Part 705. As part of a process to eliminate outdated procedures and increase transparency, NCUA is reviewing this program to provide maximum assistance to LICUs.

In their CDRLF applications for loans and TAGs, LICUs have regularly demonstrated an eager interest in providing services to their members, especially those members who had limited access to basic financial services. Specific uses for grants and loans related to providing access to credit to the unbanked and underbanked in recent years include:

- Alpena Community Federal Credit Union. Situated in Michigan, the LICU leveraged the TAG with other funds to provide both live and online financial education for 800 members of the community (both credit union members and non-members). As a result, 80 new share accounts were opened for low-income, unbanked, or otherwise underserved members.

- NYU Federal Credit Union. This New York City LICU leveraged TAG funds with internal resources and other donations to implement the "Making Ends Meet" program. This program identifies members—

primarily employees and students of New York University—having demonstrated financial difficulties and provides quarterly financial education sessions designed to help them avoid future delinquencies and late fees.

- Shreveport Federal Credit Union. The Louisiana LICU used its CDRLF loan proceeds to fund a program to help members refinance high interest rate loans from finance companies. Management estimated members each saved an average of $4,500 over the life of the loans or about $125 per month.

- Brooklyn Cooperative Federal Credit Union. The New York LICU used its CDRLF loan proceeds to expand outreach to the community by opening a second branch in the low-income, underbanked community of Bedford-Stuyvesant, and to help launch a homeownership counseling program. The homeownership counseling program now serves 500 people per year and led to the launch of a foreclosure prevention program in late 2008. This program has helped more than 70 homeowners retain their homes. By its first anniversary in May 2009, the new facility had 500 members, held close to a half million dollars in savings, and had made 55 new member business loans.

The table below summarizes appropriations and NCUA approvals for loans and TAGs offered by the CDRLF during the last decade.

Fiscal Year	Appropriations		Approvals	
	Loans	TAGs	Loans	TAGs
2001	$650,000	$350,000	$2,657,000	$369,815
2002	$650,000	$350,000	$3,259,000	$668,044
2003	$700,000	$300,000	$1,004,997	$460,242
2004	$200,000	$1,000,000	$1,797,458	$1,225,565
2005	$200,000	$800,000	$1,669,000	$949,219
2006	$0	$950,000	$4,214,000	$1,371,130
2007	$0	$950,000	$7,758,280	$1,494,175
2008	$0	$975,000	$350,000	$1,159,244
2009	$0	$1,000,000	$2,588,000	$1,055,778
2010	$0	$1,250,000	$258,497	$1,394,601

Despite the current economic climate, LICUs have remained focused on providing services to their members, which is evident in the number of requests for TAGs. During 2010, LICUs submitted 438 applications to the CDRLF and requested $2.5 million in technical assistance funds to bring needed financial services to their communities. This requested amount is twice the amount appropriated by Congress.

While the CDRLF was able to award many of the grant requests, due to limited funding, NCUA was unable to approve the majority of the worthwhile requests. In many cases, the amount awarded was less than the amount requested to award funds to as many credit unions as possible.

NCUA annually revises the CDRLF's grant initiatives to address the current needs of LICUs and their members. To support the community goals of the CDRLF, as well as NCUA's objective of providing additional resources to LICUs, NCUA opened up seven grant initiatives for 2011, including the Financial Education and Financial Literacy initiative and the Partnerships and Outreach initiative.

NCUA currently allocates a major portion of the CDRLF appropriation for the Financial Education and Financial Literacy initiative. This program provides funds to eligible LICUs to work in collaboration with community organizations, financial institutions, and others to improve the financial literacy among credit union members and the surrounding community.

The economic downturn and the increased desire by consumers to better understand their finances have spurred the growth of the financial literacy movement over the past several years. NCUA has found the need for financial literacy even stronger in LICUs where members typically maintain smaller average deposits and access more loans at smaller average amounts.

NCUA also provides funds to LICUs to deliver new financial products and services to members and the community or to expand existing services to new and potential members. LICUs working in partnership with other organizations achieve greater impact for low-income members and improve the communities in which they operate.

Providing Technical Assistance to Credit Unions

Economic development specialists working within NCUA's Office of Small Credit Union Initiatives further provide one-on-one direct assistance and training to officials of small credit unions and LICUs around the country. These specialists assist with strategic planning, adding new products and services, board and supervisory committee training, policy development, grant writing, and the formulation of partnerships. Additionally, these specialists assist credit unions in crafting programs and products directly geared to disadvantaged members, such as alternatives to payday loans, credit builder/rebuild programs, and first-time loan programs. These programs focus on helping members who are challenged in securing credit to do so, including the unbanked and underbanked within a credit union's Field of Membership.

Some examples of direct assistance provided by NCUA's economic development specialists and designed to expand access to credit for the unbanked and underbanked include:

- Risk-based Pricing Loan Program. JDMH FCU in Jeannette, Pennsylvania, adopted a risk-based pricing program after working with

NCUA specialists. Metrowire FCU in Plains, Pennsylvania, and Del Monte FCU in Rochelle, Illinois, are now working on program design to implement similar initiatives.

- Short-term, Small-loan Program. NCUA specialists worked to design a short-term borrowing program to serve credit-restricted members at Community Healthcare Credit Union in Manchester, Connecticut, Science Park FCU in New Haven, Connecticut, UFCW 1776 FCU of Plymouth Meeting, Pennsylvania, and Pennformer Community FCU, in Canonsburg, Pennsylvania.

- Credit Products for Members with Credit Problems. Both Community Healthcare Credit Union and Science Park FCU introduced alternatives to payday and anti-predatory loans, credit builder/rebuilder programs, and first-time borrower programs.

- Deviation from Common Practice of Credit Qualification. Community Healthcare Credit Union and Science Park FCU have further adopted credit-extension programs placing greater emphasis on the member-credit union relationship than on traditional credit scores.

In sum, NCUA's Office of Small Credit Unions Initiatives continues to advance the ability of unbanked and underbanked households to access credit through the provision of loans, TAGs, and one-on-one assistance.

V. Financial Literacy and Other Initiatives

Beyond the previously mentioned efforts to increase the availability, assistance and access to credit for unbanked and underbanked households, NCUA has recently undertaken two financial literacy initiatives that benefit these audiences. These efforts aim to help consumers to make better and smarter decisions with their money.

Last year, NCUA joined with the U.S. Department of Education and the FDIC to create the Financial Access and Financial Education Collaboration. This initiative encourages schools, financial institutions, federal grantees, and other stakeholders to work together to increase financial literacy, access to federally-insured deposit accounts, and savings among students and families across the country, with an emphasis on low- and moderate-income students and families. The target audience for this program is school-age and college students and their families.

Earlier this year, NCUA also launched a free consumer tool: MyCreditUnion.gov. This website provides consumers with the information they need to improve their financial literacy and enhance their financial stability. The website offers a one-stop toolbox of information and personal finance tips designed to help individuals make smart financial decisions and better financial choices.

Consumers can visit MyCreditUnion.gov to learn about saving, borrowing and managing credit, as well as to learn how to get a free credit report each year. The website also explains how credit unions work, where to find a credit union, and how to start a credit union. In addition, consumers can use MyCreditUnion.gov to file credit union member complaints.

NCUA is committed to expanding and improving MyCreditUnion.gov, as well. The agency recently released a Spanish version of the consumer website.[17] NCUA also has plans to add more material about consumer protection and financial literacy issues to the website in the near future.

In addition to the efforts of NCUA to ensure financial literacy, credit unions are taking an active role in making sure their members are financially savvy. According to the June 2011 Call Report data, FCUs offer more than 3,500 financial education programs to their members and the communities in which they operate. The programs include

[17] See http://espanol.mycreditunion.gov/.

financial counseling, financial education, financial literacy workshops, first-time homebuyer programs, and in-school branches.

VI. Options for Increasing Access

In the invitation to testify, the Subcommittee requested steps that the federal government could take to increase access to affordable and sustainable credit options for the underbanked and unbanked. At this time, NCUA has several suggestions for the Subcommittee.

The Federal Credit Union Act currently only permits credit unions with multiple common-bond charters to add underserved areas to their Fields of Membership. Allowing single common-bond credit unions and community-chartered credit unions the opportunity to add underserved areas to Fields of Membership would open up access for many more unbanked and underbanked households to credit union membership. This legislative change could also eventually enable more credit unions to participate in the programs of the Community Development Financial Institutions Fund,[18] thus increasing the availability of credit and savings options in the distressed areas where credit unions operate.

Another legislative change that would increase the number of credit unions serving the population residing and working within underserved areas entails allowing credit unions to provide services in any adjacent geographic area meeting certain criteria associated with economic distress. These metrics include data related to income, poverty, and unemployment. This contiguous underserved area expansion would apply without regard to the more restrictive requirements of the Community Development Financial Institutions Fund and the limitations associated with NCUA's local community requirements.

[18] Located within the U S. Department of the Treasury, the Community Development Financial Institutions Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States.

Congress could also consider increasing the resources of the CDRLF to make more TAGs and loans. As noted earlier, demand by LICUs for TAGs often exceeds available funding. In 2010, the dollar amount of TAGs requested by LICUs from NCUA was twice the amount available. Because of these resource limitations, the CDRLF often reduces awards for or denies funding to worthwhile proposals. Enhancing the resources of the CDRLF would allow more credit unions to undertake initiatives aimed at increasing the availability of credit for unbanked and underbanked households. Given the current fiscal realities, Congress might consider allowing the CDRLF to enter into public-private partnerships or to obtain some form of private-sector support, rather than providing funding through traditional means like increased appropriations.

Aside from legislative action, NCUA plans to continue to increase the availability of credit in at least two ways. First, the agency will expand efforts to promote awareness of the LICU designation and provide greater assistance to FCUs seeking these designations. In this regard, NCUA's Office of Consumer Protection's Division of Consumer Access stands prepared to assist any credit union in becoming more familiar with the review process. The division is also committed to helping credit unions through the application processes for the LICU designation and for underserved area additions.

Additionally, NCUA will continue to promote greater financial literacy among underserved populations. The MyCreditUnion.gov website, ongoing CDRLF TAGs for financial literacy, and the Financial Access and Financial Education Collaboration with the FDIC and the U.S. Department of Education have laid the foundation on which NCUA can build. In this regard, the agency will conduct more targeted outreach aimed at helping the unbanked and underbanked to learn more about how to obtain consumer-friendly credit and how to join the financial mainstream.

Focusing on job creation and economic growth more broadly, in recent Senate testimony[19] NCUA has indicated support for bipartisan legislation sponsored by Congressman Ed Royce (R-CA) and Congresswoman Carolyn McCarthy (D-NY) in the

[19] See http //www ncua gov/GenInfo/Members/Matz/speeches/ChairmanMatzWrittenTestimony-SenateBankingCommitteeMBLHearingJune2011 pdf

U.S. House of Representatives and supported by a number of members of the Subcommittee. NCUA is focused on making certain that credit unions make safe, well-underwritten member business loans. H.R. 1418, the Small Business Lending Enhancement Act, would prudently allow credit unions to diversify their risks and portfolios. The tiered approach incorporated into the Royce-McCarthy bill features appropriate safeguards to ensure responsible lending and expand access to credit.

Credit unions have a century of experience making member business loans and fill a market niche for the small business loans that banks generally do not make. Small businesses also deserve greater, not fewer, choices in access to credit. Safe-and-sound member business lending programs provide economic benefits and strengthen communities. By prudently lifting the cap on member business lending, credit unions would be able to offer more credit to small businesses, supporting economic growth and job creation. If Congress enacts the Royce-McCarthy legislation, NCUA will act quickly to implement the strong safety-and-soundness regime called for in the bill by writing new rules and remaining vigilant in supervising these programs.

VII. Conclusion

In conclusion, NCUA has long recognized the need to expand access to credit for the unbanked and underbanked populations. NCUA has a long-standing history of working to expand the availability of credit, increasing access to credit unions by facilitating the ability of credit unions to add members, and providing assistance to small and low-income credit unions that serve communities with high concentrations of unbanked and underbanked households. Furthermore, NCUA's recently adopted Small Loan rule provides a viable, consumer-friendly, lower-cost alternative to potentially predatory loans. Finally, NCUA stands ready to work with the Subcommittee on any legislative efforts to increase access to credit, including proposals aimed at assisting the unbanked and underbanked, as well as legislation to prudently raise the current cap on credit union member business lending.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

ROBERT W. MOONEY
DEPUTY DIRECTOR
CONSUMER PROTECTION AND COMMUNITY AFFAIRS

DIVISION OF DEPOSITOR AND CONSUMER PROTECTION
FEDERAL DEPOSIT INSURANCE CORPORATION

on

AN EXAMINATION OF THE AVAILABILITY OF CREDIT FOR CONSUMERS

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

September 22, 2011
2128 Rayburn House Office Building

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, thank you for inviting me to testify on options available to consumers in need of small-dollar, short-term credit. Expanding the availability of mainstream financial services in general, and affordable small-dollar loans in particular, is a significant priority at the Federal Deposit Insurance Corporation.

The FDIC believes that banks already have the tools and infrastructure to create small-dollar credit products that are both affordable for consumers and beneficial for banks. Also, enhancing opportunities to save and bolstering financial literacy can help consumers better manage economic disruptions, and perhaps avoid using short-term credit altogether. Small dollar loan products are a useful business strategy for banks to establish new customers and foster long-term banking relationships. To that end, the FDIC implemented a number of initiatives to help banks stimulate an increase in offerings of reasonably-priced, safe alternatives to high-cost short-term credit and to improve consumers' overall financial resilience. Our testimony addresses these initiatives in more detail, including the results of the FDIC's Small Dollar Loan Pilot Program.

Demand for Short-Term Credit is High

In the wake of the longest economic recession since the 1930's and against the backdrop of persistently high unemployment, record foreclosures, a moribund housing market, and stock market volatility, many U.S. households are struggling to make ends meet, and do not have the capacity to deal with further financial shocks. A paper published earlier this year showed that one-half of U.S. households are "financially fragile" in that they would "probably" or "certainly" be unable to cope with a short-term financial emergency.[1]

Not surprisingly, in this economic environment, there is a large demand for small-dollar credit to cover emergencies, but all too often, consumers turn to high-cost products to meet their needs. For example, estimates peg payday loan volume to be in excess of $38 billion annually[2] and annual revenue from overdraft fees at about $38 billion.[3] Annual percentage rates (APRs) for these products can top several hundred -- or even thousand -- percent, putting more stress on already weakened consumer balance sheets.

The effects of high-cost credit can be particularly significant for lower-income consumers. According to the most recent Federal Reserve Board Survey of Consumer Finances, one in five consumers in the lowest income quintile ($20,600 or less) had zero or negative net worth.[4] Moreover, the *FDIC's Survey of Unbanked and Underbanked Households* in 2009 found that nearly 20 percent of households with incomes of $30,000 or below had used non-bank companies for credit needs rather than banks.[5]

[1] Annamaria Lusardi, Daniel J. Schneider, Peter Tufano, "Financially Fragile Households: Evidence and Implications" Working Paper 17072, National Bureau of Economic Research, Cambridge, Massachusetts, May 2011. Data were collected between June and September 2009 from a statistically representative sample of 2,148 U.S. households. In response to the question "How confident are you that you could come up with $2,000 if an unexpected need arose in the next month?," 24.9 percent reported being "certainly able" to cope; 25.1 percent reported being "probably able" to cope; 22.2 reported being "probably unable" to cope; and 25.1 percent reported being "certainly unable" to cope.

[2] Jessica Silver-Greenberg "Payday Lenders Go Hunting," *Wall Street Journal,* December 24, 2010, which, cites a year-end 2009 report from Stephens, Inc. as the source for the estimate.

[3] Moebs Services, press release: "Overdraft Fee Revenue Drops to 2008 Levels for Banks and Credit Unions," September 15, 2010, which projects overdraft revenue at $35 billion in 2010 and $38 billion in 2011.

[4] 2007 Survey of Consumer Finances," Federal Reserve Board.

[5] "FDIC National Survey of Unbanked and Underbanked Households," FDIC, Washington, DC. December 2009. The household survey was conducted in January 2009 as a supplement to the U.S. Census Bureau's Current Population Survey.
http://www.fdic.gov/householdsurvey/Executive_Summary.pdf

FDIC Efforts to Encourage Banks to Offer Affordable Small-Dollar Loans

A generation or so ago, it was common for banks to make small, unsecured loans to individuals. However, over time, a series of product and technological innovations and changes in the competitive landscape in banking, among other factors, contributed to a decline in the number of banks offering small loans and an increase in alternative credit providers, such as payday loan stores, auto title lenders, and pawn shops that often offer costly credit products. Not long after, many banks began to offer automated fee-based overdraft products on a wider scale that also can be a costly way for consumers to deal with financial emergencies. The *FDIC Study of Bank Overdraft Programs* in 2008 illustrates the steep costs of automated fee-based overdraft programs; it showed that the median overdraft was \$36, but the median fee to cover overdrafts was \$27.[6]

The FDIC began reviewing whether banks could feasibly offer alternatives to high-cost short-term credit in the context of military personnel, whose financial problems can collectively affect the readiness of our armed forces. More specifically, in December 2006, the FDIC held a conference, titled "Affordable, Responsible Loans for the Military: Programs and Prototypes" where attendees, including banks, representatives from the Department of Defense and other agencies, community groups, and others developed a template for an affordable, small-dollar loan program.

Subsequently, in a broader effort to encourage more banks to offer small-dollar credit products that are affordable, yet safe and sound and consistent with all applicable federal and state laws, the FDIC issued the *Affordable Small-Dollar Loan Guidelines* (the

[6] "FDIC Study of Bank Overdraft Programs," FDIC, Washington, D.C. November 2008. Data refer to automated overdraft programs.

Guidelines) in June 2007. The Guidelines explore several aspects of loan product development, including affordable prices, reasonable loan terms, streamlined underwriting, and the benefits of linking a savings component and financial education to short-term loan products. Importantly, the FDIC recognizes that the Community Reinvestment Act (CRA) could also provide a valuable incentive to offer affordable small-dollar loans. The Guidelines clarify that FDIC institutions providing such products consistent with the Guidelines will receive favorable consideration in the CRA examination.

Building on the Guidelines, the FDIC Board of Directors in June 2007 also approved a two-year case study known as the FDIC Small-Dollar Loan Pilot Program (the Pilot) to determine the feasibility of banks offering small-dollar loans as an alternative to high-cost emergency credit sources, such as payday loans or fee-based overdraft programs. The idea for the Pilot originally stemmed from a recommendation by the FDIC's Advisory Committee on Economic Inclusion (the Committee), which was established in 2006 to provide advice and recommendations to the FDIC regarding expanding access to banking services for the one-quarter of U.S. households that are underserved.[7] The Committee is comprised of representatives from banks, academia, consumer and community groups, and government agencies.

Like all of us, underserved consumers need to cash their paychecks, pay bills, and save for the future with products that are safe, affordable, and easy to understand. They

[7] The 2009 FDIC National Survey of Unbanked and Underbanked Households (See Footnote 4) found that 7.7 percent of U.S. households are unbanked, meaning that they lack a checking or savings account at an insured financial institution, while 17.9 percent of U.S. households are underbanked, meaning that they have a deposit account at an insured financial institution, but continue to rely on alternative financial services providers

also need access to reasonably-priced credit to buy a car or a home, pay for their children's education, and, of particular relevance to this hearing, to meet unexpected short-term financial needs. The Committee provides a forum to stimulate discussion and obtain information about these and other important issues and challenges facing underserved consumers.

The Pilot was launched in February 2008, and concluded as of the fourth quarter 2009. Twenty-eight volunteer banks participated with total assets ranging from $27 million to $10 billion, and almost 450 branches in 27 states. During the Pilot, banks made 34,400 loans with a principal balance of $40.2 million. While delinquencies on loans originated under the Pilot tended to be 3 to 4 times higher than for unsecured consumer loans in general, charge-offs were in line with the charge-off ratios for unsecured consumer loans in general. The Pilot has resulted in a model, or template, of product elements for a safe, affordable, and feasible small-dollar loan. Product elements include loan amounts of $2,500 or less, loan terms of 90 days or more, APRs of 36 percent or less, low or no fees, streamlined but solid underwriting, and optional savings and financial education components. The template is replicable in that it is simple and requires no particular technology or other major infrastructure investment to implement.

Best practices and elements of success emerged from the Pilot and underpin the template. In particular, a dominant business model emerged: most Pilot bankers indicated that small-dollar loans were a useful business strategy for developing or retaining long-term relationships with consumers. In terms of overall programmatic success, bankers reported that long-term support from a bank's board of directors and senior management was most important. The most prominent product element bankers linked to the success of their program was a loan term longer than just a few pay cycles to give consumers time to repay. Perhaps most importantly, the Pilot shows that banks can offer affordable small-dollar loans in a manner that suits their business plans and is fair to consumers. In testament to that fact, 26 of the 28 institutions continue to offer the product today even though the pilot program terminated in 2009.

Going forward, the FDIC is working with the banking industry; consumer, community, and philanthropic groups; other government agencies; innovators in small-dollar lending; and others, to research and pursue strategies that could prove useful in expanding the supply of small-dollar loans. Among other things, these strategies include:

- Highlighting the successful features of the Pilot and other small-dollar loan models.
- Studying the creation of pools of nonprofit or government funds to serve as "guarantees" for small-dollar loans.
- Encouraging broad-based partnerships among banks, nonprofit organizations, and community groups to work together in designing and delivering small-dollar loans.
- Studying the feasibility of safe and innovative emerging small-dollar loan technologies and business models.
- Considering ways that regulators can encourage banks to offer safe and affordable small-dollar loan products and that these products can receive favorable CRA consideration.

Additionally, the FDIC has engaged in a number of initiatives, briefly described below, to improve the overall financial well-being of consumers and reduce their need to tap credit sources when financial shocks arise.

FDIC Model Safe Accounts Pilot

In August 2010, the FDIC Board approved a case study, recommended by the Committee, designed to evaluate the feasibility of financial institutions offering safe, low-cost transactional and savings accounts that are responsive to the needs of underserved consumers. Known as the Model Safe Accounts Pilot, the study launched in January 2011 and will run over the course of a year. The study includes nine financial institutions that volunteered to offer unbanked and low- and moderate-income consumers deposit accounts with core features for safe, low-cost transactional and basic savings account products based on account templates that were published for comment in May 2010.

The account templates address predominantly electronic accounts to limit acquisition and maintenance costs. Transactional accounts are card-based, electronic accounts that allow withdrawals through automated teller machines, point-of-sale terminals, automated clearinghouse preauthorizations, and other automated means. As needed, and on a limited basis, transactional accountholders may obtain money orders, convenience checks, or e-checks. There are no overdraft or non-sufficient funds fees associated with the transactional accounts. All of the accounts are FDIC-insured; are subject to applicable consumer protection laws, regulations, and guidance; and have reasonable rates and fees that are proportional to their cost.

As with the Small Dollar Loan Pilot Program, results of the Model Safe Accounts Pilot will be analyzed to determine best practices to share with the industry to encourage more banks to offer similar products. Over the long term, expanded access to safe and affordable bank accounts could provide more undeserved consumers with the option of tapping savings for emergencies, rather than relying on high-cost forms of credit.

Financial Education: the Money Smart Initiative

Clearly the need for small dollar short-term loans could be ameliorated if consumers became more knowledgeable about personal financial management. To address this and other needs on the part of consumers, the FDIC initiated a national financial education campaign in 2001 by launching *Money Smart*, a comprehensive financial education curriculum designed to help individuals outside the financial mainstream develop financial skills and positive banking relationships. Over 2.75 million consumers have been reached with Money Smart and over 1,200 organizations are actively part of the FDIC's Money Smart Alliance. Money Smart is available today in seven languages and comes in adult and young adult versions. In addition to the original version designed to be taught in a group setting, it is also available for consumers to complete independently online or through an MP3 player.[8]

A 2007 study of the effectiveness of Money Smart showed that the curriculum can positively influence how participants manage their finances. A majority of the Money Smart graduates surveyed reported an increase in personal savings, a decrease in debt, a better understanding of financial principles, and an increased willingness to comparison shop for financial services.

The FDIC continues to form alliances with public, private, and non-profit entities to promote financial education and encourage linkages between financial education and access to mainstream banking services. For example, last November, the FDIC entered into a partnership with the U.S. Department of Education and National Credit Union Administration to facilitate partnerships among schools, financial institutions, federal

[8] http://www.fdic.gov/moneysmart

grantees and other stakeholders. The partnerships provide effective financial education, increase access to safe, affordable and appropriate accounts at federally insured banks and credit unions, and encourage saving.[9] In addition, approximately 230 of the more than 1,200 organizations recognized as Money Smart Alliance Partners are financial institutions or their trade groups. Many of these institutions are using the Money Smart curriculum in collaboration with community-based partners by, for example, delivering the curriculum or providing bank products responsive to the needs of Money Smart program participants.[10]

Alliance for Economic Inclusion

Another area where the FDIC has addressed the needs of underserved consumers is through the Alliance for Economic Inclusion (AEI). AEI is the FDIC's national initiative to establish coalitions of financial institutions, local policymakers, community-based and consumer organizations, and other partners in 14 markets across the country to bring unbanked and underserved populations into the financial mainstream. The focus of AEI is on expanding basic retail financial services to underserved populations, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, and asset-building programs. AEI has approximately 1,130 members nationwide, and a number of the banks participating in the AEI also offer affordable small-dollar loan programs.

[9] http://www.fdic.gov/news/news/press/2010/pr10251.html

[10] See, for example, Financial Institutions Encouraged to Work With Schools to Promote Youth Financial Education, FIL-80-2010, http://www.fdic.gov/news/news/financial/2010/fil10080.html

FDIC Unbanked and Underbanked Surveys and Other Consumer Research

Section 7 of the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Pub. L. 109-173) requires the FDIC to conduct ongoing surveys "on efforts by insured institutions to bring those individuals and families who have rarely, if ever, held a checking account, a savings account or other type of transaction or check cashing account at an insured depository institution into the conventional finance system." The Act further requires the FDIC to provide a "fair estimate of the size and worth of the 'unbanked' market in the United States."

To satisfy the congressional mandate, the FDIC designed two complementary national surveys, the 2008 *FDIC Survey of Bank Efforts to Serve the Unbanked and Underbanked* and the 2009 *FDIC National Survey of Unbanked and Underbanked Households* (referenced above). The results of these surveys provided new and valuable information to policymakers, the banking industry, consumer groups, and other organizations interested in expanding safe and affordable financial access to underserved populations. We are repeating the surveys this year.

In addition to the surveys, the FDIC provides research, data, and other resources for consumers, banks, policymakers and others regarding issues related to consumer protection, underserved populations, savings, credit, and the use of alternative financial services. All of this information is available on www.economicinclusion.gov, an award-winning website maintained by the FDIC that is designed to centralize and disseminate information about our economic inclusion efforts.

Conclusion

The FDIC issued guidelines to encourage banks to offer affordable small-dollar credit products, conducted a pilot program to demonstrate the feasibility of banks offering these products, and continues to explore strategies to scale small-dollar lending across the financial mainstream. Also, the FDIC has pursued initiatives to increase underserved consumers' access to savings and financial literacy as an option to potentially avoid costly forms of emergency credit. Through these steps, and by working with other interested groups, the FDIC looks forward to the day when affordable small-dollar loans become a staple product at all banks, helping American families address their short-term credit needs in a safe, reliable and financially sound manner.

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expanding economic opportunity

Written Testimony of
Ida Rademacher, Vice President for Policy and Research, Corporation for Enterprise Development, (CFED)
House Subcommittee on Financial Institutions and Consumer Credit
An Examination of the Availability of Credit for Consumers
September 22, 2011

Thank you, Chairman Capito, Ranking Member Maloney and members of the Committee. On behalf of the Corporation for Enterprise Development, I appreciate the opportunity to present testimony before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit on the pressing need to improve access to appropriate credit for underbanked consumers.

The Corporation for Enterprise Development (C-F-E-D) is a 32 year old economic development nonprofit that fosters social innovations that help low income families and communities build wealth and financial resiliency. We see access to high quality credit as a fundamental tool in the effort to help households build wealth. But it is a tool that must be used with great care and intention, and the overwhelming majority of evidence in recent years shows that while there are many fundamental barriers to financial well being that America's families are struggling with today, access to credit is not the primary one. In fact, the proliferation of alternative high cost credit products and accumulated debt is actually a large part of the problem.

Even a cursory review of recent data on the status of American household balance sheets helps us put this issue in perspective. Simply put, Americans are underemployed and overleveraged. We have a consumer credit problem in this country, but the problem is *not* inadequate access to consumer credit: it is access to high quality and affordable credit. We are literally drowning in debt. Just last week the company CardHub.com published its Q2 2011 Credit Card Debt Study, showing that consumers accumulated $18.4 billion in new debt in the second quarter of 2011 – a 66% increase over the same quarter in 2010, and a 368% increase over the same period in 2009.

Couple this information with what we know about the increasing ratio between household debt and income. Economist Edward Wolff discussed the explosion of debt-to-income ratios in his most recent analysis of household economics. Middle income household debt-to-income ratios rose from 67 percent in 1983 to 100 percent in 2001 and 157 percent in 2007. He further concluded that the debt build-up of the 2000s went for normal consumption, not enhanced consumption.

Findings from the recent (2009) Financial Capability Study administered by the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation substantiate this finding. Nearly half of survey respondents reported facing difficulties in covering monthly expenses and paying bills. And the majority of respondents did not have any type of "rainy day" funds set aside for financial emergencies. With inadequate incomes and inadequate savings, the only option open to millions of families is to turn to credit to finance basic consumption. But our own analysis of consumer credit scores suggest that over 60% of consumers have subprime credit scores, so the credit product options that are available to them are often suboptimal and the most vulnerable households who can least afford additional financial burdens end up paying a premium for access to the credit they need to simply make ends meet.

The ultimate lens through which we should look at any financial product or policy is relatively intuitive and straightforward: Does this product help a consumer improve their financial situation, or does it make the situation worse? A growing body of evidence that shows that many of the short term alternative credit products that are available in the market for cash-strapped consumers with either thin credit files or no- or low-credit scores don't pass this fundamental tenet of "do no harm."

CFED's Assets & Opportunity Initiative provides in depth information on state and local level policies that can help households increase financial stability and build and protect assets. We support regulation of short term consumer lending products. . Small dollar installment loans – when responsibly regulated – can be a safe product. We recommend capping the interest rate charged on loans such as payday loans, car-title lending and small dollar installment loans.

Ten states have banned or capped all three types of predatory loan products and include short-term lending in basic consumer protection laws. Fourteen states do not effectively regulate any of the three predatory loan products, although nine of these states include short-term lending in basic consumer protection laws. All other states protect consumers against some, but not all, predatory short-term loan products.

So what can and should the Federal Government do? I will leave you with three recommendations that CFED feels would go a long way to helping families truly regain their financial footing.

1. *Protect Consumers from financial products that exacerbate financial distress.* States are currently innovating in this area, and the Federal Government can support these efforts in several ways. What would be a true disservice would be to preempt state efforts with federal regulation that creates any kind of ceiling on the kind of protections states can impose that are less rigorous and robust than what many states are currently fighting to enact or keep in place. We should continue down the

course of regulating all financial service providers under the same set of rules and regulations and ensure that these rules protect consumers. CFED strongly supports the Consumer Financial Protection Bureau's mandate. We are active in providing guidance in areas of mortgages, consumer credit and small business lending.

2. *Help Families Save*. First and foremost, if we can help families build more liquidity, we will greatly curb the need for emergency credit. When it comes to building assets, savings and credit are compliments. But at the day-to-day level of household budgets, savings and credit are substitutes, and the need for short term and emergency credit is ultimately a need for short term and emergency savings. The research coming out of the innovative SaveNYC and SaveUSA savings pilots provide clear evidence of this fact. In the long run, American household balance sheets would be much better served by expanding access to savings opportunities than by further expanding access to high cost credit. We appreciate the Treasury Department's leadership to enable people to buy Savings Bonds on their tax returns. We are concerned that eliminating the over the counter paper bonds program will make it more difficult for low-income families to save. Treasurydirect.gov does not provide the same access as paper bonds purchased at a financial institution. A simplifed and refundable Saver's Credit would also expand access to savings in significant and meaningful ways.

   Finally, to promote and expand banking access and savings, Congress must lift or eliminate the current "asset limits" in basic social programs that penalize savings and make it hard for families to get ahead.

3. *Help Families Build Good Credit*. I will finish where I started. The quality of credit available to families is all-important. Congress should support private efforts to

help consumers improve their credit score so that they can access the highest quality, lowest cost and lowest risk credit products available. New types of financial counseling and financial coaching models can be very beneficial to helping low-income consumers manage their financial lives and build good credit. Products such as credit-builder loans through credit unions can also be useful. One of the biggest ways that CFED feels we can help as many as 120 million of consumers to build and improve their credit score is through full file reporting. Congress should end the regulatory uncertainty and provide permission to utility and telecom companies to report on-time payment to credit reporting agencies.

Thank you for the opportunity to speak with you today. I look forward to your questions.

For Release Upon Delivery
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TESTIMONY OF

BARRY WIDES
DEPUTY COMPTROLLER FOR COMMUNITY AFFAIRS
OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
U. S. HOUSE OF REPRESENTATIVES

September 22, 2011

Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, my name is Barry Wides and I am the Deputy Comptroller for Community Affairs of the Office of the Comptroller of the Currency (OCC). In this position, I oversee the Community Affairs Department which supports the OCC's mission to ensure the banks we regulate provide fair access to financial services and fair treatment of customers. The Community Affairs Department is specifically focused on supporting national banks and federal savings associations ("banks and thrifts") in their efforts to be leaders in providing consumer credit and retail services to underserved communities and individuals.

I would like to take the opportunity to thank the Subcommittee for inviting the OCC to testify regarding consumer credit and the types of products that are available to meet the small dollar credit needs of a spectrum of borrowers. My testimony will first discuss a number of credit products that banks and thrifts offer their customers and provide details on some specific initiatives. Next I will describe how consumer credit is underwritten and the OCC's regulatory and supervisory framework for banks and thrifts that offer consumer credit products. Finally, my testimony will discuss how consumer lending is evaluated under the Community Reinvestment Act (CRA) and the OCC's activities to encourage banks and thrifts to address the financial services needs of unbanked and underbanked consumers.

Consumer Credit Products

Banks and thrifts play a crucial role in providing credit to consumers in communities across the nation. With $617.7 billion in credit card and other revolving debt plans outstanding, banks and thrifts provide the lion's share of unsecured consumer lending in the U.S.[1]

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[1] Amount held by national banks and federal savings associations as of June 30, 2011. "Other Revolving Plans" is defined as all extensions of credit to individuals for household, family, and other personal expenditures arising from prearranged overdraft plans and other revolving credit plans not accessed by credit cards.

Consumer credit offered by banks and thrifts comes in many forms—unsecured and secured credit cards, term consumer installment loans, and lines of credit linked to checking accounts. Overdraft protection lines of credit can also help meet immediate temporary financing needs.

Credit cards play a critical role in providing households with access to credit with a flexible repayment schedule. The FDIC's "Survey of Bank Efforts to Serve the Unbanked and Underbanked" found that about one-third (36 percent) of banks offer consumer credit cards.[2] In addition to being used to pay directly for items, many credit cards also offer consumers the option to obtain a cash advance through an ATM or by writing a check that draws on the credit card.

Credit cards serve customers with a wide range of credit profiles and bear either fixed or adjustable interest rates. Periodic payments based on a percentage of the outstanding balance are required, but a customer can carry an outstanding balance up to the credit limit. Lack of an established banking relationship does not preclude a borrower from being approved for a credit card.

Secured credit cards are another alternative that many banks and thrifts offer to consumers who have damaged credit or have not yet established credit. Customers agree to hold a set amount of funds in a collateral account, such as a savings account, money market account, or certificate of deposit. The financial institution then provides a secured credit card up to the amount held in that account, which offers a customer the features, convenience, and security that traditional unsecured credit cards provide. The consumer makes monthly payments and can carry an outstanding balance on the secured card at interest rates comparable to prevailing unsecured credit card rates. If the consumer fails to make payments as agreed, the financial institution may offset the outstanding debt from the collateral account.

Once the secured card holder establishes a history of good payment performance, which banks typically set between 12 and 18 months, the customer is generally eligible to apply for an unsecured credit card. With good payment performance, some issuers might reduce the collateral amount prior to the time when a consumer may graduate to an

[2] The survey results were released on February 5, 2009. For complete results, see http://www.fdic.gov/unbanked surveys/.

unsecured product (i.e. from one dollar in collateral for each dollar of credit offered to 50 cents for each dollar of credit offered). Also, banks and thrifts report customers' on-time payment performance to credit bureaus, which helps the consumer to build a credit history for a broader set of credit products as well.

In 2004, the OCC took the lead in preventing unfair and deceptive practices in connection with secured credit cards. Guidance was issued that cautioned national banks to avoid charging fees and costs that consumed much of the credit extended.[3] The guidance also recommended practices for banks to follow when marketing secured credit cards. Important reforms were also enacted into law by Congress as part of the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, so that in the first year, fees on a secured credit card may not exceed 25 percent of the account credit limit.

Some banks and thrifts offer customers an unsecured, open-end line of credit. Usually this line of credit is offered as a revolving account where the consumer can request additional draws up to the credit limit and make monthly payments to reduce the balance. A line of credit may be linked to a checking account, so that if a customer overdraws the account, funds are automatically transferred from the line of credit to cover the negative balance in the checking account. A 2008 FDIC study found that 50.1 percent of the banks participating in the study offered an overdraft line of credit program.[4]

Banks and thrifts also offer unsecured installment consumer loans—where the borrower receives the loan proceeds at origination and repays the loan in installments over a set time period. The FDIC survey on the unbanked and underbanked found that closed-end unsecured personal loans for amounts under $5,000 were offered by approximately two-thirds (69 percent) of the respondents. Turn-around time for originating these loans is generally quick, which is a critical element when competing against non-depository institution lenders. However, credit underwriting standards expected of insured depository institutions can be a barrier for some customers.

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[3] OCC Advisory Letter 2004-4.

[4] FDIC Study of Bank Overdraft Programs, November 2008, at page 5. See http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf

Unsecured and secured installment loans are also offered by banks and thrifts that partner with retailers selling big ticket items, such as. large appliances, building supplies, and autos. The consumer applies for the loan at the retail store or car dealership, a credit report is ordered, and the bank underwrites and funds the loan, which is also serviced by the bank as installment payments are made.

Initiatives to Serve the Credit Needs of the Underserved

Studies have shown that low- and moderate-income individuals use credit products offered by alternative financial service providers more frequently than the population at large. Many consumers use this type of credit product to address emergency needs. Research conducted by the Consumer Federation of America shows that less than 30 percent of low-income households and less than half of moderate-income households have at least $500 in emergency savings.[5] Credit history is a significant barrier to mainstream credit for many. Reportedly 25.5 percent of the U.S. population have FICO scores below 599, and 9.5 percent have FICO scores between 600 and 649.[6]

Banks and thrifts have undertaken a number of initiatives to address unbanked and underbanked segments of the market that have traditionally relied on non-bank financial services providers to meet their credit needs. Some of these efforts are highlighted in the discussion that follows.

Many community banks and thrifts make traditional installment loans using flexible underwriting to address the specific credit needs of their communities. For example, for many years, Fraternity Federal Savings and Loan in Baltimore has offered its depositors small dollar consumer loans between $100 and $3,000. Repayment schedules are customized to match the borrower's ability to repay, and range from six months to five years. Interest rates vary depending on market rates, the amount of the

[5] Understanding the Emergency Savings Needs of Low- and Moderate-Income Households: A Survey-based Analysis of Impacts, Causes, and Remedies, Consumer Federation of America, November 2008, at http://www.consumerfed.org/elements/www.consumerfed.org/file/Emergency_Savings_Survey_Analysis_Nov_2008.pdf.

[6] Source: FICO, April 2010.

loan, and the term. There are no application fees. Automatic repayment from the deposit account can also be set up. No additional loans are permitted until prior loans are paid in full.

Beverly Bank and Trust, NA in Chicago, offers a small dollar loan program that serves borrowers with credit blemishes. The bank only uses manual underwriting for this loan program, reviewing the past two years of the applicant's credit history to evaluate payment performance, calculating the debt-to-income ratio for open trade accounts, and verifying income sources. In making its loan decision, the bank will evaluate any mitigating circumstances that might have contributed to harming the applicant's credit. If an applicant does not qualify for this loan program, the bank offers an alternative to help a customer rebuild credit. The bank provides an installment loan and its proceeds are invested in a certificate of deposit. With timely repayment of the loan, this approach is designed to help borrowers re-establish or improve their credit.

Some banks no longer offer unsecured consumer loans with installment repayment terms, but do provide credit cards allowing cash advances or offer lines of credit. Other large banks offer small dollar, open end lines of credit tied to checking accounts that are geared to customers who do not qualify for the bank's traditional suite of unsecured credit offerings. These programs are offered to bank customers who have recurring direct deposits into their account. Key Bank, NA, a large regional bank, rolled out a small dollar loan program geared to consumers who do not qualify for their traditional unsecured loan offerings. The bank offers its checking account customers a credit line that allows repayment over as long as five years. The interest rate is equivalent to credit card rates, payments are manageable, and advances can be transferred to a checking account at no cost. The consumer can also opt to allow automatic overdrafts to cover a negative balance in the checking account for a fee.

Other small dollar loan initiatives are being developed in conjunction with the Bank On Cities initiative whose programmatic goal is to eliminate barriers to entering the financial mainstream.[7] Bank On Cities is a program begun by the National League of Cities that offers a template for banks, community groups, and local government agencies

[7] More details regarding the Bank On Cities program may be found at http://www.nlc.org/find-city-solutions/iyef/family-economic-success/asset-building/bank-on-cities-toolkit.

to work together to reach out to unbanked and underbanked individuals who are using high-cost financial services and provide them with access to mainstream banking products. A number of cities, including large urban areas, have participated in this initiative. Common barriers that prevent these consumers from doing business with banks and thrifts include minimum balance requirements, monthly service charges, penalty fees or overdraft fees, and poor past performance with bank accounts. Banks and thrifts that participate in Bank On Cities initiatives strive to overcome these barriers by partnering with trusted community organizations that provide budgeting and financial counseling services. Products designed by banks and thrifts for these consumers include prepaid debit cards, savings options, direct deposit, and small dollar loans.

FDIC's Small Dollar Loan Pilot

Five national banks also participated in the FDIC's Small Dollar Loan Pilot, conducted in 2008 and 2009, the objective of which was to test how small dollar loans performed and whether these loans could be profitably originated in a safe and sound manner. [8] The five national banks that participated in this pilot originated approximately one-third of the loans made under the initiative. Four out of the five national banks had previously realized the need for a small dollar product in their communities and had been offering such a product when the FDIC pilot was initiated.

The pilot evaluated closed-end installment loans that offered amounts of up to $2,500 with terms longer than 90 days and interest rates at or below 36 percent (including origination and upfront fees). The pilot banks set their own underwriting policies and processes. While these processes tended to be more streamlined compared to other types of consumer lending to keep origination costs low, basic underwriting procedures such as evaluating credit reports and requiring proof of identity, address, and income were retained because they were deemed essential to managing credit risk on a safe and sound basis.

[8] The five national bank participants were Liberty National Bank (TX), Amarillo National Bank (TX), Armed Forces Bank, N.A. (KS), The First National Bank of Fairfax (MN), and National Bank of Kansas City (MO). The 28 banks participating in the pilot originated approximately 34,400 small dollar loans with a total principal balance of $40.2 million.

Participants concluded that these products served as a vehicle for building or retaining long-term banking relationships. The metrics reported by national banks fell well in line with the pilot's findings, with their product performance consistent with the figures reported from the pilot in terms of the cost, terms, and default rates associated with small dollar lending.[9]

In designing their small dollar loan programs, national banks went beyond the conventional underwriting process. From the outset, national banks adopted a "high touch" approach where, in addition to credit and income verification, the loan officer generally provided counseling for the customer or referred them to other nonprofit counseling resources.

In the underwriting evaluation, loan officers often took into consideration extenuating circumstances, such as temporary unemployment and medical expenses. Bankers evaluated debt-to-income ratios, bill payment behavior, and the customer's account management skills. Flexibility in setting loan terms helped loan officers to tailor loans to meet the customer's needs and ability to repay. And in cases where the loan became delinquent, the banks employed prompt follow-up and modification strategies to make sure the customers could bring the loan current and return to a positive payment performance.

Moreover, a special effort was made to help the customers move away from short-term financial solutions to longer term, more stable financial management—often in conjunction with financial counseling organizations and programs. National bankers repeatedly mentioned cases where individuals, who became customers through the small dollar loan program, built better credit and, over time, went on to use more traditional credit products, such as car loans, credit cards, and mortgages.

Underwriting Consumer Credit

For some individuals, access to traditional types of unsecured credit is limited, available only through labor intensive underwriting that is higher cost, or is entirely unavailable for those with significant credit issues. There are many reasons for this. A

[9] See "A Template for Success: "The FDIC's Small-Dollar Loan Pilot Program," FDIC Quarterly, Volume 4, No. 2, 2010.

younger individual or recent immigrant may not yet have established a credit history or has only started to do so. Previous late payment, repossession action, bankruptcy, or foreclosure may have damaged an individual's credit score. Unforeseen circumstances such as divorce, death of a family member, disability, high medical bills, or unemployment can threaten financial stability even for those who have previously maintained excellent credit.

Underwriting processes to evaluate a potential borrower's ability to repay can range from a review that evaluates a credit report or credit score and confirms identity to more in-depth underwriting procedures. Additional requirements may include calculation of a consumer's debt-to-income ratio;[10] verification of employment and income, social security number or individual taxpayer identification number; length of employment and residence at a current address; and whether the consumer is a renter or homeowner. The financial institution may also evaluate the quality of the banking relationship—how the customer has managed a checking account or whether the applicant is a current customer.

With near-instantaneous access to a consumer's credit information, quick turn-around times for underwriting loans are possible. The FDIC survey on the unbanked and underbanked noted that 80 percent of banks could originate small dollar loans in less than 24 hours, and 97 percent funded the loans in less than 48 hours. However, if a potential borrower has credit blemishes, a loan officer may need to take a more hands on approach and interview the customer to determine if there are mitigating circumstances. A financial institution may choose to approve a loan if credit problems occurred due to temporary unemployment or high medical expenses, as long as it is clear that the customer has otherwise properly managed credit and is now on better financial footing and has the capacity to repay the loan. This type of evaluation takes extra time and effort and is more costly than a customer scenario that doesn't include those issues.

New scoring models and databases have also been developed to evaluate "thin file" consumers who have not established a sufficient credit history, but who have shown that they are capable of managing recurring bills such as rent payments, utilities, and car

[10] Lenders are now required by the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, Pub. Law No. 111-24, which amends the Truth in Lending Act to evaluate the ability of the consumer to make the required payments under the terms of the account before opening a credit card account or increasing a credit limit on an existing account.

insurance, and that they are employed or have the resources to repay credit. Increasingly, alternative payment data are being compiled by credit bureaus and data warehouses. Companies have also developed new alternative credit scoring models that cover 60 to 90 percent of consumers with no or thin traditional credit.[11]

Regulatory and Supervisory Framework for Consumer Credit Products

Consumer credit products are subject to a variety of laws and regulations that are designed to ensure that consumers receive fair, unbiased treatment, and receive appropriate disclosures regarding the terms and conditions governing credit-related products. These include the various provisions of the Truth in Lending Act, the Fair Housing Act, and the Equal Credit Opportunity Act. Historically, rulemaking authority for consumer-credit related products has resided with the Board of Governors of the Federal Reserve System.

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Consumer Financial Protection Bureau (CFPB) is given rulemaking authority over certain federal consumer financial laws and is given jurisdiction for the supervision and enforcement of those laws for depository institutions with total assets of $10 billion or more. The OCC continues to be responsible for monitoring compliance with these laws by banks and thrifts with assets under $10 billion, and will also continue to examine and assess the risks these products may present to overall safety and soundness of banks and thrifts of any size.

The OCC's core mission is to assure the safety and soundness of the institutions subject to our jurisdiction and to ensure that those institutions support fair access to financial services and fair treatment of their customers. We carry out this mission through our on-going supervisory activities. Through these activities we evaluate banks' and thrifts' compliance with applicable laws, regulations, and supervisory requirements, and we assess whether they have adequate risk management systems, controls, and capital to support the size, scope, and complexity of their activities. Where we find weaknesses or violations, we direct management to take appropriate and timely corrective

[11] "Credit Scoring in Volatile Times," Vantage Score, June 29, 2009, http://www.vantagescore.com/docs/American_Banker_Insert_9-28-09.pdf.

action. Examiners do not tell bankers which loans to make or deny. However, they will assess whether such loans have been prudently underwritten and, with respect to consumer credit products, comply with all applicable consumer protection laws and regulations.

To provide consistency and continuity in our supervision, we organize our supervision programs around a common framework and national perspective that is then supplemented by the hands-on knowledge of our examiners. Our supervision by risk framework establishes a common examination philosophy and structure that is used at all national banks. This structure includes a common risk assessment system (RAS) that evaluates each bank's risk profile across eight risk areas – compliance, credit, interest rate, liquidity, operational, price, reputation, and strategic – and assigns each bank an overall composite safety and soundness rating and individual component ratings on the bank's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risks using the interagency Uniform Financial Ratings System (informally known as CAMELS) and an overall compliance rating using the interagency Uniform Interagency Consumer Compliance Rating System. We also have examination handbooks with examination procedures tailored to specific products and activities, including Retail Lending, Credit Card Lending, and interagency examination procedures for Fair Lending, Truth in Lending, and other consumer-related compliance laws. Specific examination activities and supervisory strategies are tailored to each bank's risk profile. These strategies are updated and approved annually. While tailored to each individual bank's risk profile, they also incorporate key agency supervisory priorities for the coming year. Given the volume and complexity of the literally hundreds of thousands of transactions that flow through the banking system, it is not feasible to review every transaction in each bank, or for that matter, every single product line or bank activity in each supervisory cycle. As a result, specific examination activities and supervisory strategies are tailored to each bank's risk profile. These strategies are updated and approved annually. While tailored to each individual bank's risk profile, they also incorporate key agency supervisory priorities for the coming year.

To reflect the different expectations for controls and risk management between large and small banks, our bank supervision programs and core examination procedures to determine a bank's RAS and CAMELS ratings are aligned across two primary lines of business: Midsize and Community Bank Supervision, and Large Bank Supervision.

Our community bank supervision program is built around our local field offices located in over 60 cities throughout the U.S. Every community bank is assigned to an examiner who monitors the bank's condition on an on-going basis and who serves as the focal point for communications with the bank. The frequency of our on-site examinations for community banks follows the statutory provisions set forth in 12 USC 1820(d), with on-site exams occurring every 12 to 18 months. The scope of these examinations is set forth in the OCC's Community Bank Supervision handbook and requires sufficient examination work and transaction testing to complete the core assessment activities in that handbook, and to determine the bank's RAS, CAMELS, and compliance ratings. On-site activities are supplemented by off-site monitoring and quarterly analyses to determine if significant changes have occurred in the bank's condition or activities. Each of our districts that oversee our community and mid-size bank programs has one or more lead examiners with specialized expertise in retail credit and consumer compliance issues. These examiners, along with our Washington, D.C. policy and legal staffs, serve as resources for our examination staff on complex issues that may arise in evaluating consumer credit products.

Our large bank program is organized with a national perspective. It is centralized and headquartered in Washington, D.C., and structured to promote consistent uniform coordination across institutions. As part of our large bank supervision program, we maintain on-site resident examination staff that conduct on-going supervisory activities and targeted examinations of specific areas of focus. This process allows the OCC to maintain an on-going program of risk assessment, monitoring, and communication with bank management and directors. Our resident large bank staff includes specialists and lead experts in retail credit and consumer compliance issues.

Community Reinvestment Act (CRA)

The CRA encourages banks and thrifts to offer needed credit products to low- and moderate-income individuals. The bank regulatory agencies' CRA guidance explicitly acknowledges the importance of small dollar loans as a means of serving the credit needs of the community. Programs that provide small, unsecured consumer loans in a safe and sound manner (i.e., based on the borrower's ability to repay) and with reasonable terms are one example specifically cited as a lending activity that is likely to be responsive in helping to meet the credit needs of many communities.[12]

Favorable CRA consideration may be given to loan programs that include a financial education component for consumers to help them avoid unfair or otherwise unsuitable products, as well as lending programs that feature reporting to consumer reporting agencies or that transition low- and moderate-income borrowers from loans with higher interest rates and fees to lower-cost loans. Reporting to consumer reporting agencies gives borrowers the opportunity to improve their credit histories and thereby improve their access to more competitive credit products.

Banks and thrifts may also receive positive CRA consideration for qualified investments in financial intermediaries, such as Community Development Financial Institutions, community loan funds, low-income credit unions and others, allowing these partners to offer credit to low- and moderate-income individuals.[13]

Banks and thrifts may also receive positive CRA consideration for providing credit counseling to low- or moderate income individuals—either directly or though affiliates or third parties if the services will help the institution meet the credit needs in its community.[14] For example, an institution that contracts with a community organization to provide counseling and help low- or moderate-income customers build a good credit profile or repair their credit as part of the institution's small dollar loan program may receive consideration for that indirect activity under the CRA service test.

[12] See §II.22(a)—1 of the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, pages 11654-11655.

[13] See §II.12(t)—4 of the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, page 11652. Qualified investments include, but are not limited to, investments, grants, deposits, or shares in or to financial intermediaries (including Community Development Financial Institutions (CDFIs), Community Development Corporations (CDCs), minority- and women-owned banks and thrifts, community loan funds, and low-income or community development credit unions) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development..."

[14] See §II.12(i)—3 and §II.24(e)—1 in the 2010 Interagency Questions and Answers Regarding Community Reinvestment, Federal Register, Vol. 75, No. 47, pages 11650 and 11661.

Engagement by OCC Community Affairs

OCC's Community Affairs staff engage in a variety of activities to encourage banks and thrifts to address the financial services needs of unbanked and underbanked consumers. We maintain on-line resources and develop publications for bankers, industry associations, and community groups highlighting "best practices" in providing mainstream banking products and services to address the needs of consumers utilizing check cashers, payday lenders, and other alternative financial services providers. These publications and resources include:

- Transaction Accounts Products Targeting the Unbanked Web-Resource[15]
- Financial Literacy Web Resource Directory[16]
- Financial Literacy Update Electronic Newsletter[17]
- Bank Savings Incentive Programs Fact Sheet[18]
- Individual Development Accounts *Insights* Report[19]

Community Affairs staff work with the other bank regulatory agencies to conduct dozens of conferences and seminars around the country each year to highlight these "best practices" and for bankers to hear first hand from practitioners on how best to implement programs, such as small dollar loan initiatives. The OCC's District Community Affairs Officers also are involved in bringing bankers together with local governmental agencies who are spearheading Bank On Cities initiatives around the country. As previously noted, these Bank On Cities initiatives, which are active in approximately 100 cities, seek

[15] http://www.occ.gov/topics/community-affairs/publications/article-archives/archive-transaction-account-products.html

[16] http://www.occ.gov/finlit

[17] http://www.occ.gov/topics/community-affairs/publications/index-ca-publications.html#flu

[18] http://www.occ.gov/static/community-affairs/fact-sheets/bank-savings-incentive-programs-fs.pdf

[19] http://www.occ.gov/static/community-affairs/insights/2005-25a.pdf

to help unbanked consumers utilize the services of banks offering a range products that address the specific banking needs of this clientele.

Conclusion

Access to credit plays a vital role in our communities. The OCC supports efforts by national banks and federal savings associations to be leaders in their communities by offering products and programs that meet a spectrum of credit needs in a safe, sound, and sustainable manner.

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