Testimony of Michael Flores
House Financial Institutions and Consumer Credit Subcommittee
April 2, 2009

Thank you, Mr. Chairman, members of the Committee. I'm Michael Flores, CEO of Bretton Woods, Inc. a management consulting firm. My clients include commercial banks, thrifts, credit unions and the payday lending industry. I have more than 30 years experience and have taught at the Graduate School of Banking in Madison, Wisconsin and the Pacific Coast Banking School in Seattle, Washington and have published several articles and studies on the financial services industry. My expertise is on how financial institutions make money.

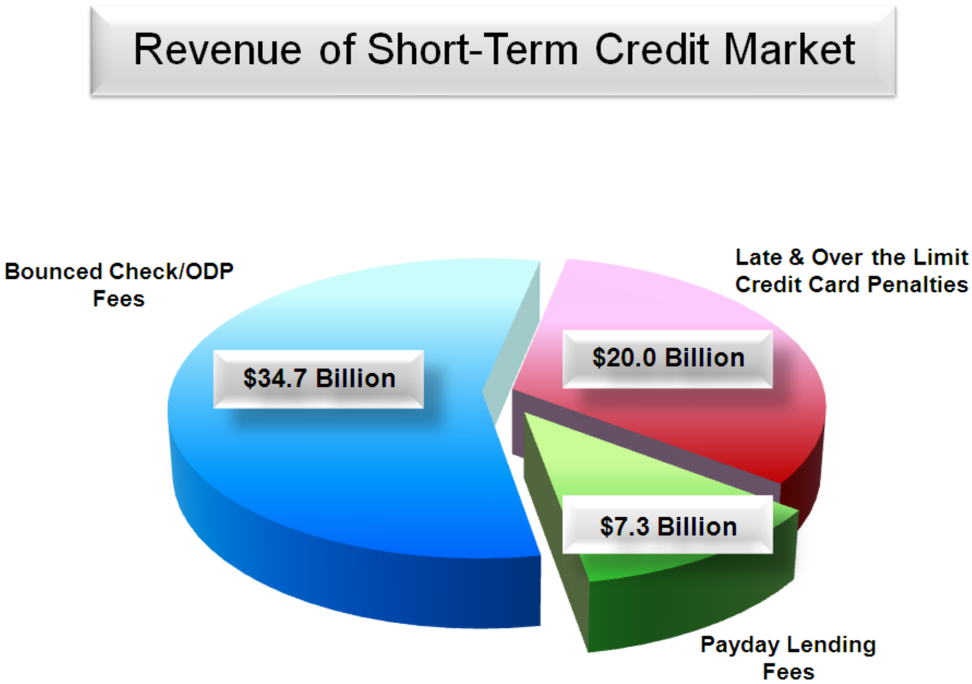
Because this hearing is about payday lending legislation, I am here today to put payday lending in the context of the bigger picture: the short-term, unsecured credit market.

The short-term credit market is made up of products and services for people who need a small amount of cash for a short period of time. It is a more than $70 billion dollar market that includes credit card over-the-limit fees, bounced-check/non-sufficient funds fees, overdraft protection and payday loans. Additionally, the market includes tens of billions of immeasurable dollars in late fees paid annually by consumers. All of these credit products are short-term, all unsecured.

Currently, banks and credit unions control the largest share of this market. That may surprise some people because very few banks offer the unsecured, short-term, small-dollar products that you would typically consider to be a loan. As the Committee may know, only 30 banks have signed up for the FDIC's small loan pilot program which was designed to see if alternatives to payday lending could be offered profitably. The results, to date, are not promising. The legacy cost structures of banks inhibit their ability to offer short term, low dollar credits in a profitable manner.

So what role do banks play in the short-term credit market? Primarily through non-sufficient funds fees (NSF) more commonly known as "bounced check fees," and overdraft protection, which the FDIC itself recently categorized as a short-term credit product. These products are all part of a competitive marketplace and are all considered alternatives to payday loans.

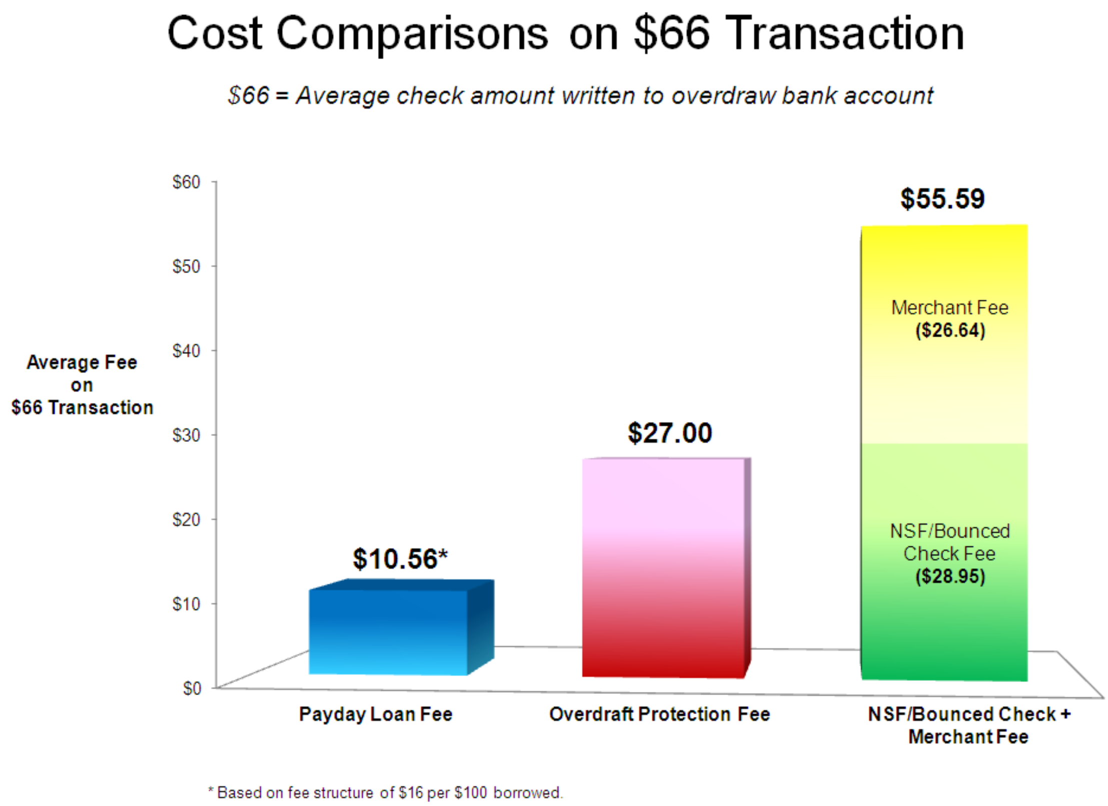
The banks are in this marketplace in a huge way. I published research I conducted in November and December of 2008 and updated in early March this year finding that bounced-check and overdraft protection fees accounted for $34.7 billion in revenue for banks and credit unions in 2008. By comparison, late and over-the-limit penalties on credit cards account for $20 billion in revenues, and payday lenders generated $7.3 billion in revenues.



Revenue from bounced check and overdraft protection fees has become so significant to banks that they implement strategies to maximize income on these fees. For example, it is common practice for a check that has already bounced to be re-deposited. Banks also process larger denomination checks first before lower dollar items. In fact, the FDIC found that 53.7 percent of large banks batched processed overdraft transactions by size, from largest to smallest.

But let's look at this from the consumers' perspective. When a consumer does not have enough money in his or her checking account to pay a bill, they have the option of bouncing a check, using overdraft protection, getting a payday loan, paying the bill late or borrowing from another institution, primarily credit card advances, all of which come at a price.

The FDIC reports that the average amount of a check written to overdraw a bank account is $66. For that $66 check transaction, a customer would pay an average fee of $27 in overdraft protection fees. Customers without overdraft protection would pay a non-sufficient funds/bounced check fee averaging $28.95, plus a merchant fee averaging $26.64, to whom they wrote the bad check. In comparison, a customer who took out a $66 payday advance to cover the cost of the check would pay a fee of $10.56, based on a fee structure of $16 per $100 borrowed.

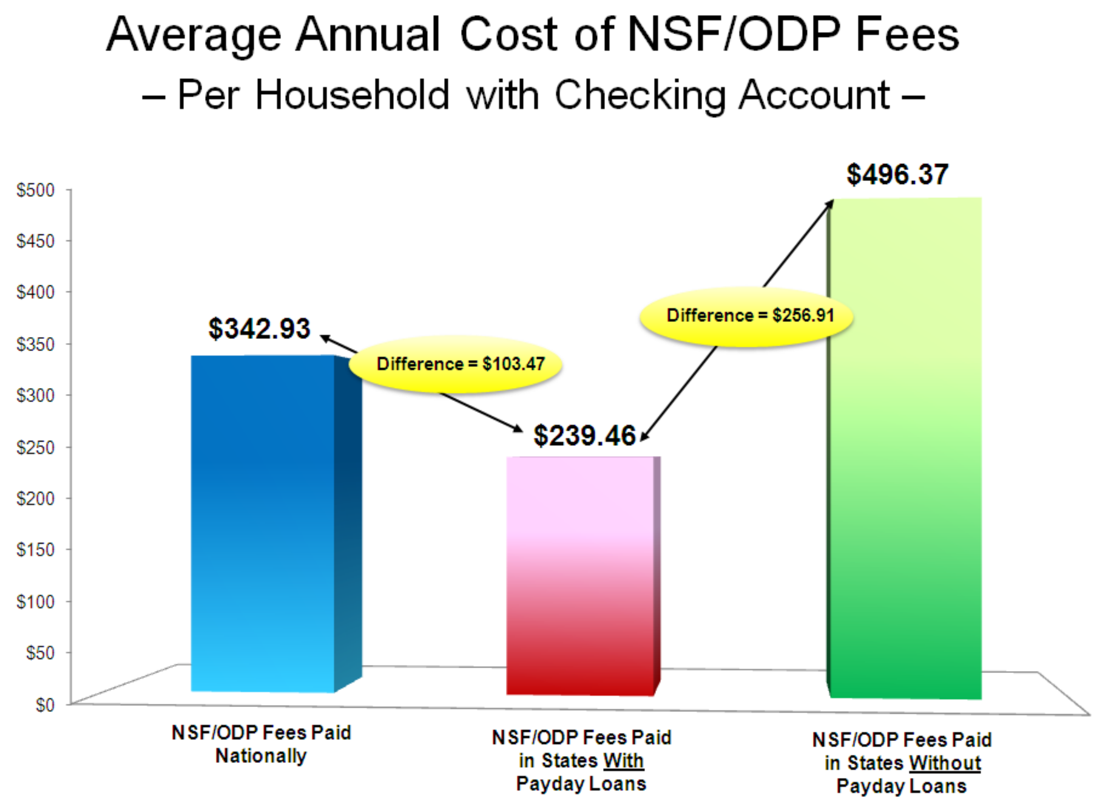


Just by looking at the household data you can get a sense of which option is used the most. And this is the major point that I want to make today.

The national average household with a checking account paid approximately $342.93 in fees in 2008. The active households with bank or credit union accounts (20.2 million households) each paid $1,374 in annual NSF/ODP fees.

In states where payday loans are available, the average consumer pays $239.46 per year in ODP and NSF fees--$103.47 less than the national average. On the other hand, in states where payday loans have been eliminated, checking account holders pay, on average, $496.37 each year—that's $256.91 more than their counterparts who live in states with payday loans.

Comparative Data- ***2008 Average NSF/ODP per Banked Household***



I do not represent that these statistics definitively prove that payday loan availability reduces NSF/OD fees; I do maintain this it is a significant indicator and that an extensive and robust analysis should be conducted to determine any correlation between availability of payday loans to NSF/OD fees.

That said, the benefit to consumers of competition between banks and payday lenders for the short-term credit market is dramatic and indisputable. I am not here today to tell the Committee that one product is better than the other, as that depends on the personal financial situation of the individual.

It is my opinion, that bank services such as overdraft protection provide a useful service for customers. And that they are a direct competitor of payday loans. Like payday loans, they should not be used as a recurring method of obtaining credit, as they are intended for short-term use.

Likewise, I believe that there is a significant market for payday loans and that, if the industry is appropriately regulated by state and federal laws, like the one we are discussing today, then these loans responsibly meet the short-term, low dollar credit needs of many consumers. And among overdraft protection, payday loans and other short-term credit options, consumers will be in a position to choose the best lending option for them.

To sum up, I believe there is a need for all options to be made available in a regulated environment in order to satisfy the short-term credit market, a multi-billion, important market. I hope this Committee will find a legislative balance that increases, not diminishes competition in this market.