Oral Statement of
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on
Payday Loans: Short-Term Solution or Long-Term Problem
Special Committee on Aging
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Chairman Nelson, Ranking Member Collins, and members of the Committee, thank you for inviting the Federal Deposit Insurance Corporation to participate in today's hearing. I am pleased to have the opportunity to share our recently proposed guidance on deposit advance products, as well as to discuss some of the FDIC's research and experiences related to small dollar credit needs and older Americans.

This is a timely topic. Recent FDIC survey results showed that in the previous 12 months, almost 6 percent of households obtained credit from an alternative financial services provider, such as a payday lender or a pawn shop.[1] For households headed by someone 65 or older, the proportion was nearly 2 percent, and for households headed by a person between 55 and 64, the proportion was nearly 4 percent. When narrowing the data to households that are unbanked, the numbers rose to close to 17 percent for all households, 6 percent for households headed by someone 65 or older, and nearly 10 percent for households headed by someone between 55 and 64. These figures would appear to indicate that consumers have small dollar

[1] *See* 2011 FDIC National Survey of Unbanked and Underbanked Households (*available at* http://www.economicinclusion.gov)

credit needs, and that these needs become more pressing for those who do not have a bank account.

As you know, the FDIC is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System, which means the banks we supervise are generally the smaller community banks. The FDIC examines these banks for operational safety and soundness, and for compliance with consumer protection laws. Larger banks and bank holding companies are generally supervised for safety and soundness by the Office of the Comptroller of the Currency and the Federal Reserve, and for consumer protection compliance by the Consumer Financial Protection Bureau (CFPB).

The FDIC has recognized the need for responsible small-dollar loan products for a number of years and issued guidance in 2007 to encourage insured institutions to offer such products to consumers to meet this need.[2] The guidance specifies that these products should be affordable, have reasonable interest rates with no or low fees, and be structured with payments that reduce the principal balance. That same year, we initiated a pilot program which demonstrated that affordable small dollar loans can be done safely and are feasible for banks.

At the same time, in its role as supervisor, the FDIC has provided guidance to delineate risks and troublesome practices that may be associated with other kinds of small dollar credit

[2] *See* Affordable Small-Dollar Loan Guidelines (June 19, 2007), *available at* http://www.fdic.gov/news/news/financial/2007/fil07050a.html.

offerings, such as payday loans. In 2003 and 2005, the FDIC provided guidance to banks that offered or were considering offering payday loans (either directly or through partnerships with third parties), stating our supervisory expectations that institutions should monitor customers' use of payday loans, prevent customers from relying excessively on the product, and take other steps to appropriately manage risks.[3]

While the FDIC continues to encourage banks to respond to the small dollar credit needs of its customers, we have observed that some of the products and practices that were beginning to appear in some segments of the industry closely resembled ones that had previously caused concern. Although the products and practices appeared to be concentrated in a limited number of institutions, we felt it was important to provide guidance to ensure that FDIC-supervised banks considering offering these products are aware of the potential of harm to consumers, as well as the potential for safety and soundness concerns.

As a result, earlier this year, the FDIC proposed guidance on deposit advance products, a credit instrument that can be quite similar to payday loans as evidenced by high fees, very short lump-sum repayment terms, and inadequate attention to a consumer's ability to repay the loan. A copy of the proposed guidance is attached to my testimony.[4] The OCC issued nearly identical guidance at the same time. The proposed guidance outlines supervisory expectations, including

[3] *See* Press Release, FDIC Issues Examination Guidance for Payday Lending (July 2, 2003), *available at* http://www.fdic.gov/news/news/press/2003/pr7003.html ; Guidelines for Payday Lending (March 1, 2005), *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[4] *See* Press Release**,** FDIC Issues Proposed Guidance on Deposit Advance Products (April 25, 2013), *available at* http://www.fdic.gov/news/news/press/2013/pr13031.html.

detailed underwriting expectations, to make banks aware of what examiners would assess in conducting a review. Before issuing the guidance in final form, we wanted to solicit public comments, and we received over 100, including from members of this Committee. We currently are carefully reviewing the comments as we work to finalize the guidance.

As I mentioned earlier, it is possible for banks to make affordable small dollar loans that do not include the features that pose unnecessary risks for banks and their customers. From 2007 to 2009, the FDIC conducted a pilot project with 28 financial institutions with assets ranging from $28 million to nearly $10 billion to demonstrate the feasibility of small dollar lending for banks. The loans made as part of this pilot program were for $2,500 or less and met certain core standards. For example, the loan terms had to be 90-days or longer, and prudent, streamlined underwriting was required to establish that consumers could reasonably be expected make their loan payments and have sufficient funds remaining to meet basic living expenses and other obligations. Annual percentage rates on these loans were 36 percent or less, with low or no fees, and a loan decision was typically provided within 24 hours.

Ultimately, as a result of the pilot, these banks made 34,400 small dollar loans for a total of approximately $40 million. The performance of the loans was shown to be in line with the performance of other unsecured consumer credit products and the pilot concluded that it was feasible for banks to offer such loans in a safe and sound manner. I have included a copy of a report on the pilot with my testimony.[5]

Lastly, I thought this Committee would be particularly interested to learn about an effort the FDIC is undertaking with the CFPB to provide older adults with resources to help them make better financial decisions. Our two agencies recently released a new financial resource tool targeted to older adults.[6] This financial literacy tool --"Money Smart for Older Adults" -- aims to help older individuals and their caregivers prevent elder financial exploitation through increased awareness and understanding of possible pitfalls and of prudent money practices. The module is part of a larger FDIC Money Smart program that serves as a comprehensive financial education resource designed to help low- and moderate-income consumers enhance their financial skills and create positive banking relationships.

Again, thank you for the opportunity to testify today. I would be happy to address any questions you might have.

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[5] *See* "A Template For Success: The FDIC's Small-Dollar Loan Pilot Program" (FDIC Quarterly, 2010, Volume 4, No. 2), *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf.

[6] *See* Money Smart for Older Adults Training Module, *available at* http://www.fdic.gov/consumers/consumer/moneysmart/olderadult.html.