January 21, 2019

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Request for Information on Small-Dollar Lending
RIN 3064-ZA04

Dear Mr. Feldman:

The importance of small-dollar credit to working Americans cannot be overstated. As the Federal Reserve found, four in ten adults could not cover an unexpected expense of $400 without borrowing money or selling something.[1] The American Financial Services Association's (AFSA)[2] members help consumers meet these unexpected expenses by offering traditional installment loans. Instead of encouraging banks to offer small-dollar credit products, AFSA suggests that the Federal Deposit Insurance Corporation (FDIC) ensure that the banks it supervises support the financial institutions, especially traditional installment lenders, that are already meeting consumers' small-dollar credit needs.

AFSA appreciates the FDIC's recognition of the important role that small-dollar credit products play in the American economy. We welcome the opportunity to provide comments in response to the FDIC's request for information on small-dollar lending (RFI). Our comments focus on three areas: (1) the reality that traditional installment lenders are already meeting the demand for small-dollar credit products, (2) the cost associated with small-dollar lending, and (3) the need small-dollar lenders have for support from their banking partners. We expand on each of these points below.

I. Traditional installment lenders serve a vast array of American consumers.

AFSA members provide traditional installment loans to individuals and families across the United States. They lend $50 billion annually to first responders, teachers, lawyers, small-business owners, farmers, childcare providers, and others. In fact, they lend to Americans of almost all professions and socioeconomic classes. The only states in which AFSA members do not operate are ones in which state laws more or less prohibit them from doing so.

Sometimes, these consumers are "unbanked" or "under-banked." They may be "credit invisible" or have credit histories containing insufficient or stale information. Theses consumers often have impaired credit histories, so

[1] Board of Governors of the Federal Reserve System. *Report on the Economic Well-Being of U.S. Households in 2017.* May 2018. Available at: https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf. pp. 21 – 23.

[2] Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

they may not be served by banks or credit unions. Some of them have prime credit scores and regular banking relationships.

Consumers may use traditional installment loans because they like the product and the personal touch of the branch-based nature of finance companies. Or they may use traditional installment loans because they have very little or no savings. Or they simply need quick access to smaller amounts of credit.

Many consumers use traditional installment loans as a thoughtful process to manage their finances. These consumers may use traditional installment loans like other Americans use home equity lines of credit or credit cards. After some consumers struggled to get out of credit card debt, they may simply prefer the more structured nature of traditional installment loans. Regardless, they still have a common need for small-dollar credit. And, because many traditional installment lenders report to one or more of the credit reporting agencies, consumers can use traditional installment lenders as a way to build or repair their credit.

As recognized by so many and for so long, installment lending has proven to be the most affordable and responsible form of consumer credit for working Americans.

Though it varies by lender, the average loan is for $1,500, the average monthly payment is $120, and the average term is 15 months. Because traditional installment lenders engage in underwriting, traditional installment loans are designed to be affordable and to allow borrowers to budget their finances. Traditional installment lenders underwrite loans based on consumers' credit reports and other factors. At the time of origination, each and every loan is made with the highest confidence and expectation that it will be paid back in full and on time.

These factors are crucial because: (1) the lender has to borrow funds in order to lend money a consumer; (2) the loan is not and never has been subsidized, and therefore not a burden on taxpayers;[3] and (3) in order to remain in business and continue lending, the lender must make a profit. It is also important to note that if a consumer is not satisfied, she will go elsewhere. Reputation is important in small communities. Traditional installment lenders have a strong desire to treat consumers fairly because of their involvement in the community. Moreover, they want repeat business and they want satisfied customers to recommend their services through word-of-mouth.

According to the Center for Financial Services Innovation (CFSI), an affordable, small-dollar loan is one for which the loan amount, repayment period, interest rate, and fees are such that the borrower can successfully repay the loan without re-borrowing,[4] while still meeting basic needs and other financial obligations. In other words, whether a loan is affordable or not depends on underwriting, structure and pricing—not on price alone. This is because "[S]tructure is just as important as price in determining whether a small-dollar loan is affordable. For example, for borrowers who struggle financially, a two-week loan with a balloon payment structure is often very difficult to repay, even at very low prices. In most cases, loans should be structured in fully-amortizing installment payments; the amount of the loan and the repayment period are variables that should be adjusted to ensure that

[3] During the previous recession, when some banks were being subsidized and failing, no traditional installment lender sought or obtained any governmental assistance.

[4] CFSI specifies that by "without re-borrowing," they are "making a distinction between borrowing again at some future date because a new credit need arises (which does not necessarily indicate that the original loan was unaffordable) and re-borrowing immediately or shortly after repaying the original loan (which strongly suggests the borrower could not afford to pay back the loan while still meeting basic needs and other financial obligations in the next period)." The point is valid, though we would use the term "refinanced" rather than "re-borrowing" (which may be a good thing), because "re-borrowing" can be confused with "repeat re-borrowing." Repeat re-borrowing is generally considered to be a bad practice associated with payday and title lending. (CFSI, *The Compass Guide to Small-Dollar Credit.* 2014. p. 7. Available at http://www.cfsinnovation.com/Document-Library/The-Compass-Guide-to-Small-Dollar-Credit.

the borrower can afford to make the regular payments while still having enough left over to meet basic needs and other financial obligations."[5]

II. Lenders cannot make small-dollar loans *at a profit* under a 36% annual percentage rate (APR).

As you know, in 2007 the FDIC implemented two-year Small-Dollar Loan Pilot Program designed to illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products such as payday loans and fee-based overdraft programs. In its 2010 report on the program, the FDIC stated, "A key lesson learned was that most pilot bankers use small-dollar loan products as a cornerstone for building or retaining long-term banking relationships."[6]

Put another way, the FDIC's small-dollar loan pilot program demonstrated that banks cannot offer small-dollar loans profitably—even though they borrow money to lend at rates dramatically lower than traditional installment lenders do.

Banks are unable to make small-dollar loans profitably at a 36 percent APR cap because of: (1) the limited amount of interest earned due to the declining principal balance from amortization; and (2) the fixed operational costs of underwriting, collecting, and managing an amortizing small-dollar loan.

Despite the positive headline of the FDIC's report on the pilot, *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program,* the FDIC concluded, "However, given the small size of SDLs [small-dollar loans] and to a lesser extent NSDLs [nearly small-dollar loans], the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products."[7]

According to a study done by three academics using industry data, in order to make a break-even loan at 36 percent APR, the loan would have to be made for at least $2,600.[8] Larger loans can be profitable because a lender gets a larger dollar return on a larger loan, even though the proportional return is the same. Many lenders' costs to originate and service loans are fixed, so lenders need to make a certain amount on each loan.

Below is a chart prepared by Dr. Thomas W. Miller, Jr.[9] that shows the costs associated with eight hundred $1,000 loans.[10] The chart demonstrates why a lender cannot make a profitable $1,000 loan below a 99 percent APR.

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[5] *Ibid, p. 7*.
[6] Miller, Rae-Ann, Susan Burhouse, Luke Reynolds, and Aileen G. Sampson. *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program.* FDIC Quarterly 2010, Volume 4, No. 2. p. 1.
[7] *Id.* p. 32.
[8] Durkin, Thomas A., Gregory Elliehausen, and Min Hwang. *Rate Ceilings and the Distribution of Small Dollar Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders*. 2016. Working Paper.
[9] Dr. Thomas W. Miller, Jr., Ph.D. is a Professor of Finance and the inaugural holder of the Jack R. Lee Chair in Financial Institutions and Consumer Finance at Mississippi State University. He has held positions at Saint Louis University, Washington University in St. Louis, and at the University of Missouri.
[10] In constructing the chart, Dr. Miller spoke with several different lenders to obtain information about costs.

Each 12-Month Loan Size		$ 1,000	$ 1,000	$ 1,000
Number of Loans Outstanding		800	800	800
Customer Monthly Payment (12-Month Loan)	12	($100.46)	($119.29)	($134.42)
Interest Rate on Loan		36%	72%	99%
Revenue from Loan (Interest Collected)		$205.55	$431.49	$613.03
Revenue from all Loans		$ 164,436	$ 345,191	$ 490,421
Bad Debts (at Bad Debt Rate of 9%)	9.00%	$ (39,184)	$ (42,232)	$ (44,404)
Salaries		$ (140,000)	$(140,000)	$ (140,000)
Rent/Other Operating Expenses		$ (25,000)	$ (25,000)	$ (25,000)
Cost of Borrowing Money to Lend (at 6%)	6.00%	$ (18,215)	$ (19,570)	$ (20,535)
Overhead Paid to Home Office		$ (120,000)	$(120,000)	$ (120,000)
Branch Net Income		$ (177,963)	$ (1,611)	$ 140,483
Receivables:		$ 435,378	$ 469,242	$ 493,374
Furniture/Equip:		$ 20,000	$ 20,000	$ 20,000
Total Assets:		$ 455,378	$ 489,242	$ 513,374
Bank Debt:		$ 303,585	$ 326,161	$ 342,249
Equity:		151,793	163,081	171,125
Total D + E:		$ 455,378	$ 489,242	$ 513,374
Debt/Equity Ratio:		2	2	2
Target ROE:	15.00%	$ 22,769	$ 24,462	$ 25,669
Assets/Equity:		3	3	3

Two notes: First, please note that this chart assumes a cost of money to the lender of six percent. In the not-too-distant past, traditional installment lenders paid over 18 percent for the money they subsequently lent to small-loan consumers. And rates will eventually increase.

Another helpful table, also prepared by Dr. Miller, shows the amortization of a $1,000 twelve-month loan at 36 percent interest (not APR).

Month	Beginning Principal Balance	Equal Monthly Payment	Interest Payment	Principal Payment	Ending Principal Balance
1	$1,000.00	$100.46	$30.00	$70.46	$929.54
2	$929.54	$100.46	$27.89	$72.58	$856.96
3	$856.96	$100.46	$25.71	$74.75	$782.21
4	$782.21	$100.46	$23.47	$77.00	$705.21
5	$705.21	$100.46	$21.16	$79.31	$625.91
6	$625.91	$100.46	$18.78	$81.68	$544.22
7	$544.22	$100.46	$16.33	$84.14	$460.09
8	$460.09	$100.46	$13.80	$86.66	$373.43
9	$373.43	$100.46	$11.20	$89.26	$284.17
10	$284.17	$100.46	$8.53	$91.94	$192.23
11	$192.23	$100.46	$5.77	$94.70	$97.54
12	$97.54	$100.46	$2.93	$97.54	$0.00
	Sum:	**$1,205.55**	**$205.55**	**20.55%**	

As you can see from the table, it takes ten payments to "pay back" $1,000—the principal. Any lender profit comes from the last two payments, nearly a year later. The amount of interest collected is $205.55 or 20.55 percent of $1,000.

III. Traditional installment lenders need strong relationships with their banking partners to serve their customers.

As you know, in 2013 the Department of Justice and other federal banking agencies, including the FDIC, began a program known colloquially as "Operation Choke Point." Although Operation Choke Point began as an effort to combat entities that commit mail or wire fraud affecting a federally insured financial institution, enforcement was expanded to include payday lending and payment processing. In parallel, federal banking agencies deemed a number of businesses to present an elevated risk to federally-insured financial institutions. Although traditional installment lenders have not been deemed to be high-risk, a number of AFSA members had long-standing bank lines and transactional relationships terminated by banks while the program was running.

While this policy was officially ended in 2017, its effects remain today. Ending Operation Choke Point did not automatically reestablish banking relationships. Some traditional installment lenders were unfairly targeted by Operation Choke Point and successful banking relationships that had been going on for decades were terminated. AFSA believes that it would be beneficial for the FDIC to ensure that lawful businesses, such as installment lenders, are able to continue to operate without fear of significant financial consequences.

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AFSA appreciates the FDIC's recognition of the importance of small-dollar lending to the millions of Americans living paycheck to paycheck. We strongly believe that traditional installment loans are a responsible and beneficial form of credit that help consumers make ends meet. We ask that the FDIC acknowledge the benefits these loans provide and work with banks to support the lenders that make them.

If you have any questions, please do not hesitate to contact me by phone at 202-466-8616 or e-mail at bhimpler@afsamail.org.

Sincerely,

[redacted]

Bill Himpler
President-elect
American Financial Services Association