

**Remarks  
By  
Donna Tanoue  
Chairman  
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Before  
The  
Seventh Annual Greenlining Economic Development Summit  
Sacramento, California  
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Thank you.

It is late, so I will be brief.

This conference is about building communities. It is about creating opportunity. About expanding prosperity. And about sustaining the development of our greatest economic resource: Our people. All our people.

Banks are chartered to be engines of economic growth.

To provide the financial power that builds communities, creates opportunity, expands prosperity, and sustains development.

But I am here tonight to discuss how some banks may be engaging in an unbecoming practice -- the practice of "renting out their charters," so to speak, to nonbank payday lenders. For the moment, the number of banks renting out their charters is small -- but that could change -- and that possibility triggers public policy concerns.

As many of you know, this organization -- through Bob Gnaizda's forceful and eloquent words -- has criticized certain forms of payday lending for undercutting the efforts of people to get ahead and for undermining communities by draining financial resources from low- and moderate-income neighborhoods . . .

The very opposite of the economic development this summit seeks to encourage.

However, if a banker enters the payday market with appropriate controls to ensure safe and sound operations, short-term small denomination consumer lending may help to expand access to banking services and may help build long-term customer relationships.

Payday loans are intended to be short-term small-dollar payments to be paid off on the borrower's next payday.

A few banks make payday loans, and a few others provide liquidity funding to nonbank payday lenders.

Within this second group, we are concerned about so-called "charter renting" -- that is to say, allowing a lender in another state to use the bank's authority to circumvent state caps on interest rates in exchange for a fee. This is not what this "authority" was intended to do. Without proper due diligence and involvement of the bank in the loan, this is not banking.

Let's step back a moment and look at what's happening in this market.

Payday lending is a growing business. Nationally, according to a recent investment advisory report, the payday loan industry has grown from a few hundred outlets in the mid-1990s to approximately 10,000 nationwide. Another investment banking firm forecasts a potential mature market by 2002 for 25,000 stores, producing 180 million transactions and \$45 billion in loan volume, that will generate \$6.75 billion in fees annually. At least three different publicly traded companies engaged in the payday lending or cash advance business – and, at present, they appear to have strong prospects.

Prospects appear positive for payday lenders right here in the state of California. My fellow speaker tonight, State Treasurer Philip Angelides, recently noted that California has the greatest gap between rich and poor of all but four states in the country. Californians below the poverty line grew by 28 percent between 1989 and 1996, increasing the number of potential payday borrowers. Since 1997, when legislation favorable to the industry was passed in the state, more than 3,500 payday lending outlets have opened – accounting for as much as one-third of all payday lending outlets in the country as a whole. More are likely. Clearly the industry has tapped into a real need for short-term, small dollar denomination credit.

In my remarks tonight, I will explore the basis for the explosive growth in payday lending; the characteristics of the payday lending business; the issues that this growth raises for me as a bank supervisor; and the steps we plan to take to address those issues.

According to the United States Census Bureau, there are more than 100 million households in the United States. Of those, approximately 30 percent earn between \$25,000 and \$50,000 per year. One or two persons in most of those households have steady jobs, banking accounts, and pay their rent, utilities, and other bills regularly and on time. Many of those households, however, have difficulty meeting all of their financial obligations all of the time. According to data from investment research analysts and a leading financial publication, for example, 31 percent of consumers with incomes below \$45,000 per year and even 22 percent of individuals earning between \$45,000 and \$65,000 per year have difficulty managing personal finances. This is a sizeable market

– and the payday lending industry has become a big business by serving the needs of these households.

As most of you know, payday loans are usually backed by post-dated personal checks or an authorization to make an electronic debit at a later date. The check or debit is held for the agreed upon period -- usually two weeks -- and then cashed in, or the customer returns with cash and reclaims the check or debit authorization. If the customer does not have the funds to repay the loan, the same process is followed to obtain an additional loan, rolling it over with additional fees that compound the debt.

Payday loans can provide a valuable service in emergencies -- helping people meet day-to-day credit needs. However, real distress is created when the small loan amount comes with high fees or interest and an invitation – or the necessity – to renew the loan, time and again, every few weeks, with an ever-increasing price tag – and with little or no payment to principal.

Ostensibly, payday loans are not designed to be rolled over from period to period. However, separate studies by the state departments of financial institutions in Illinois and Indiana reported that the typical payday customer in those states averaged over 10 loan extensions per year. As a short-term solution to temporary cash flow difficulties, payday loans may be less costly than, say, a bounced check or an overdraft fee imposed by a bank. However, the costs mount rapidly when the advances are rolled over from one pay period to the next. Payday lenders typically charge \$15 to \$20 for each \$100 advanced over a two-week period. Those fees represent an annual percentage rate (APR) of over 400 percent per year.

This type of lending is not new, nor is the controversy new. The Consumer Federation of America cites an example from a study conducted in 1939. In the 1939 study, one borrower, making \$35 a week, borrowed a total of \$83 from four different lenders because of family illness. To service the \$83 in loans, he paid those four lenders \$16 per month. At the end of the year, he had paid \$192 in interest, but still owed the \$83. Those lenders were not engaged in "banking" as we knew it then or we know it now.

For example, a financial institution here in California recently purchased a stake in a check cashing operation that also offers payday loans. It was widely announced that the operation would lower the initial rate of interest charged on these loans, limit rollovers, and cap interest on any rollover at a reasonable rate. A community group, moreover, received a 5 percent stake in the partnership in exchange for providing credit counseling, home buying assistance, and other services to customers.

Another bank in California makes small payday loans intended to provide occasional, emergency funding loans only for customers with regular deposits wired to their bank accounts. A customer can borrow up to half of the amount deposited, up to \$200. The bank charges only \$1 per \$20 borrowed – about a third of what traditional payday lenders charge.

The involvement of banks in these endeavors will increase competition, lower prices, and improve service. I urge financial institutions to compete in this market to provide appropriately underwritten and priced small loans to the large segment of the market that has fallen prey to the high rates and fees of many payday lenders.

However, a different form of bank involvement in payday lending may have a less beneficial effect -- when banks may be permitting other entities -- check cashing outlets, finance companies, even postal centers -- to use the bank's good name to make payday loans at interest rates above the levels those non-bank entities would be permitted to charge by their respective state laws.

Let me give you an example of how this relationship between a bank and its payday lender -- "charter renting" -- might go wrong.

The payday lender could circumvent state limits on certain interest rates by using an out-of-state bank to initially fund its loans, and then immediately buy back substantially all of the loan amounts right after funding.

Who is making the loan? The bank would assert that it is making the loan and, therefore, permitted to charge out-of-state customers the higher interest rate that is allowed in the bank's home state.

However, the check-cashing operation holds substantially all of the outstanding loan balance, services the loans, and collects the payment. Although the bank may have final credit approval, check cashing store personnel collect applicant information and disburse the funds.

And, while the bank has final credit approval authority, the check-casher collects all the application information, enters it into a computer-based underwriting program, and distribute the debit cards and pin numbers used to access the borrowed money. In some cases, bank personnel might not review the activities of the check-cashing operation at all.

The authority to export the allowable rates from the state in which a bank is chartered to other states where a bank does business is found in a 1978 Supreme Court decision as well as federal legislation permitting interstate branching. This authority enables banks to offer credit cards or mortgages nationwide, using a uniform interest rate structure. As a result, lenders have expanded the geographic breadth of their activity. Competition increased. New loan products and product features were developed.

Nonetheless, I do not believe the Congress contemplated that banks would be able to use this principle to take advantage of consumers.

The practice of renting a charter merely to collect a fee to allow a high-cost payday lender to circumvent state law is inappropriate.

It is legal – but I don't like it.

I urge lawmakers and bank trade associations to come up with an approach to this unbecoming practice that will work both for bankers and consumers.

And I also urge financial institutions to compete in this market to provide appropriate short-term loans for small amounts to consumers – and effectively shout out predatory lenders.

Thank you.

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