U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

March 18, 2003

The Honorable Donald E. Powell
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Powell:

We have reviewed with disappointment the Federal Deposit Insurance Corporation's Draft Guidelines for Payday Lending. We are encouraged that the FDIC has followed the lead of other financial regulatory agencies in warning insured nonmember banks of the substantial credit and reputation risks associated with conducting payday lending programs through third-party contractors. However, the guidelines do not go far enough and can be read as condoning third-party payday lending arrangements that are abusive of both consumers and other financial institutions.

As you are well aware, payday lending involves a number of inherently unsafe and unsound banking practices. Consumers are encouraged to solve their short-term credit needs with single-payment, short-term loans at annual interest rates averaging 470 percent. These loans are made without regard for the borrower's repayment ability, without conventional credit checks and without inquiring about debt obligations with other financial institutions. Even worse, these transactions require that consumers write checks on accounts that are known to have insufficient funds on deposit to cover them. This combination of check-holding, inadequate underwriting and high interest costs exposes many cash-strapped consumers to coercive collection tactics, and many others to unpayable perpetual debt.

Numerous states have enacted legislation to protect consumers from potentially abusive payday lending transactions. Twenty-nine states currently have payday lending statutes that permit payday lending with a variety of licensing and fee restrictions. Seventeen states retain older small loan laws and usury limits that essentially prohibit high-interest payday loans. Where payday lenders have been unable to change state laws to their liking, they have sought out partnerships with federally chartered banks to circumvent them. Using the interest rate exportation and preemption privileges of federal institutions, these "rent-a-charter" arrangements undermine traditional state authority to regulate small loans, expose consumers to abusive lending practices, and create a competitive disadvantage for other local lenders.

The Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) have both taken decisive action to place banks and thrift institutions on notice that loosely structured partnerships with check cashers, pawn shops and payday lenders that violate state laws are an unacceptable application of federal preemption authority. The OCC has cited serious safety and soundness risks in bringing enforcement actions against all four national banks involved in payday lending partnerships. The OTS effectively ended all indirect participation in payday lending by thrift institutions by downgrading one thrift's CRA rating and directing a second bank to terminate its payday lending operations.

These actions have left the FDIC as essentially the regulator of choice for payday lenders seeking rent-a-charter arrangements. We understand that at least seven state-chartered banks under the FDIC's supervision are currently involved in a variety of third-party arrangements with payday lenders. The draft guidelines, if implemented, will encourage additional arrangements by other FDIC-insured state banks. The guidelines offer little more than the FDIC's "expectations" for prudent risk-management practices in connection with payday lending programs. The few specific standards that are suggested to limit payday lending activities appear little different from the so-called "best practices" guidelines that the payday lending industry has been offering up for several years to thwart more effective regulation.

We find it very difficult to understand how the same practices identified by the OCC and OTS as presenting unacceptable safety and soundness risks in connection with national banks and thrift institutions can now be considered by the FDIC as appropriate and manageable for many smaller, state-regulated institutions. The difference in approach taken by the FDIC is a serious problem for two reasons. First of all, it will result in forum-shopping for the least stringent regulator, undercutting the efforts of the OCC and OTS. Secondly, we believe the position of the OCC and OTS far better reflects the safety and soundness risks presented by payday lenders attempting to circumvent state law.

Clearly, the draft guidelines must do more than outline minimum expectations for prudent risk-management practices. The FDIC's guidelines should establish specific standards that effectively prohibit FDIC-insured state banks from engaging in third-party lending arrangement that violate state laws. The FDIC should join the other federal financial regulators in making it clear that rent-a-charter arrangements undercut both federal and state authority to enforce appropriate banking and consumer laws and place the banks' reliance on preemption authority at risk. And the FDIC should immediately subject all insured state banks that are involved in payday lending arrangements to rigorous inspection for safety and soundness compliance.

We believe that financial institutions that are backed by the full faith and credit of the United States have no business making loans, directly or indirectly, that encourage consumers to write bad checks on other institutions' accounts, that fail to consider repayment ability and that violate state laws. At a minimum, federal guidelines should stop the current end-run around responsible regulation by prohibiting rent-a-charter arrangements between FDIC-insured state banks and third-party payday lenders.

Sincerely,