Testimony of Todd O. McDonald
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Before the House Financial Services Subcommittee on Consumer Protection and Financial Institutions

"Ending Debt Traps in the Payday and Small-Dollar Credit Industry"
April 30, 2019

Chairman Meeks, Ranking Member Luetkemeyer, Chairwoman Waters, Ranking Member McHenry, and members of the Subcommittee, good morning and thank you for this opportunity to testify on the small-dollar lending industry.

My name is Todd McDonald, and I am Senior Vice President and Board Director of Liberty Bank and Trust Company. In 1972, Liberty Bank was chartered in New Orleans, Louisiana, with a focus on service, integrity and a sincere interest in community and business development. Four decades later, Liberty Bank has expanded into eight states with fifteen branches.

I am also a board member of the National Bankers Association (the "NBA"). The NBA is the leading trade association for the country's Minority Depository Institutions ("MDIs"). Our mission is to serve as an advocate for the nation's MDIs on all legislative and regulatory matters concerning and affecting our member institutions as well as the communities they serve. Many of our member institutions are also Community Development Financial Institutions ("CDFIs"), and many of our member institutions have become banks of last resort for consumers and businesses who are underserved by traditional banks and financial service providers.

THE NATIONAL BANKERS ASSOCIATION SUPPORTS RESPONSIBLE SMALL-DOLLAR ALTERNATIVES

Small-dollar lending has become a fast-growing source of consumer credit in the United States and a key to financial inclusion, particularly for underserved communities. Unfortunately, existing federal law does not limit the interest rate non-banks lenders can charge on loans of $2,500 - $10,000. This lack of an interest rate cap has resulted in a recent explosion of loans with annual interest rates in the range of 100% - 225% and above. While 35 states have imposed caps on non-bank lenders, there is still a significant gap in protections for consumers.

As a CDFI that serves a largely low and moderate-income consumer base that often utilizes these high-cost, small-dollar loans, Liberty often works to help our customers get out of these predatory loans and into more manageable products. This dynamic is one of many reasons why we have created our own small-dollar product – the Freedom Fast Loan.

The Freedom Fast loan was created in 2008 part because we saw demand for responsible, small dollar credit in the markets we serve and very few competitors to payday and auto title lenders. We also encountered Liberty customers who may have gotten a payday or title loan, and we created a product that would refinance them into a lower-interest product. Our customers use Freedom Fast Loans for everything from funeral expenses to consolidation loans for other high-interest debt like credit cards or payday loans. The average loan is for just over $6,000, and the average interest rate is 12.6%. Our APR never exceeds 34.3%, and we serve customers with credit ranging from the low 500s to over 700. We also report payments to the credit bureaus, so our customers can also build their credit using our product.

Our Freedom Fast Loans meet the credit needs of the communities we serve. In order to scale our product and for community banks to provide similar products, however, we believe that there are steps that federal banking regulators and Congress must take in order to facilitate the kind of robust marketplace where community banks can compete with predatory, small-dollar lenders.

CONGRESS CAN TAKE A NUMBER OF AFFIRMATIVE STEPS TO SUPPORT COMMUNITY BANKS AS ALTERNATIVE PROVIDERS OF SMALL-DOLLAR CREDIT

The NBA supports creating a more favorable regulatory environment for community bank small dollar lending. The Credit Union National Administration's PALS program and the findings from the FDIC's Small-Dollar Loan Pilot Program should provide the basis for regulators to consider a small-dollar regulatory regime tailored to community banks like our member institutions.

The popularity of predatory small-dollar products creates both a moral and business imperative for policymakers to finds ways to create a regulatory regime for responsible alternatives to flourish. Even our Freedom Fast loans have attracted scrutiny from our regulators, despite it meeting an obvious credit need in the markets we serve. To that end, we believe that a "sandbox approach" from banking regulators that allows community banks to develop responsible small-dollar alternatives tailored to the credit needs of our communities would be a welcomed next step in carving out a role for mission-oriented lenders to provide responsible small-dollar alternatives.

In addition to a small-dollar "sandbox" for community banks, we would also urge Congress to fully fund the Small Dollar Loan Program ("SDLP") authorizing grants for loan loss reserves for CDFIs seeking to provide responsible small-dollar alternatives like our Freedom Fast product. The SDLP would provide an immediate incentive for CDFIs to develop small-dollar alternatives and help create a more competitive marketplace where mission-oriented lenders can complete in the small-dollar marketplace. We would also encourage Congress to also fund technical assistance grants for CDFIs seeking to provide payday alternatives for expenses like underwriting software and other administrative expenses that can help defray the costs of small-dollar lending.

The NBA also supports urging regulators to adopt regulations clarifying the "True Lender" and overruling the "Madden Rule." As more of our member banks consider potential partnerships with marketplace lenders and other fintechs to expand our banks' footprint with respect to various consumer loan products, having regulatory clarity regarding the Madden Rule and the True Lender doctrine is vital. No credit market can exist without a functioning secondary market to provide liquidity, and clarity with respect to community bank-fintech lending partnerships would do just that. For our members with limited branch footprints and digital relationships, partnerships with fintechs allows our member to enter into white label and other arrangements that allow our banks to provide more products to a broader audience. While we support legislative efforts to bring about clarity, we believe that Congress should urge the federal banking regulators to issue rules re-establishing both doctrines.

Finally, the NBA also supports establishing more small lending partnerships between MDIs and the Small Business Administration. It is not lost on us that many diverse entrepreneurs often have to rely on high-cost online lenders for their small business lending needs. While we understand the scope of this hearing, we would be remised if we did not also state for the record the debt traps ensnare far too many minority entrepreneurs. We, therefore, urge the SBA and the respective Small Business Committees to encourage more MDI-SBA partnerships to improve the SBA's lending to minority-owned businesses.

CONCLUSION

According to the OCC, U.S. consumers borrow nearly $90 billion every year in short-term, small-dollar loans typically ranging from $300 to $5,000. Many banks have withdrawn from this market, resulting in consumers often turning to alternative lenders.

Banks can provide affordable short-term, small-dollar installment lending options that can help consumers with their short-term financial needs while establishing a path to more mainstream financial products. Banks can meet consumers' short-term, small-dollar credit needs while providing other financial services such as financial education and credit reporting. Consumers can also benefit when they are offered products with reasonable pricing and repayment structures.

NBA member institutions stand ready to help provided the funding consumers are demanding. However, it is important that policymakers create a regulatory environment where these loans are profitable for MDIs and do not lead to additional regulatory burdens. Policymakers should also create an environment where MDIs can partner with responsible non-bank lenders to fill the obvious need in the small dollar lending space.

I thank you for the opportunity to testify today, and I look forward to your questions.