Remarks
By
Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation;
before the
Financial Services Conference
of the
Consumer Federation of America; Washington, DC
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Good afternoon, everyone. It is my pleasure to be part of the Consumer Federation of America's nineteenth annual conference exploring the challenges and opportunities that are taking place in the financial services industry.

For almost four decades, the CFA has distinguished itself as an honest broker on issues that face American consumers. The FDIC appreciates the thoughtful feedback we receive from the CFA on financial services regulatory issues. We look forward to a continuing dialogue and partnership with the CFA on issues affecting the public.

I would like to begin my remarks today by giving you my thoughts on the importance of economic inclusion. America is all about the achievement of dreams for a better life and economic improvement. For some, that may be to own a car, start a business, send a child to college or buy a home. A financial system should allow people to achieve economic progress and financial security through the traditional values of hard work and thrift. A financial system that strips wealth and locks hardworking families into an endless cycle of debt and financial distress promotes feelings of exclusion, as well as cynicism about our free market society and the ability of all to participate and benefit. An inclusive financial system strengthens the fabric of our market based system and spawns support for the principles of economic freedom upon which our political and social structures are based.

While I am committed to market based solutions, I am also concerned that market mechanisms are not working as well as they should in the area of financial services for low-to-moderate income families. It almost seems as if the market has become divided between two groups: those who successfully rely on banks for virtually cost-free basic financial services, and those who pay high amounts. Examples abound. Some pay 18 percent for a line of credit linked to their checking account; others pay 500 to 600 percent for a payday loan. Some pay nothing or minimal fees for an unlimited checking account, while others pay significant fees just to cash their paychecks and purchase money orders to pay bills. Some pay a flat 6.7 percent for a fixed, 30-year mortgage and others pay balloon rates as high as 11.4 percent for an exotic alternative loan. The fortunate accumulate wealth through cost- free savings vehicles, IRAs and 401(k)s; others pay set- up and maintenance fees for small dollar savings accounts which erode principal..

Why is market competition not working better? Part of the problem is that many people lack the financial skills needed to analyze and compare products and their prices. In many cases, the problem is lack of disclosures that fairly and simply describe a product and its true cost. We see disclosure problems all the time. For example, fee based overdraft protection is sometimes obscured in advertising for "free checking." Some high cost mortgages prominently display teaser rates of 2 or 3 percent. Subprime credit card applications may advertise seemingly reasonable annual percentage rates, but bury exorbitant fees in the fine print.

I suspect that part of the problem may also lie with the regulatory structure. I intend to investigate this during my tenure as Chairman of the FDIC and take action where it is needed. For example, we need to find out whether aspects of safety and soundness regulation unnecessarily deter banks from serving the needs of their communities, or create perverse incentives or regulatory gaps that favor high cost products. Why, for instance, do we subject lines of credit linked to checking accounts to the full panoply of disclosure, underwriting, and capital standards normally applicable to credit products, but do not do so for fee-based overdraft protection, which costs much more? Why do we subject banks and thrifts to tough standards in their complex exotic mortgage offerings, but do not subject non-bank mortgage companies—which account for so much of the subprime market—to the same standards?

Part of the problem may also lie in the types of incentives we currently provide banks to "do the right thing." Here, I think consumer groups such as the CFA need to lead the debate. We need to know, for example, whether the Community Reinvestment Act addresses the current needs of underserved populations or is trying to solve the problems of two decades ago. Is the problem today not enough credit, or is the problem too much high cost credit? Should we consider revamping CRA incentives so that at least as much emphasis is placed on the provision of basic, low cost retail financial services and asset accumulation products such as Individual Development Accounts?

I don't have all the answers, only questions, but I do sense a paradigm shift taking place. In Congress, there are bipartisan discussions on the need for a strong national anti-predatory lending law applicable to bank and non-bank lenders alike. In addition, Congress recently enacted an amendment sponsored by Senator Talent of Missouri and Senator Nelson of Florida that caps interest rates on loans to military personnel as part of last year's Defense Department authorization. This legislation presents many issues that can and will be addressed through regulation as we work with the Department of Defense to implement it, but it has put a much-needed spotlight on the pervasive need for more responsibly priced small dollar loans, particularly among our service personnel.

Regulators and banking agencies are actively engaged on consumer protection issues as well. The Federal Reserve is undertaking a comprehensive rewrite of Truth in Lending Act disclosure rules that is urgently needed. The Conference of State Bank Supervisors is committed to ensure that the recently issued guidance on alternative mortgages will eventually apply to non-bank mortgage lenders in the 50 states. Further, CSBS and the Comptroller of the Currency recently agreed on a consumer complaint information-sharing plan. Just last week, the Office of Thrift Supervision issued a proposed rulemaking to align their CRA regulations with the other regulators.

I am committed to making the mainstream financial system available to more consumers and promoting economic inclusion. One way we can do so is by helping to leverage the inherent strengths of insured depository institutions to meet the needs of the underserved. I would like to discuss two new initiatives that the FDIC is undertaking to help address this issue — a military lending initiative and our newly created Advisory Committee on Economic Inclusion.

Military Lending Initiative

One of the more troubling aspects of payday lenders is their proximity to military bases. This seems a perfect opportunity for banks to step in and offer more reasonably priced credit. The FDIC has been in contact with the Association of Military Banks of America and more than 125 banks located near military bases. These banks have told us they are willing to work with the FDIC to develop an affordable, small denomination loan product, possibly with a savings component. To facilitate their efforts, the FDIC will host a conference here in Washington on December 6 to share ideas with these banks on successful product and marketing strategies for consumers in the military. Our sessions will, of course, cover small denomination, short-term lending with a savings vehicle. We have high hopes that this effort will provide the foundation for broader programs that can be offered in the future.

A growing number of banks and credit unions have developed successful and profitable short-term loan programs. For example in 2001, the North Carolina State Employees' Credit Union introduced a short-term loan with a maximum limit of $500, a term of 31 days, a requirement that borrowers repay through direct deposit of their paycheck, and a 12 percent annual interest rate. This product also has a savings component that requires 5 percent of the loan proceeds be deposited in a savings account. Each month, more than 40,000 customers use this product. Overall, customers have accumulated $10 million in savings accounts.

Whether banks are willing to put ideas like this into practice on a large scale is a different question. In my opinion, there is no substitute for talking to banks about what they think will work and what they are willing to try. I believe that it is essential to maintain a dialogue with both consumers and the banking industry to bridge the gap in the supply and demand equation for short-term credit products. To this end, we will soon be issuing draft guidance to provide CRA credit for reasonably priced small dollar loans. In light of the Talent-Nelson Amendment, I hope consumer groups and the banking industry will work with the FDIC on this project and provide feedback on our draft guidance. As I said, this is a win-win proposition. Our small dollar loan initiatives are part of what we intend to be a continuing discussion with the industry.

Advisory Committee on Economic Inclusion

To further assist us in our efforts, the FDIC announced, earlier this month, the establishment of an Advisory Committee on Economic Inclusion. As its name implies, this Committee will provide the FDIC with advice and recommendations on ways to expand access to banking services to underserved populations and to bring more consumers into the financial mainstream.

The committee members represent a cross section of interests from consumer and public advocacy organizations, community-based groups, the banking industry, state regulatory authorities, government, academia, and others affected by banking-related practices. We are very fortunate that we are able to assemble such an accomplished and impressive group of individuals. I am convinced that their experience and insight will result in practical solutions to the barriers to economic inclusion. I am also very pleased that Diana Taylor, the New York State Superintendent of Banks has agreed to chair the Committee.

This Committee will consider many issues, including basic retail financial services like check cashing, money orders, remittances, and stored value cards, as well as how to encourage banks to make small, short-term loans. We look forward to receiving a wide range of recommendations.

As I see it, the formation of the Advisory Committee on Economic Inclusion was the next logical step in the building blocks the FDIC has been putting in place for many years to help consumers successfully navigate the financial marketplace. Our award-winning Money Smart financial education program has been the cornerstone of these efforts. The FDIC has also actively reached out to Latino immigrants through the New Alliance Task Force initiative. We are now expanding the New Alliance Task Force program to focus on all traditionally underserved populations — not just immigrants – through the Alliance for Economic Inclusion, a network of banks, community organizations, foundations, educators and state, local and federal agencies. This will be a grass-roots effort to expand banking services in low- and moderate-income neighborhoods, minority communities and rural areas.

Concluding Remarks

The gap between what the unbanked and underbanked pay for credit and what those in the mainstream pay is astonishing. Yet we can see from the efforts of those mainstream lenders that have stepped in to fill the gap—too few so far—that the cost of credit can be made much lower and still be profitable for the lender.

I am convinced that a continuing dialogue among consumer advocates, regulators and the banking industry is the key to closing this gap. We can and must find lending solutions that work for lenders and consumers alike. This is both a challenge and an opportunity to find lasting solutions for an important public policy dilemma.

Now I would be like to hear from you. I would be happy to take your comments and questions.

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