Testimony of Fran Grossman, Executive Vice-President of ShoreBank Corporation, Before the House Government Oversight Committee, Subcommittee on Domestic Policy March 21, 2007

Chairman Kucinich, ranking member Issa, distinguished members of the Committee, thank you for the opportunity to testify today on behalf of ShoreBank Corporation. I want to use my 5 minutes to give you a glimpse of the payday loan industry from our vantage point in the Chicago area and to talk about how community development banks like ShoreBank could help meet the complicated needs of customers and members of our neighborhoods who use payday loan and other similar financial services.

We are very pleased that the FDIC, under the leadership of Chairman Bair, is attempting to address payday lending and related issues. ShoreBank's founder and chairman, Ronald Grzywinski, is a member of the FDIC's Advisory Committee on Economic Inclusion. I know he is looking forward to the Committee's first meeting in two weeks, which will focus on this issue.

Payday lending fits into a broader set of businesses that provide alternative financial services and that often charge high rates for basic services, including cashing checks, paying utility bills and the like.

Now, there are no easy answers, no silver bullets to deal with payday lending. As you can well imagine, different people use short-term, high-interest, unsecured payday loans for different reasons and this can be a very profitable business. People with jobs rely on and use payday loans for quick cash. Folks may turn to payday loans for their wants, emergency needs and for basic necessities. Many payday loan customers fall behind on their payments. They are unable to pay back the full amount of the loan, as payday loans typically require, and they then find themselves without other options.

Illinois has developed regulations that have changed but not eliminated some of the more egregious aspects of payday lending. Nature hates a vacuum, and when one exists, such as the need and desire for “quick” cash, it will be filled. A number of things have been put into place, including:

- An industry wide loan cap limiting payday loan principal to 25 percent of a borrower’s income.
- A mandatory relatively short debt-free period of recovery following 345 days of continuous indebtedness.

- Special protections for military personnel, including a limit on wage garnishment.
- A statewide consumer reporting service to help with enforcement.

It is not perfect, but it does help with some of the more outrageous practices.

ShoreBank is a $2 billion community development bank. Our largest service area is in and around Chicago and we also have a branch in Detroit and a non retail branch in Cleveland. We work primarily in 25-30 neighborhoods in Chicago and close suburbs. Our communities have a median household income of just under $30,000. ShoreBank offers a range of products. Our loans to rehab multifamily buildings and mortgage loans for walk up rental apartment buildings help provide affordable rentals with no subsidy to low- and moderate-income residents. Our loans to small businesses, churches and nonprofits provide jobs, stability and growth in the communities, and we have low-fee accounts for individual customers and nonprofits.

ShoreBank is a community development bank and, as such, meets the strict criteria to be certified under the Community Development Financial Institution (CDFI) Fund in the Department of Treasury. Nationwide, interestingly enough, there are only 52 CDFI Fund-certified banks.

Some of you know about the CDFI Fund. It is housed in the Treasury Department and certifies banks, credit unions and non-profits that do 60 percent of their business in low-income areas. The CDFI Fund has been helpful with its grant program as well as helping many banks get established in areas that would not otherwise have a bank. Often, these are the same areas where payday lenders, check cashers, pawn shops and money transmission shops thrive.

Payday loan customers are sometimes customers of our bank and banks like ours. We provide many services they need and want, but obviously not all, and we well know there is a need for small, short-term, unsecured credit. We know, and we fervently believe that we need to encourage people to have a savings nest egg of at least $500 to $1,000. But until that happens, there remains a void.

There are many reasons for this void. Some have to do with the issues of pricing and prudent risk management. Others have to do with the banking culture and regulatory system and still others with all of our lack of understanding of how to effectively and responsibly meet the needs of many community residents.

So, why do these two types of institutions – community development banks and payday lenders – co-exist in the same community? Community development banks are well-positioned to meet many of the lending needs of lower-income customers, and even customers with thin or no credit history or who have had some bouts of bad credit. But we have not been able to fill all the needs of every potential customer, and we have been particularly challenged by the demand for small-sum, short-term, unsecured credit.

Let's start with why community development banks are well-positioned to meet the particular lending needs of these customers.

1. Banks like ShoreBank often take a person's character into account when making a decision. We are not formula lenders.

   Many good borrowers do not always look so good on paper. They have either long, negative credit histories, or short ones with virtually no traditional information. In either case, poor credit scores – or no score at all – make automated underwriting tough. The FDIC calls these borrowers "informationally opaque." But WE know them and WE can serve many of them.

2. Community development banks are mainly locally owned and managed.

   They are embedded in and involved with their communities. Customers and the community have access to the senior management. Decisions are made locally.

3. As small institutions, they have the ability to move quickly.

4. Community development banks are interested in having customers who are borrowers as well as savers.

As community bankers, we are intensely local and truly relationship focused. We are small organizations with finite resources which, unlike large banks limits the errors we can make. Various CDFI banks have been able to engage in some limited alternative products to payday loans; however, we have not, as a group or individually, cracked the code that enables us to not only do more, but also ideally to move residents of our communities away from payday loans. Also, we have not figured out how to do it profitably, so that the product and our relationship with those customers are sustainable over the long haul and not simply seen as a charitable act or a short-term reaction to political pressure.

There are numerous examples of products and innovative ways that CDFI banks have found to address the needs of consumers AND push and guide them on a path to prosperity. Here are two examples:

- Central Bank of Kansas City offers a CD Loan that helps customers establish good credit and avoid payday lending in the first place. It works like this: the customer takes out a loan and immediately receives a CD for $1,500 which serves as collateral for the loan. When the borrower pays off the loan in 1 – 2 years, the CD and the accrued interest belong to the customer. The loan and its successful payoff are reported to the credit bureaus, enabling the borrower to build a positive credit score, which will, in turn, lead to credit on better terms, whether from Central Bank or another lender. What distinguishes Central Bank's product from similar products elsewhere is that they actively promote it to customers.

- Legacy Bank in Milwaukee connects checking account customers who have had bad credit to financial management classes. Customers may then choose emergency loans and the bank gets paid back. Legacy focuses on making low-income customers good, solid, profitable customers by helping them learn how to use bank financial services, including credit, not by regarding them as serial fee generators.

CDFI banks are small, and while profitable, their margins are often strained by a combination of high fixed costs (including regulatory costs), and smaller loan sizes, limited fee income and a population that needs more personal attention. Small dollar, short-term credit is one of these products that we have found is quite difficult to offer under current conditions. They would, however, be interested in working with the CDFI Fund, the FDIC and others to break through financial, technological and regulatory barriers. For example:

1. CDFIs should receive favorable consideration for government deposits and loan participations.

2. THE CDFI Fund needs to be well funded.

3. The CDFI Fund needs to encourage more community oriented banks to apply for certification.

   There are more than 7,000 community banks that are committed to their communities and a good percentage do much of their business in low-income neighborhoods. Currently 67% of the certified CDFIs are nonprofit loan funds, 19% are low-income credit unions, 8% are banks or thrifts, 3% are venture capital funds and 3% are depository holding companies. Not to encourage and provide incentives to mainstream financial institutions which know and care about the community and whose ability to survive is dependent on that community is nonsensical.

4. CDFI banks need loan loss reserves to support special lending programs.

5. CDFI banks need encouragement from bank regulators – others as well as the FDIC – in the form of examiners who understand and support a bank's role in providing alternatives to payday loans.

6. CDFI banks need funding to provide the level and appropriate type of financial education and coaching that will best enable customers to not only enter but stay in the financial mainstream and build assets.

Regulating away payday lending will not eliminate the unique financial needs of individuals with low assets and poor credit, needs that high interest short-term check-cashing facilities offer easily and at a cost. We need a multifaceted approach to deal with unscrupulous payday lenders and their clones, people who used to be called loan sharks. It will take the will of the government to encourage and regulate banks, credit unions, nonprofits and government agencies to ethically and responsibly respond to the needs of consumers we have been discussing. What must be part of a regulatory package to limit payday lending are incentives to help mainstream financial institutions (community development banks are mainstream) and credit unions offer products to these customers.

The foregoing examples constitute some of our recommendations in connection with any such regulatory package. If, in our attempt to "fix it," we ignore the causes of the problem, we may find ourselves in a position not dissimilar from what we are facing today because of some clever sub prime lenders. In an attempt to increase the number of minority homeowners, we allowed and encouraged products that left many of those we were trying to help worse off.

Bottom line: it will not be easy. There are no easy answers. Let us try and get it right.

Frances R. Grossman is an Executive Vice President at ShoreBank Corporation and works on projects for its largest affiliate, ShoreBank in Chicago, Cleveland and Detroit, and with its other for profit and nonprofit companies nationwide, including the Center for Financial Services Innovation. Grossman manages external relations and investor and stakeholder activities. She is responsible for ShoreBank's civic affairs and contributions in Chicago and nationally and is involved with business development and managing government/ municipal and business relationships.

Before joining ShoreBank, Ms. Grossman worked in community development banking at Bank of America for 10 years. She created, developed and managed the Community Development Banking group and the Bank of America's Chicago Community Development Corporation. She also managed the Bank of America Foundation and government relations in Illinois.

Grossman previously oversaw a neighborhood-based community development corporation, taught in Chicago Public Schools and managed an after-school and summer program in the Ida B. Wells Homes.

Active in the community, Grossman serves on the board of directors for the National Association of Affordable Housing Lenders, the South East Chicago Commission, Chicago LISC, the Chicago Metropolitan Housing Development Corporation, the Coalition of Community Development Financial Institutions, the Community Development Bankers Association and Partnership for Quality Child Care. She recently served on a Blue Ribbon Commission addressing critical issues at Chicago Public Schools.

Ms. Grossman holds a master's degree from the University of Chicago School of Social Service Administration and a bachelor's degree from Vassar College.