

Federal Reserve Member Banks Not for Rent

April 14, 2003

The Honorable Edward Gramlich
Board of Governors of the Federal Reserve System
20th & C Streets, NW
Washington, DC 20551

Dear Governor Gramlich:

We request that the Federal Reserve Board take immediate action to stop First Bank of Delaware from renting its charter to allow payday loan chains, including Check Into Cash, Dollar Financial Group, and The Cash Store, to evade small loan laws in five states. First Bank of Delaware is a state-chartered bank located in Wilmington, Delaware that makes payday loans in North Carolina, Georgia, Ohio, Texas and California. Both North Carolina and Georgia small loan laws prohibit the type of abusive loans Check into Cash and First Bank of Delaware provide. State payday loan laws in Texas and California restrict the size and cost of loans.

You have already heard concerns about this payday loan-bank affiliation from North Carolina community advocates at a March 13 meeting. The organizations signing onto this letter demonstrate that rent-a-bank payday lending is an important consumer protection issue for groups across the country.

Federal Reserve Member Bank

First Bank of Delaware, a Federal Reserve member bank, was established in June 1999 as a subsidiary of Republic First Bancorp. First Bank of Delaware is a small bank, with \$43.5 million in total assets and not quite \$28 million in deposits as of December 31, 2002. Payday lending is a major part of First Bank of Delaware's business. As of the end of 2002, First Bank reported \$5 million in payday loans outstanding in Georgia, Texas, California and North Carolina. According to news reports, payday loans generated 52 percent of profits at Republic First Bancorp, the Philadelphia-based parent of First Bank. According to Republic First Bancorp's information filed with the SEC, the payday loan segment accounted for 59% of the company's total net income in 2002. First Bank of Delaware's community banking activities had a net income of \$120,000 while the payday loan segment had a net income of \$1.3 million. In terms of total assets, the payday loan segment accounts for more than 20% of First Bank of Delaware's total assets.

Payday Lenders Partner with Banks to Make Predatory Loans

Payday loans are small cash loans that are based on a personal post dated check and cost triple-digit interest rates. These loans are due in full on the borrower's next payday, typically

two weeks, and can trap vulnerable consumers in perpetual debt. Payday lenders encourage cash-strapped bank account holders to write checks without funds on deposit and then use those checks to coerce repeat transactions or collections. Payday lending is inherently unsafe and unsound because loans are made without regard for the borrower's ability to repay.

Payday lenders are subject to state usury laws, small loan rate caps, or payday loan laws, depending on state laws. To evade those state restrictions some payday lenders partner with banks to claim the bank's right to export home state interest rates and to preempt some state consumer protections. We believe that this is a blatant abuse of bank powers. As the Office of the Comptroller of the Currency and the Office of Thrift Supervision have found, payday lending exposes federally-insured banks to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risks. As federal bank regulators have halted charter-renting for their banks, payday lenders are turning to state chartered FDIC insured banks.

OCC and OTS Halt Rent-a-Bank Activities; FDIC Reviewing Draft Guidelines

Other federal bank regulators have been leaders in preventing this abuse of bank powers. The Office of Thrift Supervision joined the Comptroller of the Currency in issuing a Memorandum for Chief Executive Officers November 27, 2000, to warn thrifts about safety and soundness, compliance, and consumer protection concerns regarding payday lending. The Office of Thrift Supervision recently insisted that First Place Bank in Warren, Ohio terminate its payday loan arrangements with Check'n Go in Texas. The OTS had earlier given Crusader Bank, a Philadelphia thrift, a "needs to improve" CRA rating for its rent-a-bank arrangement with a payday lender.

The Office of the Comptroller of the Currency has taken important steps to prevent national banks from misusing their charters, as well. Since early 2002, the Office of Comptroller has ordered four federally-chartered banks (Eagle National Bank, Goleta National Bank, Peoples National Bank, and First National Bank in Brookings) to halt their payday loan arrangements with third-party companies, citing safety and soundness concerns. We currently know of no banks regulated by the OCC or OTS that participate with third parties to make payday loans.

We know of seven state-chartered non-member banks involved in payday loan arrangements. The Federal Deposit Insurance Corporation published draft payday loan guidelines for public comment this year and a final decision is expected by the end of this month.

First Bank of Delaware Engaged in Unsafe and Unsound Banking

Although Republic First Bancorp's 10-K SEC report states that the lending policies of its banks "require specified underwriting, loan documentation, and credit analysis standards to be met prior to funding," payday lenders knowingly accept postdated checks for which there is no money in the bank to cover them, do not perform conventional credit checks, do not inquire into borrowers' other financial obligations, and make no assessment of ability to repay. A National Cash Advance loan application used in Indiana when First Bank of Delaware was the lender asks no questions about other debts or obligations. The application notes that "First Bank of

Delaware will not perform a lengthy credit check on me, but the information I have provided in and with this Application will be sent to Tele-Track for a search of its database and for a determination as to whether I satisfy First Bank of Delaware credit criteria.” Tele-Track is a specialized credit reporting service that only tells lenders if applicants bounce checks or have other payday loans outstanding. First Bank of Delaware’s professed lending policies do not match their practices with payday lending.

One of First Bank of Delaware’s partners, Dollar Financial Group, was cited by the Comptroller of the Currency for actively promoting rollovers of the bank’s payday loans, without Eagle National bank’s knowledge, by providing an incentive to Dollar’s employees, which resulted in a higher volume of rollovers than new loan origination and a misuse of the loan product for long-term credit. The Comptroller noted that Dollar failed to consistently follow the bank’s underwriting criteria, violated federal law relating to privacy notices and Truth in Lending disclosures, and opened stores in some states and began originating payday loans without the bank’s knowledge or approval. If a national bank with \$70 million in assets was essentially taken over by its payday loan partner, a state bank with only \$43.5 million in assets is at even greater risk from affiliating with payday lenders.

Payday loans, with their astronomical interest rates, brief terms, and absence of credit worthiness verification, are risky for both borrowers and lenders. The bank’s SEC filing reveals that First Bank will make loans up to \$1,000 for two-week terms. In 2002 Republic First Bancorp had \$1.67 million in charge-offs on short-term loans, which represented 39.6% of all charge-offs in 2002 for the entire bank holding company. (It is unclear what percentage of charge-offs it represents for the much smaller First Bank of Delaware subsidiary that makes payday loans.) Though a high proportion of charge-offs are related to the payday loan business, the percentage actually underestimates the total charge-offs related to payday lending since it does not count those loans that are being made successively, as noted in North Carolina Department of Banking findings.

First Bank of Delaware Appears to be Renting its Charter to Payday Lenders

It appears that First Bank of Delaware is merely renting its charter to third-party lenders. According to the Marketing and Servicing Agreement between First Bank of Delaware and Dollar Financial Group, Inc., the bank makes single-payment, short-term loans of up to \$500 to borrowers based on checks held in trust. DFG agreed to market and service the loans and decides where outlets are located. The bank may sell, transfer, or grant an interest in or assign loans to third parties. Credit decisions are made through Tele-Track, a separate credit reporting company widely used by payday lenders. Dollar takes applications, markets loans, services them, and handles collections. Dollar indemnifies the bank and vice versa against the cost of any legal action arising from payday lending through the partnership. The contract can be cancelled if a regulator declares the arrangement illegal or constitutes an unsafe or unsound banking practice or may jeopardize the bank’s standing with or rating from the regulatory agency.¹

¹ Dollar Financial Group/First Bank of Delaware, Marketing and Servicing Agreement (expurgated), attached to Dollar Financial Group 10-Q filing, Securities and Exchange Commission, 12/31/02.

The Federal Reserve should be particularly concerned that one of its Fed member banks is aligned with a payday lender found by the Comptroller of the Currency to have used a national bank in an unsafe and unsound manner. DFG most recently partnered with Eagle National Bank to make payday loans across the country. The OCC entered into a consent order with Eagle National Bank to withdraw from payday lending and found that the bank risked its financial viability by concentrating in one line of business, relinquished supervision of the program to a single third party originator of payday loans, and conducted its payday loan program in an unsafe and unsound basis, in violation of a multitude of standards of safe and sound banking, compliance requirements and OCC guidance.

Loans made by First Bank of Delaware and Check into Cash far exceed the consumer protection limits set by North Carolina and Georgia small loan laws. In North Carolina, Check into Cash is charging \$17.65 per \$100 or 458.9% APR for a two-week loan. Payday lending is not legal in North Carolina which has a small loan rate cap of 36% APR. According to their website, Check Into Cash has 45 stores in North Carolina. In 2000 and before Check Into Cash began making payday loans with First Bank of Delaware, North Carolina consumers paid nearly \$11 million in fees to Check Into Cash with more than \$6 million of those fees paid by customers who made 15 or more transactions during the year. Nearly 20% of the fees generated in North Carolina by Check Into Cash in 2000 were paid by customers making 24 or more transactions during the year. It is reasonable to believe that the perpetual debt problem caused by Check Into Cash before it started making loans through First Bank of Delaware continue and will even be exacerbated by the higher fees and larger loans now imposed in North Carolina.

First Bank of Delaware partners with Cottonwood Financial Texas, L.P. d/b/a The Cash Store with twenty locations in Texas. Loans of up to \$1,000 are offered in Texas while Texas Finance Commission rules limit payday lending to \$500. The Cash Store/First Bank of Delaware loans cost \$20 per \$100 or 520% APR for a two-week loan. Texas rules limit the cost of a two-week loan to \$11.87 for a \$100 loan up to \$19.33 for a \$500 loan.² The only requirements to get a loan are a bank statement, most recent pay stub, a personal check and a valid ID. The consumer loan agreement used by First Bank of Delaware and The Cash Store specifies that Delaware law applies to the transaction.³ Borrowers have to sign that they are not a debtor in bankruptcy and have no intention to file a petition for bankruptcy relief.

Dollar Financial Group and First Bank of Delaware entered into a marketing and servicing agreement October 18, 2002. In California and Ohio, First Bank of Delaware partners with the Dollar Financial Group's Money Mart outlets. Although California law limits the size of the check used to get a payday loan to \$300 (typically the loan is \$255 with a \$45 finance charge), DFG's "Cash 'Til Payday" offer will loan \$100 up to \$500. The only qualifications

² Texas Finance Code, Chapter 342, Subchapter F, Rate Chart

³ Consumer Loan Agreement, The Cash Store and First Bank of Delaware: "Governing Law. The Bank is a Delaware bank which is insured by the FDIC. This Loan Agreement is made not only under the federal laws applicable to state banks making loans to out of state borrowers but also Delaware state law. To the extent such federal laws do not preempt state law, then this Loan Agreement shall be governed by and construed in accordance with the laws of the State of Delaware. To the broadest extent possible, any state law claims you may assert against us relating to this Loan Agreement, and any state law claims we may assert against you relating to this Loan Agreement will be governed by the laws of the State of Delaware. The Waiver of Jury Trial and Arbitration Provision shall be governed by the Federal Arbitration Act, 9 U.S.C. §§ 1-16."

needed are that the borrower be currently employed or have a steady source of income; have a checking account with her name printed on the checks; be at least 18 years old; have a valid, government issued photo ID, and not be delinquent on a prior payday loan. The loan application asks no questions that would permit the bank to determine ability to repay the loan. In fact the application promises that “the bank will not perform a lengthy credit check.” First Bank of Delaware offers a \$5 discount for borrowers who agree to resolve all disputes through arbitration.⁴

Request for Action by the Federal Reserve Board

We urge you to take immediate steps to halt payday loan activities at First Bank of Delaware and at any other member bank that might be tempted to put consumers and taxpayers at risk for the quick profits to be made in charging triple-digit interest rates to vulnerable consumers. By being proactive on this matter, the Board can avoid a lengthy public debate on payday lending. The Federal Reserve Board should adopt advisory guidance similar to that adopted by the OCC and OTS and effectively enforce the advisement as demonstrated by those agencies. We believe the integrity of the reputation of the federal bank regulatory system is at risk. The Federal Reserve’s ability to exercise discernment and judgement to determine when the legal system is being used to circumvent basic consumer rights is challenged by state Fed-member banks that partner with third parties just to evade state consumer protections.

We request a meeting with you to discuss these concerns. Please contact Jean Ann Fox, Consumer Federation of America, at 757-867-7523 with any questions and to schedule a meeting. Thank you very much for your consideration of this matter.

Sincerely,

Jean Ann Fox, Consumer Federation of America, DC
John Taylor, National Community Reinvestment Coalition, DC
Edmund Mierzwinski, U. S. Public Interest Research Group, DC
Ira Rheingold, National Association of Consumer Advocates, DC
John Kleiderer, U. S. Jesuit Conference, DC
Erica Lindquist, National Congress for Community Economic Development, DC
Cheryl L. Ziegler, Lawyers’ Committee for Civil Rights Under law, DC
Al Sterman, Democratic Processes Center, Inc., AZ
Jim Bliesner, San Diego Reinvestment Task Force, CA
Shelley Curran, Consumers Union, CA
Arthi Varma, California Reinvestment Committee, CA
Raphael L. Podolsky, Legal Assistance Resource Center of Ct., Inc., CT
Rashmi Rangan, Delaware Community Reinvestment Action Council, Inc., DE
Ken Spuhler, Florida Legal Services, Inc., FL
Dennis A. Goldstein, Atlanta Legal Aid Society, GA
Shelley Sheehy, John Lewis Coffee Shop, Inc., IA
Malcolm Bush, Woodstock Institute, IL
Julie Sampson, Monsignor John Egan Campaign for Payday Loan Reform, IL

⁴ Cash ‘Til Payday application. On file with CFA.

Dory Rand, Supervising Attorney/Community Investment, National Center on Poverty Law, IL
Anne Marie Regan, Office of Kentucky Legal Services Program, Inc., KY
Nancy Grandquist Fields, Former HUD Community Builder Fellow, LA
Elizabeth Renuart, National Consumer Law Center, MA
Dharmena Downey, Director of Housing, City of Somerville, MA
Glenn Davis, Mason Square CDC, MA
Cheryl Hystad, Maryland Consumer Rights Coalition, Inc., MD
Rick Gamber, Michigan Consumer Federation, MI
Ken Benner, American Council on Consumer Awareness, MN
Peter Skillern, Community Reinvestment Association of North Carolina, NC
Martin Eakes, Self Help Credit Union, NC
Alfred Ripley, NC Justice and Community Development Center, NC
Mary Mountcastle, Center for Responsible Lending, NC
Constance Stancil, North Carolina Low Income Housing Coalition, NC
Debbie Warren, Southern Rural Development Initiative, NC
Stella Adams, North Carolina Fair Housing Center, NC
Kat Rumely, Brick Capital CDC, NC
James E. Banks, Triangle National Action Network, NC
Kiki Dunton, North Carolina PIRG, NC
Shirley Williams McClain, North Carolina Hunger Network, NC
Peter Laroche, Consumer Credit Counseling of Forsyth Co., NC
Robert Price, Uhuru Community Development Corporation, NC
Phyllis Salowe-Kaye, New Jersey Citizens Action, NJ
Neil Fogarty, Consumers League of New Jersey, NJ
Ray Prushnok, New Mexico PIRG, NM
Craig Fiels, City of Santa Fe, NM
Raynell Zuni, Project Change Fair Lending Center, NM
Alison Colvin, Washoe Legal Services, NV
Jon Sasser, Clark County Legal Services Program, Inc., NV
Lee Beaulac, Rural Opportunities, Inc., NY
Ruhi Maker and Barbara van Kerkhove, Greater Rochester Community Reinvest. Coalition, NY
Kathryn Harlow, Cleveland works, Inc., OH
Michael Deemer, Ohio State Legal Services Association, OH
Stan Hirtle, Legal Aid Society of Dayton, OH
Donald K. Hardin, Administrator, Oklahoma Commission on Consumer Credit, OK
Jason Reynolds, Oregon Consumer League, OR
Alan Jennings, Community Action Committee of the Lehigh Valley, Inc., PA
Irv Ackelsberg, Community Legal Services of Philadelphia, PA
Sue Sierra, Philadelphia Association of CDCs, PA
Odalis Reyes-Cruz, Asociacion de Agencias Comunales de Puerto Rico, Inc., PR
Dottie Garrick, Columbia Consumer Education Council, SC
Richard Tomlinson, Attorney at Law, Houston, TX
Linda Hilton, Coalition of Religious Communities, UT
Sarah Dewees, First Nations Development Institute, VA
Stephen Meili, Economic Justice Institute, Madison, WI
Hubert Van Tol, Fairness in Rural Lending, WI

Bethany Sanchez, Metropolitan Milwaukee Fair Housing Council, WI
David McMahon, Mountain State Justice, Inc., WV

CC: The Honorable Alan Greenspan, Chairman
The Honorable Roger W. Ferguson, Jr., Vice Chairman
The Honorable Susan Schmidt Bies
The Honorable Mark W. Olson
The Honorable Ben S. Bernanke
The Honorable Donald L. Kohn

The Honorable Richard Shelby
The Honorable Paul Sarbanes
The Honorable Michael G. Oxley
The Honorable Barney Frank

The Honorable John Hawke
The Honorable Donald E. Powell
The Honorable James E. Gilleran