FDIC: STOP INSURING PAYDAY LOAN BANKS

May 20, 2003

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

Dear Chairman Powell:

We request that the Federal Deposit Insurance Corporation take immediate action to stop Republic Bank & Trust from renting its charter to payday loan chains to evade state laws in Texas and North Carolina. Republic Bank & Trust is a state-chartered bank located in Louisville, Kentucky, which makes payday loans in North Carolina and Texas. In North Carolina, Republic Bank & Trust partners with Advance America and McKenzie Check Advance of North Carolina, which operates National Cash Advance stores, to make payday loans that are prohibited by state law. In Texas, Republic Bank & Trust partners with ACE Cash Express at 313 locations, and Q.C.&G Financial, Inc., which operates 18 ACE America's Cash Express outlets and 46 Advance America outlets, to evade the state's payday loan laws that restrict the size and cost of loans.

The only reason for a payday lender to partner with a bank to make payday loans is to use 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 and federal deposit insurance protection. We ask that you issue a cease-and-desist order to Republic Bank & Trust for any payday lending activity.

After several years of allowing the industry to operate, the North Carolina legislature, in response to public pressure, allowed the law authorizing payday lending to sunset. However, payday lenders have partnered with out-of-state banks to continue their practices and export interest rates well above those allowed under the state's small consumer loan laws. Republic Bank & Trust is renting its charter to allow Advance America, ACE Cash Express, and National Cash Advance to circumvent North Carolina and Texas state laws. Republic Bank & Trust has indicated that it is operating in North Carolina and Texas under the Kentucky deferred deposit law.

Republic Bank & Trust Company is a subsidiary of Republic Bancorp, a bank and financial holding company with total assets of $1.8 billion at the end of 2002. As of March 2003, Republic Bank & Trust had 24 banking centers in Kentucky communities, with $1.1 billion in deposits. It has also announced plans to open six additional banking centers in Kentucky in 2003, and has stated its intentions to seek additional opportunities for expansion through acquisitions.

As of December 31, 2002, Republic Bank & Trust had approximately $3 million outstanding in payday loans, and it expects this balance to increase significantly due to new contracts with payday lenders. In its filing with the SEC, the bank stated that it expects the payday loans outstanding to reach or exceed $8 million by the end of the first quarter of 2003. The bank has exceeded that estimate; Republic Bank & Trust representatives have stated that the bank currently has $16 million in outstanding payday 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 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 loans have weak underwriting, short terms and high fees that foster chronic borrowing and trap customers in a spiral of debt. Republic Bank & Trust, through Advance America, is currently charging $17.50 for each $100 borrowed in North Carolina. The effective annual percentage interest rate on the average 12-day loan is 532%, well above the North Carolina small loan cap of 36%. In Texas, Republic Bank & Trust/Advance America charges $17 per $100 borrowed, exceeding the state's rate limits on payday loans.

The business model for payday lending relies on multiple high-fee transactions to repeat customers. Payday lending generates a disproportionate amount of revenue from customers who repeatedly renew loans or make successive back-to-back transactions. In 2000 in North Carolina, more than half of Advance America's customers took out 7 or more loans and more than a quarter of the customers took out 13 or more loans from the company during the year. More than 84% of Advance America's fees in 2000 in North Carolina came from customers who borrowed 7 or more times. Nearly 32% of the fee revenue was generated by customers making 20 or more loans during 2000.

In fact, Republic Bank & Trust, through Advance America in both Texas and North Carolina, allows ten consecutive or back-to-back transactions. At $17.50 per $100 borrowed, after ten consecutive transactions the borrower will have paid $525 in fees alone for a $300 loan.

Payday lending involves inherently unsafe and unsound banking practices because loans are made without regard for the borrower's ability to repay. As a payday lender, Republic Bank & Trust knowingly accepts postdated checks for which there is no money in the bank to cover them, does not perform conventional credit checks, and does not inquire into borrowers' other financial obligations. The only eligibility requirements are full-time or part-time employment, an active checking account, a functioning telephone, a driver's license or state ID, proof of income such as a pay stub or bank statement, and proof of current address. The application for National Cash Advance (owned by Advance America) in North Carolina states that Republic Bank & Trust will not perform a lengthy credit check, but that the application will be sent to Tele-Track, which is a specialized credit reporting service that only tells lenders if applicants bounce checks or have other payday loans outstanding.[1]

[1] The application for payday loans through Advance America in Texas includes the same statement.

As the FDIC stated in its draft guidelines on payday lending, payday lending exposes federally insured banks to safety and soundness risks and carries serious reputational risks. The guidelines state that the "combination of the borrower's limited financial capacity, the unsecured nature of the credit, and the limited underwriting analysis of the borrower's ability to repay pose substantial credit risk for insured depository institutions". The guidelines name payday lending as one of the "highest risk subsets of subprime lending" and note that bank-payday lending relationships significantly increase banks' "transaction, legal, and reputation risks".

Other federal banking regulatory agencies have actively discouraged the "rent-a-charter" affiliation of banks with third-party payday lenders. Both the Office of the Comptroller of the Currency and the Office of Thrift Supervision have issued advisories warning banks against affiliating with payday lenders and have enforced standards by requiring specific banks to end such affiliations. Republic Bank & Trust replaces Peoples Bank as the partner for Advance America and National Cash Advance in North Carolina. The OCC ordered Peoples Bank to terminate its payday loan arrangements with third-party companies due to safety and soundness concerns.

In addition, the OCC recently ordered First National Bank in Brookings, South Dakota, to end its affiliation with Cash America, and the OTS ordered First Place Bank in Warren, Ohio, to terminate its relationship with Check 'n Go in Texas. During 2001, the Office of Comptroller of the Currency ordered two federally-chartered banks (Eagle National Bank and Goleta National Bank) to halt their payday loan arrangements with third-party companies (Dollar Financial Group and ACE Cash Express, respectively), citing safety and soundness concerns.

The OTS has recently issued general guidance for third party arrangements that should provide a framework for the FDIC in dealing with bank-payday lender partnerships. Regarding the activities of the third party, the OTS says, "critically evaluate whether the third party's activities could be viewed as predatory, abusive, unfair, or deceptive to consumers, particularly if products and services offered through the association has fees, interest rates, or other terms that the third party could not otherwise offer." The OTS guidance continues, "associations should not 'lease' their charter out to nonthrift entities through an agreement that allows the nonthrift entity to circumvent state and local law."[2] These statements apply directly to payday lending arrangements. The FDIC should act in a similar manner to prevent banks from "leasing" their charters to evade state laws that would apply to abusive payday lending activities.

We urge you to take immediate steps to halt payday loan activities at Republic Bank & Trust and at any other state-regulated banks that are putting consumers and taxpayers at risk for the quick profits to be made in charging triple-digit interest rates to vulnerable consumers. Please contact Peter Skillern at 919-667-1557 ext. 22 if you have any questions or would like to discuss this issue further.

Sincerely,

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[2] Office of Thrift Supervision, Thrift Bulletin 82, 3/18/2003, p8.

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