Bretton Woods, Inc.

Subcommittee on Financial Institutions and Consumer Protection

Testimony of G. Michael Flores

Good morning, Chairman Brown, Ranking Member Toomey, and members of the Subcommittee. I am grateful for the opportunity to speak with you today on the issues of consumer credit and discuss the results of a study my firm recently completed on the customer and loan usage characteristics of online short term loans.

I have worked in banking and consulting for more than 30 years and in the past 15 years I have conducted research short-term consumer credit including overdrafts and payday loans and studied prepaid cards for the last six years. I am also on the faculty of the Pacific Coast Banking School at the University of Washington where I teach a retail banking course.

Based on my most recent research which was commissioned by the Online Lenders Alliance and analysis of other studies, the need for short-term, low dollar products is real and the demand is growing.

The Center for Financial Services Innovation estimates the *underbanked* annual demand for unsecured short-term credit to be more than $61 billion with:

- Overdrafts accounting for **$8.3 billion** (from a total of $38.3 billion in total overdrafts extended);

- Deposit advance of **$4.3 billion** which, in my opinion, will now move to overdrafts given the exit from this market by six large banks;

- Internet payday of $**18.6 billion** and Storefront payday equaling $**30.1 billion**

The intent of the study was to:

- Build a first of its kind analysis within the industry to understand the data that is currently available from the specialty credit bureaus and lenders

- Understand the strengths and weaknesses of the currently available data

- Establish a baseline from which an annual update is planned

- Catalogue and understand customer demographics and loan characteristics;

- Compare this data with all other available data including the Pew study and the CFPB report on storefront lending in order to add information to the discussion

We analyzed:

- **60 million application records** and **nine million loan records** from three specialty credit bureaus for a four year period beginning in 2009

- Because of certain constraints in the credit bureau data, we augmented this with **1.6 million customer records** from three lenders and four loan portfolios

    - The key findings track closely with Pew and CFPB with a few exceptions.

- Customer median age is 39 with an annual income of $30,000 and is primarily paid bi-weekly

- The average loan amount was $388 with a range from $300 to $500 with the average loan amount increasing each year from $380 in 2009 to $530 in 2013

- The annual number of loans ranged from two to four with the 30 percent of the customers with only one loan

- The annual days' indebted range from 70 days to 106 days as compared to the Pew research of 144 days and the CFPB storefront analysis indicating 199 days of indebtedness.

- Finally, the loan performance data from the credit bureaus indicate that **71percen**t of loans were reported as paid and **89percent** had no charge-off flag

I believe the growth of the loan amount as well as the intensity of usage measures has led to an important trend in the industry's move from a two week product to an installment product with longer terms.

These installment loans should be less expensive than the traditional two week product. That said, there is still value in the two week product because it fits into a continuum of credit services and is usually less costly than overdrafts which are less costly than returned NSF items.

Innovative companies, many of them operating exclusively on the Internet, are trying to design flexible products to meet that demand. The emergence of peer to peer lending is another example of this trend.

In my discussions with many of these companies, they say real innovation is limited because of the patchwork of legacy state laws governing access to short-term credit products.

Federal law is needed to establish the rules and regulations necessary to provide access to credit for consumers nationwide and allow companies the regulatory certainty they need to meet this growing credit need and to innovate and drive down costs. HR 1566 is designed to address this concern. The bill may need some work, but it has close to 50/50 bipartisan support in the House and offers the best current vehicle in Congress to help consumers.

Thank you for your time and I look forward to answering your questions.