

STATEMENT OF
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LENDERS RESIDENTIAL ASSET COMPANY LLC

Subject: Interest on Business Checking

Before: Senate Banking Committee

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Good Morning. I'm Ed Pinto, president of Lenders Residential Asset Company LLC in Bethesda, MD. Thank you, Chairman Shelby and Ranking Member Sarbanes, a fellow resident of the great state of Maryland, for giving me the opportunity to testify on behalf of the National Federation of Independent Business regarding interest bearing checking accounts for small businesses.

In preparing for this testimony I was reminded of a story. Many years ago a hallway was being painted in the Pentagon. After the fifth passerby could not resist checking to see if the paint was still wet, the captain posted an MP at either end to guard the hallway. Many years later, a professor of mine was teaching a class on management at the Pentagon. He asked each participant to go out and find an example of inefficiency. One lieutenant called the professor to say he could not find any example. The professor asked what was the closest object and he responded "the MP". "Well go ask him what he is doing." He did and got the response "I'm guarding the hall." "Why?" To make sure no one touches the wet paint.

Does anyone remember why Congress prohibited the payment of interest on business accounts?

I commend the Committee for conducting this hearing on Regulatory Reform. Eighty-six percent of NFIB members support allowing business owners to earn interest on their business checking account balances. During this Congress, the House has already passed legislation overturning the archaic law that prohibits interest on business checking accounts - once by voice vote and once by a vote of 418-0! S. 1967, introduced by Sen. Hagel and Sen. Snowe, repeals a law dating back to the Great Depression that prevents small-business owners from earning interest on their business accounts, but the bill continues to be stalled for reasons I can't

understand. The big banks have consistently opposed repealing the ban on interest checking, and have proposed compromise legislation that would delay implementation of the repeal by three or more years. Their efforts to insulate themselves from free-market competition have hurt small businesses, the job creation engines of this country. This consumer protection legislation is much needed, and every day it is delayed is an injustice to our members. The House-passed bill, as currently written with a two-year delay, is already a compromise, and NFIB strongly urges the Committee to resist efforts to further lengthen the phase-in period.

Lenders Residential Asset Company, which I founded in 1989, provides consulting services to the financial services industry.

When the company was started, I can recall my astonishment at being told that a business can't earn interest on a checking account. I was further astonished to find that my business account not only didn't pay interest, it came with a plethora of fees! My banker said not to worry, and introduced me to the spellbinding concept of compensating balances. Boy, was I in for an education, and one that had nothing to do with running my business. I remember thinking that all of this seemed quite foreign and not exactly consumer-friendly. I had been earning interest for years on my personal checking account, which had a much smaller balance. I recall asking my banker, "Why no interest?" I was told simply that it was against the law.

Later, as the business prospered, my banker suggested that I set up what my bank called a "sweep account" -- which, she told me, did not have the benefit of FDIC insurance, but did pay interest. And so, that's what we did. But, was it complicated. First, we analyzed my account history to determine how much to keep in my regular account (my second encounter with compensating balances) so as to "earn" enough to avoid incurring fees on my regular checking account. Next we had to project what would be earned in interest and compare that to the

additional fees incurred to administer my new sweep account. Then I had to authorize an amount to be swept each night. Here I had a choice: I could either call each afternoon to authorize the transfer or I could set a floor amount and automatically sweep all funds in excess of that amount. Not being a gluten for punishment, I selected the automatic option. After this exercise, I barely remembered what business I was in. But that was just the beginning.

As any new business owner will tell you, there are a lot better ways to spend your time than calling your banker everyday. But small business owners, by our nature, break out in hives at the thought of money sitting in a banking account not earning interest.

What I didn't know was that a sweep account is really designed for larger company with an in-house accounting and financial staff to keep up with the flow of money from account-to-account. For the small-business owner with a business to run, it can be a paperwork nightmare. We soon found that the sweep account, while addressing the non-interest bearing account issue, resulted in a flood of paper from the bank. Each day we receive a reconciliation statement letting us know how the money had been shifted around in the past 24 hours. And because this is done via the mail, there is always a two-to-three day delay in the information flow so we never have an accurate, up-to-the minute view of the flow of funds among our banking accounts. Of course, the mail piled up unopened at the rate of 250 letters per year. To add insult to injury, I now knew why the sweep account fees were so high.

Don't get me wrong. I am not arguing against sweep accounts. But they are a bookkeeping hassle for a small business that would rather have their bookkeeping and accounting staff focused on managing payables and receivables than in keeping up with a flood of paperwork pouring out of the bank.

For obvious reasons the make-work nature of the sweep account ended up significantly

reducing our interest earnings. And if you consider the allocation of staff time to handling the paperwork and the lack of oversight caused by the sweep solution, I could argue that we would have been much better off leaving the funds in a non-interest-bearing account - which is what many small-business owners do - a fact that restricts much-needed capital from those who need it most.

I know that there are many simpler non-bank alternatives to this crazy system. And so, while I have continued to work with a traditional banking institution (without a sweep account I might add), it makes little sense to me why it is continued. It would appear to me that even the banks who, on the surface, may seem to benefit from not paying interest, are running off some of their small-business customers by continuing to defend this archaic practice. I challenge anyone to present a justification for a result that can only be cited as prime example of the law of unintended consequences run amok. What we have today is an archaic law running headlong into the creativity of the free-market, with the inefficient result being to no one's liking.

I support giving banks at least the choice to offer interest-bearing accounts to small-business owners. I urge this Committee to consider this bipartisan effort and to resist efforts to further lengthen the phase-in period of this important legislation. The time is now for the Senate to act. Thank you for allowing me to express my views before the committee.