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ENDING DEBT TRAPS IN THE PAYDAY AND SMALL DOLLAR CREDIT INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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ENDING DEBT TRAPS IN THE PAYDAY AND SMALL DOLLAR CREDIT INDUSTRY

Tuesday, April 30, 2019

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER PROTECTION
AND FINANCIAL INSTITUTIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:14 p.m., in Room 2128, Rayburn House Office Building, Hon. Gregory W. Meeks [chairman of the subcommittee] presiding.

Members present: Representatives Meeks, Scott, Velazquez, Clay, Foster, Tlaib, Pressley, Wexton; Luetkemeyer, Barr, Tipton, Williams, Loudermilk, Budd, Kustoff, and Riggleman.

Ex officio present: Representatives Waters and McHenry.

Also present: Representatives Green of Texas and Hill of Arkansas.

Chairman MEEKS. The Subcommittee on Consumer Protection and Financial Institutions will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

Today's hearing is entitled, "Ending Debt Traps in the Payday and Small Dollar Credit Industry."

And I just want to apologize to my colleagues and to our panelists for the late arrival. We had a codel that had some problems, so we literally just landed and came here. I thank you for your patience.

I now recognize myself for 4 minutes to give an opening statement.

To Ranking Member Luetkemeyer and the members of the subcommittee, welcome to this hearing on, "Ending Debt Traps in the Payday and Small Dollar Credit Industry."

This hearing gets at the heart of the intersection between Main Street and Wall Street. As was the case with our last hearing on CRA modernization, this hearing offers us an opportunity to consider the challenges faced by everyday American families, far too many of which struggle to make ends meet.

According to a recent Federal Reserve report on the economic well-being of U.S. households, 10 percent of adults experience hardship because of monthly changes in income. Four in ten adults cannot cover an unexpected expense of $400 without selling something or borrowing money. Over one-fifth of adults are not able to pay all

of their current month's bills in full, and over one-fourth of adults skip necessary medical care due to financial hardship.

These numbers paint a stark picture of the financial health and resilience of American households. Indeed, despite a growing economy, the data shows that middle-class and lower-middle-class American families are falling behind.

The financial vulnerability of such a large segment of American households should not make them easy targets for predatory lenders. Congress and relevant agencies have an obligation to ensure access to financial products that do not wreck the lives and finances of our constituents. American workers deserve access to financial services products that can serve as a foundation to building a better future for themselves and their families. It is in this context that today's hearing considers payday loans, car title loans, and other small-dollar loan products.

Over a period of 5 years, engaging broadly with communities and stakeholders and reviewing over one million comment letters, the CFPB developed a payday rule aimed at curbing the most abusive practices of the payday industry, including requiring that payday lenders assess a borrower's ability to repay.

There is ample research that shows that the ability to repay, combined with amortizing loans, are key to protecting consumers from falling into debt traps. As such, it was deeply disappointing to see first, Mr. Mulvaney, and then Ms. Kraninger, the current CFPB Director, move to rescind these key provisions from the payday rule and delay the rule itself.

Congress established the Consumer Financial Protection Bureau (CFPB) in the Dodd-Frank Wall Street Reform Act in the wake of the greatest financial crisis since the Great Depression, specifically so that financial services consumers would know they have one agency tasked with the sole mission of protecting consumer interests.

It is hard to see how the actions of the Bureau, under Mr. Trump's leadership team, is fulfilling its core mission of putting consumers first.

The testimony of the panel of experts today paints a portrait of the health and vulnerability of average American households and shines an important light on some of the worst predatory practices in payday, car title, and small-dollar lending, and puts forth policy recommendations for our consideration.

Today's witnesses will also speak to the important role of community banks and fintech. These are important issues that need not be a partisan issue. All of us, as Members of Congress, have constituents struggling to earn a living, finding themselves in a growing banking desert and caught in payday debt traps.

Today's hearing is an opportunity to consider how best to serve these constituents. I very much look forward to discussing these issues further today with the panel of witnesses and members of the subcommittee.

And with that, I now recognize the ranking member of the subcommittee, Mr. Luetkemeyer, for his opening statement.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Over the years, I have heard countless stories from my constituents who rely on small-dollar, short-term loans in times of financial

hardship. When there is an unexpected auto repair, a hospital bill, or a broken air conditioner, many families simply have nowhere else to turn. Each year, more than 12 million Americans utilize small-dollar loans when they need short-term financial assistance.

Unfortunately, the reputation of the entire small-dollar lending industry has been sullied by a few bad actors exercising deceptive lending practices. This small group has caused an industry that provides access to credit for millions of Americans to be villainized. In fact, under the previous Administration, DOJ and FDIC officials specifically singled out payday lenders under Operation Choke Point and attempted to cut off these legally operating businesses from the financial services industry.

My colleagues on the other side of the aisle will call for the payday industry to be severely regulated on the Federal level and are proposing legislation that will place additional requirements on short-term loans. I would caution against this approach.

History has shown that regulations have consequences. We have seen over the years that traditional financial firms have largely gotten out of the business of small-dollar, short-term loans due to the cost of regulations.

This is clearly a demand for short-term lending products, particularly to low- and moderate-income individuals.

According to the Federal Reserve, 4 in 10 adults in 2017 would be forced to borrow, sell possessions, or not be able to pay if faced with a $400 emergency expense.

Before this committee considers any legislation related to the requirements or regulations of short-term lending, we must fully examine how it will impact the industry and the consumers who depend on these products.

I am particularly concerned about a draft proposal before the committee today which would cap the APR at 36 percent for all consumer credit transactions.

First, an APR is not an effective tool to measure a loan that typically lasts 2 to 4 weeks.

Second, the interest attached to these loans should be viewed as a service fee. If a plumber comes to my house and fixes one pipe in 30 minutes and then charges me $50, did I pay him $100 an hour or did I pay him a $50 service fee?

There is no question consumers should be protected by effective regulations that safeguard their financial wellbeing. However, regulations that curb choice and stifle access to credit have no place in our economy. According to CFPB's February 2019 rulemaking on small-dollar lending, the majority's hearing memo, 17 States and the District of Columbia have either banned payday loans or have regulations that do not allow payday lenders to sustain their business models.

Restricting the availability of short-term credit will not solve the financial problems facing so many American families but it will push them toward riskier and unregulated products.

If the Federal Government takes a similar approach to these 17 States, and small-dollar, short-term products are regulated out of existence, where will the 12 million Americans who utilize small-dollar loans go to to get the financial services they need?

This is a question that this subcommittee and the witnesses in front of us must focus on today.

Thank you, Chairman Meeks, for holding this hearing.

And I thank you, the panel, for appearing before us. I look forward to a robust discussion.

And I yield back the balance of my time.

Chairman MEEKS. Thank you. I now recognize the gentleman from Georgia, Mr. Scott, for one minute.

Mr. SCOTT. Thank you, Mr. Chairman.

First of all, I want to welcome you back home. I understand it was quite a challenging trip. It's good to have you back safe and sound.

This is an important hearing as we try to grapple with ways in which we can make sure everybody, regardless of where they fit in the economic stream, can enjoy and participate meaningfully in our grand economic system. Unfortunately, that is not so true for those who fall at a certain level within the lower income and middle income of having access.

And this is why I have, along with my Republican colleagues, introduced a couple of very important bills: the Improving Access to Traditional Banking Act of 2019; and the FinTech Act, along with my colleague, Mr. Barry Loudermilk.

I look forward to getting into this very meaningful hearing.

Thank you, Mr. Chairman.

Chairman MEEKS. I now recognize the ranking member of the full Financial Services Committee, the gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Welcome back, Mr. Meeks. Thank you for being here and thanks for holding this hearing. And thank you, Ranking Member Luetkemeyer, for your leadership as well.

Research conducted by the Pew Charitable Trust found that 62 percent of payday loan customers will be forced to delay bill payments if payday loans became unavailable. There are real lives at stake, and access to credit is limited. So for consumers with less than pristine credit or for those who are credit invisible or underbanked, financial choices are severely impaired and limited.

Misguided regulation—in fact, misguided law often limits access to credit in a way that is not in the best interest of borrowers.

We will hear firsthand today from Robert Sherrill, who is the only person on the witness stand who has actually relied on a payday loan. He has a story to tell and it's a very powerful story.

Moreover, new technologies have emerged to foster greater financial inclusion by helping customers through microloan financing, advance payment alternatives, and data-driven underwriting. Those are useful and good models. The truth is, we need to help people save. And that is in our national interest. But we also need folks who do fall behind to be able to get short-term lending so they can get back into a stable situation.

So with that, Chairman Meeks, thank you for your leadership. And I yield back.

Chairman MEEKS. Thank you.

I would now like to welcome our witnesses. And I think that we have a great panel. I am looking forward to hearing from them.

First, we have the Reverend Dr. Frederick Douglass Haynes III, who is a pastor, a passionate leader, a social activist, an orator, and an educator engaged in preaching the gospel, fighting against racial injustice, and who is committed to economic justice, empowerment in underserved communities, and who has been touching and transforming the lives of the disenfranchised for over 35 years. Dr. Haynes serves as Senior Pastor of Friendship-West Baptist Church in Dallas, Texas.

Mr. Kenneth Whittaker is a community and political activist who has spent the last 14 years fighting for racial justice for the "99 percent of us," to use his words. He currently serves as the Southeast Michigan organizing director at Michigan United and Michigan Peoples Campaign.

Mr. Whittaker has traveled the country training activists, inspiring new leaders, and developing the skills of those building the progressive movement. Mr. Whittaker is a lifelong Detroiter, where he still proudly resides with his wife, his partner in raising six young adults, including five college students and one Navy seaman.

Ms. Diane Standaert is executive vice president and director of state policy at the Center for Responsible Lending. Ms. Standaert directs CRL's State-level policy agenda to advance responsible lending policy and practices across all of CRL's issues. She also oversees CRL's work on issues of small-dollar lending. She is a graduate of the Florida State University and holds a JD degree from the University of North Carolina School of Law.

Mr. Todd O. McDonald serves as senior vice president and board director at Liberty Bank and Trust of New Orleans. He began his career at Liberty Bank and Trust 13 years ago. He is intimately involved in the company's high-level corporate strategy decisions that ultimately affect the long-term growth and sustainability of the bank.

In addition to his work at Liberty Bank and Trust, Mr. McDonald is active in real estate, technology, and fast food. He received his BS in Business Management from Morehouse College and a Masters in Business Administration from Northwestern Kellogg School of Management.

Next, we have Mr. Chris Peterson, the John J. Flynn Endowed Professor of Law at the University of Utah, S.J. Quinney College of Law, in Salt Lake City, Utah.

Professor Peterson was on leave from 2012 to 2016 serving as Special Advisor in the Office of the Director at the Consumer Financial Protection Bureau, and the Office of Legal Policy in Personnel and Readiness in the United States Department of Defense, and as Senior Counsel for the Enforcement Policy and Strategy in the Consumer Financial Protection Bureau Office's of Enforcement. Mr. Peterson is a Senior Fellow of the American Bar Association's Consumer Financial Services Committee.

Mr. Gary Reeder II is vice president for policy and innovation at the Center for Financial Services Innovation.

Mr. Reeder sets the strategic direction and is responsible for the execution of CFSI's innovation portfolio and policy activity. He leads the Financial Solutions Lab, a community of startups, financial services companies, and nonprofit organizations building solutions to improve financial health in America.

Mr. Reeder's broad experience in regulatory matters stems from his work at the CFPB, the FDIC, the U.S. Treasury, and in the asset management industry.

He holds a BA in history from Yale College, and an MBA from Columbia Business School.

Mr. Robert Sherrill is the chief executive officer of Imperial Cleaning Systems. A Nashville native, Mr. Sherrill has overcome many challenges. As a young man, Mr. Sherrill served time in a Federal penitentiary where he vowed to make a change for his family and himself.

Upon his release, he opened Imperial Cleaning Services, a commercial cleaning, restoration, and janitorial company based in Nashville, Tennessee, where he serves as President and CEO.

He has been recognized as one of Nashville's "40 under 40," and as the Black Chamber of Commerce's Rising Star. He is also the president of Impact Youth Outreach, a nonprofit organization working to combat youth crime.

And lastly, we have Mr. Diego Zuluaga, a policy analyst at the Center for Monetary and Financial Alternatives in the Cato Institute, where he covers financial technology and consumer credit. Prior to joining Cato, he was the head of financial services and tech policy at the Institute of Economic Affairs in London.

Originally from Bilbao in Northern Spain, he holds a BA in economics and history from McGill University, and an MSc in financial economics from the University of Oxford.

Thank you, witnesses, for being here.

I want to remind you that your oral testimony will be limited to 5 minutes. And without objection, your written statements will be made a part of the record

I now recognize for 5 minutes, the Reverend Dr. Haynes.

STATEMENT OF THE REVEREND DR. FREDERICK DOUGLASS HAYNES III, SENIOR PASTOR, FRIENDSHIP-WEST BAPTIST CHURCH

Mr. HAYNES. Thank you, Chairman Meeks, Ranking Member Luetkemeyer, and all of the distinguished members of this subcommittee.

It would be iniquitous and immoral for someone who has been knocked down to receive handcuffs when they have out of desperation asked for a hand up. The payday loan industry is guilty of such unjust and unethical practices. They prey upon the desperation of the poor who are already disadvantaged. Payday predators hijack the hopes of the vulnerable and revictimize them by baiting them into a debt trap. These hunters of the helpless are guilty of dealing bad hands with bad plans, to use the language of Kendrick Lamar.

As Pastor of Friendship West in Dallas, I have heard too many share their experience of being exploited and ensnared in the payday debt trap. One of my members, a 74-year-old senior citizen who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer.

Now she feels like the devil has answered her prayer. She is on a fixed income, and when the repayment was due, she didn't have

enough and had to take out another loan to pay the first one. She ended up with a dozen loans.

When she approached me for help one Sunday after church, this once proud senior saint with good credit was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620 percent. She was dealt a bad hand with a bad plan. She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse.

I could call the roll, but I will proceed.

Payday predators are a part of a hostile takeover of the unbanked and underserved. This exploitive industry targets and saturates communities already suffering from economic apartheid. I am not exaggerating when I say that when the vulnerable are drowning in desperation, the payday industry throws a life preserver weighted with iron of usurious interest rates. The average annual interest rate for payday loans in the United States, 391 percent APR, is absurd and outrageous.

Payday and car title loans use a predatory business model in order to create a long-term cycle of debt at triple-digit interest rates. These short-term loans were never designed to be paid back in a short period of time. A fact check of the average number of payday loans per borrower in each State tells this sinful story. It is oxymoronic that in the land of the free, debt traps are set for the vulnerable.

Of course, the payday predators will put the spotlight on the rare exceptions who have been able to dodge the debt trap. But that should not blind us to the many who are in the shadows of a financial nightmare that never seems to end as their bank accounts are overwhelmed with overdraft fees or closed down. Some fall into bankruptcy. Many lose their cars to repossession. It is time for a new plan for those who have been dealt a bad hand.

The 2017 CFPB rule is a plan that simply requires that before payday and car title lenders make certain loans, they assess whether potential customers can afford to pay them back with the finance charges, given the customer's income and other expenses. What a novel concept. This is a commonsense foundation of responsible lending. The rule is a good plan that protects many of our nation's families from the worst impacts of triple-digit interest debt traps set by payday and car title lenders.

A coalition of citizens committed to protecting consumers have mobilized to push for strong reforms of predatory practices. Included in this coalition of conscience of those personal impacted by debt trap practices, advocates for low-income families, veterans, the elderly, responsible businesses, and faith-based groups. We are appalled that the CFPB would propose ripping out the heart of the rule in favor of allowing payday lenders to continue to exploit those who are struggling and vulnerable.

We are calling for strong protections so those who experience an emergency don't end up drowning in debt they cannot repay. We are called to protect families from financial predators, and a 36 percent rate cap would leave no one behind and ensure that they cannot be preyed upon when life happens.

Friendship West has a credit union. We offer small-dollar loans for those who are vulnerable at an interest rate of 28 percent. A business model that is just works for all.

Please, let's protect the vulnerable, lest we hear Jesus say, "I was hungry and you gave me a payday loan. I was given a bad hand, and you gave me a bad plan."

[The prepared statement of Reverend Haynes can be found on page 44 of the appendix.]

Chairman MEEKS. Thank you. And now I recognize Mr. Whittaker, whom I understand also had received payday loans in the past.

Mr. Whittaker, you are recognized for 5 minutes.

STATEMENT OF KEN WHITTAKER, SOUTHEAST MICHIGAN ORGANIZING DIRECTOR, MICHIGAN UNITED; AND FORMER PAYDAY LOAN CONSUMER

Mr. WHITTAKER. Thank you, Chairman Meeks.

Chairwoman Waters, Ranking Member McHenry, Chairman Meeks, thank you. Ranking Member Tipton and members of the subcommittee, it is an honor to be here today.

My name is Ken Whittaker, and I am from Detroit, Michigan. As Chairman Meeks said, I am a hardworking husband and a father of six brilliant young adults, five of whom are college students, and one of whom is waiting at home for me to return so that he can go to MEPS to leave for the Navy of this great country.

Years ago I was working in IT at the University of Michigan when I withdrew money from my paycheck and proceeded to lose that cash out of my pocket as I pulled out a $20 bill to buy a hotdog for my young son. Unfortunately, I took out a payday loan of $700 to cover that loss. That turned out to be a very big mistake that truly altered the course of my life. I found out that I could not pay off that first loan without reborrowing to make ends meet until the next paycheck.

This began a cycle of debt which lasted over a year. Soon, I was paying $600 a month in fees and interest. I eventually closed my bank account to limit the payday lender's ability to draw money directly from my account, leaving my family without the cash for rent, for groceries, and for other essential bills. This led to debt collection calls and a judgment. My tax return was garnished, making things that much worse for my family. All told, that original $700 loan cost me over $7,000.

I spoke out about my experience. At the time, the Consumer Financial Protection Bureau was developing a rule that would require lenders to make loans based on customers' ability to repay and that they could afford. To me, that requirement only makes sense, and that is how all lending should be.

Having been through this experience myself, I know how devastating payday lending can be. It is quite disturbing to me that the current leadership of the CFPB is threatening to repeal the rule that we lobbied so hard for to protect us.

I strongly support keeping the 2017 CFPB rule. I also support the proposal to cap annual interest rates at 36 percent to stop predatory lenders from trapping customers into high-cost loans that can ruin their financial lives.

Since the day I bought that hotdog for my son, we have worked to make things better for working families. Coming full circle, my son and his siblings are here today with me in D.C., as we have been fighting for fairness and justice.

Please support strong reform of predatory payday and car title lending for people like me. We work hard to support our families and make finances stable, and this kind of lending only makes it harder.

Thank you for allowing me to share my story today, and I urge you to protect working families and put people over profits.

[The prepared statement of Mr. Whittaker can be found on page 94 of the appendix.]

Chairman MEEKS. Thank you.

Ms. Standaert, you are recognized for 5 minutes.

STATEMENT OF DIANE M. STANDAERT, EXECUTIVE VICE PRESIDENT AND DIRECTOR OF STATE POLICY, CENTER FOR RESPONSIBLE LENDING

Ms. STANDAERT. Thank you, Chairman Meeks, Ranking Member Luetkemeyer, and Ranking Member McHenry.

Thank you for the opportunity to testify today. My name is Diane Standaert. I am the director of State policy and executive vice president of the Center for Responsible Lending (CRL).

The Center for Responsible Lending is a nonprofit, nonpartisan policy and research organization dedicated to building family wealth through the elimination of abusive lending practices.

Our organization's nearly 20 years of research on payday and car title loans show consistently two things: one, these loans are a debt trap by design; and two, the harms of these debt trap products further economic inequality and further the racial wealth gap.

Payday and car title loans charge 300 percent annual percentage rates and strip away around $8 billion in loan fees from people typically earning about $25,000 a year. The bulk of these fees are generated by the debt trap.

Seventy-five percent of all payday loan fees are due to borrowers stuck in more than 10 loans a year. The typical car title loan is refinanced 8 times. Low-income borrowers then suffer a cascade of financial consequences, delinquency on other bills, having their bank account closed, and even bankruptcy. For car title lenders, an astonishing one in five borrowers have their cars seized.

Borrowers have described this debt trap in their own words as soul crushing, a hole you can't get out of, and a living hell.

As borrowers suffer these harms, the role of private equity has increased to fuel the engines of this industry. What people see at the street level as a small lender storefront is actually the tentacles of private equity extracting billions of dollars a year from people already struggling to make ends meet.

And research has shown time and time again that payday and car title loan storefronts disproportionately locate in black and Latino communities, even when they have the same or higher income as white neighborhoods.

Thankfully, policy trends at the State and Federal level for more than a decade have been to rein in the harms of these unsafe loans, ranging from the 2006 passage of the 36 percent rate cap for the

Military Lending Act to protect our Active Duty military families, to voter-affirmed rate caps of 36 percent in States like South Dakota, Colorado, Arizona, Montana, and others.

Today, 16 States plus the District of Columbia enforce caps of 36 percent or less covering nearly 100 million people with this most effective protection against the harms of these loans. Since 2005, no State has legalized payday lending.

Today, I would like to emphasize four important points. Payday and car title lenders have situated themselves intentionally to perpetuate our country's two-tiered financial services system. The harms and consequences of these loans exacerbate the wealth gap and disproportionately burden communities of color. Older Americans and people on fixed incomes are also particularly vulnerable.

To reduce these harms, the predatory nature must be addressed head on. Competition and alternatives will not lower the cost of 300 percent interest rate loans.

Finally, the States, Congress, and Federal regulators all have a role to play in ensuring that people are not ensnared in these debt traps.

We are thankful for Senator Durbin's leadership in proposing a 36 percent rate cap that does not override strong State laws. Congress and Federal regulators must reject any proposal that in the name of innovation or otherwise preempts stronger State law.

Today, on behalf of more than 700 organizations participating in the Stop the Debt Trap campaign, we call on the Consumer Financial Protection Bureau to implement, not delay, not repeal, its 2017 payday rule, which simply requires lenders to verify that borrowers have the ability to repay the loan.

This commonsense notion of ensuring a loan is affordable is the bedrock of responsible lending, and it is strongly supported by voters all across this country, with 75 percent support among Republicans and Democrats alike. The fact that payday and car title lenders resist such a notion confirms everything we know about the lending business model.

In summary, policymakers have a choice, siding with the vast majority of voters and borrowers who oppose the payday loan debt trap or siding with the predatory lenders who charge 300 percent annual interest rates.

Thank you for your time.

[The prepared statement of Ms. Standaert can be found on page 80 of the appendix.]

Chairman MEEKS. Thank you.

I now recognize Mr. McDonald for 5 minutes.

STATEMENT OF TODD O. MCDONALD, SENIOR VICE PRESIDENT AND BOARD DIRECTOR, LIBERTY BANK AND TRUST COMPANY, ON BEHALF OF THE NATIONAL BANKERS ASSOCIATION

Mr. MCDONALD. Chairman Meeks, Ranking Member Luetkemeyer, Ranking Member McHenry, and members of the subcommittee, good afternoon and thank you for this opportunity to testify on the small-dollar lending industry.

My name is Todd McDonald. I am a senior vice president and board director at Liberty Bank and Trust Company. I am also a

board member of the National Bankers Association (NBA), the leading trade association for the country's minority depository institutions (MDIs).

The NBA's mission is to serve as an advocate for the nation's MDIs on all legislative and regulatory matters affecting our member institutions as well as the communities they serve.

Small-dollar lending has become a fast-growing source of consumer credit in the United States and a key to financial inclusion, particularly for those underserved communities.

Unfortunately, existing Federal law does not limit the interest rate nonbank lenders can charge on loans of $2,500 to $10,000. This lack of interest rate cap has resulted in a recent explosion of loans with annual interest rates in the range of 100 percent to 225 percent and above.

While 35 States have imposed caps on nonbank lenders, there is still a significant gap in protections for customers.

As a CDFI that serves a largely low- and moderate-income consumer base that often utilizes these high-cost products, Liberty often works to help our customers get out of these predatory loans and into more manageable instruments. This dynamic is one of many reasons why we have created our own small-dollar loan product called the Freedom Fast Loan.

The Freedom Fast Loan was created in 2008 because we saw a demand for a responsible small-dollar product in the markets that we serve. Our customers use Freedom Fast Loans for everything from funeral expenses to consolidation loans for other high-interest debt like credit cards and payday loans. The average loan is just over $6,000, and the average interest rate is right at 12.6 percent. Our APR never exceeds 34.3 percent, and we serve customers with credit ranging from the low 500s over to 700 Beacon scores. We also report payments to the credit bureaus so our customers can build their credit while using our product.

In order to scale our Freedom Fast product, and for community banks to provide similar options, we believe that there are steps Federal banking regulators and Congress must take in order to facilitate the kind of robust marketplace where community banks can compete with predatory small-dollar lenders.

The Credit Union National Administration's PALS program and the findings from the FDIC's Small-Dollar Loan Pilot Program should provide the basis for regulators to consider a small-dollar regulatory regime tailored to community banks like our member institutions.

Even our Freedom Fast Loans attracted scrutiny in the past from regulators, despite it meeting an obvious credit need in the markets we serve. To that end, we believe that a sandbox approach from banking regulators that allows community banks to develop responsible small-dollar alternatives tailored to the credit needs of our communities would be a welcome next step in carving out a role for mission-oriented lenders to provide responsible alternatives.

In addition to a sandbox for community banks, we would also urge Congress to fully fund the Small Dollar Loan Program authorizing grants for loan loss reserves for CDFIs seeking to provide responsible small-dollar alternatives. Technical assistance grants for

CDFIs seeking to provide payday alternatives for expenses like underwriting software and other administrative costs would be definitely encouraged.

According to the OCC, U.S. consumers borrow nearly $90 billion every year in short-term debt, typically ranging from $300 to $5,000. Due to the cost in the increasing regulations, many banks have withdrawn from this market, resulting in consumers turning to alternative lenders as a last resort.

Within the right environment, banks can provide affordable short-term loan options that can help consumers with their financial needs while establishing a path to more mainstream financial products. However, it is very important that policymakers create a regulatory atmosphere where these loans are profitable for banks that take on this customer niche and do not lead to additional regulatory burdens.

Policymakers should also create an environment where community banks can partner with responsible nonbank lenders to fill the obvious need in this lending space.

Thank you for your time.

[The prepared statement of Mr. McDonald can be found on page 47 of the appendix.]

Chairman MEEKS. Thank you.

Mr. Peterson, you are now recognized for 5 minutes.

STATEMENT OF CHRISTOPHER L. PETERSON, JOHN J. FLYNN ENDOWED PROFESSOR OF LAW, UNIVERSITY OF UTAH, S.J. QUINNEY COLLEGE OF LAW; AND DIRECTOR, FINANCIAL SERVICES, AND SENIOR FELLOW, CONSUMER FEDERATION OF AMERICA

Mr. PETERSON. Thank you, Chairman Meeks.

Also, thank you, Ranking Member Luetkemeyer and Ranking Member McHenry. It is an honor to be here today. Thank you very much for holding this hearing and also for attending the hearing.

I would like to begin with two quick statistics to get started. First, the average interest rate of the New York City's so-called La Cosa Nostra organized crime families and their organized loan sharking syndicates, at the height of their power in 1960s, was 250 percent, a very high interest rate.

But by way of comparison, the average interest rate nationwide in storefront payday loan stores is probably about 420 percent APR, nearly twice as expensive as what the so-called mob charged.

And all throughout the vast majority of American history, for over 200 years, virtually every State in the Union did not tolerate interest rates at those prices. We had usury limits in all 13 original American colonies. All of the signatories to the Declaration of Independence, every delegate to the Constitutional Convention, all of those guys went straight back to their States where they had interest rate limits of between 6 to 7 or 8 percent or thereabouts.

It wasn't until the beginning of the 20th century where we started to raise those interest rate limits to about between 18 to 42 percent, and 36 percent was the tried and true interest rate limit all throughout the Great Depression. The Greatest Generation—the so-called Greatest Generation that went and fought the second

world war, they all came back to States that had interest rate caps of about 36 percent, even on the smallest, most expensive loans.

Without those interest rate caps, the problem is that people fall into debt traps. If there is one thing I could get you to look at, it is the screenshot that I have included in my written testimony. This screenshot is from an auto title lender that made a $1,971 loan to a woman. I have changed her name for her privacy. She was a client. She borrowed this money because she was behind on her bills. It had an interest rate of 300 percent.

She worked as a receptionist, made about $11 an hour as a receptionist. Month after month, she kept paying back as much money as she could. She made $400, $500, $480 payments. Overall, she paid $4,635 on this original $1,900 loan. But because of the simple power of a 300 percent interest rate, the lender only applied $1.16 to the principal balance of her loan.

And then afterwards, the lender still continued to claim that she owed another $2,422.05, even though she had paid back over $4,000. This is money that she is making $11 an hour as a receptionist. She was still deeper in debt than when she originally began that loan. That is not freedom. That is a trap. It is a debt trap.

And a second point I would like to make is that across this nation, a supermajority of Americans, both Republicans and Democrats, agree that we need to restore our traditional, old-fashioned interest rate caps, our usury laws, that had protected so many people from all across this country throughout the vast majority of our history. That is about 3 in 4—about 73 percent of Americans in virtually every public opinion poll that has ever been conducted. And every time there has ever been a ballot initiative on a ballot where the public actually got to vote, they have always voted in favor of usury limits.

That means that in every one of your districts, a supermajority of your constituents support imposing a traditional interest rate cap, which leaves me with the question of, are you going to go along with them, with what the public wants, or are you going to vote as legislation comes up in this Congress to protect the payday lenders that charge triple-digit interest rate caps and have prices that are higher than the New York City loan sharks charged?

And then I will end on one thing. I would urge you to consider, as a template for moving forward—think about looking at the Military Lending Act. You know, the people who defend freedom in this country, the United States military, respected on both sides of the aisle, their people were falling into trouble because of these predatory debt traps, and they put a stop to it. They got over, they lobbied, and they got Congress to pass an interest rate limitation on loans to servicemembers. That limitation is now in effect. And I am proud to say that I, along with a number of other people, helped work on drafting those regulations. And it has done a great job for our servicemembers. They still have plenty of access to credit.

It is time for Congress to learn a little bit about what freedom and free markets means from the people who defend our freedom. Freedom is not the same thing as a debt trap. And in Congress, we need to remember that and restore traditional, old-fashioned commonsense usury laws to protect our citizens all across this country.

Thank you for your time.

[The prepared statement of Mr. Peterson can be found on page 51 of the appendix.]

Chairman MEEKS. Thank you, Mr. Peterson.

Mr. Reeder, you are now recognized for 5 minutes.

STATEMENT OF GARRY L. REEDER II, VICE PRESIDENT, CENTER FOR FINANCIAL SERVICES INNOVATION

Mr. REEDER. Chairman Meeks, Ranking Member Luetkemeyer, and subcommittee members, thank you for allowing me the opportunity to share some thoughts and insights on the small-dollar credit industry and its impact on Americans' financial health.

Small-dollar credit has been a core part of my work for over a decade and is deeply entwined with my experience growing up in rural North Carolina. Some of my earliest memories involve accompanying my grandmother in her brown 1973 Ford Maverick every payday to pay her lenders. She, like so many other people in my community, had limited access to mainstream financial services.

As the son of a Baptist Minister, I also saw up close the real-world needs of our most vulnerable brothers and sisters. Nearly every week, someone came up after service seeking help paying rent, buying diapers or getting gas.

Since my family, like many others, lived paycheck to paycheck, our ability to help one another was limited by our own lack of resources.

I ask that we keep these people and the millions of Americans like them in mind as we bring our different perspectives to the table in an effort to improve the financial health of all Americans.

As we all know, financial services has the ability to protect us from economic ruin and enable us to build better lives for ourselves, our families, and our communities. However, far too often financial services, particularly credit and our antiquated payment system, make people's lives more difficult.

I am the vice president of policy and innovation at the Center for Financial Services Innovation, a leading authority on consumer financial health. We are a trusted resource for business leaders, policymakers, and innovators, united in a mission to improve the financial health of their customers, employees, and communities.

Our largest initiatives include the Financial Solutions Lab and U.S. Financial Health Pulse. The Financial Solutions Lab is a seed-stage fintech accelerator focused on advancing the financial health of low- and moderate-income and historically disadvantaged consumers.

The U.S. Financial Health Pulse is an annual snapshot of how Americans manage their financial lives with actionable insights to improve financial health.

Our research suggests that a variety of different needs and use cases underlie the demand for small-dollar credit and that many of them are symptomatic of one or more dimensions of poor financial health.

Payday lenders, auto title lenders, pawn shops, and other subprime lenders have dominated the provision of small-dollar credit for much of the last 30 years. Many of the products they have offered are rarely underwritten, rely on cycles of continuous

use, and harsh collection practices that both exploit and perpetuate borrowers' financial distress. Auto title loans are particularly concerning because of the potential loss of a car in the event of default.

Fortunately, the consumer finance industry is in the midst of a dramatic change as a result of the ever-increasing speed of technological innovation and the broadening and deepening of data availability.

Fintech startups and innovative incumbents are developing and testing products that have the potential to meet the financial needs of underserved households. However, innovation must be tempered with appropriate standards and oversight.

In an attempt to address those standards, we have developed our own compass principles for small-dollar credit. We believe high-quality products have seven core characteristics: first, the loan is underwritten; second, the loan amortizes; third, lenders make money when the customer succeeds; fourth, payment history should be reported to the credit bureaus; fifth, no fine print; sixth, multiple channels for applications and payment for customers; and seventh, customer service that meets the needs of the customer and not just the lender.

In closing, I want to thank the committee for the opportunity to share my thoughts on this important topic and remind all of us that we are here to get this right for consumers rather than to make each other wrong.

I look forward to your questions.

[The prepared statement of Mr. Reeder can be found on page 67 of the appendix.]

Chairman MEEKS. Thank you, Mr. Reeder.

Mr. Sherrill, you are now recognized for 5 minutes.

STATEMENT OF ROBERT SHERRILL, CEO, IMPERIAL CLEANING SYSTEMS

Mr. SHERRILL. Good afternoon, Chairman Meeks, Ranking Member Luetkemeyer, and members of the subcommittee.

My name is Robert Sherrill, and I am grateful for the opportunity to be able to speak to you about my experience with payday and title loans.

I am not sure if I am the only person on this panel who has actually used these products, but I hope that with my testimony I can shed some light on how important they were for me at the time when I had no other options.

Payday and title loans helped me when I had nowhere to else to turn. I might not be here if these forms of credit were not available to me.

In your invitation letter to me, you asked me to discuss research describing the various harms consumers may suffer when utilizing these products. I cannot talk about research, but I can talk about my personal experience.

When I took out my payday loan, I knew what it would cost me. While I have not taken out a payday loan recently, I still know what they cost. Given my circumstances at the time and the lack of other options, I determined that this basic small loan was the best option for me. In fact, it was a cheaper and easier solution

than the available alternatives. I am lucky that there was a lender available that would loan to someone like me in my circumstances.

But let me get back to the beginning of my story. When I was young, nobody taught me about money and finances, which is a situation not uncommon to many people. Because of family issues and hard times, I ended up raising myself and getting involved in selling drugs, which ultimately led to me going to prison. I am not proud of this, but it is an important part of my experience.

When I got out of prison, the deck was stacked against me. I was a felon with no credit, no education, and very little income.

I would ask you to put yourself in a lender's shoes. Would you have made a loan to me? Would you have offered me a lifeline? Would you have given me credit with nothing to prove I was creditworthy but my word?

Due to my release and probation requirements, I found a job as a food busser at a local Italian restaurant. I worked very hard day-to-day to make ends meet. After a year, I was given a 10-cent raise. It was then I knew I had to make a change in my life.

When I started my business, no one would give me a loan. I knew this because I applied and I was rejected several times. Most banks wouldn't even let me open an account. The only account I could get was with the credit union, because I pled my case.

Because of my history, the only company willing to front me the money I needed was a local payday lender in Nashville called Advance Financial. If Advance Financial had not been an option, I would likely not be here testifying to you today.

It is unfair for anyone to assume that everyday people don't know what they are getting into or what repayment terms of a loan are going to be. That assumption is based on the conclusion that ordinary people are uneducated or too unsophisticated to make smart financial decisions.

In my situation, I was tracking every dollar I had. I knew when money was coming in and I knew when it was going out. I knew that I would have to repay the loans that I took out.

When I went to Advance Financial, every part of the process was explained clearly and fairly, including when payments were due, how much they would be, and how much it would cost me for the loan.

Today, the business that I started with a payday loan is Nashville's premier construction and commercial cleaning service. I am a minority certified business belonging to the Chamber of Commerce, the Better Business Bureau, and Nashville's Rotary Club. Now, I qualify for lines of credit and other types of loans. I have developed a solid business foundation. But it is all because of the lifeline that Advance Financial gave me when no one else would give me the time of day.

I have also come to learn from being in business that sometimes a market determines what things cost. Many today will probably ask if I would like these types of loans to be cheaper. Well, there are a lot of things in life that I wish were cheaper. But forcing these lenders out of business would not make loans cheaper; it would only hurt people in a situation like I was in.

I want to repeat what I said at the beginning of this statement. I understood what a payday loan was going to cost me when I took

it out, and I understood when I had to pay it back. The best consumer protection that I got was to have someplace to go that was willing to make a loan to me, and to explain the loan I got.

I can also tell you that if I had not had that option—[audio malfunction].

Chairman MEEKS. The microphone must have gone out.

Give him 30 seconds to wrap up.

Mr. SHERRILL. If you eliminate these loans and these lenders, where do you expect people to turn for a lifeline? I had tried everything else. For many people like me, these products are a first step towards getting things back together. People choose them because they are better than the alternatives. If they weren't, they wouldn't exist.

We should trust people to choose what is best for their own situations, not take options away from them, because the most expensive credit is the credit you cannot get when you need it.

Thank you.

[The prepared statement of Mr. Sherrill can be found on page 78 of the appendix.]

Chairman MEEKS. Thank you.

And Mr. Zuluaga, you are recognized for 5 minutes.

STATEMENT OF DIEGO ZULUAGA, POLICY ANALYST, CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES, CATO INSTITUTE

Mr. ZULUAGA. Thank you, Chairman Meeks, Ranking Member Luetkemeyer, and members of the subcommittee for the opportunity to testify before you this afternoon.

My name is Diego Zuluaga, and I am a policy analyst at the Cato Institute Center for Monetary and Financial Alternatives.

Creating the conditions for a dynamic and competitive market for short-term credit is essential to promoting financial security and financial inclusion.

At a time when 24 percent of American families and 50 percent of low-income families lack enough liquid savings to cover a $400 emergency expense, broad and immediate access to credit is a matter of great urgency.

Furthermore, with 8.4 million households unbanked and another 24 million underbanked, a share of that emergency credit is bound to come from nonbanks, including payday and vehicle title lenders.

Payday loans are often one of very few options available to cash-strapped households. Sixteen percent of payday borrowers use these loans to cover emergencies, while 69 percent borrow to pay for recurring items, such as rent and utility bills.

Payday loans offer a way to cope with unexpected events and month-to-month income volatility, which is a reality for more than a third of low-income households.

While the media often describe payday loans as predatory, the evidence suggests otherwise. Professor Ronald Mann of Columbia Law School, in a study quoted extensively by the Consumer Financial Protection Bureau, finds that 60 percent of payday borrowers accurately estimate the time it will take them to repay the loan. And importantly, there is no systematic bias in their predictions of

repayment, so borrowers overestimate roughly as much as they underestimate the time it will take them to repay.

Professor Mann's results contradict the assertion that payday borrowers are misled by predatory lenders or that they suffer from some behavioral bias. The academic literature, in fact, on payday lending finds that these loans are helpful to borrowers and that payday loan bans are harmful, at least as often as it finds the opposite.

Payday borrowers make the best of limited options. As Professor Lisa Servon of the University of Pennsylvania writes, "The question is whether expensive credit is better than no credit at all." Like Professor Servon, I worry that placing an interest cap on short-term credit would altogether remove access to emergency funds for the most vulnerable Americans.

Now, I have had the opportunity to study in detail the impact of payday loan interest rate caps in the United Kingdom. While U.K. regulators expected loan volume to decline by just 11 percent after the introduction of an interest cap, it dropped by 56 percent. That is 5 times what regulators estimated within 18 months. The number of borrowers dropped by 53 percent, versus 21 percent, which was the estimate.

Now, given that the regulators' forecast aimed for the "optimal amount of payday borrowing," this miscalibration of the cap's impact almost surely left hundreds of thousands of payday borrowers worse off.

I worry that the Bureau's payday rule, which predicts loan volume to drop by up to 68 percent, but expects most borrowers to retain access to payday facilities, will actually prove similarly overly optimistic and the consequences of regulatory error could be very damaging, as the U.K. case demonstrates.

Low usury caps were once widespread across American credit markets. But progressive reformers in the early 1900s recognized that caps harm low-income people by throwing them into the hands of loan sharks. Gradually, they persuaded legislators to lift or remove interest caps, helping a formal market for short-term credit to flourish.

Placing a cap on small-dollar loans today risks leaving vulnerable households at the mercy of either family members or unscrupulous providers, or otherwise forcing them to go without basic necessities.

Policymakers can, however, do more to promote financial inclusion, and I welcome efforts to bring a greater focus on underserved households to financial regulators. For example, I think the CFPB and the Federal Deposit Insurance Corporation should conduct a joint review of the regulatory costs to banks of maintaining deposit accounts. This will permit them to compare the cost of regulation with its benefits and to determine whether financial regulation excludes low-income and minority borrowers who are overwhelmingly represented among the ranks of the unbanked.

But I wouldn't limit this work to fostering access to depository institutions, important as such access is. Financial innovations like mobile money accounts have delivered impressive results around the world. And with 94 percent of Americans now owning a cellphone, mobile accounts could bring essential financial services

to households which, for reasons related to cost or trust or both, do not own a bank account.

Mobile payments could therefore help low-income consumers avoid account fees and gradually gain access to other financial services and build a credit record.

Thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Zuluaga can be found on page 95 of the appendix.]

Chairman MEEKS. Thank you.

And I now recognize myself for 5 minutes to ask questions. Let me first say that I listened very intently to everyone on this panel, and I did not hear one person say that those who are in low-income areas, et cetera, should not have access to some financial services, not one.

What I did hear is some say that we do have basically—they didn't use these words, but we have some who will con people; we have some who will just come and try to confuse people for their own benefit, for their own basis. And so they don't mind whether or not someone gets trapped in a loan that they can't get out of because that is not their interest, not that individual. Their interest is to make as much money as they can at the expense of someone else.

And so when we had the Dodd-Frank Act, what we did was, we said we were going to create the Consumer Financial Protection Bureau so that somebody can review this, because we know we have good people, we have bad people, so that somebody could review it and make an impartial, if you will, determination, to make sure that you could continue to do business, if that is what you wanted to do, but to also serve someone who needed a loan.

Now, one of the things—and one of the reasons why we are here is that immediately the CFPB, after the change of Administrations, got rid of the unfair, deceptive, or abusive acts or practices and how that was defined. So if you get rid of that, you have a fixed game, because you have a situation where on one side—and yes Mr. Sherrill, I agree with you that some people know how to manage their money and some don't. That is a fact. And as a matter of public policy, we have to look out and protect those who don't.

I would also say—and my question would go to Mr. McDonald, because one of the basic tests would be ability to pay. If somebody comes—and I would now ask you this question later, Mr. Sherrill—and I have no ability to pay—I have no idea how I am going to pay you back, no because nobody is going to give you any money, not if they are serious. But you have to show some ability to pay it back.

That is how we got in the financial crisis, the worst financial crisis since the Great Depression, in 2008, when people were giving no-doc loans, and it almost brought our financial institutions, our financial services and this country to its knees.

Mr. McDonald, you work in these communities and you have a financial institution. What is the best way you would think to make sure that someone has the ability to pay when you make a loan at your facility?

Mr. MCDONALD. So we follow a couple of different guidelines, but we definitely ask for verification of income, via a copy of their paystub or a W-2 or 1099.

Chairman MEEKS. So you do check to make sure that they have a job or some kind of way to pay?

Mr. MCDONALD. Absolutely.

Chairman MEEKS. All right. Now, Mr. Reeder, in my limited time, because I listened—your testimony was so riveting, I had to take up my time earlier with that comment.

But I want to make sure—I wear this suit now, but I come from public housing. My parents were poor, okay? And I can remember that they had loan sharks back then. And so it wasn't money; they'd take your limb, too. But I also could know when they were getting ripped off.

I am looking at ways to make sure that we have some ability for financial services in the community. Fintechs have been talked about, but fintechs unregulated have the same problems.

Can you give us some ideas on how fintechs should be regulated or how they could be helpful in this industry?

Mr. REEDER. Sure. Thank you, Mr. Chairman.

In terms of regulation, obviously a number of financial institutions are regulated at the State level. But it is true, for purposes of Dodd-Frank, that many institutions in what people broadly call fintech are not covered persons under Dodd-Frank for the CFPB. So one piece there is that the CFPB would need to write a larger participant rule for a number of these institutions in order to supervise them. And for many people who have been regulators, supervision is a very powerful tool to both understand what the institutions are doing, but more importantly what are the outcomes for the consumer.

So I think that is a capability that the Federal Government has today, if the CFPB were to write a larger participant rule.

Chairman MEEKS. Thank you. I am out of time, and I recognize the ranking member of the subcommittee, Mr. Luetkemeyer, for 5 minutes for questions.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I think most of the testimony today has centered around the cap, the APR of 36 percent or higher rates that we are talking about. And to me it is a little difficult to accept the arguments from the standpoint that when you are looking at a short-term loan, to me, that is very similar to a service charge.

In my testimony, in my opening comment, I said, look, if you have a plumbing problem at your house, you call the plumber. And he comes and he fixes it within 30 minutes and charges you 50 bucks. Did he charge you 50 bucks or did he charge you $100 bucks an hour. To me, he charged me 50 bucks because it took him that long to get there, he had to pay for his tools, pay for his insurance, he had to pay for his workmen's comp, he had to pay for his gas and oil to get there. It is a service charge to provide that product.

And so I think today when we use APR on short-term lending, it is a disservice to everybody. To me, personally, I don't think you need to be using an APR unless it is an annual—unless you are over 12 months. If it is a 12-month loan or more, you use an APR. Anything less than that has to be a service charge.

What does it cost to put the loan on the books? Mr. McDonald, you are in the banking business, what does it cost you to put a loan on the books, a small-dollar loan? Does it cost 15 bucks? Is that going to cover it?

Mr. MCDONALD. I don't have that exact number. However, it does cost money to market to those individuals and also use our back office to book those loans, yes.

Mr. LUETKEMEYER. So there is a cost there that has to be covered, otherwise that service is not going to be provided. So you get into the situation of, well, we don't have any services or the loans are misused or abused. The CFPB in the fall of 2018, their own members, so that is 7/10th of 1 percent were the complaints received by CFPB on smaller loans or payday loans, which is consistently one of the lowest of the various financial products according to CFPB.

When I was in the State House in Missouri, as a State rep, my committee oversaw—I was the chairman of the Financial Services Committee, and what I always did every year was go look at the complaints with regards to banks, payday lending, and all the different services that were seen by the division of finance. Payday lending was always the lowest number of complaints of any of the financial groups.

So I think we are looking at something here that is a worthwhile service. Mr. Sherrill, you tell a compelling story. Where would you have gone if you wouldn't have had the opportunity to have that loan? What was your next step if you didn't get the loan?

Mr. SHERRILL. Coming from where I come from, my next step was going back to the streets. The only thing that stands between the streets and the pawn shop is payday lending, that is it, that is all we have, so you have to do what you have to do.

Mr. LUETKEMEYER. So what we need to do in your mind would be help folks have more access to credit. If we need to tweak the laws, need to improve it, that would be the way to go rather than trying to dismiss it. And you talked about the APR as well, you had some compelling testimony. Can you elaborate on that a little bit?

Mr. SHERRILL. Yes. I mean, the payday loan I got was just for a couple of weeks. It wasn't for a year. I have never known anyone to receive a payday loan for a year. So I would be confused when people say APR, I kind of think about buying a car or something like that, but—

Mr. LUETKEMEYER. I know when I was in the House in Missouri, we redid the payday lending laws. We were actually model legislation for the whole country for a long time. And one of the things that we did was put a box on the form that showed what the actual cost of the loan was going to be, how much you were actually going to pay with interest and charges. So there was a disclosure. To me, that is helpful to you, to actually see the costs. You said you looked at it, and you knew what it was going to cost you.

Mr. SHERRILL. Yes, when I went in there they explained to me, this is what we are giving you. This is what we expect back at this time. If you don't pay it back, then this is what happens. You sign something that you understand this before they give you any money.

Mr. LUETKEMEYER. Mr. Reeder, in your testimony you note that an annualized percentage rate is a very poor tool for the small-dollar lending market. Would you like to explain that a little bit?

Mr. REEDER. Sure. APR was really created to compare like financial products to one another, so it is a shopping tool. If I were to get a 30-year fixed-rate mortgage from Bank A, and a 30-year fixed-rate mortgage from Bank B, I would be able to take the APR and compare to understand what were the interest rates and the charges. So that is what it was designed for. The problem becomes, as the term gets shorter and shorter, the APR becomes geometric, so it increases rapidly.

Mr. LUETKEMEYER. Okay. I have one more quick question. Mr. Zuluaga, you talked about the UK and how they estimated that the loan volume would decline slightly and it went over 56 percent. Where did those people go who no longer have access to credit?

Mr. ZULUAGA. Mostly to family members, from the research that has been done afterwards. But those are the people who have access to alternative options. A lot of people just go without.

Mr. LUETKEMEYER. They go without. What about some of the unscrupulous folks on the streets or on offline lending, which is unregulated. Is that possible as well?

Mr. ZULUAGA. It could be possible, it's very hard to monitor, or course, and that is one of the challenges. At least now we can monitor a lot of these lenders and they are in the open. Thank you.

Mr. LUETKEMEYER. Thank you. Thank you Mr. Chairman.

Chairman MEEKS. The gentleman's time has expired. I now recognize the Chair of the full Financial Services Committee, the Honorable Maxine Waters, for 5 minutes.

Chairwoman WATERS. Thank you very much, Mr. Chairman. Dr. Haynes, as Senior Pastor at Friendship-West Baptist Church, you moderated a panel I convened of interfaith leaders to address predatory lending in American communities, and working with members of your community in Dallas, Texas, many of whom have been targeted by predatory payday loan and auto title loan stores.

You stated that, "We want access to credit, but it must be quality credit. Anything less adds to the stress of the desperate and the needy. Well-crafted and compassionate legislation can weed out the predators, and enable more responsible and reputable lenders to thrive while rendering a helpful service to communities."

Can you tell us about the terrible consequences of falling into payday debt traps, and your efforts as a faith leader to help these vulnerable consumers?

Mr. HAYNES. Thank you, Madam Chairwoman. First and foremost, of course, when you fall into the debt trap, one of the things that accelerates the downward spiral are the overdraft fees, not to mention the fact that I have had a number of persons come to me, and along with their overdraft fees, some have just basically had their bank accounts wiped out. They were pressured. They were called on-the-job. Not to mention, family members were harassed. And so this is something that is predatory.

And so what we are calling for is a system. One of the things that I have heard repeatedly from the opposition is that we have some who do well because they had no other option. And my point is, you always have some who are good enough to beat the system.

But if the system is broken, you want to correct the system. Tupac Shakur talked about a rose out of concrete. Well, if one rose can burst through the concrete, we salute that rose. But what about the rest of the seeds who don't make it? And that is why we are concerned about a predatory industry that continues to harass individuals into deeper and deeper debt.

And so, again, they are asking for a life preserver and they end up with one made of iron that causes them to sink further and further in debt.

Chairwoman WATERS. Wow. Well, Pastor, let me ask you this. As we have wrestled with this very, very troubling problem in this country, and as we have fought off the payday lending industry, et cetera, we have had people come to us with different ideas and different proposals. One of them that seems to be emerging is, what about limiting payday lending interest rates to 36 percent the way they do for veterans?

Mr. HAYNES. Right.

Chairwoman WATERS. Have you had a chance to think about that?

Mr. HAYNES. Oh, without question. Not only that, but even in our church, we have a credit union, a Federal credit union, and we offer micro loans, small-dollar loans. And our interest rate is 28 percent. It is a great business model because it is moral and just. Thirty six percent is a moral and just interest rate. It is a model that will work as opposed to prey on individuals. It is a model that will help them to do what the payday industry claims they want to do, and that is is to get out of debt—get out of the debt trap, and at the same time, move forward in their lives. And so 36 percent, I think, is not only moral, it is just, and it is doable.

Chairwoman WATERS. Wow. Well, I thank you for sharing that with us because some of us who were not thinking about anything but trying to stop the payday loan industry because of all of the trauma and the pain that was experienced by people who were desperate who needed some help and would go to them, but yet get caught in that debt trap that you talked about, we had not thought a lot about doing what we do for the veterans.

Mr. HAYNES. Yes.

Chairwoman WATERS. And when I began to think about that, I thought I wanted you here to ask what you thought about it, to get your opinion because of the work that you have put into it, the work that your community has done, the work that the church has done. And I know that you have had to run some out of Dallas basically who were exploiting. And so now we have these proposals, and you have given me something to think deeper about. Because what you are doing in your church were with your loans at 28 percent, it is working, and what we have been doing with the veterans at 36 percent, it means that perhaps we can do the same with the entire industry.

So I want to thank you for coming, I know on short notice, but you are so appreciated. And I certainly appreciate you, and thank you.

And I yield back the balance of my time. Thank you so much, Mr. Chairman.

Chairman MEEKS. Thank you, Madam Chairwoman. I now recognize the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman. And I thank the panel for taking the time to be here. Obviously, I think all of us want to make sure that people are treated fairly, but we also have regulations, ability to repay that need to be addressed. And I don't want to put anybody on the spot here, but Mr. McDonald, you listened to Mr. Sherrill's testimony. Would you have made him a loan coming out of prison?

Mr. MCDONALD. That depends on several factors, and obviously, we look at credit history, we look at repayment capacity—

Mr. TIPTON. Out of prison with no job, probably couldn't have made the loan at that time.

Mr. MCDONALD. I believe he said he had a job. And we certainly have lent money to individuals who come from unfortunate backgrounds, who may not have a long history of income, but we have certainly made loans.

Mr. TIPTON. I am just a little interested in your model, you are a CDFI, right?

Mr. MCDONALD. Yes.

Mr. TIPTON. All right. Do you make $100 loans?

Mr. MCDONALD. No, our minimum is $500.

Mr. TIPTON. So if Mr. Sherrill needs $100, $200, to be able to fix his car, you won't cover that loan?

Mr. MCDONALD. No, sir, not at this time.

Mr. TIPTON. Where do they go?

Mr. MCDONALD. They would go to a payday lender.

Mr. TIPTON. Is that their only option?

Mr. MCDONALD. In some cases.

Mr. TIPTON. Probably in most cases. Please understand, I am not trying to put you on the spot. It is just we do have regulations in place, and it is part of the only purpose of the committee in terms of what we are doing in terms of accountability on the banks and the institutions. And when you are talking about the interest rate that you do charge on the Freedom Fast loan, how does that compare to somebody with an 800 credit score?

Mr. MCDONALD. It is a tiered scale based on—

Mr. TIPTON. What would you charge for that same loan, $600, for somebody who has an 800 credit score?

Mr. MCDONALD. Unfortunately, I don't have our rate matrix memorized.

Mr. TIPTON. It probably would be a lot less, though, wouldn't it?

Mr. MCDONALD. So just in general, our short-term loan products will cap at 19.9 on the interest rate side, but I am not really sure how that will calculate out into the APR. But as the example that I used earlier, we have an average APR of 34.6 percent, I believe.

Mr. TIPTON. Okay. Well, I guess the point I am trying to make is this obviously is a challenge for people with low income to be able to deal with. Mr. Sherrill, you have lived that life. But it is going to be some actual access to some capital at the times when people need it to be able to address that.

In my home State of Colorado, we went through several iterations. In November of 2018, we passed, by referendum, a new law, that is going to be capping that at 36 percent effectively. And

that was the balance that was struck to be able to address that in terms of a challenge for short-term credit products that we have.

Mr. Sherrill, maybe you could address this a little bit more. In terms of the availability of payday lending, where do people go in the case of—if they only need that $200, $300 to be able to get a loan? If payday lending, as an example, doesn't exist, what do they do?

Mr. SHERRILL. Go back to the streets or go ask a family member. But I come from a low-income family. My family doesn't have any money. So, if it wasn't for me getting the payday loan, I would have gone back to the streets. That is just realistic.

It sounds good in testimony for people to get up here and say what is being said right now, but in reality, where I am from, it affects many people. I am not the only one with this story. There are many people who use these services and use them responsibly, and we need to spotlight that, and then you would understand because there are no other options.

Mr. TIPTON. Well, Mr. Sherrill, in 2013, the Fed, the OCC, and the FDIC issued guidance because most banks—to stop making or providing products to the customers in terms of short-term small-dollar loans. These are institutions that are well-regulated and have to make sure that you have the ability to repay, as Mr. McDonald was talking about.

What is a good solution to be able to fill that gap for the short-term loans? Should we extend that to more banks or just—

Mr. SHERRILL. I really don't know what the answer—the magic bullet should be. But I know taking this option away from low-income people or people who don't have access to credit or who don't have a history of credit, will be doing a disservice to the community.

Mr. TIPTON. Mr. Zuluaga?

Mr. ZULUAGA. Just quickly, I think banks are now very concerned about coming back into this because of that guidance. And unless there are very strong and clear signals that these products are going to be tolerated and accepted and not prosecuted, I think we will run out of options if we don't continue to allow payday loans.

Chairman MEEKS. The gentleman's time has expired. I now recognize the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. We have 56 million unbanked and underbanked consumers in this country. So many of them are victims, as has been pointed out. I think the good Reverend Dr. Frederick Douglass, love that name, and Frederick Douglass, as you may know. And your comments were right on target—all of your comments are.

I have introduced two major pieces of legislation that I want to kind of get the witnesses' reaction on. The first one is the Improving Access to Traditional Banking Act of 2019. And what this Act would do, is it would create an office that is specifically tasked with examining factors contributing to households that are unbanked and underbanked, identifying them, their status, and developing the best business practices for improving that situation.

Mr. Sherrill, you are right. Where else do they have to go? But to some of these people, if we don't provide a way and get that in-

formation to them. Another bill that I have is the Fintech Act. And as you know, and I want to get comments from you. Some of these fintech companies are dealing with this area because they are developing partnerships with some of the traditional banks that will not even deal with some of the unbanked and underbanked. So what I am saying is that there are things out there that we are trying to work with to get that.

So let me just ask you, Mr. McDonald, you are from the National Bankers Association, tell me about this. What about the impact of these fintechs helping some of these people that traditional banks won't help? Are you aware of some of those partnerships there?

Mr. MCDONALD. Yes, I am. And as an organization, we actually do encourage partnerships with fintechs, obviously, to a certain extent. But coupled with the technology and the know-how of a traditional bank, it could actually bring down the costs and make the costs more efficient and product and service more efficient and effective. And so that is how we have been leveraging our experience.

Mr. SCOTT. Very good. Now, Mr. McDonald, let me ask you, from the banker's standpoint, can you tell us the importance of financial inclusion in the traditional banking sector, and in particular, how increased safety and affordability and convenience of financial services can have a positive impact on low- and moderate-income consumers?

How can this bill—what we are trying to do with this bill is to try to identify the problem, bring it together, and then apply the necessary resources of coordination to really get to the heart of the matter, and make these—and try to put an end or at least slow down these predatory lenders. They have nowhere else to go because they don't have a checking account, they don't have a banking account. We have to create this—does that make sense to you?

Mr. MCDONALD. Absolutely. And the National Bankers Association will be—open doors and we are definitely willing to speak further in terms of ideas and strategies around solving that problem. It is not an easy problem, obviously, but we definitely welcome ideas and strategies.

Mr. SCOTT. All right. Now, Mr. Reeder, you are the president of the Innovation—I think—what is that, the technological innovation and—

Mr. REEDER. The Center for Financial Services Innovation?

Mr. SCOTT. Yes. And that is what we are trying to do. We are trying to use these innovators, the fintechs, the other areas to try to create some answers and solutions to this. Are we making some progress with the fintechs, what our initiatives would be doing, what our bill would be doing in terms of trying to find ways that we can increase the access of capital to these people, lending to them?

Mr. REEDER. Mr. Chairman, should I answer another time, I know the time has expired?

Chairman MEEKS. I am going to let you finish. Go ahead. I have my own judgment here.

Mr. REEDER. Yes, I think there is enormous opportunity. We work with companies that do things such as allowing people access to wages that they have already earned. We live in a country where people work and they are not paid for their work for some

period of time, sometimes 2 weeks, sometimes a month. So we work with people to allow people access to assets that they already have.

There is obviously a lot of work to help understand who is creditworthy. Because of a long history of discrimination in this country, credit scores and other traditional means have biases that are embedded in them, they are very difficult to undue. And so there are opportunities for us to do that. So in my testimony, I list a number of companies that—

Chairman MEEKS. Thank you. The gentleman's time has expired.

Mr. SCOTT. Thank you, Mr. Chairman, for the time, I appreciate it.

Chairman MEEKS. I now recognize the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. Mr. Zuluaga, a question for you. Many small banks and credit unions in my congressional district in central Kentucky have told me that overly zealous supervision, over-regulation, and higher compliance costs stemming from the Dodd-Frank Act and other regulations have forced those lenders out of the small-dollar lending business, and out of the consumer lending space altogether. This has had the impact of pushing many borrowers to payday lenders and other forms of nonbank and noncredit union lenders.

Is the answer for unbanked credit-challenged borrowers more regulation and banning higher-cost products? Or is the answer more competition and choice through financial deregulation? And as you answer that question, keep in mind the testimony from Ms. Standaert, who said that competition is not the answer.

Mr. ZULUAGA. Thank you for the question, Congressman. I think the answer is clearly more competition and more choice, because that drives prices down for consumers, it creates options that are more well-adjusted to exactly what it is that they need and want, and it also encourages continued innovation so that whatever negative features are in a financial product are no longer present there.

In the particular case of small-dollar lending, it was mentioned before that there was a 2013 guidance from the OCC and the FDIC that led banks to retreat entirely from the small-dollar lending market, and this is in keeping with the general retreat of banks, as you suggested, since passage of the Dodd-Frank Act.

Mr. BARR. So you are telling me that banks and credit unions have retreated from this space after Dodd-Frank?

Mr. ZULUAGA. The evidence that I have seen for banks, decidedly yes, but for credit unions, I will have to get back to you, because they do some different types of—they offer some types of alternative products, but obviously they don't reach everybody.

Mr. BARR. I can tell you the credit unions and community banks have told me that they exited consumer lending post-Dodd-Frank, because of an avalanche of regulations. But let me explore this idea of an APR rate cap. In 2018, a major super regional bank in the United States began offering small-dollar short-term loans. The program has a limited scope to those customers with a current banking account. And even with the pricing advantages of lower capital costs and additional risk mitigation employed by that bank, in order for the program to be sustainable, the bank is charging interest rates between about 71 percent and 88 percent APR, more

than double the 36 percent APR rate cap that has been advocated by some.

If a large super regional institution with all of its market advantages and economies of scale can't make a 36 percent APR work, why is it realistic to think that a State-licensed or nonbank lender could do that?

Mr. ZULUAGA. I don't think it is realistic, Congressman. And in fact, I think we need to think about the small-dollar lender space, it is something of a spectrum, that are products for prime borrowers that carry low rates because they have a credit history and they have a record of paying back their debts. Some people, for various different reasons, don't necessarily have access to such low rates. In removing the options that they have, the people that will accept them as borrowers doesn't make them better off it. It makes it difficult for them to build a credit record. It makes it difficult for them to survive emergencies and so on.

Mr. BARR. Reverend Dr. Haynes, thank you for your advocacy and work to empower people who are credit-challenged and are struggling financially. Let me ask you this, in the course of your advocacy, have you ever engaged those populations that you minister to, that you serve in financial literacy, specifically on payday loans, to say, educate those vulnerable populations about the difference between the interest rate if the product is used as it is designed, meaning that it is paid off in 2 weeks or 4 weeks, as opposed to rolling it over, in order to avoid that triple digit APR, which it is never designed to be?

Mr. HAYNES. Well, yes, we have—to answer your question, we do have, not only financial literacy classes for those who find themselves in that predicament, but we also, again, offer the small-dollar, 28 percent loan, micro loan for those persons who are struggling. And a part of their getting the loan is going through the class.

Mr. BARR. And Mr. McDonald, I appreciate your sandbox approach, and I also appreciate your advocacy for clarifying true lender to create liquidity in the secondary market with fintech. Let me ask you this, without the small-dollar loan program, without technical assistance grants, could you offer small-dollar loans, or is taxpayer assistance essential in order to originate and service small-dollar loans with interest rates below 36 percent?

Mr. MCDONALD. I would not say it is essential. This is a specific business model that we have chosen as an organization. And a lot of organizations within the MBA have chosen to do so as well. So our profits are not at peer group levels. We have sort of—

Mr. BARR. Yes, and I am sorry, my time has expired. But what I worry about is that without taxpayer assistance, Mr. Sherrill doesn't have an alternative, and he has testified to that today.

And so the only model that works is having the government compete, and compete with private businesses and put them out of business. And there is a limit to the amount that taxpayers can provide, and so we do need private capital to provide access to credit for some folks. And I yield back.

Chairman MEEKS. The gentleman's time has expired. I have now evened it up, I gave Mr. Scott 40 seconds extra and I have given Mr. Barr 40 seconds extra. So now, I will go back to my 5-minute

rule. And the gentlewoman from Massachusetts, Ms. Pressley, is recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Chairman Meeks. And I welcome this opportunity to examine the practices of this industry, which it seems more often than not, instead of offering a life raft has offered dead weight, wreaking financial havoc in any community that it touches. I am, however, thankful for the protections of my home State of Massachusetts, which has guarded against these debt traps. Payday loans are not allowed in my State, and my constituents, anywhere, are not exactly clambering for a 400 percent interest loan.

In fact, according to the Center for Responsible Lending report, consumers in Massachusetts saved more than $248 million in 2017 as a result of these protections.

Ms. Standaert, can you tell me, based on your organization's research, how big of a role the State's rate cap has in creating these savings?

Ms. STANDAERT. Thank you, Representative Pressley, for the question. A rate cap such as what Massachusetts has in place is the most effective protection against the debt trap, it is due to the rate cap that has garnered the millions of dollars of savings for your own residents, and it is the same rate cap that is saving over $5 billion a year to residents across the country in similar States.

Ms. PRESSLEY. And so where consumers do not have these protections, payday and small-dollar lenders have preyed on the desperation of the working poor, turning their need for a dollar today into a profit of $2 tomorrow. But as we examine this industry, I would be remiss if I did not acknowledge its disparate impact on communities of color.

So, open to anyone on the panel who would care to comment, very briefly, just to better understand the common threads of these intrenched inequities, what is the profile of a typical payday loan borrower?

Mr. WHITTAKER. Thank you, Representative Pressley. The typical profile, I think if you look on this panel you can see the extremes of the profile. Mr. Sherrill has spoke about not having access to credit, and not having an opportunity to seek help in his situation. But when you provide a tool, a debt tool like this that is marketed as easy, accessible, and safe, people begin to stop looking for other options. There are many other options.

People say that—well, Mr. Sherrill said that he didn't have family who could help him or there wasn't—they are low income, so there was no income. Well, there is family, there are friends, there is the sweat of your brow, if you need to go buy some clothes and sell them on eBay, there are many other options that are available. But when you put the easy solution in front of somebody and you say that this is safe, why continue to look for harder options?

Ms. PRESSLEY. Thank you, Mr. Whittaker. And picking up on that, since you said the magic word, "marketing," I am curious about the marketing of these debt traps since the prevalence of them is in low-income communities and communities of color.

So, Ms. Standaert, can you elaborate on where payday lenders are located and how they compete for businesses in these communities?

Ms. STANDAERT. Yes. Thank you. Payday lenders explicitly state that they compete on factors such as location, convenience of service, and other things. Notably missing from the list is competition based on price. Everywhere that payday lenders operate, they charge the maximum rate allowed by law. So 300 to 400 percent interest rates, despite a bunch of them being clustered together. Then we also see that payday lenders disproportionately concentrate in communities of color.

In California, for example, we see payday lenders locating at over 2 times the rate in black and Latino communities, than other similarly situated white communities. And this pattern exists all throughout the country: Michigan; Georgia; Florida; Louisiana; and Colorado, all have been documented. And so this combination of the importance of payday lending locations and their ability to get customers in the door.

Ms. PRESSLEY. Thank you. Reclaiming my time. Thank you. And then picking up on the Reverend's point about people, instead of getting a hand up, getting handcuffed. Mr. Peterson, I know you have done quite a bit of work on the industry's reliance on small claims courts, particularly in States like Utah that do not have interest rates or protections. So what happens when people can't repay? Are there criminal charges? What happens?

Mr. PETERSON. Well, I have a study coming out, it is not out yet, but we have been looking at collection efforts in small claims courts and we have been surprised to find that there are a lot of small claims borrowers who end up getting bench warrants issued for their arrest.

Ms. PRESSLEY. Thank you. Reclaiming my time. This is what is clear. In the universe with payday lending, is one answering the question of how to make poverty a sustainable profitable enterprise? A lot of people are getting rich off of keeping people poor. And so how do we reform anything that is based on that premise? The short answer is we don't.

Thank you. I yield back.

Chairman MEEKS. The gentlelady's time has expired. I now recognize the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. I appreciate the panel, there are quite a few of you up here. But I do appreciate this, this is a very sensitive issue. Mr. Sherrill, I have to say, I am inspired. Your story is incredible. I think you saw that your story doesn't exactly fit in the narrative that some would like to paint, but I am particularly inspired, not just by you seeing the opportunity that this nation can give you, but by you finding a way around the obstacles and the hurdles. That is what makes this country great.

The other aspect of it is I have been where you were. I have been in situations where early in my life after I left the military, I was trying to get a small business started, and I didn't find anyplace just to buy groceries for my family, I mean, it is—I just needed it for a short time. I knew the next check was coming from a job I did, but I didn't have anything to fill the gap. So sometimes people just don't know where it is coming from, and I am not defending the industry, but I am saying, any business exists where there is a need to fill.

And often we create the problem ourselves, being government, by overregulating areas to where we can't fulfill some of those needs, and that is one of the concerns I have. And the chairman in his opening remarks brought up the statistic that 40 percent of U.S. adults could not cover a $400 emergency without selling property. I agree with Mr. Whittaker, maybe that is what you need to be doing to cover an emergency, if you have property.

The problem I ran into in my situation was, I had just moved across the country and I had sold most everything I had to relocate to this new location. So we sometimes try to paint with a broad brush something that is—each individual person has a unique situation, and a lot of times these businesses exist to actually fulfill that need. Yes, they are charging a large amount—sometimes too much amount in interest, but yet, they are loaning to are folks who couldn't get the loan anywhere else.

But, on the same hand, we are creating a situation because we have pretty much, through regulation, prohibited the banking community from making these small-dollar short-term loans. And I think that is part of the problem, we could relieve some of this if we could just allow these businesses to make these loans. I wrote a letter to the Federal Reserve asking and the FDIC last year, asking for both of them to join the OCC in allowing, banks, once again, to make these small-dollar short-term loans to constituents.

So, quickly, Mr. McDonald, the FDIC recently accepted comments from stakeholders on small-dollar lending. And if the Federal Reserve and the FDIC explicitly stated that these loans are allowed, as the OCC did last year, would that encourage banks to get back into small-dollar lending?

Mr. MCDONALD. I would certainly hope so.

Mr. LOUDERMILK. Yes, I would, too. I think it would resolve some of the concerns that we have to give at least some folks an alternative. Mr. Reeder, as you know, Georgia is a hub for fintech and payment processing, and I also co-Chair, with my colleague from Georgia, Mr. Scott, the Fintech and Payments Caucus. When a bank or credit union partners with a fintech company to make these loans, do the same consumer protection requirements apply if the consumer got the loan directly from the bank?

Mr. REEDER. If the consumer received it directly from the bank, yes, the OCC or the FDIC or whomever is the examiner in charge would have the same authority over that—

Mr. LOUDERMILK. Even if there is a fintech involved somewhere in that process?

Mr. REEDER. Yes. The complication here is how the product is structured. The other avenue for regulators is third-party vendor management, which is a tool that bank regulators have, even in the event that the legal entity is a nonbank, the examiner in charge usually requires third-party vendor management to ensure that certain protections are in place.

Mr. LOUDERMILK. Okay. Thank you. Last question. Mr. McDonald, in your testimony you discussed a regulatory sandbox, which I am highly in favor of, for banks to test small-dollar consumer loan products. Can you elaborate in the few seconds I have left?

Mr. MCDONALD. Sure. So if regulatory bodies sort of allowed us to take on more risk without identifying them as high-risk loans,

and that is sort of the problem that we had initially a few years back when we started doing this specific product. The scrutiny came where these loans were given to individuals with significantly lower interest rates, and they were identified as those high-risk loans.

Now, over the years our regulators have become more comfortable with us managing a portfolio like that within a much larger portfolio. So to your point, yes, a sandbox approach where other community banks can operate in a very comfortable manner would definitely be helpful.

Chairman MEEKS. The gentleman's time has expired. I now recognize the gentlewoman from Virginia, Ms. Wexton, for 5 minutes.

Ms. WEXTON. Thank you, Mr. Chairman. I was glad to hear some testimony about the Military Lending Act (MLA), because that is something that really has impacted the people in my district in Virginia, which is the State I am from. It was enacted in 2007, and it imposes a 36 percent interest rate cap for payday loans for Active Duty servicemembers and their dependents. However, with the arrival of Mick Mulvaney, and now, Director Kraninger, the CFPB has decided to suspend MLA compliant supervision even though Federal law clearly directs that they conduct this supervision.

Now, this is a big deal for us in Virginia because we have military bases. We don't really have payday lending, but as a result we have twice as many car title lenders, and they set up their shops near military bases, especially Quantico Marine Base, and the Norfolk Naval Base.

Mr. Peterson, while you were at the CFPB, you worked with the Pentagon to help design MLA regulations. Is that correct?

Mr. PETERSON. Yes, Representative Wexton.

Ms. WEXTON. Okay. And can you describe what you were seeing in terms of predatory practices that were going on that you needed to guard against?

Mr. PETERSON. Sure. We saw a lot of evasion of the interest rate cap with companies that would redesign their products to get in the nooks and crannies of the rule to try to make triple digit and straight loans to our military servicemembers in ways that Congress had not intended, and that is why it was so important that we had a tight, well-drafted regulation, and also rigorous supervision and enforcement follow up.

Ms. WEXTON. So if CFPB is not enforcing these regulations, who is?

Mr. PETERSON. Well, they are claiming to enforce it. They are not doing preventative supervisory examinations, but the other prudential regulators also have supervisory authority. The Federal Trade Commission also has some enforcement authority. And also, servicemembers themselves can bring private causes of action to enforce that law. But it is very troubling that the only Federal regulator that has supervisory preventative examination authority over payday lenders is not conducting Military Lending Act compliance over those payday lenders and car title lenders that you just mentioned. That is a troubling development.

Ms. WEXTON. Thank you very much.

Ms. Standaert, I was looking at the new Center for Responsible Lending updated report about payday car title lenders draining

nearly $8 billion in fees every year. Is that an accurate amount for the fees that they are collecting annually?

Ms. STANDAERT. Yes, that is correct.

Ms. WEXTON. So this is a very lucrative business model for these operators. Is that correct?

Ms. STANDAERT. Yes, again 75 percent of these collected are due to borrowers stuck in more than 10 loans a year. So the bulk is due to the debt trap.

Ms. WEXTON. Now, there are a number of States that have State protections against these payday or car title borrowing debt traps. Most of New England has enacted such legislation, as well as Pennsylvania, New York, and New Jersey. What do people do in those States? Are they able to get credit?

Ms. STANDAERT. Most importantly, consumers in those States are not stuck in the quicksand of the debt trap, and so they have—they are protected from these dangers, they have other options for addressing financial shortfalls, and they are able to move more quickly to pathways of building assets and wealth for their future.

Ms. WEXTON. And have you observed that the market has responded and that these folks still have access to credit, even though they are not caught in the debt trap?

Ms. STANDAERT. Yes, that is correct.

Ms. WEXTON. Thank you very much. I yield back.

Chairman MEEKS. Thank you. I will now recognize the gentleman from North Carolina, Mr. Budd, for 5 minutes.

Mr. BUDD. Thank you, Chairman Meeks, for yielding, and for hosting this hearing. I also want to thank all of the witnesses for sticking around.

I am particularly taken, Mr. Sherrill, by your story, and not just because of your background, but also because of the industry that you are in, and that is my family's business that I grew up in. And so I appreciate what you do day-in and day-out, and the customers and their issues and the challenges you face, not from a background perspective, but from the business perspective. And custodial and janitorial work is a tough business, it is a noble business, and I appreciate what you do. My family's business started around 1963, and it is now in its third generation. So you might have a legacy on your hands. I wish the best to you. So thanks for what you do.

Mr. McDonald, in 2013 the OCC and the FDIC issued guidance placing strict restrictions on a bank's ability to offer deposit advanced products. So how has this decision by the regulators, coupled with the current regulatory environment, affected your bank's ability to offer small-dollar loans to consumers?

Mr. MCDONALD. Over the years, we have become more comfortable in sharing our experience with small-dollar loan products with our regulators. And as a business model, we actually are okay with doing less than peer group numbers. And so with their approval and with their oversight, we are okay with doing small-dollar loans within a certain perimeter.

Mr. BUDD. I want to expand this to all of the panelists. Would you agree that it is good for consumers in an unforeseen situation where they are in immediate need of funds to allow highly regulated or what we think of as normal banks to offer a small-dollar

lending product? And if we could just start from the right and go this way—my right.

Mr. ZULUAGA. I think it is absolutely right for that to be the case. My only caveat is that banks generally require a credit history and an experience of the borrower. So they will be able to help out a lot of people if the environment is created for that, but that doesn't mean that some people won't rely on alternative options because they are unbanked or because they do not have a credit score that is sufficient to obtain a loan from the bank.

Mr. BUDD. Mr. Sherrill?

Mr. SHERRILL. Can you repeat the question for me?

Mr. BUDD. Sure. So we are asking if your regular normal bank should be able to offer these small-dollar loans. It seems that since 2013, they haven't be able to due to the regulators making a lot of rules where they can't.

If anybody has an opinion? If you want to weigh in, great, if you would like to not weigh in, that is okay as well. But if you have any thoughts, please?

Mr. SHERRILL. I think that if they could ,they would be doing it by now. Payday lending in my city is the only thing that is going. I don't see any other alternatives. I keep hearing that word though, but I don't know of any. I am a businessman. I am smart. I can find the money if it is there. It is not there.

Mr. BUDD. Thank you.

Mr. REEDER. I would support that with the one caveat of the relationship between overdraft and the small-dollar credit offered by a bank and sort of how those two interact. But our organization helped design the U.S. Bank product, and I have been a long time supporter of small-dollar credit that is bank-issued.

Mr. BUDD. Thank you.

Mr. PETERSON. It is simply not accurate to say that banks or credit unions are not offering small-dollar loans. In fact, every credit card in America can be used to expand small-dollar credit; you just borrow a little bit of money on your credit card. And every credit card in America also includes a free payday loan for borrowers who are not maintaining a balance, a monthly balance, during the grace period. So you can borrow $100, $150, $200, $300 on your credit card and then repay that. Now, not everybody has access to credit cards, but banks have done a pretty good job of increasing availability for credit, and have a variety of credit cards that are available out there for people with subprime credit histories, especially if they are willing to put down a deposit on the card. It is one alternative; there are lots of others out there.

So I think there are plenty of credit opportunities out there across the country, and that is just factually driven at interest rates that are below 36 percent.

Mr. BUDD. All right. Thank you.

Ms. STANDAERT. Yes, banks should not start acting like the payday lenders on the corner. At the time before the 2013 regulations, those direct deposit advance loans trapped people, on average, in 19 loans in a year at effective rates of 200 to 300 percent. And those borrowers were also experiencing the harm of the overdraft. So banks should not be in the business of offering harmful small-dollar credit and should stay under the 36 percent rate cap.

Mr. BUDD. Thank you. My time has nearly expired. I will finish with this. Continued innovations and financial technology will, in my view, also create more credit opportunities for the consumer offering them a product at a lower price point.

And I hope this committee can continue to support further development in this space because it should play a continued role in the small-dollar space, along with banks and payday lenders.

I yield back. Thank you all.

Mr. MEEKS. Thank you. I now recognize the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman, and Ranking Member Luetkemeyer. Reverend, you mentioned that you provide micro loans?

Mr. HAYNES. Yes.

Ms. VELAZQUEZ. Have you partnered with the SBA?

Mr. HAYNES. Pardon me?

Ms. VELAZQUEZ. Have you partnered with the Small Business Administration?

Mr. HAYNES. No, we have not.

Ms. VELAZQUEZ. And why is that? Would you—so the Small Business Administration has a micro loan program, and they provide money to intermediaries like you so that you could provide technical assistance to the borrowers, because it is not only about providing access to capital, but making sure that these individuals will succeed in their enterprises. So I will suggest to you that maybe you should explore that option.

Mr. HAYNES. Okay. Thank you.

Ms. VELAZQUEZ. And so for the Republicans who are concerned about providing access to capital to low-income communities, they should advise the President not to zero-out the micro lending program that we have under SBA.

Mr. Reeder, online lenders, so-called fintech lenders, originated almost $23 billion in small-dollar consumer and small business loans in 2015, according to one estimate. And as you know, expansion in this area has been rapid, growing 163 percent between 2011 and 2015.

Do you think the current regulatory environment is doing an appropriate job balancing investor protections and access to capital? What possible changes would you make?

Mr. REEDER. Thank you for the question.

A couple of things. One, I would note that small business credit has unique features in that it does not have the same protections as consumer credit. So in the case of consumer credit, the Truth in Lending Act applies, which requires a set of disclosures and requires a computation of an APR.

That does not apply to small business credit. I think that is something that should be considered. On a positive note, the Equal Credit Opportunity Act does apply to small business credit. One distinction I would make in this space, which is very important, is that there are lenders and there are merchant cash advance businesses.

Lenders are subject to the same laws as others on the State level as being lenders. Merchant cash advance businesses in general are

not considered lenders for State law, and that creates a set of issues from a regulatory standpoint.

Ms. VELAZQUEZ. Thank you.

Mr. Peterson, would you like to comment?

Mr. PETERSON. Could you repeat the question, please?

Ms. VELAZQUEZ. Is there anything we should do in the regulatory climate to provide investor protections and access to capital? What changes would you make to the current regulatory environment?

Mr. PETERSON. I would recommend expanding the Military Lending Act that is currently functioning and doing a great job for our active duty servicemembers right now, and expanding those protections to all Americans all across the country. There will still be plenty of access to credit and that will crowd out some of the worst predatory abuses.

Ms. VELAZQUEZ. Thank you.

Mr. Reeder, reports indicate that the average online loan carries an interest rate that is much higher than compared to a traditional bank loan. Why would a consumer or small business owner use an online lender even when the interest rate exceeds that of a traditional bank loan?

Mr. REEDER. There are a couple of answers. Obviously, once again, small business and consumer are different. But I would say one of the issues in credit in general is just the ability for consumers to shop. Often, consumers don't have the opportunity to compare alternatives, so sometimes that is an issue.

The other is that the online channel in general is faster, and so many people find that convenient, something that they are willing to pay for.

Ms. VELAZQUEZ. So are you concerned about the possible predatory nature of these high-interest online loans?

Mr. REEDER. Any credit product that ends with a consumer worse off than where they started is a problem.

Ms. VELAZQUEZ. Are you concerned that providing loans of this nature fosters an environment similar to the build-up of the subprime mortgage crisis of 2008?

Mr. REEDER. I do think that the mortgage crisis is unique in both its scale and its impact. However, I will say that having large amounts of credit that are not regulated from a Federal level in the case of the Truth in Lending Act could be problematic.

Ms. VELAZQUEZ. Mr. Peterson?

Mr. PETERSON. Yes, I think that online loans, in particular the online payday lending market, is one of the most abusive and problematic markets in the country. The average interest rates in the online payday loan market are actually higher than they are in the storefront market.

Ms. VELAZQUEZ. Thank you.

Ms. Standaert and Mr. Reeder, some have noted that online marketplace lending could fail as an industry because these lenders often fail to fully inform borrowers of the terms of the loan and their high interest rates.

How can we achieve transparency? How can we make sure that people who are getting money, borrowing money, they know the APR, know the terms of the loan? Would you support a borrower's bill of rights? What provisions would you seek to include?

Ms. STANDAERT. We are most concerned with the underlining terms of the products and whether or not they are properly priced, properly underwritten, and whether or not they comply with State laws. One of the concerning developments in the marketplace industry is their partnership with out-of-State banks to make loans that are at rates higher than what is otherwise allowed by law.

Chairman MEEKS. Thank you. The gentlelady's time has expired.

I now recognize the gentlewoman from the great State of Michigan, Ms. Tlaib, for 5 minutes.

Ms. TLAIB. Thank you, Mr. Chairman.

I want to thank all of you so much for being here.

About three-fourths of payday borrowers make about $40,000 a year. In my district, that is about 60 percent of the residents essentially being targeted by predatory lenders. Many of my neighbors who are single moms, veterans, and young professionals are burdened by immense student loans, teachers and so forth, all throughout my Wayne County community.

And one of the things that we are seeing is that payday loan establishments pop up on the corners of my district, but literally at the doorsteps of communities, and especially communities of color, where there is concentrated poverty.

Mr. Sherrill, when you talk about how there was no other option, I just want you to know that I think government is about people and it is about us creating those options that are better than this.

But, also, ensuring that there is some sort of regulation and oversight of practices that are ready fed through corporate greed. Corporate greed leads to unjust practices that hurt residents, especially when they are pushed more into poverty. And every time I see my residents kind of stuck, and they have these flashy signs, and come on in, we will take care of you, at the end as soon as the sign—they don't take care of them. They don't help them.

Not like credit unions and not like the Reverend's services through, you know, incredible service that you are doing through residents. So it is really important that when we talk about how there are no other options, it is our job to create those options for you.

My question, and really, you know, the CFPB has decided to aid in what I call legal robbery by proposing a rule that will drain our communities of their hard-earned savings, instead of developing a system that helps the most vulnerable. And, as you know, so in 2007, the payday lending rule—they prevented that trap that we are talking about, and this is something that I really want to focus on in this committee hearing. We should not be subjecting families to that.

Mr. Reeder, what kind of harm could low- and moderate-income consumers, particularly communities, be exposed to if CFPB's current proposal is finalized?

Mr. REEDER. In full disclosure, I was at the CFPB, and I was Chief of Staff during a period in which the rulemaking was underway. So I want to be very clear about that. I do think that the rule offers enormous opportunity, probably once in a decade, or maybe once in a generation, to put protections in place that really do weigh access and protection. And that without that, many of us will be back in this room 10 years from now or 20 years from now

having the same discussion when many of the opportunities we have in front of us are quite evident, and we spent almost a decade here in Washington working this out.

Mr. Peterson here would know better than me, he helped write the rule. But that is something where it would be a great missed opportunity if we were unable to move forward.

Ms. TLAIB. Thank you. Mr. Whittaker, you and I have worked on grassroots advocacy on just the amount of what poverty from water shut-offs to ensuring that we have a right to breathe clean air and so forth.

One of the things that, you know—we are government, the public, I always feel like is stuck subsidizing the cycle of poverty that is created by practices like that. Does that make sense?

So when we don't do our job on this end in preventing folks to be chained, as the Reverend called it, or being held back, and that is what it is by not creating alternative options, we, the public, is subsidizing that poverty.

Can you talk a little bit about—because you are from the city I grew up in. You talk about what that looks like from the ground up, because I see it in our school system, I see it in so many ways of how poverty is costing us more money on the other end in trying to provide all these other services.

Mr. WHITTAKER. Thank you, Representative Tlaib.

When we divest resources from these communities, we don't support our schools. We close down community banks. We divest in community development, and then we seed these institutions throughout our community, and then we say that this is most affordable and safest option.

Well, I would challenge you, Representatives, that if this is the most affordable and safest option, then I would say that it is evidence of decades of failure by the people that we elect to make decisions for us.

I agree with you, Representative Tlaib, that it is your job to create these options as this country moves forward. If you look and you see that there is nobody at the wheel, then you take the wheel.

I will end this by saying that if you continue to keep the lights off, the roaches will continue to feast on the crumbs of this country that you have created.

Ms. TLAIB. Thank you so much. And I just would end with this: Close to 80 percent of Americans live paycheck to paycheck. And many of you at this table know that.

I have the third poorest congressional district in the country, and one in every two households will face some sort of burden of unexpected financial emergency. And this should not be their last option. We should be, again, working together to provide alternatives and supporting what you are doing, Reverend, in Texas. So I, again, really appreciate it.

And I yield back the rest of my time. Thank you.

Chairman MEEKS. Thank you.

I now recognize the gentleman from Texas, Mr. Green, who is the Chair of our Subcommittee on Oversight and Investigations, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. Chairman, this hearing has been informative, but it has also been painful. And it has been painful because you and I know that most poor people who cannot get a payday loan do not take to the streets. That is highly inflammatory language. It is designed to say to white people that black people who don't get payday loans are likely to engage in criminal conduct.

Poor people across the length and breadth of this country suffer in poverty without committing crimes. And to imply that if you can't get a payday loan, you are likely to take to the streets, that is a painful thing to hear. And it is regrettable, to be quite candid with you, that it has been said.

So, Mr. Sherrill, since you want to play this game, let me play with you.

Did you get your pardon from Donald Trump yet?

Mr. SHERRILL. Are you asking me a question?

Mr. GREEN. Yes, sir.

Mr. SHERRILL. I wish.

Mr. GREEN. You did request one, didn't you?

Mr. SHERRILL. I am working on it.

Mr. GREEN. That is right. You are working on a pardon. And there is a reason for that. How many felonies did you have?

Mr. SHERRILL. State or Federal? I have both.

Mr. GREEN. This call—

Mr. SHERRILL. I don't know.

Mr. GREEN. You determine.

Mr. SHERRILL. I need to understand.

Mr. GREEN. Let me just share this with you. Ordinarily, I would not do this. But for you to do what you have done—

Mr. SHERRILL. What is that?

Mr. GREEN. To imply that people of color—because you happen to be a person of color—to imply that if you can't get a payday loan, you will take to the streets.

Mr. SHERRILL. That was my circumstance, sir.

Mr. GREEN. That is for you. But don't imply that that is the only option for people.

Mr. SHERRILL. That is for most of the people that I know.

Mr. GREEN. Well, but not for most of the people in this country. That is what you have done.

Mr. SHERRILL. I can only speak from my experience, sir. That is why I am here.

Mr. GREEN. Well, you can speak from your experience, but you ought not try to put that experience on other people.

Mr. SHERRILL. They know it, too.

Mr. GREEN. What you have done, sir, is shameful.

Mr. SHERRILL. The truth can never be shameful.

Mr. GREEN. The truth is shameful when you exaggerate and you try to pretend that it is more than what it is. Poor people are not criminals just because they are poor.

Mr. SHERRILL. I didn't say that.

Mr. GREEN. But that is what the implication is. If you can't get the loan, you are going to take to the streets.

Mr. SHERRILL. That is what I would have done.

Mr. GREEN. Well, that is why you went to jail.

Mr. SHERRILL. Exactly.

Mr. GREEN. Well, look—don't speak for other poor people.

Mr. SHERRILL. And I have changed my life, too, sir.

Mr. GREEN. Well, I am glad you did. Let me commend you for that. I commend you for changing your life, and I commend you for getting the pardons.

But I would ask you, dear sir, don't use that highly inflammatory language in such a general way.

Mr. SHERRILL. I am just trying to—

Mr. GREEN. Well, but what you are doing is causing white people to believe that black people are going to take to the streets if they can't get a payday loan.

Mr. SHERRILL. Everybody—

Mr. GREEN. Therefore, we should not regulate payday lending.

Mr. SHERRILL. Everybody uses this product—

Mr. GREEN. Excuse me. Let me go on to something else.

We don't want to see this invidious discrimination that takes place with reference to these loans. These lenders locate in black communities, they charge black communities more for their loans than they do in other communities.

If you walk into a payday lender's shop, one person black and one white, both equally qualified, would you expect them to get the same type of treatment, Mr. Sherrill?

Mr. SHERRILL. Of course.

Mr. GREEN. Okay. And if one is discriminated against, would you condone that?

Mr. SHERRILL. Of course not.

Mr. GREEN. All right. Then that is one of the things that we are talking about, how these lenders discriminate and they charge black people more in fees and products than they charge white people. That happens.

So if you locate on one side of town and you charge more than you charge on another side of town, that, too, is a problem. I am not saying to you that all payday lenders are loan sharks, but a good many are. They have found a way to feast on the poor, the underprivileged, and people who are trying to make it, who do not take to the streets.

Thank you, Mr. Chairman. I yield back my time.

Chairman MEEKS. The gentleman's time has expired.

Let me take this opportunity to really thank all of our panel members. I know Mr. Whittaker had to step out for an emergency.

But I did want to get into the record—when I listened to all of the witnesses, I think that we have extremely diverse ideas and thought patterns and moving forward to try to figure out how do we remedy this problem.

I didn't hear anyone, as I stated in my opening, say that we need to get rid of payday lenders. We say we need to get rid of the predatory payday lenders, those that are doing things that are ripping people off, where you get caught into the never ending debt.

And I think that there is a lesson to be learned. And I think this is not whether you are a Democrat or a Republican, that we need to do and make sure that we take care of all consumers.

I heard someone talk about how we take care of the military and we cap it at 36 percent. I heard Reverend Haynes say that he thought that might be reasonable in response to a question from

Chairwoman Waters. I think that is something that we need to look at and be able to figure out in a bipartisan way.

I think, Mr. Sherrill, the fact that you were able to turn your life around is admirable.

I also think that Mr. Whittaker is admirable for what he has done with his kids, trying to fight for them and to make a better life, and from his experience, never forgetting who he is, going around the country, fighting for equality and racial justice, organizing people, because it could have been very easy that he could have just given up and said nothing.

So I want to thank particularly the two individuals who have had different experiences with payday lending, Mr. Whittaker and Mr. Sherrill.

But I would not let this go without Mr. Whittaker being thanked personally also because of who he is, his background, and his children with him, who clearly he wants to make sure that they have a better life.

I want to thank the experts.

And, Reverend, what you do on a regular basis is important.

And for what you have been doing, Ms. Standaert, Mr. McDonald, Mr. Peterson, Mr. Reeder, and Mr. Zuluaga, thank you. It is what makes us who we are.

Ending debt traps in the payday and small-dollar credit industry is important. It is ensuring that our constituents have access to affordable—I think that is what we are talking about—nonpredatory financial products, because I believe that is essential.

Members of the subcommittee and witnesses today have pointed to several datapoints that confirm what many us know from our daily engagement with constituents and families we represent. The scope of unbanked and underbanked Americans is grave and should concern us all.

The growth of banking deserts should worry us all. And the extent of financial vulnerability for the American households is on the top of the minds of this subcommittee, and I know also of the full Financial Services Ccommittee under the leadership of Chairwoman Maxine Waters.

Today, in addition to the testimony of the panel of witnesses, we have considered a discussion draft of legislation to set a national usury rate at 36 percent, legislation introduced by Mr. Scott to establish an office for underbanked and unbanked and underserved consumers at the CFPB, and a letter to appropriators, which I led, requesting funding for the Small Dollar Loan Program under Section 1206 of the Dodd-Frank Act.

These are important issues for us to consider, ensuring access to fair and affordable financial products and protecting consumers from debt traps is and should be a priority. And I look forward to working with all of you on these critical issues.

I also, without objection, will submit for the record letters from the American Financial Services Association and from Mastercard in support of the letter to Appropriations to advance the loan loss reserves, to enable more than 1,000 CDS to participate.

Without objection, it is so ordered.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing.

Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

I ask our witnesses to please respond as promptly as you are able.

This hearing is now adjourned.

[Whereupon, at 5:26 p.m., the hearing was adjourned.]

A P P E N D I X

April 30, 2019

Ending the Debt Trap

Testimony by Dr. Frederick Douglass Haynes, III

My name is Frederick Douglass Haynes, III. I serve as Senior Pastor of Friendship West Baptist Church in Dallas, Texas. I also serve as chair of the Samuel DeWitt Proctor Conference, a national coalition of faith based social justice activists and advocates.

It would be iniquitous and immoral for someone who's been knocked down to receive handcuffs when they have, out of desperation, asked for a hand up. The payday loan industry is guilty of such unjust and unethical practices that prey upon the desperation of the poor who are already disadvantaged. Payday predators hijack the hopes of the vulnerable and re-victimize them by baiting them into a debt trap. These hunters of the helpless are guilty of dealing "bad hands with bad plans" to use the language of Kendrick Lamar.

As pastor of Friendship West Baptist Church in Dallas, Texas, I have heard too many share their experience of being exploited and ensnared in the payday debt trap. One of my members, a 74 year old senior citizen, who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer. Now she feels like the devil answered her prayer. She is on a fixed income and when the repayment was due, she didn't have enough and had to take out another loan to pay the first one. She ended up with a dozen loans. When she approached me for help one Sunday after church, this once proud senior saint with good credit, was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620%! She was "dealt a bad hand with a bad plan." She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse.

Another member of Friendship West, a recent college graduate, was in an unexpected financial predicament because his widowed mother became sick. He was working two jobs in order to make ends meet. He wasn't, however, financially prepared for her illness. He didn't want to choose between paying his car note and paying for her medication and light bill. He took out a payday loan and spiraled into debt propelled by an interest rate of 450%. He eventually lost his car because he couldn't pay the interest. He was "dealt a bad hand with a bad plan."

Payday predators are a part of a hostile takeover of the economy of the unbanked and underserved. This exploitative industry targets and saturates communities that are already suffering from economic apartheid. I'm not exaggerating when I say that when the vulnerable are drowning in desperation the payday industry throws a life preserver weighted with iron. The average annual interest rate for payday loans in the U.S. (391% APR) is absurd and outrageous. Payday and car title loans use a predatory business model in order to create a long-term cycle of debt at triple-digit interest rates. These "short term" loans were never designed to be paid back in a short period of time.
A fact check of the average number of payday loans per borrower in each state tells this sinful story. It's oxymoronic that in the "land of the free" debt traps are set for the vulnerable.

Of course the payday predators will put the spotlight on the rare exceptions who have been able to dodge the debt trap, but that should not blind us to the many who are in the shadows of a financial nightmare that never seems to end as their bank accounts are overwhelmed with overdraft fees or closed down. Some fall into bankruptcy. Many lose their cars to repossession.

It's time for a new plan for those who have been dealt a bad hand. The 2017 CFPB "Rule" is a plan that simply requires that before payday and car title lenders make certain loans, they assess whether potential customers can afford to pay them back with the finance charges, given the customers' income and other expenses. This is a commonsense foundation of responsible lending. The rule is a good plan that protects many of our nation's families from the worst impacts of triple-digit interest debt traps set by payday and car title lenders.
A coalition of citizens committed to protecting consumers has mobilized to push for strong reforms of predatory practices. Included in this coalition of conscience are those personally impacted by debt trap practices, advocates for low-income families, veterans, the elderly, responsible businesses and faith based groups. We are appalled that the CFPB would propose ripping out the heart of the rule in favor of allowing payday lenders to continue to exploit those who are struggling and vulnerable.

It has come to our attention that an agency whose name speaks of protecting consumers is encouraging other financial service entities to explore new products in the marketplace that sets desperate consumers up for more debt. It is reprehensible that there may be a plan to open the way for old bank payday loans to re-enter the marketplace, as well as predatory high-cost bank installment loans. I joined other faith leaders in 2018 by delivering letters to the banks

asking them not to reinstitute bank payday loans though the Office of the Comptroller of the Currency had rescinded its guidance on such. Ultimately, I as well as others in the faith community, believe that we need a 36% federal rate cap. We are called to protect families from financial predators and a 36% rate cap would leave no one behind and ensure that they cannot be preyed upon when "life happens" and they experience a setback.

We are calling for strong protections so those who experience an emergency don't end up drowning in debt they cannot repay. We must ask how can we strengthen the law to protect the needy as opposed to enriching the greedy? Friendship West now has a credit union. We offer small dollar loans for those who are vulnerable at an interest rate of 28%. Less than 8% of those who have taken out a "liberty loan" have defaulted. This business model just works for all.

Finally, it is morally right to protect the poor and vulnerable. The prophet warned a nation in Jeremiah 22:22 "Do not exploit the poor because they are poor." The Bible teaches that nations will be judged by how they treat "the least of these." It must not be said of this nation, "I was hungry, and you gave me a payday loan... I was given a bad hand and you gave me a bad plan."

Testimony of Todd O. McDonald
Senior Vice President and Board Director, Liberty Bank and Trust Company on behalf of the National Bankers Association

Before the House Financial Services Subcommittee on Consumer Protection and Financial Institutions

"Ending Debt Traps in the Payday and Small-Dollar Credit Industry"
April 30, 2019

Chairman Meeks, Ranking Member Luetkemeyer, Chairwoman Waters, Ranking Member McHenry, and members of the Subcommittee, good morning and thank you for this opportunity to testify on the small-dollar lending industry.

My name is Todd McDonald, and I am Senior Vice President and Board Director of Liberty Bank and Trust Company. In 1972, Liberty Bank was chartered in New Orleans, Louisiana, with a focus on service, integrity and a sincere interest in community and business development. Four decades later, Liberty Bank has expanded into eight states with fifteen branches.

I am also a board member of the National Bankers Association (the "NBA"). The NBA is the leading trade association for the country's Minority Depository Institutions ("MDIs"). Our mission is to serve as an advocate for the nation's MDIs on all legislative and regulatory matters concerning and affecting our member institutions as well as the communities they serve. Many of our member institutions are also Community Development Financial Institutions ("CDFIs"), and many of our member institutions have become banks of last resort for consumers and businesses who are underserved by traditional banks and financial service providers.

THE NATIONAL BANKERS ASSOCIATION SUPPORTS RESPONSIBLE SMALL-DOLLAR ALTERNATIVES

Small-dollar lending has become a fast-growing source of consumer credit in the United States and a key to financial inclusion, particularly for underserved communities. Unfortunately, existing federal law does not limit the interest rate non-banks lenders can charge on loans of $2,500 - $10,000. This lack of an interest rate cap has resulted in a recent explosion of loans with annual interest rates in the range of 100% - 225% and above. While 35 states have imposed caps on non-bank lenders, there is still a significant gap in protections for consumers.

As a CDFI that serves a largely low and moderate-income consumer base that often utilizes these high-cost, small-dollar loans, Liberty often works to help our customers get out of these predatory loans and into more manageable products. This dynamic is one of many reasons why we have created our own small-dollar product – the Freedom Fast Loan.

The Freedom Fast loan was created in 2008 part because we saw demand for responsible, small dollar credit in the markets we serve and very few competitors to payday and auto title lenders. We also encountered Liberty customers who may have gotten a payday or title loan, and we created a product that would refinance them into a lower-interest product. Our customers use Freedom Fast Loans for everything from funeral expenses to consolidation loans for other high-interest debt like credit cards or payday loans. The average loan is for just over $6,000, and the average interest rate is 12.6%. Our APR never exceeds 34.3%, and we serve customers with credit ranging from the low 500s to over 700. We also report payments to the credit bureaus, so our customers can also build their credit using our product.

Our Freedom Fast Loans meet the credit needs of the communities we serve. In order to scale our product and for community banks to provide similar products, however, we believe that there are steps that federal banking regulators and Congress must take in order to facilitate the kind of robust marketplace where community banks can compete with predatory, small-dollar lenders.

CONGRESS CAN TAKE A NUMBER OF AFFIRMATIVE STEPS TO SUPPORT COMMUNITY BANKS AS ALTERNATIVE PROVIDERS OF SMALL-DOLLAR CREDIT

The NBA supports creating a more favorable regulatory environment for community bank small dollar lending. The Credit Union National Administration's PALS program and the findings from the FDIC's Small-Dollar Loan Pilot Program should provide the basis for regulators to consider a small-dollar regulatory regime tailored to community banks like our member institutions.

The popularity of predatory small-dollar products creates both a moral and business imperative for policymakers to finds ways to create a regulatory regime for responsible alternatives to flourish. Even our Freedom Fast loans have attracted scrutiny from our regulators, despite it meeting an obvious credit need in the markets we serve. To that end, we believe that a "sandbox approach" from banking regulators that allows community banks to develop responsible small-dollar alternatives tailored to the credit needs of our communities would be a welcomed next step in carving out a role for mission-oriented lenders to provide responsible small-dollar alternatives.

In addition to a small-dollar "sandbox" for community banks, we would also urge Congress to fully fund the Small Dollar Loan Program ("SDLP") authorizing grants for loan loss reserves for CDFIs seeking to provide responsible small-dollar alternatives like our Freedom Fast product. The SDLP would provide an immediate incentive for CDFIs to develop small-dollar alternatives and help create a more competitive marketplace where mission-oriented lenders can complete in the small-dollar marketplace. We would also encourage Congress to also fund technical assistance grants for CDFIs seeking to provide payday alternatives for expenses like underwriting software and other administrative expenses that can help defray the costs of small-dollar lending.

The NBA also supports urging regulators to adopt regulations clarifying the "True Lender" and overruling the "Madden Rule." As more of our member banks consider potential partnerships with marketplace lenders and other fintechs to expand our banks' footprint with respect to various consumer loan products, having regulatory clarity regarding the Madden Rule and the True Lender doctrine is vital. No credit market can exist without a functioning secondary market to provide liquidity, and clarity with respect to community bank-fintech lending partnerships would do just that. For our members with limited branch footprints and digital relationships, partnerships with fintechs allows our member to enter into white label and other arrangements that allow our banks to provide more products to a broader audience. While we support legislative efforts to bring about clarity, we believe

that Congress should urge the federal banking regulators to issue rules re-establishing both doctrines.

Finally, the NBA also supports establishing more small lending partnerships between MDIs and the Small Business Administration. It is not lost on us that many diverse entrepreneurs often have to rely on high-cost online lenders for their small business lending needs. While we understand the scope of this hearing, we would be remised if we did not also state for the record the debt traps ensnare far too many minority entrepreneurs. We, therefore, urge the SBA and the respective Small Business Committees to encourage more MDI-SBA partnerships to improve the SBA's lending to minority-owned businesses.

CONCLUSION

According to the OCC, U.S. consumers borrow nearly $90 billion every year in short-term, small-dollar loans typically ranging from $300 to $5,000. Many banks have withdrawn from this market, resulting in consumers often turning to alternative lenders.

Banks can provide affordable short-term, small-dollar installment lending options that can help consumers with their short-term financial needs while establishing a path to more mainstream financial products. Banks can meet consumers' short-term, small-dollar credit needs while providing other financial services such as financial education and credit reporting. Consumers can also benefit when they are offered products with reasonable pricing and repayment structures.

NBA member institutions stand ready to help provided the funding consumers are demanding. However, it is important that policymakers create a regulatory environment where these loans are profitable for MDIs and do not lead to additional regulatory burdens. Policymakers should also create an environment where MDIs can partner with responsible non-bank lenders to fill the obvious need in the small dollar lending space.

I thank you for the opportunity to testify today, and I look forward to your questions.





Consumer Federation of America

United States House of Representatives
Committee on Financial Services
Subcommittee on Consumer Protection and Financial Institutions

Hearing on: "Ending Debt Traps in the Payday and Small Dollar Credit Industry"

Written Testimony of

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April 30, 2019

Chair Meeks, Ranking Member Luetkemeyer, and members of the committee, it is an honor to appear today. Thank you for the opportunity to share some thoughts on the high-cost financial debt traps harming so many Americans and the opportunities for Congress to improve consumer protections for our country. My name is Christopher Peterson and I am the John J. Flynn Endowed Professor of Law at the University of Utah where I teach classes on contract law and consumer protection in Salt Lake City. I also serve as a senior fellow and the director of financial services at the Consumer Federation of America in Washington, D.C. The Consumer Federation of America ("CFA") is an association of non-profit consumer organizations headquartered in Washington, D.C. that works to advance the consumer interest through research, advocacy, and education. Over 250 non-profit consumer rights organizations, cooperatives, and credit unions from around the country are members of CFA. I commend the members of this Committee for holding this hearing and for providing an opportunity to discuss these important and timely national issues.

From 2012 to 2016, I worked in a number of different capacities for the federal Consumer Financial Protection Bureau. From 2012 to 2014, I served as Senior Counsel for Enforcement Policy and Strategy in the CFPB's Office of Enforcement. In this role I led issue teams focused on identifying violations of federal consumer protection law and designing law enforcement investigations related to payday, vehicle title and other similar small dollar loans, retail finance, deposit accounts, payment systems, and related financial services. I also served as a regional liaison between the CFPB's Office of Enforcement and state enforcement and regulatory agencies throughout the Western United States. From 2014 to 2016, I served as a Special Advisor in the Office of the Director of the CFPB where I advised Director Richard Cordray on legal and policy issues. In this time period I also worked temporarily at the Pentagon as a Special Advisor in the United States Department of Defense General Counsel's Office of Legal Policy within Office of Personnel and Readiness. In that capacity, I assisted the Pentagon in designing the Military Lending Act regulations that provide a national usury limit on loans to active duty military service members.

I have been asked to testify on payday loans, vehicle title loans and similar forms of high-cost credit, as well as the challenges and opportunities America faces in protecting borrowers in this market. My testimony will: (1) explain how triple-digit interest rates common in the payday and vehicle title lending markets are a historical anomaly; (2) describe how triple-digit interest rate loans capture struggling borrowers in a harmful debt trap; (3) point out many better alternatives to triple-digit interest rate loans; (4) discuss how the Trump administration is retreating from providing necessary consumer protections in this market; and (5) encourage Congress to protect consumers by expanding the Military Lending Act's 36 percent usury limit to protect all Americans.

I. The Triple-Digit Interest Rates Common in the Payday Lending Market are a Dangerous Historical Anomaly

Throughout the United States, the average effective interest rates on payday loans and similar forms of installment credit are approximately 400 percent at store-front locations[1] and about 650 percent in online web-based loans.[2] From a long-term historical perspective, consumer loans at prices this high are anomalous and dangerously expensive. For most of American history payday loan products were considered usurious and would have constituted a crime in many states. For example, Table 1 illustrates that all thirteen original states had aggressive price regulation of consumer loans with simple nominal annual interest rate caps of between five and eight percent.

Table 1. State Usury Limits at Independence.

State	Max. annual rate	Year adopted
Connecticut	6%	1718
Delaware	6%	1759
Georgia	8%	1759
Maryland	6%[a]	1692
Massachusetts	8%	1641
N. Hampshire	6%	1791[b]
N. Jersey	7%	1738
N. York	7%	1737
N. Carolina	6%	1741
Pennsylvania	6%	1700
Rhode Island	6%	1767
S. Carolina	8%	1748
Virginia	5%	1734

[a]Loans payable in tobacco or other property were capped at 8%.
[b]N.H. adopted its first usury statute after independence.
Source: Tyler on Usury (1878).

Every signatory to the Declaration of Independence and delegate to the Constitutional Convention returned to states where a consensus existed regarding the need to protect citizens from high cost loans. American leaders and the public were skeptical of high interest rate loans because of the potential for reducing citizens to poverty as well as their moral view, rooted in their Christian faith, that the taking of excessive interest is a grave sin.[3]

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[1] Consumer Financial Protection Bureau, *What is a payday loan?* (June 2, 2017), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/.

[2] Pew Charitable Trusts, *Fraud and Abuse online: Harmful Practices in Internet Payday Lending* 3 (October 2014), http://www.pewtrusts.org/~/media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf.

[3] About a dozen Biblical passages suggest that usurious lending, especially to the poor, is a grave sin. For example, the first reference to usury in the Bible states: "If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shall thou lay upon him usury." Exodus 22:25 (King James). See also Ezekiel, 18:8-17; Ezekiel 22:16-22; Jeremiah, 15:10; John 2:14-15; Leviticus, 25:35-37; Luke 6:33-35; Mathew 5:42; Neh. 5:1-13; Proverbs 28: 6-9;

At the beginning of the twentieth century state legislatures began relaxing interest rate regulation to facilitate more credit availability for consumers. These relaxed usury limits generally took the form of a small loan law which granted licensed lenders special permission to charge interest rates ranging between 18% and 42% per annum with a 36% cap being typical. Laws of this nature remained in force in virtually every state in the union through the 1970s. Individuals and companies that loaned money in excess of these limits were aggressively prosecuted by state and federal criminal investigations. For example, loans made by the New York City *La Cosa Nostra* organized crime families carried average annual interest rates of 250% per annum[4]—nearly half the current average payday loan interest rates in many states. The federal Consumer Credit Protection Act includes a criminal loan sharking law that creates a federal crime for extortionate lending at high interest rates.[5] Under this law, an annual interest rate of more than 45 percent is considered *prima facie* evidence that a loan is extortionate.[6] And during the George W. Bush Administration, Congress adopted a national usury limit on loans to active duty military service members of 36 percent.[7] During all but the last years of the twentieth century, usury limits in this range were the accepted norm in American consumer protection and criminal law.

However, in the past generation, non-bank finance companies became effective at lobbying some state legislatures for new exceptions to traditional consumer credit price limits that far exceed the historical American norm. A handful of states, such as Delaware and Utah, have eliminated interest rate regulation altogether. At the beginning of the 1990s, the best available estimate suggests less than 200 business locations nationwide offered triple-digit interest rate payday or auto-title loans.[8] But because triple-digit interest rate loans have the potential to be very profitable, the industry exploded in the 1990s with exponential growth in the number of locations nationwide. In North Carolina, payday lending outlets roughly quadrupled in four years, growing from 307 in 1997 to 1204 in 2000.[9] Payday and/or auto-title lending outlets quintupled in Salt Lake City between 1994 and 2000.[10] Wyoming payday lenders tripled between 1996 and 1997.[11] Iowa's payday lenders increased from eight to sixty-four in two years.[12] In states where payday lending was once illegal

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Psalm 15: 1, 4-5. The Biblical condemnation of usurious lenders is closely related to the deep and consistent message of the Bible demanding kind and just treatment of poor and vulnerable members of society. Deuteronomy demands "thou shalt not oppress an hired servant that is poor and needy, whether he be of thy brethren, or of thy strangers that are in thy land within thy gates." Deut., 24:14. The Bible commands Christians to "[e]xecute true judgment, and shew mercy and compassion every man to his brother; and oppress not the widow, nor the fatherless, the stranger, nor the poor...." Zechariah 7:9-10.

[4] Comment, *Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 Colum. L. Rev. 167, 167 (1966); SELWYN RAAB, FIVE FAMILIES: THE RISE, DECLINE AND RESURGENCE OF AMERICA'S MOST POWERFUL MAFIA EMPIRES 103 (2005).

[5] Consumer Credit Protection Act, Pub. L. No. 90-321, § 202(a), 82 Stat. 146, 15962 (1968) (codified as amended at 18 U.S.C. §§ 891-896 (2010)).

[6] 18 U.S.C. § 892.

[7] 10 U.S.C. § 987

[8] JOHN P. CASKEY, THE ECONOMICS OF PAYDAY LENDING 3 (2002).

[9] OFFICE OF THE COMM'R OF BANKS, REPORT TO THE GENERAL ASSEMBLY OF PAYDAY LENDING, Feb. 22, 2001, at 5.

[10] Christopher L. Peterson, Note, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 Utah L. Rev. 543, 560-61.

[11] Consumer Federation of America, *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry* 3 (Nov. 1998), *available at* http://www.consumerfed.org/The_Growth_of_Legal_Loan_Sharking_1998.pdf.

[12] *Id.*

under state law, bills purporting to regulate the industry have in fact legitimized it, leading to astonishing growth nearly over night. For instance, after Mississippi began regulating payday lenders in 1998, the number of outlets in that state quickly tripled.[13] By 2001, there were over 12,000 payday loan outlets were operating nationwide.[14] Today there are approximately 16,000 storefront payday lenders around the country.[15] Every year, about 12 million Americans put their financial well-being at risk with payday, vehicle title, and similar forms of high-cost credit. Of these people, 52 percent of are women; 12 percent are African Americans; and 13 percent are struggling through marital separation or divorce.[16] Millions of these consumers have young children.

II. Triple-Digit Interest Rate Loans Capture Struggling Borrowers in a Harmful Debt Trap

Critics of payday and auto-title lending allege that loans with triple digit nominal annual interest rates by their nature can develop into harmful debt traps. Generally speaking, a high-risk debtor facing a cash shortfall in any given day may be unlikely to have corrected their liquidity crisis two weeks later. As payday lending exploded in the 2000s, studies by industry-sponsored think tanks,[17] federal regulators,[18] state regulators,[19] private contractors hired by state governments,[20] consumer

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[13] Jimmie E. Gates, *Check-Cashing Businesses Rolling out the Dough*, CLARION LEDGER, Feb. 6, 2005.

[14] *Consumer Federation of America & U.S. Public Interest Research Group, Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections* 2 (Nov. 2001).

[15] Consumer Financial Protection Bureau, Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54480 (November 17, 2017).

[16] Pew Charitable Trust, Payday Lending in America: Who Borrows, Where They Borrow, and Why." The Pew Charitable Trusts, Accessed November 12, 2018.
http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

[17] Gregory Elliehausen and Edward C. Lawrence, Georgetown University McDonough School of Business Credit Research Center, *Payday Advance Credit in America: An Analysis of Demand* (2001) 39 (about 40 percent of borrowers rolled over more than five times in preceding year, about 20 percent of borrowers who renewed existing loans nine times or more, 10 percent renewed 14 times or more).

[18] United States Office of the Comptroller of the Currency, Fact Sheet: Eagle National Bank Consent Order, January 3, 2002, at 2 (discovering payday loan employee compensation incentives for promoting repeat borrowing); Mark Flannery & Katherine Samolyk, Payday Lending: Do the Costs Justify the Price?, FDIC Center for Financial Research Working Paper No. 2005–09, 16–17 (2005) (high frequency borrowers are more profitable because they generate lower loss ratios and lower operating costs).

[19] Report of the Uniform Consumer Credit Code Rev. Comm. And Action of the Colorado Commission on Consumer Credit 16 (Nov. 4, 1999) (reporting instances of as many as thirteen or more refinances); Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENVER U. L. REV. 387 (2005) (discussing official Colorado statistics); Ill. Dept. of Fin. Inst., Short Term Lending: Final Report 30 (1999) (average payday loan customer borrows thirteen times per year and remains indebted for at least six months); Indiana Department of Financial Institutions, *Summary of Payday Lender Examination*, 1–2 (77% of payday loans are extensions of previously existing contracts); Survey Iowa Division of Banking (2000) (finding an average of 12.5 loans per customer per year); North Carolina Office of the Commissioner of Banks, Report to the General Assembly on Payday Lending, (87% of borrowers roll over payday loans more than once with each individual lender); Washington State Department of Financial Institution, Payday Lending Report 3 (2003) (over thirty percent of borrowers borrow more than ten times per year, almost ten percent borrow twenty times or more per year).

[20] Veritec Solutions, Florida Trends in Deferred Presentment: State of Florida Deferred Presentment Program, http://www.veritecs.com/FL_trends_sep_2005.pdf (2005) (average Florida customer borrows 7.9 times per year, 25% of borrowers borrow 12 or more times per year); Veritec Solutions, Oklahoma Trends in Deferred Deposit Lending:

advocacy organizations,[21] and academics[22] quickly showed that borrowers of single-payment, triple-digit interest rate loans tend to fall into reoccurring debt patterns. Because these loans carry such high prices, unless lenders use underwriting guidelines to determine borrowers' ability to repay in a timely manner, payday and vehicle title loans typically compound for durations far beyond the initial one- or two-week due date. Looking past the boilerplate terms written into loan contracts, in the absence of effective underwriting, it is economically more accurate to think of auto-title and payday loans as medium-term debts with modest prepayment rates. Across the country, average payday loan borrowers take out eight loans of $375 each per year incurring about $520 on interest.[23] About 75% of all payday loan fees are due to borrowers stuck in more than 10 loans a year.[24] For its part, a large and comprehensive CFPB study found that that over 80% of payday loans are rolled over or followed by another loan within 14 days because borrowers were not able to pay back the loan and make it to their next payday without re-borrowing.[25]

Oklahoma Deferred Deposit Program, http://www.veritcs.com/OK_trends_11_2005.pdf (2005) (average Oklahoma borrower borrows 9.4 times per year and 26.8 percent of borrowers borrowing 12 times or more per year, accounting for about 62 percent of all transactions)

[21] Jean Ann Fox and Ed Mierzwinski, Consumer Federation of America & U.S. Public Interest Research Group, *Show Me the Money: A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures* 8 (2000); Oregon State Public Interest Research Group, Preying on Portlanders: Payday Lending in the City of Portland (2005) (three out of four payday loan borrowers are unable to pay their loan when it comes due).

[22] Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending*, 87 MINN. L. REV. 1, 55–76 (2002); Michael A. Stegman & Robert Faris, *Payday Lending a Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8 (2003).

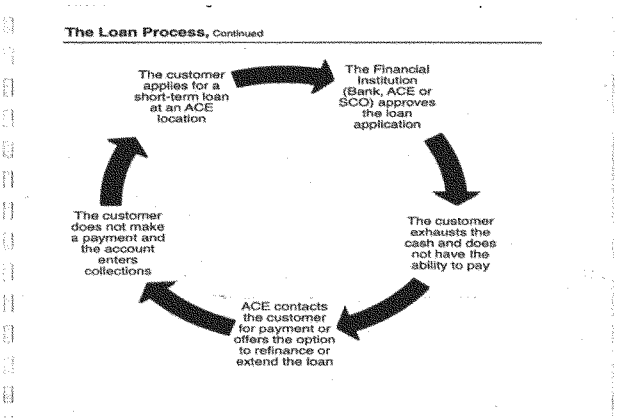
[23] Pew Charitable Trusts, *Payday Lending in America: Who Borrower, Where they Borrow, and Why* 4 (July 2012).

[24] CONSUMER FINANCIAL PROTECTION BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS A WHITE PAPER OF INITIAL DATA FINDINGS 22 (April 24, 2013), https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[25] Consumer Financial Protection Bureau, *CFPB Data Point: Payday Lending* 4 (March 2014).

The CFPB's law enforcement work also revealed that high cost creditors are aware of these patterns and intentionally design their business models to keep low- and moderate-income consumers trapped in debt. For example, one of the largest payday lending industry chains in the country included the following diagram in the manual it used to train its employees. In its "loan process" the business intentionally loaned money at triple digit interest rates to applicants knowing that the customer would "exhaust the cash" and "not have the ability to pay." In "The Loan Process," the customer then enters collections and ultimately borrowers starting the cycle all over again. For many borrowers, this cycle begins anew after the borrower has already repaid nearly as much in fees and interest as they originally borrowed.[26] And, for borrowers in the most dire financial straits, renewal loans are also often for larger amounts than the loans they replace leaving borrowers deeper in debt than when they started.[27]

Figure 1. ACE Cash Express New Hire Training Manual.



For individual consumers, triple digit interest rate loans can create severe financial harm. Figure 2 is a screenshot from the computer records of a national auto title lending chain. The borrower,

[26] *See* Paige Marta Skiba & Jeremy Tobacman, *Payday Loans, Uncertainty & Discounting: Explaining Patterns of Borrowing, Repayment, and Default* (Aug. 21, 2008) (finding (1) over half of payday borrowers in data sample default on a payday loan within one year of their first such loan, and (2) that defaulting borrowers have on average already repaid or serviced five payday loans, making interest payments of 90% of their original loan's principal); *see also Payday Loans, Inc.*, supra note 6, at 9-10 (finding 37% of payday borrowers in sample experienced default in the first year of borrowing, and 44% experienced default within the first two years of borrowing).

[27] *See Uriah King & Leslie Parrish, Payday Loans, Inc.: Short on Credit, Long on Debt*, CENTER FOR RESPONSIBLE LENDING, at 6-8 (March 31, 2011).

whose name I have changed for her privacy, works as a receptionist for $11.00 per hour in Albuquerque, NM and is a proud, enrolled member of the Navajo Nation. When her partner did not receive as many hours at his place of employment, the couple fell behind on their bills. Ms. Begay took out a $1971.05 vehicle title loan with a 300% APR, secured by her lien on her truck. Over the next eight months, Ms. Begay made $4,635 in payments on her loan. Because she was only making $11.00 per hour, coming up with these payments was extraordinarily difficult for Ms. Begay and represented a daily struggle. Yet despite all her efforts, simply because of the extraordinarily high interest rate, the vehicle title lender only applied $1.16 out of her many payments to the loan's principal balance. After all of these months, the lender claimed Ms. Begay still owed $2,422.05—more than the original principal of her loan. When Ms. Begay eventually gave up and stopped paying, the lender engaged in harassing debt collection calls including calls to her place of employment because it interfered with her job. For Ms. Begay, and millions of Americans like her, this 300 percent interest rate loan was a debt trap.

Figure 2. Vehicle Title Lender Account Record Screenshot for Raedell Begay[28]

Date	Transaction	Funds amount	Days late	Principal (before)	Balance (before)	Principal (applied)	Interest (applied)	Fees (applied)	Principal (after)	Balance (after)
04/23/2015	Payment received	$100.00	4	1,971.05	2,538.06	(0.00)	(100.00)	0.00	1,971.05	2,438.06
04/30/2015	Payment received (renewal)	$405.00	11	1,971.05	2,551.46	(0.00)	(405.00)	0.00	1,971.05	2,146.46
05/28/2015	Payment received (renewal)	$500.00	9	1,971.05	2,600.07	(0.00)	(500.00)	0.00	1,971.05	2,100.07
06/23/2015	Payment received (renewal)	$500.00	4	1,971.05	2,521.27	(0.00)	(500.00)	0.00	1,971.05	2,021.27
07/23/2015	Payment received (renewal)	$500.00	4	1,971.05	2,507.28	(0.00)	(500.00)	0.00	1,971.05	2,007.28
09/01/2015	Payment received (renewal)	$480.00	13	1,971.05	2,655.28	(0.00)	(480.00)	0.00	1,971.05	2,175.28
09/22/2015	Payment received	$300.00	3	1,971.05	2,515.49	(0.00)	(300.00)	0.00	1,971.05	2,215.49
09/25/2015	Payment received (renewal)	$200.00	6	1,971.05	2,264.09	(0.00)	(200.00)	0.00	1,971.05	2,064.09
10/22/2015	Payment received	$200.00	3	1,971.05	2,501.50	(0.00)	(200.00)	0.00	1,971.05	2,301.50
10/29/2015	Payment received (renewal)	$445.00	10	1,971.05	2,414.89	(1.16)	(443.84)	0.00	1,969.89	1,969.89
12/14/2015	Payment received (renewal)	$500.00	25	1,969.89	2,714.67	(0.00)	(500.00)	0.00	1,969.89	2,214.66
01/27/2016	Payment received (renewal)	$505.00	39	1,969.89	2,927.05	(0.00)	(505.00)	0.00	1,969.89	2,422.05
Total		$4,635.00				(1.16)	(4,633.84)	0.00		

Moreover, the triple-digit interest rates disclosed to consumers at the outset of a transaction in fact dramatically understate the true costs associated with payday and vehicle title loans. As borrowers fall into a default and reborrowing cycle, they frequently lose the ability to successfully manage their checking accounts causing them to incur overdraft and insufficient funds penalties both on their high cost loan as well as on their other pre-existing obligations.

For Ms. Begay and consumers like her, payday loans, vehicle title loans, and similar forms of high-cost credit tend to be harmful in a variety of ways including:

- **Foregoing basic living expenses.** Consumers who are struggling to repay debts that exceed their ability to repay often forgo basic living expenses like rent, groceries, electricity, and health

[28] Name changed for consumer's privacy.

care as a result of using covered products that were offered without any determination of their ability to repay them.[29]

- **Disruption of relationships with banks and credit unions.** Another CFPB study found that in an 18-month period half of online payday loan borrowers were charged an average of $185 in bank penalties for overdrafts or insufficient funds.[30] These patterns can cause mainstream banks and credit unions to lose confidence in payday loan borrowers causing involuntary checking account closures.[31]

- **Vehicle repossession.** The CFPB's research has found that over one-third of vehicle-title loan borrowers secure loans with their household's only vehicle.[32] Repossession of a borrower's sole means of reliable transportation, as the result of an unaffordable car title loan, adversely affects his or her ability to get to work or school, or perform day-to-day tasks like obtaining food, medicine, or other vital services.[33]

- **Aggressive debt collection.** The payday lending industry has been dogged by allegations of illegal collection practices such as illegal calls, harassment at borrowers' residences or places of work, and false threats of legal action, and misuse of the criminal justice system.[34] The persistence of widespread abusive collection practices is inherent in a business model that makes loans to borrowers who are unable to repay without defaulting on their other obligations or neglecting basic living expenses.

- **Health effects.** Recent public health research increasingly demonstrates a troubling link between unaffordable payday and vehicle-title loans and negative health outcomes. Medical and public health research shows growing evidence that payday loan use is risk factor associated with a variety of poor health outcomes including higher blood pressure, weight gain, inflammation, and

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[29] *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54591 (Nov. 17, 2017) ("borrowers … experience injury when covered short-term loans are made without making a reasonable assessment of their ability to repay and they are unable to cover the loan payment on top of major financial obligations and basic living expenses. These injuries include those associated with default, delinquency, and re-borrowing, as well as the negative collateral consequences of being forced to forgo major financial obligations or basic living expenses to cover the unaffordable loan payment.").

[30] Consumer Financial Protection Bureau, *Online Payday Loan Payments* 3 (April 2016).

[31] Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures* 32 (June 6, 2008), *available at*: http://ssrn.com/abstract=1335873 or http://dx.doi.org/10.2139/ssrn.1335873 (finding a "positive relationship between the existence of payday lending and involuntary account closures.");

[32] *Id.* at 54574.

[33] *Id.*

[34] *Id. See also See* Melanie Hicken, *In Texas, payday lenders are getting borrowers arrested,* CNN Money (Jan. 8, 2015), https://money.cnn.com/2015/01/08/pf/payday-lenders-texas/ ("Texas Appleseed analyzed more than 1,500 criminal complaints filed by more than a dozen payday lenders between 2012 and mid-2014. Yet it says these are 'just the tip of the iceberg' since it only examined public records from eight of the state's 254 counties."); In addition, a recent report by the ACLU found that collection litigation related to payday and vehicle-title loans have led to borrowers' arrest and imprisonment. AM. C.L. UNION, A POUND OF FLESH: THE CRIMINALIZATION OF PRIVATE DEBT, 33 (2018), https://www.aclu.org/sites/default/files/field_document/022118-debtreport.pdf. This "debt-to-jail pipeline" can result in long-term lost income, psychological trauma, and other harmful effects on consumers and their families. *Id.* at 19. In one case identified by the ACLU, a Missouri borrower was jailed for three days after failing to appear at a collection hearing on a $425 payday loan.

anxiety.[35] One recent study found "a sharp increase in attempted suicides after gaining access to payday loans" that "appear[ed] to be related to mental health deterioration from financial distress."[36]

- **Reborrowing that costs billions of dollars.** The various fees associated with payday and vehicle-title loans cost consumers an estimated $8 billion in fees annually.[37] Nationally, according to the CFPB's own data, 75% of all payday loan fees are due to borrowers stuck in more than 10 loans a year. Delaying the compliance date of the Bureau's rule would lead consumers to pay billions in fees on reborrowing unaffordable payday and vehicle-title loans across the proposed fifteen-month period. Indeed, the CFPB found that 85% of payday loans are reborrowed within 30 days, suggesting the borrower did not have the ability to repay them.[38]

III. There are many Better Alternatives to Payday Loans, Vehicle Title Loans and Similar forms of High-Cost Credit

Payday loans and similar forms of credit crowd out better alternatives that are widely available in states with traditional usury limits. Many consumers in in the small dollar lending market have difficulty comparing prices and terms of credit. This allows many lenders to compete, not by offering the lowest price, favorable qualitative contractual terms, or the best customer service, but instead by charging *higher* prices that support costly investments in expensive storefront branch locations, internet referrals, and advertising. Paradoxically, in markets where consumers have difficulty understanding how long they will be in debt and how much they will ultimately pay, lenders have a strong incentive to charge higher prices in order to promote the salience of their services in comparison to other businesses. The result is that the primary factor controlling credit prices in this market is not competition, but consumer protection law.[39]

Superior alternatives to high-cost payday and vehicle title loans include:

- **Credit cards.** Every credit card in America effectively includes the equivalent of a free payday loan. Credit card borrowers who are not carrying a revolving monthly balance are

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[35] *See,* Elizabeth Sweet, et al., *Short-term lending: Payday loans as risk factors for anxiety, inflammation and poor health,* 5 POPULATION HEALTH 114, 114 (2018) ("[W]ithin the broader context of financial debt and health, short-term loans should be considered a specific risk to population health"); Jerzy Eisenberg-Guyot, et al., *From Payday Loans to Pawnshops: Fringe Banking, the Unbanked, and Health,* 37 HEALTH AFFAIRS 429, 433 (2018) ("[P]ast-year fringe loan use was associated with 38 percent higher prevalence of poor or fair health. . . .").

[36] Jaeyoon Lee, *Credit Access and Household Well-being: Evidence from Payday Lending* (January 1, 2019). Available at SSRN: https://ssrn.com/abstract=2915197 or http://dx.doi.org/10.2139/ssrn.2915197.

[37] DIANE STANDAERT AND DELVIN DAVIS, CENTER FOR RESPONSIBLE LENDING, PAYDAY AND CAR TITLE LENDERS DRAIN $8 BILLION IN FEES EVERY YEAR, 1 (2016), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_statebystate_fee_drain_may2016_0.pdf.

[38] CFPB, SUPPLEMENTAL FINDINGS ON PAYDAY, PAYDAY INSTALLMENT, AND VEHICLE TITLE LOANS, AND DEPOSIT ADVANCE PRODUCTS, 111 (June 2016).

[39] Pew Charitable Trusts, *How State Rate Limits Affect Payday Loan Prices* (April 2014), https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf (study of payday loan prices in 36 states showing "a state's limit on interest rates is the key factor driving loan pricing. . . . in states with higher or no interest rate limits, the same companies charge comparable borrowers far more for essentially the same small-loan product.").

entitled to a no-cost grace period each month. Many banks and credit unions offer credit cards especially designed to work for subprime borrowers with poor and very poor credit histories. While shopping for a new credit card takes more time than applying for a payday loan, even many subprime credit cards are a far more inexpensive, safer product.

- **Federal credit union Payday Alternative Loans.** Many federal credit unions offer "PAL" loans with interest rates of 28% and an application fee to compete with triple digit interest rate payday loans. These are relatively inexpensive, safe products that are widely available to borrowers who invest the time in developing a banking relationship with a federal credit union.

- **Finance company installment loans.** Some finance companies specialize in making loans with interest rates below 36% to subprime borrowers. Although some of these companies have significant consumer protection challenges, nevertheless, subprime finance company installment loans are usually much cheaper than debt-trap payday and vehicle title loans.

- **Charitable community and poverty assistance organizations.** America is blessed with a diverse and robust non-profit sector that provides many subsidized and charitable payday loan alternatives. Many faith organizations, local governments, and charities have programs specifically designed to help consumers who are facing an emergency. The financial advice website Nerdwallet.com is currently maintaining lists dozen charitable organizations providing payday loan alternatives in many areas around the country.[40]

- **Payroll Access Services.** A growing number of employers provide active payroll access services to protect their employees from predatory payday loans. Some employers provide the services directly through their payroll department while others outsource these advances to a technology company. For example, Oakland-based Even provides payroll advances to 1.4 million employees of Walmart. Under this arrangement the Walmart employees can obtain a portion of their accrued wages eight times a year free of charge. The workers can pay a relatively inexpensive flat fee if they want more than eight payroll advances per year.[41]

- **Negotiated forbearance agreements with landlords, merchants, utilities and other creditors.** Many lenders and loan servicers understand that borrowers running to payday lenders can make repayment of a home mortgage or auto loan less likely. Loan servicers in some cases have the authority to negotiate forbearance agreements that are typically cheaper than a payday loan and similar forms of credit. Many landlords, merchants and utilities will also work with struggling borrowers to accommodate delayed repayment for free or at lower prices than payday and car title lenders, or can make referrals to reputable local charities.

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[40]Payday Loans: Find Better Alternatives, Nerdwallet.com (March 27, 2019) https://www.nerdwallet.com/blog/loans/payday-loans/.

[41] Michael Corkery, *Walmart Will Let Its 1.4 Million Workers Take their Pay Before Payday*, N.Y. TIMES, Dec.13, 2017, https://www.nytimes.com/2017/12/13/business/walmart-workers-pay-advances.html.

- **Pawnshops.** Although pawn credit is expensive, it is still a better alternative than triple-digit interest rate payday and car-title debt traps. In bona fide pawn loans, borrowers preplan their exit from the debt. Borrowers select an item of personal property to serve as collateral and forfeit the item they themselves chose if they cannot repay. Pawn credit tends to nudge borrowers toward savings by forcing them to relinquish something of value prior to borrowing. Principle balances tend to be more manageable for lower-income consumers than those in payday and car title loans. And, pawn loans are widely available in every state and have maintained a moderately profitable business model for thousands of years.

- **Assistance from friends or family.** Not everyone has family or friends to turn to in times of need. But many people do. Payday loan borrowers are better off turning to friends or family before a payday loan turns a tough financial situation into a crisis. Indeed many borrowers are forced to turn to friends and family to help them escape from payday or vehicle title lenders, but need *more* assistance when they do.

- **Increasing income or cutting back on expenses.** While not everyone can increase their income or cut back on expenses, many people can.

- **Struggling consumers may qualify for bankruptcy protection under federal law.** The most common causes of personal bankruptcy include medical expenses, job loss, and family instability. Yet, many consumers struggle for years to overcome insurmountable financial obstacles. Bankruptcy isn't for everyone, but Americans should consider making a "fresh start" bankruptcy before turning to predatory lenders.

IV. Under the Trump Administration, The CFPB is Turning Its Back on Protecting Consumers.

In the wake of the 2008 financial crisis and the Great Recession, Congress recognized the need for a regulator focused on consumer financial protection. Much of the CFPB's early regulatory work focused on the home mortgage lending market shattered by the foreclosure crisis. Nevertheless, the CFPB turned to payday loans, vehicle title loans, and similar forms of triple-digit interest rate lending early in 2012. Under the Dodd-Frank Act, Congress gave the CFPB the legal authority to identify and issue regulations to stop unfair, deceptive, or abusive acts or practices in consumer finance markets. However, as a political compromise, Congress also did not authorize the Bureau to adopt a traditional usury limit capping interest rates. Based on this authority, the Bureau began a four-year process of studying, taking public comments, and consultation with small business, federal and state regulators, a consumer advisory board, industry trade associations, and leaders in the banking, credit union, and small dollar lending industries.

After years of careful study, debate, public notice, and comments, in 2017 the Bureau issued a final regulation in designed to limit some of the worst practices in the high cost lending market. The

CFPB's regulation is designed to temper some of the worst consequences of some types of triple digit interest rate payday and vehicle title loans. In particular, the CFPB adopted a regulation that requires lenders to determine whether borrowers have the ability to repay their debts without defaulting on other preexisting obligations including minimum necessary living expenses. The regulation is currently set to require compliance in August of 2019.

However, it now appears this regulation is unlikely to provide protection to American consumers. Under the leadership of Trump Administration appointees, the CFPB has announced its intentions to revisit the payday lending regulation. Recently the CFPB issued new proposed regulations that would delay the August 2019 compliance date and repeal the core "ability to repay" consumer protection in the Bureau's own rule. Sadly, the Bureau's cost-benefit analysis projects that for payday lenders "not having to comply with the requirements in the 2017 Final Rule would translate to an increase in their annual revenues of approximately $3.4 billion to $3.6 billion."[42] And for vehicle title lenders, "the proposed elimination of the Mandatory Underwriting Provisions of the 2017 Final Rule would translate into an increase in annual revenues for these lenders of approximately $3.9 billion to $4.1 billion."[43] By the Bureau's own analysis without government intervention, payday and vehicle title lending will drain approximately eight billion dollars per year from precisely those struggling borrowers that objectively cannot afford their loans. Congress should pressure the CFPB to allow the current ability-to-repay standards to go into effect.

V. Congress Can Do Better: Expand the Military Lending Act's 36% Usury Limit to Protect All Americans.

The effects of the CFPB's withdrawal from actively protecting consumers in high cost lending will not affect all Americans in the same way. Currently over a dozen states have retained or reestablished traditional usury laws that prohibit triple-digit interest rate lending. These states include red and blue states, northern and southern states, as well as eastern and western states. New York, Vermont, Connecticut, North Carolina, Arkansas, South Dakota, Montana, and Colorado all have traditional interest rate limits of no more than 36 percent APR that effectively prohibit abusive payday lending. For residents of these states, the Trump Administration's expected retreat from payday lending regulation will have minimal effect because either through ballot measures or the leadership of state legislators, consumers are protected under state law. Residents of these states are thriving without access to payday and vehicle title loans.

Moreover, the political leaders who helped protect consumers are in these states are revered by their voters for taking a stand against predatory lending. Virtually every poll conducted on the subject indicates that an overwhelming majority of Americans—about three out of four—support

[42] 84 Fed. Reg. 5452, 4287 (February 14, 2019).
[43] *Id.*

traditional usury law that would prohibit triple-digit interest rate loans.[44] And in every public ballot referendum ever conducted on the issue, Americans have overwhelmingly voted in favor of traditional usury limits on the interest rates of consumer loans.[45] The members of this committee

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[44] *See* Center for Responsible Lending, *Congress Should Cap Interest Rates: Survey Confirms Public Support for Cracking Down on High-Cost Lending* (Mar. 2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf ("Three out of four Americans who expressed an opinion think that Congress should cap interest rates at some level. 72% think that the annual interest rate cap should be no higher than 36% annually."). "Only one quarter of those who expressed an opinion think Congress should not cap interest rates at all." *Id.* The telephone survey reached 1,004 adults in the continental United States. *Id.* CRL weighted the sample by age, sex, geographic region, and race to suggest a 95% chance that the survey results are accurate within 2%. *Id.*. *See also* Holly Beaumont, *Capping Interest at 36% is Ethical, Just*, Albuquerque Journal, February22, 2015, ("A poll conducted by the Center for Responsible Lending Public Policy Poling in January shows that 86 percent of New Mexicans support interest caps of 36 percent or less."); Rudolph Bush, Statewide Survey Shows Broad Support for Payday Lending Reform, Dallas News City Hall Blog (June 21, 2012), http://cityhallblog.dallasnews.com/2012 /06/statewide-survey-shows-broad-support-for-payday-lending-reform.html/ (reporting that 79% of Texans polled favored capping interest rates on payday and auto title loans at 36% APR or less); Center for Policy Entrepreneurship, *Poll on Payday Lending Legislation* (Feb. 15, 2008), *available at* http://www.c-pe.org/download/PaydayLendingReform/PollPaydayLending.pdf (stating that a weighted sample of 500 Colorado voters found "74% of respondents are in favor of proposed legislation that will set a cap of 36% on the interest and fees that a company can charge for payday loans"); Tim Evans, Lawmakers Face Familiar Question: How Much is Too Much to Charge for Small, Short-term Loan? INDY STAR, January 14, 2018, https://www.indystar.com/story/news/2018/01/14/lawmakers-face-familiar-question-how-much-too-much-chart-smalfate-high-interest-short-term-loans-bac/1020203001/ (poll of 600 registered Indiana voters conducted by Bellwether Research and Consulting of Alexandria, Virginia finding "68 percent 'strongly favor' and another 20 percent 'somewhat favor' the 36 percent cap."); Timothy E. Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does the Law Reflect the Public's Desires?* 89 CHICAGO-KENT L. REV. 115, 127 (2014) (survey of New Mexicans finding "over 72% of participants felt that the closest approximation of the rate at which these loans should be capped was 25% or less."); Iowans for Payday Loan Reform: Iowa Poll Reveals Strong Bi-partisan Support for Payday Lending Reform, IowaPolitics.com (Jan. 26, 2011), http://www.iowapolitics.com/index.iml ?Article=224730 (reporting about 7 in 10 Iowans support capping payday loan interest rates); Kentucky Coalition for Responsible Lending, *Kentucky Voters Support a 36 Percent Rate on Payday Loans, Despite Database and Job Loss Threats* (2010), *available at* http://kyresponsiblelending.files.wordpress.com/2010/01/kcrl_polling_data_fact_sheet_2-7-11.pdf (stating that a survey of "[n]early 400 voters from 179 cities and towns across the Commonwealth" found "73% of voters across the Commonwealth support a 36% APR cap on payday loans"); Pascale Mondesir, AARP New Poll Shows Support for Payday Loan Cap, KSFY News, October 28, 2015 (South Dakota poll commissioned by AARP "showed that 77% of the participants agree that there needs to be a cap on payday loans, with a 64% percent strongly agreeing."); Public Affairs Research Council of Alabama, *Alabama Public Opinion Survey* at 19-20 (Summer 2018), http://parcalabama.org/wp-content/uploads/2018/09/PARCA-2018-Public-Opinion-Survey.pdf (finding 73.6 percent of Alabamians agree or strongly agree with the statement "[t]he Alabama legislature should pass legislation capping the maximum rates on payday loans at 36%."); Jennifer H. Sauer, Summary of AARP Poll of Texans Ag 45+: Opinions on Payday loan Rates and Legislation (January 2013), https://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2013/Summary-of-AARP-Poll-of-Texans-Age-45-Plus-Opinions-on-Payday-Loan-Rates-and-Legislation-AARP.pdf (finding 79% of Texans aged 45 years-old or believed the highest annual percentage rates payday and auto-title loan businesses should be able to charge is 36% APR or less); R.I. Office of the Gen. Treasurer, Press Release, Coalition, Raimondo, Taveras Raise Awareness on Payday Lending Pitfalls (Apr. 17, 2012), http://www.ri.gov/press/view/16334 (reporting that 76% of Rhode Islanders polled support capping payday loan interest rates).

[45] Ballot measures on usury limits have occurred in Arizona, Montana, Ohio, South Dakota, and Colorado. The public voted overwhelmingly in favor of usury limits in all of these states. *See* Tom Jacobson, Op-ed., GREAT FALLS TRIB.

could earn the respect and admiration of many voters by restoring the simple, effective usury limits that Americans previously enjoyed throughout most of the twentieth century.

The federal Military Lending Act provides an excellent template for congress to establish a national usury limit. Rather than returning to the drawing board, Congress should consider simply expanding the Military Lending Act's usury limit as implemented in the Department of Defense's 2015 regulations to all Americans. Expanding the MLA has several political and legal advantages:

- **The MLA's usury limit is strategically targeted to stop the most problematic debt traps.** The MLA does not apply to home mortgage loans, vehicle purchase loans, or secured retail finance—avoiding political opposition from several important constituencies. And, although the MLA does apply to banks, the 2015 final rule is crafted in a way that these institutions can live with. While they may not support a 36% usury limit, most banks do not exceed this price anyway.
- **The MLA makes a reasonable compromise on credit cards and overdrafts.** Very few credit cards have historically charged a periodic interest rate of more than 36 percent. So, the MLA doe s not generally interfere with credit card rates. And the Department of Defense's MLA regulation restricts only unreasonable nonperiodic credit fees—effectively deferring to the CARD Act as the primary of source consumer protection for non-periodic fees in the card market. The 2015 MLA rule follows the lead of Regulation Z in treating nonperiodic courtesy overdraft fees as a separate issue. But overdraft lines of credit and Deposit Advance products (so called "bank payday loans") are subject to the Act's all-in usury limit. The result is a usury limit that, appropriately, cuts primarily into the product offerings of payday lenders, vehicle title lenders, and finance companies that rely on collections as a business model instead of authentic ability-to-repay underwriting.

(Great Falls, MT), Jan. 6, 2011 ("Ballot Initiative 164, which took effect Jan. 1, capped the annual interest rates on payday and car title loans at 36 percent . . . . The measure passed with 72 percent of the vote statewide. It won in every county and House district . . . ."); Marian McClure & Debbie McCune Davis, Op-ed., *Let's Make Sure the Sun Sets on Arizona Payday Loans*, ARIZONA REPUBLIC, Nov. 21, 2009, at B5 ("60 percent of Arizona voters soundly rejected 400 percent annual interest rates on payday loans, when 1.2 million Arizonans rejected the payday lenders' Proposition 200. The lenders spent more than $14 million trying to fool the people. The voters saw through their scam."); Editorial, *Ohio Voters Prove that a Good Idea Can Beat $22 Million*, AKRON BEACON J. (Ohio), Nov. 6, 2008 ("Voters handed the industry a deservedly humiliating defeat, rejecting one of the slickest and most misleading campaigns in the state this election season by a ratio of roughly 2-to-1. The defeat of the lenders is particularly gratifying, as their efforts carefully concealed the industry's goal to regain the license to charge excessive interest rates to borrowers desperate for quick loans."); Ballotpedia, South Dakota Payday Lending Initiative, Initiated Measure 21 (2016), https://ballotpedia.org/South_Dakota_Payday_Lending_Initiative,_Initiated_Measure_21_(2016) (reporting 75.58% voting "in favor of placing an interest rate cap of 36 percent on short-term loans."); Ballotpedia, Colorado Proposition 111, Limits on Payday loan Charges Initiative (2018), https://ballotpedia.org/Colorado_Proposition_111,_Limits_on_Payday_Loan_Charges_Initiative_(2018), (reporting 77.25% voting in favor of reducing "the loan costs on a payday loan to a maximum APR of 36 percent . . . . regardless of whether payday lenders have a physical location in the state, they may not offer higher cost loans via electronic or U.S. mail, the internet, or telemarketing.").

- **Expanding the MLA to all consumers would be easier for industry than crafting a new usury limit.** Although the MLA protects only a relatively small (but important) proportion of our population, it currently applies to *all* creditors that extend loans within its scope. Financial institutions have already revised their policies and procedures, redesigned their origination and servicing software, and trained their compliance staff on how to conduct business under the MLA. As time goes on, financial institutions will have an even better sense of how making MLA-compliant loans affects their business model, tactics, and bottom line. Congress should consider taking advantage of this expertise and sunk compliance costs. Expanding the MLA is a consumer protection benefit-to compliance cost ratio bargain.

In conclusion, thank you for work on behalf of Americans in working to resolve these complex and important national problems.

CFSI Center for Financial Services Innovation

Testimony before the House of Representatives Committee on Financial Services
Sub-Committee on Consumer Protection and Financial Institutions
Hearing on: Ending Debt Traps in the Payday and Small Dollar Credit Industry
April 30, 2019 2:00 PM
2128 Rayburn
Written testimony by: Garry L. Reeder II
Vice President, Center for Financial Services Innovation

Chairman Meeks, Ranking Member Luetkemeyer, and Committee members: Thank you for allowing me the opportunity to share some thoughts and insights on the small dollar credit (SDC) industry and its impact on Americans' financial health. The Center for Financial Services Innovation (CFSI) is the leading authority on consumer financial health. We are a trusted resource for business leaders, policymakers, and innovators united in a mission to improve the financial health of their customers, employees, and communities. Through research, advisory services, measurement tools, and opportunities for cross-sector collaboration, we advance awareness, understanding and proven best practices in support of improved consumer financial health for all. Our largest initiatives include the Financial Solutions Lab and the U.S. Financial Health Pulse. The Financial Solutions Lab -- a partnership with JP Morgan Chase -- is a seed-stage fintech accelerator focused on advancing the financial health of low- and moderate-income (LMI) and historically disadvantaged consumers. The U.S. Financial Health Pulse is an annual snapshot of how Americans manage their financial lives with actionable insights to improve financial health.

Summary

With this written testimony, I intend to (1) discuss the sources of demand for SDC; (2) explore the features of responsible supply; (3) identify emerging sources of responsible supply; and (4) briefly discuss the most promising opportunity to improve SDC consumer outcomes.

As an authority on the financial health of Americans, CFSI has researched the consumer behaviors, products, and providers that comprise the SDC market. And we have supported and highlighted innovations in this market that are most consistent with advancing consumers' financial health.

Our research suggests that a variety of different needs and use cases underlie the demand for small-dollar credit and that many of them are symptomatic of one or more dimensions of poor

financial health on the part of borrowers. Historically, payday lenders, auto title lenders, pawn shops, and other subprime lenders have dominated the provision of small-dollar loans. Many of the products they have offered are expensive, rarely underwritten, rely on cycles of continuous use, and harsh collection practices that both exploit and perpetuate borrowers' financial distress. Auto title loans are of particular concern because of the potential loss of a car in the event of default.

Understanding the nature of demand for such products should inform how providers can meet that demand responsibly—and the limits to their doing so. Short-term, small-dollar credit products must generate sufficient profit in order for providers to make them available to credit-worthy consumers who need them. The success of responsible products must be measured not simply by whether they meet demand, but by their potential to help users improve their financial health.

Consumer financial health and SDC demand

Like most other forms of credit liabilities that reside on consumers' balance sheets, demand for small-dollar credit is derived demand. Mortgage credit derives from consumers' needs and preferences for shelter; auto loans from needs and preferences for personalized transportation; student loans for human capital and credentials; and some credit card and installment credit for needs and preferences for purchases of large durable goods. For each of the above credit liabilities, a corresponding asset or future use value sits on the other side of the consumer's balance sheet.

The source of demand for most small-dollar credit diverges from the use cases described above. As the term "liquidity lending" implies, these loans are generally used to pay either for regular living expenses when the borrower has insufficient cash on hand to pay for them, unexpected or emergency expenses, or to displace another short-term liabilities, such as overdue bills or servicing of an existing debt.

According to the FDIC's 2017 National Survey of Unbanked and Underbanked Households, 19.7% of households surveyed had no mainstream credit in the past 12 months.[1] 6.9% of households used an alternative financial services form of credit (these include payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, and auto title loans) in lieu of bank products.

[1] 2017 National Survey of Unbanked and Underbanked, Federal Deposit Insurance Corporation, October 2018.

Of that:

- 1.7% of households used payday loans
- 2.4% used refund anticipation loans
- 1.4% used rent to own
- 1.4% used pawn loans
- 1.4% used auto-title

The share of households with no mainstream credit varied substantially across socioeconomic and demographic groups. Lower-income households, less-educated households, black and Hispanic households, working-age disabled households, and foreign-born, noncitizen households were more likely not to have mainstream credit.

There is ample evidence to suggest that a large portion of American households face expenses for which they do not have sufficient cash on hand one or more times during the year. CFSI's Financial Diaries Project, which studied the day-to-day earnings and expenses of 235 LMI households over the course of a year, found that month-to-month spikes in expenses, coupled with income volatility associated with variable and uncertain work scheduling and employment insecurity, led expenses to exceed income in multiple months of the year.[2] These findings were further supported by the JP Morgan Chase Institute's seminal 2015 study on income volatility.[3] Separately, the Federal Reserve's Report on the Economic Well-Being of U.S. Households in 2017 found that "Four in 10 adults...would either borrow, sell something, or not be able to pay if faced with a $400 emergency expense."[4]

CFSI research has identified four primary drivers of demand for SDC[5]:

- **An unexpected expense** such as a car repair, medical bill, home repair, or help provided to family and friends. (32% of respondents)
- **Misaligned cash flow**, when income and expenses are mistimed due to income variability or expense management issues and borrowing is needed to pay recurring expenses such as utilities, rent, or groceries. (32% of respondents)
- Expenses that **regularly exceed income**. (30% of respondents)
- A **planned purchase** of a personal asset or paying off debt. (9% of respondents)

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[2] Rachel Schneider and Jonathan Morduch, Spikes and Dips: How Income Uncertainty Affects Households, CFSI and the Financial Access Initiative at New York University, October 2013.
[3] Weathering Volatility: Big Data on the Financial Ups and Downs of U.S. Individuals, JP Morgan Chase & Co. Institute, May 2015.
[4] Report on the Economic Well-Being of U.S. Households in 2017, Board of Governors of the Federal Reserve, May 2018.
[5] Know Your Borrower: The Four Needs Cases of Small-Dollar Credit Consumers, CFSI, December 2013.

Financial health lens

As stated earlier, the value of an SDC product should be measured by its ability to improve the financial health of the consumer. Unfortunately, too many traditional sources of SDC contribute to, rather than address, poor financial health.

CFSI defines financial health as having a day-to-day financial system that builds resiliency and enables people to pursue opportunities. We have identified eight key indicators of financial health that characterize how consumers spend, save, borrow, and plan for the future.[6] Consumers are financially healthy when they:

- Spend less than income
- Pay bills on time and in full
- Have sufficient living expenses in liquid savings
- Have sufficient long-term savings or assets
- Have a sustainable debt load
- Have a prime credit score
- Have appropriate insurance
- Plan ahead for expenses

When combined to provide an overall measure of consumers' financial health, these indicators can help business leaders, employers, policymakers, and innovators better understand how their actions are supporting improvements in financial health over time.

Viewed through the lens of consumer financial health, the primary use cases for SDC represent constrained choices and are indicative of poor financial health. While a short-term loan may manage an immediate symptom, use of SDC often fails to address the underlying causes and in some cases—particularly with sustained use—may worsen them.

For example:

- **Unexpected expense:** Using SDC to meet unexpected emergency expenses may reflect that a consumer does not have an adequate **cushion of liquid assets** (one key positive indicator of financial health) or does not carry **appropriate insurance** (another indicator) to cover emergency medical, auto, or home repairs.

- **Misaligned cash flow:** Volatility creates chronic mismatches between income and expenses requiring even larger liquidity cushions and that are increasingly difficult to

[6] Eight Ways to Measure Financial Health, CFSI, May 2016.

replenish. Building and maintaining such cushions involves **planning ahead** (another key indicator), while the use of credit to meet them may reflect a lack of planning.

- **Planned purchases:** Some types of credit are designed to facilitate large purchases cost-effectively spreading purchase costs over the life of the asset. However, these sources of credit are generally only accessible to consumers who have established **good credit scores** (another key indicator). Use of subprime, small-dollar credit for such purchases can be far more expensive and can reflect lack of access to prime credit and the presence of an unsustainable **debt load** (a negative indicator).

- **Expenses regularly exceed income:** No source of credit can sustainably address cash shortfalls that occur when a consumer chronically **spends more than they earn** (another negative indicator).

CFSI Compass Principles

In 2014, as part of CFSI's Compass Principles, we issued The Compass Guide to Small-Dollar Credit. We outline seven characteristics of small-dollar credit products that embrace inclusion, build trust, promote success, and create opportunity among borrowers.

A high-quality loan:

1. **Is made with high confidence in the borrower's ability to repay.** We advocate using the best available underwriting techniques to ensure a borrower's ability to repay without re-borrowing and while still meeting basic needs and financial obligations. We discourage reliance solely on collateral to assure repayment.

2. **Is structured to support repayment.** We encourage lenders to make closed-end loans that are fully amortizing and without prepayment penalties. We encourage lenders to strike a balance between making payment amounts affordable (including minimum payments on lines of credit) and minimizing cost over the length of the loan. We encourage products that get borrowers to pay their balances down to zero creating capacity for new credit when it is needed.

3. **Is priced to align profitability of the provider with success for the borrower.** We encourage lenders to reward positive repayment behavior by lowering costs and to avoid relying on penalty fees as profit drivers.

4. **Creates opportunities for upward mobility and greater financial health.** We encourage reporting to the major credit bureaus to help borrowers improve their credit

scores when they successfully repay. We also encourage institutions to combine SDC products with savings opportunities and incentives, helping borrowers improve their ability to manage future emergencies or cash shortfalls.

5. **Has transparent marketing, communications, and disclosures.** We encourage lenders to disclose the full cost of the loan to the borrower in simple, clear, and easy-to-understand language, with no hidden fees, industry jargon, or misleading information or fine print. This includes providing pricing information prior to the application. We discourage bundling of add-on products (such as credit insurance) that muddy the consumer's understanding of the full cost of the loan.

6. **Is accessible and convenient.** We encourage lenders to allow loan payments through multiple channels, such as Automated Clearing House (ACH), in-person, online, mobile, or via kiosk. Likewise, flexibility in loan applications and loan disbursements can help to increase access and improve the customer experience.

7. **Provides support and rights for borrowers.** We encourage lenders to ensure that borrowers can obtain customer support easily and are treated respectfully. This means assigning borrowers to individual relationship managers when servicing and collection issues arise. It means not using collections tactics that employ harassment or intimidation under any circumstances.

Note on the cost of credit

Concerns about both the charging of interest and the amount of interest being charged have deep religious, cultural, and legal roots. In the United States, these debates have revolved around a usury cap of 36% since the early 20th century. Many proponents reasonably argue that usury caps (such as those prevailing in some states and under the federal Military Lending Act (MLA)) provide an implicit incentive for institutions to make loans that borrowers have the ability to repay and to underwrite in ways that limit default risk levels that cover the cost of credit. Others validly argue that price caps, either explicitly imposed under usury laws or implicitly under the guise of safety and soundness concerns, limit lenders' ability to offer credit to consumers who pose a higher default risk—often those most in need of liquidity credit.

The true cost of a short-term depends heavily on the structure of the product, the length of time in debt, and the anticipated range of borrower outcomes. A two-week, $500 deposit advance, at a cost of $10 per $100 advanced, may seem relatively inexpensive at $50 if it avoids a loss of utilities or a car repossession. However, if the loan has a high probability of triggering an extended sequence of re-borrowing (i.e., six loans, over 12 weeks and a total cost of $300), the transparency and safety of the product is compromised. In contrast, a $500 closed-end, 90-day

installment loan with an upfront cost of $12 per hundred has a higher price but it may have a lower probability of re-borrowing and an extended cycle of fees. Even a subprime credit card with a 36% APR may ultimately lead to a higher cost per use if the borrower carries a balance for a sustained period: a $500 cash advance on such a card, with the typical 3% advance fee and repaid only using minimum payments for the six months following use, would cost roughly $115.

CFSI recognizes that there is often a trade-off between cost and availability. We encourage policymakers to allow institutions to experiment along the cost and availability spectrum, including for products with pricing above 36% APR. Policymakers should focus their efforts around understanding whether a product improves consumer outcomes in a measurable and demonstrable way rather than just filling immediate demand or meeting compliance requirements.

Note on annualized percentage rate (APR)

APR was created as a tool for comparison shopping of similar credit products (e.g. 30-year fixed mortgages). The APR calculation does allow the consumer the ability to compare real world trade-offs such as a payday loan versus paying rent. While a standard measurement of cost is essential for a transparent market, APR is not that tool for the SDC market.

An annualized percentage rate (APR) is calculated as follows:

$$\text{APR} = \left(\left(\frac{\frac{\text{Fees+Interest}}{\text{Principal}}}{n} \right) \times 365 \right) \times 100$$

where:

Interest = Total interest paid over life of the loan

Principal = Loan amount

n = Number of days in loan term

As n (the number of days) approaches zero the APR calculation becomes less helpful as a true measure of the cost of credit.

Innovations in responsible SDC

The broader consumer finance industry is in the midst of dramatic change, as a result of the ever-increasing speed of technological innovation and the broadening and deepening of data availability. Fintech start-ups and innovative incumbents are developing and testing products that have the potential to meet the financial needs of underserved households.

Some of the most important developments include:

- **Early wage access:** Several companies, including Even, PayActiv, and FlexWage allow a consumer to obtain early access to wages already earned. In some cases, these services are offered through employers as an employee benefit. By tying repayment automatically to deductions from upcoming paychecks, the advances minimize risk of default and thus dramatically lower cost. In early experiments both uptake and employee satisfaction have been high; and there is evidence of employer benefit in the form of lower employee turnover.[7]

  Allowing early access to wages can help consumers manage needs frequently filled by SDC products, particularly mismatches in income and expense timing. At present, many early wage access products share the same structural weakness of payday loans and other single-payment forms of credit: the potential to leave borrowers short on the next payday possibly leading to a high degree of repeat use. However, providers and their employer partners could address this potential harm by allowing wage advances to be repaid in installments over multiple pay periods.

  Ideally, employers and their payroll service providers will find solutions that allow employees to receive their earned wages without the involvement of a financial services provider.

- **Overdraft insurance:** At least three companies (Dave, Oportun, and Brigit) have launched subscription services that advance small amounts of credit specifically to enable users to avoid overdrawing their accounts. Advances are automatically triggered when checking account balances fall below a pre-set threshold. Underwriting based on the consumer's cash flow data is made possible when users provide the services permission to view their daily account balances and transaction histories. Savings to consumers appear substantial as the monthly subscription fees and voluntary payments received by these providers are far less than what users would otherwise pay in overdraft fees.

- **Cash flow-based underwriting:** A variety of non-bank lenders and credit bureaus are pioneering the use of consumers' deposit and spending patterns to assess creditworthiness. Some are applying these techniques to lower default risks and costs in the small-dollar credit arena. The data are made available with the customer's permission

[7] Todd H. Baker, FinTech Alternatives to Short-Term Small- Dollar Credit: Helping Low-Income Working Families Escape the High-Cost Lending Trap, Mossavar-Rahmani Center for Business and Government, at the Harvard Kennedy School, May 2017. See also "Walmart's pay-advance app Even used by 200,000 employees," American Banker, July 19, 2018.

through aggregators, who are increasingly using secure Automatic Program Interfaces (APIs) to obtain data.

Cash flow-based underwriters include both some early wage access providers and overdraft insurance providers. Banks already possess account deposit and spending history on their customers and are readily positioned to use this asset in underwriting their own credit products.

- **Advanced liquidity management tools:** The last decade has witnessed a proliferation of digital tools that help consumers better manage their day-to-day spending and thereby help avoid cash shortfalls. These can effectively reduce demand for small-dollar credit while addressing the daily challenges of managing limited budgets. These tools have been introduced as both stand-alone fintech tools and as account features by a growing number of banks.

  The tools that are experiencing the greatest uptake by consumers include:

  - **Income earmarking,** which allocates portions of incoming earnings to expected recurring obligations before they can be used for discretionary spending;

  - **Digital registers,** which use automated intelligence to predict automated bill payments and other recurring transactions and, accordingly, adjusting consumers' discretionary spending balances;

  - **Automated savings,** which operate in the background of consumers' daily financial lives to build cushions of liquid assets that can be drawn on in emergencies and automatically replenished.

- **Bank-issued SDC:** In their roles as hosts to our national payment systems and providers of deposit and transaction accounts, banks have unique insights into the day-to-day earning and spending—and ultimately, the financial health—of their customers. They are well-positioned to offer solutions to financially vulnerable consumers to improve and maintain their financial health. SDC products can be a part of these offerings.

  Banks are also well-positioned to lower the risk and cost of extending small-dollar credit. Lending to existing customers can largely eliminate fraud risk, while banks' insight into customers' earning and spending behavior can enable them to assess default risk and extend credit to consumers whose credit scores underestimate their ability to repay.

Separately, banks' ability to debit repayments from consumers' incoming deposits can reduce their default risk.

However, permission to collect payments via auto-debit should not be made a condition for extending credit. Likewise, loss of one's checking account should never be made a consequence of non-payment of credit.

CFSI supports the efforts of the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration (NCUA), and the Federal Deposit Insurance Corporation (FDIC) to build a framework that spurs the growth of another source of responsible SDC.

The potential for consumers to better manage their short-term liquidity needs, through both better forms of credit and new spending management and savings tools, has never been greater.

Note on bank-issued SDC

Last year CFSI, the Pew Charitable Trusts, and other non-profits worked with U.S. Bank to design a responsible SDC product. In September of 2018, U.S. Bank introduced an installment loan that is repaid over three months, with monthly payments set at 5% of a customer's monthly income. Whereas a traditional $400 payday loan repaid over three months costs an average of $350, the U.S. Bank product offers the same credit that serves deep subprime consumers for $48 -- representing an 86% savings for consumers.[8] Not only does this product represent a significant improvement for consumers but is a model of how different stakeholders collaborate on innovative solutions. Lastly, this product and other bank-issued SDC will require extensive research to understand the impact on consumer outcomes.

Current policy reforms

Following the passage of the Dodd-Frank Act the Consumer Financial Protection Bureau (CFPB) undertook almost a decade of robust research and rulemaking activity. While we, like most other stakeholders, had specific proposals that conflicted with the final rule we applaud the integrity of the CFPB's efforts.[9] The rule was narrowly tailored to address the most urgent issues in SDC -- short-term balloon payment loans. Importantly, the CFPB's final rule created space for innovation around loans greater than 45 days in duration. The SDC market has been incorporating the CFPB's requirements and is providing a range of products across various price points and durations.[10] We are dismayed to see an unjustified abandonment of core provisions of

[8] Nick Bourke, American Banker, "Momentum is Building for Small-Dollar Loans," Sept. 12, 2018
[9] CFSI's comment letter to the CFPB on the "Payday, Vehicle Title, and Certain High-Cost Installment Loans," notice of proposed rulemaking, July 22, 2016.
[10] State Laws Put Installment Loan Borrowers at Risk, Pew Charitable Trusts, October 2018.

the final rule -- particularly the ability to repay requirement which already exists with mortgages, credit cards, and the income-driven repayment programs for federal student loans. Our forthcoming comment letter in response the CFPB's recission RFI will discuss our concerns in more detail.

Conclusion

CFSI recognizes that SDC products often treat the symptoms of consumer credit issues rather than the cause of those issues. Financial products are not and never will be a substitute for policies that ensure equal opportunity for all Americans. The U.S. needs policies that mitigate the need for SDC, such as livable wages, access to affordable healthcare, dependable work schedules, and family and sick leave policies for hourly and contingent workers. We recognize these policies are not within the scope of this hearing, but they will be important elements in addressing the true drivers of SDC demand.

Hearing Before the United States House of Representatives Committee on Financial Services, Subcommittee on Consumer Protection and Financial Institutions

April 30, 2019

Testimony of Robert Sherrill, CEO, Imperial Cleaning Systems

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Good afternoon Chairman Meeks, Ranking Member Luetkemeyer, and members of the Committee.

My name is Robert Sherrill, and I am grateful for the opportunity to be able to speak to you about my experience with payday and title loans.

I'm not sure if I am the only person on this panel who has actually used these products, but I hope that with my testimony I can shed some light on how important they were for me at a time when I had no other options. Payday and title loans helped me when I had nowhere else to turn. I might not be here if these forms of credit were not available to me.

In your invitation letter to me, you asked me to discuss "research describing the various harms consumers may suffer when utilizing these products." I cannot talk about research but I can talk about my personal experience.

When I took out my payday loan, I knew what it would cost me. While I have not taken out a payday loan recently, I still know what they cost. Given my circumstances at the time and the lack of other options, I determined that this basic small loan was the best option for me. In fact, it was a cheaper and easier solution than the available alternatives. I am lucky that there was a lender available that would make a loan to someone in my circumstances.

But let me go back to the beginning of my story.

When I was young, nobody taught me about money and finances, which is a situation not uncommon to many people. Because of family issues and hard times, I ended up raising myself and got involved in selling drugs, which ultimately led to my going to prison.

I'm not proud of this, but it's an important part of my experience. When I got out of prison, the deck was stacked against me. I was a felon with no credit, no education, and very little income. I'd ask you to put yourself in a lender's shoes – would you have made a loan to me? Would you have offered me a lifeline? Would you have given me credit with nothing to prove I was creditworthy but my word?

Due to my release and probation requirements, I found a job as a food busser at a local Italian restaurant. I worked hard every day to make ends meet. After a year, I was given a ten-cent raise. It was then I knew I had to change my life. .

When I started my business no one would give me a loan. I know this, because I applied and was rejected several times. Most banks wouldn't even let me open an account. The only account I could get was with a credit union because I pleaded my case.

Because of my history, the only company willing to front me the money I needed was a local payday lender in Nashville called Advance Financial. If Advance Financial had not been an option, I would likely not be here testifying to you today.

It is unfair for anyone to assume that every day people don't know what they're getting into or what the repayment terms of a loan are going to be. That assumption is based on the conclusion that ordinary people are uneducated or too unsophisticated to make smart financial decisions. In my situation, I was tracking every dollar I had. I knew when money was coming in, and I knew when it was going out. I knew that I would have to repay the loans that I took out. When I went to Advance Financial, every part of the process was explained clearly and fairly, including when payments were due, how much they would be, and how much it would cost me for the loan.

Today, the business that I started with a payday loan is Nashville's premier construction and commercial cleaning service. I am a minority certified business, belonging to the Chamber of Commerce, the Better Business Bureau, and Nashville's Rotary Club. Now, I qualify for lines of credit and other types of loans. I have developed a solid business foundation. But it is all because of the lifeline that Advance Financial gave me when no one else would give me the time of day.

I have also come to learn from being in business that sometimes a market determines what things cost. Many today will probably ask if I'd like these types of loans to be cheaper. Well, there are a lot of things in life that I wish were cheaper. But forcing these lenders out of business will not make loans cheaper, it will only leave people in the situation I was in with even fewer options.

I want to repeat what I said at the beginning of this statement. I understood what a payday loan was going to cost me when I took it out, and I understood when it had to be paid back. The best consumer protection that I got was to have someplace to go that was willing to make a loan to me and to explain the loan I got. I can also tell you that if I did not have this option I could have gotten money somewhere, but those other lenders would have been much, much worse for me. Until you are in a situation like mine, you cannot really appreciate the lifeline that was thrown to me by a company that you would put out of business.

If you eliminate these loans and these lenders, where do you expect people to turn for a lifeline? I had tried everything else. For many people, like me, these products are a first step toward getting things back together. People choose them because they are better than the alternatives. If they weren't, they wouldn't exist. We should trust people to choose what is best for their own situations, not take options away from them.

Thank you, and I look forward to your questions.

Testimony of Diane M. Standaert on behalf of the Center for Responsible Lending

Before the House Financial Services Subcommittee on Consumer Protection and Financial Services

April 30, 2019

> *Kathy, from Springfield, Missouri, received a payday loan in 2014, ended up in a debt trap that lasted two years. She described the stress from her payday and title loans as "soul-crushing."*
>
> *She says: "You are constantly worried about how to keep the loan and your necessary bills (rent, utilities, etc.) paid...You are stressed and it impacts everyone around you, children included. I want people to understand how devastating the effects of getting a payday loan really is on a family. The stress is unbearable. You are worried and upset all of the time. Your children get stressed out because the parents are worried about how to cover all the bills and a payday loan payment. It's a horrible way to live...Why will the government not pass laws to protect our most financially vulnerable citizens from these predatory lenders?"*[1]

Thank you for the opportunity to provide testimony today. My name is Diane Standaert, and I am the Executive Vice President and Director of State Policy for the Center for Responsible Lending. The Center for Responsible Lending (CRL) is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a one of the nation's largest community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and families of color, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided $6.4 billion in financing to 87,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through more than 40 retail credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, and Wisconsin.

Payday and car title lenders charge annual percentage rates of 300% and strip away around $8 billion annually from people typically earning approximately $25,000 a year. The debt trap of unaffordable loans drives this business model, with 75% of fees generated by people stuck in more than 10 loans a year. Low-income borrowers face a cascade of consequences such as delinquency on other bills, bank account closures, and even bankruptcy. As borrowers suffer the harms of these debt trap loans, private equity plays a growing role in fueling the engines of the industry.

Policy trends at the state and federal level for more than a decade have been to rein in the harms of the unsafe loans, ranging from the 2006 passage of the 36% rate cap in the Military Lending Act to voter-enacted 36% rate caps in South Dakota and Colorado, in 2016 and 2018, respectively. Since 2005, no new state has legalized payday lending. States with rate caps that prevent the payday loan debt trap are home to about 100 million people.

My testimony today will:

- Describe how payday and car title lenders have situated themselves to perpetuate our country's two-tiered financial services system,
- Discuss how the harms and consequences of payday loans exacerbate racial wealth disparities and disproportionately burden communities of color,

- Highlight how competition and alternatives do not address the harms of predatory lending practices; and
- Conclude with policy recommendations for addressing these abusive lending practices.

CRL calls on the Consumer Financial Protection Bureau (CFPB) to stand with the millions of people trapped in the cycle of debt caused by payday, car title, and high-cost installment loans. To do so, the CFPB should implement, not repeal, its 2017 rule which simply requires lenders to determine before making a loan whether a borrower can afford to repay it.

Payday and Car Title Lenders Perpetuate a Financial System Rooted in a Legacy of Discrimination and Exclusion

The United States' two-tiered financial services system is rooted in a legacy of discrimination and perpetuates wide racial wealth disparities. Homeownership is a prime example, as it remains the single largest opportunity for people to build wealth in this country; yet, business practices and federal, state, and local housing policies have systematically excluded families of color, especially Black families, from this opportunity. Specifically, Black communities were redlined as not worthy of investment to deny access to federally insured mortgage loans, which denied them the opportunity to build home equity in the same manner as whites who have since passed on that wealth created intergenerationally. Today, the Black homeownership rate predates its level at the passage of the Federal Fair Housing Act. As a result, white families now have 12 times the wealth of Black families based on unfair economic advantage, which enables them to better weather financial shocks.

By 2008, the homeownership gap had begun to close. However, predatory lenders exploited these gains by targeting communities of color with dangerous mortgage lending products peddled by subprime lenders that swept in to take advantage of equity borrowers of color had built. Subprime lenders made loans in communities of color at far greater rates than in white communities, even after accounting for income and credit risk—meaning that these borrowers could have qualified for more affordable, responsible loans that were crowded out by unfair and deceptive lending.

Payday lending in many ways is playing out the same way that the mortgage crisis did. Abusive lenders purport to provide access to credit in communities of color. However, lax regulation enables lenders to offer loans on predatory terms that are designed to strip wealth, rather than build it.

Although state usury limits, or interest rate caps, have been part of the nation's fabric since its Independence, the payday lenders chipped away at the between the mid-1990s and late 2000s.[2] Payday lenders went state-by-state-by-state, lobbying state legislatures to provide them exclusive exemptions to long-standing state interest limits in order to charge 400% APR under the pretense of offering access to emergency credit.[3] As states quickly learned, these loans were debt traps that would lead to further financial devastation in their communities. **Since 2005, no state has legalized payday lenders to allow them into its borders, and several states have reversed course to restore their rate limits' applicability to these loans.**[4]

Communities of color have historically been disproportionately excluded from the mainstream banking system due to discrimination. About 17% of Black and 14% of Latino households are unbanked, compared to 3% of white households.[5] Generally, a bank account is required to obtain a payday loan,

but because these loans cause significant debt, payday loans increase the likelihood that a borrower will have their bank account involuntarily closed, exacerbating the racial disparity between those with bank accounts and those without.

A history of redlining and race-based restrictive covenants have led to racial residential segregation, which payday lenders are able to exploit through the location of their payday loan shops. Due to long-term, systemic discrimination in housing, lending, policing, and other areas such as employment, communities of color are also more likely to experience higher rates of poverty. Likewise, people of color are likely to both have lower wages and higher cost burdens just to pay for basic living expenses as the result of facing broad societal discrimination. Women of color have faced the double-burden of racial and gender discrimination, resulting in even wider and more startling gaps in wages and employment. For example, Black women only earn 61 cents and Latinas only 53 cents for every dollar earned by a white male.[6] These disparities mean that people of color are more likely to be financially distressed, more likely to struggle to make ends meet--and thus more vulnerable to predatory lenders.

The history of racial discrimination and exclusion in our country's banking system has produced racially inequitable outcomes which persist today. Payday and car title lenders are profiteers of this history of racial discrimination. Payday and car title lenders frequently promote their products as providing access to credit to emergencies, but in reality they are exploiting chronic racial and economic disparities that cannot be solved or ameliorated with a 400% APR loan. As explained further below, these predatory products strip borrowers of hard-earned money and assets, leaving them worse off, while stifling the development of responsible products—a double-edged sword. Permitting their unfair and abusive practices unfettered entrenches the two-tier financial services system. One group of consumers has access to the mainstream financial system which is cheaper, while another is further marginalized, relegated to predatory lenders pushing costly debt trap products, reinforcing a history of financial exploitation.

The Harms of Payday Lending, Car-Title Lending, and High-Cost Installment Loans Perpetuate Income and Wealth Disparities

"Payday lending is bad for many consumers, but like many predatory scams, it invariably ends up as a weapon against the disadvantaged communities that are least able to bear its terrible burden. It uses the lure of quick cash to trap struggling families in a cycle of debt and slowly drain them of what little money they have."

Vanita Gupta, President and CEO of The Leadership Conference on Civil and Human Rights[7]

Payday and car title loans are debt traps by design. The lender takes control of a coercive payment device—access to the borrower's bank account or the title to their car. They make a loan, without any assessment of the loan's affordability in light of the borrower's income and expenses, and typically tie the loan payments to a borrower's payday. The borrower is typically unable to afford the payment, plus the high fees. As a result, the borrower is left with three options, all of them harmful: take out a new (unaffordable) loan to repay the loan, default on the loan, or repay the loan and default on other obligations or expenses. The vast majority of the loans payday lenders make are made within 30 days of a prior loan, indicating the initial loan was unaffordable from the start. The payday and vehicle title

business model, then, is not about providing access to productive credit or bridging a short-term financial shortfall. It is about flipping a borrower from one unaffordable loan to another for, the lenders hope, a very long time.

This debt trap is the core of the payday lenders' business model:

- The typical payday loan borrower is stuck in 10 loans a year, generally taken in rapid back-to-back succession.[8]
- Over 75% of all payday loan fees are due to borrowers stuck in more than 10 loans a year.[9]
- Only 2% of payday loans go to borrowers who take out one payday loan and do not come back for a year.[10]

While this debt trap is extremely lucrative for the lenders, it is incredibly devastating for borrowers and for the communities in which payday lenders are situated. For borrowers, payday loans are associated with a cascade of financial consequences, such as increased likelihood of bankruptcy, bank penalty fees, delinquency on other bills like rent and medical bills, delinquency on child support payments, and involuntary bank account closures.[11]

Car title loans likewise result in a debt trap followed by harmful consequences like the seizure of people's cars. The typical short-term car title loan is refinanced 8 times. And, an astounding one in five auto title loan borrowers have their vehicle seized.[12] **In Virginia, a state that allows longer-term car title loans, lenders seized over 70,000 cars between 2014 and 2017.**[13]

The CFPB has quantified bank fees triggered when funds were insufficient on longer-term loans, as well as subsequent lost bank accounts. It found that about half of borrowers paid an insufficient fund (NSF) or overdraft fee. These borrowers paid an average of $185 in such fees, while 10% paid at least $432. It further found that 36% of borrowers with a bounced payday payment later had their checking accounts closed involuntarily by the bank.

The debt treadmill becomes so unsustainable that eventually nearly 50% of borrowers default, even though they have generally paid significant amounts in fees and interest.[14] For one borrower in South Dakota, prior to the enactment of the state's rate cap, a borrower who had received an original $2,000 loan, was flipped 13 times in loans carrying 260% APR over the course of two years, paying over $8,300 in interest and fees before defaulting. Three years after her last payment, the payday lender filed a lawsuit to collect $5,300.[15] For another person, **a $200 loan resulted in seven flips, $3,233 interest and fees paid before defaulting, and a debt collection suit of $3,400.**[16] Upon default, payday lenders employ aggressive debt collection tactics, such as contacting people at work or their friends and family. Once a payday loan debt goes into collection, it is often reported to the credit bureaus, thus further damaging their credit standing and increasing barriers to jobs, housing, insurance or other affordable products in the future.

While the bulk of payday and car title loans are due in full with a single payment in 14 or 30 days, many of these payday and car title lenders are now also making high-cost installment payday and car title loans. Lenders falsely argue that simply because a loan is an installment loan, it is a good loan. Despite their installment terms, these loans have the same troublesome characteristics as other payday and car title loans: a lack of underwriting; access to a borrower's bank account or car as security; structures that

prevent borrowers from making progress repaying; and excessive rates and fees that increase costs further when loans are flipped.

The move to longer-term high-cost installment loans is occurring in the traditional brick and mortar lenders, but also through lenders operating online. Many of these online lenders, making excessively priced loans with direct access to a borrowers' bank account and no safeguards of affordability, seek to disguise their harmful lending practices under the guise of "fintech." The "fintech" label does not wipe away the underlying harms and consequences of these unaffordable loans. One online lender that makes high-cost installment loans, Elevate, reported charged-off debt amounting to 52% of their domestic revenues in both 2016 and 2017, with no intent to drive those numbers down.[17] Bloomberg reports that two large online lenders failed to verify income and employment in a significant percentage of the loans they make: one lender did not verify income or employment for about 25% of their loans, and another did not verify income or employment for about two-thirds of its loans.[18]
When made a loan they cannot afford, the borrower experiences inescapable debt or loss of assets, while, thanks to some combination of the high cost and repeat reborrowing, the lender lines his pockets. That's the business model of predatory lenders: they succeed by setting up the borrower to fail. And this is true whether the loan is a high-cost, unaffordable balloon payment loan or a high-cost, unaffordable installment loan.

Finally, what people see at the street level as a lender's little storefront on the corner is actually one of many tentacles that private equity firms use to extract hard earned money from people already struggling to make ends meet. Over the last several years, private equity firms have been acquiring ownership stakes in high-cost lending companies.[19] For example, DFC Global, which does business as names like Money Mart making loans at 300% APR, is owned by the behemoth firm Lone Star Fund, a $70 billion private equity fund. Ace Cash Express, with stores in 23 states charging rates between 200 and 661% APR, is owned by JLL Partners of New York. Community Choice Financial, a publicly-traded payday lender which charges rates upwards of 150% APR, is primarily owned by two private equity firms – Diamond Castle Holdings and Golden Gate Capital. These are just a few of many examples of private equity's ownership stake in predatory lenders.

Wall Street investors also benefit through purchasing these loans in the forms of asset backed securities.[20] As a range of subprime consumer lenders have begun bundling and selling their loans back to Wall Street. In some cases, such as with high-cost online lender Enova, the interest rates on these bundled loans reach up to 100% APR.[21]

Unaffordable lending fueled by these investors has profound human cost: Enova was the subject of a recent CFPB enforcement action that illuminated the unaffordability of its loans for many borrowers.[22] That's but one example. Borrower experience after borrower experience makes painfully clear the "soul-crushing" impacts of unaffordable high-cost lending.[23] These entities siphon billions of dollars a year from people making $25,000 a year, and it is going into the pockets of the wealthiest people in the world.

Communities of Color Disproportionately Bear the Burden of Predatory Payday Loans

"A drive through any low-income neighborhood clearly indicates people of color are a target market for legalized extortion...Visits to payday stores...are threatening the livelihoods of hardworking families and stripping equity from entire communities."

Julian Bond, former national chairman of the NAACP[24]

In determining their locations, payday and car title lenders are able to exploit the compounding harms of residential racial segregation and the continuing effects of disinvestment due to redlining. Research has repeatedly found that payday lenders concentrate in communities of color. In other words, payday lenders engage in a type of reverse redlining, locating primarily in communities that have been historically and systematically deprived of mainstream financial services in order to extract fees on the false promise of access to credit.

These patterns are not new nor accidental. They been found all over the country. Payday lenders in California are 2.4 times more concentrated in Black and Latino communities, even after controlling for income and a variety of other factors.[25] Payday lenders in Florida were also more concentrated in majority Black and Latino communities, even after controlling for income.[26] A 2018 analysis of storefront locations in Rhode Island, in which 26 of the state's 28 payday loan stores are owned by Advance America and Check 'N Go, shows similar patterns. **Among 80% to 120% area median income, neighborhoods with a significant population of Black and Latino residents have a 70% higher concentration of payday loan stores than those neighborhoods that are predominately white.**[27] There is only one payday loan store in any Rhode Island neighborhood that is upper-income, and predominately white. Dating back to 2005, when the Center for Responsible Lending produced the first report of this kind, payday lenders still had shops in North Carolina, and the pattern was clear even then. At that time, Black neighborhoods had three times as many stores per capita as white neighborhoods.[28] This three-fold disparity remained unchanged even after controlling for the neighborhood characteristics of income, homeownership, poverty, unemployment rate, urban location, age, education, share of households with children, and gender.[29] Similar patterns are well-documented in many other states such as Michigan,[30] Louisiana, [31] Colorado,[32] and Georgia.[33]

Payday lenders publicly acknowledge that location of their stores is one of the most critical factors in their competitive edge among other payday lenders. Payday lenders compete on location and convenience, rather than price (as further evidenced by payday lenders' each charging the maximum rate under state law). Payday lenders aggressively market their loans in order to lure people in to their doors for the first time, such as by offering their first loan free, a frequent borrower discount, or discounts for referring a friend, because lenders know that the typical borrower will cycle through the revolving door many more times.

In light of this concentration in communities of color and the importance of location in the payday lenders' business model, it is unsurprising that a disproportionate share of payday borrowers are people of color:

- In Pima County, Arizona, while Black, Latino, or Native American adults make up 30% of the population, they represented 65% of all payday borrowers when such loans were legal.[34]

- In California, while Black, Latino, and Native American people make up about 35% of the adult population, they represent 56% of all payday borrowers.[35]
- In Texas, researchers found that Black and Latino individuals make up over three-quarters (77%) of all payday borrowers, while they comprise only 40% of the population.[36]
- A survey by the Pew Charitable Trust found that African Americans were 105% more likely than other races/ethnicities to have had a payday loan in the last five years.[37]

Older Americans are Particularly Attractive to High-Cost Lenders and Especially Vulnerable to the Harms the Loans Cause.

Older Americans are particularly attractive to payday and vehicle lenders and especially vulnerable to the harm the loans cause. Coupled with recent dramatic declines in the value of their largest assets—homes and retirement assets—many older Americans also struggle with limited incomes. Nearly half of all older Americans are considered economically insecure, living on $29,425 per year or less. Forty-seven percent of single recipients of Social Security depend on it for 90% or more of their income. Senior women in particular face diminished incomes because of lower lifetime earnings and Social Security and pension benefits. Not only are these incomes limited, but they are also fixed, meaning seniors are particularly unlikely to be able to address financial shortfalls by working extra hours or otherwise earning extra income.

Facing these financial hardships, older Americans are particularly vulnerable to payday and car title lenders' claims of quick cash. And older Americans are particularly attractive to lenders because Social Security benefits provide a steady source of repayment. Indeed, an analysis by one researcher found that payday lender storefronts cluster around government-subsidized housing for seniors and the disabled in a number of states across the country.[38]

As one payday lender described federal benefits recipients: *"These people always get paid, rain or shine . . . [They] will always have money, every 30 days."*[39]

As another put it: *"[Borrowers receiving Social Security or disability] payments would come in for a small loan and write a check to the company dated the 3rd of the month, when their government checks would arrive. All the Advance America employees were required to come in early on that day, so we could quickly cash their checks and wipe out their checking accounts."*[40]

It is unsurprising, then, that significant numbers of older Americans become trapped in payday loans. Moreover, in recent years, trends have suggested that older Americans have comprised a growing share of payday borrowers. The share of payday borrowers in Florida age 65 and older more than doubled over the past decade, while the share of Florida's overall population comprised of that age group grew by only 9.7%.[41] The share of older borrowers in California has also grown steadily in recent years.[42]

CRL's research on bank payday loans found that over one-quarter of bank payday borrowers were Social Security recipients, making these borrowers 2.2 times as likely to have had a bank payday loan as bank customers as a whole.[43] One widow who relied on Social Security for her income testified before the Senate Committee on Aging that her $500 bank payday loan from Wells Fargo got her trapped for five years and ended up costing her nearly $3,000.[44]

Unaffordable payday loans made to seniors are particularly troubling because the Social Security funds the lenders routinely seize are protected from creditors in other contexts. Congress has long sought to protect Social Security funds and other public benefits intended for necessities from the unilateral reach of creditors. The Social Security Act prohibits collection of Social Security benefits through assignment, garnishment, or other legal process. The policy underlying this legal protection is to ensure the debtor a minimum subsistence income—for essential needs like food, shelter, and medicine—and courts have repeatedly upheld it.

Payday lenders making loans to Social Security recipients who cannot afford to repay the loans grossly undermine this critical protection by requiring the borrowers to provide direct access to their bank accounts and immediately taking the Social Security income for repayment—even if that means that the borrower is left with no funds for essentials. CRL research found that bank payday lenders took an average of 33% of the recipient's next Social Security check to repay a bank payday loan. For Annette Smith, the borrower described above, they took more than half.[45] The threat that unaffordable payday loans pose to Social Security recipients became more pronounced in 2013, when electronic distribution of government benefits became mandatory.

Competition and Alternatives Do Not Address the Harm of Predatory Lending Practices

"We don't want our families in any way vulnerable to the abuse payday lenders carry out – trapping people with little money into cycles of debt that put them into ever worse situations."

Lisa Hasegawa, Executive Director of the National Coalition for Asian Pacific American Community Development[46]

Payday lenders and their supporters deflect regulatory attention away from the lenders' inherently destructive business model by pointing to competition and other alternatives. Data show that neither will interrupt the debt trap of unaffordable, high cost loans.

In support of its gutting of the 2017 payday loan rule, the CFPB under Director Kathy Kraninger suggests that substantive protections to ensure loans are affordable are not needed if additional products by banks and others also exist in the marketplace. There is no evidence to support this claim. In fact, the evidence points to the contrary – that additional high-cost, poorly underwritten products push borrowers deeper into unsustainable debt, rather than substitute or drive down the cost of even higher-cost products.

Predatory subprime mortgages were prolific despite the availability of responsible mortgages. Only meaningful regulation could drive these products form the market, not competition. The time period in which six major banks made payday loan-like loans known as deposit advance loans is also informative. When six banks were making deposit advance loans at one-half to two-thirds the price of nonbank payday loans, their annual volume was about $6.5 billion.[47] There is no evidence that this lending drove down the cost or volume of nonbank payday lending. Moreover, the Bureau's research suggested these loans did not substitute for high-cost overdraft fees, and that many bank payday borrowers were carrying loads of both bank payday and non-bank payday loan debt. Indeed, software developers love to tout that bank payday loans, as well as installment loans being considered currently by the National

Credit Union Administration, will not "cannibalize" overdraft fee revenue. If these loans were truly substituting for higher-cost credit, they would drive down overdraft fees.

The introduction of high-double-digit APR loans from our nation's banks is a step in the wrong direction. Thus far, only US Bank has rolled out a 70% APR loan. There is no evidence to support that this will draw borrowers away from payday loans, rather than compound their high-cost debt. Rather, this product undermines state usury limits and threatens a race to the bottom by bank and nonbank lenders alike.

Additionally, competition among payday and other high-cost lenders has abjectly failed to lower costs. The last annual financial report from Advance America (before it was bought by Grupo Elektra) notes about the market "the principal competitive factors are customer service, location, convenience, speed, and confidentiality."[48] Missing from that phrase is the word "price."

In hopes of turning attention to other products besides their debt traps, payday and car title lenders will claim there are no other options for low-income consumers. The experiences of states without these products show that this is not the case. Moreover, as discussed above, there is generally credit available for customers with the capacity to take on more credit. Just as pulling weeds from a garden allows flowers to bloom, ridding the market of predatory loans clears space for responsible credit to thrive.

The presence of these other alternatives is helpful to people as they are options that do not lead people into financial quicksand. However, their presence alone will not reduce the cost of 300% interest rate loans, nor otherwise address the harms flowing from payday and car title lenders' debt trap business mode. The best way to mitigate the harms of the debt trap is not to look elsewhere to other products, but rather to address the harms of the flawed products head on – such as their cost and inherent unaffordability.

Both State and Federal Government Must Act to Rein in Payday and Car Title Lending Debt Traps

"Clearly, more needs to be done to rein in these uniquely unscrupulous lenders. States can push for interest rate caps to complement the CFPB's rule and play an even greater role in ensuring consumers do not fall into debt traps."

Janet Marguia, President, UnidosUS. [49]

- **States can and must address the harms of predatory payday lending in its communities of enforcing rate caps of 36% or less.**

  Today, 16 states plus the District of Columbia enforce such as cap, protecting nearly 100 million people from these harms and saving their residents over $2.2 billion annually in fees that would otherwise be paid to payday lenders for high-cost loans.[50] The two most recent states to join these ranks were South Dakota and Colorado, when over 75% of voters in each state affirmed lowering the cost of these loans to 36%. These ballot initiatives, along with those in Arizona, Ohio, and Montana, and a significant number of public polls nationally and states like Michigan, Iowa, Indiana, and others, show overwhelming public support for reining in the harm of these debt trap products.[51]

- **Due to the important role of these voter-affirmed state level protections, Congress and federal regulators must reject any proposals that preempt state laws or allow lenders to evade them by partnering with out-of-state banks.**

Such proposals allow payday lenders and others to partner with banks in order avoid state usury limits. Pushed under the guise of providing access to credit, these schemes will simply usher in a new wave of triple-digit interest rate loans across the country, even in states that seek to prohibit them.

- **Congress can and should enact a rate cap of 36% or less, while not pre-empting the laws of states with even stronger rate caps.**

  In 2006, upon the finding by the U.S. Department of Defense that predatory lending "undermines the military readiness,"[52] Congress enacted with bi-partisan support a 36% rate cap for consumer credit, including for payday and car titles, to active duty military and covered dependents.[53] Congress should extend the same protection to prevent the harms of the debt traps.

  With the protection of a rate cap of 36% or less in place, people have other options to navigate financial shortfalls that do not sink them into a spiraling debt trap.[54] Households with lower credit scores are served by a range of credit products; these include credit cards, as even subprime cards are far cheaper than a payday loan; pawn, which is typically cheaper than payday loans and offers an exit strategy (forfeiture of the item) if the borrower cannot repay; small loans from credit unions; and payment plans from utility companies. In fact, rather than providing a productive source of credit that meets consumers' credit needs, unaffordable payday loans generate their own demand—80% of payday loans are taken out to repay a prior payday loan. And the 100 million Americans living in states without payday lending deal with cash shortfalls without unaffordable payday loans and the harms they cause. Despite payday lenders' claim to the contrary, states with rate caps do not experience higher rates of online lending than those with payday loans.[55]

- **The Consumer Financial Protection Bureau must reverse its course of seeking to delay and repeal the ability-to-repay provisions of its 2017 protections for payday, car-title, and high-cost installment loans.**

  The 2017 rule aimed at stopping the debt trap of these loans established common sense principals of ensuring that these lenders assess a borrower's ability to repay the loan in light of their income and expenses.[56] Rather than do the necessary work to prepare for compliance of this rule by its August 2019 effective date, the lenders have sought to block the rule in every way possible -- through Congress, through the courts, and now through the CFPB itself.

  Both the delay and the repeal of the rule will allow payday and car title lenders' debt trap business model to continue as usual and leave millions of people across our country burdened with the unavoidable harms of this crushing debt.[57] For example, during the CFPB's proposed 15-month delay of the rule's implementation, an estimated 425,000 cars will be repossessed by car title lenders. Over that same time, payday and car title lenders will siphon over $9 billion out of the pockets of people earning on average $25,000 a year. The CFPB must allow the 2017 rule to go into effect as scheduled in August 2019, and reject its current proposal to gut them.

  Allowing the 2017 rule to go into effect as planned is the bare minimum that the CFPB should do. It is absurd that we should even have to make such a straightforward request of an agency whose charge is to protect consumers from unfair, deceptive, and abusive financial practices. Even so, the CFPB must not only do this work, but do even more – such as use its enforcement authority to

provide redress to people harmed by predatory lending practices, and it must continue the work to address the harms of long-term payday, car-title, and high-cost installment loans as it originally set out to do in its 2016 proposed rule.

- **Finally, federal banking regulators have a key role to play in ensuring that people are not ensnared in these dangerous debt traps.**

  Before 2014, a handful of banks issued so-called deposit advance products that were payday loans, dressed up in a suit and tie. Banks put deposit advance borrowers in an average of 19 of these loans a year at over 200% annual interest.[58] The Office of Comptroller of the Currency should restore its 2013 guidance against bank payday loans, just as the FDIC should continue the guidance it still has in place.

  Federal regulators, as well as states, should reject the notion that income-only underwriting is ability-to-repay--it is not. Provisions that require lenders to only assess whether payments exceed a certain percentage of a borrower's income do not ensure that a loan is affordable to the borrower. Most importantly, this approach fails to account for the borrower's other obligations, like rent or mortgage payments, car payments, medical bills, or other loans. Data from the CPFB show that for 12-month, fully amortizing long-term payday loans, the default rate is as high as 40% when the payment accounts for 5% of a borrower's monthly income. A coalition of over 500 civil rights, consumer, labor, faith, veterans, seniors, and community organizations from all 50 states, have expressed that an income-only approach to ability-to-repay that permits payments of up to 5% of a borrower's pay will not prevent the harm caused by unaffordable loans.

  Neither the OCC nor FDIC should take steps that would enable non-bank lenders to usurp state interest rate limits. Specifically, the OCC must reject any special purpose charter for non-bank lenders that would make loans at rates higher than permitted under state laws. And, the FDIC must hold firm on its 2005 guidance regarding banks' third-party relationships which is a critical safeguard against non-bank lenders, such as payday lenders, partnering with out-of-state banks in order to export interest rates that are higher than what is permitted under state law. Finally, the FDIC should not roll back its affordable small dollar loan guidelines that established a reasonable interest rate limit of 36%.

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[3] Gary Rivlin, Broke, USA: How the Working Poor Became Big Business, (2010, HarperCollins Publishers), at page 78 ("The more ambitious payday companies had lawyers researching the usury laws of every state. Illinois! Illinois had no cap on the rates a lender could charge. Wisconsin! Oregon! New Mexico! And when they worked their way through the scattering of available states, they explored new frontiers with the help of the lobbyists they put on retainer.")

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[13] Virginia Bureau of Financial Institutions." 2017 Annual Report," page 57, http://bit.ly/2UOkDj1

[14] Susanna Montezemolo & Sarah Wolff, Payday Mayday: Visible and Invisible Payday Lending Defaults, Center for Responsible Lending (2015), at 4, http://bit.ly/2vujBOY (based on N. Dakota data). Data from North Dakota show that a large proportion of borrowers ultimately default after taking out their first payday loan: 39% did so within one year of their first loan, and 46% did so within two years. For most borrowers, default did not signal the end of the cycle of debt: Two-thirds of defaulters ultimately paid back the debt in full, and 39% of defaulters re-borrowed at a later date. Of defaulters, one-third experienced a subsequent default. Nineteen percent of borrowers and 39% of defaulters had a loan charged off, i.e., taken off the books for being more than 60 days past due.

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Testimony of Ken Whittaker
Ending Debt Traps in the Payday and Small Dollar Credit Industry
4.30.19

Madam Chairwoman Waters, Ranking Member McHenry, Chairman Meeks, Ranking Member Tipton, and Members of the Committee:

It's an honor to be here today. My name is Ken Whittaker. I'm from Detroit, Michigan. I'm a hard-working husband and a father of six brilliant young adults. Five of them are college students and one is a Navy seaman. I'm also a former payday loan borrower.

Years ago, I was working in IT for the University of Michigan, when I withdrew the money from my paycheck and proceeded to lose the cash out of my pocket, which I noticed when I was buying a hot dog for my son.

Unfortunately, I took out a payday loan of about $700. That turned out to be a very big mistake that truly altered the course of my life.

I found I could not afford to pay off the first loan without taking out another one. Thus, began a cycle of debt, which lasted over a year.

Soon I was paying $600 per month in fees and interest. I eventually closed my bank account to stop payments from being drawn out and leaving me without cash for my family's rent, groceries and other essential bills.

This led to debt collections and a judgment. My tax refund was garnished, making things that much more difficult for my family. All told, that $700 loan ended up costing me $7,000.

I spoke out about my experience at the time the Consumer Financial Protection Bureau was developing the rule that would require lenders to make loans based on their customers' ability to afford and repay them. To me, that requirement only makes sense, and it's how all lending should be done. Having been through the experience myself, I know how devastating payday lending can be. It is quite disturbing to me that the current leadership of the CFPB is threatening to repeal that rule.

I strongly support keeping the 2017 CFPB rule. I also support the proposal to cap annual interest rates at 36% to stop predatory lenders from trapping customers in high-cost loans that can ruin their financial lives.

Since that day I bought my son a hot dog, we have worked to make things better. Coming full circle, he is here in DC today, fighting by my side for fairness and justice.

Please support strong reform of predatory payday and car title lending, for people like me. We work hard to support our families and make our finances stable, and this kind of lending only makes it harder. Thank you for allowing me to share my story today.

CATO INSTITUTE | CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES

Testimony
Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Consumer Protection and Financial Institutions
Hearing on "Ending Debt Traps in the Payday and Small Dollar Credit Industry"

Diego Zuluaga
Policy Analyst, Center for Monetary and Financial Alternatives, Cato Institute

April 30, 2019

Chairman Meeks, Ranking Member Luetkemeyer, members of the subcommittee, thank you for the opportunity to testify before you this afternoon.

My name is Diego Zuluaga and I am a policy analyst at the Cato Institute's Center for Monetary and Financial Alternatives.

Creating the conditions for a dynamic and competitive market for short-term credit is essential to promoting financial security and financial inclusion. At a time when 24 percent of American families, and 50 percent of low-income families, lack enough liquid savings to cover a $400 emergency expense,[1] broad and immediate access to credit is a matter of great urgency. Furthermore, with 8.4 million households unbanked and another 24.2 million underbanked,[2] a share of that emergency credit is bound to come from nonbanks, including payday and vehicle title lenders.[3]

Payday loans are often one of very few options available to cash-strapped households. 16 percent of payday borrowers use these loans to cover emergency expenses, while 69 percent borrow to pay for recurring items, such as rent and utility bills.[4] Payday loans offer a way to cope with unexpected events and month-to-month income volatility, which affects more than a third of American households with incomes below $50,000.[5]

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[1] Neil Bhutta and Lisa Dettling, "Money in the Bank? Assessing Families' Liquid Savings using the Survey of Consumer Finances," Board of Governors of the Federal Reserve System, November 19, 2018, https://www.federalreserve.gov/econres/notes/feds-notes/assessing-families-liquid-savings-using-the-survey-of-consumer-finances-20181119.htm.

[2] Federal Deposit Insurance Corporation, "2017 FDIC National Survey of Unbanked and Underbanked Households," October 2018, 1, https://www.fdic.gov/householdsurvey/2017/2017report.pdf. "Unbanked" means no member of the household owns an account at an FDIC-insured institution. "Underbanked" means the household has an account but used products from alternative financial services providers – such as check cashers, payday lenders, pawn shops, and auto title lenders – in the last 12 months. Vehicle title lenders, because they use car titles as collateral, do not require a bank account. See Thomas W. Miller, Jr., *How Do Small-Dollar, Nonbank Loans Work?* (Mercatus Center at George Mason University, 2019), 12 and 34-39, https://www.mercatus.org/system/files/miller_small-dollar_nonbank_loans.pdf

[3] Traditionally, payday lenders have required borrowers to have a checking account. However, some lenders now accept proof of income or a savings account.

[4] Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why," July 2012, 14, https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

[5] Jonathan Morduch and Rachel Schneider, *The Financial Diaries: How American Families Cope in a World of Uncertainty* (Princeton University Press, 2017), 33.

While the media often describe payday loans as predatory, the evidence suggests otherwise. Prof. Ronald Mann of Columbia Law School, in a study quoted extensively by the Consumer Financial Protection Bureau, finds that 60 percent of payday borrowers accurately estimate the time it will take them to repay the loan.[6] Importantly, there is no systematic bias in borrowers' predictions of repayment: borrowers overestimate roughly as much as they underestimate the time it will take them to repay.[7]

Prof. Mann's results contradict the assertion that payday borrowers are misled by predatory lenders, or that they suffer from behavioral biases. His results are not atypical of the empirical academic literature on payday lending, which finds that these loans are helpful to borrowers, and payday loan bans harmful, at least as often as it finds the opposite.[8]

Payday borrowers are not stupid. They make the best of limited options. As Prof. Lisa Servon of the University of Pennsylvania writes, "The question [...] is whether expensive credit is better than no credit at all."[9] Like Prof. Servon, I worry that placing an interest cap on short-term credit would altogether remove access to emergency funds for the most vulnerable Americans.

I have had the opportunity to study in detail the impact of payday loan interest-rate caps in the United Kingdom. While UK regulators expected loan volume to decline by 11 percent after the introduction of the cap, it dropped by 56 percent – five times what regulators estimated – within 18 months.[10] The number of borrowers dropped by 53 percent, versus the 21 percent that regulators estimated.[11] Given that regulators' forecasts aimed for the "optimal" amount of payday borrowing, this miscalibration of the interest cap's impact almost surely left hundreds of thousands of borrowers worse off.

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[6] Ronald Mann, "Assessing the Optimism of Payday Loan Borrowers," Columbia Law & Economics Working Paper No. 443 (2013), 18, https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=2798&context=faculty_scholarship.

[7] Ibid., 26.

[8] For evidence of the positive welfare effects of access to payday loans, see Neil Bhutta, Jacob Goldin, and Tatiana Homonoff, "Consumer Borrowing after Payday Loan Bans," *Journal of Law and Economics* Vol. 59 No. 1 (February 2016): 225-259, https://www.journals.uchicago.edu/doi/abs/10.1086/686033; Donald P. Morgan and Michael R. Strain, "Payday Holiday: How Households Fare after Payday Credit Bans," Federal Reserve Bank of New York Staff Report no. 309, November 2007, revised February 2008, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr309.pdf; Adair Morse, "Payday Lenders: Heroes or Villains?," *Journal of Financial Economics* 102.1 (October 2011): 28-44, https://www.sciencedirect.com/journal/journal-of-financial-economics/vol/102/issue/1; Jonathan Zinman, "Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap," Journal of Banking and Finance 34.3 (March 2010): 546-556, https://www.sciencedirect.com/science/article/pii/S0378426609002283.

[9] Lisa Servon, *The Unbanking of America* (New York: Houghton Mifflin Harcourt, 2017), 83.

[10] Financial Conduct Authority, "High-Cost Credit: Including Review of the High-Cost Short-Term Credit Price Cap," Feedback Statement FS 17/2, July 2017, 11, https://www.fca.org.uk/publication/feedback/fs17-02.pdf; FCA, "Proposals for a price cap on high-cost short-term credit," Consultation Paper CP14/10, July 2014, 6, https://www.fca.org.uk/publication/consultation/cp14-10.pdf.

[11] Consumer Finance Association, "Impact of Regulation on High Cost Short Term Credit: Hoe the Functioning of the HCSTC Market Has Evolved," March 2017, 8, https://cfa-uk.co.uk/wp-content/uploads/2017/03/030317-HCSTC-and-market-functioning-Oxera.pdf.

I worry that the CFPB's payday rule, which predicts loan volume to drop by 62 to 68 percent but expects 90 percent of borrowers to retain *physical access* to payday facilities, will prove similarly over-optimistic. The consequences of regulatory error could be very damaging.

Low usury caps were once widespread across American credit markets. But Progressive reformers in the early 1900s recognized that these caps harmed low-income people by throwing them into the hands of loan sharks. Gradually, they persuaded legislators to lift or remove interest caps, helping the formal market for small-dollar credit to flourish.[12] Placing a cap on small-dollar loans risks leaving vulnerable households at the mercy of family members and unscrupulous providers – or forcing them to go without basic necessities.

Policymakers can, however, do more to promote financial inclusion. I welcome efforts to bring a greater focus on underserved households to financial regulators. For example, the CFPB and FDIC should conduct a joint review of the regulatory costs to banks of maintaining deposit accounts. This will permit them to compare the costs of regulation with its benefits and determine whether financial regulation excludes low-income and minority borrowers.

But I would not limit this work to fostering access to depository institutions, important as such access is. Financial innovations like mobile money accounts have delivered impressive results in Africa and Asia.[13] With 81 percent of Americans now owning a smartphone, and another 13 percent owning a more basic cell phone,[14] mobile money accounts could bring essential financial services to households which, for reasons related to cost, trust, or both, do not own a bank account.[15] Mobile payments could help low-income consumers avoid account fees and gradually gain access to other financial services.

Thank you. I'd be happy to answer any questions.

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[12] Miller, *How Do Small-Dollar, Nonbank Loans Work?*, 30-31. See also "The Uniform Small Loan Law," *Columbia Law Review* Vol. 23 No. 5 (May 1923): 484-487, https://www.jstor.org/stable/1112339?seq=1#metadata_info_tab_contents.

[13] Asli Demirgüç-Kunt, Leora Klapper, Dorothe Singer, Saniya Ansar, and Jake Hess, "Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution," World Bank Group, 2018, 22, https://globalfindex.worldbank.org/.

[14] Kyle Taylor and Laura Silva, "Smartphone Ownership Is Growing Rapidly Around the World, but Not Always Equally," Pew Research Center, February 5, 2019, https://www.pewglobal.org/2019/02/05/smartphone-ownership-is-growing-rapidly-around-the-world-but-not-always-equally/.

[15] According to the FDIC, 53 percent of the unbanked cite not having enough funds as a reason for lacking a bank account; 30 banks say they do not trust banks; 28 percent believe being unbanked gives them more privacy; and 25 percent say bank account fees are too high. See FDIC, "2017 FDIC National Survey of Unbanked and Underbanked Households," October 2018, 4.

U.S HOUSE COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCIAL INSTITUTIONS

ENDING DEBT TRAPS IN THE PAYDAY AND SMALL DOLLAR CREDIT INDUSTRY

TESTIMONY OF SENATOR RICHARD J. DURBIN

APRIL 30, 2019

Chairwoman Waters, Subcommittee Chairman Meeks, members of the subcommittee: Thank you for allowing me to submit testimony on this important consumer protection issue. We know that nearly 12 million cash-strapped Americans are charged interest rates exceeding 300 percent for payday loans, and that the payday lending industry collects about $8 billion in fees each year as a result.

But there are two numbers that really tell the story about the payday lending industry for me: "75 percent" and "10"—75% of all fees collected by the payday loan industry are generated from borrowers who have been forced to renew their loans more than 10 times in a given year because they lacked the ability to repay the full loan. These figures make one thing clear: the payday lending business model is designed to trap consumers in never-ending cycles of debt that can result in serious and irreparable financial harm.

These payday lenders prey on desperate individuals who find themselves in need of quick cash, often for things like necessary car repairs or medical care. They know that these individuals have trouble accessing lower-interest-rate forms of credit that are offered by traditional banks, and they charge higher interest-rates as a result.

Since the payday loan business model doesn't require the lender to take any consideration of whether the borrower has the ability to repay their loan, payday lenders provide these loans knowing full well that the borrower lacks the ability to repay them in full with their next paycheck. This effectively forces them to choose between default and repeated borrowing. As a

result, nearly four out of every five payday loans are renewed within 14 days, and the majority of these loans are renewed so many times that borrowers end up paying more in fees than the amount they originally borrowed.

In my home state of Illinois, payday lenders charge consumers an average interest rate of 323 percent, an egregious amount given that the average payday loan is typically for $365. These loans pose serious financial consequences for borrowers, including delayed medical care, and even bankruptcy. These predatory lenders should not be allowed to pad their pockets with the hard-earned money of families that are barely getting by.

I am pleased that the Committee is seeking ways to rein in predatory loan practices in the payday lending industry. My legislation, *the Protecting Consumers from Unreasonable Credit Rates Act*, would combat these abusive payday lending practices by capping interest rates for consumer loans at an Annual Percentage Rate (APR) of 36 percent—the same limit currently in place for loans marketed to military service-members and their families. I've been honored that Representatives Cohen and Cartwright have joined me in this fight by introducing the House companion legislation in past years. I'd also like to thank my Senate colleagues—Senators Merkley, Blumenthal, and Whitehouse—for leading this fight with me in the Senate. This legislation is supported by Americans for Financial Reform, the NAACP, Leadership Conference on Civil and Human Rights, Center for Responsible Lending, and Woodstock Institute.

Simply put—if a lender can't make money on 36 percent APR, then maybe the loan shouldn't be made. Fifteen states and the District of Columbia have already enacted laws that protect borrowers from high-cost loans, while 34 states and the District of Columbia have limited annual interest rates at 36 percent or less for one or more types of consumer credit. But there's a problem with this state-by-state approach—most of these state laws are riddled with loopholes

and out of state lenders are able to evade state usury laws. My bill would require all consumer lending to conform to the 36 percent APR limit, effectively eliminating the many loopholes that have allowed predatory practices to flourish in states around the country.

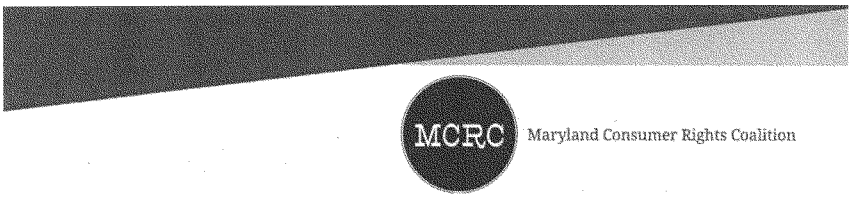
During the Obama Administration, the Consumer Financial Protection Bureau (CFPB) finalized new rules requiring payday lenders to use traditional underwriting standards that assess whether a consumer has the ability repay a loan before the loan is made. This important action by the CFPB marked the first time ever that the federal government had stepped in to rein in predatory payday loan practices. Unfortunately, the Trump Administration is working to help the payday loan industry by attempting to eliminate this crucial consumer protection rule. This is another reason why Congress should act now by passing my bill or similar legislation.

We all understand that families sometimes fall on hard times and need a loan to make ends meet—most Americans have been there at one time or another. That is why I included in my bill the flexibility for responsible lenders to replace payday loans with reasonably priced, small-dollar loan alternatives. The bill allows lenders to exceed the 36 percent cap for one-time application fees that cover the costs of setting up a new customer account and for processing costs such as late charges and insufficient funds fees.

At a time when 40 percent of U.S. adults report struggling to meet basic needs like food, housing, and healthcare, establishing a 36 percent APR on consumer loans would help the nearly 12 million Americans who take out payday loans each year dedicate more of their resources to providing for their families and buying American goods and services instead of padding the pockets of payday lenders.

I want to thank you, Chairwoman Waters and Chairman Meeks, again, for holding this hearing. Unfortunately, under Republican control in recent years, Congress has largely failed in

its oversight responsibilities of the payday lending industry—failing to hold hearings to examine the role payday lenders are playing in exacerbating the financial conditions of our most vulnerable citizens. It gives me hope that in the opening months of your leadership of this committee, there is renewed attention to Congress' responsibility to oversee the payday loan industry and protect Americans from the abuses posed by bad actors in the financial marketplace.



Chairwoman Maxine Waters
House Financial Services Committee
2129 Rayburn House Office Building
Washington, D.C. 20515
cc: Members, House Financial Services Committee

April 30, 2019

Chairwoman Waters and Members of the Committee

On behalf of the Maryland Consumer Rights Coalition, I appreciate the opportunity to provide a statement on Maryland's experiences with the payday lending industry, as well as our recommendations for regulating payday and other high cost lending.

The Maryland Consumer Rights Coalition (MCRC) advances economic rights and financial inclusion through research, advocacy, education, organizing, and direct service. Our 8,500 supporters and members work with us to mobilize for systemic policy change which focuses on reducing inequality and expanding racial and gender equity.

Overview of Payday Loans and other High-Cost Lending in Maryland

Payday Loans
Maryland has a long history of keeping credit affordable by capping the interest rates for loans of $1,000 or under at 33%.[1] The 33%rate-cap has been codified in Maryland law for more than 30 years. Consequently, there are no brick-and-mortar payday loan institutions in our state. Payday lenders' business model relies on both a high interest rate on the initial loan, and compounding interest on the subsequent loans borrowers are required to take out to pay back the initial line of credit.

The Consumer Financial Protection Bureau says that 94% of repeat payday loans – or "churning," as these additional loans are called by consumer advocates– are taken out within one month of the first loan. Data demonstrates that consumers using payday loans borrow an average of 10 times a year.

According to a Pew Charitable Trusts study, at least 3%of Marylanders take out a payday loan online – despite the fact that these businesses are unlicensed in the state.[2] These online lenders charge borrowers 400%interest rates

[1] CL § 12-306 permits a lender to charge a maximum interest rate of 33 percent interest on loans up to a $1,000.
[2] Pew Charitable Trust, *Payday Lending in America: Who Borrows, Where they Borrow, and Why.* July 2012. http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf

on average. In four years, Maryland's Commissioner of Financial Regulation's office received 404 complaints about

payday lending – a practice that is illegal in our state. In 2014-2015, 154 Maryland consumers complained to the Commissioner of Financial Regulation's office about the high-cost, unsustainable loans they had taken out.[3] In 2011-2013, the office received 250 complaints about payday lenders, and approximately 200 more on the businesses collecting on these illegal loans.[4]

These loans are void and unenforceable in Maryland, and will be pursued by Maryland's Commissioner of Financial Regulation's office. That office has aggressively pursued payday lenders and, in 2014, won a $2 million settlement from Western Sky and Cash Call for making usurious payday loans with 1,825%interest rates to more than 1,200 Maryland consumers.[5] Western Sky, based on the Cheyenne Sioux Reservation, claimed tribal sovereignty and argued that state usury rate caps would not apply to them.

Car-title and other loans

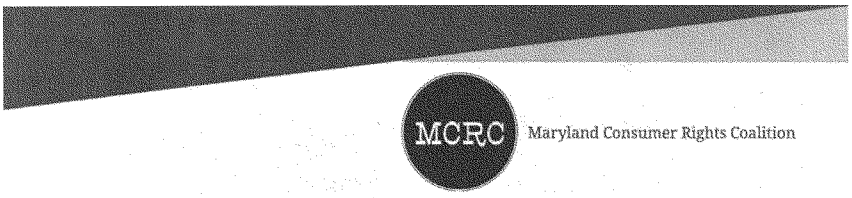
In Maryland, title-loans secured by a vehicle comprise one of the most common loans made in violation of our usury rate caps. A recent settlement agreement[6] found that one firm, Roadrunner, made 284 illegal auto-title loans with interest rates ranging from 514% to 598%. Each of the cases were secured by the consumer's motor vehicle or other titled personal property and the interest rates exceeded 500%. In 261 of the 284 loans, the firm understated the true annual interest rate to the consumer. Moreover, many loans were for less than $700 – including 206 of the 284 loans – and, despite being prohibited by law from doing so, the Roadrunner firm took a security interest in consumer loans of less than $700.

In many cases, title-loans were secured by other personal property so we urge that the scope of the proposed rule includes other vehicles such as motorcycles, mopeds, boats, and manufactured homes as well as any other titled equity that might be used as security. In vehicle-title loan cases, several consumers had their vehicles repossessed but did not receive the required discretionary notice nor the notice of repossession. Even after paying to redeem the vehicle, many consumers lost their personal belongings, which were never returned.[7]

Although problems persist despite Maryland's 33%rate cap and vigorous enforcement, the safeguards Maryland has placed on consumer lending has saved working families millions of dollars. In fact, the Center for

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[3] Email correspondence with Carmen Flowers, MPIA Officer, Commissioner of Financial Regulation's Office, March 15, 2016
[4] Ambrose, Eileen *"Maryland Goes After Payday Lender's Banks to Stop Illegal Loans," Baltimore Sun*, August 19, 2013.
[5] Sherman, Natalie *"State Announces $2 Million Lending Settlement," Baltimore Sun*, June 23, 2014
[6] *In the Matter of Roadrunner Title Pawn, LLC; Advanced EZ Cash, L.L.C., a/k/a Advanced EZ Cash, LLC a/k/a Advanced EZ Cash LLC; George T. Parker a/k/a Timothy Parker a/k/a Tim Parker; and Mandy Lynn Parker f/k/a Margaret Teresa Vick*, http://www.dllr.state.md.us/finance/consumers/enforcement2015.shtml accessed on October 3, 2016.
[7] ibid



Responsible Lending estimates that Maryland consumers have saved a total of **$141,016,533** in payday fees and **$111,967,142** in car title loan fees each year, thanks to our protective laws.[8]

Payday Lenders' Myriad Attempts to Exploit Loopholes

Undeterred by Maryland's small loan rate cap, payday lenders have tried time and time again to exploit legal loopholes to provide high-cost loans to financially fragile consumers.

In the past seven years, Maryland regulators, legislators, and consumer advocates have thwarted three attempts by payday providers to lend in our state. In 2010, payday lenders attempted to circumvent Maryland's usury rate caps by providing online loans that met the usury rate caps but also charged a broker's fee of $20 per $100 borrowed. Factoring in the fees, Marylanders were paying an average of 640%per loan.[9] In 2013, Maryland's Commissioner of Financial Regulation pursued banks that were partnering with payday loans in Maryland despite the rate cap. While the original loan met the rate cap, fees for the bank and other charges compounded to create an average APR of 400% – well above Maryland's 33% cap. In 2014, Maryland's Commissioner of Financial Regulation reached a $2 million settlement from Western Sky and Cash Call for usurious payday loans with 1,825%interest rates to more than 1,200 Maryland consumers.[10]

Most recently, in 2017, out-of-state, payday lenders offered payday-type loans to Marylanders as open-end lines of credit. Open-end lines of credit were not covered by the 33%rate cap at the time because no one had ever offered a consumer loan under that subtitle. While these loans carried a 24% APR, high fees put the annual rates on these predatory loans well above 300%, more than 10 times the highest rate permitted for Maryland's other consumer loans. In addition to packing excessive fees into the loan cost, the lender could seize money directly from borrowers' bank accounts.

The financial and psychological costs of these loans is exemplified by several of the complaints that Maryland's Commissioner of Financial Regulation received concerning these predatory, high-cost loans.

- *"I took out a loan and was advanced $14,975 – to date, I've paid $38,893 and still owes $1,897." (Woman, Maryland resident)*
- *"CashNet took money out of my account each week, when it was supposed to be every other week. I've had to file bankruptcy." (Woman, Baltimore County)*

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[8] David, Delvin and Lupton, Susan. *States without Payday and Car-title Lending Save $5 Billion in Fees Annually.* June 2016. http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_fee_savings_jun2016.pdf

[9] Ambrose, Eileen *"Payday Lenders Face Tougher Restrictions," Baltimore Sun*; April 12, 2010

[10] Sherman, Natalie *"State Announces $2 Million Lending Settlement," Baltimore Sun*, June 23, 2014

- *"They have caused my account to be overdrawn and left me unable to pay [my] household obligations. My balance at the time of complaint for the $1,000 loan had reached $2,582.66." (Woman, Baltimore City)*
- *"The debt is crippling. I have paid my advance off three times but am making no progress on paying off the debt – I pay $225 per month but principal goes down by $18." (Man, Anne Arundel County)*

The Importance of the Ability to Repay (ATR) Standard

The Ability-to-Repay (ATR) standard requires payday lenders to make a reasonable determination that the consumer can repay the loan. This isn't just prudent – this type of sound underwriting is the basis for most of the financial services and products currently on the market.

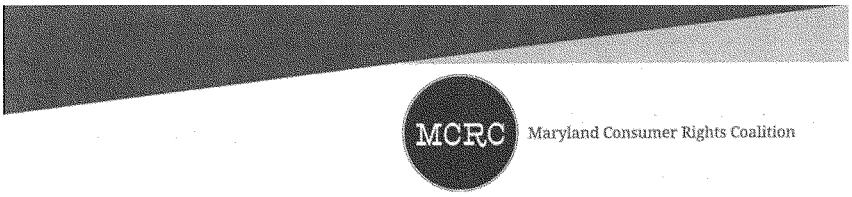
Reviewing the terms of payday loans taken out online by cash-strapped Marylanders, we see that a number of the consumers defaulted on their first or second loan. Although our review included only a small portion of the 250 complaints filed with the Commissioner of Financial Regulation's office, our findings support the conclusions of the Center for Responsible Lending's research, which found that a large portion of borrowers default by their second loan. Our review of settlement cases found that Maryland borrowers faced bank penalty fees and abusive collection practices after they defaulted on their loan. Rather than help consumers, these usurious loans increased the financial hardships of already struggling families.

The need for an ATR determination at the outset – prior to the first loan being offered – is particularly important in cases of auto-title loans. In these instances, the lender has access to the borrower's car title as leverage. Again, a review of Maryland cases found that many borrowers defaulted within the first two loans and, in many cases, had their vehicle repossessed and were never able to regain missing personal items and property that were lost during the repossession. Not surprisingly, losing one's vehicle can lead to an array of additional problems. In Baltimore City and towns throughout most of Maryland, public transit is infrequent, if it exists at all. Without access to a car, commuting to work, running errands, and providing enrichment activities for children is difficult.

Eliminating the ATR standard would gut the heart of the CFPB proposed rule. Moreover eliminating the ATR standard would enable payday lenders to offer a "CFPB approved" loan to cash-strapped Maryland consumers. A high-cost loan lacking meaningful underwriting standards that has the imprimatur of the CFPB would be seized on by payday lenders in order to introduce these usurious, high-cost loans to Maryland consumers – despite the state's long history of maintaining a 33%rate cap and beating back attempts to skirt the rate cap.

This is not conjecture; it's based on our history of fending off attempts to exploit loop-holes in our usury rate caps or carve-outs to allow payday lenders to legally provide high-cost loans to struggling families in our state.

Instead of focusing on the numerous other pressing consumer protection issues, consumer advocates will have to spend scarce resources fending off payday products that override our usury rate caps, rate caps that the Bureau acknowledges are one of the most effective ways to reduce the prevalence of high-cost, predatory loans being offered to consumers who cannot repay them.



Alternatives to Payday Lending in Maryland

One argument that payday lenders marshal is that their predatory products are needed because consumers require access to credit to meet basic or emergency needs. As housing, loans, and healthcare costs have skyrocketed, many Maryland residents do face challenges paying for the basics, let alone having enough saved to cover the cost of an emergency repair, unexpected medical expenses, or other financial setbacks. What is a financial speedbump for some, can be a financial catastrophe for many low -income and working families in Maryland.

Payday loans do not help lift a family out of poverty. They are, instead, a debt trap which keeps borrowers mired in high-cost loans and deepens a cycle of debt. Instead, what Maryland residents need is access to affordable, sustainable credit – which is vastly different than payday loans.

Fortunately, Maryland consumers have options should they face a cash shortfall. Many employers participate in programs which provide short-term small loans at 18%interest to employees. The loans are repaid over time through withdrawals from pre-tax earnings. The employee does not end up churning a loan, they are able to repay it over time, and they are focused on their work, rather than their finances. Without payday loans in Maryland, other consumers receive loans and assistance from their places of worship, their families, or their friends. Still others cut back on their spending or forego making the purchase until they are able to afford it.

Enforceability and State Laws

As advocates from a state with strong usury rate caps, MCRC is concerned that eliminating the ATR standard within the final rule, will allow payday lenders to legally operate in Maryland. We urge the Bureau to close the exemptions and affirm that the final rule will defer to stronger state laws.

MCRC urges the CFPB to strengthen the enforceability of our state laws by strengthening the proposed payday lending rule to state that offering, collecting, making, or facilitating loans that violate state usury or other consumer protection laws is an unfair, deceptive, and abusive act or practice (UDAAP).

For Maryland, and other states with strong usury rate caps, eliminating the ATR standard is tantamount to inviting payday lenders into our borders to offer predatory loans, contrary to the express wishes of our state lawmakers. For these reasons, we urge the CFPB to maintain the proposed rule as released.

Thank you for your consideration of this statement.

Marceline White
Executive Director

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United States House of Representatives
Committee on Financial Services, Subcommittee on Consumer Protection and Financial Institutions
2129 Rayburn House Office Building
Washington, DC 20515

Delivered electronically

April 29, 2019

RE: "Ending Debt Traps in the Payday and Small Dollar Credit Industry" (Hearing April 30, 2019)

Chairman Meeks, Ranking Member Luetkemeyer, and Members of the Committee:

Millions of the most financially fragile individuals in this country are experiencing harm because payday loans and other small-dollar loans that they seek to get help paying bills actually have the reverse effect of making it harder to make ends meet. This problem is compounded when lenders abuse "leveraged payment mechanisms" such as post-dated checks or electronic payment plans to collect on loans even when it undermines borrowers' ability to meet basic needs or other financial obligations. The case for reform is overwhelmingly supported by research, as summarized below (see "Conclusions Based on Research Findings" section, below).

I oversee the consumer finance project at The Pew Charitable Trusts, where since 2011 our team of professionals has conducted rigorous, non-partisan, in-depth analysis on the market for payday, vehicle title, and similar loans. We have published the most extensive body of research on this topic available, including detailed policy recommendations for federal and state lawmakers (see "Pew's Qualifications for Commenting on Payday and Small-Dollar Credit Policy" section, below).

I write to express strong support for the Consumer Financial Protection Bureau's 2017 payday loan rule, which is narrowly tailored to address the most harmful balloon-payment loans, and strong opposition to the CFPB's current proposal to rescind or delay it. Secondly, if legislative bodies such as Congress want to address the payday loan problem, they should not attempt to replicate the CFPB's "ability to pay" rule but instead should use the full scope of their legislative powers to regulate loan terms directly. The CFPB's 2017 rule would help millions of borrowers, but because of the Bureau's limited authority, it did not regulate loan prices, durations, total costs, the size of payments, or other factors that are important to balance the interests of lenders and borrowers. Congress and state legislatures can, and should, regulate these terms.

The 2017 CFPB Rule for Payday and Similar Loans Is Working, and the Agency Should Not Undo It

The CFPB recently issued a Notice of Proposed Rulemaking stating its preliminary intention to eliminate the core component of its 2017 rule on payday, vehicle title, and certain high-cost

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Attachment: Pew comment letter to the CFPB dated March 18, 2019

(continued from page 1) installment loans. The agency has also proposed to delay implementation of the rule while it completes its evaluation. In recent comments to the agency, Pew expressed support for the 2017 rule and opposition to the agency's plans to change or delay it. Our comment letter dated March 18 of this year, which is attached here, noted that "the final rule set strong consumer protections for loans that consistently harm consumers—single payment and balloon-payment loans—without eliminating them, and it gave lenders complete leeway in offering both affordable and high-cost loans repayable in equal installments over terms longer than 45 days."

The CFPB's 2017 payday loan rule is narrowly targeted to regulate the most harmful types of loans in this market: balloon-payment loans and loans that last 45 days or less. Under the rule, if a loan lasts 45 days or less, lenders must undergo a prescribed process of determining a loan applicant's ability to repay the loan or follow an alternative process that includes several consumer safeguards; but if the loan lasts longer than 45 days, lenders do not need to follow the ability-to-repay guidelines. The net effect of this rule has been to encourage lenders to give borrowers more than 45 days to repay their loans in equal installments—which our research demonstrates is the right outcome.

As we explained in our March 18th letter to the CFPB, bank and credit union regulators took important steps in the wake of the CFPB rule that help demonstrate its success. For example, the Office of the Comptroller of the Currency published a bulletin in May of 2018 giving banks guidelines for issuing small installment loans with terms lasting longer than 45 days. In September of 2018, U.S. Bank began offering a new small installment loan repayable over three months with strong consumer protections and dramatically lower costs than existing options for people with low credit scores (whereas borrowing $400 from a payday lender for three months typically costs $360, U.S. Bank is offering that same credit for $48 to $60).[1]

The CFPB now claims that credit will be constrained under the 2017 payday loan rule, but this is not substantiated. While there is likely to be a reduction in the number of loans with terms lasting less than 45 days, there is and will continue to be ample access to credit that is repayable in more than 45 days. This is shown not only in the launch of new small installment loan products from banks, but also in the expansion of installment lending from payday lenders and other nonbank lenders. In sum, the CFPB's payday loan rule will not result in the drop in access to credit that the 2019 proposal alleges, because it discourages lenders from making short-term loans with balloon payments, which most borrowers cannot afford, but places virtually no impediments to allowing credit to flow in the form of amortizing installment loans.

Under the final 2017 rule, credit would be widely available. Lenders could issue single-payment loans by assessing applicants' ability to repay or using a principal payoff option. Or lenders could easily offer payday installment loans, payday lines of credit, or vehicle title-secured versions of these loans. The rule would benefit consumers by ending long sequences of single-payment loans, and it would benefit transparent lenders who acknowledge, disclose, and structure loans with sufficient time to repay in installments.

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[1] For commentary about the U.S. Bank Simple Loan, see The St. Louis Post-Dispatch, "Editorial: Finally, Banks and Others Challenging Payday Lenders" (September 13, 2018), https://www.stltoday.com/opinion/editorial/editorial-finally-banks-and-others-are-challenging-payday-lenders/article_fa29143b-8d73-57b3-af47-723fa7871bb7.html. See also The Albuquerque Journal, "Editorial: Technology Leads Way to Fair Small-Dollar, Short-Term Loans" (September 29, 2018), https://www.abqjournal.com/1227262/technology-leads-way-to-fair-smalldollar-shortterm-loans.html.

The 2019 proposal cites as its rationale that access to credit will be severely curtailed under the 2017 rule and competition[2] will be harmed. The Bureau's claim is that the 2017 provisions "would have the effect of restricting access to credit and reducing competition for these products." The Bureau now argues the 2017 rule would have "dramatic impacts in restricting consumer access to payday loans" and "eliminating over 90 percent of all payday and vehicle title loans would adversely affect the interests of all borrowers." The Bureau's 2019 proposal describes the 2017 final rule as saying that "...the Bureau estimated that, absent the conditional exemption in 1041.6, the Mandatory Underwriting Provisions of the Rule would reduce payday loan volume and lender revenue by approximately 92 to 93 percent relative to lending volumes in 2017 and vehicle title volume and lender revenue by between 89 and 93 percent."

This paraphrasing makes it sound like the 2017 rule estimates there will be large drops in access to credit. But the 2017 rule does not reach that conclusion. Instead, the 2017 rule says "...the Bureau estimates that the restrictions on short-term vehicle title lending will prevent between 89 and 93 percent of *short-term vehicle title loans that are currently made*" (emphasis added). That conclusion is substantially different than the agency's current paraphrasing of it, because lenders are not limited to only offering short-term loans with terms up to 45 days. Instead, many lenders have shifted, and others will shift, to offering loans that are not covered because they have terms beyond 45 days. The 2017 rule acknowledges this, explaining "The primary impact of this rule, *prior to any reforms it may prompt in market practices*, will be a substantial reduction in the volume of *short-term* payday and vehicle title loans..." (emphasis added).[3]

A borrower who uses a single-payment vehicle title loan before the law change and would not pass the ability-to-repay test will generally still have access to credit. The borrower can obtain 1) a longer-term auto title loan, 2) a subprime consumer loan from a traditional installment lender, or if the borrower is among the large majority of auto title loan customers that have a checking account, 3) a payday installment loan or payday line of credit, or 4) a small installment loan or line of credit from their bank or credit union. None of these loans are required to adopt the 2017 safeguards because they all have terms of more than 45 days and do not carry balloon payments. The 2017 rule correctly recognizes that the borrower will only have reduced access to single-payment and balloon-payment loans, not to all forms of credit available to them.

The 2019 proposal appears to be motivated primarily by a misunderstanding of the availability of credit under the 2017 rule. The writers of the 2019 proposal are not the first ones to make such a fundamental error. Several analysts and industry consultants have made similar errors in attempting to evaluate the impact of policy changes. At this point there is enough evidence to be certain that their assumptions (that lenders will not extend the terms of loans beyond 45 days or comply with new laws under which they can operate profitably) are incorrect.

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[2] Payday lenders do not primarily compete on price, instead pricing at the state rate ceiling no matter where it is set, as the Bureau tentatively acknowledged in its 2019 proposal. It is unclear how consumers would suffer even if the ostensible lack of competition materialized under the 2017 rule; see The Pew Charitable Trusts, "How State Rate Limits Affect Payday Loan Prices" (2014), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

[3] Pew published research in 2016 documenting that payday lenders were already moving away from balloon-payment, or "lump sum" products and toward installment loans that last longer than 45 days. See note 4, below.

The Bureau's 2019 proposal argues that there is insufficient or inadequate research to support the findings of unfairness and abusiveness in the 2017 rule. The proposal especially focuses on two studies, one by Pew, which it believes the 2017 rule misinterprets. While we believe the two studies discussed were interpreted correctly in the 2017 rule, they are hardly the only basis for the 2017 rule. The CFPB studied payday lending for six years before finalizing a rule, and we count 153 separate studies that the Bureau cited in its 2017 rule, including 60 distinct academic studies. The 153 studies total more than 8,000 pages. The 2019 proposal's reinterpretation of three survey questions in two of the more than 20 Pew publications on small loans and fault with the scope of one study from a Columbia Law professor does not undercut the rest of the research basis for the rule.

If the 2017 final rule takes effect, high-rate lending will continue in most or all states where it exists today, and is even likely to thrive, though consumers will have more time to repay in most instances. Payday and auto title lenders have already started adapting to the 2017 rule by becoming makers of longer-term loans; in fact, our research shows that these lenders are already making high-cost installment loans and lines of credit in a majority of states and are likely to expand to others.[4] This is not necessarily a problem in and of itself, and it renders the bulk of the 2019 proposal's arguments moot because borrowers will maintain access to credit.[5] We have concluded, along with most industry experts who have spoken with us or published on this issue, that a majority of today's payday loan borrowers will continue to be approved for high-cost loans or lines of credit under the rule, though lenders will shift mostly to loans with terms of more than 45 days.

Please see our attached letter to the CFPB (March 18, 2019) for more information.

Legislative Solutions to the Payday Loan Problem Are Possible, But Legislators Should Not Replicate the CFPB's Ability-to-Repay Rule

After more than eight years of relevant research and analysis, we have concluded that credit can in fact help people cope with periodic shortfalls in their monthly budgets, but *only if that credit is structured to foster affordable repayment and has reasonable pricing*. In the case of small loans for people with low credit scores (like payday and auto title loans) any regulatory reform must come as

[4] The Pew Charitable Trusts, *From Payday to Small Installment Loans* (2016), 5, http://www.pewtrusts.org/~/media/assets/2016/08/from_payday_to_small_installment_loans.pdf#page=5. These states are the 26 identified in the cited brief, minus South Dakota, which has since enacted a 36 percent rate cap, plus Washington and Kentucky. In Washington, at least one lender has used the payday lending statute to issue multi-payment loans. In Kentucky, lenders can use the traditional installment loan statute to issue small loans with credit insurance, resulting in three-digit all-in APRs. Oklahoma passed a law in April 2019 to enable payday lenders to issue high-cost payday installment loans. In Iowa, lenders can issue high-cost lines of credit though we are not aware of lenders who have yet switched to doing so. Including Oklahoma and Iowa, that would mean that in at least 29 of the 38 states where payday and title lenders operate, they can issue high-cost installment loans or lines of credit.

[5] Our research has shown that liquidity credit can be helpful, even at high annual percentage rates, but only if it is structured in a way to ensure affordable payments, reasonable time to repay, and the other safeguards noted above.

close as possible to ensuring that several conditions are met. Pew published its original recommendations elaborating this concept in October of 2013, and they are summarized as follows:

- Limit payments to an affordable percentage of a borrower's periodic income.
- Spread costs evenly over the life of the loan.
- Guard against harmful repayment or collection practices and excessively long loan terms.
- Require concise disclosures that reveal both periodic and total costs.
- Set maximum allowable charges on loans for those with poor credit.[6]

In its 2017 payday loan rule, the CFPB did not set clear requirements for affordable payments, maximum allowable charges, or the other loan terms suggested above because of its limited authority. Instead, the CFPB used its powers under Dodd-Frank to require lenders to complete a prescribed process of determining a borrower's ability to repay the loans. While the net effect of the CFPB's rule governing short-term loans is positive, applying the ability-to-repay rule more broadly would likely prove harmful to consumers and to the marketplace in general. If legislative bodies such as Congress wish to address the problems with these longer-term loans, they should use their legislative powers to regulate loan terms directly rather than adopting this framework.

In 2016, Pew wrote to the CFPB to warn against applying its ability-to-repay requirements to loans lasting *longer* than 45 days, both because it would not provide sufficient consumer protections (monthly installment payments would routinely exceed research-based standards for affordable payments by hundreds of dollars) and it would tend to shut out mainstream lenders like banks from this market, essentially giving the most harmful or aggressive payday lenders control of it. The CFPB heeded this warning and only applied its ability-to-repay rule to loans lasting 45 days or less.

While the CFPB's ability-to-repay process works for short-term loans, it would break down for loans lasting longer than 45 days. We explain why in Pew's 2016 comment letter to the CFPB, at Section 5 starting on p.43. The following excerpt from the letter demonstrates, using the CFPB's own estimates of what would be possible under the ability-to-repay rule, that lenders would be able to take far too much of a borrower's income if that rule were applied to longer-term loans:

> If, for instance, the applicant makes $2,499 monthly and has actual total household expenditures at the 10th percentile level ($888), then remaining income would be $1,611 ($922—or 134 percent—higher than the average). Conversely, if this applicant's actual expenses were at the 90th percentile level ($2,281), then remaining income would be $218 ($471—or 68 percent—lower than the average). In this example alone, a lender would have the option of choosing to base its estimate of the appropriate monthly loan payment somewhere between $218 at the low end, $689 using published averages, or $1,611 at the high end—minus whatever other debt obligations may be revealed on the applicant's credit reports (such as credit card

[6] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

monthly minimum payments) and whatever the lender chooses to estimate for "other living expenses."[7]

The CFPB's ability-to-repay rule works well to combat the problem of short-term balloon payment loans, but it does not provide for a helpful regulatory or legislative tool for installment loans—in fact quite the opposite. By contrast, legislative bodies typically regulate loan terms directly, and there are several options for reforming the market for payday and similar small-dollar loans. For example, whenever a lender takes a leveraged payment mechanism such as a post-dated check or electronic access to a borrower's checking account, the legislature could require that 95% of the borrower's income is shielded (that is, the lender is prevented from taking more than 5% of the borrower's monthly income through required monthly loan payments); require reasonable time to repay (by limiting total loan revenue to 50% of the original loan amount or setting firm minimum and maximum loan terms); prohibit or strictly regulate origination fees or ancillary products like credit insurance; stipulate clear disclosures; and regulate pricing so that it is fair to borrowers and lenders (e.g. 28 to 36 percent interest plus a reasonable monthly maintenance fee). Pew has written about how state legislatures could pursue these reforms.[8] We have also published a review of market practices and state laws in the nonbank installment loan market (policy recommendations are included in this report).[9] Most recently, Ohio lawmakers dramatically reformed that state's payday loan market via the Fairness in Lending Act of 2018, setting clear requirements for loan terms resulting in widespread access to credit in the form of safe installment loans with prices that are three to four times lower than before the law changed.[10]

Pew's Qualifications for Commenting on Payday and Small-Dollar Credit Policy

The Pew Charitable Trusts is a global, non-governmental research and public policy organization dedicated to serving the public. We strive to improve public policy by conducting rigorous analysis, linking diverse interests to pursue common cause, and focusing on tangible results. Consumer finance is an area to which Pew has dedicated significant resources in recent years.

Pew's consumer finance project works to provide thorough, objective analysis to help inform the efforts of policy makers including the CFPB. In choosing in 2010 to begin working on small-dollar

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[7] The Pew Charitable Trusts, comment letter to the Consumer Financial Protection Bureau, "Payday, Vehicle Title, and Certain High-Cost Loans (Proposed Rule); Docket No. CFPB-2016-0025 (RIN 3170-AA40)" (October 7, 2016), at p. 50-51, https://www.regulations.gov/document?D=CFPB-2016-0025-142716.

[8] The Pew Charitable Trusts, "State Payday Loan Reform," https://www.pewtrusts.org/en/research-and-analysis/articles/2019/01/11/state-payday-loan-reform.

[9] The Pew Charitable Trusts, "State Laws Put Installment Loan Borrowers at Risk: How Outdated Policies Discourage Safer Lending" (October 17, 2018), https://www.pewtrusts.org/en/research-and-analysis/reports/2018/10/17/state-laws-put-installment-loan-borrowers-at-risk.

[10] See Nick Bourke, Olga Karpekina, and Gabriel Kravitz, "As Payday Loan Market Changes, States Need to Respond" (August 22, 2018), https://www.pewtrusts.org/en/research-and-analysis/articles/2018/08/22/as-payday-loan-market-changes-states-need-to-respond. See also The Pew Charitable Trusts, "Ohio a National Model for Payday Loan Reform: New Policies Support Borrower Protections, Lender Profitability, and Credit Availability" (November 9, 2018), https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/ohio-a-national-model-for-payday-loan-reform; Bourke, Nick ,"The Ohio Legislature Got Payday Loan Reform Right" (October 29, 2018), https://www.pewtrusts.org/en/about/news-room/opinion/2018/10/29/the-ohio-legislature-got-payday-loan-reform-right.

lending, we realized that there were significant gaps in available research about the market for payday, auto title, and similar forms of small-dollar loans, particularly with respect to understanding the needs and experiences of borrowers and identifying and evaluating policy responses to perceived consumer harms.

Now, more than eight years later, Pew's consumer finance project has produced a comprehensive body of research and developed a group of highly qualified experts on this subject. The team's director has been with the project since its inception in 2010, and the two lead researchers have been with the project since 2011. Altogether, the staff on this project collectively has had more than thirty years of experience working together to conduct research and analysis on the market for payday and similar small-dollar loans. Their prior training and experience includes advanced degrees in law and public policy (including training in statistical research methods), professional public opinion research at the highest levels, product management and consulting work in the consumer finance industry and elsewhere, federal regulatory experience, and backgrounds in banking, community organizing, and policy analysis and advocacy.

In July of 2012, we published our first report, entitled "Payday Lending in America: Who Borrows, Where They Borrow, and Why." This report included findings from a first-ever nationally representative telephone poll of payday loan borrowers about their experiences using the loans.[11] The *Payday Lending in America* series of reports grew to include a total of five reports about payday lending, online payday lending, and auto title lending—essentially, all of the loans covered by the Bureau's 2017 final rule."[12]

As of this writing, Pew's research and contributions to the literature include the following:

- Unique, nationally representative surveys consisting of in-depth telephone interviews with borrowers of payday and similar loans (as well as the general public) conducted according to the highest standards of survey research.

- Conversations with hundreds of borrowers in more than 20 focus groups throughout the country.

- Scores of meetings, interviews, and store visits with lenders and consumer finance professionals of all types.

- More than 100 one-on-one conversations with bank and credit union officials about small-dollar lending. We convened a group of executives from more than ten banks (which collectively operate approximately one-fifth of all bank branches in the United States) to discuss federal regulation of small-dollar loans.

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[11] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf. Methodology for the report is available at page 31.

[12] The reports are available as a collection online at http://www.pewtrusts.org/en/research-and-analysis/collections/2014/12/payday-lending-in-america.

- Extensive consultation with community groups in a majority of states, including representatives of consumer advocacy groups, civil rights and faith-based organizations, consumer credit counselors, legal advocates, and others.

- Analysis of academic literature and regulatory data. We have read all published academic papers about payday and auto title loans and reviewed all publicly available data about this market from state and federal government agencies as well as additional non-publicly available data obtained through special requests to various regulators and private companies.

- Including the five *Payday Lending in America* reports, Pew's small-dollar loans project has released more than two dozen carefully researched and reviewed issue briefs, fact sheets, and multi-media publications. See our website for links (www.pewtrusts.org/small-loans).

- In recent years, we have submitted comment letters, testimony, technical assistance, and informal input to federal regulators and state government officials throughout the country and spoken about this topic at dozens of conferences and other professional gatherings. Our work has been cited or quoted in a wide variety of publications from federal, state, and local government officials including the Bureau.

- Pew's publications on small-dollar loans have been cited in scholarly articles by academics and other researchers more than 140 times.

- Pew's work on small-dollar loans has been cited in more than 1,000 media stories.

- The CFPB's 2016 Notice of Proposed Rulemaking cited our work more than 40 times; the 2017 final rule cited our work more than 50 times; and the 2019 proposed rescission cited our work 19 times.

Pew spent nearly three years researching the markets for payday and similar forms of small-dollar credit before developing initial policy recommendations, in October of 2013.[13] The report included a case study of Colorado's 2010 payday loan reform law (which converted payday loans in that state from conventional short-term loans to those that last about six months); survey data finding that borrowers favor having more time to repay loans in smaller installment payments; and discussion of various potential benefits and harms associated with installment lending and how policy could help ensure that the migration to installment lending is safe and effective.[14] In the years since, we have revisited the data underlying that report and supplemented our recommendations with additional research and analysis, making revisions where appropriate.

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[13] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

[14] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

Pew is deeply committed to unbiased research and dedicated to improving public policy through pragmatic measures that would accommodate legitimate interests of both borrowers and lenders, as well as the public generally. Stakeholder outreach has been a constant feature of our work since it started.

In sum, Pew is highly qualified to comment on small-dollar lending to The House Financial Services Subcommittee on Consumer Protection and Financial Institutions.

Conclusions Based on Research Findings

The following section summarizes some key research findings about the market for payday, vehicle title, and similar loans.

(a) Borrower profile

Individuals who use high-cost payday loans are struggling financially, and 58 percent report trouble covering ordinary living expenses from month to month.[15] A majority (52 percent) report paying bank overdraft fees, and most carry credit cards but with little available credit.[16] Almost all have a damaged credit history that makes them ineligible for mainstream consumer credit, with credit scores that are at the lowest end of the scale (typical FICO scores in the low 500s[17] and similarly low VantageScores in the mid-to-high 500s[18]). These consumers are not the unbanked–they have an income and checking account, which are requirements for getting a payday loan–but they are dealing with periodic cash shortfalls rather than rare and unexpected emergency expenses.[19]

The average payday loan borrower earns about $30,000 per year,[20] although borrowers within every income group have used a payday loan.[21] Regardless of income, most borrowers find it

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[15] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 10, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=10.

[16] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loan Choices and Consequences*, Oct. 11, 2012, Vanderbilt Law and Economics Research Paper No. 12-30, 13, http://dx.doi.org/10.2139/ssrn.2160947. Fifty-nine percent of borrowers in the dataset have a credit card.

[17] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loan Choices and Consequences*, Oct. 11, 2012, Vanderbilt Law and Economics Research Paper No. 12-30, http://dx.doi.org/10.2139/ssrn.2160947.

[18] Jennifer Priestley, *Payday Loan Rollovers and Consumer Welfare*, Table 5, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2534628.

[19] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2013), 14, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=16.

[20] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 53, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=59

[21] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 10, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=12.

difficult to repay the average lump-sum payment of $430 that is required on their next payday, which represents 36 percent of the average borrower's paycheck. Only 14 percent of borrowers say they can actually afford this amount.[22]

Instead, the average payday loan borrower can afford to pay $50 per two weeks (or $100 per month)—similar to the fee for renewing a typical payday loan today. These data help explain why most borrowers renew or reborrow rather than repay their loans in full, and why the CFPB has found that 82 percent of loans are renewals or quick reborrows[23] while lenders report that loan loss rates are only 3 percent.[24]

Auto title loans are a similar form of high-cost lending and mirror payday loans in both structure and borrower experience. These borrowers are also unable to qualify for traditional financing, and they struggle to make ends meet. Three-quarters of auto title loan borrowers report having a checking account,[25] though they do not necessarily need an income to obtain the loan, as the lender can repossess the borrower's vehicle if they fail to repay. Further, loan payments are even larger and consume half of the average borrower's monthly income.

Borrowers are not shopping for credit in the conventional sense, but rather trying to cover regular recurring expenses: 69 percent of first-time payday borrowers used the loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food, while 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.[26] Yet research has found that use of payday loans has a negative effect on the ability of lower-income households to meet other expenses.[27] Borrowers are torn about the experience–a majority says payday loans take advantage of them, and a majority also says they provide relief. The appreciation for urgently needed cash and friendly service conflicts with borrowers' feelings

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[22] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 14, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=14.

[23] Consumer Financial Protection Bureau, *CFPB Data Point: Payday Lending* (2014), 9, http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf#page=9.

[24] Advance America, Cash Advance Centers Inc., *Form 10-K Annual Report* (Period Ending 12/31/11), 5 and 41, http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNYS:AEA&ft=&d=c12cd1f791e34bf03980d4825adc1730. Using 2011's Annual (10-K) Report from Advance America, the largest storefront lender, as an example, we can calculate an approximate loss rate by dividing the "provision for doubtful accounts" by the "aggregate principal amount of cash advances originated." This calculation of $107,911,000 divided by $3,965,225,000 yields an estimated loss rate of 2.72 percent. Borrowers may renew or reborrow a loan, or experience temporary defaults by bouncing checks and incurring nonsufficient funds fees while still paying back a loan eventually; Jamie Fulmer, "Advance America and Payday Lending: Who Borrows and Why," *Advance America*, presentation, Oct. 18, 2012, http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf#page=12. Advance America has made a similar point, stating, "97 percent of our customers pay us back;" David Burtzlaff and Brittny Groce, *Payday Loan Industry*, Stephens Inc. (2011).

[25] The Pew Charitable Trusts, *Auto Title Loans: Market Practices and Borrowers' Experiences* (2015), 7, http://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf#page=11.

[26] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2013), 14, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=16.

[27] Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, The Quarterly Journal of Economics (2011) 126: 517-555, http://qje.oxfordjournals.org/content/126/1/517.full.pdf+html.

of dismay about high costs and frustration with unaffordable payments and lengthy indebtedness.[28]

Repaying the loan in one lump sum is difficult for most borrowers. Previous research, as well as discussions with industry leaders, and state-level reports, all make clear that a typical borrower uses payday loans many times per year, and much of this borrowing comes in relatively quick succession once someone begins using payday loans.[29] To repay a loan, 41 percent have needed a cash infusion of some kind, including getting help from friends or family, selling or pawning personal possessions, or taking out another type of loan.[30] Frequently, these alternatives borrowers use to retire payday loan debt were available to them instead of using the loans in the first place. But desperation or unrealistic expectations, fueled by the product's unsustainable promise of debt lasting only weeks, often make comparisons with more transparent alternatives—and the fundamental decision about whether to borrow in the first place—difficult.[31] Long-term debt and high costs are the rule rather than the exception: Only 3 percent of lump-sum payday loans go to customers who use just one or two per year, and more borrowers use 17 or more loans in a year than use just one.[32] The single-payment loan, whether offered by a bank,[33] a storefront lender,[34] or an online lender,[35] simply does not work as advertised for the vast majority of borrowers.

(b) Borrowers of covered loans are unusually fragile consumers

Payday and auto title loan borrowers are unusually fragile financially compared to consumers who do not rely on high-cost credit to make ends meet. Just 49 percent of all payday loan borrowers are employed full-time, 14 percent are unemployed, and 13 percent are employed

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[28] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 39, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=39.

[29] Consumer Financial Protection Bureau, *CFPB Data Point: Payday Lending* (2014), 12, http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf#page=12. Data show "that half of all loans are in sequences of 10 or more loans; 62% are in sequences of seven or more loans." Consumer Financial Protection Bureau, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* (2016), 111, http://www.consumerfinance.gov/data-research/research-reports/supplemental-findings-payday-payday-installment-and-vehicle-title-loans-and-deposit-advance-products/. Data show over 80 percent of loans are reborrowed within 14 days from the same lender.

[30] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 37, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=37.

[31] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 19-29, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=19.

[32] Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending* (2011), https://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

[33] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[34] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf. The median storefront payday loan customer uses 10 loans in a year.

[35] David Burtzlaff and Brittny Groce, *Payday Loan Industry* (Stephens Inc., 2011). This paper notes that online payday lenders are not profitable unless borrowers use multiple loans.

part-time. Further, borrowers who self-identified as disabled or unemployed in Pew's national survey were the most likely to have used a loan of any employment group, with usage rates of 12 percent and 10 percent respectively.[36] High-cost loan borrowers mostly do not qualify for traditional loans because they have damaged credit histories.

Like many low- and moderate-income households, they are at risk of seeing their incomes fluctuate. Since 1979, nearly half of households in the U.S. have experienced an income gain or drop of more than 25 percent in any given two-year span.[37] And in recent years, contract employment has continued to increase–a shift often referred to as the "gig" or "sharing" economy. Data show that since 2010, 1099s (the forms that some employers fill out when paying contract workers more than $600) have been gaining ground and even outpacing W-2 forms. As companies drop employees and add contract workers, W-2s decrease and 1099s increase. The Census Bureau's count of non-employment businesses (i.e. independent workers) has also increased.[38] Together, these data suggest an increasing shift to hourly jobs, which could exacerbate income volatility since wages fluctuate with varying work schedules.

Swings in income can destabilize a family's finances by making it difficult to budget and meet monthly expenses, including loan payments. Data from the U.S. Financial Diaries Project show that for households living below the poverty line, 26 percent of monthly income is unpredictable compared with only 9 percent for those earning 200 to 300 percent of the poverty line.[39]

This shift will likely have a greater impact on lower-income households. Research shows that poorer households experience higher rates of income volatility than their middle-income counterparts,[40] and low-income households with children and people with disabilities are among those more likely to experience sharp income declines.[41] Further, research on work schedules for young adults shows that part-time employees experience a higher level of work-

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[36] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 11, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=13. It is possible that unemployed people were employed at the time of their last payday loan, or that they are receiving a loan based on some other form of income, such as a benefits check.

[37] The Pew Charitable Trusts, "The Precarious State of Family Balance Sheets" (2015), http://www.pewtrusts.org/en/research-and-analysis/reports/2015/01/the-precarious-state-of-family-balance-sheets

[38] Justin Fox, "The Rise of the 1099 Economy," *Bloomberg View*, Dec. 11, 2015, https://www.bloomberg.com/view/articles/2015-12-11/the-gig-economy-is-showing-up-in-irs-s-1099-forms.

[39] Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household evidence from the US Financial Diaries*, 2015, 1, https://static1.squarespace.com/static/53d008ede4b0833aa2ab2eb9/t/553521dae4b048e6faa46cdb/1429545456581/paper1.pdf#page=1. The authors summarized income volatility by an average coefficient of variation of monthly income, which was 55 percent for those below the poverty line and 34 percent for those from 100-300 percent of the poverty line.

[40] Gregory Mills and Joe Amick, "Can Savings Help Overcome Income Instability?" *The Urban Institute*, 6, http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412290-Can-Savings-Help-Overcome-Income-Instability-.PDF#page=6. Coefficient of variation for monthly household income in lowest quintile was 0.499 and 0.321 for middle quintile.

[41] Gregory Acs, Pamela Loprest, and Austin Nichols, "Risk and Recovery: Understanding the Changing Risks to Family Incomes" (2009), *The Urban Institute*, http://www.urban.org/sites/default/files/alfresco/publication-pdfs/411971-Risk-and-Recovery-Understanding-the-Changing-Risks-to-Family-Incomes.PDF.

hour instability and lower averages of work hours, and that fluctuations in work hours may result in financial insecurity.[42]

Recent research has also found that highly indebted households' consumption is more sensitive to income shocks. Because these households devote a greater share of their income to fixed monthly debt payments, they have less room to cut non-essential expenses when faced with an income loss. In short, the population of borrowers using covered loans is more fragile than nonborrowers, and are exposed to a great deal of risk, especially considering that most borrowers earn less than $40,000 annually, struggle to make ends meet, and seek the loans for consumption-smoothing rather than wealth-building purposes.

(c) Payday and title lenders have unusually strong leverage over consumers to ensure their ability to collect loan payments

As Pew has previously discussed,[43] payday lenders are unique in that they do not use traditional underwriting to determine whether applicants have the ability to repay loans while fulfilling other obligations.[44] They focus primarily on the ability to collect repayment, using leveraged payment mechanisms such as deferred presentment (holding the borrower's check or having electronic access to the borrower's checking account).[45] Many other types of lenders use electronic access as a way of ensuring and streamlining repayment, but conceptually, electronic repayment plans differ from deferred presentment arrangements for several reasons: 1) payday lenders condition credit on use of a leveraged payment mechanism; 2) the repayment is tied to a borrower's payday, meaning lenders are first in line to get paid before the borrower's other creditors; and 3) borrowers can cancel the plans with other lenders and retain control over the inflows and outflows of their checking accounts. Thus, payday lenders have unusually strong ability to collect unaffordable payments, which sets them apart from other creditors.

A leveraged payment mechanism becomes a dangerous tool when it lacks limits and is coupled with a high-cost loan to a financially fragile borrower. For storefront loans, borrowers are required to return to the store to repay the loan in cash, or if they cannot afford the full payment, to pay the fee to renew it and extend the due date; if the borrower does not return, the lender can deposit the check or use ACH to debit the full loan amount. For online loans,

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[42] Susan J. Lambert, Peter J. Fugiel, and Julia R. Henly, "Precarious Work Schedules among Early-Career Employees in the US: A National Snapshot," *University of Chicago*, 12, https://ssascholars.uchicago.edu/sites/default/files/work-scheduling-study/files/lambert.fugiel.henly_.precarious_work_schedules.august2014_0.pdf#page=14.

[43] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 27, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=33

[44] Some providers have begun to create automated underwriting models that assess more than just whether someone has a checking account and an income stream, but do not engage in an assessment of all of the borrower's expenditures and liabilities to assess their ability to pay the loan because they still retain the ability to collect via the leveraged payment mechanism.

[45] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), 44, http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf#page=44. "Lenders may instead rely on their relative priority position in the repayment hierarchy to extend credit without regard to whether the consumer can afford the loan. This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses."

electronic access is almost universal, as there is a strong disincentive for the borrower to choose an alternate method of applying for, receiving, and repaying the loans by mail.[46] Auto title lenders also retain strong leverage through the use of a car title, which can lead to repossession of a borrower's vehicle as a consequence of falling behind on loan payments. The threat of repossession alone is enough to make borrowers return to the lender to make a payment to extend the term for another pay period or month.

This mechanism allows the lender to compel payment on an unaffordable loan. This explains why defaults, charge-offs, and losses are all artificially low in this market even though borrowers often struggle to repay and repeatedly renew the loans. In short, lenders of covered loans hold unusually strong leverage over unusually fragile borrowers.

(d) What do borrowers want?

Borrower Survey

In 2017, Pew published a survey of payday loan borrowers to gauge their views on payday lending, the key elements of the Bureau's 2016 notice of proposed rulemaking, and possible outcomes of the rulemaking.[47] The survey found that:

- 70 percent of borrowers believe that payday loans should be more regulated. This finding is consistent with Pew's 2013 survey finding that 72 percent of payday loan borrowers said they wanted more regulation.[48]

- Borrowers support requiring installment payment structures: More than 3 in 4 borrowers say it will be a major improvement if they are given several months to repay a loan and if they can repay it in smaller installments. Pew's 2013 survey had similar results.[49]

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[46] "Frequently Asked Questions," CashNetUSA, accessed Sept. 28, 2016, https://www.cashnetusa.com/faq.html#. For example, see the following response regarding CashNetUSA loan terms in Alabama to the question: "What if I want to make payments without agreeing to the ACH authorization portion of the loan contract?" The response: "If you would like to make payments without agreeing to the ACH authorization portion of the contract, you can follow the procedures below: 1. Print out the loan contract, cross out the ACH authorization agreement and initial next to the section. 2. Provide us with a post-dated check (using the date of your next payday) for the amount of your total payment, including principal and fees, and a copy of the contract via mail, FedEx, or another delivery service. 3. We will confirm the issuing of your loan once we receive these documents."

[47] The Pew Charitable Trusts, "Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks: Results of a nationally representative survey of U.S. borrowers" (April 29, 2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/payday-loan-customers-want-more-protections-access-to-lower-cost-credit-from-banks.

[48] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 48, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=48.

[49] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 22, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=28

- Borrowers saw loans' prices, the affordability of payments, and whether they could obtain them from banks and credit unions as important, while most did not view additional underwriting as a major improvement for them.

- When deciding where to get a loan, borrowers ranked the top three factors as: 1) the fees charged, 2) how quickly they can get the money, and 3) certainty of approval.

- 8 in 10 borrowers would prefer to borrow from a bank or credit union if they were equally likely to be approved. And 93 percent of borrowers would view it as a good thing if banks and credit unions offered small loans at prices 6 times lower than payday lenders. (Pew has concluded that this is a likely outcome under the 2017 final rule, pending action from bank regulators along the lines of the bulleting the Office of the Comptroller of the Currency issued in May 2018 and modifications by the National Credit Union Administration to its Payday Alternative Loan program.)

In summary, borrowers want loans that cost less, have longer repayment terms with smaller payments, and where they have a reasonable certainty of approval. They would prefer to borrow from banks and credit unions if the loans are competitive in terms of price, speed of loan origination, and certainty of approval. All of these developments were beginning to occur, and are likely to accelerate if the 2017 final rule goes into effect.

(e) What does the public support?

Public Survey

In 2017, Pew also published a survey of the general public to gauge their opinions on some of the possible outcomes of the proposed rule and the types of loans that might result from it.[50] The survey found that:

- 70 percent of American adults believe that payday loans should be more regulated. Similar results were reported in Pew's 2015 survey.[51]

- 7 in 10 Americans want to see banks offer small loans to borrowers with low credit scores. 70 percent said that their view of a bank would be more favorable if the bank offered a $400, three-month loan for $60 (as has begun happening since the 2017 rule was finalized and as is likely to continue if it takes effect).

[50] The Pew Charitable Trusts, "Americans Want Payday Loan Reform, Support Lower-Cost Bank Loans: Results of a nationally representative survey of U.S. adults" (April 19, 2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/americans-want-payday-loan-reform-support-lower-cost-bank-loans.
[51] The Pew Charitable Trusts, "A Survey of Americans: CFPB Proposal for Payday and Other Small Loans" (2015), 3, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=5.

- 86 percent of respondents believe it would be a good outcome if most people who use payday loans could obtain lower-cost credit from their banks and credit unions (as is likely to happen under the 2017 final rule).

- By almost 5 to 1, respondents believe it would be a good thing if banks began offering small loans at prices six times lower than payday lenders (as has begun since the 2017 rule was finalized), even when they are told the rates would be higher than those for credit cards.

These findings reveal that when evaluating effectiveness of regulation, Americans and payday loan borrowers view favorably the likely outcomes of the 2017 final rule: giving borrowers more time to repay in equal installments, and welcoming lower-cost installment loans and lines of credit from banks and credit unions. Even though the Bureau lacks the power to regulate prices, the 2017 rule created regulatory certainty for banks and credit unions and gave them a great deal of leeway as long as they give borrowers more than 45 days to repay in equal installments.

(f) Key problems in the market

Pew's research identified the following key problems in the market:

i. Unaffordable payments enforced by leveraged payment mechanisms (typical payments take more than one-third of borrower paychecks when most borrowers cannot afford to pay more than 5 percent)

A typical payday loan payment takes 36 percent of an average borrower's gross monthly income, and the average lump-sum auto title loan payment consumes 50 percent of the borrower's paycheck.[52] Most borrowers cannot afford to lose this much from their paycheck and still make ends meet, yet lenders use leveraged payment mechanisms to ensure their ability to collect anyway. This leads borrowers to renew or reborrow their loans repeatedly. As a result, a typical borrower, who takes out a $375 two-week loan, is indebted for five months of the year, and pays $520 in fees instead of the originally contracted fee amount of $55.[53]

ii. Deceptive business model

Although conventional two-week payday loans are advertised as a quick short-term solution for unexpected expenses, the average borrower is in debt for five months during the year. Data from lenders' filings and industry officials' testimonies reveal that renewals are an

[52] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 31, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=37 The Pew Charitable Trusts, *Auto Title Loans: Market Practices and Borrowers' Experiences* (2015), 1, http://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf#page=5.

[53] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 9, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=11.

essential part of the payday lending business model: If borrowers were using single-payment loans as advertised, the lenders would go out of business.[54] As the CFPB has noted, four in five loans are taken within two weeks of a previous loan. Data from Florida show that approximately 97 percent of loans go to those who use three or more annually, and about 3 in 5 go to those who use 12 or more loans.[55] Data from Oklahoma show that more borrowers use 17-plus loans in a year than just one.[56] To ensure that loans work as advertised, they should have affordable installment payments that fit into a borrower's budget and pay down principal. In addition, all fees and charges should be clearly disclosed and be pro rata refundable to reduce the incentive for lender-driven refinancing. Colorado's 2010 payday loan reform shifted the market from single-payment loans lasting an average of 18 days to installment loans lasting an average of 3 months (there is a 6-month minimum term but most loans are repaid early). Before that law change, a loan's advertised price represented 13 percent of finance charges actually paid in a year, whereas after the 2010 reform, the advertised price represented 87 percent of actual annual spending.[57] Much like the CFPB's 2017 final rule that would steer the market toward installment lending, this change gave borrowers more time to repay in equal installments and improved transparency.

iii. Origination fees and other lender incentives to refinance

When small loans carry an origination fee, lenders can earn a substantial portion of revenue at the outset of the loan. This creates a strong incentive to encourage borrowers to refinance so that the lender earns another origination fee. Similarly, when interest front-loading applies, lenders earn a disproportionate amount of income in the early months of the loan, creating an incentive to encourage refinancing.[58]

Frequent lender-driven refinancing places borrowers at risk of financial harm because of the additional fees, interest payments, and months of debt. They can also mask defaults by renewing unaffordable loans to avoid borrowers defaulting when they cannot afford a loan payment. However, the solution to this problem lies not with rationing the number of loans a borrower can take out, but with eliminating lender incentives to refinance loans. If the loan is structured in a way that makes every month of the loan equally profitable, then the lender does not have an incentive to encourage refinancing (and a refinance does not include a *de facto* prepayment penalty for borrowers). If borrowing is not limited (for example, at to two times per six months or year), the customer will borrow only what they

[54] John Robinson, president of TitleMax Holdings LLC, "Affidavit of John Robinson, President of the Debtors, in Support of First Day Motions and Applications," 11, April 21, 2009, U.S. Bankruptcy Court for the Southern District of Georgia, Savannah Division, http://s3.documentcloud.org/documents/1227212/tmx-exec-delcaration-in-bk-case.pdf; Robert DeYoung and Ronnie J. Phillips, *Payday Loan Pricing* (Federal Reserve Bank of Kansas City Economic Research Department, 2009), https://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.
[55] Veritec Solutions LLC, *Florida Trends in Deferred Presentment* (2010). On file with The Pew Charitable Trusts.
[56] Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending* (2011), https://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.
[57] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 12, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=18
[58] National Consumer Law Center, *Installment Loans: Will States Protect Borrowers From A New Wave Of Predatory Lending?* (2015), 22, http://www.nclc.org/images/pdf/pr-reports/report-installment-loans.pdf#page=32.

need and prepay when possible.[59] Eliminating lender incentives to refinance without placing limits on borrowers' ability to access safer credit will lead to less indebtedness and lower consumer cost.

iv. Defaults

Payday loan borrowers' low credit scores mean they are at higher risk of defaulting on any loan. And yet defaults for these and other covered loans are much lower than they could be because of the lender's use of a leveraged payment mechanism. This creates artificially low default rates because it allows lenders to compel repayment (either the full amount or a fee to renew the loan, effectively masking a default), even though the borrower may be struggling to meet other obligations. When lenders do not have a leveraged payment mechanism, such as in the credit card market or traditional installment loan market for example, default rates are generally less than 10 percent even on subprime loans to borrowers who do not have prime credit scores.[60]

v. Unnecessarily long repayment terms

Ensuring that borrowers have more time to repay and requiring installment payments is imperative but not sufficient to protecting consumers. In some cases, lenders have set up terms that are unnecessarily long to derive more revenue from borrowers without incurring more risk. For example, a $500 auto title loan that has been offered in Arizona has a repayment period of 18 months and carries $1,126 in fees.[61] Pew's survey found that respondents believe that four to six months is a reasonable term for a $500 loan.[62]

vi. Abuse of leveraged payment mechanisms

Online payday loan borrowers are at especially high risk of unauthorized withdrawals because their bank accounts are exposed to lenders and sometimes others who buy their information from lenders or lead generators. Research shows that lenders have repeatedly accessed borrowers' accounts when debits fail, causing multiple overdraft fees. In Pew's national survey, 46 percent of online borrowers reported that their bank accounts were overdrawn by payday lenders' withdrawals, twice the rate among storefront borrowers.[63]

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[59] In general, it is unnecessary to ration safe loans; however, when it is not possible to make the underlying loan safe—as in the 2017 final rule's short-term conditional exemption—Pew supports loan limits.

[60] World Acceptance Corporation, *2015 Annual Report*, http://www.worldacceptance.com/wp-content/uploads/2015/07/2015-ANNUAL-REPORT_6-25-15.compressed.pdf; Regional Management, *2015 Annual Report*, http://www.regionalmanagement.com/phoenix.zhtml?c=246622&p=irol-sec#14225200; Springleaf Financial, *2014 Annual Report*, http://files.shareholder.com/downloads/AMDA-28PMI5/1248530341x0x823670/5A26396A-A4D8-4870-B693-B8F6B87F954A/Springleaf_2014_AR10K.pdf.

[61] "Arizona Rates and Terms," Speedy Cash, accessed Oct. 3, 2016, https://www.speedycash.com/rates-and-terms/arizona. The referenced Speedy Cash loan is available in Arizona as an auto title installment loan.

[62] The Pew Charitable Trusts, "A Survey of Americans: CFPB Proposal for Payday and Other Small Loans" (2015), 5, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=7.

[63] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 32–35,

Further, 22 percent of borrowers reported closing their checking accounts or having them closed by their bank in connection with an online payday loan.[64] Unscrupulous lenders have also been shown not to honor borrowers' requests to cancel the loans,[65] and there can be lag time between the request and when it takes effect,[66] demonstrating that safeguards are needed to protect against aggressive or fraudulent practices. Many unscrupulous lenders have been targets of judicial[67] and regulatory[68] actions because of the propensity for abuse via the ACH system, which is atypical of depository institutions that are subject to prudential regulatory oversight, underwrite their customers, and offer lower-cost loans.

Auto title loan borrowers are also at risk of harm due to lenders' ability to repossess their cars. Lenders often charge repossession-related fees to reduce or avoid losses on defaulted loans and to earn additional revenue. This drives up the cost for borrowers who repay and retrieve their cars and reduces any potential surplus refund for those whose cars are sold at auction. Because lenders add these fees to the outstanding debt, borrowers rarely receive any net profits from the car sale though it is typically mandated by state law. It should be noted that these fees are not a core part of the title loan business model.[69]

vii. Negligible price competition

Borrowers of high-cost loans show little sensitivity to price because they are not shopping for credit, but rather looking for quick cash to meet an urgent need, usually paying a bill. Lenders recognize this behavior and therefore do not compete on price, and instead, compete on non-price elements, such as location, certainty of approval, and customer

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http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=32.

[64] The Pew Charitable Trusts, *Fraud and Abuse Online: Harmful Practices in Internet Payday Lending* (2014), 16, http://www.pewtrusts.org/~/media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf#page=20.

[65] Federal Trade Commission, "Online Payday Loans," accessed Sept. 28, 2016, https://www.consumer.ftc.gov/articles/0249-online-payday-loans. The FTC discusses lawsuits against online payday lenders for alleged violations of federal laws.

[66] Baptiste and Brodsky v. JP Morgan Chase Bank, filed Oct. 1, 2012, http://www.neweconomynyc.org/wp-content/uploads/2014/08/Baptiste-v.-Chase-complaint-FINAL.pdf. This is a complaint in a high-profile case of withdrawals by online payday lenders resulting in large bank fees for borrowers.

[67] Nick Bourke, Fintech Law Report, *Online Lending and the Integrity of the Banking System: Behind the Heated Rhetoric Over "Operation Choke Point,"* Mar/Apr 2015, Volume 18, Issue 2, pp. 5-6, http://www.pewtrusts.org/~/media/assets/2015/05/fintech1802_aa_bourke_proofed.pdf?la=en#page=5.

[68] NACHA, "ACH Network Risk and Enforcement Topics," Aug. 26, 2014, https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics.

[69] Tennessee Department of Financial Institutions, *2016 Report on the Title Pledge Industry* (2016), 11, http://www.tennessee.gov/assets/entities/tdfi/attachments/Title_Pledge_Report_2016_Final_Draft_Apr_6_2016.pdf#page=14 In Tennessee, lenders report spending 3 percent of revenue on repossession expenses; Jim Hawkins, "Credit on Wheels: The Law and Business of Auto-Title Lending," *Washington and Lee Law Review* 69, no. 2 (2012), accessed Oct. 4, 2016, 551–52, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1952084. "The notion that lenders repossess vehicles to generate significant profits is almost certainly wrong. Repossessing, storing, and selling vehicles are expensive relative to the value of most pledged vehicles. One operator estimated the costs at around $500 for his company—$250 to pay a company to repossess the vehicle and $250 to pay for the sale; another confirmed that '[r]epossessions, at best, are a breakeven process and most often simply mitigate our loss.'"

service.[70] The same lenders charge different prices to similarly situated borrowers across states. For states with usury caps, lenders typically charge the ceiling, and in states with no rate caps, lenders charge even higher prices.[71] For example, on a $500 loan, the same lender charges 664 percent APR to borrowers in Texas, but 391 percent APR to borrowers in Kansas.[72] Yet, in states with lower rate limits, payday credit is not significantly constrained; instead, fewer stores simply serve more customers each.[73] For example, in the five years after Colorado's 2010 reform lowered permissible interest rates for payday loans, more than half of stores closed; but each remaining store doubled its average customer count. Borrowers' access to credit in the state was virtually unchanged.[74]

The Bureau cannot set prices for loans and did not do so in its 2017 final rule. However, the Bureau's 2019 proposal alleges that the 2017 final rule would have the effect of "reducing competition" and that the purported reduction in supply "would have a dramatic effect on competition." The 2019 proposal acknowledges that "because of State-law regulation of interest rates, the effect of reduced competition may not manifest itself in higher prices." The proposal then argues that "lenders compete on non-price dimensions" but does not enumerate them or offer evidence that the 2017 rule would hurt competition on these unspecified dimensions. It proceeds to note that some new products have come to market in recent years enabling employees to access earned wages prior to payday and that the "2017 Final Rule included exclusions to accommodate these emerging products." Despite the fact that these products are not covered by the 2017 rule, the 2019 proposal claims without substantiation or example that the 2017 rule "would constrain innovation in this market."

To summarize, the 2019 proposal acknowledges that the 2017 rule is unlikely to result in higher prices, it acknowledges the 2017 rule does not cover emerging products that let consumers access their wages early, and it surmises that the 2017 rule could hurt nonprice competition, but does not specify any forms of nonprice competition and does not provide evidence that the 2017 rule would hurt nonprice competition. Therefore, the 2019

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[70] There is strong evidence that borrowers would choose lower-cost options if they were aware of them and these options were competitive on these factors; see The Pew Charitable Trusts, "Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks," (2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/payday-loan-customers-want-more-protections-access-to-lower-cost-credit-from-banks.

[71] The Pew Charitable Trusts, "How State Rate Limits Affect Payday Loan Prices" (2014), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

[72] "Find Your Closest Store," Advance America, accessed Sept. 30, 2016, https://www.advanceamerica.net/locations.

[73] Robert B. Avery and Katherine A. Samolyk, "Payday Loans Versus Pawn Shops: The Effects of Loan Fee Limits on Household Use" (2011), http://www.frbsf.org/community-development/files/2-avery-paper.pdf; and Mark J. Flannery and Katherine A. Samolyk, "Scale Economies at Payday Loan Stores" (2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2360233. Both papers have detailed this tendency.

[74] Colorado Office of the Attorney General, *2009 Deferred Deposit Lenders Annual Report* (2010), http://coag.gov/sites/default/files/contentuploads/cp/ConsumerCreditUnit/UCCC/AnnualReportComposites/2009_ddl_composite.pdf; Colorado Office of the Attorney General, *2015 Deferred Deposit Lenders Annual Report* (2016), http://coag.gov/sites/default/files/contentuploads/cp/ConsumerCreditUnit/UCCC/AnnualReportComposites/2015_ddl_composite.pdf.

proposal's claim is unfounded that the 2017 rule would hurt competition or that the alleged harm to competition would harm consumers.

Thank you for the opportunity to provide commentary for the committee's consideration. Please do not hesitate to get in touch if we can provide additional information.

Regards,



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Attachment: Pew comment letter to the CFPB dated March 18, 2019

ATTACHMENT

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March 18, 2019

Comment Intake
Consumer Financial Protection Bureau
1700 G St. NW
Washington, DC 20552
Via Electronic Submission

RE: Payday, Vehicle Title, and Certain High-Cost Installment Loans; Delay of Compliance—Docket No. CFPB-2019-0007 (RIN 3170-AA95)

Director Kraninger:

The Pew Charitable Trusts is a global, nongovernmental, nonpartisan research and public policy organization dedicated to serving the public. We strive to improve public policy by conducting rigorous analysis, linking diverse interests to pursue common cause, and focusing on tangible results. Ensuring that consumer financial markets are safe and transparent is a goal to which Pew has dedicated significant effort, time, and resources. As explained below, we urge you not to delay implementation of any part of the 2017 final rule on payday, vehicle title, and certain high-cost installment loans.

Based on extensive research conducted over eight years on payday and vehicle title lending, there is clear evidence of both a market failure and significant consumer harm. Through analyses of other subprime consumer credit markets; lenders' and borrowers' outcomes in states with different payday and auto title loan regulations; and bank and credit union small-dollar loan experiences, we have developed a strong research base and found overwhelming evidence that well-designed regulatory structures can promote access to useful small-dollar credit and improve consumers' well-being. Drawing on this deep research, we will offer detailed feedback about the CFPB's rescission proposal in a future comment letter. Here, we provide just brief commentary about the proposed rescission because it is the primary rationale offered in the proposal to delay compliance by 15 months from August 19, 2019 to November 19, 2020.

The Bureau preliminarily plans to eliminate the 2017 final rule's affordability safeguards ("mandatory underwriting provisions"). At a high level, we observe that the final rule set strong consumer protections for loans that consistently harm customers—single-payment and balloon-payment loans—without eliminating them, and it gave lenders complete leeway in offering both affordable and high-cost loans repayable in equal installments over terms longer than 45 days. There would be widespread access to credit from payday, auto title, installment, depository, and other lenders under the final rule.

Since the CFPB finalized its 2017 payday lending regulation, bank regulators and credit union regulators have taken important steps that were consistent with, and demonstrate the success of, the final rule. As an example, in May of 2018 the Office of the Comptroller of the Currency

issued a bulletin giving banks guidelines for issuing small installment loans with terms longer than 45 days.[1] In September of 2018, U.S. Bank began offering a new small installment loan, repaid over three months, with monthly payments set at 5 percent of a customer's monthly income. Whereas borrowing $400 from a payday lender for three months costs an average of $360, U.S. Bank is offering that same credit for $48 to $60, while serving many of the same customers who have very low credit scores.[2] The FDIC and National Credit Union Administration have also taken initial steps to provide guidelines for how banks and credit unions can offer small loans safely and sustainably to their customers who currently use payday and other high-cost loans.[3] These developments are a major benefit of the CFPB's 2017 regulation, because that regulation established minimum protections for balloon payment loans but placed virtually no restrictions on small installment loans lasting longer than 45 days.

The CFPB also explains in its 2019 notice of proposed rulemaking that it intends to rescind the 2017 safeguards because they would dramatically reduce access to credit, but this assertion is unsubstantiated. The estimates cited in the notice only reference *short-term* loan volume but do not recognize that a large majority of consumers would still be able to access small loans that last longer than 45 days under the 2017 regulation. Many consumers can or will soon be able to access small installment loans from banks and credit unions (U.S. Bank's three-month Simple Loan described in the previous paragraph is an example of a new, more affordable product that entered the market *after* the CFPB finalized its original rule, arguably because the rule helped provide regulatory certainty and open the market to new forms of competition). Further, small loans would continue to be available from payday and auto title lenders under the 2017 rule. In two-thirds of the states where payday or auto title lenders operate, they can comply with the 2017 regulation simply by giving consumers adequate time to repay with terms beyond 45 days—and in fact, they are already issuing some high-cost installment loans or lines of credit in these states. For example, in 2012 in Texas, only 27 percent of payday loan revenue came from payday installment loans. But in the most recent report from Texas, 85 percent of payday loan revenue came from payday installment loans.[4] When Colorado outlawed two-week loans in 2010, requiring that customers be allowed six months to repay, lenders simply shifted to making six-month loans. Credit remained available to the same type of customer and state regulatory data show that borrowers fared much better.[5] In short, decreased availability of loans with terms of shorter than 45 days does not signal a reduction in access to credit, because small loans that last longer than 45 days are often readily available or will quickly become readily available. The

[1] Office of the Comptroller of the Currency, "Core Lending Principles for Short-Term, Small-Dollar Installment Lending," OCC Bulletin 2018-14 (May 23, 2018), https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html.

[2] Nick Bourke, *American Banker*, "Momentum is Building for Small-Dollar Loans," Sept. 12, 2018, https://www.americanbanker.com/opinion/momentum-is-building-for-small-dollar-loans.

[3] FDIC, "Request for Information on Small-Dollar Lending," FIL-71-2018 (November 14, 2018), https://www.fdic.gov/news/news/financial/2018/fil18071.html. National Credit Union Administration, Notice of Proposed Rulemaking on "Payday Alternative Loans," 83 FR 25583 (June 4, 2018).

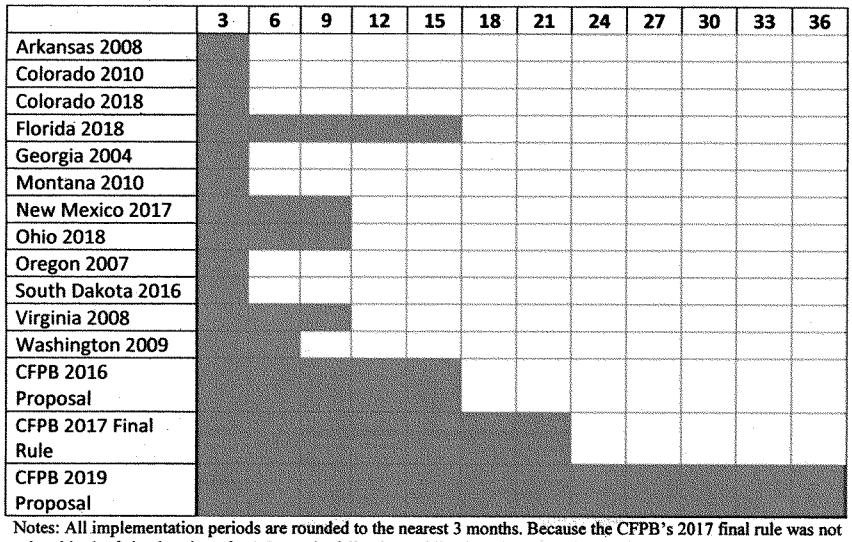
[4] Texas Office of the Consumer Credit Commissioner, Financial Services Activity Reports: Credit Access Businesses, https://occc.texas.gov/publications/activity-reports#cab.

[5] The Pew Charitable Trusts, *Trial, Error, and Success in Colorado's Payday Lending Reforms* (2014), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2014/12/trial-error-and-success-in-colorados-payday-lending-reforms.

Bureau's fundamental premise—that there would be little access to credit under the 2017 regulation—is not borne out by experience.

On the time frame for compliance itself, there is not adequate justification for a delay in implementation. In the CFPB's 2016 notice of proposed rulemaking for these loans, it set an initial implementation period of 15 months. This was an unusually long period of time to allow for compliance relative to state payday loan law changes, which have typically allotted three to nine months for full implementation (see chart below). Even the Credit CARD Act of 2009—a major act of Congress that required fundamental changes to a part of the consumer finance industry serving more than 100 million customers who carry hundreds of billions of dollars in debt—gave credit card issuers just nine months to comply with major new consumer protections including an ability-to-repay requirement.[6] In its 2017 final regulation, the CFPB increased the initial implementation period of the payday loan rule to 21 months. In this new proposal, the CFPB suggests increasing that to 36 months.

Chart: Implementation Period for Payday Loan Law Changes
Number of months



Notes: All implementation periods are rounded to the nearest 3 months. Because the CFPB's 2017 final rule was not printed in the federal register for 1.5 months following publication, the actual time periods for both the 2017 final rule and 2019 proposal are 1.5 months longer than shown. All time periods shorter than three months are listed in the category of three months. The chart excludes temporary payday loan laws that had sunset provisions and no implementation periods, such as in Arizona and North Carolina.

[6] Public Law No: 111-24 (May 22, 2009), at Section 3.

The changes to payday lending laws made by states generally had a more substantial impact on the payday and auto title lending industries than the 2017 CFPB regulation would, because the state laws included regulations of loan terms including prices and durations. The 2017 final CFPB regulation did not set prices or terms, and it provided industry with four compliance options including a) assessing ability to repay, b) using a principal payoff option, c) giving consumers more than 45 days to repay high-cost loans in installments, or d) giving consumers more than 45 days to repay high-cost lines of credit. In two-thirds of the states where payday or auto title lenders operate, they already issue at least some longer-term high-cost installment loans or lines of credit, and these products were not covered by the 2017 regulation's ability-to-repay requirements.[7]

The proposed delay also cites as a rationale that it has identified:

> *"...[C]ertain potential obstacles to compliance that were not anticipated when the original compliance date was set. For example, several State laws applicable to payday or similar loans have been enacted subsequent to the 2017 Final Rule that have more immediate compliance dates. Some industry participants have indicated that, given time and resource constraints, their need to comply with these intervening State laws may impede their ability to comply with the 2017 Final Rule's Mandatory Underwriting Provisions by the August 19, 2019 compliance date."*

States make changes to payday loan laws periodically, and there was no reason to believe that when the CFPB set a 21-month implementation period in 2017 that state law changes would cease. For example, in 2016 and 2017, when the CFPB was in its rulemaking phase and considering the compliance time period, Mississippi expanded auto title installment loans, South Dakota effectively eliminated payday and auto title loans, and New Mexico limited rates to 175 percent APR and set a four-month minimum loan term. The fact that three states—Colorado, Florida, and Ohio—have made changes to their payday loan laws since then is not unusual.[8] Further evidence that the industry can comply with state law changes as well as the federal regulation is that payday lenders offered vocal support for the Florida law change and have also supported law changes in several other states since the regulation was finalized in the fall of 2017.

The Bureau also wrote: "Similarly, industry participants have indicated that they need additional time to finish building out, or otherwise making investments in, technology and critical systems necessary to comply with the Mandatory Underwriting Provisions of the 2017 Final Rule." The two main systems needed for compliance would be a way to check a database and a way to assess ability to repay. Lenders have routinely checked databases like Teletrack for more than a

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[7] The Pew Charitable Trusts, *From Payday to Small Installment Loans* (2016), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/08/from-payday-to-small-installment-loans. Since publication, both Colorado and South Dakota have passed ballot initiatives capping rates for deferred deposit loans at 36 percent, so lenders are not issuing payday or auto title loans in those states.

[8] Colorado's loans had terms of more than 45 days so fell outside the scope of the 2017 rule. Florida's new loans authorized by the 2018 law have terms of more than 45 days so fall outside the scope of the 2017 rule. Ohio, both before and after the law change, enabled lenders to offer loans with terms longer than 45 days which fall outside the scope of the 2017 law change.

decade. And vendors to the payday and auto title loan industries were advertising in 2017, before the regulation was even finalized, that they had created turnkey solutions to comply with the CFPB's ability-to-repay requirements.[9]

As demonstrated by lenders' experiences in states, the ready availability of payday loan databases, and the turnkey products marketed by vendors to facilitate compliance with the 2017 regulation, there is no need for additional time to comply. The 21-month implementation period set out in the 2017 regulation is an unusually long one, and no further time is necessary. The additional 15-month compliance delay would subject consumers to continued harm without federal protections. The 2017 regulation also offers lenders several options for compliance, the easiest of which is simply to give borrowers at least 46 days to repay a loan or line of credit. For these reasons, we recommend that the Bureau not delay the compliance date of the 2017 final regulation. We are available to discuss our extensive research on the topic of small-dollar credit that can help inform the Bureau as it undertakes this rulemaking.

Regards,



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[9] For example, Clarity Services, Inc. was one of several companies offering such products, https://www.clarityservices.com/insights/weve-got-covered/.

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