CFA Consumer Federation of America

Position Paper
The Need for High Cost Lending Consumer Protections

Background – The Problem for Consumers

Consumers are paying astronomical rates for credit, especially those who have the fewest resources. Payday loans cost 400 percent annual percentage rate (APR) or higher; car title loans cost 300 percent APR and put car ownership at risk; loans secured by expected tax refunds cost 50 to 500 percent APR; bank overdraft loans can cost quadruple-digit interest rates; and credit card fees and interest can combine to produce triple-digit rates.

The ability of states to enact meaningful reforms on credit card and bank overdraft practices has been severely restricted as a result of federal preemption. Banks are now permitted to locate in a state without consumer protections and then engage in unregulated lending in the other forty-nine states, which are powerless to protect their citizens against high cost credit cards and tax refund anticipation loans. State usury caps have been riddled with loopholes and exceptions, leaving consumers in thirty-five states exposed to outrageously expensive payday loans.

A growing body of research demonstrates that taking out payday loans is harmful to borrowers. Using payday loans doubles the risk a borrower will end up in bankruptcy within two years, doubles the risk of being seriously delinquent on credit card payments, and makes it less likely that consumers can pay other bills and get healthcare. Payday loan use also increases the likelihood that a consumer's bank account will be closed involuntarily. Finally, given the lower bank account penetration rate for minority consumers, this product undermines progress being made to bring unbanked consumers into mainstream financial services.

Due to concerns that members of the military were becoming heavily indebted to payday lenders, Congress, in 2006, enacted a 36 percent inclusive rate cap to protect active duty service members and their families from outrageously expensive credit that harmed their financial security and the military readiness of our nation.

A March 2009 survey conducted by the Center for Responsible Lending found that over 70 percent of respondents supported an interest rate cap of 36 percent APR or less.

The Solution for Consumers: "Protecting Consumers from Unreasonable Credit Rates Act" (S. 500 and H.R. 1608)

The Consumer Federation of America supports S. 500 and H.R. 1608, the "Protecting Consumers from Unreasonable Credit Rates Act." These bills limit the total cost of consumer credit to 36 percent per year per loan, keeping billions of dollars in the hands of low and moderate-income consumers, helping to stimulate the economy without costing taxpayers a penny.

The fees and interest rate cap on consumer credit included in this legislation is set high enough not to hamper mainstream responsible lending. A 36 percent rate cap is twice the limit for federally-chartered credit unions and enables credit to be responsibly extended to consumers with less than perfect credit ratings. This is the rate cap enacted by Congress through the Military Lending Act and is the limit typically used in state small loan laws.

This measure is designed to keep affordable financial products available, as lenders who offer sustainable loans do so at rates well below 36 percent annually. It would eliminate abuses that rely on high fees, interest and other devices to charge extremely high annual rates to trap consumers in debt they cannot afford to pay off.

Under the bill, the cap will be the maximum amount lenders can charge, but states will be able to set lower rate caps to protect their citizens, such as New York's 25 percent criminal cap and Arkansas's constitutional cap.

In contrast, H.R. 1214, the "Payday Loan Reform Act of 2009," harms consumers and provides Congressional consent to single payment loans of 390 percent APR for two weeks or 780 percent APR for one week. The loan cap of fifteen cents per dollar loaned authorizes lenders to charge $60 for a typical $400 loan, which is due in one pay cycle. This means that, for the typical borrower with nine loans per year, H.R. 1214 authorizes lenders to collect $540 in finance charges for a $400 loan taken out over an 18-week period.

The bill also purports to limit borrowers to one loan at a time from a single lender and limits borrowers to one extended repayment plan every six months. However, these provisions will not stop this product from being a debt trap for borrowers because they are easily evaded by the industry. The bill also fails to address the fundamental problem with the payday lending model--requiring the borrower to repay the entire principle and interest from a single paycheck in just one to two weeks--that ensures the typical borrower cannot pay back a loan without needing to take out another. In states that have adopted these and other provisions, regulators report an average of 9 loans per borrower each year, with the typical payday loan user engaging in more than one transaction every month while using this product.

The practical impact of Congressional passage of H.R. 1214 will be to stop the progress of reform in the states. No state has legalized payday lending since 2005. Since then Ohio, Oregon, New Hampshire, and the District of Columbia have either capped rates at low levels or repealed payday lending outright. The Arkansas Supreme Court overturned the state's payday loan law for violating the state's constitutional usury cap. By wide margins, voters in Arizona and Ohio rejected payday lending at 391 percent APR.

A blanket usury cap as included in H.R. 1608 and S. 500 provides the only effective protection for consumers against extremely expensive credit and avoids the loopholes and definitional problems that plague bills targeted at a specific product.