



Consumer Federation of America

**Written Testimony of Consumer Federation of America
Submitted to the
Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives
Washington, D.C.**

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Consumer Federation of America (CFA)¹ is pleased to submit written testimony to the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services as part of the Subcommittee's consideration of current and pending regulations that impact non-depository financial institutions. The harmful practices of payday and auto title lenders, and the importance of effective regulations to protect consumers from abusive practices is of particular concern. The comments provided below address two pending regulatory actions: the working draft of possible payday, auto title and payday installment rule released by the Consumer Financial Protection Bureau (CFPB); and the proposed rule to improve the Military Lending Act under consideration by the Department of Defense (DoD).

1. A Strong CFPB Rule is Necessary to Protect Consumers from the Financial Harm Caused by Payday, Auto Title and Payday Installment Loans

Currently 35 states authorize triple digit interest rate payday loans made without any consideration of a borrower's ability to repay.² As a result 71 percent of Americans live in states that would see a considerable improvement in consumer protections for payday and auto title loans if a strong CFPB rule is enacted. According to the Center for Responsible Lending, the failure to limit repeat, abusive borrowing results in \$3.5 billion in additional fees paid by payday loan borrowers³ and \$3.6 billion in additional fees paid by title loan borrowers each year.⁴

As a data-driven regulator committed to improving the financial market place and protecting consumers, the CFPB has exhaustively documented the frequency of repeat borrowing and other harmful practices that its current proposal seeks to address. In March 2014, the CFPB released research documenting that repeat borrowing is standard practice—over 80 percent of loans are renewed because a borrower is unable

¹ CFA is an association of over 250 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy and education.

² *State Payday Loan Regulation and Usage Rates*. The Pew Charitable Trusts, July 11, 2012.

http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/~media/Data%20Visualizations/Interactives/2014/State%20Payday%20Loan%20Regulation%20and%20Usage%20Rates/Report/State_Payday_Loan_Regulation_and_Usage_Rates.pdf.

³ Parrish, Leslie, and Uriah King. *Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76% of Total Volume*. Washington, DC, July 9, 2009. <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf>.

⁴ *Driven to Disaster: Car-Title Lending and Its Impact on Consumers*. Washington, DC: Center for Responsible Lending and Consumer Federation of America, February 28, 2013. <http://www.responsiblelending.org/other-consumer-loans/car-title-loans/research-analysis/CRL-Car-Title-Report-FINAL.pdf>.

to repay in full and on time and half of all loans are part of a series of ten or more loans.⁵ In a 2013 white paper on payday lending, the CFPB also found that 75 percent of loan fees were charged to borrowers that used 11 or more payday loan in a 12 month period.⁶

The ability to repay standard proposed by the CFPB will protect consumers

At a March 2015 field hearing in Richmond, Virginia, the CFPB issued a working draft of possible consumer protections under consideration for a proposal rule – a critical first step to ensuring that consumers are protected from abusive practices such as poor underwriting and back-to-back lending. The proposal contains a straight-forward, common-sense ability to repay standard that requires lenders to review borrowers’ income and expenses before issuing a loan to ensure that they can repay the loan in full and on time without additional borrowing. The adoption of such a standard that applies to short-term and long-term payday and auto title loans, without loopholes for unsafe repeat borrowing, is critical to protecting consumers and stopping the debt trap caused by unsafe credit products.

Preventing loopholes in a final rule is critical to a successful rule that protects consumers and a competitive market

The CFPB proposal rightly applies the ability to repay standard to short- and long-term payday and auto title lending, as well as to similar, harmful products structured as open-end lines of credit. The broad scope of the proposal is fundamental to protecting consumers and to ensuring that lenders do not develop new products to evade a final rule. Likewise, the broad scope of the proposal also seeks to ensure that lenders seeking to comply with important consumer protections enjoy fair competition.

A 2014 report by payday lending analysts Stephens, Inc., illustrates the need to apply consumer protections to both short- and long-term payday and auto title loans and open-end credit by highlighting the shift from balloon payment payday loans to payday installment loans among storefront lenders. The Stephens report found that, as of 2014, installment loan growth represented well over half of the total growth for payday industry participants who experienced growth in 2013.⁷ One of the largest lenders, Cash America has also shifted from balloon payment payday loans to longer-term payday loans and open-end lines of credit. Including both storefront and online lending, Stephens, Inc. noted that Cash America’s installment and open-end products now comprise about 56 percent of the company’s domestic loan balance as of December 2013.⁸

The broad scope of the proposal will ensure that lenders do not exploit common loopholes in state laws that are intended to protect consumers from short-term payday and auto title loans, but leave them susceptible to triple digit interest rates and poorly underwritten longer-term loans. However, the CFPB is also proposing a series of exemptions from the ability to repay standard that undermine its effectiveness.

⁵ *CFPB Data Point: Payday Lending*. Washington, D.C.: Consumer Financial Protection Bureau, March 2014. http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

⁶ *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings*. Washington, DC: Consumer Financial Protection Bureau, April 13, 2013. http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

⁷ Hecht, John. “Alternative Financial Services: Innovating to Meet Customer Needs in an Evolving Regulatory Framework.” presented at the CFSA Solutions, Little Rock, AR, February 27, 2014.

http://cfsaa.com/Portals/0/cfsa2014_conference/Presentations/CFSA2014_THURSDAY_GeneralSession_JohnHecht_Stephens.pdf.

⁸ *Ibid.* Note that Cash America has since spun off its online lending operation, Enova Financial.

Of particular concern, the proposal allows lenders to make up to three back-to-back payday loans without a review of the borrower's income and expenses. This exemption could harm consumers if adopted in a final rule since it would, in effect, serve as a stamp of approval for back-to-back lending and could undermine stronger state protections, particularly those states that limit interest rates through state usury laws. CFA has urged the Bureau to issue a rule that does not include exemptions to the ability to repay standard and that combines both prevention and protection measures.

Borrowers can and do turn to lower-cost, more sustainable financial options if abusive, back-to-back lending is restricted

A strong rule would not unduly reduce access to safe and sustainable credit options. Instead it would ensure that all lenders, including storefront and online lenders, are only issuing loans that a borrower can repay without entering into a long-term cycle of debt.

In 2012, the Pew Charitable Trusts issued a report examining how borrowers would manage their financial options if high-cost payday lending was unavailable. The report found that 81 percent of borrowers that used payday loans would cut back on expenses. Borrowers also indicated that they would borrow from family or friends or sell or pawn possessions instead of taking out a high-cost payday loan. Likewise, 44 percent indicated that they would take a loan from a bank or credit union, 37 percent would use a credit card and 17 percent would borrow from an employer.⁹

A strong rule based on an ability to repay standard that applies to the entire payday and auto title market would serve the dual purpose of preventing widespread, well-documented abuses and giving borrowers the option of turning to lower-cost and more sustainable credit options as they already do in states that do not allow payday and auto title lending. While the proposal as currently structured may ultimately limit the number of back-to-back loans, this should be viewed as a dramatic improvement in a marketplace where over 80 percent of all loans are followed by another loan just days or weeks later.

2. Additional Regulations are Needed to Protect Service Members from Financial Abuse

The Department of Defense is currently considering modifying the rule implementing the Military Lending Act. The proposed rule, if adopted, would protect Service members from the loss of security clearance, involuntary force separation and financial insecurity as a result of using high-cost payday, auto title and other loans made with no consideration of the Service members' ability to repay. The proposed rule closes a number of well-documented loopholes created by the initial rules implementing the Military Lending Act and is supported by over 180 consumer, community and civil rights groups,¹⁰ 22 state Attorneys General,¹¹ members of The Military Coalition¹² and others.

The Department of Defense recognizes the harm caused by payday, auto title and other high-cost loans and has previously stated that "predatory lending undermines military readiness, harms the morale of

⁹ *Payday Lending in America: Who Borrows, Where They Borrow, and Why*. Washington, DC: The Pew Charitable Trusts, July 2012. http://www.pewtrusts.org/~media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf.

¹⁰ Comment letter submitted to the Department of Defense available at http://www.consumerfed.org/pdfs/1412122_DoD_RIN-0790-AJ10_nationalandstate_letter.pdf

¹¹ Comment letter submitted to the Department of Defense available at <http://1.usa.gov/1IXQvWO>

¹² Comment letter submitted to the Department of Defense available at <http://1.usa.gov/1FGxOJF>

troops and their families, and adds to the cost of fielding an all-volunteer fighting force.”¹³ In 2013, the Department of Defense also described payday lending as “the biggest, current financial challenge facing our Service members, Veterans, and their families.”¹⁴

Loopholes in the current rule implementing the Military Lending Act put Service members’ financial security at risk

In 2006, Congress passed the Military Lending Act (MLA) as part of the John Warner National Defense Authorization Act of 2007. The MLA was enacted to protect active-duty Service members and their dependents from high-cost loans and other predatory credit practices that adversely impacted their military readiness. The MLA caps total interest and fees at 36 percent and bans harmful credit product features such as: renewals and refinances that do not benefit the borrower; forced arbitration; prepayment penalties; use of checks, vehicle titles or other automatic methods of access to the borrower’s bank account; and requiring repayment by allotment as a condition of the extension of credit.

As part of the Military Lending Act, Congress authorized the DoD to define the scope of consumer credit and creditors covered by the MLA. The DoD subsequently issued its rule defining “consumer credit” that took effect on October 1, 2007 and applied the Act’s protections only to closed-end payday loans of \$2,000 or less with a loan term of 91 days or less, closed-end vehicle title loans with a loan term of 181 days or less, and tax refund anticipation loans. These narrow definitions were easily evaded by lenders who modified products to fall outside the rule’s scope by either lengthening the loan term or structuring the loan as an open-end line of credit. For example:

- ***400 percent Title Installment Loan*** - A South Carolina lender made a vehicle title loan to a Service member on June 24, 2011 on a 13 year old car. The loan amount was \$1,615 to be repaid in 32 months with \$15,613 in interest at a 400 percent annual percentage rate. The title loan was exempt from the current rule’s scope as the loan term exceeded 181 days. The loan included a forced arbitration clause that would have been prohibited if the loan was covered by the MLA.
- ***584 percent Open-end Line of Credit*** - Prior to the enactment of the MLA, one military lender made traditional closed-end payday loans but then changed its product to open-end payday loans that are exempt from the current rule’s scope. A 2012 monthly activity statement discloses a “584.68 Annual Percentage Rate” on a loan balance of \$2,000, plus other fees.
- ***360 percent Online Installment Loan*** - A sailor borrowed \$500 from an online lender in 2012 and was charged \$523 in interest for a total repayment of \$1,024 for a loan over 140 days. Since the term of the loan exceeded 91 days the MLA protections did not apply.

¹³ *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*. Washington, DC: Department of Defense, August 9, 2006. http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

¹⁴ Testimony of Colonel Paul Kantwill, Director of Legal Policy, Office of the Undersecretary for Personnel and Readiness, Department of Defense before the Senate Committee on Veterans Affairs on July 31, 2013 available at <http://www.veterans.senate.gov/imo/media/doc/kantwill-7-31-13.pdf>

DoD has documented the harmful effects of payday, auto title and other products on Service Members

Recognizing that loopholes in the 2007 rules have allowed lenders to evade the MLA protections, Congress required DoD to issue a report to evaluate the impact of abusive credit on Service members' financial readiness. In April 2014, DoD issued their report, "Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents." The report included the results of a Service member survey and feedback from military financial counselors and found that 11 percent of enlisted Service members continue to turn to high-cost credit options. The report found that military financial counselors overwhelmingly reported that Service members would not be negatively impacted if access to high-cost credit was restricted. The findings suggested that applying the 36 percent rate cap on a product-by-product basis is unlikely to reduce the accessibility of high-cost and abusive credit. DoD concluded that an expanded and comprehensive definition of consumer credit would be a more effective approach to protect Service members from high-cost, abusive credit.

The proposed rule protects Service members by applying military financial protections to the entire high-cost credit market

The proposed rule closes the loopholes in the current rule by expanding the definition of consumer credit under the Military Lending Act to include products that are currently subject to the protections of TILA. Rather than taking a product-by-product approach, the proposed rule will prevent lenders from exploiting Service members by ensuring that high-cost products with abusive terms are covered by the protections established by the MLA regardless of the term of the loan or the loan's structure.

For example, the proposed definition of covered consumer credit would prevent lenders from structuring payday loans for longer than 91 days or larger than \$2,000 for the purposes of charging higher rates. It would also stop lenders from structuring auto title loans as longer than 181 days or issuing high-cost, open-end lines of credit with abusive features that are currently exempt. Likewise, the proposed rule would cover additional high-cost products that negatively affect a Service members' financial security, such as high-cost overdraft lines of credit and abusive installment lending.

The proposed rule also addresses widespread concern about the use of add-on products. It ensures that certain additional charges, such as single premium credit insurance, debt cancellation, debt suspension or other ancillary fees are included in the calculation of interest and are capped as part of the MLA's 36 percent interest and fee cap. Add-on products, such as insurance products, often serve as a way to increase revenue in states that restrict interest rates and significantly increase the total cost of borrowing beyond the disclosed annual interest rate.

While the proposed rule would also apply the MLA protections to credit cards for the purpose of preventing abusive lenders from using high-cost credit cards to avoid MLA protections, DoD provided important exemptions for bona fide, reasonable and customary credit card fees. Most credit cards in the marketplace would be excluded from the rule, and Service members that rely on these products to meet their credit needs would not be affected.

The proposed rule strikes an appropriate balance between access to credit and restricting access to high-cost abusive credit. The proposed rule provides a targeted restriction for credit products that have been shown to negatively impact Service members' financial security, and ensures access to lower-cost options such as the \$142 million in no-cost loans provided by Military Relief Societies in 2012.

3. Conclusion

Effective regulation of the lenders that offer high-cost payday, auto title and other loans is critical to protecting consumers and Service members from abusive practices and the financial insecurity that results from the sustained use of high-cost debt. The rules under consideration by the CFPB and DoD are the result of a comprehensive analysis of the high-cost credit marketplace and are the result of considerable research. They represent targeted responses that prevent bad practices so that good practices can flourish. We urge members of the subcommittee to carefully weigh the cost of compliance for lenders with the profound harm suffered by consumers and Service members that turn to high-cost credit to meet a short-term need only to learn that they often spiral into a long term problem.