

Safeguard Consumers from Risky Payday and Online Lending and Empower States to Enforce Credit Protections

April 26, 2012

Dear Representative:

We, the undersigned consumer and community organizations, are writing to alert you to the dangers of payday and online small dollar lending and to urge you to support legislation to protect consumers from costly high risk lending. An industry trade group representing internet payday lenders who offer triple-digit interest rate loans will be in Washington this week promoting a predatory loan product that leaves already-struggling consumers even worse off.

Payday loans are small loans secured by direct access to the borrower's bank account, either through a post-dated check or authorization to withdraw funds on the borrower's next payday. A survey of twenty payday loan websites by Consumer Federation of America last fall found that the typical loan costs \$125 to borrow \$500 for just two weeks, or an annual percentage rate of 652 percent. Loans of up to \$1,500 are available online.

Although payday loans are marketed as short-term credit, many borrowers become indebted over long periods of time, taking out one loan after the other. Payday lenders pay up to \$135 per qualified lead, while some offer a first loan at a steep discount or even for free, a sure indication that the loans are expected to result in long-term debts. According to research by the Center for Responsible Lending, over 75 percent of all loans are not used by borrowers to deal with an emergency need but are the result of "churning" trapped borrowers from one loan to the next each pay period. Academic research demonstrates that payday lending is harmful to borrowers' financial situation, increasing their risk of being seriously delinquent on credit card payments, of having trouble paying other bills, of having a bank account closed due to excessive overdraft fees, and even of filing for bankruptcy.

The mechanism by which payday loans are repaid permits lenders to "hijack" consumers' bank accounts. The majority of online lenders set their default payment arrangements to withdraw just the finance charge for three or four paydays before any reduction in the loan amount is collected. Under this repayment scheme, a \$300 loan would cost \$675 in finance charges for a total repayment of \$975 over a 20-week period. Some lenders even claim the right to extract payment from any bank account the borrower owns, not just the account listed on the loan application. Other loan contracts authorize lenders to create unsigned paper checks to withdraw payment from consumers' accounts, even when consumers exercise their rights under the Electronic Fund Transfer Act to stop electronic funds transfers.

Although all payday borrowers face significant harm because of the product's fundamental flaws—whether they obtain the loan at a local shop, bank branch, or in front of a computer—those who receive payday loans via the internet are at additional risk. Consumers have difficulty in distinguishing websites for lenders from lead generators that sell completed loan applications, including sensitive information, to the highest bidder. Borrowers supply bank account numbers, Social Security numbers, and other sensitive financial and personal information electronically via loan applications that are easy to transmit and to steal. Consumers from coast-to-coast have been harassed and threatened by fraudulent debt collectors who may be getting personal financial information from applications to marketers and lenders. The Federal Trade Commission (FTC) recently filed charges against two such companies, but officials have yet to stop the flow of personal information used by off-shore collectors to frighten consumers into making payments on loans they do not owe or do not owe to the callers.

Online lenders often hide behind anonymous domain registrations and do not provide complete lender information or physical addresses on their websites. Complaints about unauthorized withdrawals from accounts, coercive collection tactics, and inability to stop withdrawals from bank accounts are common. In the last few years, the FTC has brought several cases against lenders and marketers that use bank account information from loan applications to make unauthorized withdrawals from consumers' accounts to pay for other products or services.

Online lenders often try to evade state law enforcement and protections. Some do so by claiming to be located outside the United States and lending under the jurisdiction of a foreign country. For example, the Arkansas Attorney General filed a case this year against an online lender that claimed to be lending from the Caribbean island of Nevis, when in fact the lender's operation is based in the Kansas City area. The Minnesota Attorney General filed several cases against unlicensed illegal online lenders, as have many other state regulators and state Attorneys General. Since there is no federal usury cap and the Consumer Financial Protection Bureau is prohibited from setting one, it is essential that states are fully empowered to enforce state laws capping interest rates and fees to protect both consumers and fair competition among lenders.

A growing roadblock to consistent enforcement of state credit protections is the trend of online lenders partnering with Native American tribes to evade state enforcement under the claim of tribal sovereign immunity. States that are currently in court to enforce state rate caps against online lenders claiming tribal immunity include Maryland, West Virginia, Missouri, Colorado, and California. The FTC recently filed a federal case against a major online lender claiming tribal status, charging that network of companies with violation of Truth in Lending and the Electronic Fund Transfer Act.

Congress must resolve the debate over the use of tribal sovereign immunity by lenders that attempt to affiliate with a tribe or when tribes are directly making off-reservation loans. We urge Congress to act to stop online lenders from evading state enforcement through claims of tribal immunity.

We strongly urge you to support legislation that safeguards consumers' bank accounts from unscrupulous lenders and that requires all small-dollar lenders to comply with state rate caps and fee limits. High-cost lenders should not be allowed to claim tribal sovereign immunity by maintaining that states cannot enforce their consumer protection laws, when loans are made to non-tribal members outside a Native American reservation.

If you have any questions or would like further information, please contact Jean Ann Fox at the Consumer Federation of America at (928) 772-0674 or jafox@consumerfed.org.

Sincerely,

Consumer Federation of America
Consumers Union
Americans for Financial Reform
Center for Responsible Lending
National Association of Consumer Advocates
National Consumer Law Center
US PIRG
Arizona Consumers Council
Arizonans' for Responsible Lending Coalition
Center for Economic Integrity, Tucson AZ

Democratic Processes Center, Inc, Tucson AZ
Arkansans Against Abusive Payday Lending
Florida Consumer Action Network
Illinois Asset Building Group
KY Coalition for Responsible Lending
Kentucky Equal Justice Center
Raise Kentucky
NEDAP (NY)
NC Justice Center
Reinvestment Partners (NC)
Coalition of Religious Communities (UT)
Virginia Citizens Consumer Council
Virginia Poverty Center