

Statement of CONSUMER SERVICE ALLIANCE OF TEXAS

SAN ANTONIO CITY COUNCIL

Intergovernmental Relations Committee

November 10, 2010

Re: Proposed Resolution of the City of San Antonio to request that the Texas Legislature and Governor of Texas take action to compel payday and auto title lenders to stop usurious lending and comply with the same standards as licensed consumer lenders in Texas

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The Consumer Service Alliance of Texas (CSAT) is a trade association advocating for the protection of financial choice based on personal responsibility for Texas consumers. CSAT represents the interests of consumers and Credit Service Organizations (CSO) across Texas.

Credit Service Organizations provide retail financial products and services to Texas consumers. From stores in neighborhoods across the state, hard-working Texans have access to small, short term loans; money orders; pre-paid telephone and debit cards and other services to help them manage their finances.

One of the services a CSO provides is locating and securing an independent third-party lender for customers who need small, short term loans for immediate financial needs. CSOs do not provide loans to consumers. The small, short term loans are underwritten using the criteria of the unaffiliated third-party lender.

Many CSOs also help consumers improve and rebuild their credit ratings by providing the opportunity for the successful repayment of their loans to be reported favorably to the Payment Reporting Builds Credit (PRBC)[™] credit bureau.

The Consumer Financial Protection Bureau (CFPB) is the centerpiece of the recently enacted federal “Wall Street - financial industry reform” legislation. The CFPB was created to consolidate the responsibility for making consumer rules for financial products --- including home mortgages, student loans, small, short-term loans (including “payday and auto title loans”), credit cards, etc. --- under one federal agency.

The CFPB has:

- **Exclusive rulemaking authority** to prescribe rules to prevent “abusive practices” under every federal consumer financial law;
- **Exclusive examination authority** over consumer lenders and financial services providers; and
- **Exclusive enforcement authority** with respect to all consumer financial laws, subject to coordination with the Federal Trade Commission with respect to enforcement actions by each agency.

Elizabeth Warren, a Harvard Law School professor and recognized consumer advocate, has been appointed to launch the CFPB. Warren and her staff are currently hiring over 1,000 examiners and analysts.

One of the first CFPB priorities is collecting and analyzing detailed loan and financial product data from consumer lenders and financial services providers.

The law also requires the CFPB to create a nationwide consumer-complaint center.

The law also establishes a **government-backed loan loss reserve fund** to encourage banks to make small, short-term loans. A recent two-year FDIC pilot project proved banks cannot make small consumer loans profitably at 36% APR. The loss reserve fund will cover bank losses --- establishing a government subsidy for bank small loan programs. Congress is expected to appropriate \$7.5 million to start the fund. Certified Community Development Financial Institutions (CDFI) can access the fund. The law provides access to the loss reserve fund to banks and credit unions that partner with CDFIs.

1. A 36% rate cap on small, short-term loans will require a much larger government subsidy than the \$7.5 million (to “start” the loss reserve fund) contemplated by the new federal law. Taxpayers will be required to cover the losses incurred by banks and credit unions.

2. The Texas Legislature will face a substantial budget deficit when it convenes in 2011. State agencies were asked to reduce their budgets by 5% in 2010. State agencies have been asked to cut an additional 10% from their budgets for the next biennium (two year budget cycle).

Consideration should be given to carefully evaluating the responsibilities and priorities of the CFPB before recommending spending state tax dollars on duplicative activities.

3. Assertions that credit service organizations (CSOs) or the unaffiliated third-party lenders that make small, short-term loans are unregulated --- and therefore, unaccountable --- are false.

CSOs and the lenders must comply with an extensive array of federal and state consumer protection laws, including:

Texas Credit Service Organization Act (Texas Finance Code Chapter 393)
Texas Deceptive Trade Practices Consumer Protection Act
(Texas Business and Commerce Code Chapter 17)
Texas Constitution, Article 16
Texas Finance Code Chapter 302
Texas Business and Commerce Code, Article 9
Federal Truth in Lending Act
Regulation Z (12 CFR part 226)
Texas Debt Collection Practices Act (Texas Finance Code Chapter 392)
Federal Debt Collection Practices Act
Federal Equal Credit Opportunity Act
Regulation B (12 CFR part 222)
Federal Fair Credit Reporting Act
Regulation V (12 CFR part 222)
Federal Trade Commission Act
Federal Gramm-Leach-Bliley privacy laws
Federal Trade Commission Regulations (16 CFR parts 313 and 314)

4. A 36% APR cap on lender interest rates and CSO fees will eliminate the small, short-term loan industry in Texas.

On the surface, a 36% APR cap seems reasonable for loans of one to five years. But for small, short-term loans, a 36% APR cap equals \$1.38 of interest and fees on a two-week \$100 loan. **It is impossible to sustain a business lending money to strangers with financial emergencies if you can only charge them 10 cents a day.**

Annualized interest rates are appropriate for loans with long terms, but are nonsensical for loans with a two-week term. Equating the interest rates on loans with drastically different terms leads to absurd conclusions.

The Texas Mexican American Legislative Caucus reports Texans borrow \$2.5 billion dollars annually from CSOs and pay \$400 to \$500 million per year in interest and fees. Those figures represent a 16% to 20% annual return. This revenue *before expenses* is consistent with other retail stores in Texas. Net profits typically fall in the 6% to 11% range.

In other consumer transactions, short-term options cost more than long-term options, and no one is offended.

Is Holiday Inn a “predatory hotel” because it charges \$154 per night? Compared with the cost of a one year apartment lease, Holiday Inn’s \$4,620 per month looks outright extortionate. You can rent a studio apartment in most cities across America for about \$500 per month. Using the same rate and fee cap proposed for small, short-term loans, the \$154 room rate should be set at a maximum of \$16 per night. A \$16 limit would not technically be a ban, but the semantics would hardly matter to hotels driven out of business.

5. Providers of small, short-term loans do not charge usurious rates of interest.

The maximum rate of interest for a small, short-term loan is 10% per annum (Texas Constitution, Article 16).

CSOs assist consumers in obtaining small, short-term loans from unaffiliated, third-party lenders. These loan services are considered “costs of the loan” under the Federal Truth-in-Lending Act and are included in the finance charge and APR (annual percentage rate) disclosed to the consumer before the loan is made.

The fees are not usurious. Interest rates are subject to usury laws. Fees are not. Fees for financial services are determined by competition in the marketplace.

Fees charged by banks, credit unions and utilities are not limited or capped. They are determined by competition in the marketplace. Those fees are not, however, required by law to be disclosed to consumers in an APR calculation for comparison shopping purposes because they are not considered “costs of a loan”. They are the only realistic alternatives for consumers with an immediate financial need other than borrowing from family or friends.

The costs of realistic alternatives for short term credit expressed in terms of APR calculations are never discussed by those pushing for the elimination of the small, short-term loan market.

<u>14 day term</u>	<u>APR</u>
\$100 small, short-term loan with \$15 fee	391%
\$100 small, short-term loan with \$20 fee	521%
\$29 late fee on \$100 credit card balance	756%
\$100 utility bill with \$47 reconnect fee	1,225%
\$100 check with \$30 NSF charge and \$24 merchant fee	1,408%
 <u>10 day term</u>	
\$100 utility bill with 5% late charge after 10 days	1,825%
 <u>1 day term</u>	
\$100 ATM withdrawal with \$1.44 fee	526%

6. The CSO Act is not a loophole to evade state consumer lending laws. The Act is recognized by the courts as appropriate for small, short-term consumer credit.

The United States Fifth Circuit Court of Appeals ruled CSOs were authorized to offer financial products and services in retail stores across the state under Chapter 393 (the “CSO Act”) of the Texas Finance Code [Lovick v. Ritemoney, 378 F.3d 433 (5th Cir. 2004)].

Under the Act:

- A \$10,000 bond per store location is required.
- CSOs must register with the Secretary of State.
- CSOs must disclose all fees and charges for financial products.
- CSOs give every customer three days to change their minds without penalty or charge.
- Customers are entitled to actual damages, potential punitive damages, and attorneys’ fees in actions against CSOs for violations of the Act.
- Violations of the Act are also specifically subject to the Texas Deceptive Trade Practices Consumer Protection Act.

7. Consumers are protected from unfair and deceptive business practices.

A consumer may file a complaint against a CSO with the Federal Consumer Financial Protection Bureau, the Texas Attorney General’s Office, the Federal Trade Commission and against the bond on file with the Texas Secretary of State.

Customers are entitled to actual damages, potential punitive damages, and attorneys’ fees in actions against CSOs for violations of the Act. **Violations of the Act are also specifically subject to the Texas Deceptive Trade Practices Consumer Protection Act.**

8. Military servicemen and their families have access to low cost credit that is unavailable to the general public.

The military makes hundreds of millions of dollars of non-interest bearing loans to servicemen and servicewomen and their immediate families every year. The Army Emergency Relief (AER) is a tax exempt charity, funded primarily by troop donations, that provides emergency aid to servicemen and their families. The Navy, Air Force and Marines have similar charities.

The emergency financial aid --- in the form of non-interest bearing loans --- covers mortgage payments, food, car repairs, medical bills, travel to family funerals and similar expenses. The military also provides special incentive to servicemen to repay their loans by withholding promotions and transfers for those with an outstanding loan.

When small, short-term loans to the military were effectively banned by a 36% APR cap, servicemen and their families had another source of funds to turn to for their emergency financial needs. Who will provide millions in emergency funds for Texans if small, short-term loans are eliminated by a 36% APR rate and fee cap?