Testimony of Kerry Smith, Community Legal Services, Inc.
before the Pennsylvania House Consumer Affairs Committee
May 3, 2012

Chairman Godshall, Democratic Chairman Preston, and members of the Committee, thank you for holding this hearing and inviting me to speak about payday lending and our opposition to HB 2191, a bill that would codify the harms of payday lending in Pennsylvania.

Community Legal Services, Inc. ("CLS") provides free civil legal assistance to low-income Philadelphia residents. Throughout its history, CLS has committed substantial resources to protecting consumers from exploitation in the credit marketplace. We have filed affirmative lawsuits against predatory lenders, and provided assistance and representation to victimized borrowers.

In my role as a Staff Attorney in the Homeownership and Consumer Law Unit at CLS, I have seen the significant negative effect that payday loans have on low- and moderate-income borrowers. Today I will share with you what we've learned about how predatory loans entrap borrowers in a long-term cycle of debt and how Pennsylvania law already effectively regulates these loans whether offered online or not. I also will discuss how provisions similar to those in HB 2191 have failed to stop the payday loan cycle. In short, HB 2191 worsens the very problem it claims to solve.

HB 2191 Creates a Payday Loan Debt Trap

Payday loans are marketed as short-term, two-week loans for an occasional unexpected expense. The industry says that the borrower simply takes out a loan with high fees and interest, pays it back with their next paycheck, and walks away. Unfortunately, payday lending very rarely works this way. In fact, it only works this way about 2% of the time.[1]

The reality is: payday loans are an abusive form of lending that traps financially vulnerable borrowers into a long-term cycle of debt. As allowed under HB 2191, the loan product itself is structured to create repetitive borrowing. A payday loan requires a single balloon payment of principal and triple-digit interest rates over a very short period of time. The loan is secured by direct access to a borrower's bank account, either by post-dated check or electronic debit—which means the payday lender always gets paid back first, before the mortgage company or landlord, before the electric company, and before the childcare provider or any other creditor. As a result of this loan structure, the typical borrower is unable to pay it back and still have enough money to cover their regular expenses until the next payday. Borrowers then have to quickly re-borrow against their future income just to make it to the end of the month, at which point they'll face the same financial crisis all over again. This is the debt trap cycle, and HB 2191 codifies all of the toxic terms of the payday product into state law, allowing them to be made in store and over the internet to Pennsylvania residents.

Pennsylvania Laws Already Prevent the Payday Loan Debt Trap

Pennsylvania has reasonably regulated small loans for more than a century. HB 2191 would gut the long-standing statutes that limit annual interest rates on small loans to 6% for unlicensed lenders and to about 24% APR for lenders licensed by the Banking Department. The

Commonwealth's Supreme Court, Attorney General, and Banking Department, have continuously upheld the state's existing small loan loans. Pennsylvania's laws have withstood numerous attempts by payday lenders to evade consumer protections. Time and again, the courts have held that the purpose of the Commonwealth's usury laws is "to protect the citizenry of this Commonwealth from being exploited at the hands of unscrupulous individuals seeking to circumvent the law at the expense of unsuspecting borrowers."[2]

The out-of-state payday lenders pushing HB 2191 are notorious for attempting to evade Pennsylvania's strong usury law. These same payday lenders have attempted to circumvent existing law by offering illegal payday loans over the Internet, disguising loans as open lines of credit, and packing exorbitant fees into the cost of the loan. However, contrary to what the industry wants you to believe, this state and its courts have been very effective at keeping these illegal practices and loans out of Pennsylvania. Most recently, the Pennsylvania Supreme Court unanimously held that the state's usury laws prohibit Internet payday lending at rates above those allowed.[3] Cash America, one of the main proponents of HB 2191 and the payday lender at the center of the Supreme Court ruling, offered Internet-based payday loans at interest rates that ranged from 260% APR for a 35-day loan to 1140% APR for an eight-day loan.[4] The Court made clear that the laws apply to all lenders offering small loans, explaining that, "We... reject Cash America's attempt to avoid licensure, regulation and limits on the rates it may charge simply by operating over the Internet rather than being physically present in the Commonwealth. If an out-of-state lender is engaging in business in Pennsylvania of making [small loans]..., then it is subject to the licensing requirements and regulatory restrictions of [our small-loan law]."[5]

The payday lenders pushing this bill also suggest that HB2191 is needed to protect Pennsylvania residents against illegal Internet payday lenders partnering with Native American tribes. That is not so – state law already regulates Internet lending and state and federal regulators are fighting against any illegal practices. In the last year, the Federal Trade Commission has brought several lawsuits against payday lenders that are affiliating with Native American tribes to offer payday loans on the Internet. At least five states are currently in court to enforce state rate caps and other consumer protection laws against Internet lenders claiming tribal immunity, and the Consumer Financial Protection Bureau is also looking into the practice. In short, HB 2191 is not needed to protect Pennsylvania residents against this practice – current law is effective at protecting the state against illegal online payday lending.

Because payday loans are already effectively regulated, Pennsylvania consumers are protected from falling into the debt trap caused by payday loans. In the rare case when we have represented clients dealing with the effects of payday loans, whether obtained online or in another state, resolution of those issues has been relatively easy and straightforward because of our existing law. HB 2191 would increase prevalence of the harms caused by payday loans, and make them nearly impossible to resolve.

Provisions of HB 2191 Do Not Protect Consumers

In states with laws like HB 2191, the payday loan debt trap is the norm, not the exception. Provisions limiting rollovers, providing a one day "cooling off period", and extended repayment plan do not work to stop the cycle of debt as proponents of the bill would have you believe. For example, in Florida, which has a many of the same provisions included in HB 2191 already on the books, data from the state regulator show borrowers are stuck in an average of 9 loans per year, and payday lenders earn 60% of revenue from borrowers with 12 or more loans per year.[6] Data from Florida and other states with similar laws show that 76% of payday lender business is due to repeat borrowers.[7]

Payday supporters claim that "rollover bans" stop the cycle of debt. Data shows they do not. In Oklahoma and Florida, both states with cooling off periods and renewal bans, about half of re-opened loans in those states were taken out at the borrower's first opportunity, and almost 90% of new loans were made during the same pay period as the previous loan was paid off.[8] Despite these provisions, borrowers remain indebted for more than 200 days in a single year.[9]

Similarly, extended repayment plans have provided little effective relief for borrowers for various reasons. Significantly, states that collect data on repayment plan usage report that less than 3% of eligible transactions actually use the extended repayment plan option.[10] It is clear that the payday loan debt trap is not mitigated by the provisions of HB 2191 because at its core the bill legalizes a product that by its very design creates the debt trap.

HB 2191 Extends, Not Solves, Families' Financial Crisis

Finally, I would like to point out that payday loans put borrowers already living paycheck-to-paycheck in a worse financial situation than they were in before taking out a loan. Research shows that borrowers approved for a payday loan are 90% more likely to file bankruptcy than those denied a loan.[11] Payday loans also increase the chances that a household will experience financial hardship, have difficulty paying bills, and delay medical care.[12]

Contrary to what the industry says, payday loans are not better than overdraft fees or bounced check fees. Both products are predatory products. In fact, payday loans increase the burden of overdraft and bounced check fees on families because the loan is secured by access to a borrower's checking account. Every year, payday lenders collect millions of dollars of bounced check fees from their own customers,[13] and research has shown that payday lending increases the odds that households ultimately lose their checking accounts due to repeated overdrafts.[14] These are very real consequences under HB 2191, as the bill allows for electronic debit authorization and automatic repayment of the payday loan to out-of-state and internet payday lenders.

These concerns are not hypothetical. In 2006, the U.S. Department of Defense examined the impact of payday loans on soldiers. After an in-depth study, they found that financial devastation was so great that it threatened soldiers' military readiness, and ultimately national security.[15] As such, President George Bush signed a law prohibiting the very loans that HB 2191 seeks to bring to Pennsylvania to be made to soldiers and their families. If these loans were found to be so harmful to our soldiers, then the same would be expected for those in much more vulnerable situations, such as seniors on fixed income.

Conclusion

While payday loans are marketed as a quick loan to address financial shortfalls between paychecks, they typically end up trapping borrowers in a cycle of long-term debt. Because payday loans are offered at triple-digit annual interest rates, with the entire amount due in two short weeks, borrowers who pay back their loan are often unable to meet their other obligations without taking out a new payday loan during the same pay period. This is the start of the debt trap, which can leave borrowers indebted to payday lenders for several months or years. HB 2191 codifies the debt trap design of payday loans, putting the financial well-being of Pennsylvania low- and moderate-income families, my clients, at risk. For these reasons, CLS and a growing coalition representing hundreds of consumers from across the state are opposed to HB 2191. I have attached to my testimony a letter to the Committee from a diverse coalition of stakeholders who are deeply concerned about the harms of legalizing abusive payday lending. We urge you to oppose the bill and keep predatory payday loans out of Pennsylvania.

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[1] Leslie Parish & Uriah King, *Phantom Demand: Short-Term Due Date Generates Need For Repeat Payday Loans, Accounting For 76% Of Total Volume* (Center for Responsible Lending July 9, 2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-dategenerates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html.

[2] *Smith v. Mitchell*, 420 Pa. Super. 137, 143 (1992) (emphasis in original).

[3] *See Cash America Net of Nevada, LLC v. Pa. Dep't of Banking*, 607 Pa. 432 (2010).

[4] *Id.* at 436.

[5] *Id.* at 451.

[6] *See Florida Trends in Deferred Presentment*, May 2010.

[7] Leslie Parish & Uriah King, *Phantom Demand: Short-Term Due Date Generates Need For Repeat Payday Loans, Accounting For 76% Of Total Volume* (Center for Responsible Lending July 9, 2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-dategenerates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html.

[8] *Id.*

[9] Leslie Parish & Uriah King, *Payday Loans, Inc: Short on Credit, Long on Debt* (Center for Responsible Lending March 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loans-inc.html

[10] According to regulator data, 0.42 percent of eligible transactions have employed a grace period in Florida; 2.4 percent of eligible transactions have gone into a payment plan in Michigan, and 1.8 percent of eligible transactions have gone into a payment plan in Oklahoma. *See* Uriah King and Leslie Parrish, *Springing the Debt Trap* (Center for Responsible Lending December 13, 2007), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf.

[11] In a recent study, economists Professor Paige Marta Skiba of Vanderbilt University and Professor Jeremy Tobacman of the University of Pennsylvania found that payday borrowers are significantly more likely to file for bankruptcy than similarly-situated people who do not use payday loans. Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* (Oct. 10, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215

[12] *See* Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market* (Jan. 3, 2009), *available at* http://www.kellogg.northwestern.edu/faculty/melzer/realcosts_melzer_01_03_09.pdf.

[13] See, e.g. Advance America, 2011 10K Annual Report.

[14] *See* Dennis Campbell, et al., Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures (Dec. 3, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=133587.

[15] U.S. Department of Defense, *Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents* (July 22, 2008), *available at* http://www.dcuc.org/PDF%20Files/Senate%20Report%20Final.pdf.

Oppose HB 2191 – Keep Predatory Lenders Out of Pennsylvania

To: Honorable Members of the House Committee on Consumer Affairs

May 1, 2012

Dear Representatives:

We write to urge you to oppose HB 2191 and keep predatory payday loans out of Pennsylvania.

HB 2191 explicitly authorizes predatory payday loans, at rates well above Pennsylvania's long-standing usury laws. Payday loans are an abusive form of lending that traps financially vulnerable borrowers into a long-term cycle of debt. These loans are short-term cash advances with extraordinarily high fees and interest. An average payday loan is about $300 and carries a fee of $46 which represents a **419% annual percentage rate (APR)** for a two-week loan, as would be allowed under HB 2191.

HB 2191 codifies the abusive terms of the product which perpetuate a long-term cycle of debt. While payday lenders market these loans as "short-term" or "emergency" loans, lending patterns demonstrate that these loans actually create a long-term debt trap. In fact, the loan product itself is structured to create repetitive borrowing. Payday loans typically require a single balloon payment of principal and interest over a very short period of time, and require access to a borrower's bank account as a condition of the loan. As result, most borrowers are unable to pay it back and still have enough money to pay for their other regular expenses. Borrowers then have to take out another payday loan shortly after just to make ends meet. This begins the debt trap cycle, and HB 2191 will make it legal, leaving no recourse to stop it.

According to a comprehensive report on payday lending conducted by the U.S. Department of Defense, "***The debt trap is the rule not the exception.***"[1] In the words of the CEO of Cash America International, one of the out-of-state companies pushing HB 2191, the debt trap is the core of the business model: ***"The theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is."***[2]

Payday lending at triple-digit interest rates has long been illegal under Pennsylvania law, regardless if those loans are made on-line or at a storefront. Unlicensed, small-loan lenders are limited to charging only

Organizations Opposing HB 2191

- AARP Pennsylvania
- Pennsylvania Council of Churches
- Pennsylvania AFL-CIO
- United Methodist Advocacy in Pennsylvania
- Housing Alliance of Pennsylvania
- Lutheran Advocacy Ministry in Pennsylvania
- Pennsylvania Interfaith Impact Network (PIIN)
- Pennsylvania Utility Law Project
- Pennsylvania PIRG
- Pennsylvania chapter of Nat'l Assoc. of Consumer Attorneys
- The Reinvestment Fund
- Advantage Credit Counseling Services
- CLARIFI Credit Counseling
- Community Housing Services
- Esperanza
- Just Harvest
- Community Legal Services
- Hill District Consensus Group
- Community Justice Project
- Homeownership Counseling Assoc. of Delaware Valley
- Public Citizens for Children and Youth
- Tabor Community Services
- United Way of Southeastern Pennsylvania
- Veterans Leadership Program of Western Pennsylvania

...and many more

6% interest annually and lenders licensed by the Banking Department may charge higher rates of about 24% APR. HB 2191 eviscerates this level playing field and allows payday lenders to charge up to 419% APR for a two-week loan of $300.

The Pennsylvania Supreme Court has upheld enforcement actions taken by the Banking Department to shut down illegal payday lending operations run out of store-fronts in the Commonwealth as well as those made over the Internet.[3] In its 2010 opinion against Cash America International's illegal online payday loans to Pennsylvania borrowers, the Court noted that *"[i]t is well established that public policy in this Commonwealth prohibits usurious lending, and this prohibition has been recognized for over 100 years."*[4]

Bill supporters say this is a necessary step to protect Pennsylvanians from predatory lenders, when in fact it is the exact opposite. HB 2191 does nothing more than open the door to unscrupulous practices that Pennsylvania has successfully fought to keep out of its borders. Bill supporters also claim it provides "consumer protections," such as renewal limits, a database, a cooling off period, etc. However, these are meaningless provisions which do not stop the debt trap. Data from other states with provisions and interest rates similar to HB 2191 reveal that payday borrowers are stuck in 9 transactions a year, typically taken out back-to-back, and 60% of payday revenues are due to borrowers with 12 or more loans a year.

We urge you to make every effort to stop this bill from passing. Recent academic research verifies the harm created by the exploitative design of the payday loan. Payday loans are a stepping stone to delinquency on other bills[5], bank account closures[6], and even bankruptcy[7]. In fact, payday loans caused so much harm to the finances of service members that Congress banned them because they threatened military readiness. Pennsylvanians are currently protected from these harms with our long-standing small loan laws.

HB 2191 would roll back our state's existing consumer protections which have been successfully enforced for years against the same companies which now lobby for this bill.

If we can provide you with any additional information, please contact Kerry Smith from Community Legal Services at 215-981-3724 or 215-680-0838 (cell), or any of the organizations listed below.

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[1] U.S. Department of Defense, "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents." Aug. 9, 2006, http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf

[2] Dan Feehan, CEO of Cash America, remarks made at the Jeffries Financial Services Conference, 6-20-07.

[3] See e.g, *Pa. Dept. of Banking v. NCAS of DE, d/b/a Advance America Cash Advance Centers*, 596 Pa. 638, 948 A.2d 752 (2008) (holding that the fees and interest Advance America charged on payday loans made in its Pennsylvania stores violated Pennsylvania's usury laws); and Consent Agreement and Order, *Pa. Dept. of Banking v. East Side Lenders LLC,* Docket 11-20020, available at http://www.portal.state.pa.us/portal/server.pt/document/1226744/east_side_lenders%2C_llc22112_pdf (ordering an Internet payday lender to pay a $150,000 fine to the Commonwealth, to issue refunds to borrowers and to cease making illegal payday loans to Pennsylvania residents).

[4] *Cash America Net of Nevada, LLC v. Pa. Dept. of Banking*, 607 Pa. 432, 449, 8 A.3d 282, 292 (2010) (holding that payday loans made over the Internet to Pennsylvania residents by Cash America were illegal under state law).

[5] A researcher from the University of Chicago, Brian T. Meltzer, found that access to payday loans increases the chances that a household will encounter hardship, have difficulty paying bills, or have to delay medical care or prescription purchases. Brian T. Melzer, The Real Costs of Credit Access: Evidence from the Payday Lending Market (Jan. 3, 2009), available at http://www.kellogg.northwestern.edu/faculty/melzer/realcosts_melzer_01_03_09.pdf.

[6] Payday lending also increases the odds that households will repeatedly overdraft and ultimately lose their checking accounts. Researchers from Harvard Business School analyzed involuntary bank account closures, which usually result from an account holder bouncing checks or overdrawing an account too many times. Using national data, the study found that payday loans are associated with an increase in closed bank accounts due to multiple overdrafts. Dennis Campbell, et al., Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures (Dec. 3, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873

[7] In a recent study, economists Professor Paige Marta Skiba of Vanderbilt University and Professor Jeremy Tobacman of the University of Pennsylvania found that payday borrowers are significantly more likely to file for bankruptcy than similarly-situated people who do not use payday loans. Paige Marta Skiba & Jeremy Tobacman, Do Payday Loans Cause Bankruptcy? (Oct. 10, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215