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COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA

BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

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Good afternoon, Chairman Neugebauer, Representative Clay, and other members of the Subcommittee. My name is Dennis Shaul, and I am Chief Executive Officer of the Community Financial Services Association of America (CFSA), the national organization for small-dollar, short-term lending, including payday loans. We are pleased to be here today to discuss the Consumer Financial Protection Bureau's rulemaking process for small-dollar, short-term loans.

Your hearing today takes a look at the Bureau's rulemaking from two important perspectives: its effect on state regulation of these practices, and its impact on consumers. CFSA is concerned with both of these elements, especially its potential impact on consumers. Over the last two decades, CFSA members have worked for and embraced reforms at the state level to achieve a range of specific credit products that will serve our customers well by answering their credit needs and affording them better consumer protection. The customer is at the center of everything we do, and we have a vested interest in seeing them succeed with our products. We believe the Bureau's current proposals will do very little in the way of enhancing consumers' financial well-being, and will cut off an important credit source for millions of Americans. Indeed, consumers will be worse off if these proposals were enacted in their current form.

The Community Financial Services Association of America

CFSA was created in 1999 as a national organization for small-dollar, short-term lenders committed to best business practices that balance strong consumer protections with access to short-term credit for millions of Americans. CFSA member companies represent more than half of all non-bank storefronts in the United States offering payday and installment loans and vehicle title loans, among many other valued financial products and services, and serving more than 19 million American households that use small-dollar, short-term credit as a tool to manage their personal and family finances.

CFSA member companies are licensed and regulated, and they adhere to a code of Best Practices (attached to this statement), which include full disclosure; compliance with all applicable laws; truthful advertising; appropriate collection practices; and pledge to take no criminal action against borrowers for bounced checks or failure to repay. Our members display a list of these 13 Best Practices in all their stores, and also provide consumer guides to all customers regarding the responsible use of small-dollar, short-term credit.

CFSA members fill a vital role in Americans' access to financial services. The FDIC estimates that 51 million Americans, or 20% of all households, are underbanked, and not served by traditional banking products. As many as 76% of Americans are living paycheck to paycheck, without resources to cover unexpected expenses or disruptions in income. Small-dollar, short-term loans of the type our members provide are an essential option for these households — one option among several, which may include incurring late fees, bouncing checks, or allowing services to be cancelled and reconnected at a later date. Compared to these alternatives, payday loans are often not only the most convenient but also the least expensive option.

Loans offered by CFSA members are simple, transparent, cost-competitive and regulated. Eliminating or restricting access to our members' products will not encourage new lenders to enter the marketplace, but rather will force consumers into alternatives that are more complex, less transparent, less cost-competitive and potentially unregulated.

Payday Loans in the Consumer Financial Marketplace

The typical payday loan is a two-week loan for a fee that varies according to state law, but averages $15 per $100 borrowed. The average amount of a payday loan is $355. These are small-dollar loans, typically used to meet expenses, such as a medical bill, rent, or perhaps a late car payment, when income flow is interrupted or additional expenses make the borrower short on funds.

To obtain a payday loan from one of our members, a borrower needs an active checking account, proof of regular income, and proper identification. The loan application process consists of submitting a simple form that contains Truth in Lending (TILA) disclosures and a personal check for the amount of the loan plus a fee. The lender advances the funds, but holds the check for an agreed-upon period (usually two to four weeks). At the end of that time, the borrower returns to the store with cash to redeem the check, or in some instances, the lender cashes the check.

More than 20,000 payday loan stores operate across the United States, making approximately $38.5 billion in loans annually to borrowers in 19 million households. The majority of these borrowers repay the loans on time, without needing to renew them.

Since payday loans emerged in their current form in the early 1990s, thirty-five states have set up licensing, regulatory and supervisory structures for these products. State laws include limits on the amount of an advance; maximum fees and interest rates; limits on the number of times a borrower can renew a loan; a right of rescission; and various additional disclosure requirements. State and federal laws also govern collection practices. In addition, some states have put structures in place to let customers repay these loans under a no-cost extended payment plan. These structures often mirror CFSA's Extended Payment Plan, as mandated by our Best Practices.

Individual states have taken different approaches to the regulation of payday loans, based on the specific needs of their consumers and markets. As each state has tried to strike its own balance between preserving access to small-dollar, short-term credit and enhancing consumer protections, they have learned from the experiences of other states. For instance, state laws differ in maximum loan amounts: all states set a ceiling, usually under $500, but many also tie the maximum loan amount to a percentage of the borrower's income. Some states limit consumers to one or two simultaneous loans. Indiana prohibits renewals, and requires a “cool-off” period of seven days after five consecutive loans. Florida and 13 other states have a statewide database that keeps track of borrowers. Utah allows loans for terms of up to 10 weeks, with a no-cost payment plan available once every 12 months.

Where states have chosen to effectively ban payday lending through the imposition of a rate cap that makes lending unprofitable, the evidence shows that consumers suffer. A study by the Federal Reserve Bank of New York found that both Georgia and North Carolina saw higher incidences of returned checks, bankruptcy filings and complaints to the Federal Trade Commission about collection practices after those states banned payday lending. Consumers who do not have access to payday loans turn to costlier sources of credit and often to the Internet, where lending may be entirely unregulated.

Payday lenders meet a need in the American economy that traditional lenders are unable or unwilling to provide. Banks that once provided small-dollar, short-term loans no longer do so. Banks find these loans unprofitable and unsustainable largely because bank’s personnel and real estate costs, the principal drivers of the cost of a payday loan, are much higher on a unit basis than that of a payday lender. The FDIC’s Small Dollar Loan Pilot Program, launched in 2008, set a 36% interest rate cap on small-dollar, short-term loans. However, participating banks quickly found that these loans were not practical or profitable. Furthermore, a recent national study commissioned by the American Bankers Association demonstrated that only one percent of banks surveyed currently offer small dollar loans of $500 or less.

In discussing the role of payday loans in the American economy, it is important to recognize that these loans are demand-driven products, and that the demand for these products reflects fundamental economic shifts. Thirty-one percent of Americans do not have a constant, predictable income source, according to a recent report from the Federal Reserve. The nature of credit in our consumer economy has changed over the past two decades. While credit is still a tool used to advance households socially and economically — through mortgages, car loans, student loans and the like — it is also, increasingly, a financial management tool for households struggling to keep afloat.

Payday loans, perhaps once used more often to meet emergency expenses, are now used to offset income disruptions as well. Households with two incomes may have once provided a financial cushion; today, however, two-earner households may also double a household's financial risk. Tools for managing this uncertainty may include overdrafts, late fees, and, yes, payday loans. The vast majority of funds borrowed through payday loans go directly to pay other debts. The availability of small-dollar, short-term credit is a benefit to the consumer that cannot easily be replaced, if at all.

CFPB Regulation of Short-Term, Small Dollar Loans

The Dodd-Frank Act of 2010 authorized the Consumer Financial Protection Bureau to regulate small-dollar, short-term loans, including payday loans. The Bureau has held several different field hearings on payday lending. The CFPB also opened its consumer complaint portal in late 2013, and more recently began to release monthly complaints reports, including data about payday lending practices. Bureau Director Richard Cordray has said that these complaints are the agency's "compass," helping the Bureau identify prioritize areas for action.

Of the hundreds of thousands of consumer complaints the Bureau has received, only 1.5 percent — 12,193, to be exact — have concerned payday loans. The CFPB's monthly updates also report that payday lending is the only industry area that has seen a regular DECREASE in consumer complaint submissions. Nevertheless, the CFPB is pursuing a course that will decimate the industry and leave consumers in need at the mercy of unregulated lenders. Charged with regulating payday loans, the Bureau released a rule outline of proposals in March 2015 that ignores a long history of legislative and regulatory work at the state level, and opts instead for an end to payday lending.

The CFPB's outline, which is still under review by its small business advisory panel, seems entirely disconnected from the reality of how consumers use payday loans, and how the states currently regulate these products.

The stated goals of the CFPB's proposals are to prevent borrowers from becoming trapped by insurmountable, unaffordable debt — the so-called "debt trap" — and to restrict harmful payment collection practices. While these are laudable goals, the CFPB's objectives are based on assumptions that are not valid and seem based on little to no evidence.

Despite nearly 20 years of experimentation and experience at the state level, the CFPB seems to have conducted no analysis of existing state regulatory structures or practices, and has offered no information about how its proposals would interact with state law. The CFPB's outline leaves no room for continuing state experiments or innovations.

Even more importantly, however, the CFPB seems to have conducted no cost-benefit analysis of payday loan products at all. The Bureau seems unaware that these products emerged because customers have urgent needs, and that those needs will not disappear even if the lenders offering those products do.

Any federal regulatory process should begin with a general welfare analysis that looks at how users of payday loans have been helped or harmed by the products. Field hearings and complaints have provided some anecdotal evidence, but the systemic statistical analyses we have seen, such as the New York Federal Reserve's study, argue against the Bureau's assumptions.

The CFPB seems to assume that the suppliers of payday loans push these products on uneducated and unwary borrowers who do not understand the nature of their obligations. Instead, the academic research on this question shows that the opposite is true. The need for these small-dollar, short-term loans is real. Where people cannot find these loans in their communities, they seek them out online. A majority of the states have recognized that payday loans are a demand-driven product, and have determined that these services ought to be available to their citizens.

The CFPB's duty is to balance access to credit with consumer protection, not cut off all access to credit. This is not the public policy outcome Dodd-Frank envisioned or requires, and it harms the consumer. Because the Bureau has not acknowledged the need for or the benefits of these small-dollar, short-term loans, they cannot effectively weigh the potential harm of fees, interest rates, and payment terms.

Addressing Ability to Repay

CFSA's members make loans with the expectation of repayment, and take steps to make sure that borrowers can repay. In developing and implementing our Best Practices, CFSA's members recognize that payday loans are not appropriate products for all borrowers, and that they can become inappropriate products for borrowers who have used them successfully in the past. Unfortunately, some borrowers do seek loans they will never be able to repay. Others customers borrow wisely, but become victims of adverse circumstances.

CFSA's members acknowledge the obligation to give these borrowers a solution. Where state law permits, CFSA's Best Practices provide for an extended payment plan for borrowers who are unable to repay their loans.

The Consumer Financial Protection Bureau's outline would impose an overly restrictive and unworkable new standard for the ability to repay. No available evidence justifies this new standard, which would require the lender to collect additional information from the borrower and make an underwriting decision that payday loans currently do not involve. These new underwriting requirements, combined with a proposed 60-day cooling off period and limits on additional consumer debt, would effectively end payday lending as it currently exists.

With responsible payday lenders out of the market, who will meet those borrowers' needs? Where will those borrowers go? Experience tells us that they will go online, and to lenders that operate outside regulatory structures and the boundaries of law. Borrowers, and those who seek to protect them, will find themselves in uncharted territory.

Moving Forward on Responsible Reforms

CFSA urges the CFPB to look closely at recent state initiatives to protect consumers while ensuring continued access to small-dollar, short-term credit. State laws in Indiana, Michigan, Utah, South Carolina, Florida and Kentucky, among others, enhance consumer protections while allowing responsible lenders to continue to offer credit. Any federal initiative should not only look to the states as models, but should also preserve the opportunity for states to experiment with new approaches to consumer protection and credit availability.

We also urge the CFPB to make its decisions based on empirical data rather than anecdotal information, and carefully weigh the real benefits of these products against their potential harm.

Since the CFPB opened its doors, the Community Financial Services Association and its members have stood ready to help inform and educate stakeholders about the industry and to assist with the rulemaking process. We remain dedicated to advancing financial empowerment for consumers, while supporting and encouraging responsible lending practices. Thank you for the opportunity to share our views. I look forward to any questions the Committee may have.

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA
A COMMUNITY OF RESPONSIBLE LENDERS

BEST PRACTICES FOR THE PAYDAY LOAN INDUSTRY

CFSA Members must abide by the following Best Practices:

1. FULL DISCLOSURE. A member will comply with the disclosure requirements of the state in which the payday advance office is located and with federal disclosure requirements including the Federal Truth in Lending Act. A contract between a member and the customer must fully outline the terms of the payday advance transaction. Members agree to disclose the cost of the service fee both as a dollar amount and as an annual percentage rate ("APR"). A member, in compliance with CFSA guidelines where they do not conflict with applicable federal, state or local requirements, will further ensure full disclosure by making rates clearly visible to customers before they enter into the transaction process.

2. COMPLIANCE. A member will comply with all applicable laws. A member will not charge a fee or rate for a payday advance that is not authorized by state or federal law.

3. TRUTHFUL ADVERTISING. A member will not advertise the payday advance service in any false, misleading, or deceptive manner, and will promote only the responsible use of the payday advance service.

4. ENCOURAGE CONSUMER RESPONSIBILITY. A member will implement procedures to inform consumers of the intended use of the payday advance service. These procedures will include the placement of a "Customer Notice" on all marketing materials, including all television, print, radio and on-line advertising, direct mail and in-store promotional materials.

5. ROLLOVERS. Members shall not allow customers to rollover a payday advance (the extension of an outstanding advance by payment of only a fee) unless expressly authorized by state law, but in such cases where authorized the member will limit rollovers to four (4) or the state limit, whichever is less.

6. RIGHT TO RESCIND. A member will give its customers the right to rescind, at no cost, a payday advance transaction on or before the close of the following business day.

7. APPROPRIATE COLLECTION PRACTICES. A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member's practice in this area.

8. NO CRIMINAL ACTION. A member will not threaten or pursue criminal action against a customer as a result of the customer's check being returned unpaid or the customer's account not being paid.

9. ENFORCEMENT. A member will participate in self-policing of the industry. A member will be expected to report violations of these Best Practices to CFSA, which will investigate the matter and take appropriate action. Each member company agrees to maintain and post its own toll-free consumer hotline number in each of its outlets.

10. SUPPORT BALANCED LEGISLATION. A member will work with state legislators and regulators to support responsible legislation of the payday advance industry that incorporates these Best Practices.

11. EXTENDED PAYMENT PLAN*. Each member will provide customers who are unable to repay a payday advance according to their original contract the option of repaying the advance over a longer period of time. Such an extended payment plan will be offered in compliance with any requirement in state law to provide an extended payment plan or, in the absence of such a requirement in state law, in compliance with the Best Practice "Guidelines for Extended Payment Plans." A member will adequately disclose the availability of the Extended Payment Plan to its customers in compliance with any requirement in state law for such a disclosure or, in the absence of such a requirement in state law, in compliance with the Best Practice "Guidelines for Extended Payment Plans."

12. INTERNET LENDING. A member that offers payday advances through the Internet shall be licensed in each state where its payday advance customers reside and shall comply with the disclosure, rollover, rate, and other requirements imposed by each such state, unless such state does not require the lender to be licensed or to comply with such provisions, or the state licensing requirements and other applicable laws are preempted by federal law.

13. DISPLAY OF THE CFSA MEMBERSHIP SEAL. A member company shall prominently display the CFSA Membership Seal in all stores to alert customers to the store's affiliation with the association and adherence to the association's Best Practices.

SUPPLEMENTAL GUIDELINES FOR MEMBER COMPANY IMPLEMENTATION OF CFSA BEST PRACTICES ARE INCORPORATED HEREIN BY REFERENCE AND ARE AVAILABLE UPON REQUEST.

** LAWS IN SOME STATES DO NOT PERMIT IMPLEMENTATION OF CFSA'S EXTENDED PAYMENT PLAN (EPP). CFSA IS WORKING WITH REGULATORS IN THESE STATES TO OBTAIN APPROVAL OF CFSA'S EPP AND WITH LEGISLATORS TO PROMOTE ITS ADOPTION INTO STATE LAW.*

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