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United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

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RANKING MEMBER

April 25, 2019

# Memorandum

**To:** Members, Committee on Financial Services

**From:** FSC Majority Staff

**Subject:** April 30, 2019, "Ending Debt Traps in the Payday and Small Dollar Credit Industry"

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The Subcommittee on Consumer Protection and Financial Institutions will hold a hearing entitled, "Ending Debt Traps in the Payday and Small Dollar Credit Industry," on April 30, 2019, at 2:00 p.m. in Room 2128 Rayburn House Office Building. This single-panel hearing will have the following witnesses:

- **Rev. Dr. Frederick Douglass Haynes, III**, Senior Pastor, Friendship-West Baptist Church
- **Kenneth Whittaker,** Southeast Michigan Organizing Director, Michigan United, former Payday Loan Consumer
- **Diane Standaert**, Executive Vice President and Director of State Policy, Center for Responsible Lending
- **Todd Ortique McDonald**, Vice President and Board Director, Liberty Bank & Trust Company, representing the National Bankers Association
- **Christopher Lewis Peterson**, John J. Flynn Endowed Professor of Law, University of Utah, S.J. Quinney College of Law, and Director of Financial Services and Senior Fellow, Consumer Federation of America
- **Garry Lacy Reeder II**, Vice President, Policy and Innovation, Center for Financial Services Innovation
- **Robert Sherrill**, CEO, Imperial Cleaning Systems
- **Diego Zuluaga**, Policy Analyst, Center for Monetary and Financial Alternatives, Cato Institute

Additional witnesses may be added.

## Overview

Short-term, small-dollar loans are consumer loans with relatively low initial principal amounts, often less than $1,000, and with relatively short repayment periods, generally for a small number of weeks or months. A payday loan is a form of small-dollar loan, typically due on the borrower's next payday. Payday loans are sometimes called cash advance or check advance loans. A car-title loan is another form of a small dollar loan where the borrower's vehicle serves as collateral for the loan. Small-dollar loans are provided by nonbank lenders, such as payday lenders and automobile title lenders. Banks and credit unions offer other forms of small-dollar loans through financial products such as credit cards, credit card cash advances, and checking account overdraft protection programs.[1]

As described below, research has shown that borrowers who take out payday and car-title loans may fall into a harmful debt-trap cycle with deceptively high interest rates. Some states have responded by imposing

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[1] *See* CRS Report R44868, Short-Term, Small-Dollar Lending: Policy Issues and Implications, by Darryl E. Getter.

various interest rate caps and other limitations on these harmful forms of small dollar loans. At the Federal level, there is a 36 percent interest rate cap for many consumer loans provided to active-duty servicemembers and their dependents. In addition, Federal regulators, like the Consumer Financial Protection Bureau (Consumer Bureau), have previously sought to further protect consumers through guidance and rulemaking, though recent proposals appear aimed to reverse some of these protections. This hearing will provide the Committee an opportunity to review these market and policy developments, and to consider legislative options that may better protect consumers.

**Consumer Impact of Payday and other Small-Dollar Loans**

Small-dollar loans are often used to cover a consumer's cash needs due to unexpected expenses or periods of inadequate income.[2] However, research has shown many payday and car-title loans can be harmful to consumers. According to one estimate, payday and car-title loans carry an annual percentage rate (APR) of 391 percent on average.[3] Many borrowers who take out payday loans roll them over when they come due and take out up to 10 such loans a year, and car-title borrowers generally refinance their loan up to eight times. One out of five car-title borrowers lose their car in repossession. Experts have noted that payday loans often target communities of color, military servicemembers, and seniors,[4] charging billions of dollars a year in unaffordable loans to borrowers with an average annual income of $25,000 to $30,000.[5]

Many payday and car-title loans not only undermine wealth-building opportunities for vulnerable communities, but also force people that are already struggling financially and underbanked into worse circumstances, including losing their bank accounts, vehicles, or even bankruptcy. According to the Center for Responsible Lending (CRL), payday loans cost over $4.1 billion in fees a year for those persons in states that allow triple-digit interest rate payday loans. Car title loans cost consumers over $3.8 billion in fees annually. Together, these loans cost consumers nearly $8 billion in fees every year.[6] CRL also estimates that in states that cap annual interest for these loans at 36 percent or less, consumers save over $5 billion in fees every year—$2.3 billion from payday lending, plus another $2.8 billion from car-title lending.[7]

**State Regulation of Payday Loans**

According to the Consumer Bureau, as of February 2019, 33 states permit payday loans, and 17 states and the District of Columbia either ban payday loans or have regulations that do not allow payday lenders to sustain their business models.[8] Of the states that permit payday loans, 10 states have binding laws regulating payday loans, which generally limit either payday loan size or rollovers, and may set caps in fees and interest rates (see Figure 1 below). Some cities and counties also have local ordinances relating to payday lending.[9]

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[2] According to the Federal Reserve, "Four in 10 adults in 2017 would either borrow, sell something, or not be able pay if faced with a $400 emergency expense." See https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-dealing-with-unexpected-expenses.htm.

[3] CRL, "The Debt Trap of Triple-Digit Interest Rate Loans: Payday, Car-Title, and High-Cost Installment Loans" (Mar. 20, 2019), https://www.responsiblelending.org/research-publication/debt-trap-triple-digit-interest-rate-loans-payday-car-title-and-high-cost.

[4] https://www.opploans.com/payday-news/who-do-payday-loans-target-and-why/

[5] 82 Fed. Reg. 54581.

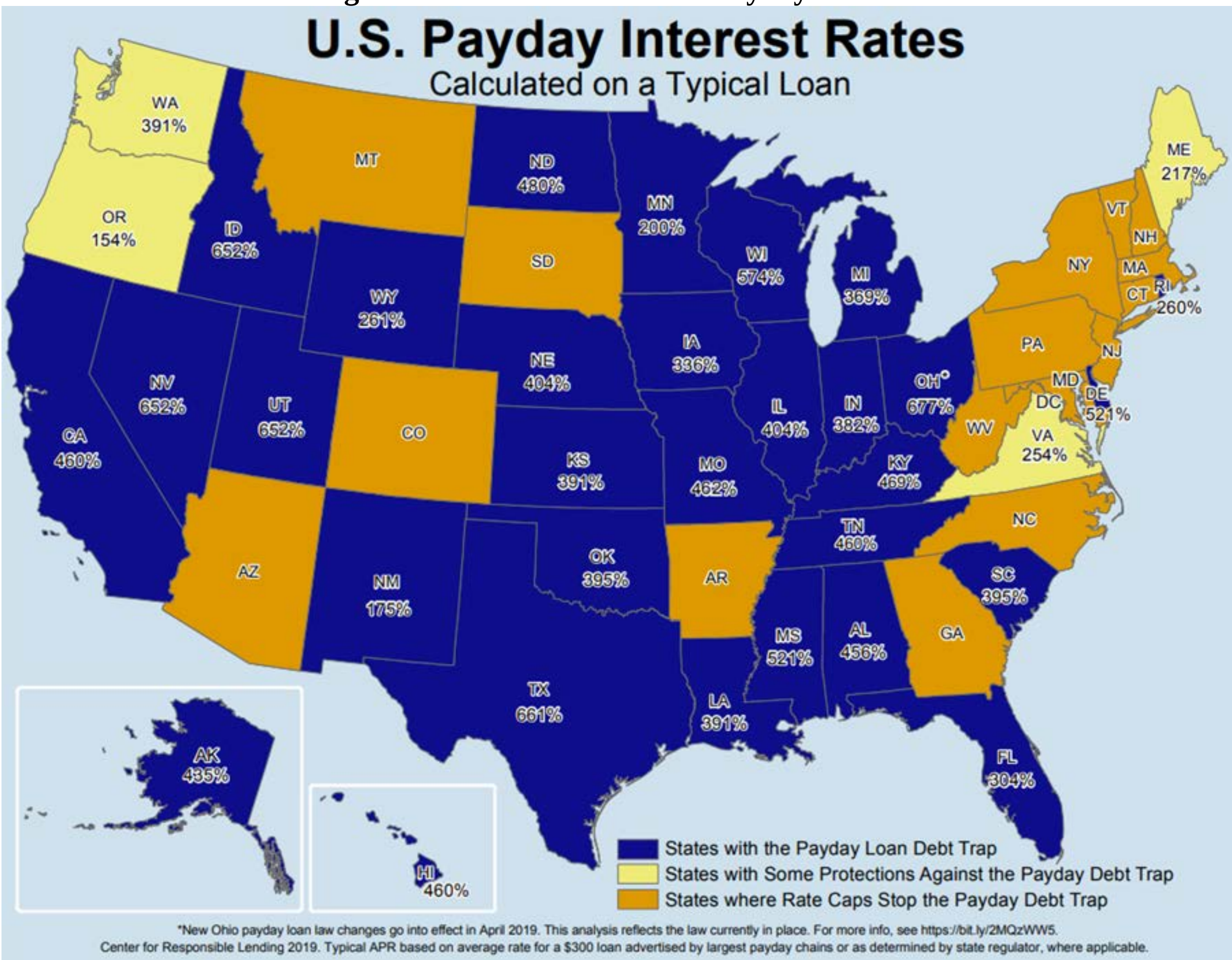
[6] Diane Standaert and Delvin Davis, Payday and Car Title Lenders Drain $8 Billion in Fees Every Year (Jan. 2017), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_statebystate_fee_drain_may2016_0.pdf.

[7] See *supra* note 3.

[8] According to the CFPB's proposed rule from February 2019, as of the date of the rule, p.32: CFPB, "Payday, Vehicle Title, and Certain High-Cost Installment Loans," 84 Federal Register 4252, Feb. 14, 2019.

[9] The National Conference of State Legislatures (NCSL) has compiled a list of payday lending laws by state. The list is current as of January 23, 2018 and can be found at: http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.

**Figure 1. State Limitations on Payday Loans**[10]




**Federal Policy regarding Payday and other Small Dollar Loans**

In 2006, Congress imposed an interest rate cap on many consumer loans, including payday products, for active-duty servicemembers and their dependents under the Military Lending Act (MLA).[11] The purpose of the law was to better protect military personnel from certain predatory lending practices, characterized by the Department of Defense in a congressionally mandated study as the use of deceptive marketing techniques to sell high-fee/interest rate, short-term, or installment loans, primarily to young and inexperienced military borrowers.[12]

The MLA's 36 annual percent interest rate cap was introduced as a bipartisan amendment by Senators Jim Talent of Missouri, and Bill Nelson of Florida, to the John Warner National Defense Authorization Act for Fiscal Year 2007.[13] The 2007 final rule implementing the MLA required that payday loans have terms of 91 days or less; that vehicle title loans have terms of 181 days or less; and that short-term small-dollar loans to military personnel be limited to a 36 percent annual interest rate, which is known as the military APR

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[10] Typical APR based on average rate for a $300 loan advertised by largest payday chains or as determined by state regulator, where applicable. Center for Responsible Lending, "Map of U.S. Payday Interest Rates," (Feb. 14, 2019), available at: https://www.responsiblelending.org/research-publication/map-us-payday-interest-rates.

[11] P.L. 109-364. For more information, see: CRS Insight IN10988, Military Lending Act: Rules, Enforcement, and Servicemember Financial Stability, by Kristy N. Kamarck.

[12] Department of Defense, Report on Predatory Lending Practices Directed at Members of the Armed Forces, August 9, 2006, http://archive.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

[13] P.L.109-364.

(MAPR). In 2015, the Department of Defense announced final rules to extend the MAPR to a wider array of products, including credit cards.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act[14] gave the newly established Consumer Bureau the authority to oversee payday lenders for the first time at the federal level,[15] but stipulated that the Consumer Bureau was not conferred authority to impose a usury limit on the extension of credit unless explicitly authorized to do so.[16] The Consumer Bureau has the power to supervise, bring enforcement actions, and regulate payday lenders. The Consumer Bureau also has the authority to use its unfair, deceptive or abusive acts and practices (UDAAP) authority to combat predatory products.

In 2013, the OCC, FDIC, and Federal Reserve issued supervisory guidance regarding the offering of deposit advance products by banks, in which they expressed concerns that the high costs and repeated extensions of credit could add to borrower default risks, similar to payday loans.[17] The guidance recommended that customers with impaired credit should not be eligible for this product, each deposit advance should be repaid in full before extension of a subsequent advance loan, and no more than one loan may be offered per monthly statement cycle. Most banks subsequently discontinued offering deposit advances.[18]

In October 2017, after 5 years of research, market supervision, field hearings across the country, and engaging stakeholders, the Consumer Bureau issued a proposed rule to rein in the debt traps caused by payday and car-title loans.[19] The Consumer Bureau received over one million comments from consumer and civil rights organizations, community groups, consumers, and industry, and issued its final rule in October 2017. The rule asserted that it is "an unfair and abusive practice" for a lender to make certain types of short-term, small-dollar loans "without reasonably determining that consumers have the ability to repay the loans." The rule, which mandated a loan be underwritten, exempted some short-term, small-dollar loans if made with certain loan features. The original compliance deadline for the rule is August 19, 2019.

In 2018 the Department of the Treasury issued a report calling for the Consumer Bureau to rescind the rule, and for bank regulators to issue guidance promoting small dollar lending.[20] Shortly after Director Kathy Kraninger was confirmed, the Consumer Bureau issued two proposed rules in February 2019 that would rescind the mandatory underwriting provisions before the 2017 final rule goes into effect, and would delay the compliance deadline by 15 months to November 19, 2020.[21] The proposal would maintain other provisions relating to protections for consumers paying back these loans. Furthermore, the OCC rescinded its deposit advance guidance in late 2017, and issued core lending principles for short-term, small-dollar lending in 2018.[22] The FDIC put out a request for comment on small-dollar lending in November 2018.[23]

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[14] P.L. 111-203.
[15] 12 U.S.C. §5513.
[16] 12 U.S.C. §5517. For more information on the payday loan market and its regulation, see CRS Report R44868, Short-Term, Small-Dollar Lending: Policy Issues and Implications, by Darryl E. Getter.
[17] *See* http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-69.html, http://www.fdic.gov/news/news/press/2013/pr13105a.pdf; and https://www.federalreserve.gov/supervisionreg/caletters/CA13-07attachment.pdf.
[18] *See* Danielle Douglas, "Wells Fargo, U.S. Bank to End Deposit Advance Loans, Citing Tougher Regulation," January 17, 2014, at https://www.washingtonpost.com/business/economy/wells-fargo-us-bank-to-end-payday-loans-citing-tougher-regulation/2014/01/17/b65f0512-7f82-11e3-93c1-0e888170b723_story.html.
[19] Consumer Financial Protection Bureau, "Payday, Vehicle Title, and Certain High-Cost Installment Loans," 82 Federal Register 54472, Nov. 17, 2017.
[20] https://home.treasury.gov/news/press-releases/sm447.
[21] https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-releases-notices-proposed-rulemaking-payday-lending/ and https://www.washingtonpost.com/business/2019/02/06/cfpb-proposes-weakening-obama-era-payday-lending-rule-win-industry/?utm_term=.9bc9f208036d.
[22] https://www.occ.treas.gov/news-issuances/bulletins/2018/bulletin-2018-14.html.
[23] https://www.fdic.gov/news/news/press/2018/pr18084.pdf.

**Legislative Options regarding Payday and other Small Dollar Loans**

There are several legislative actions the Committee and Congress could consider to provide additional protections to consumers and to promote responsible short-term lending products:

- Discussion Draft of Protecting Consumers from Debt Traps and Unreasonable Rates Act. This draft, based on legislation sponsored by Senators Durbin and Merkley and Representatives Cartwright and Cohen in prior Congresses,[24] would impose a 36 percent usury APR cap for all open-end and closed-end consumer credit transactions, including mortgages, car loans, overdraft loans, car title loans, and payday loans. The bill would permit initial application fees and the recovery of ongoing lender costs, such as insufficient funds fees and late fees. The proposal would not preempt stricter state laws, and it would create specific penalties for violations of the cap and allows for enforcement through civil courts and by state Attorneys General.

- H.R.1285, the Improving Access to Traditional Banking Act of 2019, introduced by Rep. David Scott, would establish in the Consumer Bureau the Office for Under-Banked, Un-Banked, and Underserved Consumers. This office would, in part, periodically study and report on barriers for individuals and families that do not participate in the traditional banking system, coordinate with other agencies, and develop strategies to increase participation in the traditional banking system.

- Fund Small Dollar Loan Program. Subcommittee Chairman Meeks led a letter to the Appropriations Committee requesting $10 million to fund Dodd-Frank's Small Dollar Loan Program, which is administered by the Community Development Financial Institutions Fund (CDFI Fund). Joined by several other Members, this letter promotes the prioritization of Section 1206 of the Dodd-Frank Act, which authorized the CDFI Fund to provide financial assistance for the creation of loan loss reserves to support small dollar loan offerings among CDFIs, including certified banks and credit unions. The program has never been funded but would help individuals build credit, access affordable capital and enter the mainstream financial system.

[24] https://www.durbin.senate.gov/newsroom/press-releases/durbin-merkley-cartwright-cohen-introduce-bicameral-bill-to-crack-down-on-predatory-lending-practices.