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ENDING DEBT TRAPS OR RESTRICTING ACCESS TO SAFETY NETS? INITIAL REACTIONS TO THE CONSUMER FINANCIAL PROTECTION BUREAU'S LENDING PROPOSALS

MAY 6TH, 2015 OVERSIGHT HEARING

SUMMARY REPORT

SECTION ONE

HEARING FINDINGS AND SUMMARY OF WITNESS TESTIMONY

INTRODUCTION

On May 6th, 2015, the California Senate Banking and Financial Institutions Committee convened an oversight hearing to solicit feedback on payday and installment loan proposals recently released by the federal Consumer Financial Protection Bureau (CFPB). The hearing was titled, "Ending Debt Traps or Restricting Access to Safety Nets? Initial Reactions to the Consumer Financial Protection Bureau's Lending Proposals."

The proposals that formed the basis for the hearing were released by the CFPB on March 26th, 2015, in advance of a future CFPB rulemaking intended to provide greater protections for consumers who take out payday loans, high-interest rate installment loans, and car title loans. Full text of the proposals is available at http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf.

Once finalized, the CFPB regulations will have a significant impact in California. Statewide, they are likely to affect over 12 million payday loans, totaling over $3.1 billion annually, and over 500,000 installment loans, totaling approximately $1 billion annually. The new rules will not require legislative or congressional approval to become effective; instead, they will become operative automatically following the conclusion of CFPB's rulemaking.

Because the CFPB's rulemaking will have such a significant impact in California, and because the CFPB is actively soliciting feedback on its preliminary proposals, the Senate Banking and Financial Institutions convened a hearing designed to help Committee members, interested members of the public, and the CFPB understand the potential impacts of the CFPB proposals on California consumers, California businesses, and the California economy as a whole.

Key questions addressed by the witnesses included the following:

- How many Californians will the proposals help?
- Will Californians who are caught in endless cycles of debt be able to escape those debt traps, if the proposals are enacted?
- How many Californians will the proposals hurt?
- Will Californians who currently rely on payday or installment loans have anywhere to turn when they need money, if the proposals are enacted?
- Will California lose any jobs if the proposals are enacted?
- How, if at all, should the proposals be modified to better achieve their intent?

Sixteen invited witnesses, testifying across four panels, provided input on those questions, and offered specific recommendations regarding which aspects of the CFPB's proposals can be implemented as drafted, and which will require modification in order to be workable.

Chairman Marty Block convened the hearing at 1:35 PM and adjourned it at 4:45 PM. The hearing was held in Room 112 of the State Capitol. It was available for viewing on Senate television and via a live webcast streamed from the California State Senate's home page. Five Committee members attended the hearing, as well as the Chair of the Assembly Banking & Finance Committee. Members attending the hearing included:

Senator Marty Block, Chair
Senator Andy Vidak, Vice Chair
Senator Ben Hueso
Senator Cathleen Galgiani
Senator Mike Morrell
Assemblymember Matt Dababneh

This report contains the staff summary of the testimony provided (Section One), reproduces the written material provided by hearing witnesses and others that chose to submit comments to the Committee (Section Two), and reprints the hearing agenda and the background paper (Section Three). An archived video of the hearing is available on the Committee's website at http://sbnk.senate.ca.gov/hearings. Copies of this final paper are available for download on the Committee's website or in hard copy at no charge from the Committee in Room 405 of the State Capitol.

KEY FINDINGS

During the course of the hearing, the Committee heard consensus from witnesses on four general points, described immediately below. There was, however, considerable disagreement on the finer aspects of these points and on many other issues.

Both Short-Term and Longer-Term Loans Should Be Underwritten

Consumer advocate witnesses were unanimous in their views that all covered loans, both short-term and longer-term, should be underwritten to evaluate a borrower's ability to repay those loans. Consumer advocates favor the types of underwriting envisioned by the CFPB proposals, as they believe that lenders should consider a borrower's income *and* expenses, using verifiable information.

Lenders were also unanimous in agreeing that all loans must be underwritten. Lenders look not only at a borrower's ability to repay, but also at a borrower's willingness to repay his or her loan. There is considerable variability in ways in which different lenders underwrite their borrowers. Many of the lenders that testified use proprietary underwriting models that do not rely on the types of verifiable income and expense information the CFPB is considering requiring; instead, the lenders' proprietary models tend to focus on alternative sources of information, much of which is "big data analytics"-driven.[1] The alternative data sources utilized by many lenders can

[1] "Big data" is an evolving term, which refers to extremely large data sets that can be mined for information. "Big data analytics" is the process of examining these large data sets to identify

be less time-consuming and less expensive to obtain than the types of information the CFPB is considering requiring, and can, in the minds of the lenders, be equally as predictive of borrower behavior as the more traditional underwriting methods the CFPB proposals envision.

Online lenders lean particularly heavily on big data to vet borrowers; these lenders are not only evaluating a borrower's ability and willingness to repay, but are also verifying the borrower's identity to minimize the likelihood of fraud.

Some lenders voiced concern that the CFPB's traditional approach to underwriting would discourage the development and use of innovative new underwriting models that rely on big data. Many lenders believe that technology holds great promise for vetting borrowers, and want to ensure that new rules do not preclude development and use of these data-driven tools.

The Debt Trap Protection Options Are Not Workable As Proposed

As discussed immediately above, consumer advocates believe that all covered loans, both short-term and longer-term, must be underwritten to evaluate a borrower's ability to repay those loans. Because of this view, the consumer advocates did not favor the debt trap *protection* alternatives contained in the CFPB's proposals, which do not require underwriting, but instead focus on limiting repeat borrowing and limiting borrowers' debt load. Consumer advocates believe that some elements of the debt trap protection alternatives could be paired with up-front underwriting to form the basis for an acceptable regulatory scheme, but the debt trap protection alternatives, viewed alone, are unacceptable, because they do not require income and expense underwriting.

Lenders of all types and sizes agreed with the consumer advocates that the debt trap protection alternatives were unworkable, albeit for very different reasons than those offered by the consumer advocates. In the short-term (e.g., payday) lending space, lenders observed that the debt trap protection alternative would require them to turn certain customers away, if those customers had reached their pre-determined loan frequency maximums. The idea that a business would be required to turn away a loyal customer, and be unable to direct that customer to alternate sources of credit, was very problematic for the short-term lenders.

In the longer-term installment loan space, lenders expressed concern that the maximum allowable loan lengths in the debt trap protection alternative were too short and the maximum allowable loan amounts in that alternative too small to adequately address consumers' needs. In addition, the proposal's prohibition against extending a loan to a borrower whose loan payment exceeds 5% of that borrower's gross income is likely to exclude a significant number of otherwise-qualified borrowers.

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hidden patterns, previously unknown correlations, market trends, customer preferences and other information that can be useful to the entity performing the analysis.

Pre-Emption Issues Must Be Clarified

Possible pre-emption issues will arise in two key contexts: states' rights and Native American tribal sovereignty issues. With respect to states, clarity will be needed from the CFPB regarding the extent to which the regulations, once finalized, will pre-empt state lending laws versus the extent to which the regulations will form a regulatory floor, beyond which states are free to go, if they wish. California's lending regulator and the consumer advocates that testified strongly favor the latter option (i.e., that the CFPB's regulations form a regulatory floor and do not pre-empt state laws that are more protective of consumers).

With respect to tribally-affiliated lenders, clarity will be needed around two key questions. First, will the CFPB regulations, once finalized, apply to lenders that affiliate with Native American tribes to offer short- or longer-term covered loans? Second, if so, what entity or entities will have the power to enforce those regulations over tribally-affiliated lenders?

Evasion of the Rules Must Be Minimized

Nearly all of the lenders that testified expressed concern that a significant number of borrowers will lose access to sources of credit that are currently available to them, if the CFPB proposals are enacted in a form similar to what is being proposed. Consumer advocates are hopeful that borrowers who are denied for loans under the new regulatory scheme envisioned by the CFPB will figure out ways to make due, without taking out loans they cannot afford. These advocates envision that borrowers may be able to seek out loans from family or friends, pawn some of their possessions, reduce their expenses, and/or seek out social service safety nets to help bridge their gaps between income and expenses.

However, if borrowers who are denied loans under the new regulatory scheme turn to lenders that are outside the regulatory reach of the CFPB and states, many of the benefits sought by the CFPB and the proposals' supporters will not be realized. Borrowers in many cases will be worse off, because they will lose the consumer protections they are currently afforded under state lending laws. Both lenders and consumer advocates agree that the rules will not achieve their intent, if widespread evasion of those rules is possible. There is, however, no consensus around how best to minimize such evasion.

STAFF SUMMARY OF WITNESS TESTIMONY

The summaries that follow are intended to provide readers of this final report with a brief review of the main points raised by each witness. They are not intended to substitute for the archived hearing video, available on the Committee's website, nor for the written testimony in Section Two.

OPENING REMARKS

Chairman Block convened the hearing at 1:35PM. After welcoming the Members in attendance, he thanked all of the witnesses and audience members for attending, and welcomed attendees

who were watching the hearing on Senate TV or via the live webcast being streamed from the State Senate's home page.

Once the CFPB finalizes its new payday and installment lending rules, those rules will apply in California and in every other state across the country. California may choose to conform to the new rules or go beyond them to be more protective of consumers, but we will not be able to reject them.

The CFPB's proposals have the potential to impact billions of dollars in loans made annually to millions of California consumers who rely on them, and thousands of people employed by the lenders that make those loans. We may decide to weigh in on the proposals before the CFPB issues proposed regulations, or may wait until proposed regulations are issued before weighing in.

The Committee and the Legislature as a whole need to better understand the potential impacts of the proposals on California consumers, California lenders of all sizes, and on the California economy.

Before inviting witnesses to testify, Chairman Block explained how the hearing would be organized. The first two panels (Brian Sala, introducing the proposals, and Commissioner Jan Owen, discussing potential state regulatory impacts resulting from the proposals, would each be allotted ten minutes). Committee Members would be asked to hold their questions until the end of each panel, and questions from Committee Members would not count against the time allotted for witness testimony.

The next two panels would each be allotted fifty minutes, with equal time (25 minutes each) given to the witnesses offering consumer perspective and the witnesses offering industry perspectives. Member questions would be held until the end of each 25-minute segment.

Chairman Block concluded his opening remarks by observing that some of the invited witnesses participated as small entity representatives on the CFPB's Small Business Advisory Review Panel in late April. The Committee is extremely fortunate to be hearing from people who were invited to offer their opinions on the proposals to the CFPB. However, the Committee will gain an even deeper understanding of the potential impacts likely to result from the proposals than the CFPB was able to achieve through its Small Business Advisory Review Panel, because the witnesses invited to testify during the oversight hearing represent a more diverse group, with a much broader set of perspectives, than those who addressed the CFPB through its Small Business Advisory Review Panel effort.

PANEL ONE: INTRODUCTION TO THE PROPOSALS

Brian Sala, Acting Director, California Research Bureau (written testimony included in Section Two)

Mr. Sala's remarks focused on three areas: 1) where we are in the federal regulatory process, 2) the significance and structure of the payday loan market in California, and 3) the major features of the CFPB's proposals.

Where we are in the federal regulatory process: On March 26th, 2015, CFPB Director Richard Cordray announced that the Bureau was publishing an outline of regulatory proposals on payday and installment lending. That announcement preceded a late April convening of the Small Business Advisory Review Panel and included an invitation to stakeholders and other interested parties to provide input and feedback before the CFPB proceeds to a formal Notice of Proposed Rulemaking.

Because the CFPB has not yet formally proposed a rulemaking, its rules and policies regarding *ex parte* communications do not yet apply. Any interested party may provide written or oral comments to the CFPB regarding a rulemaking proposal not yet released, without those comments entering the public record. Furthermore, the CFPB is under no obligation to consider or take into account such pre-rulemaking comments in its Notice of Proposed Rulemaking or any subsequent Final Rule. Once a Notice of Proposed Rulemaking is published, the CFPB will begin accepting on-the-record public comments on the proposed rules.

California's payday loan market: In 2013, 1.7 million California consumers borrowed $3.1 billion in payday loans through 12.2 million transactions. The average customer took out 6.8 loans. However, because the Department of Business Oversight (DBO) reports data by licensee and not by borrower, 1.7 million consumers is an upper bound on the true number of unique borrowers. The true number is likely less, as there is likely some overlap in customers across licensees.

In 2013, California Finance Lenders Law (CFLL) licensees issued 908,000 consumer loans totaling $39.5 billion. Sixty-nine percent of those loans were for amounts below $5,000, but 96% of the dollar amount was for loans above $10,000. CFLL loans below $5,000 tend to be unsecured loans; in contrast, CFLL consumer loans over $10,000 are predominantly secured, either with real property, automobiles, or auto titles.

Major features of the CFPB's proposals: Because Mr. Sala's written testimony is included in Section Two of this report, and the CFPB's proposal is described in detail in the background paper prepared for this hearing (Section Three of this report), a summary of this aspect of Mr. Sala's testimony is not included here.

PANEL TWO: POTENTIAL STATE REGULATORY IMPACTS RESULTING FROM THE PROPOSALS

Jan Owen, Commissioner, Department of Business Oversight (written testimony included in Section Two)

Commissioner Owen opened by observing that she and her fellow state regulators do not always agree with the CFPB, but they appreciate and respect the Bureau as a valuable new partner in achieving a common objective: ensuring that the crucial consumer finance market remains safe and healthy for consumers and businesses.

The title of the oversight hearing alludes to the balancing act that financial services regulators must perform every day. They must protect consumers, but also make sure that they do not unduly impede consumers' access to capital. DBO (the Department) will withhold judgment on the CFPB's proposal until the Department has something more fleshed out to consider.

In some ways, California law is stricter than what the CFPB is proposing; in other ways, the CFPB framework is stricter; in still other ways, the two (California law and the CFPB proposals) differ in approach. As just one example of the latter point, the CFPB proposals give lenders a choice of how to comply; California's payday loan law and CFLL do not provide lenders with those types of compliance options.

Commissioner Owen will be closely monitoring developments at the CFPB as the framework evolves into a formal set of rules. One issue that will be near the top of her watch list is how any rules that are ultimately adopted will affect California law. The Commissioner wants to make sure that the CFPB regulations do not pre-empt California's laws, where our laws are stricter than the CFPB rules. So far, CFPB officials have indicated that any rules they adopt will co-exist with and not pre-empt state laws. That sounds like they're heading in the right direction. But, there is a long way to go, and DBO will remain vigilant to make sure the rules end up in the right place.

In response to questions from the Chair, Commissioner Owen added the following:

DBO has not yet decided whether to weigh in on the proposed regulations. The Department may submit its own comments or may withhold submitting its own letter and instead join in with other regulators on a letter submitted by the trade association representing state regulators.

Once the CFPB's regulations are finalized, Commissioner Owen will not automatically have the authority to enforce those regulations in California. The Legislature will have to grant her that authority.

Senator Galgiani asked about whether the small dollar loan pilot program has been successful. Commissioner Owen indicated that her department will be issuing a report summarizing the results of that program in July of this year. To date, approximately 200,000 pilot program loans have been made. There are six pilot program lenders, and the department is reviewing an

application for a seventh. The Commissioner is also encouraging CFLL licensees that are not yet members of the pilot program to consider applying for it.

Senator Galgiani asked if the Commissioner is concerned that companies might leave California if the CFPB's proposals are enacted, leaving fewer options for people who need access to credit. Commissioner Owen doesn't believe that will happen. Thirty-five percent of Californians are unbanked or underbanked. There's an incredible market in California. We need to get the law right so more people will have access to capital and to the financial products they need.

PANEL THREE: INPUT FROM INTERESTED PARTIES REGARDING THE SHORT-TERM COVERED LOAN PROPOSAL

CONSUMER PERSPECTIVES

Paul Leonard, Director, California Office, Center for Responsible Lending (written testimony included in Section Two)

According to Mr. Leonard, the data are clear that payday loans result in real debt traps for a large proportion of borrowers. CFPB data show that 80% of payday borrowers re-borrow within two weeks of obtaining a payday loan. Center for Responsible Lending (CRL) data show that the typical borrower is in debt for seven months out of every year. DBO data show that 76% of all loans go to borrowers who take out seven or more loans per year; 60% go to borrowers go to borrowers who take out ten or more loans per year. The CFPB's main goal with its proposal is to break the debt trap associated with this frequent reborrowing.

CRL believes that imposing an ability-to-repay requirement on lenders is a critical protection for borrowers, because lenders hold first-in-line access to the borrower's bank account. The lender is not relying on the borrower's ability to repay, but instead on the lender's ability to collect from that borrower through access to the borrower's account, whether or not the borrower can actually afford to repay the loan.

CRL encourages the CFPB to eliminate the debt trap *protection* option, because it does not include an ability-to-repay component. The organization strongly believes in universal application of ability-to-repay requirements, a component of the debt trap *prevention*, but not the debt trap protection option. In addition to required underwriting, CRL sees other aspects of the debt trap prevention option as favorable, as well. For example, CRL strongly supports the elements of the debt trap prevention option that restrict short-term loan flipping and the 60-day cooling off period for borrowers who have taken out three loans in a sequence.

Finally, CRL believes that the 90-day indebtedness limitation (a component of the debt trap *protection* option) should be imposed in addition to the ability-to-repay requirement, not offered as an option in lieu of it.

Liana Molina, Organizer, California Reinvestment Coalition (written testimony included in Section Two)

The California Reinvestment Coalition (CRC) associates itself with the views of CRL in connection with the CFPB's short-term covered loan proposal. Ms. Molina described the experiences of a borrower named Carmen, who was harmed by payday and installment loans she took out over the course of several years. Ms. Molina used Carmen's story as an example of why lenders should be required to assess a borrower's ability to repay all loans, factoring in their income, expenses, and debt obligations, as well as their borrowing history.

CRC believes that California needs tools to enforce existing state law and the CFPB's proposed rule, both of which limit consumers to one loan at a time across all lenders. Too many people like Carmen are in over their heads with multiple loans they cannot afford and shouldn't have been given in the first place.

Finally, if the CFPB sets forth a 90-day indebtedness limit and provides protections around lender collection practices (as proposed), it will prevent people like Carmen from falling into perpetual debt that strips them of their hard-earned income, impedes their ability to save, forces them out of the financial mainstream, ruins their credit, and creates a lot of stress and anxiety for them and their families.

Leslie Bailey, Staff Attorney, Public Justice

Public Justice is a national public interest law firm that brings impact cases against corporate abuses on behalf of low-income consumers. The firm has represented consumers across the country in several cases against payday lenders and has obtained millions of dollars in refunds for borrowers whose lenders charged them illegal fees and interest. Ms. Bailey believes that the CFPB's proposal is a good thing for California consumers, because California law does not always adequately protect consumers or enable them to get their money back when they are cheated.

This is because payday lenders have a long history of finding loopholes that allow them to evade state laws intended to protect consumers. The latest loophole being exploited in a way that is harming consumers involves partnerships between lenders and Native American tribes. Lenders are seeking out tribes in an attempt to borrow the tribes' special legal status. Lenders will approach a tribe and offer the tribe a token percentage of their profits in exchange for entering into an agreement, which is drafted up to make it look as if the tribe owns and controls the lending business, when in reality the lender is funneling the profits from the lending away from the tribe.

The agreement is set up in this way so that, if there is a lawsuit, the lender can persuade a court that it is a part of the tribe and is entitled to tribal sovereign immunity. Courts around the country are grappling with this issue. It can be very difficult to decide who is a true tribal lender and who is operating under a rent-a-tribe model. With the rent-a-tribe model, it's hard to see any benefits accruing to the tribes; the lenders are benefitting, not the tribes. Furthermore, many payday borrowers are tribe members.

Ms. Bailey believes that the CFPB proposals will level the playing field. Borrowers will be protected wherever they borrow, whether it is from a tribal lender, online, or from a brick-and-mortar lender.

Ms. Bailey concluded by imploring the CFPB not to include any carve-outs for any groups, including tribes, from its CFPB rulemaking. Any loophole that is left by the CFPB will be exploited by payday lenders, as has been the case for many years. If the CFPB wishes to recognize tribes' special legal status in its regulations, it should apply the regulations to tribal lending and empower the tribes to enforce the regulations on behalf of their borrowers.

Ted Mermin, Executive Director, Public Good Law Center (written testimony included in Section Two)

The Public Good Law Center has been involved in cases involving the financial products covered by the CFPB's proposals, including one now pending before the California Supreme Court. When the CFPB indicated it was planning to issue new rules in the area of payday lending, Mr. Mermin tried to keep an open mind, and surveyed his colleagues about their clients' experiences, to see how payday borrowers and short-term auto title loan borrowers had benefited from their loans, and to gauge the potential impact of the CFPB's proposed rules.

None of the borrowers whose stories were related to him by his colleagues were helped by their loans. Instead, the borrowers, some of whose stories Mr. Mermin related to the Committee, were harmed by their loans in ways they would not have been, if the CFPB's rules had been in place. Prohibiting concurrent short-term loans from multiple lenders would have helped Maria Gonzales from Oakland. Requiring that both income and a borrower's ability to repay their loan be verified in the case of short-term auto title loans would have helped Ralph Simpson from San Francisco.

To sum up the results of his survey, Mr. Mermin quoted a colleague from the East Bay Law Center, who said: "I have never seen a payday loan solve someone's problem. I have seen people hurt by payday loans. I have saved those people from being evicted because of them. I have heard clients talk about not having enough money for food because of them. And the cycle of taking out more loans to pay the interest is never-ending. It takes a toll on people."

The CFPB's new rule should set a floor above which states are free to go. States should be free to impose rules that are more protective of consumers than the CFPB rule, if they choose.

Mr. Mermin also believes that the CFPB should beef up the privacy protections in its rule, to ensure the security and privacy of borrowers' personally identifiable information and financial information. As drafted, the CFPB's proposals do not address those issues, but should.

QUESTIONS AND ANSWERS (Consumer Perspectives, Short-Term Covered Loan Panel)

Chairman Block asked Mr. Leonard and Ms. Molina where they would suggest consumers go, if the consumers need money, and they are unable to obtain a short-term covered loan as a result of

the new rules. Mr. Leonard and Ms. Molina believe that borrowers who do not qualify for a short-term covered loan have both credit and non-credit options available to them. On the credit side, consumers who are turned down for a short-term covered loan could seek out a small dollar installment loan from a pilot program participant, pawn one or more of their possessions, seek out a loan from family or friends, or reach out to their creditors and negotiate a reduction in their debt load. At some point, however, when people are over-extended, credit is not necessarily the answer. On the non-credit side, these individuals could do without, seek out a food bank, or seek out referrals for other types of social services.

Chairman Block asked Ms. Bailey if she believes that the CFPB proposals apply to tribes. Ms. Bailey responded in the affirmative. The Dodd-Frank Act, which created the CFPB, is a law of general applicability. Dodd-Frank applies, unless an exception applies. There are three possible exceptions that could apply, but none does in this case. The CFPB proposals will not interfere with a tribal government power internal to the tribe (exception one) or abrogate rights established by a treaty to which the tribe is a signatory (exception two). Furthermore, there is no evidence that Congress expressly intended to exclude tribes from enforcement of the law (exception three). Because none of those three exceptions applies, Ms. Bailey believes that tribes will be covered by the new regulations.

Senator Galgiani asked Mr. Leonard if the credit union associated with his organization (Self-Help Credit Union) charges bounced check fees. Mr. Leonard is not familiar with the specifics of Self-Help's fees, but believes that Self-Help's bounced check fee is about $20. Senator Galgiani suggested that repeated bounced check fees could act as a debt trap, as well. Mr. Leonard suggested that there was no continuous ongoing obligation associated with a bounced check (as can be the case when a borrower falls into a debt trap in connection with a loan) and that Self-Help offers financial counseling to its members.

Senator Morrell asked Mr. Leonard what the default rate is on payday loans. Mr. Leonard responded that if one looks at the default rate on a loan-by-loan basis, the default rate is fairly low – in the single digits. But, if one tracks borrowers who take out payday loans over a period of time, data from other states shows that 30% to 50% of borrowers who take out payday loans experience at least one default over a two-year period.

Senator Morrell asked Ms. Molina, "When a person takes that first payday loan, what are they using it for?" Ms. Molina responded that a lot of people use their loans for regular necessities. Senator Morrell followed up by referring to Ms. Molina's testimony, in which she claimed that payday loans strip away consumer's assets, and wanted to know what she meant by assets. Ms. Molina replied she meant a borrower's income, savings, and their car, if it's a short-term car title loan.

Senator Morrell asked Mr. Leonard if he was concerned that consumers unable to obtain credit under a new regulatory regime, yet in need of money, will go to loan sharks and illegal, online lenders to borrow. Mr. Leonard responded that the CFPB is creating a single federal floor for all sources of loans, and he hopes that the Bureau comes up with means of addressing transactions occurring over the Internet, wherever those transactions are based. Mr. Leonard agreed with Senator Morrell that we can't simply leave the Internet to be a place of lawlessness. However,

Mr. Leonard believes that federal regulators have resources at their disposal with which to crack down against illegal activity, if illegal lenders are using our banks and financial networks to help facilitate those transactions.

Assemblymember Dababneh followed up on Mr. Mermin's remarks and offered his opinion that it was an overstatement to say that no one had ever benefitted from a payday or a car title loan. He then asked witnesses to look beyond the federal proposal and offer their opinions on what California should be doing to educate consumers when they take out a payday loan. Ms. Molina and Mr. Leonard agreed that better consumer disclosures would help. For example, before they take out a payday loan, payday borrowers should be warned about the likelihood that they will take out multiple payday loans, which can result in their paying more than one fee. Ms. Molina also observed that, in some jurisdictions, payday lenders are required to offer their borrowers a local resource list of social service providers, which can be helpful.

Assemblymember Dababneh asked the consumer advocates to look into how many of the consumers of these products have a credit card they could have used, instead of taking out a short-term covered loan.

Assemblymember Dababneh also asked if payday borrowers would be better served if they could borrow more than California currently allows. Mr. Leonard split the question into two different groups of people: 1) repeat borrowers, and 2) borrowers with multiple simultaneous loans. Repeat borrowers would not have been better served; allowing them to borrow more would simply allow them to dig themselves a deeper hole. Rather than looking at the size of the loan, we should also look at the structure of the loan, which is just as important. We should get away from requiring the entire amount borrowed to be repaid at once (a balloon loan) and move to an installment loan underwritten based on ability to repay. That would better serve borrowers.

Senator Vidak observed to Mr. Mermin that he was a very satisfied payday customer several years ago, so, like Assemblyman Dababneh, he believes that some people do benefit from payday loans. Mr. Mermin responded that he was quoting a colleague who works for a legal service provider, and that they tend not to see satisfied customers.

INDUSTRY PERSPECTIVES

Dan Gwaltney, President, California Financial Service Providers (written testimony included in Section Two)

The California Financial Service Providers is a trade association whose members offer a variety of financial services, including check cashing, deferred deposits (i.e., payday loans), installment loans, pawn, debit cards, and money transfer services. Mr. Gwaltney participated as a small entity representative on the CFPB's Small Business Advisory Review Panel in late April, 2015.

Mr. Gwaltney stated that short-term, small dollar loans such as California's payday loan product are popular, because they are simple, easy-to-understand, and convenient for the customer. The Bureau's proposed changes will eliminate these features. The ability-to-repay rules that are part of the Bureau's short-term debt covered loan proposal will require payday lenders to run a "Big

Three" credit report, perform lengthy verifications of a borrower's major obligations, and report loan transactions to all commercially available reporting systems. These requirements will make applying for a payday loan no different than applying for a car or home loan. Applicants will be burdened with cumbersome paperwork requests. Certain customers who are cash-based and cannot document their expenses will be locked out.

The Bureau's proposal also fails to take into account lenders' cost to underwrite all applicants. Lenders will incur costs to underwrite all consumers that apply for loans, not just those consumers who are approved to borrow. For this reason, each funded loan will have to provide sufficient revenue to offset the cost to underwrite those applicants who aren't approved. Given the average size of a payday loan in California, and factoring in the additional labor, documentation, and verification costs, the underwriting requirement being proposed by the CFPB is not financially viable.

Furthermore, the underlying premise of the Bureau's proposal is that payday loan customers do not gain any economic benefit from the liquidity provided by the use of these loans. However, the Bureau has not provided any scientifically-based analysis of this claim, as is required by law.

The Bureau is also attempting a one-size-fits all approach, which is failing to take existing state law consumer protections into account. Payday borrower experiences in one state may differ dramatically from one another, something that is not factored into the Bureau's proposal.

If customers are experiencing tremendous difficulties with this form of credit, one would expect to see a high level of complaints. That is not the case. Out of 12 million California payday loan transactions last year, the CFPB received only 510 complaints.

The effect in California if the CFPB's proposals are enacted will be dramatic. Small businesses will go out of business. Over 90% of the 297 licensed payday lenders in California are small businesses. Both the Bureau's analysis and an independent analysis of small payday lenders performed by Charles River Associates show that the proposal will have enormous impacts on small businesses. Mr. Gwaltney's business is just one example. His business' 93 employees will need to look for new jobs, its 25 landlords will have vacant storefronts, and its thousands of customers will lose access to financial services they need. Similar effects will be experienced by California's other 280 licensed small lenders.

Finally, Mr. Gwaltney observed that the effect of the proposed rules on California customers will be dramatic, as well. The CFPB has not taken into consideration the lack of other small dollar loan alternatives in California. When most of the $3 billion in payday loan credit becomes unavailable, many customers will simply lose access to legitimate lenders and turn to the unregulated black market.

Mr. Jabo Covert, Senior Vice President for Government Relations, Check Into Cash (written testimony included in Section Two)

Check into Cash operates 175 stores in California, with over 500 employees. It offers a range of consumer financial services through those stores, including short-term, small dollar loans.

Mr. Covert observed that, since its creation through enactment of the Dodd-Frank Act of 2010, the CFPB has established nearly 400 new regulations and imposed more than $20 billion in new compliance costs on the financial industry. These regulations have weighed more heavily on small businesses and banks; smaller entities cannot absorb the new compliance costs as easily as their giant rivals. Many of Dodd-Frank's costs have been passed on to consumers in the form of higher fees and reduced services. Meanwhile, the Federal Deposit Insurance Corporation (FDIC) estimates that the number of unbanked consumers in America rose by one million from 2009 to 2011, and that usage of payday lending and other alternative financial services increased during the same time frame.

The Dodd-Frank Act has continually pushed customers out of existing products, and away from traditional financial services. Now, the CFPB is considering rules that may, yet again, move these customers away from another set of existing, legitimate products and into more uncertainty.

Mr. Covert echoed Mr. Gwaltney in demanding that the CFPB conduct fact-based research establishing that payday loans and short-term car title loans harm consumers before promulgating regulations to rein in those types of lending. To date, the CFPB has not conducted this research, and has ignored other research which supports the conclusion that short-term credit products enhance the welfare of consumers.

According to the FDIC, more than 40 million households lack access to traditional banking services. For these households, financial services, like payday, installment, or title loans are among their best options when they need credit. Over 14 million households annually rely on alternative financial services outside the traditional banking system. Consumers and communities will not be helped by rules that will end access to a legitimate credit option and, at the same time, put thousands of small businesses at risk, along with the jobs of their employees.

The new rules do nothing to decrease the demand for credit. The ability to choose among options is at the heart of the free market enterprise system. Consumers are not served if protections are so overreaching that they have no options or access to credit. When legal choices are restricted, people turn to illegal choices.

Carol Stewart, Senior Vice President, Advance America (written testimony included in Section Two)

Advance America has over 260 locations in California and employs over 750 Californians. The company offers a variety of consumer financial services in California, including payday loans.

Ms. Stewart told the Committee that the CFPB has failed to address the most critical question: if these rules are implemented, what happens when a consumer with an urgent financial need walks into a payday lending center and can't get the credit they need, when they need it? Arbitrary limits on access to credit will push borrowers to alternatives that are either more expensive or have fewer consumer protections. In California, there is no legal, viable loan option other than a payday loan for consumers who want to borrow less than $2,500.

The Federal Reserve Bank of New York studied what happens when short-term credit options are unavailable to consumers. In states where payday lending is effectively banned, the Federal Reserve Bank of New York study found that consumers bounced more checks, complained more about lenders and debt collectors, and filed for Chapter 7 bankruptcy at a higher rate than in states where payday loans were available. The outcomes seen in the Federal Reserve study are the inevitable effects of the CFPB's proposed rule.

Furthermore, the proposed rules do not create a level playing field among similar, competing products. Instead, they will create winners and losers in the marketplace. Winners will be the banks that offer more expensive alternatives to consumers, such as credit cards and overdraft programs, which some borrowers may turn to in the absence of payday loans. The government doesn't tell consumers they have to wait between credit card transactions or between uses of their overdraft protection program, despite the often unclear terms, hidden fees, and higher costs associated with these competing credit products.

The other big winners from the CFPB's proposal will be the illegal and unlicensed lenders that operate in the shadows, and which prosper and benefit wherever regulated payday lending is restricted or banned. As California's DBO knows, even if one unlicensed web site is shut down, it reopens quickly under another name. The proponents of the CFPB's proposals are well-heeled activists who have never had to use payday loans to make ends meet and think payday borrowers can't make informed financial decisions on their own.

The big losers under the CFPB's proposal will be consumers, who will lose an effective, popular option for managing financial challenges. The proposed rules show that the Bureau does not understand Advance America's customers, their needs, or the rational decisions they make to use payday loans to manage episodic financial challenges.

States like California will also lose, because they will no longer be able to regulate payday loans as they see fit. Laws that have been crafted and debated over decades will be usurped by shortsighted and overbearing federal regulations.

Finally, small businesses will lose. The proposed rules will immediately destroy small businesses and subject larger operators to a slow death.

Robert Grieser, Senior Vice President of Governmental Affairs, Community Choice Financial (written testimony included in Section Two)

Community Choice Financial offers alternative financial services through a network of 547 retail storefronts across 15 states, including 160 branch locations in California. The company offers payday loans and installment loans above $2,500 in California. It operates through brick-and-mortar stores with the store names California Check-Cashing and Cash One and online through a subsidiary called Cash Central of California. The company employs approximately 950 Californians.

Mr. Grieser began his career as a financial regulator in Ohio. As a former regulator, he is a strong proponent of state regulation of retail credit. He believes it is important that states maintain their roles as the primary regulators of consumer loan products.

Although the CFPB proposal will present many problems for his industry and the financial marketplace, most troubling is that the proposals will severely reduce the availability of credit for the average middle-class American.

The CFPB proposal will result in fewer legitimate, regulated, short-term credit choices for consumers at a time when government should be working to improve and increase regulated alternatives. Consumers ought to have the ability to make the best choices for their own personal situations.

A 2013 study conducted by the FDIC found that 60 million adults in the United States are either unbanked or underbanked. Further limiting credit choices and credit availability to this population is not the direction we should be moving.

Consumers will, without a doubt, continue to seek and find credit where they can. There are many unregulated, illegal options available to consumers in need, and these options will fill the gap, if regulated, legitimate options do not exist.

QUESTIONS AND ANSWERS (Industry Perspectives, Short-Term Covered Loan Panel)

Chairman Block asked the panelists if any of their companies will shut their doors in California if the CFPB's rules are enacted in a form similar to what is proposed. Mr. Gwaltney cited a study that looked at the impact of the CFPB short-term covered loan proposal on eight small payday lenders. That study found that the CFPB rules would render 84% of the stores maintained by those small lenders unprofitable. Speaking on behalf of his company and the small companies that are a part of his association, Mr. Gwaltney explained, "We can't operate a business at a loss. There are other products we offer, but in California specifically, because we can't profitably offer loans installment loans in amounts below $2,500, we're left without options."

Ms. Stewart responded that the CFPB proposal would result in a slower death for a larger company like hers. However, when one looks at the fixed costs lenders have, the risks they take with uncollateralized loans, and the significant reduction in number of customers the CFPB proposal would cause, she doesn't see how her company could sustain a viable business model for long.

Mr. Covert: Best case scenario, we reduce the number of stores and the number of employees, putting people out of work.

Mr. Grieser: I don't know a single company in the U.S. that tells a returning customer, "I cannot do business with you. I can't even direct you to a place you can get what you need." That's very unusual, but it's what these rules would require us to do.

Observing that the industry panel had expressed concerns with the proposed underwriting criteria, Chairman Block asked if the lenders disagreed with the idea of underwriting entirely, or only with the specific underwriting rules in the proposals. Mr. Covert explained that all short-term lenders underwrite. We make money by picking the right customers and choosing the right amount to lend to each customer. We all have proprietary underwriting models.

Ms. Stewart echoed Mr. Covert's comments. We're not in the business of lending to people who can't pay us back. We have sophisticated underwriting criteria. It's the overly restrictive underwriting in the CFPB's proposal with which we have concerns.

Chairman Block asked the panel if there were underwriting rules short of what the CFPB is requiring, which industry might find acceptable. Ms. Stewart urged the CFPB to look at what certain states are doing in the way of underwriting. She listed California, Michigan, Florida, South Carolina, Wisconsin, and Indiana as states that had imposed underwriting criteria, which balanced access to credit with consumer protections, and with which her industry could live.

Mr. Covert added that he does not think anyone believes it makes sense to underwrite a home the same way as a short-term, small dollar loan.

Chairman Block then asked the panelists about the CFPB's proposal to cap the frequency with which short-term covered loans could be obtained, and specifically asked if there is any reasonable cap. Mr. Covert responded that some states have tried to put limits on the number of loans a borrower can obtain in a year. However, borrowers' need for credit doesn't go away if there is an arbitrary limit on the number of loans they can get. The borrowers simply go elsewhere to get the money they need.

Senator Morrell asked industry to clarify the average default rate of payday loans. Mr. Gwaltney cited DBO data, which show that 2.8% of the amount lent by California licensed payday lenders is charged off.

Senator Morrell asked if all payday lenders use debt-to-income ratio when underwriting a borrower's ability to repay their payday loan. Mr. Covert said yes, most companies look at both debt and income. Mr. Gwaltney responded that a lot of companies have their own internal procedures, but most look at residual income to see if the consumer will have enough money with which to repay the lender. Mr. Gwaltney added that payday loss rates are very low, because customers are just looking for liquidity.

Senator Morrell expressed concern that so many installment lenders have gone out of business. He asked the panelists why so many financing options are going away. The panelists suggested that the question was more appropriate for the longer-term loan panel but offered brief responses. Mr. Grieser agreed that many of the consumer finance companies have gone away. The costs of operating have increased, but lenders' ability to charge more hasn't. Ms. Stewart commented that if there were a way to fill the gap and profitably make a $2,000 loan in California, borrowers wouldn't take out as many simultaneous payday loans.

PANEL FOUR: INPUT FROM INTERESTED PARTIES REGARDING THE LONGER-TERM COVERED LOAN PROPOSAL

INDUSTRY PERSPECTIVES

Jabo Covert, Senior Vice President for Government Relations, Check Into Cash

Mr. Covert opened by continuing the discussion that had begun during the question and answer session immediately preceding his panel. In Tennessee (Mr. Covert's home state), Check Into Cash is licensed to offer multiple payday loan alternatives. Because of this, customers who need more money than they can obtain through payday, or who need money for a longer period of time than a payday product will allow, can get the money they need without having to take out multiple payday loans. California doesn't have installment loan products that are payday loan alternatives. California does offer a pilot program to increase the number of installment loans made in amounts below $2,500, but the number of payday loans made in California on an annual basis is twelve times the number of pilot program loans. California is missing an opportunity to encourage longer-term installment loan alternatives to payday.

Robert Reich, President, Community Loans of America (written testimony included in Section Two)

In addition to serving as president of Community Loans of America, Mr. Reich is president of the national trade association representing title lenders. He also attended the Small Business Advisory Review Panel hearings in Washington, D.C.

Community Loans of America operates approximately 160 stores and employs approximately 400 employees in California. The company offers fully-amortizing car title loans of one- to three-years in length. In California, its loans are for principal amounts of $2,500 and above. These are non-recourse loans; the only liability a customer has is the car they put up as collateral. The single largest reason for default on a car title loan is mechanical breakdown of the collateral. Sometimes, it can make more sense for a borrower whose car has broken down or been stolen to take their car title loan money and use it as a down payment on another vehicle. Community Loans of America customers must pay their loans back via either cash or money order; Community Loans of America does not access its customers' bank accounts.

Approximately 30% of Community Loans of America's customers are self-employed, small business owners. Another significant source of customers is non-homeowners, who don't have access to home equity, and who rely, instead, on their largest asset – their car – to collateralize their loans.

The CFPB's proposed rules for longer-term covered loans would be devastating. Who is looking out for the customers? Certainly not the CFPB. The proposal will eliminate to access to credit for those with no other legal alternatives and will increase the number of people who are unable to legally borrow money. Furthermore, in the title lending, installment loan area, the CFPB has failed to show that there is any harm to the consumer under existing law, nor to recognize the 90% of Mr. Reich's customers who derive benefit from Community Loans of America's car title

loan products. If enacted as proposed, the CFPB's proposed rules will annihilate car title lending.

Sarah Cutrona, General Counsel, Elevate (written testimony included in Section Two)

Elevate Credit operates in California as an online, state-licensed installment lender under the dba Rise Credit. Elevate supports efforts to end the cycle of debt and protect consumers from bad actors in the industry and harmful lending practices. Elevate employs rigorous underwriting standards and relies on empirically-derived data analytics to determine a consumer's ability to repay. Elevate is concerned that the overly prescriptive guidance contained in the CFPB's proposal will stifle continued innovation to consumers' detriment. Elevate hopes that the ability to repay standard ultimately developed by the CFPB is based on empirically-derived data provided by responsible lenders. Finally, Elevate observes that the CFPB rules will trump many of the California laws governing financial services. The issues that arise from federal pre-emption can be messy, and create a great deal of uncertainty in the market, both for lenders and consumers.

James Gutierrez, Chief Executive Officer, Insikt (written testimony included in Section Two)

Mr. Gutierrez participated as a small entity representative on the Small Business Advisory Review Panel convened by the CFPB in April 2015. He currently runs a company (Insikt) accepted to participate in California's small dollar loan pilot program. He previously ran the pilot program's first and largest participant, Progreso Financiero (currently changing its name to Oportun).

Operating under California's small dollar loan pilot program, Insikt offers fully-unsecured, installment loans of six to 24 months in length and principal amounts between $300 and $2,500. The average FICO score of those of his customers who have a score is 570. However, half of his borrowers have no credit score or a very thin credit file. None of his borrowers qualify for traditional bank or credit union loans.

Most of the loans Insikt makes would be covered under the CFPB's longer-term covered loan proposal. Mr. Gutierrez believes that his company can comply with the CFPB's rules, but he notes that Insikt is not a typical small company; to date, it has already raised $26 million in venture capital and has spent a considerable amount of this money building a fully-automated underwriting platform that allows Insikt to do full income underwriting using the cloud.

Even though Mr. Gutierrez believes that Insikt could comply with the CFPB rules, he would like to see changes made to the longer-term covered loan proposal to make it work better. For example, as drafted, the proposal requires lenders to verify both income and expenses. Insikt is often unable to verify the expenses of its borrowers. If someone is unbanked or underbanked, there is often no lease agreement; expenses are very unreliable when they are self-reported. Expenses that are reported to a credit bureau can be used to underwrite, but self-reported expenses should not be part of the underwriting equation.

Second, the CFPB proposal requires a lender to verify that a borrower can afford the loan over that loan's entire life. Insikt has no way to ensure that a customer will be able to afford his or her loan six months or a year after it is made; Insikt can only underwrite a borrower's ability to repay that loan at the time the loan is made. Mr. Gutierrez suggests that the CFPB look to California's pilot program rules for an example of underwriting that is workable in the longer-term installment loan context.

If the longer-term covered loan proposal is enacted as proposed, Insikt would have to comply with the debt trap *prevention* option, because the debt trap *protection* option is unworkable, as proposed. The debt trap protection option requires loan lengths to be a maximum of six months and a maximum of $1,000; nearly all of the loans Insikt makes are longer and larger than that.

Even for loans that meet those criteria, the debt trap protection option is unworkable. For example, if Insikt was required to exclude borrowers whose loan payments exceeded 5% of their gross income, 32% of Insikt's approved borrowers wouldn't qualify for their loans. Mr. Gutierrez believes that 12% would be a better number to use than 5%, but believes that other cutoffs are even better. Again, Mr. Gutierrez believes that California's pilot program (which uses a 50% debt-to-income ratio) provides a better alternative.

Mr. Gutierrez concluded his testimony by referencing two trends that should be considered in the context of longer-term installment loans. First, under international capital standards rules like Basel II and Basel III, and under Dodd-Frank, banks aren't able to provide installment loans of the types being discussed during the oversight hearing. When they lend to borrowers with low FICO scores, banks have to hold too high a percentage of risk-weighted assets. For that reason, it's not cost-effective for them to lend to borrowers with low FICO scores.

Second, if these proposals are enacted, it will place lenders making longer-term installment loans at a competitive disadvantage relative to lenders offering credit cards. Rules put in place by the federal Credit CARD Act of 2009 do not require credit card issuers to calculate annual percentage rates using the same "all-in" calculations contemplated by the CFPB in its proposal for installment loans. The federal Credit CARD Act also imposes a less restrictive ability-to-repay requirement than is contemplated by the CFPB. For those reasons, lenders will be able to extend credit card offers that are higher-priced than longer-term installment loans covered by the CFPB proposal, but will not be held to the same standards for consumer protection.

Dan Gwaltney, President, California Financial Service Providers (written testimony included in Section Two)

The members of CFSP have concerns with the long-term installment loan proposal. Many of the abuses the CFPB is targeting are not allowed in California. For example, the California CFLL does not allow balloon payments or negative amortization, two of the issues the CFPB is trying to address with its longer-term loan proposal. This is another example of where the CFPB should do a state-by-state review of existing state laws before suggesting a one-size-fits-all approach that may not be appropriate in certain states given existing state laws. Furthermore, Mr. Gwaltney's organization has analyzed the debt trap protection options proposed by the

CFPB and agrees with Mr. Gutierrez that neither of the two alternatives proposed under the debt protection option will work.

Finally, Mr. Gwaltney touched on the two collection proposals released by the CFPB. He observed that neither proposal takes into account recent rule changes released by the National Automated Clearinghouse Association. Those rules should solve the problems the CFPB is trying to address with its collection proposals.

TRIBAL PERSPECTIVE

Sherry Treppa, Chairwoman, Habematolel Pomo of Upper Lake Tribe (written testimony included in Section Two)

Mr. Treppa is the Chairperson of the federally-recognized Habematolel Pomo of Upper Lake tribe. Since 2012, her tribe has owned, operated, and self-regulated an online lending enterprise that offers small-dollar installment loans. Ms. Treppa also serves as the Vice-Chairperson of the Native American Financial Services Association (NAFSA), an intertribal organization that advocates for tribal sovereignty and responsible business practices in the context of the e-commerce industry.

Ms. Treppa observed that the question of the CFPB's jurisdiction over tribal businesses is currently being considered by the Federal Ninth District Court of Appeals. For that reason, she did not use her testimony to offer her tribe's views on the topic.

The businesses operated by Ms. Treppa's tribe are governed by tribal law, voluntarily comply with all applicable federal laws, and enforcement activities are conducted by tribal regulatory agencies. The role of tribes as regulator is not new to tribes. As sovereign governments, tribes have significant regulatory experience.

Operating a tribal lending business offers tribes expanded tribal government revenues and living wage employment opportunities for their citizens. Proceeds from lending enterprises represent more than 70% of most NAFSA members' annual budgets and substantially improve the quality of life for tribal members. Tribal lending revenue represents 100% of the non-grant revenues received by Ms. Treppa's tribe. Revenue from tribal lending funds education programs, including scholarships, job training opportunities, and has enabled the Habematolel Pomo of Upper Lak to reacquire some of its ancestral homeland. Lending revenue helps her tribe achieve self-determination and self-sufficiency. If the CFPB's rules are found to apply to tribal enterprises like the ones operated by Ms. Treppa's tribe, much, and possibly all of her tribe's recent progress toward self-sufficiency will be undone.

However, Ms. Treppa's views center on more than just the impact of the CFPB's proposals on her tribe's revenues. The Habematolel Pomo of Upper Lake Tribe is proud to offer a product that empowers consumers. A common-sense examination of these draft rules finds that they are overly restrictive and will have the effect of choking off a vital source of access to credit among consumers who need it the most. Ms. Treppa's tribe's business entities already utilize sophisticated underwriting software, allow for varied payment methods, and perform exhaustive

fraud checks. Her tribal businesses *do* take consumers' ability to repay their loans into account. The Bureau's proposals around underwriting fail to recognize that the required information is often unavailable or too burdensome for consumers to supply.

QUESTIONS AND ANSWERS (Industry and Tribal Perspectives, Longer-Term Covered Loan Panel)

Assemblymember Dababneh asked Mr. Gutierrez whether the CFPB's regulations will make it easier or more difficult for him to use finders in the context of his current company. Mr. Gutierrez responded that, because his company's underwriting system is always used to vet borrowers, regardless of whether finders are involved in customer acquisition, he does not believe that the proposed regulations will negatively impact his ability to use finders.

Assemblymember Dababneh asked Ms. Treppa to comment on the extent to which her tribe is involved in the lending activities or whether her tribe is merely a front for another company that actually offers the loans. He also asked her to discuss how the revenue from her tribe's lending activities is used. Ms. Treppa responded that her tribe owns and operates 100% of the lending business. They started off with a single lending enterprise and now have three, including a call center and a lead generation-marketing company. All three enterprises are run in-house and staffed by tribal members and some contracted employees. All of the profits from its lending activities go to support the tribe and its neighboring communities. Tribal revenue funds scholarships, health care, job incentive programs and unemployment assistance. Her tribe's philosophy is to give its members the ability to become self-sufficient.

In response to another question by Mr. Dababneh, Ms. Treppa responded that the tribe's lending enterprises will not extend more than one loan to the same borrower at the same time, and that they do not report borrower repayment history to the major credit bureaus.

Before concluding, Ms. Treppa offered a response to Ms. Bailey's testimony earlier during the hearing. It is Ms. Treppa's tribe's understanding that the Dodd-Frank Act is not a law of general applicability. That Act clearly defines tribes as states. For that reason, it allows tribes to co-regulate with the CFPB. As such, Ms. Treppa shares Commissioner Owen's concerns that the CFPB's rules could pre-empt the authority of her tribe and other tribes that offer loans, as well as the state's authority to regulate itself.

CONSUMER PERSPECTIVES

Paulina Gonzalez, Executive Director, California Reinvestment Coalition (written testimony included in Section Two)

Ms. Gonzalez related her upbringing as a daughter of working class, immigrant parents. She is glad her family did not take out loans they could not afford to pay back. What her family needed, and what so many California families need, is income; they do not need predatory loans. The products which are the focus of the CFPB's rules are not a credit service to the needy; instead, they leave families worse off than when they started. Ms. Gonzalez believes that access

to good forms of credit is critical to a household's financial health and capacity to achieve milestone goals.

There are those who argue that credit, even high-cost credit, is needed by communities in order to serve as a safety net during times of economic need. Ms. Gonzalez disagrees. She provided the Committee with the story of Joann Taylor, a woman who took out a high-cost installment loan from Rise Credit, ended up defaulting on that loan due to her inability to afford it, later fell behind on her rent, and was subsequently evicted from her apartment, along with her youngest daughter. Stories like Ms. Taylor's are why the California Reinvestment Coalition (CRC) believes that the CFPB's proposed rules set an important floor for California consumers.

However, CRC does not believe that the CFPB's proposed rules go far enough. The CFPB is considering rules for longer-term loans that would allow lenders to choose between underwriting or an alternative debt trap protection requirement where the periodic payment could not exceed 5% of the borrower's expected gross income for the corresponding pay period. CRC strongly opposes the debt trap protection alternative and believes that meaningful underwriting should be a requirement, rather than an option.

Furthermore, the CFPB is considering permitting certain loans not exceeding $1,000 to be made on terms similar to those permitted for National Credit Union Administration-sanctioned loans. While CRC believes that this would be a vast improvement to the current lack of regulation around installment loans, CRC vastly prefers a requirement that all loans be underwritten, taking into account income and expenses, as well as borrowing history. Underwriting should be required before the first long-term installment loan is made, before any subsequent loans are made to a person who has already borrowed, and before any long-term installment loan is refinanced.

Furthermore, if underwriting only takes into account income and fails to consider expenses, it will fail to adequately determine whether a loan will be affordable by a borrower or whether that loan will spiral the borrower into an unsustainable debt trap which leaves the borrower worse off than before they borrowed (as was the case with Ms. Taylor).

CRC believes that without proper underwriting, long-term installment loans at best push the shock of an expense forward a short while; at worst, they intensify the shock, until it is not survivable.

Suzanne Martindale, Staff Attorney, Consumers Union (written testimony included in Section Two)

Ms. Martindale began by referencing the story related by Ms. Gonzalez. Stories like the one Ms. Gonzalez shared are important. There are faces behind the data. That's why groups like Consumers Union (CU) and CRC bring consumers' stories to hearings like this oversight hearing. Consumer advocates want Members to understand the human cost of lending to people who cannot afford to pay their loans back.

CU believes that the CFPB proposal is an important first step in setting national standards for high-cost lending. By focusing on the basic principle that lenders should make loans that consumers can afford, at the outset and over time, the CFPB's proposal supports lenders that are responsible, and marginalizes those that are not. CU wants to see rules of the road that protect consumers and give a competitive advantage to businesses that are providing affordable and safe loans to consumers.

However, the CFPB's proposal contains a menu of options that could leave gaps in consumer protection. CU is especially concerned that there is no across-the-board requirement for lenders to assess a borrower's ability to repay their loans. Because of this, it is important that states such as California not wait for the CFPB to protect consumers; states must play an active role on the front lines of consumer protection.

Longer-term covered loans pose many of the same problems as short-term covered loans. In addition to charging high interest rates, some installment lenders keep consumers in debt through multiple refinancings. For these reasons, CU is concerned that the CFPB proposal would permit alternatives to the ability-to-repay requirement. Even though some of the alternatives in the debt protection option menu of alternatives are improvements over current industry practices, meaningful underwriting is critical.

It is important to remember that the CFPB proposal is a floor, and a start of the conversation, not a ceiling. It in no way mitigates the authority and responsibility of individual states to do more to protect their residents from abusive financial products and services. In California, the Legislature has shown interest in encouraging safer longer-term loans through establishment of California's small dollar loan pilot program. CU thinks that the across-the-board underwriting requirement in the pilot program is an important and powerful precedent.

Although the pilot program is not perfect, and CU continues to have concerns that pilot program loans may be too expensive for some consumers, CU supports the principles contained in the pilot program and looks forward to seeing the data that will be released by DBO in July 2015. The pilot program represents the start of a longer conversation in California about how best to protect consumers and support responsible businesses offering longer-term loans.

Ms. Martindale concluded by observing that the need for these products is symptomatic of a larger problem. If consumers in large numbers cannot make ends meet, that is our collective failure. If they can only access high-cost credit, instead of more affordable, safe options, that is also our failure. We need a bolder vision for how to reduce working families' financial insecurity and how to promote true economic justice in California.

Paul Leonard, Director, California Office, Center for Responsible Lending (written testimony included in Section Two)

Mr. Leonard stressed the importance of underwriting for longer-term loans. The CFPB's proposal offers lenders a menu of options (either the debt prevention option or two choices on the debt protection side). CRL strongly believes that universal, across-the-board underwriting is critical and thus does not favor the debt protection alternative, as drafted.

However, on the debt protection side, if there has to be an option available that doesn't include underwriting, CRL favors the NCUA approach, because it looks to more than just percentage of gross income as a measure of affordability. Using only income and ignoring expenses is not an effective way to evaluate a borrower's ability to pay.

It's also important to think about the narrow scope of the CFPB proposal. The CFPB's proposal covers loans with annual percentage rates greater than 36%, where the lender has access to a consumer's bank account. CRL believes that the scope of the CFPB's proposal should be expanded to include true unsecured loans, where access to a borrower's account is not given to the lender. CRL also thinks that other areas deserve to be considered, including credit cards, personal property, and pawn in certain circumstances. CRL is concerned that those products could be used to create mechanisms to evade the intent of the CFPB's proposals. Protections that are envisioned, particularly around underwriting, should apply to those products, as well, to reduce the likelihood of their being used to evade the rules.

The CFPB is going to collect and hold large amounts of data regarding the performance of covered loans. This data collection effort is critically important for enforcement. There are a number of lenders that are currently lending in amounts above $2,500 in California. There are no interest rate caps on loans of this size, and we know very little about the performance of these loans. Mr. Leonard is concerned that many of these loans have very high charge-off rates. The interest rates and fees on these loans are high enough that the lenders making these loans can sustain high levels of charge-offs and still be profitable. The high charge-off rates on these loans suggest that the underwriting being used by longer-term lenders is not as robust as the lenders suggest it is. Furthermore, if the up-front underwriting on these loans is as effective as the lenders assert it is, CRL questions why lenders need access to a borrower's car title or bank account.

QUESTIONS AND ANSWERS (Consumer Perspectives, Longer-Term Covered Loan Panel)

Chairman Block asked Ms. Gonzalez if Rise Credit had violated its agreement with the borrower (Joann Taylor) whose story she related during her testimony. Ms. Gonzalez does not believe that Rise violated its agreement. However, the borrower's story shows that Rise did not adequately underwrite the borrower, because the borrower clearly could not afford to repay her loan. The CFPB underwriting rules would have prevented the situation in which the borrower found herself.

PUBLIC COMMENT

No members of the public chose to offer testimony during the public comment period. Two organizations (National Council of La Raza and the California Asian Pacific Chamber of Commerce) chose to offer written testimony. That testimony is included in Section Two of this report.

CLOSING REMARKS

Chairman Block concluded the hearing by thanking his colleagues for attending and the witnesses for providing a very informative hearing. He directed interested parties wishing more information to the Senate Banking and Financial Institutions Committee's website, where they can find a copy of the hearing video, and a summary report that includes all of the written testimony submitted in connection with the hearing. The Chair directed those with questions to his office or the Banking Committee office. He adjourned the hearing at 4:45PM.

SECTION TWO

WRITTEN TESTIMONY SUBMITTED BY WITNESSES AND OTHER INTERESTED PARTIES

An Introduction to the Consumer Financial Protection Bureau's March 26, 2015 Outline of Proposals Regarding Payday, Vehicle Title, and Similar Loans

Brian Sala, Acting Director
California Research Bureau

Testimony before the Senate Banking and Financial Institutions Committee

May 6, 2015

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Senate Committee on Banking and Financial Institutions Oversight Hearing: "Ending Debt Traps Or Restricting Access To Safety Nets? Initial Reactions To The Consumer Financial Protection Bureau's Lending Proposal." Wednesday, May 6, 2015, State Capitol, Room 112

Remarks of Brian R. Sala, Ph.D., Acting Director of the California Research Bureau, California State Library

Good afternoon, Chairman Block and members of the Committee.

My name is Brian Sala. I am the Acting Director of the California Research Bureau at the California State Library.

CRB's primary function is to provide independent, non-partisan research and reference services to the Legislature, Governor's Office, and other Constitutional Officers.

I am here today to provide a BRIEF overview of what we know to date about the language of the federal Consumer Financial Protection Bureau's March 26 outline of proposals under consideration for a potential rulemaking for payday loans, vehicle title loans, and similar loans.

My remarks will focus on three areas:

- Where we are in the federal regulatory process
- The significance and structure of the payday loan market in California
- The major features of the CFPB's current proposal

Where we are in the process.

On March 26, 2015, CFPB Director Richard Cordray announced that the Bureau was publishing an outline of regulatory proposals on payday lending.[1]

This announcement preceded a late April convening of the Small Business Advisory Review Panel[2], and included an invitation to stakeholders and other interested parties to provide input and feedback before the CFPB proceeds to a formal Notice of Proposed Rulemaking.

The Small Business Advisory Review Panel consists of

- CFPB representatives
- The Small Business Administration's Chief Counsel for Advocacy, and
- Representatives from the Office of Information and Regulatory Affairs within the Office of Management and Budget.

The Review Panel met with a "selected group of representatives from small businesses" to gather feedback on the current outline of proposals. Additionally, these selected participants will have an opportunity to provide written comments.

The Panel has 60 days to issue a report on the input it received at the April convening.

Once a proposed rule is published, the Panel's final report will be included as part of the public rulemaking record. Until a proposed rule is published, there is no other FORMAL mechanism for the CFPB to receive and incorporate stakeholder input.

As the CFPB has not yet formally proposed a rulemaking, its rules and policies regarding *ex parte* communications do not yet apply. Any interested party may provide written or oral comments to the CFPB regarding a rulemaking proposal not yet released without those comments entering into the public record.

The CFPB is under no obligation to consider or take into account such pre-rulemaking comments in its Notice of Proposed Rulemaking or any subsequent Final Rule.

Once a Notice of Proposed Rulemaking is published, the CFPB will begin accepting on-the-record public comments on the proposed rules.

The payday lending market in California

Commissioner Owen will have more to say about potential state regulatory impacts resulting from the proposal in a few minutes.

Here I only note a couple of salient facts about the nature and size of the relevant lending market.

The Department of Business Oversight collects data on both short-term "Deferred Deposit Transactions" – roughly, payday loans; and longer-term credit products under the California Finance Lenders Law.[3,4]

Payday loans:

- In 2013, 1.7 million California customers borrowed $3.1 billion in payday loans in 12.2 million transactions. Average transaction: $260. The average customer: 6.8 transactions.[3]

Caveat: data is reported by licensee, not by borrower. 1.7 million is an UPPER BOUND on the true number of unique borrowers. There likely is some overlap in customers across licensees.

A key question is about lengths of loan sequences. National data collected by CFPB[5] suggests that nearly 2/3rds of all borrower sequences end with the 1st, 2nd or 3rd loan, but that half of all loans are in sequences of 10 or more loans.

Here, a sequence is a chain of loans each separated by no more than 14 days from the contractual end date of the prior loan.

The data thus suggest that if the payday borrower has not completed the sequence by the 3rd loan, 40 percent of the time it will turn into a sequence of 10 or more loans.

A second key question is how many loan sequences the typical borrower engages in during a year. National data collected by the CFPB[5] indicate that

- 48 percent of borrowers had only one loan sequence in their study period and
- 26 percent had two sequences but
- Only 15 percent of borrowers had only one loan for the year.

[Compare to CFPB data showing that 40 percent of all sequences end with a length of one loan. This shows that many borrowers engage in multiple sequences; some of those are borrowers engaging in two or more very short sequences.]

A third key question has to do with whether or how these loans are secured.

- In 2013, CFLL license holders issued 908,000 consumer loans totaling $39.5 billion. 69 percent of these loans were for amounts below $5,000, but 96 percent of the dollar amount was for loans above $10,000.[4]

CFLL loans under $5,000 tend to be unsecured loans. In contrast, CFLL consumer loans over $10,000 are predominantly secured by real property, autos or auto titles.

CFLL license holders also issued 1.3 million commercial loans of $5,000 or more, totaling $134.8 billion in 2013.

91 percent of commercial CFLL loans, accounting for 47 percent of total loan amounts, were secured with motor vehicles.

The proposal in brief[1]

Loan sequences

A loan sequence is defined as any set of covered loans obtained by a borrower, regardless of lender, where the contracted beginning of a loan, renewal, or extension is within 60 days of the contracted end point of a prior loan.

[Contrast with the CFPB payday loan study, which uses 14 days between loans as the threshold for sequencing.[5]]

Covered short-term loans

- Contractual duration of 45 days or less

Covered longer-term loans

- Contractual duration of more than 45 days and
- All-in annual percentage rate over 36 percent and

- Lender obtains a preferred repayment position by
  - Access to consumer's account or
  - Non-purchase security interest in consumer's vehicle

Loans not covered include short-term pawn loans, credit-card accounts, real estate-secured loans and student loans.

The CFPB states that it is concerned that many consumers are taking out unaffordable loans because lenders are offering credit without determining whether consumers have the ability to repay the debt on time.

The outline identifies two possible strategies, labeled "debt trap prevention" and debt trap protection," respectively.

Debt-trap Prevention

The CFPB is considering a "rebuttable presumption" that the consumer lacks the ability to repay a second or third covered short-term loan or covered long-term loan with a balloon payment in a sequence, and a "conclusive presumption" of lack of ability for a 4th loan.

- Would require lender to show evidence of a borrower's ability to repay (including income, major financial obligations, and borrowing history) to justify an initial loan.
- Would require lender to show evidence of a change in borrower circumstances to justify a 2nd or 3rd loan.
- Would impose a 60-day cooling off period before a 4th loan.

Debt Trap Protection

This would be an alternative for the lender to the Debt Trap Prevention requirements

Short-term covered loans

- Screening to determine that a loan would not result in the consumer entering a sequence of 4+ loans nor more than 6 loans total in a 12-month period
- Maximum of $500 and 45 days
- No security interest in a vehicle
- Tapering requirement. Each successive loan has to be smaller OR no-cost extensions to complete a third loan.

Debt Trap Protection

Longer-term covered loans

- National Credit Union Administration (NCUA)-type loans:
  - Screening for income; no more than 2 longer-term loans in 6-month period
  - Between $200 and $1,000 and 45 days to 6 months; fully amortizing; meets NCUA cost criteria (maximum 28 percent interest and maximum application fee of $20)
- Maximum Payment-to-Income (PTI) loans
  - Below a 5 payment-to-income ratio
  - Screening for income; no more than 2 covered longer-term loans in 12-month period
  - Limits payments to 5 percent of gross income during each payment period; fully amortizing; term of 45 days to 6 months

Record-keeping requirements

Lender would be required to keep records on covered loans for 36 months after the last entry on the loan.

Additional Remarks

Market indicators of unaffordability might include shares of loans for which the lender charged a late fee, refinanced the loan or sold the borrower a new loan within a very short window (i.e., a "sequence" of loans), or, in the case of Deferred Deposit Transactions, resulted in a returned check.

According to the Department of Business Oversight, 5.8 percent of Deferred Deposit transactions in 2013 resulted in a returned (or "bounced") check, covering 6 percent of the dollar amount of the transactions. About half of these bounced checks were eventually recovered, and half charged off. These data likely understate the "true" rate of Deferred Deposit transactions sequences that end in default, as many consumers roll over a payday loan into a second, third, or subsequent loan rather than defaulting on the original loan.

As noted above, national data suggest that about 2/3rds of payday loan sequences are 1, 2 or 3 loans long, but that half of all payday loans are part of sequences of 10 or more loans.

In the longer-term CDLL market, DBO data does not separately report original loans vs. refinances. Reporting is further complicated by the fact that many CDLL loans span more than one calendar year. Hence it is not possible to calculate a meaningful rate of loans resulting in late charges or charge-offs from the reported data.

Additional Comments Not Shared At the Panel

Most borrowers have short loan sequences. *In the CFPB study*[5], *borrowers who end loan sequences with repayment within the first 7 loans outnumber defaults within that duration by about 7:1. Of the ~45 percent of borrowers who extend their loan sequences beyond a second loan, about 40 percent eventually repay and ~5 percent default (8:1). Caveat: censored observations are treated as being paid off, not defaulting. This is probably not true – it appears that the conditional odds of default are not decreasing with spell length.*

- *According to CFPB data, 40 percent of loan sequences end with the first loan (36 percent by repayment; 4 percent by default, a 9:1 ratio)*
- *Almost 55 percent of loan sequences end with the first or second loan (~11-12 percent by repayment of second loan; ~1-2 percent by default on second loan)*
- *and 78 percent of borrowers have sequences of 7 or fewer loans. About 8-9 percent of borrowers end in default in the first 7 loans, 69-70 percent end with repayment, or around 7:1 or 8:1 repayment:default.*

The odds of default are not strongly related to the length of the loan sequence. *This is important for policy. If payday lenders were driving customers to default through predatory policies that induce long sequences, it probably should show up in increasing conditional odds of default. This may be true, but the effect appears to be quite small in CFPB's reported data.*

I would interpret the data as suggesting that lenders are instead setting terms such that borrowers either pay off the loan in the current period or are solvent enough to roll it over.

Hence, restrictions on sequence lengths will likely hurt many borrowers by forcing them to pay back a loan at a shorter sequence length or default. Some of the borrowers who are able to pay back the nth loan in full will not be able to pay back the $n\text{-}1^{th}$ or $n\text{-}2^{th}$ or ... $n\text{-}m^{th}$ loan in full and therefore will default, assuming that they entered into the sequence at all.

Even without considering the possible additional underwriting costs implied by the proposal, by pushing defaults to earlier points in loan sequences, this proposed CFPB policy likely would deter some lending. Some borrowers who previously would have been extended loans in part because the lender anticipates a lengthy sequence of loans to those borrowers likely now would become unprofitable customers.

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Ending Debt Traps or Restricting Access to Safety Nets? Initial Reactions to the Consumer Finance Protection Bureau's Lending Proposal

Senate Banking and Financial Institutions Committee

Informational Hearing

May 6, 2015

Commissioner of Business Oversight Jan Lynn Owen

Testimony

INTRODUCTION

Good afternoon, Mr. Chairman and members.

Thank you for inviting us to share our thoughts about this important development in the consumer finance market.

I and my fellow state regulators may not always agree with the CFPB.

But I can tell you we appreciate and respect the Bureau as a valuable new partner in achieving a common objective: ensuring this crucial market stays safe and healthy for consumers and businesses.

The title of this hearing alludes to the balancing act that financial services regulators must perform every day.

As we carry out our duties, we have to protect consumers, but also make sure we don't unduly impede their access to capital.

To borrow from the hearing title, we help make capital available, but also make sure that when consumers purchase a financial safety net they don't end up buying a booby trap.

As the CFPB navigates this regulatory process, I'm sure it will work to properly weigh the interests of consumers and businesses.

No doubt you will hear from witnesses today who will have different views of whether the CFPB's framework strikes the right balance.

For our part, we will withhold judgment until we have something more fleshed out to consider.

<u>CALIFORNIA LAW AND THE CFPB PROPOSAL</u>

I thought it would be helpful for the Committee to compare the major elements of the CFPB's framework to what we have in California law.

Our state has two laws relevant to the comparison: The California Deferred Deposit Transaction Law (CDDTL) and the California Finance Lenders Law (CFLL).

> ***Lender Option***

- For both short-term and longer-term loans, the CFPB proposal would give lenders two optional methods for making loans: "debt trap <u>prevention</u>" and "debt trap <u>protection</u>."

- Under the first, lenders would have to determine the borrower has the ability to repay the loan – including fees – on time and in full.

- Under the second approach, the lender would forego the underwriting, but the loan would be subject to restrictions, including caps on the term and amount.

- <u>California's payday lending law and the CFLL do *not* provide lenders that kind of option.</u>

➢ ***Short-Term and Longer-Term***

- The CFPB proposal defines short-term as loans that have a duration of 45 days or fewer.

- It defines longer-term loans as those that have a duration that exceeds 45 days and an all-in APR that exceeds 36 percent.

- California's payday lending law limits loans' duration to 31 days.

- The CFLL sets maximum terms based on the loan amount: 2 years for less than $500; 36 months for $500 to $1,499; 4 years for $1,500 to $2,999; and 5 years for $3,000 to $4,999.

- The CFLL small-dollar pilot program – which covers loans of $300 to $2,499 – sets minimum, not maximum terms. The minimums range from 90 days to 180 days, depending on the amount.

- So, with a minimum term of 90 days, pilot program loans would not be covered by the short-term component of the CFPB plan.

➢ ***Interest/Fee Limits***

- The CFPB plan proposes limits on interest rates or fees for longer-term loans – under certain conditions.

- Both the payday lending statute and the CFLL limit interest rates and fees.

- California's payday lending law limits fees to 15 percent of the loan amount. For the typical loan, that works out to an APR of about 460 percent.

- The payday statute also places limits on various fees associated with loans.

- The CFLL caps interest rates on consumer loans of less than $2,500 – roughly 21 percent to 30 percent APR, depending on the loan size.

- The CFLL does not limit rates on loans of $2,500 or more.

- With respect to fees, the CFLL places limits on administrative and other fees.

- Under the small-dollar pilot program, interest rates are capped at 36 percent, and fees also are limited.

➢ ***Multiple Outstanding Loans***

- For both short-term and longer-term loans, the CFPB plan appears to require that borrowers have no current outstanding loans when they initially enter a loan with a lender.

- California's payday lending statute limits borrowers to one outstanding loan at a time.

- The CFLL does not contain similar provisions.

- Nor does the small-dollar pilot program.

➢ ***CFPB 'Debt Trap Prevention' – Short-Term***

- Lenders would have to make a reasonable, good-faith determination that the borrower can repay the loan on time and in full <u>before</u> making the loan.

- After making the initial loan, lenders generally would have to observe a 60-day moratorium on making subsequent loans to the same borrower.

- To make a second or third loan within the 60-day cooling off period, the lenders would have to document the borrower's financial condition has improved sufficiently to allow them to repay the subsequent loan.

- The 60-day moratorium would be mandatory after a third loan was made to the same customer.

- California's payday lending law does not require lenders to determine a borrower's ability to repay the loan.

- The CFLL does not explicitly mandate that lenders determine ability to pay before making loans.

- However, the CFLL does allow the Commissioner to suspend or revoke a license if the lender repeatedly fails to consider ability to pay when determining the size and duration of loans. And the regulations governing CFLL licensees require them to consider ability to pay before making loans.

➢ ***CFPB 'Debt Trap Protection' – Short-Term***

- Instead of making the ability-to-pay determination, lenders would:

  ✓ Verify borrowers' income; determine the loan would not be the borrower's third in a 6-month period; and determine the loan would not be the borrower's sixth such loan from all lenders during a rolling 1-year period.

- Neither the California payday lending statute nor the CFLL have similar provisions.

- Additionally, under the CFPB plan, these "debt trap protection" loans could not exceed $500.

- California's payday lending law limits loans to a maximum of $300.

- The CFLL does not have a similar provision.

- For borrowers who accumulate three short-term loans, the CFPB plan would require lenders to provide borrowers who can't repay their debt a "no-cost off-ramp" that allows them to repay over time without penalty.

- Or they could reduce the aggregate principal so the total debt is repaid in full when the third loan is due.

- The California payday lending statute and CFLL do not have similar provisions.

➢ ***CFPB 'Debt Trap Protection' – Longer-Term***

- The lender must make reasonable, good-faith determination of borrower's ability to repay the loan without re-borrowing.

- <u>Under the CFLL's small-dollar pilot program</u>, lenders must determine the borrower's ability to repay the loan. And lenders are prohibited from making a loan of the monthly debt service payments exceed 50 percent of the borrower's gross income.

- <u>The pilot program also limits refinancings</u>. Under the program, borrowers can refinance a loan only if:

  - ✓ They have paid off at least 60 percent of the original principal; they are current on the original loan; they have not previously refinanced the same loan; they use the proceeds for personal family or household purposes; and the lenders properly underwrites the loan.

➢ ***CFPB 'Debt Trap Protection' – Longer-Term***

- Lenders would have two options if they didn't want to make the ability-to-pay determination. They could:

  - ✓ Provide loans with terms similar to the National Credit Union Association's payday alternative program – loan amounts between $200 and $1,000; interest rate capped at 28 percent and application fee capped at $20; consumer has no other outstanding covered loans; consumer can't have more than one such loan at a time.

✓ Provide loans that require the borrower to pay no more than 5 percent of their gross monthly income – as long as the borrower has no other outstanding covered loans, and the lender makes no more than two such loans to the same borrower in a 1-year period.

- These loans would have to be for amounts of $200 to $1,000 and have a duration of between 45 days and six months.

- Under the CFLL small-dollar pilot program, the size of loans range from $300 to $2,499.

- Interest rates are capped at 36 percent, and fees also are limited.

- The minimum terms under the pilot program range from three months to six months, depending on the loan amount – three months for the smallest and six months for the largest.

CONCLUSION

As you can see, the CFPB framework and California law intersect at many points.

At these points, sometimes the California law is stricter from a consumer protection perspective, and sometimes the CFPB plan is stricter.

And occasionally they just offer different approaches.

We will be closely monitoring developments at the CFPB as this framework evolves into a formal set of rules.

One issue that will be near the top of our watch list is how any rules that are ultimately adopted affect California law.

We want to make sure the CFPB regulations do not preempt California's laws, where our laws are stricter.

So far, CFPB officials have indicated any rules they adopt will "coexist with" and not preempt, state laws. That sounds like they're heading in the right direction.

But there's a long way to go, and we'll remain vigilant to make sure they end up in the right place.

Testimony of Paul Leonard
California Director, Center for Responsible Lending
Informational Hearing on the Consumer Financial Protection Bureau
Rulemaking for Payday, Vehicle Title and Similar Loans
California Senate Banking Committee

May 6, 2015

I. Introduction

Thank you for the opportunity to speak with you today. I am Paul Leonard, California Director of the Center for Responsible Lending (CRL). I am grateful for having the opportunity to share CRL's perspectives on the Consumer Financial Protection Bureau's (CFPB or "the Bureau") new proposals for payday and car title and other similar loans.

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (Self-Help Federal)), and a non-profit loan fund. Over 30 years, Self-Help has provided over $6 billion in financing to help nearly 90,000 low-wealth borrowers buy homes, start and build businesses, and strengthen community resources.

SHCU has been a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded Self-Help Federal to expand Self-Help's mission by building a statewide network of branches in California that serve working families and underserved communities. With 20 branches in the Bay Area, Central Valley and San Gabriel Valley (LA), three branches in Illinois, approximately $600 million in assets, and serving more than 70,000 members and clients, Self-Help Federal is one of the fastest-growing low-income designated credit unions in the country.

II. Overview

The CFPB aims to cover payday and similar loans under its rule regardless of the provider or channel offering the loans (storefront and online; bank/credit union, non-depository, tribal entity). The Bureau's proposal would create a single consistent regulatory floor, while maintaining the prerogative of states to strengthen its consumer protections as they see fit. We strongly support this effort.

These loans are by definition made on extremely risky terms: they are either balloon-repayment loans (and thus covered under the short-term portion of the rule, usually bearing triple-digit interest rates), or they are longer-term but still very high-cost, carrying an APR inclusive of fees

exceeding 36 percent. In both cases, the lender holds extreme leverage over the borrower to coerce repayment irrespective of a borrower's other obligations and expenses. The extreme nature of these loans informs our recommendations on scope and the other areas where we urge the Bureau to strengthen its proposed protections.

The proposal, for both short- and long-term loans, holds the potential to bring desperately needed protections to the small dollar loan market. It holds this potential because it is, generally speaking, rooted in the principle that a lender be expected to determine that a borrower has the ability to repay a loan before extending it. Ability-to-repay should be a fundamental requirement of any loan transaction. It became the law for mortgages following the subprime mortgage crisis. It is uniquely important in the payday loan industry, and for any loan, particularly a high-cost one, where the lender can coerce repayment by holding priority access to the borrower's checking account or other critically needed collateral, like the borrower's vehicle. In these instances, a lender's typical incentive to ensure that borrowers can afford to repay a loan is flipped entirely on its head: The lender collects payment on the loan regardless, and actually earns more when the borrower *cannot* afford to repay without needing to reborrow, allowing the lender to flip the borrower from one high-cost loan into another for an extended period of time.

Though the Bureau's proposal is largely rooted in this ability-to-repay principal, both the short- and long-term proposals would provide lenders an ability to opt out of determining the borrower's ability-to-repay the loan. The CFPB's so-called "debt trap protection requirements." These alternative options, or safe harbors, would severely undermine the ability-to-repay principle and, consequently, the rule's efficacy in protecting borrowers from financial harm caused by unaffordable loans. As a national organization that works in many states across the country as well as here in California which permits payday lending, CRLis concerned that the alternative option will undermine those states that have chosen to prohibit or significantly constrain high-cost payday and/or car title lending. We thus urge that the Bureau require determination of ability-to-repay on *every* loan.

We first present a summary of our views, followed by more detailed discussion.

Critical elements of CFPB's proposal that must remain intact:

1. A scope that:
    a. Includes single- and multi-payment (i.e., short- and longer-term) payday and car title loans, essential to preventing harm as well as foreseeable efforts at evasion;
    b. For longer-term loans, excludes only loans where the annual percentage rate (APR) is 36 percent or less *using an APR that is inclusive of fees and add-on products*, similar to the APR under the Military Lending Act.
2. A strong ability-to-repay principle, including consideration of income and obligations; in addition, for short-term loans, a requirement that the assessment of ability to repay cover a period extending 60-days beyond the loan's contract term;
3. Reporting requirements that facilitate back-end monitoring of loan performance, including reborrowing, to help ensure that front-end "reasonable determinations" of ability-to-repay are indeed reasonable and effective.
4. Payment protections that prevent lenders from holding sustained abusive control over a borrower's checking account.

Our primary concerns with the proposal, which we urge be addressed:

1. Short-term loans: alternative to ability to repay. In the short-term proposal, CFPB offers an alternative to the ability-to-repay requirement that would sanction three back-to-back loans twice during the year (six loans total), and 90 days' total indebtedness, with no underwriting for ability-to-repay. These loans will cause consumers harm – delinquency, default, and consequent harms. Even when delinquency or default doesn't occur, harms caused in efforts to avoid them (delinquency and default on other bills and overdraft fees, for example). *We urge that no loans without ability-to-repay underwriting or any unaffordable back-to-back loans be sanctioned, and that the 90 days' indebtedness limit be coupled with the ability-to-repay requirement rather than in lieu of it.*

2. Long-term loans:

   a. Protections against long-term, high-cost, unaffordable debt. For longer-term loans, we are concerned that the overall suite of proposed protections – upfront underwriting, protections against flipping, and back-end indications of unaffordability – are together not sufficient to keep borrowers out of long-term, high-cost debt they cannot afford. *We urge stronger protections against making these high-risk loans to borrowers already struggling with other debt; broadening the definition of "refinance" and the circumstances under which a refinance carries a presumption of inability to repay; and ensuring that back-end loan performance assessment consider late and bounced payments as additional indicators of borrower distress.*

   b. Payment-to-income alternative to ability-to-repay. The Bureau proposes that for certain longer-term loans, the lender may avoid an ability-to-repay determination by limiting the periodic loan payment to 5% of the borrower's corresponding periodic income. *This income-only method will not ensure affordability and will not prevent borrower harm, and we strongly oppose it.*

3. Scope. While we strongly support the Bureau's proposal not to limit scope based on the length or size of the loan, the Bureau proposes carving out credit card accounts, pawn loans, and loans secured by personal property other than vehicles and unsecured loans. Such credit products should be covered by the rule to the extent that they may create loopholes for replicating the risky practices that the proposal aims to constrain. *We urge the Bureau to include loans made on credit cards to the extent they otherwise meet the scope of the rule, to include some pawn loans to the extent they are functioning like payday loans, and to include loans secured by any personal property, in addition to car titles.*

III. Strong Proposed Ability-To-Repay Standards Must Not Be Undermined By Offering Lenders "Alternative Options"

A. Payday loans create a debt trap.

State regulator and independent academic studies and the CFPB's own research have reached an overwhelming data conclusion: payday loans create a debt trap for borrowers. They do so because lenders typically lend without regard to ability-to-repay. Indeed, borrowers typically *cannot* afford to repay the loan and meet ongoing financial obligations, so the lender flips them from one loan into another.

CRL's published research shows that the *average* payday borrower is in these purportedly two-week or one-month loans for *seven months* of the year.[1] The Bureau's data show 75% of all payday loan fees are from borrowers with more than 10 loans per year, with those loans churned on a nearly continual basis.[2]

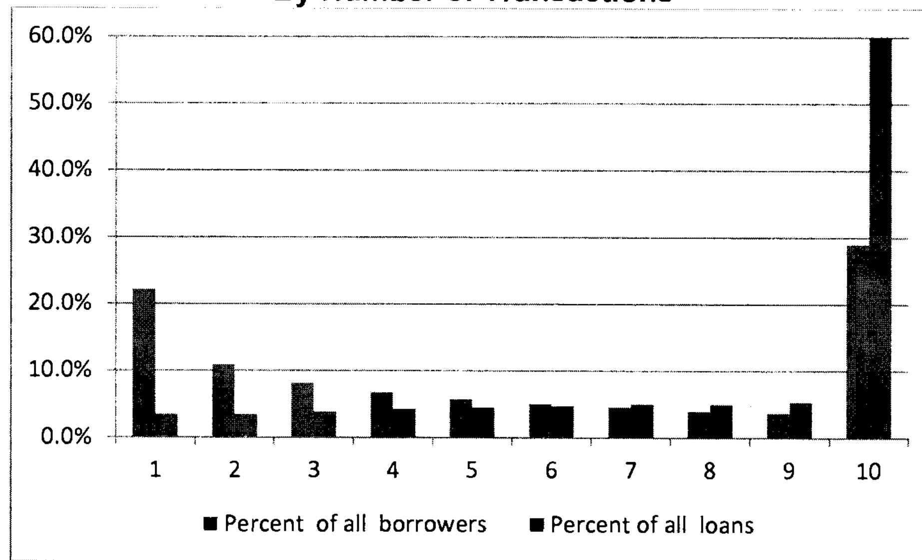
California's Department of Business Oversight 2014 payday licensee survey data confirm the findings of the CFPB on the pervasiveness of the payday lending debt trap:

- ***Payday lenders rely on borrowers who get stuck in a cycle of repeat borrowing.***[3]
  - 76% percent of all payday loan fees are due to borrowers stuck in 7 or more payday loans per year.
  - 60% of payday loan fees are from borrowers with 10 or more loans in a year.

- ***The long-term debt trap is the most typical California borrower experience.***[4]
  - Borrowers taking out 7 or more loans per year accounted for 45% of borrowers.
  - The "10 or more" loan category was the single largest, accounting for 29% of all borrowers. Conservatively, borrowers in this category received an average of 13 loans annually, or more than one loan per month.

- ***The debt trap in California is growing deeper:*** The number of borrowers with 10 or more loans in 2013 increased by 11 percent over 2012, even as the total number of payday loans declined slightly over the same period.[5]

- ***Payday loans that are used only occasionally – as they are advertised – account for only a small portion of payday lending business.***
  - Only 4 percent of all payday loan activity in 2013 was from borrowers with just one loan in 2013. These borrowers accounted for 22% of all borrowers.
  - Only 15 percent of all payday loan activity in 2013 was from borrowers with 4 or fewer loans.



Source: CA Department of Business Oversight

B. The proposed ability-to-repay standard, requiring consideration of income and expenses, is strong.

We strongly support the Bureau's proposed standard for ability to repay: a good-faith, reasonable determination that the borrower has the ability to repay the loan when due while satisfying major financial obligations and other living expenses, without defaulting or reborrowing. Indeed, if a borrower repays a loan but reborrows shortly thereafter, the borrower likely did not have the ability to repay in the first instance.

We are deeply concerned that this strong standard will be undermined by proposed alternatives to determining ability-to-repay for both short- and longer-term loans.

C. "Debt protection options" would severely undermine the strong ability-to-repay standard.

We strongly oppose any exemption from an ability-to-repay requirement. The Dodd-Frank Act and the CFPB have established the importance of ability-to-repay in mortgage lending and should extend the concept as a requirement for all lending. An ability-to-repay requirement is particularly important for payday loans, where the market incentive to underwrite is flipped on its head because the lender holds first-in-line access to the borrower's checking account. In this context, the lender is counting not on the borrower's ability to repay the loan, but rather on their ability to collect on the loan, whether or not the borrower can afford to repay it. Indeed, because substantial lender revenue is derived through loan flipping – which occurs when the loan is not affordable – the lender has a disincentive to lend to borrowers who do have the ability to repay.

CRL recently studied loan performance of payday loans made in North Dakota, a state with payday loan laws typical of states that permit payday lending.[6] We found that a very large

portion of borrowers default on their first or second loans. This provides further support that an ability-to-repay determination at the outset is required in order to prevent the harm caused by payday loans.[7] Any default may result in lender-imposed late and NSF fees, bank fees, and abusive collection tactics, and cascading financial hardships.

1. Short-term loans.

The Bureau's proposal would permit certain short-term loans not exceeding $500 to be made without regard to the borrower's ability to repay the loan. These loans would be limited to two rollovers (defined as a loan made within 60 days of the previous loan), followed by a 60-day cooling off period, coupled with an outer limit of 6 such loans and 90 days' indebtedness in such loans annually.

By sanctioning two rollovers, which are evidence of inability to repay, and exempting six very high-cost loans annually from an ability-to-repay requirement, the Bureau would undermine the basic principle of requiring universal ability-to-repay and existing state laws in about a third of states that do not permit such loans at all. While clearly not preemptive, the Bureau's rule will be seen as a federally approved guideline and will likely set the tone for debates around payday lending in the states. It should not send the message that any loan made without a determination of the borrower's ability to repay is acceptable.

A 90-days' indebtedness limit is a useful backstop against prolonged indebtedness, consistent with the FDIC's 2005 guidelines addressing payday lending.[8] *But critically, it should be a backstop, or a check, to ensure that ability-to-repay determinations at the outset are meaningful for all short-term loans—not an option in lieu of determining front-end affordability.*

We do strongly support the proposal that no short-term car title loan would be exempted from a front-end ability-to-repay requirement; this approach should be extended to payday and other covered loans as well.

2. Longer-term loans.

a. Income-only underwriting should not be permitted in lieu of a meaningful ability-to-repay determination.

The Bureau is considering permitting certain loans not exceeding $500 to be exempt from ability-to-repay underwriting where the periodic payment does not exceed 5 percent of the borrower's expected gross income for the corresponding pay period. We strongly oppose this alternative.

Income-based underwriting, with no required consideration of expenses, does not ensure affordability. As noted previously, these loans are among the riskiest, most harmful in the consumer financial market, typically made to borrowers who have already experienced financial distress. These are among the last borrowers for whom an income-only-based approximation should ensure affordability. This approach will not prevent harm, as the Bureau is charged to do, and it should not be permitted.

b. If an exemption from ability-to-repay is provided, loans similar to National Credit Union Administration-sanctioned loans would be far preferable to the income-only option.

The Bureau is also considering permitting certain loans not exceeding $1,000 with terms between 45 days and six months to be made on terms similar to those permitted for National Credit Union Administration-sanctioned loans (including an application fee reflecting costs of no more than $20 per loan and an APR not exceeding 28 percent); these would not be subject to the general underwriting requirements and would be limited in number to four annually.

These loans would mark a dramatic improvement over current market payday installment loans (installment loans paired with direct access to a borrower's bank account) and could help to bail borrowers out of loans made on far worse terms. However, we urge important additional safeguards around these loans, including:

- Underwriting must require consideration of income and expenses;
- The application fee should be limited following the first loan in a 12-month period. Since it is meant to reflect lender costs, which decrease as subsequent loans are made to the same borrower, it should not be permitted to remain static at $20 per loan.

IV. Short-term Loans: Upfront Underwriting, Protections Against Flipping, and Back-End Review of Loan Performance

For any covered loan, it is essential that the combination of strong initial underwriting, protections against loan flipping, and back-end performance review are sufficient to ensure the lender cannot trap the borrower in unaffordable loans for an extended period of time.

A. Underwriting

Both the short- and long-term proposals require similar underwriting unless the lender chooses one of the alternative, safe-harbor options. As noted above, we oppose providing alternative options and support requiring underwriting on every loan. This section addresses the proposed underwriting requirements when the alternative option is not chosen.

We support that the Bureau's proposed underwriting would require verification with third-party documentation of income and major financial obligations; indeed, we believe that any income-only based underwriting will not reasonably ensure affordability and prevent harm.

For underwritten loans, the Bureau's proposal would also require consideration of a consumer's borrowing history, which we support but urge strengthening. The Bureau is considering requiring lenders to assess whether a borrower has recently defaulted or is currently delinquent on any covered loan with that lender or affiliate, or has recently defaulted on a covered loan with any lender.

- We urge that recent delinquency or default on a covered loan at a minimum create a rebuttable presumption of inability to repay that the lender can overcome only by documenting a change in borrower circumstances.

- We further urge that a recent default on any credit, whether covered or not, create the same rebuttable presumption; if the borrower lacked the ability to repay less risky credit, it only follows that the borrower likely lacks the ability to repay this high-risk credit.

- In addition, we urge that, should the Bureau proceed in allowing the short-term non-underwritten, alternative option loan (which, as discussed below, we oppose) the rule prohibit a lender from flipping a borrower from a short-term, safe harbor loan into a long-term loan within 60 days of repayment of the safe harbor loan; otherwise, lenders may "bait" borrowers with loans that carry no underwriting requirements, allowing for quick and easy approval, only to switch them into longer-term loans carrying smaller payments but locking them into high-cost debt for an extended period of time.

B. Loan Flipping

For short-term loans that are underwritten (i.e., outside the safe harbor), the Bureau's proposal would establish a 60-day "underwriting period," meaning that the lender must determine the borrower's ability to repay the loan and meet other obligations for 60 days following the end of the loan term. As such, the proposal would prohibit additional loans within the 60-day period without demonstration of a change in circumstances. Following a third loan within sixty days of a previous loan, additional loans would be prohibited until a 60-day "cooling-off" period has passed. We support these measures.

In addition, as noted above, we support an additional backstop: an outer limit of 90 days' total indebtedness within a rolling twelve-month period, consistent with the FDIC's longstanding 2005 guidelines addressing payday lending. The CFPB has proposed this limit as part of its alternative option, but we urge that this limit be coupled with required underwriting on every loan. Again, this additional protection is warranted, and needed, in the context of a market where lender incentive is flipped on its head, the lender has a super-lien on the borrower's limited income, and the loan purports to be intended for a short-term, occasional emergency.

The Bureau also notes its concern about lenders alternating between covered and non-covered loans to evade the rules. We share this concern and urge the Bureau to include non-covered "bridging" loans in the 60-day underwriting period and the 60-day cooling off period to guard against it.

C. Back-End Loan Performance

Loan performance is an essential component of ensuring that borrowers have the ability to repay loans. Indeed, the Bureau's proposal notes that "extensive defaults or reborrowing" may be an indication that a lender's upfront underwriting methodology is not reasonable. The proposal would require annual reports containing data sufficient to monitor performance of covered loans, including information on defaults and reborrowing for both short- and long-term loans. We strongly support this requirement and urge that it also include information on late payments and bounced payments, further indicators of borrower distress and inability to repay.

V. Longer-term Loans: Upfront Underwriting, Protections Against Flipping, and Back-End Review of Loan Performance

A. Underwriting

The proposed underwriting requirements, including required verification of income and major financial obligations and consideration of borrower history, are substantially the same for longer-term loans as for short-term loans. Our recommendations in V. above apply here as well.

B. Loan Flipping

For longer-term loans, the underwriting period is the loan term, but the Bureau proposes protections around refinancings; we urge significant strengthening of protections against flipping long-term loans.

The Bureau's proposal would provide a rebuttable presumption of inability to repay for refinances under certain circumstances where borrower distress is demonstrated, but we are concerned these circumstances are too limited. In addition, the Bureau would not provide heightened protections around loans taken out very shortly after a previous loan is repaid, even if that the previous loan is repaid early. This leaves borrowers vulnerable to lenders encouraging prepayment and subsequent reborrowing in order to maximize fees and prolong indebtedness.

To address these concerns, we urge the Bureau to define a refinance to include any loan made within at least 30 days of a previous loan that is repaid early. We further urge that any refinance be deemed a sign of distress and thus trigger a presumption of inability to repay, with a possible narrowly drawn exception for cash-out refinances that are clearly not indicative of borrower distress.

Further, we are concerned about lenders switching borrowers from short-term to longer-term loans. As recommended above, we urge that a lender be prohibited from making a longer-term loan to a borrower with 60 days of short-term loan that is not underwritten, with a possible exception for longer-term loans complying with proposed (yet strengthened, as we suggest) NCUA-based requirements.

C. Back-End Review of Loan Performance

As with underwriting, the Bureau is considering similar requirements for back-end monitoring of loan performance for both short- and long-term loans. We strongly support these requirements in the longer-term loan context as well, and again urge the Bureau to require reporting of late and bounced payments for longer-term loans.

California Finance Lenders Law (CFLL) licensee annual report data show that many California lenders offering loans greater than $2,500 appear to have particularly weak underwriting based on their recent loan performance. According their 2014 annual report, Rise Credit reported charge-offs amounting to more than 100% of their average monthly loan balances. Other large installment lenders which generally have direct access to borrowers' accounts also experienced high rates: Check 'N Go (the largest installment lender in the $2,500 - $5,000 loan space) typically charged APRs of greater than 200% on such loans and reported average monthly charge

off rates of 46% in 2013 and more than 80% in 2014. Similarly, Cash Call and Net Credit also reported 2014 charge-offs in excess of 30%.[9]

These extremely high levels of defaults suggest inadequate up-front underwriting. But many such lenders can remain profitable even if they experience high levels of default because sky-high interest rates allow the loans to become profitable for the lender after only a small fraction of loan payments are made. For example, a typical Check N' Go $3,000 one year loan has an APR of approximately 220%, with monthly payments of $623.88.[10] After just five months of payments, the borrower will have repaid more than the original loan amount, or $3,119. After the sixth payment, the lender will have made $743 on this one loan. If at any point thereafter, the borrower defaults, the lender will have still made a significant profit. The borrower, however, may continue to suffer damaged credit and to contend with aggressive debt collection efforts by both the original lender or by subsequent buyers of the debt.

CFPB should both require reporting of loan performance metrics and vigilantly use these metrics to identify and take action against lenders whose upfront underwriting is not resulting in a reasonable, accurate determination of true ability to repay.

VI. Scope: Support but Expand to Include Possible Evasion Mechanisms

The Bureau's proposal would establish for the first time a single national regulatory floor for covered loans regardless of the type of lender or the channel by which the loan is delivered. Covered lenders would include deposit-taking institutions like banks and credit unions, non-depository lending businesses, as well as tribal businesses. Similarly, CFPB's standards would apply to loans originated in bank branches, in storefronts and online. We strongly support the creation of a single national floor, while also recognizing that such standards would not preempt states from establishing more robust consumer protection regimes as they see fit.

The Bureau appropriately proposes to include both single-payment and longer term, multi-payment loans, as well as both closed-end and open-end loans, within the scope of its rule. This is critical both to protect borrowers against harm from existing products and to guard against foreseeable efforts to evade a rule. In states like California where high rates are permitted on longer-term loans, payday lenders like Check N' Go are already making installment loans secured by access to the borrower's checking account. For these loans, like for balloon loans, the lender puts itself first-in-line for repayment, reasonably assured of its ability to collect regardless of the borrower's true ability to repay.

We also strongly support inclusion of all car title loans within the scope of the rule. In most of the 21 states that permit car title lending, loans are one-month balloon payment loans. In California, the rapidly growing car title lending market falls under the California Finance Lenders Law, marked by at least $2,500 long-term installment loans with triple digit interest rates and elevated rates of repossessions. Here again, lenders lack incentive to assess borrower ability to repay, taking a lien on a car the borrower owns free and clear and needs desperately, using the threat of repossession to coerce repayment. For more on car title lending abuses, see our 2013 report.[11]

The proposal would exclude from scope longer-term loans whose "all-in" APR, i.e., an APR inclusive of fees and add-on products, does not exceed 36 percent. Given deficiencies in the way

the APR is often calculated, we strongly support using an "all-in" APR, similar to the APR under the Military Lending Act, which limits interest rates to military members and their families. This "all-in" APR is critical to preventing evasion of coverage under the rule by charging periodic interest rates under 36% but with outsized origination or other fees.

While we support the above elements of the proposed scope, we have several significant concerns about potential dangerous limitations to scope: exclusion of credit cards, pawn transactions that function similarly to payday loans, and loans secured by personal property.

There should be no carve-out for credit cards. The Bureau's long-term proposal, under which typical credit cards would fall, would already provide a carve-out for loans less than 36 percent APR inclusive of most fees; thus, mainstream credit cards would typically fall outside the scope of the rule. Higher cost credit cards, typically targeted at borrowers with lower credit scores, should be covered. We are particularly concerned about the prospect of a payday lender using a credit card to evade the CFPB's proposal, which the proposal would not currently prevent.

We are also concerned that pawn transactions that function similarly to payday loans will skirt the rule's protections This is especially concerning where payday lenders use pawn to evade laws aimed to address payday loans. Currently in Ohio, for example, Cash America is attempting to move legislation that would allow it to operate under a new "pawn plus" license – escaping both payday lending regulation and tripling the state's interest rate limits, allowing triple digit APRs and no safeguards for affordability or against refinancing.[12]

Finally, loans secured by personal property provide lenders coercive leverage similar to checking account or car title access. The Federal Trade Commission recognized this with its 1984 Credit Practices Rule, prohibiting non-possessory interests in household goods, which it defined as including clothing, furniture, appliances, and personal effects, including wedding rings.[13] But this list has not been updated for many years, and it does not include certain personal property like cellular phones. The Credit Practices Rule should be updated in many respects;[14] in the meantime, CFPB should ensure that any loan secured by a non-possessory interest in personal property is covered by its payday and similar loans rule.

VII. Payment Practices: Support but Strengthen

The Bureau's proposal also includes protections around lender collection practices, (1) requiring notice to consumers at least three (and no more than seven) days prior to attempting to collect payment from the account, and (2) limiting attempts to collect payment from a consumer's account to two failed attempts at which point a new consumer authorization is required for that and future payments.

These proposals underscore the tremendous harm that payday and car title lenders cause borrowers through first-in-line access to their checking accounts.[15] We support the above proposed protections while urging that they be strengthened.

CFPB should clarify that the lender notice should be required regardless of payment presentment method (e.g., ACH, debit card), and it should include notice of the borrower's right to revoke authorization.

With respect to reauthorizations, since repeated failed presentments indicate an inability to repay, the requirements for obtaining a borrower's reauthorization should be more stringent than obtaining the initial authorization. The lender should be required to document demonstrated change in financial condition or sufficient funds. Further, providing a single payment after automatic revocation of the initial authorization should not constitute or be concurrent with reauthorization for future, recurring payments.

Beyond these two elements of the proposal, we urge that CFPB make clear that the only method by which lenders may provide incentive to borrowers to provide lenders with electronic access to their account is by offering a modest monetary discount. They may not, for example, deny expedited access to funds when borrowers refuse to provide access to the account.

VIII. Conclusion

We thank the Committee for the opportunity to testify on this important proposal, and we would be happy to discuss our comments further.

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[1] Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf.

[2] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 22 (April 24, 2013) *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[3] Center for Responsible Lending calculations based on Summary Report: California Deferred Deposit Transaction Law – Industry Survey, Page 6. The total number of loans is assumed to be 12.2 million, as reported in the DBO 2013 Annual Report, http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2014_CDDTL_Industry_Survey_Summary_Report_Letter.pdf:

[4] Paul Leonard & Graciela Aponte, *Analysis: New State Data Show California Payday Lenders Continue to Rely on Trapping Borrowers in Debt, (*Oct. 9, 2014) available at http://www.responsiblelending.org/payday-lending/research-analysis/CRL-Analysis-CA-Payday-Lenders-Rely-on-Trapping-Borrowers-in-Debt.pdf. DBO's survey provides very conservative estimates of the debt trap. The survey does not take into account borrowers who use multiple lenders over the course of the year. A borrower who takes out three loans from one lender might also be taking out 8 or 10 loans from one or more other lenders. Because each lender would report only its own data, this would under count the total number of loans for that borrower and potentially over count the number of borrowers in the more occasional use categories.

[5] This estimate is very conservative, since it does not adjust for the lower percentage of licensees replying to DBO's survey in 2013 (78% in 2013 vs 93% in 2012). See page 6, http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2013_CDDTL_Industry_Survey_Summary_Report_Letter.pdf There were 12.2 million loans in 2013, a decline of 91,194 or less than 1% Data on number of transactions comes from *DBO Annual Report 2013, p 7.*

[6] Susanna Montezemolo and Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, Center for Responsible Lending (Mar. 2015), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-mayday-visible-and.html.

[7] *Id.* at 5-6 (finding that nearly half of all North Dakota payday borrowers defaulted within two years of taking out their first loan, and of those who defaulted, nearly half defaulted on either their first or second loan).

[8] FDIC 2005 Payday Loan Guidelines, *available at* https://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[9] CRL calculations based on each licensee's DBO Annual Reports, available upon request.

[10] Terms taken from Check N' Go California Installment Loan Schedule of Charges, https://www.checkngo.com/wp-content/themes/cng/assets/stateDisclosures/California_ILP/schedcharges__ILP___CA___online_.jpg, viewed May 5, 2015.

[11] Susanna Montezemolo, *The State of Lending in America and Its Impact on U.S. Households: Car-Title Lending*, Center for Responsible Lending (July 2013), *available at* http://www.responsiblelending.org/state-of-lending/reports/7-Car-Title-Loans.pdf.

[12] Sheryl Harris, *Payday lenders sneak new loan license into House*, The Plain Dealer (May 1, 2015), *available at* http://www.cleveland.com/consumeraffairs/index.ssf/2015/05/payday_lenders_sneak_a_new_loa.html#incart_river.

[13] 16 C.F.R. § 444.1(i).

[14] Margot Saunders, *Time to Update the Credit Practices Rule: CFPB Should Modernize FTC Rule Addressing Abusive Creditor Collection Practices,* National Consumer Law Center (Dec. 2010), *available at* https://www.nclc.org/images/pdf/debt_collection/credit-practices-rule-update.pdf.

[15] *Payday Mayday, supra,* at 10 (finding that for payday borrowers (across a range of states) in a dataset we analyzed, overdrafts and bounced transactions frequently occurred close in time to the use of payday loans. Nearly half of payday borrowers incurred an overdraft or NSF fee in the two weeks after a payday loan transaction, and 64% paid overdraft or NSF fees at some point during the period they were in the dataset).

Senate Banking Committee Informational Hearing on the Consumer Financial Protection Bureau's Proposal to End Debt Traps
Wednesday, May 6, 2015

Testimony by Liana Molina, Organizer
California Reinvestment Coalition

Thank you for the opportunity to share our organization's experience and perspectives on the Consumer Financial Protection Bureau's (CFPB) preliminary proposal for regulating the short-term small dollar credit market. My name is Liana Molina and I'm an organizer with the California Reinvestment Coalition, also known as CRC. CRC is a statewide, membership-based, nonprofit advocacy organization dedicated to increasing fair and equal access to banking and other financial services for California's low-income communities and communities of color. Our members include affordable housing developers, housing counselors, small business technical assistance providers, financial counselors, community development financial institutions (CDFIs), legal services providers and other practitioners who see firsthand the needs of economically marginalized communities across the state.

Throughout the years, we've worked with our members and allies in dozens of California cities to educate policy makers and the public on the harms of predatory payday lending. Numerous cities, ranging from Sacramento to Fresno, San Jose to Long Beach, and many other jurisdictions have enacted local ordinances to prohibit or restrict the expansion of payday and other fringe financial entities within their communities. Local governments have done so on the premise that payday lenders and other high-cost financial services companies pose a threat to the public good, erode the quality of life in our cities, strip away the income and assets of vulnerable consumers and create an economic drain on families and communities.

These local efforts are also partly in response to the state legislature's failure to advance strong consumer protections against unfair and abusive lending practices, especially in the payday lending market. We know from the Department of Business Oversight's annual reports, as well as extensive research by the federal Consumer Financial Protection Bureau and countless other, nonpartisan research organizations that short-term, high-cost, balloon payment payday loan products create a long-term cycle of debt for most consumers.

That is why CRC optimistically welcomes the CFPB's proposal, and we are heavily invested in ensuring strong rules are enacted, and loopholes that would enable high-cost debt trap products to continue to harm consumers are closed. We are encouraged that the CFPB is

proposing a broad rule that encompasses a range of high-cost loan products. We know that when consumers are treading tumultuous financial waters, payday loans are like an anchor, which only sink consumers deeper into debt and often times, drown them in a cycle they cannot get out of. We share a similar analysis and echo many of the same concerns that our partners at the Center for Responsible Lending have outlined in their oral and written testimony.

I have been leading CRC's campaign to reform high-cost payday lending since 2008, during which time I've sat and met with several consumers and heard heartbreaking stories of how their lives have been impacted by financial debt traps. This afternoon, I'd like to share a brief case study which demonstrates why the CFPB rules are so urgent and important, and why we believe that a mandatory ability to repay requirement is absolutely essential for any meaningful reforms by the CFPB.

Currently it is very easy, perhaps too easy to access payday loans and other extremely expensive forms of credit. The over-proliferation of payday lending storefronts in low-income neighborhoods, coupled with the complete lack of underwriting standards ensures that anyone who wants money in their pocket right now can get some from their neighborhood payday lender, as long as they have an income and a checking account. It doesn't matter if they have a low-income that isn't enough to meet their basic necessities, or if their only income is a public benefit such as social security or disability insurance. It doesn't matter if their bank account balance is consistently low or entirely empty. These things do not matter to payday lenders, because they always make sure that they get repaid first since they have direct access to the borrower's bank account.

While the industry argues they are doing working people struggling to make ends meet a favor by extending them credit, this easy, unbridled access to credit is often to the detriment of the unsuspecting consumer. This type of easy credit is hurting hard working people like Carmen Munoz and Davina Esparza, who have both struggled with triple-digit interest payday and installment loan debt for years on end.

Carmen and Davina are neighboring residents of East Los Angeles, in Senator De Leon's district. Carmen is currently unemployed and her unemployment benefits ended on April 27th. She did clerical work for a law office for 18 years before being laid off last October. She specifically assisted their attorneys working with clients on debt collection issues, so she has some familiarity with lending and debt collection practices. However, that didn't help Carmen from falling into a bottomless financial pit.

At one time, Carmen had four simultaneous payday loans from Advance America, ACE Cash Express, PLS (the Payday Loan Store), and Speedy Cash, all storefront lenders located in her neighborhood. Each of these was for the maximum amount of $300. At the same time, she had two internet payday loans, one for $300 from United Loan and one for $1,000 from AmeriLoan.

On top of these six storefront and online loans, she also had two installment loans, one for $5,000 from Cash Call, and another for about $8,000 from Springleaf Financial.

Carmen carried her multiple payday loan debts on a consistent basis from about 2007 up until about 2012. During this time, she estimates that she paid over $14K in interest and fees, not including the hundreds of dollars that she lost in overdraft fees to Bank of America. She permanently forwent her home telephone and cable television services and even had her water shut off at some points. In 2012, she received an email solicitation from Payless Financial, advertising their payday loan consolidation program for consumers with 3 or more payday loans. In an effort to deal with her overwhelming payday loan debt, she signed-up. That is how she finally ended her payday loan nightmare, but it wasn't without negative consequences. Carmen also had to close her bank account. To this day she uses a prepaid debit card for her financial transactions.

Though the phone calls from the payday lenders stopped, Payless Financial failed to provide Carmen with any documentation verifying her account details, and her credit score plummeted from 620 to 104. Carmen is still struggling to pay off her Cash Call and Springleaf Financial loans. She initially wanted a $2500 loan from Cash Call, however they deposited $5,000 into her account and told her she could return the extra $2500 early so that she wouldn't have to pay interest on it. But at that point, since the money was already in her account, she decided to keep it and purchase some home appliances that she needed, a washer, dryer and a stove. She's been paying on her Cash Call loan since February of 2007 and when she's done she will have paid a finance charge of $16,478 to borrow $5,000.

This is unconscionable. These industries are running amok and they need to be reined in at all levels. While Carmen's situation is extreme, we know that this is a common experience for people mired in high-cost debt traps. Carmen's case illustrates why lenders should be required to assess the borrower's ability to repay any and all loans, factoring in their income, their expenses and debt obligations as well as their borrowing history. Furthermore, we need tools to enforce our existing state law and the CFPB's proposed rule that specifies that consumers should only be able to access to one loan at a time. Too many people like Carmen are in over their heads with multiple loans that they cannot afford and shouldn't have been given in the first place. That is why we need both an ability to repay requirement from the onset plus additional debt protections, not optional underwriting that most lenders will opt not to do.

Finally, if the CFPB sets forth a 90- days' indebtedness limit and provides protections around lender collection practices, it will prevent people like Carmen from falling into perpetual debt that strips them of their hard-earned income, impedes their ability to save, forces them out of the financial mainstream, ruins their credit, and creates a lot of stress and anxiety for them and their family.

Thank you for your time and consideration.

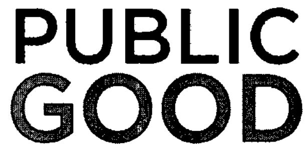
Davina Esparza's Story:

Davina Esparza is a substance abuse counselor who works and resides in East Los Angeles. She's been working in this field for the past 5 years. She currently has four $300 payday loans from PLS, Speedy Cash, ACE Cash Express and Advance America. She also borrowed an installment loan in the amount of $2,600 from Speedy Cash in September of 2014.

She first started using payday loans about 6 or 7 years ago. However, her current situation of using multiple payday loans every two weeks started at the end of 2012. Her roommate moved out and she was left to cover all of her housing expenses on her own. She has been churning four payday loans every two weeks for over two years, and she has paid an estimated $10,000 in fees. In addition, she's been paying $141 every two weeks on her Speedy Cash installment loan, and has already paid $2,256 between September of last year and March of this year. However, her total balance as of May 1st is still $2,675. On top of her outstanding payday and installment loans, she has a car note from her credit union that she pays $325 a month on, plus $180 in insurance and $1150 in rent. After taxes, Davina earns about $1,800 a month.

Davina has reached her breaking point, and she is struggling to figure out a way to get out of debt. She doesn't want to default on the loans, but at this point she cannot find another alternative. She has recently received three utility disconnection notices from her gas, water and light companies. To make matters worse, she is facing being laid off from work, because her agency was recently acquired by another company.

If there were a strong ability to repay requirement, and if the one loan at a time law were actually enforced, Davina would not be in this situation.



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Testimony of Ted Mermin
Executive Director, Public Good Law Center
Senior Adviser, Consumer Law Practice, East Bay Community Law Center

California Senate Banking Committee
Informational Hearing

Re Consumer Financial Protection Bureau
Small Business Advisory Review Panel
Potential Rulemakings for Payday, Vehicle Title, and Similar Loans
Outline of Proposals Under Consideration and
Alternatives Considered

May 6, 2015

Good afternoon and thank you for the opportunity to speak with the Committee on a subject of pressing importance to our nation and our state. My name is Ted Mermin. I am the Executive Director of the Public Good Law Center, and a senior adviser to the Consumer Law Practice of the East Bay Community Law Center (or EBCLC). I also teach Consumer Law at the UC Berkeley Law School. Public Good has been involved in cases involving the financial products at issue here, including one now pending in the California Supreme Court. The East Bay Community Law Center is the largest provider of legal services to low-income residents of the East Bay and home to a consumer practice that has seen thousands of clients since its doors opened 7 years ago.

I began this process with the idea that payday loans must provide some benefits to go along with the vividly documented debt traps that those who work at EBCLC, and in other legal service clinics around the state, have seen all too many of our clients fall into. It was my assumption that if there are more payday lending storefronts in this country than there are McDonald's[1] then they must be doing *some* good. So I tried to keep an open mind as I surveyed my colleagues about their clients' experiences with short-term payday and auto title loans, and what the impact of the CFPB's proposed rules might be.

Here's how they responded:

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[1] John Oliver, Last Week Tonight, *Predatory Lending* (Aug. 10, 2014), available at https://www.youtube.com/watch?v=PDylgzybWAw

I. On payday loans:

From Oakland:

"Our client Maria Gonzales is 68 years old and receives as her sole income $1759 in monthly SS retirement. Over the last year, in order to help out her struggling granddaughter, Ms. Gonzales has taken out payday loans – indeed, Ms. Gonzales currently renews 7 low-dollar loans every month. She has never defaulted on any of them. This means she has renewed multiple loans more than 12 times, and has renewed every loan no fewer than 6 times. She pays over $500 in fees per month just to stay up to date with all 7 payday loans, and has no way to pay them off (because she could never come up with the necessary lump sum payments). And because her monthly living expenses exceed the amount of money that remains, she is being driven ever more deeply into debt."

This is what the cycle of debt means. People are living on a fixed-income or paycheck to paycheck, and the additional burden of paying back payday loans drives them over the edge. The CFPB proposal prohibiting concurrent short-term loans from multiple lenders would have stopped this cycle before it began.

II. On auto title loans:

From San Francisco:

"Our client, Ralph Simpson, was homeless and living in his car. He had no income and yet somehow managed to get an auto title loan. Then when the title lender came to repossess the car, Mr. Simpson was left with nothing."

As another colleague told me, payday and auto title loans are the tipping point for real trouble. Clients already don't have excess income and now it's redirected to trying to pay back an endless cycle of loans. To keep their car, which is often the only way they can get to work to make money, they will prioritize loan payments ahead of the necessities of life. Ahead of paying for utilities, or for groceries, or for their child's dental treatment. The Bureau's proposal requires that both income and ability to repay be verified in the case of auto title loans. If that requirement had been in place, it would have saved Mr. Simpson his car.

From San Diego:

"One lender charged an exorbitant interest rate for a series of loans secured by our client's car title. In addition to inaccurate and deceptive disclosures regarding the annual percentage rate, hidden finance charges, and undisclosed payments to third parties, they even sneaked an unauthorized tracking device onto the vehicle during an 'inspection.'"

That hidden tracking device is of course a violation of the Penal Code.[2] *In that and the other enumerated violations, this example illustrates that the CFPB's rulemaking needs to retain its emphasis on harmonizing other applicable federal law and on* _not_ *supplanting more protective state law. Instead, the new Rule should set a floor above which states are free to go. There is perhaps no place more appropriate for underscoring the importance of respecting states' authority to offer further protections to their consumers than the legislature of the most populous state in the Union.*

III. On Privacy
(*Here is an issue where the CFPB proposal needs work.*)

From Oakland:
"Around 7 or 8 years ago, our client Stephen Jones borrowed $250 from a payday lender. He made some payments but defaulted. Recently someone has been calling Mr. Jones claiming the debt was transferred to them and that he must pay a substantially higher amount or the sheriff will pick him up. They have his birthday and his social security number. They keep insisting that he put the money on a prepaid card. They refuse to give him their company name or address. Mr. Jones visited the payday lender, and they confirmed that there is no record that his debt was sold."

From San Diego:
On the same topic, colleagues write: "We have received a large number of calls from clients regarding payday loans they purportedly took out and are receiving very threatening debt collection attempts. ('The sheriff is coming to arrest you' type of calls.) However, it is not the payday lender or authorized third party debt collector, but a 'fraudster' who has significant personal identifying information regarding the client, including social security numbers. It appears the source of the personal identifying information is a payday lender."

The Bureau needs to provide measures that will ensure the security and privacy of borrowers' personally identifiable information and financial information. The Proposal as written does not address these issues.

Those are just a few examples of the issues raised by payday and auto title loans among legal service providers around the state – in many cases the front lines for dealing with the serious financial and personal harm that these types of loans can cause. There are of course more example – scores more – even in response to a brief survey. (And then there are the examples of abuses in the context of *longer*-term covered loans. As it turns out, I learned in preparing for this hearing, legal service providers in the state see as many of those or more.)

As to shorter term loans: The consensus of legal service providers around the state is that people who take out payday loans know they are being taken advantage of, but they just don't think that

[2] *See* Penal Code § 637.7.

there are any options. They wish that what they are experiencing were illegal, so there might be some relief. The CFPB's rulemaking is very welcome.

Now, remember that I began this survey of my colleagues with an open mind and en eye toward hearing not only about abuses but also about the people whom payday loans were actually *helping*. I wanted to hear the stories on the other side of the ledger. So I asked my colleagues around California, including one at the East Bay Community Law Center who used to run the housing clinic there, whether they had ever seen payday loans work in the way they are marketed – for example, to tide a family over for the few days needed to make a rent payment and keep them from being evicted. I expected that my colleague would say she had, that these were the people that payday loan helped even while there were many others who got caught in a debt trap. But that's not the response I got. This is what she said:

"I have never seen a payday loan solve someone's problem. I have seen people hurt by payday loans. I have saved those people from being evicted because of them. I have heard clients talk about not having enough money for food because of them. And the cycle of taking out more loans to pay the interest is never-ending. It takes a toll on people."

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We have to recognize that we have a problem. It is the only way we are going to solve it. Whatever we may have done over the past two decades, we have to look forward to what we can do, what we should do, to provide credit – and protection – to the most vulnerable Californians.

Remember what we have heard here already today. While there are storefront payday lenders who have adhered to existing California law, there are other lenders who have done everything they could to avoid it: from moving online and declaring themselves beyond the state's jurisdiction, to trying to borrow alleged immunity from state law from national banks, to styling themselves credit service organizations, and now to affiliating with Native American tribes and declaring themselves cloaked in *their* sovereign immunity. Remember this is all to go *beyond* the 459% APR that is currently permitted under California law. There is something deeply wrong here. One day we will look back wonderingly, after the frenzy – as we did with "liar loan" mortgages and the pay-option ARM – and ask "Why did we let that happen? What were we thinking?" Perhaps that time has finally come.

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There is a demand for credit among low-income consumers in this state. As we have just heard, and as the CFPB and the Pew Trust[3] have painstakingly documented, some of the products offered in response to that demand have caused too much injury, are simply too hazardous, to remain on the market as is. The CFPB has proposed, therefore, to place some safeguards on those products. We would prefer that the various safety measures be more stringent than they

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[3] The Pew Charitable Trusts, *Payday Lending in America* (Mar. 27, 2015), *available at* http://www.pewtrusts.org/en/research-and-analysis/collections/2014/12/payday-lending-in-america

are. I have no doubt that others in the room here today would prefer that they be less stringent.

But let us agree on one thing: the time for hiding our heads and pretending that all is just fine is over. The time to act is upon us.

Presentation by Dan Gwaltney to the
Senate Banking & Finance Committee, May 6, 2015
Initial Reactions to the CFPB's Lending Proposal (Short Term Loans)

Mr. Chair and Members, I am Dan Gwaltney, President of the California Financial Service Providers. Since the founding of our trade association in 1950, our members have been providing access to financial services to California consumers in the communities in which they work and live. Currently, CFSP members operate under licenses and permits issued by the Department of Business Oversight and the Department of Justice. Our neighborhood financial service centers offer such services as check cashing, deferred deposits, installment loans, title loans, pawn, debit cards and money transfer services. We are grateful to the committee for giving us the opportunity to testify today on the impacts to the CFPB's proposed rules on California.

Our members are deeply concerned about the ramifications of what the federal regulator is proposing. After reviewing the CFPB's 57 page document, it has become quite evident that the Bureau is attempting to fundamentally change the nature of small dollar lending in America. Short term, small dollar loans such as California's Deferred Deposit Transaction product are popular because they are simple, easy to understand and convenient for the customer. Unfortunately, the Bureau's proposed changes will eliminate these features. For example, the additional requirements under the ability-to-repay rules such as running a "Big 3" credit report, performing lengthy verifications of major obligations, and reporting transactions to <u>all</u> commercially available reporting systems will make applying for a payday loan no different than applying for a car or home loan. Applicants would be burdened with

cumbersome paperwork requests. Certain customers who are cash based and cannot document their expenses would be locked out. Moreover, the Bureau's underwriting cost analysis of these new rules ignores the added expense of validating all applications regardless of whether or not a transaction is eventually completed. This means that each funded loan must absorb the underwriting cost for those applicants that aren't approved. The average payday advance in California is only $221 dollars. Factoring in the additional labor, documentation, and verification costs, it is clear to see that this requirement is not financially viable. If this was, the banks would already be doing it. Looking at the 2013 California Deferred Deposit Annual Report, it is a stretch to conclude that lenders are engaging in inadequate underwriting given that loan loss rates are just 2.8% of principal lent. As For-Profit enterprises, lenders want to get paid back and therefore do not wish to extend credit to customers that cannot afford to repay.

If we step back and look at the underlying premise of the Bureau's proposal, it is believed that a payday loan customer does not gain any economic benefit from the liquidity provided by the use of these loans. In fact, the opposite is suggested in that sequences of short term credit use only produces harm. This theory has led to the proposed short term alternatives with mandatory 60 day credit denial periods. However, the Bureau has not provided any scientifically based analysis of this claim as required by law and is attempting a one-size-fits-all approach. Missing from their proposed rulemaking document is any reference to various state law protections. Experiences in one state may differ dramatically from another. Furthermore, one would think that if customers are experiencing tremendous difficulties with this form of credit, it would be indicated in the level of complaints. Out of 12 million California

transactions last year, the Bureau only received 510 complaints. This isn't even a 10th of a percent of deferred deposit transactions.

So what will be the effect on businesses in California if these proposed rules are adopted? Simply put - Small businesses won't be able to make it. There are 297 licensed payday lenders in California. Over 90% of these companies are small businesses. Referencing the table on page 45 of the proposal, the Bureau projects large companies will experience between a 60 to 75% drop in revenue if these rules go into effect. A recent Charles River Associates study analyzed 234 small business locations and concluded that they will see a more severe drop in revenue of 82% leading to 84% of the stores becoming unprofitable. My company was one of the lenders studied. Frankly put - we will not be able to stay in business. Our 93 employees will need to look for new jobs, our 25 landlords will have vacant storefronts and most importantly, our thousands of customers will lose access to financial services they need. Now extrapolate this to the other 280 licensed small lenders and 17 larger lenders in California collectively with 2,058 locations to see the overall economic impact.

Finally, the effect of these proposed rules on Californian customers will be quite dramatic. Since the CFPB has not taken into consideration the lack of other small dollar loan alternatives in California, most of the 3 billion dollars in annual regulated payday loan credit will become unavailable. Many customers will simply lose access to legitimate lenders and turn to the unregulated black market. We ask that this state legislature inform the CFPB that their proposals will hurt our customers and our licensed providers. Please request that the Bureau slow down, do the required analysis and thoughtfully come up with targeted consumer

protections that help the small group of customers that need them but not harm the majority that use small dollar loans responsibly. Thank you.

California State Senate Committee on Banking and Financial Institutions
CFPB Lending Proposal – Oversight Hearing May 6, 2015

Testimony of Jabo Covert, Sr. Vice President, Check into Cash

Mister Chairman and committee members, my name is Jabo Covert. I am Senior Vice President of Check into Cash. We operate 175 stores in California, with more than 500 employees. Our stores provide a range of consumer financial services, including short term, small dollar loans. Thank you for inviting me to participate today.

In 2010, Congress passed what is known as the Dodd-Frank law. Enacted in response to the 2008 financial meltdown, this reform legislation empowers the federal government to centrally manage risks to the American financial system. It was designed to prevent another crisis and eliminate the problem of too-big-to-fail banks.

This legislation gave birth to the CFPB, the Consumer Financial Protection Bureau, a new agency with a $600 billion budget that has no Congressional oversight over either its policy or its budget.

To date, the CFPB has created nearly 400 new regulations. And, according to data from the American Action Forum, it has imposed more than 20 billion dollars in new compliance costs on the financial industry. These regulations have weighed more heavily on small businesses and banks that cannot absorb the new costs as easily as their giant rivals that were the supposed cause of the financial meltdown.

Not surprisingly, many of Dodd-Frank's costs so far have been passed on to consumers in the form of higher bank fees and reduced services.

Meanwhile, the F-D-I-C, Federal Deposit Insurance Corporation, estimates the number of "unbanked" consumers in America rose by one million from 2009 to 2011, with payday lending and other alternative financial services increasing during the same time frame.

The bottom line: Dodd-Frank has continually pushed customers out of existing products, away from traditional financial services. Now, CFPB is considering rules that may – yet again – move these customers away from another set of existing, legitimate products and into more uncertainty.

Regulations on credit from the CFPB must achieve a delicate balance. They must enhance consumer protections. But, they also need to preserve access to credit. And to truly strike this balance, any new rules for short-term credit, have to be grounded in fact-based research, not anecdote or conjecture. However, to date, the CFPB has not conducted the necessary research to determine the consumer welfare impact of products like payday loans.

The CFPB's examination of the short-term credit industry thus far has been conclusion-rich and research-poor. For example, the CFPB is sure consumers are harmed by short-term credit products. But, the Bureau has NOT established through rigorous empirical research that these credit products actually harm consumers. All the while, the Bureau ignores other research that supports the conclusion short-term credit products enhance the welfare of consumers.

Our industry is prepared to entertain reforms to payday lending that are consumer focused. But, those reforms need to be supported by real data.

While the economy is growing, so is income inequality. Millions of Americans already live paycheck-to-paycheck and more than 40 million households lack access to traditional banking services, according to the FDIC. For these households, financial services like payday, installment or title loans are among their best options when they need credit. According to the FDIC, more than 14 million households annually rely on alternative financial services outside the traditional banking system.

It's important to remember regulation already exists for legitimate small lenders. In California and more than 30 states where these loans are offered, for example, there are already strict limits on loan amounts and fees. Legitimate companies are subject to audit and enforcement action by both state and federal agencies.

Consumers and communities will not be helped by rules that will, in effect, just end access to a legitimate credit option and, at the same time, put thousands of small businesses at risk along with the jobs of their employees. My company alone employs more than 400 employees in California with an annual payroll of 17 million.

If the CFPB wanted this rule to protect consumers, it would consider the real-world impact the rule would have on access to credit. In fact, for millions of borrowers, the CFPB's proposed rules would further constrict already-limited credit options. Consumers fare well with choice; without it, they are imperiled.

The ability to choose among options is at the heart of the free market enterprise system. It is the very essence of personal freedom. Consumers are not served if "protections" are so overreaching that it means they have

no options or access to credit. In order to maintain the integrity of the rulemaking and protect consumers, it is important that the CFPB truly listen and take into account the very real impact that its actions in Washington have on small businesses, their employees and consumers across America

No one feels that our banking system is more safe and secure now than it was in 2010. Instead of tackling and solving the hard problems, CFPB is currently focused on $255 loans taken out by middle class voters who had nothing to do with the banking failures of the last decade.

All experience suggests that when legal choices are restricted, people turn to illegal choices. The demand for credit will not evaporate due to potentially new onerous federal rules. Loan sharks and racketeers could soon make a comeback, all because of Dodd-Frank's consumer protection provisions.

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California State Senate Committee on Banking and Financial Institutions
CFPB Lending Proposal – Oversight Hearing May 6, 2015

Testimony of Carol Stewart, Sr. Vice President, Advance America

Thank you, Mister Chairman and members of the committee.

My name is Carol Stewart, Senior Vice President of Government Affairs for Advance America, a non-bank provider of consumer financial services in the United States, including cash advances. We have over 260 locations in California and employ over 750 Californians.

The CFPB and its supporters have failed to address the most critical question: If these rules are implemented, what happens when a consumer with an urgent financial need walks into a payday lending center, and can't get the credit they need when they need it?

Whether they are dealing with medical expenses, car repairs, or just an unexpected cash shortfall before their next paycheck, consumers cannot predict the financial challenges they may encounter in a year, especially in our current economy and constricted credit market.

The Federal Reserve's Report on the Economic Well-Being of U.S. Households found that 52 percent of respondents could not cover a hypothetical emergency expense of $400. Taking away their ability to borrow – as the proposed rules would effectively do – doesn't erase the need for credit or ease the challenges our customers face. Rather, these

arbitrary limits on access to credit will push borrowers to alternatives that are either more expensive or have fewer consumer protections. In fact, in California, there really is NO legal, viable loan option for consumers who want to borrow under $2500 other than a payday loan.

The proposed rules do not create a level playing field among similar, competing products, as the Bureau said it would. Rather, lock-out periods and punitive underwriting standards amount to the CFPB picking winners and losers in the marketplace, creating entirely new products, and disregarding consumers' clear preferences in favor of the Bureau's own biased judgments. All without credible research to justify its proposals.

Among the Bureau's handpicked winners would be more expensive bank alternatives such as credit cards and overdraft programs, which some borrowers may have the option to turn to in the absence of payday loans. Despite the unclear terms, hidden fees and higher costs associated with these competing credit products, the government doesn't tell consumers they have to wait between credit card transactions or between uses of their overdraft protection program. As a result, these services have everything to gain from rules that block consumers from regulated payday lenders.

The other big winners will be the illegal and unlicensed lenders who operate in the shadows, and who inevitably prosper wherever regulated payday lending is restricted or banned. As California's Department of Business Oversight knows, these lenders are outside of the State's jurisdiction and even if one site is shut down, it will open quickly under another name and consumers here will have no protection from them.

And let's not forget who is pushing for these proposals: well-heeled activists who have never had to use payday loans to make ends meet, and think payday loan borrowers can't make informed financial decisions on their own.

On the other side of the equation, the losers.

At the top of this list are the consumers who will lose an effective, popular option for managing financial challenges. The proposed rules show that the Bureau still does not understand our customers, their needs, or the rational and informed decision they make to use payday loans to manage episodic financial challenges.

States like California, which have worked hard to develop laws and regulations that balance consumer protection with equitable access to credit, will also lose. These states will lose the ability to regulate payday loans as they see fit, no longer able to ensure that their residents have real credit options to choose from. Laws that have been crafted and debated over decades will be usurped by shortsighted and overbearing federal regulations.

And finally, small businesses will lose. The proposed rules set requirements that no small operator can meet – and that no other industry must adhere to. The rules would immediately destroy small businesses, while subjecting larger operators to a slow death.

Customers choose cash advances because they are reliable, transparent and readily accessible. They're also cost-effective – consumers know these loans can be cheaper than overdraft fees, insufficient funds fees and missed payment penalties.

The proposed rules essentially invent new products, completely unlike any credit option currently available in California or any of the 35 states that make up today's regulated marketplace. The Bureau is prescribing over-reaching test lab solutions, without ever attempting to study the actual effects on consumers who occasionally count on regulated payday loans, or examining the effectiveness of different state regulatory approaches.

In a national poll conducted this year, almost 7 in 10 respondents from households that have used payday loans in the past agree that they "should be able to decide how often you take out a payday loan and not be limited by government restrictions." But as usual, people who have no need for payday loans are leading the charge to eliminate them, while dismissing the rational actions of millions of Americans who value our service.

In conclusion, I'd like to return to my original question: what happens when a consumer with an urgent financial need walks into a payday lending center and can't get credit when they need it most?

In fact, we know the answer: a Federal Reserve of New York staff study compared households in states where payday loans are available to the states of Georgia and North Carolina, where short-term lending is effectively banned. The study found that consumers in Georgia and North

Carolina "bounced more checks, complained more about lenders and debt collectors and have filed for Chapter 7 bankruptcy at a higher rate." That is the inevitable effect of the CFPB's proposed rules.

Bottom line -- tens of millions of Americans choose and appreciate our products and services, yet Washington remains intent on limiting or eliminating their choices.

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California State Senate Committee on Banking and Financial Institutions
CFPB Lending Proposal – Oversight Hearing May 6, 2015

Testimony of Rob Grieser, Sr. Vice President, Community Choice Financial, Inc.

Good afternoon Chairman Block and committee members. My name is Rob Grieser. I am Senior Vice President of Governmental Affairs for Community Choice Financial Inc. Community Choice is a leading retailer of alternative financial services through a network of 547 retail storefronts across 15 states. In California we operate 160 branch locations under the store names California Check-Cashing and Cash One, and employ approximately 950 Californians.

In addition to our branch network, we also offer loans over the Internet through a subsidiary, Cash Central of California, which is licensed under the Deferred Deposit Statute and Consumer Finance Law.

We provide a variety of financial products and services, including short-term loans, medium-term installment loans, check-cashing, prepaid debit cards, and other financial services that address the needs of our customers. Specifically, in California, we offer short-term loans up to $255 and installment loans above $2,500. The current regulatory structure of the California Financial Code does not provide us the ability to offer a profitable loan product between the $255 and the $2,500 level.

Prior to my industry experience, I spent half my career as a state regulator in Ohio for the Division of Financial Institutions. My first job out of college was as a field examiner for Consumer Finance. Later in my career, I also spent 8 years as the

primary regulator for the Consumer Finance area of the Division of Financial Institutions. In my capacity as Deputy Superintendent for Consumer Finance we regulated all of the financial lending statutes for non-depository financial institutions operating in Ohio.

As a former regulator, I am a strong proponent of state regulation for retail credit. Regulation of these industries at the state level has been in existence for approximately 100 years. This model has worked well and met the needs of the American consumer. While there is a need to update many statutes to increase the regulated product choices offered to consumers in the marketplace, it is clear state regulation still works today.

The subject of our meeting today is the proposed rule concepts recently publicized by the Consumer Financial Protection Bureau (CFPB). As we heard earlier, these administrative regulations focus on both closed-end and open-end credit products with specific requirements for loans made with duration of 45 days or less and different requirements for loans in excess of 45 days. While the concepts present all sorts of problems for our Industry and the financial marketplace, what is most troubling is the fact that - if enacted - the new loan rules will severely reduce the availability of credit for the average middle-class American.

The proposed rules will result in fewer choices in legitimate, regulated short-term credit for consumers ... at a time when we should be working to improve and

increase regulated alternatives so consumers can make the best choices for their own personal situations.

We serve a large and growing market of individuals who have limited or no access to traditional sources of consumer credit and financial services. A 2013 study conducted by the FDIC indicates that approximately 60 million adults in the U.S. are either unbanked or underbanked. Further limiting credit choices and availability to this population is - in my opinion - NOT the direction we should be moving.

We should not pretend that limiting legitimate choices will somehow automatically end up helping consumers. Limiting legitimate choices does not instantly make the demand go away. Consumers will – without a doubt – continue to seek and find credit where they can. But, without legitimate choices ... the question is "to where will they turn?" As we all know, there are certainly many unregulated, illegal services out there – on the Internet, overseas and elsewhere – ready to fill the gap if regulated, legitimate options do not exist.

During my days as a young field examiner for Ohio's Division of Financial Institutions, there were many companies running successful businesses offering loans to consumers. Today, almost all of those companies have gone out of business. Overall, the availability of credit for middle-class Americans has been greatly reduced. According to a recent Federal Reserve Bank of New York report, total consumer credit outstanding has declined by over $1.4 trillion dollars since its peak in the third quarter of 2008. This contraction in the supply of consumer credit has resulted in significant unmet demand for consumer loan products. If

the CFPB is successful in implementing its proposed rules, unmet demand is sure to continue to increase.

It is important that states maintain their role as the primary regulators of consumer loan products. And states should lead the way in developing more choices in legitimate credit for consumers, not further limiting the few that are available today.

Instead of building more barriers between consumers and credit choices, we should be building bridges to help consumers connect with the real, legitimate financial solutions they clearly need.

###

Submitted By Robert Reich, Community Loans of America

Excerpts from CFPB

Outline of Proposals

Small Business Review Panel

March 26, 2015

A. (pg 46)

- **"There is therefore, less clarity about the impacts of the proposals under consideration on small entities that make covered longer-term loans."**

B. (pg 47)

- **"Some consumers may not have such electronic records and may visit a lender's storefront without the required documentation. This would require a second visit to the lender, imposing the costs on the lender of dealing with the consumer on multiple occasions prior to making a loan, and may lead to some consumers failing to complete the loan application process, reducing lender revenue".**

C. (pg 48 and 49)

- **"The data used for this analysis were submitted to the Bureau voluntarily or in response to orders issued by the Bureau under Section 1022 (c) (4) of the Dodd-Frank Act. The data come from several non-**

depository lenders that make installment loans, typically receive payments on those loans through pre-authorized ACH withdrawals, and charge all-in rates higher that 36 percent APR. These loans would, therefore, be covered by the proposals under consideration. Some of the lenders originate loans online, while others originate loans through storefronts."

- "It is unclear how similar the results would be for installment vehicle title loans."

- "There are a number of sources of uncertainty in this analysis."

- "In addition, there is uncertainty about how consumers and lenders would react to the restriction's that would be imposed by the proposals under consideration and how the overall market for these loans would change."

- "The reaction of lenders is also uncertain. They may change their pricing (to the extent allowed by state law), may change the range of products they offer, may consolidate locations, or may cease operations entirely."

D. (pg 50)

- "Section III.B.3.b describes an alternative requirement under consideration to the ability-to-repay requirement that would allow

lenders to make loans with a PTI ratio below 5 percent and duration no longer than six months. The Bureau believes that many consumers who would qualify for a PTI-based loan under the alternative requirements would also satisfy the requirements of an ability-to-repay determination, and that the PTI would be easier for lenders to calculate. Therefore, the Bureau believes that this alternative, in particular, would ease the operational costs associated with the proposals under consideration. Using data for the current lending market, 18 percent of the loans in the installment database have PTI ratios below 5 percent. Many of these loans have durations longer than six months; only 9 percent of all loans have a PTI ratio below 5 percent and are no longer than six months."

- **"Lenders may respond to the proposals under consideration by increasing the duration of the loans to reduce the PTI ratio. In the installment dataset, however, the loan size and other terms are such that this would not be viable for many of these loans. That is, there are few loans shorter than six months with a PTI ratio above 5 percent that would have a PTI ratio below 5 percent if the terms were extended to six months. Similarly, there are few loans with a PTI ratio below 5 percent and terms longer than six months that would still have PTI ratios below 5 percent if the term were shortened to six months."**

E. (pg 52)

- **"The proposals under consideration would apply to loans obtained "by consumers primarily for personal, family, or household purposes." The proposals would not apply to loans obtained primarily for business purposes, even if loans similar to those that would be covered, such as vehicle title loans, are also used by small entities for business purposes."**

G. (pg 53)

- **First the proposals could impact the availability of credit to small entities if small businesses are using loans from lenders that also make loans covered by the proposals and the proposals lead to a contraction in the market, regardless of the loan purpose. Second, the proposals could impact the availability of credit to small entities if there are loans that are made primarily for personal, household, or family purposes but are partially used as funding for a small entity.**

- **The Bureau believes that these effects would be temporary, lasting until a new competitive equilibrium is achieved in the affected markets.**

Elevate

May 12, 2015

Senator Marty Block
Chairman, Banking & Financial Institutions Committee
State Capitol, Room 405
Sacramento, CA 95814

Chairman Block,

We support you, the California Department of Business Oversight and the CFPB's efforts to end the cycle of debt and protect consumers from bad actors in the industry and harmful lending practices.

Elevate employs rigorous underwriting standards to extend credit and uses ability and willingness to repay as key metrics, but we are concerned that overly prescriptive guidelines will stifle innovation in the market to the consumers' detriment. As a responsible lender, we rely on empirically derived data analytics to determine ability to repay.

We are concerned that the CFPB's rules will trump many of CA's laws governing financial services. The issues that arise from Federal preemption of state laws and regulations can be a messy and create much uncertainty in the market and even for consumers.

Thank you for the opportunity to testify in this very important matter.

Sincerely,

Sarah Cutrona
Chief Counsel

www.elevate.com | 817-928-1500 Phone + Fax | 4150 International Plaza Suite 300 Fort Worth, TX 76109

4150 International Plaza, Suite 300
Fort Worth, Texas 76109

May 11, 2015

State of California
Senate Committee on Banking and Financial Institutions
State Capitol, Room 405
Sacramento, CA 95814

RE: CFPB Oversight Hearing

Honorable Chair Senator Marty Block and Staff Director Eileen Newhall:

Thank you for organizing the Oversight Hearing on the Consumer Financial Protection Bureau's Lending Proposal for the benefit of the Senate Committee on Banking and Financial Institutions. Elevate appreciated the invitation to participate and would like to take the opportunity today to follow up with additional information for the record.

In addition to the testimony I submitted at the hearing, I want to address specifically the testimony submitted by Mr. Paul Leonard, Director of the California Office of the Center for Responsible Lending, and Ms. Paulina Gonzalez, Executive Director of California Reinvestment Coalition, regarding RISE charge-off rates and a specific RISE customer experience.

At Elevate, we employ extremely rigorous underwriting and ability-to-repay analysis. In fact, we only approve approximately 25 percent of the organic applications we receive. In California specifically, we typically see approximately 25 percent principal charge-offs over the life of the average loan (which can be up to two years) related to credit losses.

Those facts are in direct contrast with Mr. Leonard's conclusory statement that Rise had charge-offs greater than loan balances which "proves" that Rise does not underwrite consumer loans properly. Given the opportunity, we would have been happy to explain the data filed with the Department of Business Oversight and clarify the matter for Mr. Leonard. We hope in the future they opt to contact us in advance of testimony to prevent them from making erroneous claims in such an important setting.

Additionally, Ms. Gonzalez spoke of a customer who took out an installment loan from RISE. I have reviewed the account in question and found that while it is unfortunate that the customer was unable to pay off the loan in full, the record does not indicate any lack of focus on affordability or responsible lending practices.

When the customer applied for a loan she was fully underwritten using information from a "Big Three" credit bureau and an ability-to-repay assessment was made. The customer was notified of all of the terms of the loan including the repayment schedule and amounts. Furthermore, this customer made numerous successful, on-time payments indicating that at the time of the underwriting she was indeed able to afford the loan payments.

To ensure that borrowers do not face any bank fees due to bounced payments it is Rise's policy to notify all borrowers several days in advance of any payment so that if they don't have adequate funds in their account they can make other arrangements. As such, when the customer requested that we not process any ACH payments we immediately stopped any electronic payment processing and began working with the customer to settle her account. In fact, the customer was offered a 50% reduction in the outstanding due to help her get out of debt.

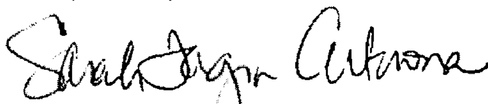
Like any other credit product, when customers' financial statuses change they may not be able to pay off their loans. As a responsible lender, we work with customers if they become past due and never pursue legal action.

All of that noted, we are never pleased to hear of a dissatisfied customer and have requested that all reference to this account be deleted from all credit bureaus.

Thank you again for the opportunity to testify and submit written testimony and comments. At Elevate, we are committed to innovative new approaches to provide credit to consumers who have been pushed out of the traditional credit system. We have built a sophisticated data and analytics capability and continue to innovate in order to optimally price loans to risk levels while eliminating fraud. All of our products include: rates that drop over time (to as low as 36%), credit bureau reporting, free credit monitoring, five free days to change your mind, flexible rates and terms, responsible lending disclosures and financial literacy tools.

We actively support the California Department of Business Oversight and the Consumer Financial Protection Bureau's efforts to protect consumers from irresponsible and abusive lending practices. We urge you to continue your important work while ensuring consumers continue to have access to innovative credit solutions.

Respectfully submitted,



Sarah Fagin Cutrona
Chief Counsel, Elevate

INSIKT

MEMORANDUM

To: Consumer Financial Protection Bureau

From: Insikt, Inc.

Date: May 13, 2015

Re: Small Business Advisory Review Panel for Potential Rulemakings for Payday, Vehicle Title, and Similar Loans

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This memorandum summarizes Insikt's comments to proposals under consideration by the Consumer Financial Protection Bureau ("Bureau") to limit certain practices for payday, vehicle title and similar loans ("Proposals").

In this memorandum, we focus on the following aspects of the Proposals relating to covered longer-term loans[1] that we believe will have a potential economic, regulatory and operational impact on our business: (1) Ability to Repay Requirements, (2) Alternative Requirements—Covered Longer Term Loans, and (3) Payment Collection Practices Limitations. The memorandum follows the agenda discussion topics at the Panel meeting hosted by the Bureau on April 29, 2015, pursuant to the Small Business Regulatory Enforcement and Fairness Act ("SBREFA").

Insikt's loans will be covered longer-term loans under the Proposals to the extent that Insikt (i) charges an all-in annual percentage rate ("APR") in excess of 36% and (ii) obtains an ACH authorization from a borrower prior to the first payment on the loan. We estimate the Proposals will impact approximately 50% of our loans.

ABOUT INSIKT, ITS PRODUCTS AND CUSTOMERS

Insikt (pronounced "in-seekt") is a white label, loan origination and investing platform that enables any brand to lend to its customers and any accredited investor to invest in consumer loans. Founded by serial entrepreneur, James Gutierrez (founder Progreso Financiero, renamed to Oportun), Insikt is based in San Francisco and backed by leading venture funds and investors. Altogether, Insikt has raised over $26 million of venture capital to fund its business and over $100 million of debt capital to fund its loans. Insikt, through its subsidiary, Lendify Financial LLC, makes small dollar consumer loans to customers under the California Pilot Program for Increased Access to Responsible Small Dollar Loans ("Pilot Program") and will soon begin making loans as a regulated lender in Texas. Unlike a direct lender, Insikt employs a "Lending as a Service" (LaaS) model where it partners with banks, non-bank financial service companies, and

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[1] This memorandum only addresses the Proposals on covered short-term loans to the extent they overlap with the Proposals on covered longer-term loans.

retailers who use Insikt's centralized underwriting and origination technology to offer small dollar loans to existing customers. Currently, Insikt's platform is making loans through its partners in 30 locations throughout California.

We make closed-end, fully amortizing, unsecured installment loans in amounts ranging from $300, payable in equal installments over 5 months, to $2,500, payable in equal installments over 2 years. All loan payments are tied to a borrower's paycheck cycle which makes it easier for our customers to budget. Loans are currently structured with a single upfront administrative fee between 5-7% of the total loan amount and ongoing simple interest accrued daily at an annualized rate of 34-36%. This corresponds to an APR (inclusive of fees as defined by Reg. Z) of between 36% and 59%.

A large proportion of Insikt's borrowers are underbanked customers, meaning that they are not adequately served by the traditional banking system in the United States. This is evidenced by the fact that approximately 50% of applicants report that they do not deposit their paychecks into a bank account and 30% report that they do not have a bank account at all. Furthermore, 45% of our applicants do not have a traditional credit score and, for those who do, the average FICO score is 570. The median gross income of our applicants is approximately $25,000 per year.

ABILITY-TO-REPAY ("ATR")

Insikt believes that incorporating ATR into underwriting is a key component of responsible lending. We apply a two-step process to assess a borrower's ATR. First, we collect and verify income, and also collect expenses that are self-reported by applicants and/or verified by one of the major credit bureaus. Second, we apply a quantitative framework that combines verified income, self-reported expenses, and expenses verified by a major credit bureau into an assessment of ATR. Based on our experience and shared belief in a rigorous assessment of ATR, we would like to comment on the Bureau's ATR proposals and recommend some needed modifications. We will also provide details of Insikt's current methodology and its management team's many years of experience making small dollar loans to underbanked borrowers who are largely "credit invisible".

1. Collecting and Substantiating Income and Expenses

Determining ATR must include an assessment and verification of income and certain major financial obligations. Accordingly, we support the Bureau's proposals on income verification for covered longer-term loans, through manual verification of bank statements, paystubs or other means, although we note that these processes are costly to set up and execute, and also require upfront investments in personnel, supporting infrastructure and technology. In our experience, building technology that accurately and easily captures information, such as pay stubs or utility bills (to prove address), from applicants at a retail location or via their mobile phone is costly (measured in upfront costs and resulting from fewer would-be borrowers finishing the process) and very difficult to execute.

We also support the Bureau's proposal that lenders verify the amount and timing of a consumer's existing debt obligations by obtaining a credit report from one of the three major credit bureaus. However, we would like to suggest modifications to the Bureau's proposals on manual

verification of certain major financial obligations, including housing payments, child support, and other legally required obligations.

A. Housing Expenses Are Hard To Verify and Manual Verification is Costly.

We believe that it is essential to consider housing expenses in determining a consumer's ATR. But housing expenses are hard to verify for the following reasons. First, there are limited external data sources to draw upon in the marketplace to verify housing expenses, many such sources are unreliable and match rates obtained from these sources are low. Second, requiring a borrower to provide a lease agreement to verify housing expenses is impractical because underbanked borrowers often have informal or shared housing arrangements and are not a named party on a lease at the property where they reside. For example, only about 1% of our applicants use a signed lease as a proof of address and around 40% of applicants have monthly housing expenses that are less than or equal to $300. Third, bank statements or checks are not an effective means of verifying housing expenses because 30% of our customers report that they do not have a bank account, 50% report that they do not deposit their paycheck into a bank account, and 10% transact business exclusively in cash. Furthermore, transactions are often not clearly labeled in bank statements.

Manual verification is also costly because it requires a document review team and supporting infrastructure that is expensive to set up and implement. We estimate that the direct cost of manual verification is approximately $12 per loan, which we anticipate will reduce to $10 per loan at scale based on a fully-loaded headcount. The indirect cost is also high because (i) almost 50% of our current applicants must submit verification documents multiple times (10% for ID, 10% for address, 40% for income, and some for multiple reasons) and on average customers must submit documents 1.5 times; and (ii) verification takes a long time (only 36% are verified within 24 hours, 50% take longer than 2 days and 13% take longer than 1 week). Therefore, we anticipate that additional manual verification requirements will add a substantial amount of time to the application process and increase the number of trips a customer must make to a retail location during the application process. We estimate that this would result in a 30% loss of conversion from preapproved applicants to customers receiving a loan, thereby increasing the cost of acquisition by 40% which, depending on a lender's scale, is $40 to $80 per loan (corresponding to 7% to 15% in effective APR on a $1000, 12 month loan).

While we agree that housing expenses are an essential part of the ATR determination, for the reasons described above, we believe that housing expenses should be considered on a self-reported basis only and not manually verified. However, a lender should include in its ATR analysis the consumer's stated cost of housing, subject to the lender's reasonable procedures to evaluate the reasonableness of the consumer's statement.

B. Child Support and other Legally Required Payments are Hard to Verify and One Cannot Assume Everyone Has Them.

In our experience, one cannot uniformly assume that everyone has child support or other legally required payment obligations and it is extremely difficult to know that a consumer has such an obligation unless they self-report it. This is due to the fact that there are limited external data sources to obtain this information. Additionally, it is impossible to verify the nonexistence of an expense in the case of a borrower who truly does not have the expense. This applies broadly to any major expense that we cannot assume all borrowers incur, such as auto, housing and

healthcare. For example, 10% of our customers report no housing expenses and 80% report no auto expenses. Therefore, we propose that all less common but major financial obligations, including child support and other legally required payments, be considered in the ATR determination on a self-reported basis only, unless those expenses (such as delinquent child support or an auto loan payment) appear in a credit report.

C. Anything verified by a Major Credit Bureau is Acceptable; All other Expenses Should be Self-Reported with no Verification Requirement.

For the reasons described in 1.A. and 1.B. above, major financial obligations (expenses) that are not available in a credit bureau report are extremely difficult to verify. We agree that expenses are important factors in one's ATR, but requiring them to be verified would result in a significant reduction of responsible credit in the market. As an alternative, we suggest that the Bureau focus on how ATR information is used to calculate certain ratios, such as the PTI ratio we describe in 2.A. below, to ensure that rigorous ATR standards are met. Any and all ATR calcuations would, as a result, factor in acceptable "residual income" and cash flow to cover household expenses.

2. Proposed ATR Framework

Although the Proposals do not specify an ATR framework, the Bureau indicates that it is considering various alternatives that would give lenders significant flexibility to make a reasonable determination of a borrower's ATR. Insikt currently utilizes a robust ATR framework that incorporates both a maximum total debt Payment to Gross Income Ratio ("PTI")[2] of 50% as well as a minimum free cash flow ("FCF") floor that varies by a borrower's unique financial situation.

A. ATR Assessment Should Require No Greater Than 50% PTI Ratio as Opposed to Any Frameworks Involving "Residual Income" or "FCF".

Since 2005, our management team has wrestled with many ways to properly assess ATR without declining applicants who due to their "credit invisible" nature would later prove to be strong credits. Initially, we relied only on a minimum FCF ratio (as a % of after-tax income) which considers the following: (i) verified borrower income, (ii) verified bureau-based debt obligations, (iii) self-reported housing expenses, (iv) self reported auto expenses, (v) self-reported phone expenses, (vi) self-reported utilities, (vii) self-reported number of dependants, and (viii) the maximum scheduled payment of the prospective loan. However, we found that based on geography, age, and number of dependents, establishing an appropriate FCF ratio (%) varied widely and that borrowers with higher income would be treated unfairly in this assessment due to lower FCF % (but higher absolute FCF). We have concluded that PTI is the best, net assessment of ATR and recommend a maximum 50% cut off in PTI as a requirement for covered loans (which is consistent with California's Pilot Program rules).

B. Assessing Periodic ATR v. Loan Life ATR: ATR Assessment Should Only be Based on Information Received and Verified at the Time of Underwriting, but using the Largest Installment Payment.

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[2] PTI = (Payments on existing debt <u>plus</u> payments on the new loan) <u>divided by</u> gross income.

Insikt performs the aforementioned ATR assessment at the time of application considering the borrower's current financial situation. The Bureau has proposed that a lender should assess a consumer's income and major financial obligations throughout the entire contractual term of the loan. We respectfully submit that there is no reasonable way to determine how a borrower's current income and major financial obligations may change over the life of the loan. This is especially true for covered longer term loans where the contractual period may extend for multiple years. We therefore propose that lenders should be able to assume that a borrower's current income and expenses will not materially change over the life of the loan. The only exception to this assumption should be in the case of loans with a balloon payment where lenders should be required to calculate ATR using the largest scheduled payment on the loan.

The Bureau has also proposed that the lender reasonably determine that the consumer can make each payment without having difficulty paying other expenses occurring through the date of the next payment. Insikt's loans are payable on each payday, and the majority of consumers are paid biweekly. However, many expenses are payable monthly, and a cash flow analysis limited to two week periods will always show a shortfall, even without a small dollar loan payment. In our experience, our borrowers budget monthly and are able to make "lumpy" payments, such as rent, without financial distress, even though the borrower's cash flow in the two weeks when rent is due is technically negative. We propose that the Bureau permit ATR analysis for longer term loans to consider consumer cash flows on a monthly basis, so long as the lender's experience is that consumers are able to make more frequent payments without financial distress.

ALTERNATIVES TO ATR

1. NCUA Short-Term, Small Amount Loan

A. The NCUA is Not Economically Viable and Insikt Could Never Meet its Requirements.

The NCUA proposal is not a viable option for our business for the following reasons. First, a maximum term of 6 months is too short. Approximately 67% of our loans have a term longer than 6 months. Second, the maximum loan amount of $1,000 is too small. We expect more than 50% of our loans will be greater than $1,000. Third, the proposed maximum pricing of a $20 application fee plus a 28% interest rate is too low to be economically feasible. The economics for such a loan are as set forth in the chart below. The NCUA loan pricing results in a net loss of approximately $77 per loan. This is clearly not a viable option for any lender.

B. As an Alternative we Recommend this Proposal be Modified to Reflect the Terms set forth in the California Pilot Program.

We propose the following adjustments to the Bureau's proposal on NCUA short-term, small amount loans: (i) loan amount up to a maximum of $5,000, (ii) term up to 36 months, (iii) maximum simple annual interest rate of 36%, (iv) application fee of 7% of the loan amount up to $90 (similar to the Pilot Program in California), and (v) allowing more than one covered loan at a time. We believe (v) is important to help borrowers meet unexpected expenses and believe that adequate protections can be imposed by creating appropriate guard rails, such as instituting a maximum total PTI of 50%. Our proposals result in significantly improved economics as shown in the chart below.

Analysis of Loan Economics[3]

	Example NCUA Loan Economics		Insikt Proposed Loan Economics	
Loan Details				
Loan Amount	$1,000		$1,000	
Loan Term	6 months		12 months	
Application Fee	$20		$70	
Interest Rate	28%		36%	
Monthly Payment	$184		$107	
	Lifetime Total $	**Annualized %**	**Lifetime Total $**	**Annualized %**
Loan Revenue				
Application Fee	$20	7%	$70	13%
Billed Interest	$77	28%	$198	36%
Total Revenue	**$97**	**35%**	**$268**	**49%**
Loan Costs				
Gross Losses	($80)	-29%	($80)	-15%
Cost of Funds	($14)	-5%	($28)	-5%
Servicing	($30)	-11%	($60)	-11%
Acquisitions	($50)	-18%	($50)	-9%
Total Costs	**($174)**	**-63%**	**($218)**	**-40%**
Net Revenue	**($77)**	**-28%**	**$51**	**9%**

2. Loans with Periodic Payments Below a Specified Payment to Income Ratio

While preferable to the NCUA proposal, this option is also not viable for our business for the following reasons: (i) the 6-month term is too short (for reasons described above), (ii) the maximum loan amount of $1,000 is too small (for reasons stated above), (iii) 32% of our existing loans would not pass a 5% PTI threshold even though they meet our stringent and responsible underwriting standards, and (iv) underserved borrowers sometimes need more than one covered loan at a time to meet unexpected expenses.

Insikt proposes the following adjustments to the Bureau's proposal: (i) loans up to $5,000, (ii) terms up to 36 months, (iii) PTI threshold of up to 12%, and (iv) allowing more than one covered loan at a time. We believe (iv) is important for the reasons stated above.

PAYMENT COLLECTION PRACTICES

1. Notice to Consumers Prior to Attempting to Collect Payment

[3] Billed Interest assumes an average loan balance of 55% of the original loan amount over the scheduled term of the loan. Gross Losses assumes an 8% static pool loss rate. Cost of Funds assumes a 5% annualized cost based on the aforementioned average balance. Servicing assumes a $5 cost per month over the scheduled term. Acquisitions assumes a fixed $50 cost per loan.

The Bureau has proposed that lenders provide consumers with a written notice by U.S. mail or email prior to each attempt to collect payment from a consumer's account, including each attempt to re-present a payment after a failed attempt. The Bureau also seeks comments on whether lenders currently provide notices by mail or email and other means by which such notices are provided, whether by phone or text message (SMS).

Insikt believes that advance payment notification is a key component of responsible collections. Insikt currently sends payment reminders to all customers regardless of payment method at least 2 days prior to each payment due date to inform the borrower of the amount due and payment due date. We also give customers the ability to opt out of receiving a reminder. However, we believe that *borrowers* should decide the means of notification; they should have the ability to select the form of notification that works best for them; and should be able to opt out of notifications at any time. We believe this has worked well in the Pilot Program in California.

The Bureau is considering requiring lenders to provide payment notices by U.S. mail or email. This may work for certain internet based lenders where an email address is required, however this does not work well for underbanked customers who seek financial services through retail locations. To highlight this, only 33% of our borrowers report having an email address. Under the current proposal our only alternative would be to provide notice by U.S. mail.

Providing notice by mail is operationally intensive and expensive, especially for small businesses that lack the operational scale and customer base to efficiently execute a mailing strategy. Furthermore, reaching scale is difficult because it involves significant investment in systems, staffing and operations. We estimate that each mailing costs $1.00 per letter at low scale and $0.40 per letter at high scale (based on 100,000+ mailings each month). In context, for a $1,000 loan payable over 12 months in semi-monthly installments the total cost of providing payment reminders by mail would be $24 (a 4% annualized cost basis at low scale) and $10 (2% at high scale). If notices were required to be provided by U.S. mail, this would result in higher APRs for customers to cover the additional costs.

In contrast, providing notices through an SMS reminder is far less operationally intensive and expensive. For example, an SMS costs approximately $0.0075 per message and a phone call costs approximately $0.025 per minute. Further, our capture rate for phone numbers is 100% and the SMS opt in rate is 80% which demonstrates that this is the preferred form of notification for our customers. We are currently executing payment reminders through these channels with great success. However, we acknowledge that this requires substantial investment in an open source platform and software to execute SMS and phone notifications, and involves substantial development costs.

The Bureau proposes a payment notice that contains extensive information about the borrower's upcoming payment. Insikt agrees that customers should have easy access to information about the payments due on their loan. This information can easily be provided by phone. It can also be provided by an SMS message that would effectively convey all of the information that a customer needs to manage their payment obligations and personal finances. For example, a series of 2 SMS messages that contain the following information would accomplish this:

> SMS-1: "Lender Payment Alert, $xxx.xx will be debited from your account ending in xxxx on xx/xx/xx. Reply 1 to stop payment reminders and 2 for additional information"

SMS-2 if customer replies "2": "click https://lender.com/payments/xxxx for additional payment information"

We also believe that essential payment information should be accessible through other means such as by telephone, online customer portal, or by providing the customer with an amortization schedule at the time of loan consummation.

COST OF FUNDS

The CFPB rules will help Insikt achieve lower borrowing costs by eliminating uncertainty in the market about what is an "acceptable CFPB loan" or not. Our management team has experienced countless investor meetings where the terms "regulatory" and "reputational" risks are repeated over and over as reasons for not investing. The fact that the CFPB is publishing clear rules on what is acceptable and what is not will help to clear up any confusion about "regulatory risk" and "reputational risk" associated with small dollar lending. Insikt currently borrows at a 12% annual coupon and its management team has borrowered at 15% annual coupons in the past.

CREDIT CARD v. INSTALLMENT LOAN

We firmly believe that installment loans due to their fixed terms, payment amounts, and rates are better for underbanked borrowers to understand and be successful with than credit cards. However, given the relative ease of complying with the Credit Card Act's ATR requirements, we are concerned that installment loans will be at a competitive disadvantage to credit cards in the market as a result of these new rules. Credit Cards offers are not required under Reg Z. to combine required fees and rates into their APR calculations. Now, they will not be required to meet the same ATR requirements as covered installment loans. Using an example from Capital One's website, one of their "secured credit card" offers at a minimal utilization rate has an effective APR (inclusive of fees) of 200%+. Yet, this card would never have to quote its true APR in a marketing offer or be required to rigorously assess a consumer's ATR in its underwriting. We are concerned that this creates a dangerous double standard in the rules that will result in credit cards being more readily available to underbanked borrowers (despite them having more demonstrable success with installment loans).

CONCLUSION

Thank you for allowing us the opportunity to submit our comments on the Bureau's proposed rules. We believe in the Bureau's push for higher ATR requirements and more rigorous federal standards, and with minor adjustments described in our memo, we will be able to comply with the proposed rules. We look forward to continuing our mission of providing responsible and affordable access to credit as a necessary stimulus to long term, positive change that improves whole communities.

Presentation by Dan Gwaltney to the
Senate Banking & Finance Committee, May 6, 2015
Debt Traps or Restricting Access to Safety Nets?
Initial Reactions to the CFPB's Lending Proposal

Mr. Chair and Members, thank you for allowing me to address the committee again today during the discussion of the CFPB's proposed rulemaking for Longer-term loan products. In addition to deferred deposit loans, our association members make longer term loans in the form of both secured and unsecured installment loans.

The proposed CFPB rule governing long-term loans is once again a one-size-fits-all type of approach. The Bureau has attempted to solve what it sees as structural problems with certain loan models that do not provide adequate consumer protections. Loans with several small payments followed by a single substantially larger payment, such as a balloon payment, are not permitted under California's Consumer Finance Lenders Law for small dollar consumer loans. In addition, the Bureau's concerns about negatively amortizing loans are not relevant since our state law also prohibits this loan structure for small dollar consumer loans.

Similar to the short-term loan requirements, the CFPB proposals will mandate that all longer-term loan providers conduct an ability-to-repay analysis prior to entering into a new or subsequent loan. California law already requires lenders to perform this task during its underwriting process. However, our members have some concerns with the proposals. First, the CFPB will require the underwriting period for which a lender would need to consider income and obligations must be the same as the contractual duration of the loan. Most lenders underwrite based on the information about the borrower's ability-to-repay collected at the

time of the application. This requirement creates confusion as to how a lender will take into consideration future unknown variables. Second, the proposed alternative loan structures such as the National Credit Union Administration model or the Bureau's 5% Payment-to-Income model more than likely not work for certain lenders. The requirement that a consumer not have any other outstanding "covered" loans would prevent refinancing a customer's short term loan into a more appropriate longer-term loan often at a time when the consumer needs that refinancing the most. These very limited structures will remove flexibility from state lawmakers and more than likely will stifle future attempts to update the CFL small dollar loan programs.

In addition, we are also concerned that the Bureau has not conducted any rigorous study of longer-term loan use and how their proposals will impact the availability of credit in the marketplace. The proposal document states that the Bureau lacks sufficient data to model the effects. We therefore suggest that this committee caution the CFPB about moving forward without fully understanding the complexity of their one-size-fits-all approach.

I have the honor last week of participating as a Small Entity Representative during the SBREFA panel held last week in Washington, DC. The purpose of the panel was to solicit feedback from small business lenders on what they thought of the proposals, what they thought worked and what wouldn't. It was clear that many different types of companies ranging from payday lenders, title lenders, tribal lenders, banks and small credit unions voiced concerns about the broadness, complexity and potential grave consequences that may occur if

the Bureau does not conduct more detail analysis before moving forward with their current ideas. A clear example of this was the CFPB's failure to consider or model the effect of the new NACHA electronic payments rules that will go into effect in September. Those new rules will restrict access to the ACH network by those providers with high rates of return items. The Bureaus' collection payments rules do not reflect either the new realities of the marketplace nor consumers' expressed desires for convenient and low-cost payment options.

The California Financial Service Providers stands ready to work with the Bureau and this committee to help craft reforms to installment lending that will be safe, regulated and accessible for California consumers.

Statement of Sherry Treppa

Chairperson, Habematolel Pomo of Upper Lake

Vice-Chairperson, Native American Financial Services Association

Senate Banking and Financial Institutions Committee Informational Hearing on "Ending Debt Traps or Restricting Access to Safety Nets? Initial Reactions to the Consumer Financial Protection Bureau's Lending Proposal"

May 6, 2015

Introduction

Good Afternoon, Chairman Block and members of the Committee. Thank you for holding this hearing and affording me the opportunity to provide testimony on this important issue. My name is Sherry Treppa, and I am the Chairperson of the Habematolel Pomo of Upper Lake, a federally recognized tribe located in Lake County, California. I also serve as the Vice-Chairperson of the Native American Financial Services Association (NAFSA), an intertribal organization formed in 2012 to advocate for tribal sovereignty and responsible business practices in the context of the e-commerce industry.

NAFSA is comprised of tribes from all around the country. Some are currently engaged in the financial services industry; others are not. But they all share a common goal: protecting tribal sovereignty and promoting tribal self-determination while ensuring that tribal lending entities conduct business responsibly.

Poverty in Indian Country

Native American communities, including those in California, are among the poorest in the United States. Recent studies have confirmed that Native Americans face poverty at a rate nearly *double* that of the general population.[1] They live in overcrowded, run-down housing, often without heat, running water or proper sewage systems. Employment opportunities are scarce; high-school graduation rates are far below the national average; and adolescent

[1] Sari Horwitz, *The Hard Lives—and High Suicide Rate—of Native American Children Living on Reservations*, Washington Post (Mar. 9, 2014), *available at* http://www.washingtonpost.com/world/national-security/the-hard-lives--and-high-suicide-rate--of-native-american-children/2014/03/09/6e0ad9b2-9f03-11e3-b8d8-94577ff66b28_story.html; *see also* U.S. Census Bureau News: American Indian and Alaska Heritage Month (Nov. 12, 2014), *available at* http://www.census.gov/content/dam/Census/newsroom/facts-for-features/2014/cb14ff-26_aian_heritage_month.pdf.

pregnancy is all too common. Indeed, by any measure, many Native Americans live in third-world conditions, with a lower life expectancy than any other racial or ethnic group in America.[2]

For generations, these problems have created a culture of hopelessness, particularly among Native children, and this hopelessness has given rise to another tragic cultural phenomenon: the extraordinarily high suicide rates among Native youth. In fact, on some reservations, suicide among youth occurs at a rate that is *ten times* the national average.[3] This has to change.

The root cause of many of these social problems is the lack of meaningful tribal economic development. It is extremely difficult for tribal governments to achieve economic growth. Unlike states, tribes cannot impose a property tax, as the land is held in trust by the federal government. Nor can they realistically impose an income tax, because, as I stated earlier, most tribal members already live in poverty.

With taxation unavailable, tribal governments rely on two sources of funding: federal aid and tribal business enterprises. Federal aid is helpful, but it is grossly insufficient to combat all of the severe problems facing tribal communities. And in any event, if tribes want to achieve true self-determination, they must not rely entirely on federal grants. So they turn to tribal business enterprises.

Contrary to popular belief, gaming has *not* been a cure-all for tribal economic development. While casinos provide some jobs, unless a tribe happens to be located in a high-population metropolitan area (which very few are), gaming revenues alone cannot support a tribal government. Indeed, for the majority of tribes that are remotely located, it is difficult for almost *any* land-based business to really succeed. Moreover, tribes in California have a unique challenge of being landless or having severely limited land base due to congressional termination in the 1950s.

With these geographical constraints, many tribes have turned to e-commerce, specifically, online consumer financial services. My own tribe is case-in-point, as our experience illustrates the importance of e-commerce to tribal economic development.

Indeed, the history of the Habematolel Pomo of Upper Lake is marred by a series of tragic federal policies. In 1850, the United States Calvary attacked a population of our ancestors—predominantly women and children—in an aggressive military operation known as the "Bloody Island Massacre." The following year, the United States promised lands to our ancestors in a federal treaty that was executed, but never ratified. By 1907, the United States had set aside the Upper Lake Rancheria on a parcel of land that ultimately grew to approximately 564 acres, and in 1935 the Upper Lake Rancheria adopted and ratified its Constitution in accordance with the Indian Reorganization Act. However, in 1958, Congress passed the California Rancheria Act,

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[2] Fact Sheets, Disparities, Indian Health Service, http://www.ihs.gov/newsroom/factsheets/disparities/

[3] Horwitz, *supra* note 1.

which had the disastrous effect of "terminating" the Tribe's recognition, revoking its Constitution and distributing the Rancheria's assets. This was a truly dark time in the Tribe's history.

In 1975, the Tribe filed suit against the United States in federal district court, alleging that the termination of the Upper Lake Rancheria was unlawful. The Tribe prevailed, and in 1983, federal recognition was restored by the Court in *Upper Lake Pomo Association v. James Watt.*[4]

After restoration, the Bureau of Indian Affairs refused to recognize the Tribe's earlier Constitution; the Tribe was thus forced to reorganize, and it was not until 2004 that the Tribe received formal approval of its Constitution. The Tribe remained landless, however, until 2008 when the United States finally accepted an 11-acre parcel of land into trust.

In the years that followed, the Tribe worked towards opening a small gaming facility on its trust land. This project was also met with disaster. After contracting with a casino developer and taking on millions of dollars of debt in the hopes of opening a Class III gaming facility, in August 2010, the Assistant Secretary–Indian Affairs with the BIA rejected the Tribe's Compact with the State of California. The Tribe thus had no authorization to start gaming, and yet it still owed millions in debt.

A year later, in August 2011, the BIA approved the Tribe's new Compact with the State of California, and the Tribe broke ground on its Running Creek Casino. The Casino opened on Memorial Day 2012, but unfortunately revenues have been far below expectations. With millions of debt still owed, the Tribe will not see profits from the Casino for years to come.

The Tribe searched for new business opportunities, and in 2012 the membership voted to pursue opportunities in the online consumer financial services industry.

Tribal Lending and Regulation

As part of its overall mission, NAFSA has developed a set of best practices for tribal lending entities. These best practices form the industry standard for tribal online lending.

Each NAFSA tribe that engages in online lending, including my own, does so in conformance with NAFSA's best practices. This means that the respective tribal lending entity is wholly owned and operated by the tribe, and the revenues are used to benefit the tribal government and the tribe's members.

Before entering into the industry, the tribe must pass the appropriate governing laws. At the general level, the tribe will usually need a corporations or LLC code. In addition to general business laws, the tribe will need to enact a comprehensive consumer finance ordinance. This

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[4] No. C-75-0181SW (N.D. Cal. Aug. 31, 1983).

ordinance sets forth the consumer protection safeguards and specifically establishes an independent tribal regulatory commission to enforce those standards.

In this sense, the tribal lending business is nearly identical to tribal gaming. In the gaming sphere, tribes enact a gaming ordinance and create an independent regulatory agency to enforce that ordinance. The same principles govern tribal lending. In fact, much of the reason tribes have been successful in this business is that, through gaming, tribes have become experts in operating and regulating sophisticated businesses.

Contrary to certain allegations by critics of tribal lending, the lending entities of all NAFSA-member tribes, including Habematolel, are 100% owned and operated by their respective tribal governments and are regulated by independent tribal regulatory agencies. These are *not* "rent-a-tribe" operations where a non-tribal lender sets up shop on-reservation and simply pays the tribe a token percentage of the profits. Rather, the lending entities operated by NAFSA tribes represent a true exercise of tribal sovereignty.

Of course, we acknowledge that there are certainly some bad actors in this industry. Some lenders merely pretend to be tribal, while in fact they operate under no tribal law or regulation whatsoever, and the tribe does not benefit from the lending at all. NAFSA wholeheartedly supports efforts to protect consumers against these sorts of entities.

The Benefits of Tribal Lending

The profits of tribal lending entities provide a tangible and direct benefit to tribal members, substantially improving their quality of life. All profits go toward the funding of important tribal governmental programs.

In my own tribe, for example, the revenues from the tribal lending business are used for education programs and scholarships, including programs designed to help our youth become gainfully employed as they enter adulthood. The revenues from lending have also enabled us to purchase a small piece of our former homeland, including our ancestral cemetery.

Without tribal lending, these programs would be impossible.

Tribes' Status Under the Consumer Financial Protection Act

As to the impact of the CFPB's proposal on tribal lending entities, as a threshold matter, it is by no means certain that the rule would apply to tribal lending entities at all.

The Bureau was created by Title Ten of the Dodd–Frank Act. Under the terms of the Act, the Bureau has supervisory authority over "covered persons" to enforce compliance with federal consumer financial protection laws.[5] The word "person," which marks the outer boundary of the

[5] 12 U.S.C. § 5511(c)(4); *see also* § 5481(6), (15).

Bureau's power, is defined as including various individual and corporate entities.[6] Notably, the definition of person makes no reference to sovereign entities such as States or Tribes.

Instead, the Act expressly includes tribes within the definition of "State."[7] Under the Act, "States"—and therefore, tribes—are regulators. They are not among the regulat*ed*. Indeed, tribes have embraced this regulatory role. As set forth above, tribes have enacted robust consumer protection ordinances and have established independent regulatory commissions to enforce those laws. Again, this is a role that tribes are familiar with, given their substantial experience in the gaming industry.

Furthermore, the California State Legislature should note that because tribes and states fall under the same definitional provision in Dodd–Frank, any assertion of regulatory authority over a *tribal* enterprise is tantamount to an assertion of regulatory authority over a *state* enterprise. Beyond a doubt, if the Bureau is to exercise regulatory authority over tribal enterprises, such an egregious infringement of tribal sovereignty clears the path for an equally severe infringement of *state* sovereignty.

Consider all of the various entities through which state governments provide consumer finance products and services: state student loan programs, lending programs for state employees and veterans, and state housing finance agencies. Take, for example, the State of California's CalVet Home Loans program, which helps California's military veterans finance their homes.[8] Surely the CalVet program should be under *California's* regulatory control, not the Bureau's. Yet, because tribes and states are equivalent under Dodd–Frank, if the Bureau could exercise regulatory authority over tribal enterprises, this would necessarily mean that it may also take enforcement action against CalVet, including by issuing administrative subpoenas to CalVet or even suing CalVet in federal court. It is implausible that Congress could have intended granting the Bureau such sweeping authority.

In addition to the statutory requirement that the Bureau treat tribes as states, not "persons," the Bureau maintains a separate obligation to tribes as a consequence of the federal government's unique trust responsibility owed to Indian nations. Pursuant to this trust responsibility, it is

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[6] § 5481(19) ("The term 'person' means an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity.").

[7] Opponents of tribal lending cite *Donovan v. Coeur d'Alene Tribal Farm*, 751 F.2d 1113 (9th Cir. 1985), for the proposition that Dodd–Frank is a law of "general applicability," and therefore the CFPB has supervisory and enforcement jurisdiction over tribal lending entities. However, *Coeur d'Alene* explicitly limited its analytical framework to federal statutes that are "silent on the issue of applicability to Indian tribes." *Id.* at 1116. The *Coeur d'Alene* presumption is thus inapplicable because Dodd–Frank is *not* silent regarding tribes. To the contrary, the statute specifies exactly how tribes are to be treated: as states, i.e., as regulators. *See* 12 U.S.C. § 5481(27).

[8] CalVet Home Loans, www.calvet.ca.gov/homeloans.

incumbent upon the Bureau to act in a manner that is protective of tribal sovereignty and promotes tribal self-determination and economic development.[9]

This trust responsibility is a foundational underpinning of federal Indian law, having its roots in three Supreme Court decisions authored by Chief Justice John Marshall in the early 1800s.[10] It has since been consistently recognized by the Executive and Legislative branches of our government as a core component of the federal–tribal relationship.[11] It would be antithetical to this trust obligation for the Bureau to infringe on tribal sovereignty by preempting tribes' ability to regulate their own tribal enterprises pursuant to tribal law, especially when they lack the statutory authority to do so.

In any event, the issue of the Bureau's enforcement authority over tribes under the Dodd–Frank Act is currently being litigated in the United States Court of Appeals for the Ninth Circuit. Until that litigation is fully resolved, there is no definitive answer as to whether tribes would be subject to any proposed CFPB rule. However, in the interest of providing this Committee with effective testimony, I will address how the Bureau's proposal *would* affect tribes in the event it does apply to them.

<u>The Bureau's Proposal</u>

The Bureau's Proposal—again, assuming for the sake of argument that it applies to tribes to begin with—would have a significant detrimental impact on tribal lending entities. In all likelihood, it would force us out of business.

To begin with, tribal lending entities operate exclusively online. As we understand it, although the Bureau researched the topic of small-dollar lending for three years, they have focused entirely on storefront payday lenders. That is, in formulating its Proposal, the Bureau did not take into account the unique status of tribal e-commerce businesses, i.e., the fact that tribal lending entities already use sophisticated underwriting software, allow for varying payment methods to maximize consumer control, perform exhaustive fraud checks, and take an active approach to compliance.

Ability-to-Repay

The Tribe's online lending business already takes ability to repay into account for every single loan that it makes. This is something we must do in order for the business to be profitable. It is

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[9] *California v. Cabazon Band of Mission Indians*, 480 U.S. 202, 217–18 (1987) (noting that, "in carrying out the Federal Government's trust obligations to Indian tribes," the Department of the Interior has sought to encourage tribal self-sufficiency and economic development "by promoting tribal bingo enterprises").
[10] *See Johnson v. M'Intosh*, 21 U.S. 543 (1823); *Cherokee Nation v. Georgia*, 30 U.S. 1 (1831); *Worcester v. Georgia*, 31 U.S. 515 (1832).
[11] *See, e.g.*, Exec. Order 13175; 25 U.S.C. § 4301(a)(6) (finding that "the United States has an obligation to guard and preserve the sovereignty of Indian tribes in order to foster strong tribal governments, Indian self-determination, and economic self-sufficiency among Indian tribes").

not the Tribe's goal to make loans to people that can't afford them. In fact, we actively encourage our customers to take steps to continue to improve their financial education. Our website offers a financial literacy program for all customers.

We already gather thousands of data points in the underwriting process regarding the customer's ability to repay the loan. Requiring verification of income and major obligations is problematic because such verification is often not available or is too burdensome for the consumer to supply, especially when they are often seeking a loan at their most urgent time of need. These verification requirements would likely cause a large percentage of consumers to simply walk away.

There are no real-time databases that keep information such as a consumer's major financial obligations. And even if such data were readily available, it is not more predictive of a consumer's ability to repay than the current factors used.

For example, it is simply not realistic for the consumer to dig up their latest W-2 and then fax or scan it to us. And even if they did, the average cost of loan origination would likely double. These costs, of course, would ultimately have to be passed on to the consumer.

Alternative Requirements

The alternatives to the ability-to-repay restrictions, such as the National Credit Union Association model and the 5% payment-to-income rule, are *not* economically workable alternatives. They will cause a reduction in conversion rates of applications to loans, increased cost per loan for the consumer, and they will also require additional staffing and reduce profitability.

Conclusion

The Internet is proving to be a great equalizer for tribal governments. It has allowed remotely located tribes to finally compete in the larger economy. Embracing new technology, many tribes have chosen to enter the e-commerce space by engaging in small-dollar lending. They do so in conformance with strict consumer protection standards under tribal law, in a nearly identical fashion to their well-established gaming enterprises. E-commerce has breathed new life into tribal economies, and has allowed tribes to make significant strides towards self-determination by allowing them to the generate funds desperately needed to provide important tribal governmental services such as education programs for our youth.

Of course, I believe that the Bureau does not have enforcement jurisdiction over tribes at all, because tribes are not "persons" under the Dodd–Frank Act. However, for the sake of argument, if the Bureau's Proposal applied to our business, it would likely eliminate the ability of tribes to compete in the consumer finance marketplace. We hope to work with the Bureau during the course of the rulemaking process to ensure that any restrictions it places on this industry do not

go so far as to in effect prohibit the product entirely, and thereby choke off access to credit to those consumers that need it most.

Thank you for the opportunity to testify and I am happy to answer any questions the Committee may have.

Testimony for Senate Banking Committee
Informational Hearing on the Consumer Financial Protection Bureau
Rulemaking for Payday, Vehicle Title and Similar Loans

Paulina Gonzalez, Executive Director
California Reinvestment Coalition

May 6, 2015

Thank you for this opportunity to share CRC's perspective on the impact of long term loans on low income families in California and the Consumer Financial Protection Bureau's (CFPB's) new proposals for payday, car title and other similar loans.

My name is Paulina Gonzalez and I am the Executive director of the California Reinvestment Coalition. We are a statewide coalition, of over 300 community based organizations working in low and moderate income communities and communities of color.

On a personal level, I understand firsthand the desperation of trying to make ends meet. I understand what it's like for a family to not have enough income every month to pay the rent, not to have enough money to pay the bills, keep the lights on, or put gas in the car to get to work every day. I understand the desperation that might make a family walk into a payday store and take out a loan hoping to obtain some immediate relief to the uncertainty of poverty.

I understand this because I grew up in south Montebello, CA, a working class community just outside of Los Angeles, CA as the daughter of immigrant parents from Mexico, who struggled to put food on the table and keep a roof over our heads. We suffered through the humiliation and uncertainty of being rejected by traditional sources of credit on more than one occasion. But like many in our communities, for my family, it wasn't a need for "credit" – it was a need for more income to make ends meet that we badly needed in order to help keep a roof over our heads or the lights on at our home.

In those days, there was no such thing as payday loans in order to help meet the gap between income and expenses. We had to tighten our belts, borrow from family and friends, recycle cans, we did whatever it took. It wasn't easy.

What I am glad we didn't do, what WE DIDN'T HAVE THE OPTION TO DO, is end up in a debt trap that left us worse off than when we started, with our credit in shambles, that left us deeper in an uncontrollable cycle of debt that could end with us possibly being homeless, and at the end of the day that would have left us with a bigger gap between our income and our

expenses than when we started. What I'm glad we didn't have the option to do it is to walk into a payday store.

Because what we, and so many California families need is income, and what we DEFINITELY DO NOT NEED ARE PREDATORY LOANS. What my family needed back when I was a kid, and what Californians need now is a living wage – and better financial security in general. And what Californians need is protection from predatory loan products. That is why what the CFPB is proposing to do, the rules it is undertaking this year to rein in payday and other forms of predatory lending, are essential to the financial wellbeing of low income families in California. Because although the payday, installment, and auto title industries would like to sell us their products as a service to working families who need to make ends meet and keep a roof over their heads, these products are far from that. These products, as currently designed, are made to profit off the fact that people who use them can't afford them and have to take out repeated loans in order to pay them back.

These products are not a credit service to the needy, they are a largely unregulated product that leaves families worse off than when they started.

I like many of you, believe that income, and access to good forms of credit is critical to a household's financial health and capacity to achieve milestone goals.

The harm in payday and predatory installment loans is that they are unaffordable from the get go, they are structured this way—that is how these lenders make their profits.

In California, we are seeing an increase in high dollar installment loans and auto title loans.

From 2012-2013, the number of unsecured loans valued above $2,500 grew in the range of 51% to 104%. Depending on the size of the loan.

In the same time period, the total number of auto title loans above $2,500 increased between 41%-55%. Depending on the size of the loan.

There are those that would argue that credit, any form of credit, 400% interest rate or not, is needed by our communities. That it is needed by families like the one I grew up in order to serve as a "safety net" during times of economic need and dire straits.

In the time I have left, I'd like to share a story from a consumer from Los Angeles who fell prey to a high cost installment loan, perhaps her story will shed further light on why we need strong CFPB rules.

Joann Taylor lives in south central Los Angeles. She is a food service worker with LA Unified School District, where she has worked for the past 15 years. Last year, she received an email indicating that she was "pre-approved" for a $3,000 loan with Rise. Since Joann only works when school is in session, she often has periods throughout the year when she has trouble making ends meet. She also has a daughter who is a senior in high school and who is getting ready to start college at Cal State University. Upon receiving Rise's solicitation, she thought it

would be helpful to have some extra money to help with her expenses, especially to be able to give her daughter a nice senior year, since senior year festivities can be expensive. So she decided to take the $3,000 loan. She told the lender that she could afford to repay $289 a month. Instead, the lender began debiting $289 from her checking account every 10 days, over $600 a month. This was absolutely unaffordable and unsustainable for Joann, and she quickly found herself falling behind on bills and rent. Because Rise was automatically deducting $289 from her bank account, she incurred numerous overdraft fees. She estimates that she paid at least $245 during this period on overdraft fees alone.

In December 2014, she decided to default on the loan after paying almost $4,500 to the lender for her original $3,000 loan. She was forced to close her bank account so that the lender could no longer access her account.

Rise claims that Joann still has an outstanding debt of $3,000 on her loan, though Joann doesn't understand how they are allowed to charge so much more than she borrowed in the first place, especially since she has already repaid the loan plus $1,500.

Worst of all, she fell a couple of months behind on rent and was evicted from her apartment. Now Joann and her youngest daughter are homeless. They are staying with her older daughter, and Joann is currently trying to find an affordable place to live.

This consumer story, which is one of the many we hear every month from our members, is the reason that CRC believes that the CFPB's proposed rules, which are broad and cover predatory loans beyond the small dollar payday loans and cover installment and auto title lenders, set an important floor for California consumers where there are no regulations in the high dollar lending space.

At the same time, we believe that the proposed rules do not go far enough and need to be strengthened as the CFPB goes through its rule making process this year. The CFPB is considering rules for certain loans that would allow lenders to choose between underwriting – taking into account both income and expenses, as well as borrowing history – or an alternative debt trap protection requirement where the periodic payment does not exceed 5 percent of the borrower's expected gross income for the corresponding pay period. We strongly oppose this alternative and believe that meaningful underwriting should be a requirement, not an option.

In addition, the CFPB is considering permitting certain loans not exceeding $1,000 to be made on terms similar to those permitted for National Credit Union Administration sanctioned loans, which include an application fee reflecting costs of no more than $20 per loan and an APR not exceeding 28 percent. While we believe that this would be a vast improvement to currently unregulated installment loans, we encourage requiring underwriting that takes into account income and expenses, as well as borrowing history, for these loans.

In short, CRC believes that underwriting, based on income and expenses as well as borrowing history, should be required at the onset of any long term installment loan, and before any subsequent loans are given or refinancing the loan.

This lack of adequate underwriting has been the basis of the unsustainable debt trap currently suffered by borrowers and the business model by which the industry has operated and profited.

If underwriting only takes into account income and fails to take into account expenses, it will fail to adequately determine whether the loan is ultimately affordable to the borrower or whether it will spiral the borrower into an unsustainable debt that will leave the borrower in a situation in which he/she, like Joann Taylor, ends up in a situation worse off than when she started.

We believe that a loan should enable a family to make ends meet, not make them have to choose between keeping the lights on or borrowing another loan. The supposed purpose of these loans is to minimize the shock of an expense to a person's wallet. Without proper underwriting, these loans at best push the entire shock forward a short while, at worst they intensify the shock until it is not survivable.

Thank you.

POLICY & ACTION FROM CONSUMER REPORTS

Testimony of Suzanne Martindale
Staff Attorney, Consumers Union
Informational Hearing on the Consumer Financial Protection Bureau
Rulemaking for Payday, Vehicle Title and Similar Loans
California Senate Banking Committee

May 6, 2015

Chair and members,

My name is Suzanne Martindale and I am a staff attorney at Consumers Union, the advocacy division of Consumer Reports. Thank you for the opportunity to testify today about the Consumer Financial Protection Bureau's proposal to set minimum standards for certain high-cost loans, including installment and auto title as well as payday loans.

Since 1936, Consumers Union has worked for a fair, just, and safe marketplace for all consumers. We are an expert, independent and nonprofit organization that seeks to empower consumers to protect themselves, as well as increase fairness in the marketplace through policy reform. Our work in the area of financial services focuses on the major decisions that affect your wallet – from how best to manage the money you've got, to how and when to borrow money you need.

Given the enormous power that the financial services industry enjoys today, it is more important than ever for us all to work together to prevent abusive lending practices that drain precious dollars and cents from those who can least afford to do without them. My colleague from the California Reinvestment Coalition shared a heartbreaking

example of what happens when unscrupulous lenders are allowed to engaged in legalized theft. Unfortunately, her story is only one of many echoed throughout this state and across the country.

That's why we believe that the CFPB proposal is an important first step in setting national standards for high-cost lending. By focusing on the basic principle that lenders should make loans that consumers can afford, at the outset and over time, the proposal supports lenders are that responsible, and marginalizes those that are not.

However, the proposal contains a menu of options that could leave gaps in protections for consumers. We are especially concerned that there is no across-the-board requirement that lenders assess a borrower's ability to repay. For these reasons, we believe that states such as California should not wait for the CFPB to protect consumers – they can and they must play an active role on the front lines of consumer protection.

Longer-term loans pose many of the same problems as those discussed on the previous panel. While a balloon payment on a short-term loan may be the most egregious example of a high-cost loan product, make no mistake: consumers can get stuck in cycles of debt from risky longer-term loans as well. In addition to charging high interest rates, some installment lenders keep consumers in debt through multiple refinancing, extending the principal owed and pushing back the light at the end of the tunnel for consumers in financial distress.

For these reasons, we are concerned that the CFPB proposal would permit alternatives to an ability-to-repay requirement. Allowing loans of $500 or less where the periodic payment does not exceed 5 percent of expected gross income doesn't account for

the consumer's expenses or other obligations. Although the alternative option of permitting loans of $1000 or less using the NCUA-sanctioned cap of 28% APR plus fees would be a marked improvement over current industry trends, these loans could still be problematic in the absence of meaningful underwriting.

Still, it is important to remember that the CFPB proposal is a floor, not a ceiling. It in no way mitigates the authority responsibility of individual states to do more to protect their residents from abusive financial products and services.

Here in California, the legislature has shown interest in encouraging safer longer-term loans. Several of us in this room have worked on the recent pilot programs for safer small-dollar loans, enacted by SB 1146 in 2010 and later replaced by SB 318 in 2013. These pilots have set minimum requirements for licensees under the Consumer Finance Lenders Law seeking to offer installment loans between $250 and $2500. Notably, the current SB 318 pilot includes interest rate and fee caps, limits on refinancing, and an ability-to-repay requirement for all loans. The pilot is not perfect, and we continue to have concerns that the loans may be too expensive for some consumers. However, we support the substantive principles contained in the pilot, and we look forward to seeing the resulting data to be gathered and analyzed by the Department of Business Oversight. The pilot represents the start of a longer conversation here in the state about how best to protect consumers and support responsible businesses offering longer-term loans.

Thank you.

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Statement from the National Council of La Raza
Informational Hearing on the Consumer Financial Protection Bureau
Rulemaking for Payday, Vehicle Title and Similar Loans
California Senate Banking Committee

May 6, 2015

I. Introduction

Thank you for the opportunity to provide a written statement for the record on the Consumer Financial Protection Bureau's (CFPB) proposals on payday, vehicle title and similar loans.

The National Council of La Raza (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300 affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families. NCLR's Affiliate network in California includes 62 community-based organizations that provide a wide array of direct services to Latino, and underserved families throughout the state.

NCLR's Office of Research, Advocacy, and Legislation (ORAL) is one of the most influential and visible national advocacy voices championing public policy on behalf of Latinos. In order to achieve its mission, ORAL is composed of several departments and issue-focused policy projects that: 1) gather and share information, research, and data on Latinos; 2) develop policy analyses, proposals, and ideas; 3) equip Hispanic-serving community leaders and NCLR Affiliates with information that empowers and engages them in public policy debates; and 4) provide decision-makers with strategic advice on how best to advance policy issues for Latinos.

II. Background

Latino families share the same fundamental goals of financial security and upward mobility as the majority of Americans. To achieve the security that has long characterized the middle class, most rely on financial tools, including homeownership, to gradually expand their access to wealth-sustaining or income-generating assets. Building positive net-worth and an asset-based financial safety net often takes years or even decades. A true transformation of the Latino community will come when assets are successfully maintained over their lifecycle and passed to their children. Unfortunately, attainment of this goal has been impeded for a significant number

of Hispanic families. Current economic conditions have exacerbated the historical and systemic barriers that Hispanic households confront when connecting with entry-level financial tools and long-term assets.

In the wake of the near collapse of financial markets in 2008, issues of financial scams and unscrupulous lending, misconduct on Wall Street, and the financial capability of consumers garnered significant attention from policymakers, regulators, and advocates. The Department of Justice's numerous settlements with financial institutions since the financial crisis speak to the extreme levels of misconduct rampant within the financial services sector.

The sharp focus led to positive results in 2010 when the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Dodd-Frank created the Consumer Financial Protection Bureau (CFPB), which is focused on protecting the interests of consumers. The CFPB has introduced several important protections for Hispanic consumers, including a remittance rule that went into effect in October 2013 and nationwide mortgage servicing standards that went into effect in January 2014.

NCLR's research and policy work over the years has documented gaps and limitations in social safety nets and work-support systems that overlook too many working families. NCLR has published the following original research related to the financial conditions of Latino families:

- *Latino Financial Access and Inclusion in California*
- *Banking in Color: New Findings on Financial Access for Low- and Moderate-Income Communities*

In addition, NCLR has submitted the following statements to the U.S. Congress for the record:

- "Putting an End to the Foreclosure Crisis for Latinos and Communities of Color"
- "Principles to Modernize the Community Reinvestment Act: How CRA Can Help Low-Income Latino Families Build Wealth and Secure Their Financial Future"
- "Harnessing the Power of the Community Reinvestment Act to Connect Latinos to Banking Services"

NCLR also participated in the Bipartisan Policy Center's Financial Regulatory Reform Initiative and co-authored a report titled *The Consumer Financial Protection Bureau: Measuring the Progress of a New Agency.*

Given the significant existing racial and ethnic disparities in access to mainstream financial services, Blacks and Hispanics have few choices when seeking products and safety services to meet their financial needs. This means that nonbank credit products can substantially impact the household balance sheets of Latinos and other minority consumers.

III. Concerns with Payday Lending

Today, the most ubiquitous providers of these alternative financial products are payday loan lenders, nationally numbering more storefronts than McDonald's and Starbucks combined.[i] A recent study released by the Center for Responsible Lending found that race and ethnicity are the leading factors in determining payday lender locations, with concentrations of these businesses in lower-income and largely minority communities.[ii]

Payday loans are inherent debt traps, locking borrowers in a cycle of rollover loans that can last several months and ultimately cost hundreds of dollars in interest. According to testimony before the Senate Committee on Banking, Housing, and Urban Affairs, more than 58% of payday loan borrowers report using the loans to cover monthly expenses such as utilities, rent, and food.[iii] However, a payday loan used to cover these basic expenses will usually require a balloon payment averaging $400 from a borrower's next paycheck. This results in a pattern for countless borrowers who pay off their loan and then must immediately take out another loan to continue covering their living expenses. This revolving door of loans creates a debt trap that can leave a borrower in a worse financial position than before they took out the original loan. Regulations are needed to protect consumers from these harmfully designed and largely unchecked financial products.

The payday lending marketplace is not a small segment of consumers: research shows that 12 million Americans take out a payday loan each year. Of these consumers, four out of five are not able to pay it back within the original loan term,[iv] suggesting that the loan is not affordable for the majority of consumers who use them. While there is a definite need for small-dollar credit and loans, especially for low-income consumers and those who may be outside the financial mainstream, consumers should not end up in financial ruin as a result of taking out a loan.

The Center for Responsible Lending's analysis of data provided by the California Department of Business Oversight on repeat lending in the state demonstrated the extent to which repeat borrowers make up the bulk of the industry's profits, with 76% of all payday loan fees originating from borrowers with seven or more payday loans per year.[v] Further, analysis showed that the number of borrowers with 10 or more loans in California in 2013 increased by 11% over 2012 figures, even with the total number of loans declining slightly over the same period.[vi] It should behoove policymakers to address the long-term financial stress in which the current payday lending model is placing consumers.

Many of NCLR's Affiliates work with clients who have first-hand experience with the payday debt trap. One agency, Montebello Housing Development Corporation (MHDC) in Los Angeles, works with members of the Latino community who are looking to purchase their first home. They have shared the personal testimony from a client whose credit has suffered, incurred long-term debt, and who is now years from being able to purchase a home, as a result of the payday lending business model:

> My name is Maria Cervantes and I would like to share my experience with payday loans. Although I knew about the pitfalls of payday loans, I found myself in a situation where I thought I had no other choice but to take out

> a payday loan. What I thought would be a short term loan turned into 5 years. It's been approximately 5 years of paying 3 loans at $45 each, every two weeks. I was paying $135 biweekly and $270 a month. Every time I thought that I was going to pay off the $300 loan, something always happened so I found myself in a cycle.
>
> I regret ever taking the loan that from the start the lender gives you only $245 and not the full $300. If I had to do it all over again, I would ask a friend of family member instead of paying the hundreds of dollars I gave the payday lenders. Not only did I have to pay the high interest, but the harassing phone calls about late payment at work or to my references I wrote on my applications.

Maria's credit dropped to a FICO score of 500, she filed bankruptcy twice, and she was unable to obtain preapproval for a home loan because of her credit history. MHDC is working with her on budgeting and prioritizing her debt to improve her credit score, which will likely take years to do.

IV. Reaction to CFPB's Proposals

The CFPB recognizes that a crucial principle—the ability to repay a loan—must apply to a sufficiently broad range of small-dollar loans, not just a narrowly defined set of payday or car-title loans. The proposed rule released by the CFPB in late March 2015 is a huge step in the right direction—providing much-needed protections for products that have gone unregulated for far too long. The ability-to-repay component should be a fundamental requirement of any consumer loan transaction.

However, there is concern over the provisions in the proposals that would allow lenders to use alternatives to the ability-to-repay determination at the outset, in the "debt trap protection requirements." These options would undermine the ability-to-repay principle, and the rule's overall effectiveness in protecting consumers from financial harm due to unaffordable loans.

With respect to the short-term loan provisions, CFPB's proposal would offer an alternative to the ability-to-repay requirement that would sanction three back-to-back loans twice during the year (for a total of six loans within one year),and 90 days of total indebtedness, with no underwriting required for the ability-to-repay. We strongly suggest that the final rule not allow short-term loans without ability-to-repay underwriting or any unaffordable back-to-back loans to be sanctioned. Further, indebtedness should be limited to 90 days in addition to the ability-to-repay requirements, not in place of it.

The longer-term loan proposal would permit certain loans not exceeding $500 to be exempt from ability-to-repay underwriting, where periodic payment does not exceed 5% of a borrower's expected gross income during the pay period. The concern with this provision is that income-

based underwriting, absent consideration of the borrower's major financial obligations and expenses, would not ensure that a loan is affordable.

The CFPB proposal would require annual reports containing data sufficient to monitor performance of covered loans, including information on defaults and re-borrowing for both short- and longer-term loans. We support this requirement and also urge CFPB to include information on late payments and bounced payments, which would provide further information on borrowers' ability to afford the loans.

The proposal's scope includes single-payment and longer-term, multi-payment loans, as well as closed-end and open-end loans. This is critical in protecting borrowers against financial harm from products currently in the marketplace and from potential future efforts to evade the rule. In addition, we also support the inclusion of car title loans in the rule's scope.

V. Conclusion

Thank you for the opportunity to provide our perspective on this proposal. NCLR welcomes these efforts to reduce household debt and help Latino families and other consumers continue recovering from the economic crisis. We are happy to provide further information on the proposals as the CFPB moves closer to releasing its draft rule. Please contact Marisabel Torres, Senior Policy Analyst, with any questions, mtorres@nclr.org.

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[i] Federal Reserve Bank of St. Louis, *Payday Loans: Time for Review* (St. Louis, MO: Federal Reserve Bank of St. Louis, 2014), https://www.stlouisfed.org/publications/inside-the-vault/fall-2014/payday-loans (accessed April 14, 2015).
[ii] Wei Li, et al., *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California* (Washington, DC: Center for Responsible Lending, 2009).
[iii] Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions, *Are Alternative Financial Products Serving Consumers*, 113th Cong., 2nd sess., 2014.
[iv] Susanna Montezemolo, *The State of Lending in America and its Impact on U.S. Households*, (Washington, DC: Center for Responsible Lending, 2013).
[v] Paul Leonard and Graciela Aponte, *Analysis: New State Data Show California Payday Lenders Continue to Rely on Trapping Borrowers in Debt* (Washington, DC: Center for Responsible Lending, 2014).
[vi] Ibid

May 6, 2015

Honorable Marty Block, Chair
California State Senate
Senate Banking and Financial Institutions Committee
California State Capitol, Room 405
Sacramento, CA 95814

RE: CFPB'S proposed regulations pertaining to short-term consumer loans.

Dear Senator Block:

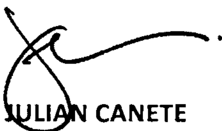
On behalf of the California Asian Pacific Chamber of Commerce (CalAsian Chamber), I am writing to express our concerns regarding the CFPB's recently proposed regulations pertaining to short-term consumer loans.

CalAsian Chamber represents the interest of the over 600,000 Asian Pacific Islander business owners throughout California, an overwhelming percentage of them being small businesses. Our members are keenly aware of how important access to small amounts of legitimate short-term credit can be for both individuals and small businesses.

Today, because of legislation in California, there are very few legal, regulated credit options for consumers to turn for small dollar loans. It is important to provide the hard working people of California with financial products to suit their needs. We are very concerned that the CFPB's lending proposals will not only restrict consumer's access, but possibly force consumers to illegal, unlicensed Internet lenders.

The CFPB is failing to address the needs of the consumers and under the current proposals will limit or even eliminate their legitimate financial choices. Therefore, we urge the CFPB to slow down the process and truly take into consideration small business and consumer financial needs.

Sincerely,



JULIAN CANETE
DIRECTOR OF PUBLIC POLICY

SECTION THREE

HEARING AGENDA AND BACKGROUND PAPER

MEMBERS
ANDY VIDAK
VICE CHAIR
CATHLEEN GALGIANI
ISADORE HALL, III
BEN HUESO
RICARDO LARA
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California State Senate

SENATE COMMITTEE ON BANKING AND FINANCIAL INSTITUTIONS

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SENATOR MARTY BLOCK
CHAIR

ENDING DEBT TRAPS OR RESTRICTING ACCESS TO SAFETY NETS? INITIAL REACTIONS TO THE CONSUMER FINANCIAL PROTECTION BUREAU'S LENDING PROPOSAL

OVERSIGHT HEARING

Wednesday, May 6, 2015
State Capitol, Room 112
1:30 PM – 4:30 PM

I. **Welcome and Opening Remarks** – Chairman Block

II. **Introduction To The Proposal** – Brian Sala, Acting Director, California Research Bureau

III. **Potential State Regulatory Impacts Resulting From The Proposal** – Jan Owen, Commissioner, California Department of Business Oversight

IV. **Input From Interested Parties Regarding The Short-Term Covered Loan Proposal**

Consumer Perspectives:

Paul Leonard, Director, California Office, Center for Responsible Lending
Liana Molina, Organizer, California Reinvestment Coalition
Leslie Bailey, Staff Attorney, Public Justice
Ted Mermin, Executive Director, Public Good Law Center

Industry Perspectives:

Dan Gwaltney, President, California Financial Service Providers
Jabo Covert, Senior Vice President for Government Relations, Check Into Cash
Carol Stewart, Senior Vice President, Advance America
Robert Grieser, Senior Vice President of Governmental Affairs, Community Choice Financial

V. Input From Interested Parties Regarding The Longer-Term Covered Loan Proposal

Industry Perspectives:

Jabo Covert, Senior Vice President for Government Relations, Check Into Cash
Robert Reich, President, Community Loans of America
Sarah Cutrona, General Counsel, Elevate
James Gutierrez, Chief Executive Officer, Insikt
Dan Gwaltney, President, California Financial Service Providers

Tribal Perspective:

Sherry Treppa, Chairwoman, Habematolel Pomo of Upper Lake Tribe

Consumer Perspectives:

Paulina Gonzalez, Executive Director, California Reinvestment Coalition
Suzanne Martindale, Staff Attorney, Consumers Union
Paul Leonard, Director, California Office, Center for Responsible Lending

VI. Public Comment

VII. Closing Remarks – Chairman Block

MEMBERS
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ENDING DEBT TRAPS OR RESTRICTING ACCESS TO SAFETY NETS? INITIAL REACTIONS TO THE CONSUMER FINANCIAL PROTECTION BUREAU'S LENDING PROPOSAL

BACKGROUND PAPER

INTRODUCTION

On March 26th, 2015, the federal Consumer Financial Protection Bureau (CFPB; the Bureau) released an outline of proposals it is considering adopting to provide greater protections for consumers who take out payday loans, high interest rate installment loans, and car title loans (http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf). Although the proposals are preliminary, they will form the basis for the CFPB's rulemaking in this area. Furthermore, once the CFPB finalizes its consumer lending regulations, the new rules will apply in all fifty states; they will not require legislative or congressional approval to become effective. In California, the new rules will affect over 12 million payday loans, totaling over $3.1 billion annually, and over 500,000 installment loans, totaling approximately $1 billion annually.

Because the CFPB's rulemaking will have such a significant impact in California, it is critical that the California Legislature begin reviewing the proposals now, before the CFPB becomes locked into any particular regulatory approach. On May 6th, the California Senate Banking and Financial Institutions Committee will convene an oversight hearing to solicit feedback on the CFPB proposals outlined in the CFPB's March 26th release. The hearing is designed to help Committee members, interested members of the public, and the CFPB understand the potential impacts of the CFPB proposals on California consumers, California businesses, and the California economy as a whole. The Committee will hear from the California Research Bureau, Commissioner of the California Department of Business Oversight, and nearly twenty other witnesses, representing a variety of viewpoints. Witnesses include consumer advocates; attorneys who represent consumers in predatory lending actions; small and large lenders, including one tribal lender; lenders that lend exclusively online; lenders that operate exclusively through brick-and-mortar storefronts; payday lenders; unsecured installment loan lenders, and car title lenders.

Following the hearing, staff will prepare a final report that summarizes oral witness testimony and compiles written testimony submitted to the Committee in connection with the hearing. A copy of that final report will be posted on the Committee's web site, along with this background paper and an archived video recording of the hearing.

The remainder of this background paper summarizes the CFPB proposals and describes the process that CFPB will undertake to develop its final rule. It also discusses the choices with which the California Legislature will be faced following adoption of that final rule.

SUMMARY OF PROPOSAL

Short-Term Credit Products Covered By the Proposal:

- The CFPB's short-term covered loan proposal covers loans with a contractual loan term of 45 days or less. According to the CFPB, this proposal covers payday loans, deposit advance products, open-end lines of credit where the credit line terminates within 45 days or the credit is repayable in full within 45 days, and short-term vehicle title loans. In California, the most significant impact of the short-term loan proposal will be felt by

payday lenders (i.e., those licensed under the California Deferred Deposit Transaction Law; CDDTL; payday loan law). The short-term covered loan proposal also has the potential to impact California depository institutions that offer deposit advance products (payday loan-like products offered by depository institutions). However, because no depository institutions in California are currently offering deposit advance products, this impact is more theoretical than real; in practice in California, the short-term loan proposal will be felt almost exclusively by payday lenders and their customers.

Longer-Term Credit Products Covered By the Proposal:

- The CFPB's longer-term covered loan proposal covers loans with a contractual loan term of greater than 45 days, where the "all-in" annual percentage rate (APR) exceeds 36%, and lender collects payments through access to a consumer's deposit account or paycheck or holds a security interest in the consumer's vehicle.

  The "all-in" APR includes all interest and fees associated with the loan, *plus* the cost of any add-on products sold along with the loan, such as credit insurance memberships. "Access to a consumer's deposit account or paycheck" includes a post-dated check; automated clearing house (ACH) authorization; remotely created check (RCC) authorization; authorization to debit a prepaid card account; payroll deduction; a right of setoff or to sweep funds from a consumer's account; and any other method of collecting payment from a consumer's checking, savings, or prepaid account.

  According to the CFPB, the longer-term covered loan definition includes vehicle title loans with a contractual loan term greater than 45 days, as well as certain unsecured installment loans and open-end loans. In California, the longer-term covered loan proposal will have its greatest impact on lenders licensed under the California Finance Lenders Law (CFLL; installment loan law), which extend car title loans and installment loans with annual percentage rates greater than 36%.

Lenders Are Given a Choice Of How to Comply:

Both proposals allow lenders to choose their method of compliance. The CFPB characterizes option one under both proposals as "debt trap prevention," and option two under both proposals "debt trap protection."

Need For a Centralized Database or Other Loan Tracking System: Both of the CFPB's proposals require lenders to verify a borrower's borrowing history and report a borrower's use of a covered loan. To fulfill these requirements, the CFPB expects lenders to rely on what the Bureau calls a "commercially available loan reporting system." While some read that language as requiring a centralized loan database, the CFPB suggests that compliance may be achieved through alternate means.

In language accompanying the proposals, the CFPB explains that "the Bureau anticipates that it would specify criteria that would make a consumer reporting system eligible for lenders to use in verifying borrowing history. To facilitate consideration of borrowing history, lenders would be

required to report use of covered loans to commercially available reporting systems meeting the Bureau's eligibility criteria. Under this proposal, lenders would need to report to all applicable commercially available reporting systems, but would have to check only one such reporting system meeting the Bureau's eligibility criteria.

"The Bureau understands that in the payday lending market, may states currently require lenders to check a state-recognized database prior to the extension of certain loans and to report consumer use of those loans to the same database. The Bureau also understands that, as part of their own risk analytics when making loans, many lenders voluntarily use a handful of credit reporting agencies that provide information about a consumer's loan history. The Bureau is not considering creating its own reporting system for borrowing on covered loans. The Bureau also is not considering administering or otherwise contracting with a third-party to create or administer a reporting system."

Details of the Proposals: As envisioned by the CFPB, a lender making a covered loan (either short-term or longer-term) will have to comply with *either* the debt trap prevention requirements (Row 2 in the table immediately below) *or* the debt trap protection requirements (Row 3 in the table below). That lender will also have to comply with *both* the borrower notification requirements (Row 4) and the cap on unsuccessful attempts to debit an account (Row 5).

	Short-Term Covered Loans	**Longer-Term Covered Loans**
Debt Trap Prevention	Determine ability to repay before extending credit: A lender must verify a borrower's income, major financial obligations, and borrowing history, and make a good faith, reasonable determination that the borrower has enough money to repay the loan after satisfying major financial obligations and living expenses. A lender may not extend a new short-term covered loan to a borrower who already has an outstanding short-term covered loan from any lender. A commercially available loan reporting system that tracks short-term loans across all lenders making these types of loans will be necessary to comply with this requirement. Minimum 60-day cooling off	Determine ability to repay before extending credit: A lender must verify a borrower's income, major financial obligations, and borrowing history, and make a good faith, reasonable determination that the borrower has the ability to repay the loan (including principal, interest, and fees for add-on products) after satisfying major financial obligations and living expenses. If the lender is extending a covered longer-term loan with a balloon payment, underwriting must consider income and major financial obligations for 60 days beyond the term of the loan. A lender may not extend a new loan or refinance an existing loan without new underwriting. If a borrower has been delinquent, a lender is prohibited from

	Short-Term Covered Loans	Longer-Term Covered Loans
	period between loans (with an exception): A lender must wait at least 60 days after a borrower pays off their prior short-term covered loan before extending a new short-term covered loan to that borrower, *unless* the lender can document that the borrower's financial circumstances have improved enough to repay a new loan without re-borrowing. Minimum 60-day cooling off period between loans (no exception): After three successive loan with less than 60 days between them, a lender may not make a new short-term loan to the same borrower for at least 60 days.	refinancing that borrower into another loan with similar terms, without documentation that the borrower's financial situation has improved enough to allow that borrower to afford the new loan. 60-day cooling off period following a longer-term loan with a balloon payment: A lender must wait 60 days before extending credit to a prior borrower, unless the lender can document that the borrower's financial circumstances have improved enough to repay the new loan without re-borrowing. After three loans in a row with less than 60 days in between them, a lender may not make a new loan to the same borrower for 60 days.
Debt Trap Protection	Available only for the following loans: loan amount must be $500 or less, loan term must be 45 days or less, no more than one finance charge may be imposed, and a borrower's vehicle may not be used as collateral. Lenders making short-term covered loans that do not meet these criteria must comply with the debt trap prevention requirements above. Limitations on repeat borrowing: If all the criteria above are met, a lender will have to verify a borrower's income and borrowing history; and, before extending a new loan to that borrower, ensure that the borrower does not already have a covered loan outstanding with any lender; ensure that the new loan will not result in the borrower having taken out more than three short-term covered	This option is available only for loans with durations between 45 days and six months. Lenders making longer-term covered loans with durations greater than six months must comply with the debt trap prevention requirements above. For loans that do meet the eligibility criteria for the debt trap protection option, two alternatives are available. Under the first (so-called NCUA-type) alternative, the loan principal must be between $200 and $1,000, the application fee is capped at $20, the interest rate is capped at 28%, the loan must be fully amortizing over at least two payments, the lender must verify a borrower's income and borrowing history, must report use of the loan

	Short-Term Covered Loans	Longer-Term Covered Loans
	loans in sequence, with less than 60 days between loans; ensure that the new loan will not result in a borrower receiving more than six covered short-term loans from any lender in a rolling 12-month period; and ensure that, following completion of the contractual loan term, the borrower will not have been in debt on covered short-term loans for more than 90 days in the aggregate during a rolling 12-month period. In addition to those requirements, a lender that wants to extend a short-term covered loan to a borrower who previously obtained a short-term covered loan within the prior 60 days will have to choose between two different options aimed at offering borrowers an affordable way out of their short-term debt. Under the first option, the lender will have to reduce the principal amount of each subsequent loan over the course of a three-loan sequence (e.g., $300, $200, $100). Under the second option, the lender will have to provide a borrower unable to repay his or her third loan according to its terms with a no-cost loan extension, which allows the borrower four additional installments in which to repay the loan, without incurring additional cost. If this option is selected, the lender may not extend any additional credit to the borrower for at least 60 days following repayment of the third loan.	to all applicable commercially available reporting systems, and, before extending a new loan, must verify that the borrower does not have any other outstanding covered loans, and ensure that the new loan will not result in a borrower having more than two of these types of loans in a rolling six- month period. Under the second alternative, the lender must verify the borrower's income and borrowing history, report use of the loan to all applicable commercially available reporting systems, and, before extending a new loan, ensure that loan payments will not exceed 5% of the borrower's gross monthly income, verify that the borrower does not have any other outstanding covered loans, and ensure that the new loan will not result in a borrower having more than two of these types of loans in a rolling twelve- month period.

	Short-Term Covered Loans	Longer-Term Covered Loans
Borrower Notification Before Accessing Deposit Accounts	A lender must provide each of its borrowers with three business days' advance notice before submitting a transaction to the borrower's bank, credit union, or prepaid account for payment.	A lender must provide each of its borrowers with three business days' advance notice before submitting a transaction to the borrower's bank, credit union, or prepaid account for payment.
Limit Unsuccessful Withdrawal Attempts	A lender may not make any more than two unsuccessful attempts to collect money from a borrower's account. Before a lender may attempt to collect money from that account a third time, the borrower would have to provide new authorization to that lender.	A lender may not make any more than two unsuccessful attempts to collect money from a borrower's account. Before a lender may attempt to collect money from that account a third time, the borrower would have to provide new authorization to that lender.

COMPARISON OF CALIFORNIA LAW AND THE PROPOSALS

CDDTL (Payday Loan Law): The short-term covered loan proposal will have its greatest impact in California under our payday loan law. Generally speaking, and as discussed below, none of the requirements of the short-term covered loan proposal are already present in California law.

- The debt trap prevention option requires underwriting to determine a borrower's ability to repay (not required under California's payday loan law), prohibits the extension of a short-term covered loan to any borrower with an outstanding, short-term covered loan from any lender (California's law prohibits the same lender from extending more than one payday loan to a borrower with a payday loan outstanding, but California's regulator does not apply this prohibition across multiple lenders, as is contemplated by the CFPB), and limits the frequency with which short-term loans can be extended to borrowers that obtained a prior short-term loan during the recent past (California's law lacks any restrictions around lending frequency).

- The debt trap protection option is available only for loans that are less than $500, shorter than 45 days, and include only one finance charge. These criteria are consistent with California's payday loan law, which caps the maximum face value of a check that may be presented by a borrower at $300, caps the maximum length of a loan at 30 days, and allows only one finance charge, equal to $15 per $100 borrowed. Thus, California licensed payday lenders would be eligible to use the debt trap protection option, if they wish.

  Any lender wishing to use the debt trap protection option for its short-term covered loan will need to verify a borrower's income and borrowing history (not required under California law), ensure that a borrower seeking a short-term covered loan does not have another short-term loan outstanding from any lender (California's law prohibits the same lender from extending more than one payday loan to a borrower with a payday loan

outstanding, but California's regulator does not apply this prohibition across multiple lenders, as is contemplated by the CFPB proposal), limit the frequency of repeat loans by the same borrower (California law lacks any restrictions around lending frequency), and following three consecutive loans, offer borrowers an affordable way out of debt (California law lacks special rules for borrowers who have taken out consecutive loans).

- The borrower notification requirements and cap on successive unsuccessful attempts to debit an account also represent new requirements, relative to existing California law. California's payday loan law does not require lenders to notify borrowers before debiting the borrowers' accounts, nor does it limit the number of repeated, unsuccessful attempts to debit an account.

CFLL (Installment Loan Law): The longer-term covered loan proposal will have its greatest impact in California under our Finance Lenders Law.

- The CFPB longer-term loan proposal will have little impact on installment loans made in California in amounts below $2,500. With one exception (the Pilot Program for Increased Access to Responsible Small-Dollar Loans; pilot program), the CFLL caps interest rates and fees on installment loans with principal amounts below $2,500 at levels below 36% APR. The longer-term covered loan proposal applies to installment loans greater than 45 days in length, whose "all-in" APR exceeds 36%. Thus, the CFPB proposal is unlikely to impact the general provisions of the CFLL that apply to loan amounts below $2,500.

- The pilot program does allow for interest rates and fees that can result in an all-in APR in excess of 36%. Depending upon the amount borrowed and the loan length, some pilot program loans do exceed 36% APR; others are below this threshold. Some pilot program lenders do not access their customer's deposit accounts; others do, and could therefore be covered by the CFPB proposal. However, because the pilot program requires rigorous underwriting to evaluate borrowers' ability to repay their loans and limits the frequency with which pilot program loans may be refinanced, it appears that compliance with pilot program rules will automatically place a pilot program lender into compliance with the debt trap prevention rules for longer-term loans.

  The only areas where changes to the pilot program rules may be necessary to conform to the CFPB proposal lie in the areas of borrower notification prior to a collection attempt and limitation on the number of successive collection attempts made. The pilot program requires that borrowers be given a reminder about their next payment two days prior to that payment (rather than three, as proposed by CFPB). Furthermore, the pilot program does not cap the number of times a lender may attempt to debit a borrower's account to collect a payment, if the first attempt is unsuccessful.

- In contrast, the CFPB's longer-term covered loan proposal will have a significant impact on installment loans made in California in amounts of $2,500 or more, because none of the requirements of that proposal are contained in California law. For example, the CFLL does not cap interest rates on installment loans with principal amounts of $2,500 or

more, require these loans to be rigorously underwritten, limit the frequency with which these loans can be made or refinanced, require lenders to notify borrowers before accessing their accounts, or limit the number of unsuccessful attempts to debit a borrower's account.

Although Section 1452 of Title 10 of the California Code of Regulations references the need for finance lenders to take into consideration the ability of borrowers to repay their loans according to their terms, that regulation is quite vague; it requires finance lenders to "take into consideration, in determining the size and duration thereof, the financial ability of the borrowers to repay the same, to the end that the borrowers should be reasonably to repay said loans in the time and manner provided in the loan contracts."

NEXT STEPS

The document released by the CFPB on March 26th is an outline of a proposal; it is not a proposed regulation. Before the CFPB can issue its proposed regulation, it must solicit input from small business representatives regarding the potential impact of its rule on small businesses. The Small Business Regulatory Enforcement Fairness Act (SBREFA) requires the CFPB to convene a Small Business Review Panel when it is considering a proposed rule that could have a significant economic impact on a substantial number of small entities. The Dodd-Frank Wall Street Reform and Consumer Protection Act further requires the CFPB to collect advice and recommendations from small businesses and non-profits on whether any of its proposals are likely to increase the cost of credit for small business lenders and to solicit idea for alternative approaches that would minimize any such increases. The proposals released by the CFPB on March 26th were intended to provide necessary background to facilitate the Small Business Review Panel process.

The SBREFA Small Business Review Panel held a meeting on Wednesday, April 29th, 2015 to discuss the CFPB's March 26th outline. Within 60 days following that meeting, the Panel is required to complete a report for submission to the CFPB. The Bureau is required to consider the Panel's report as it prepares its proposed regulations.

The CFPB will also be considering feedback from several other entities when developing its proposed regulations. In its March 26th release, the CFPB indicated that it is "also consulting with other federal agencies, as well as tribal governments, and is seeking feedback from a wide range of other stakeholders on the proposals under consideration." Witness testimony provided during this Committee's May 6th hearing will offer the CFPB some of the feedback it is seeking.

Once published in the Federal Register, likely sometime later this year, the CFPB's proposed regulations will be subject to a formal public comment process. Final regulations will follow, once public input on the proposed regulations has been considered. When it issues its final regulations, the CFPB expects to provide businesses covered by the regulations with some period of time in which to implement the new rules, before they will be enforced. Given this timeline, the issuance of proposed regulations is likely sometime during 2015, and issuance of final regulations is likely to follow during 2016.

THE ROLE OF THE CALIFORNIA LEGISLATURE

Members of the California Legislature may provide comments to the CFPB at multiple stages in the CFPB's rulemaking process. However, once the CFPB finalizes its regulations, those rules will apply in all fifty states. Where existing state law is more protective of consumers than the CFPB regulations, state law will govern. Where the CFPB regulations are more protective of consumers than state law, the CFPB regulations will govern.

Once the CFPB regulations are finalized, the Legislature will have to decide whether to update the Deferred Deposit Transactions Law and Finance Lenders Law. Doing so will likely minimize confusion about what protections are available to California borrowers and what rules apply to California licensed lenders. Updating California law will also clarify the authority of the Commissioner of the Department of Business Oversight to enforce the new rules in California.

However, revising and updating the Deferred Deposit Transaction Law and Finance Lenders Law is likely to spark fierce debate over the extent of the revisions. Some will likely argue for simple conformity with the federal regulations. Others are likely to argue that California should go beyond the federal regulations, and ensure that our laws are more protective of consumers than what is required by the CFPB. These debates are likely to begin later this year and continue through 2016, perhaps beyond.