Consumer Federation of America

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Arizona Senate Appropriations Committee

HB 2370 Strike Everything: Payday Loans

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Good afternoon. I am Jean Ann Fox, director of financial services for Consumer Federation of America, a national organization of consumer groups including several in Arizona. I live in Prescott and serve on the Steering Committee of Arizonans for Responsible Lending. I specialize in high-cost credit product consumer issues and have testified on payday lending before committees of Congress and legislatures in Virginia, Pennsylvania, and Arkansas. I appreciate the opportunity to testify in opposition to HB 2370 and to urge you to let Arizona's failed experiment with payday lending sunset this year.

Payday Loan Amendments to HB 2370 Do Not Reform Arizona Payday Loans

Under this legislation, as with Prop 200, payday lenders are authorized to make single payment loans based on holding unfunded checks at 400 percent APR for a two-week balloon payment loan. The provisions of HB 2370, as with Prop 200, do not make loans affordable or safe to use. In fact, this bill makes payday lending even riskier for Arizona borrowers. Voters rejected 400% lending in 2008 and we urge this committee to do so as well.

The "Reforms" Claimed for HB 2370 Have Not Worked in Other States

Payday loans will still trap borrowers in perpetual debt. Data from Florida and Oklahoma, states that have the features touted by this bill's backers (database, renewal limits, repayment plans), demonstrate that payday loans are a debt trap. The average payday loan borrower takes out 9 loans per year. Over 90 percent of payday loan business is generated by borrowers with five or more loans per year while over 60 percent of business is generated by borrowers with 12 or more loans per year. Only two percent of loans go to consumers who take out one loan, repay it, and never return.[1]

Renewal bans do not stop payday loan churn. The industry claims that over 90 percent of loans are repaid. On payday, consumers rush to the payday loan store to "buy back" the check used to get the loan to keep it from bouncing. But consumers are then short and take out a new loan at their first opportunity or within the next pay period so they can pay their other bills. This "churn" accounts for 76 percent of all payday lending. Renewal bans do nothing to curb this pattern of back-to-back loans; they just give lenders a fresh check to hold every pay period.

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[1] Leslie Parrish, *Financial Quicksand,* Center for Responsible Lending, 2005.

HB 2370 authorizes the key features that make payday loans a debt trap.

(1) High annual percentage rate: 391 percent APR rate for a two-week loan or 782 percent for a one-week loan. Consumers can be charged $75 for a single $500 loan.

(2) Short balloon payment period: Loans due in full in as little as five days. Typically payday loans are for two week terms. There is no limit on the number of loans a borrower can have over a year.

(3) Direct access to the borrower's bank account: Lenders hold unfunded checks. Apparently, HB 2370 opens Arizona up to loans secured by electronic access to borrowers' bank accounts by repealing the deposit requirement. This gives lenders first claim on the borrower's next deposited pay check or Social Security payment and exposes borrowers to coercive collection tactics.

(4) No real consideration of the borrower's true ability to repay. HB 2370 does not require a determination of ability to repay.

None of the other features of this legislation overcomes these debt trap triggers. In fact, this bill makes payday lending more risky than current law. It permits borrowers to have multiple loans outstanding up to the maximum $500 and permits lenders to charge NSF fees on multiple checks if the borrower is unable to repay the loans when due. The bill permits lenders to charge **two** NSF fees for each check returned for insufficient funds, plus another round of NSF fees should borrowers then stop payment on the check.

Payday loan use harms borrowers. Independent academic research shows that payday lending increases a borrower's chances of filing for bankruptcy, becoming delinquent on a credit card, having a hard time paying other bills, delaying medical care and prescription drug purchases, and losing their bank account. A summary of these research papers with references is attached to this testimony.

Payday lending targets consumers who struggle to make ends meet. According to the Federal Reserve Board's Survey of Consumer Finances (SCF) conducted in 2007, families that used payday loans in the last year tend to have less income, lower wealth, fewer assets, and less debt than families without payday loans. They are more likely to be minorities, single female head of household, less well educated, and younger than non-payday loan users.[2]

The table attached to this testimony illustrates how a payday borrower earning $35,000 a year would be hard pressed to pay back a $300 loan, plus its $46 fee as set by H.B. 2370, in just one pay period. Even if the payday loan came with *no* finance charge, a borrower earning $35,000 a year cannot afford to repay the typical payday loan in a single payment on his or her next payday and still meet the family's other obligations.

Letting payday lending sunset will put Arizona in step with other states to restore small loan rate caps and protections.

Payday lending is legal in Arizona only because the legislature carved out a special exemption from the state's small loan rate cap in 2000. Letting the payday loan carve-out expire June 30 will place these small loan companies under the rules that apply to other small lenders.

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[2] This is consistent with research from CFA which finds that a family earning $25,000 per year and no savings is eight times as likely to take out a payday loan in a year as the same income family with at least $500 in emergency savings.

No state has carved payday lending out of state usury or small loan rate caps since Michigan in 2005. In recent years, North Carolina let its payday loan law sunset after determining that repeat lending resulted. The District of Columbia repealed its payday loan ordinance, restoring the District's 24 percent usury cap. Ohio enacted a 28 percent annual rate cap for payday loans, protections upheld by ballot in 2008 by a two to one vote despite a $15 million campaign blitz by the payday lenders. Oregon enacted a 36 percent rate cap for payday and car title loans plus a one-time $10/$100 fee for loans with a minimum term of one month. New Hampshire's 36 percent rate cap for payday and car title loans took effect last year. Arkansas's Supreme Court ruled that payday lending violated the state's constitutional usury cap and the Attorney General shut down all payday lending in the state.

Currently triple-digit interest rate two-week payday lending is legal in thirty-five states. A third of the US population lives in the fifteen states where payday lending is not authorized.

Congress enacted a 36 percent rate cap for Service members and families and placed loans based on unfunded checks or electronic access to bank accounts off-limits for Service members after the Department of Defense requested these protections to improve readiness and morale. According to the Department of Defense one year after the law's enactment, substantially fewer dollars had to be devoted to military members previously trapped by payday loans, and they did not see a migration of military members to other high-cost lending products.[3]

What happens when payday lending ends June 30, 2010 in Arizona?

The $150 million now paid for payday loans each year will stay in Arizona consumers' pockets, not go to out-of-state payday lenders. Instead of rushing down to the payday loan store every payday to cover the loan amount and pay $76 in finance charge and database fee to keep the loan check from bouncing, Arizona families will have this money to pay for groceries and other essentials.

Consumers will no longer be solicited to write unfunded checks or sign over access to their bank accounts to get small loans. The traditional small loan companies licensed in Arizona and permitted to charge up to 36 percent annual interest for loans are likely to increase lending, based on the experience in North Carolina when payday lenders were expelled. All small loan lenders will have to play by the same rules.

The industry claims that consumers will be worse off, using a draft paper from an economist at the New York Federal Reserve bank as proof. The findings by Don Morgan are flawed. The authors consistently intermingle data from Georgia and North Carolina – states which outlaw 400% interest rates – with data from states which allow these high interest rates. Mr. Morgan's attempt to assess the difference between states with 400% loans and those without is just not reliable or accurate.

Let payday lending sunset. Voters have spoken. Arizona consumers don't want 400% loans. The legislature should respect voters and let the sun set on this failed experiment with usurious lending. Let borrowers keep 100% of the revenue they generate for this industry, not the 1.5% kickback included in this bill.

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[3] U.S. Dep't of Defense, "Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents," July 2008, http://www.dcuc.org/PDF%20Files/Senate%20Report%20Final.pdf

Appendix: Balloon Payment Payday Loans Are Not Affordable

For Family Earning $35,000 per Year

	Cost of Two-Week Payday Loan		
	$0 per $100 (free loan)	$15 per $100 (391% APR)	$20 per $100 (521% APR)
Income and Taxes			
Income per half-month pay period	$ 1,458.33	$ 1,458.33	$ 1,458.33
Taxes	$ 17.79	$ 17.79	$ 17.79
Social Security	$ 96.33	$ 96.33	$ 96.33
Income after tax	**$ 1,344.21**	**$ 1,344.21**	**$ 1,344.21**
Payday loan payment due on $300 loan	**$300**	**$345**	**$360**
Paycheck remaining after paying back payday loan	**$ 1044.21**	**$ 999.21**	**$ 984.21**
Household Expenditures per 2 week period			
Food	$ 193.54	$ 193.54	$ 193.54
Housing	$ 516.21	$ 516.21	$ 516.21
Utilities	$ 128.00	$ 128.00	$ 128.00
Transportation	$ 165.42	$ 165.42	$ 165.42
Healthcare	$ 103.88	$ 103.88	$ 103.88
Total Essential Expenditures	**$ 1,107.04**	**$ 1,107.04**	**$ 1,107.04**
Money from paycheck remaining (deficit)	**$ (62.83)**	**$ (107.83)**	**$ (122.83)**

Source: 2007 Consumer Expenditure Survey, Bureau of Labor Statistics, households earning $30,000-39,999 annually. Prepared by Center for Responsible Lending.

This example is of a borrower earning $35,000 a year, and excludes other costs such as childcare, clothing, etc. which are likely applicable to many payday borrowers.

Appendix: Research on the Adverse Impact of Payday Loans on Borrowers

Payday loan borrowers are worse off than consumers who have no access to payday loans. Colby College researchers simulated families trying to pay bills in spite of budgetary constraints over a 30 month period. "Borrowers" who used the typical volume of payday loans per customer per year for this industry were found to be worse off financially than those without access to payday loans.[4]

Using payday loans causes financial hardship for families. A University of Chicago Business School doctoral student compared households in states with and without access to payday loans over a five year period and found that access to payday loans increases the chances a family will face hardship, have difficulty paying bills, and have to delay medical care, dental care, and prescription drug purchases.[5] These finding are bolstered by findings in the Detroit Area Study (DAS), conducted by a University of Michigan law professor. Comparing payday loan users with similar low to moderate-income households in Detroit who did not use payday loans, the DAS found almost three times the rate of bankruptcy, double the rate of evictions and phone cut-off, and almost three times the rate of having utilities shut off.[6]

Using payday loans increases the chance of losing a bank account. Harvard Business School researchers examined involuntary bank account closures in states where payday loans are available and states where these loans are prohibited to determine the impact of loan availability on account closure. Advocates argue that using payday loans leads consumers to overdraw accounts while lenders claim that the ability to get payday loans saves consumers from otherwise overdrawing their accounts. The study found that an increase in the number of payday loan outlets in a county is associated with an eleven percent increase in involuntary bank account closures, even when other variables such as income and poverty rate are taken into account. To test the theory, researchers looked at Georgia, a state that bans payday loans but is surrounded by states that permit the product. Counties at least 60 miles from the border with payday loan states had a 15.6 percent decline in account closures when Georgia expelled payday lending.[7]

Payday loan users who also have credit cards are twice as likely to become delinquent on the card. Researchers at the Chicago Federal Reserve Bank, Vanderbilt University, and the University of Pennsylvania examined a large sample of payday loan users who also had a credit card from a major issuer. They found that taking out a payday loan makes a borrower almost twice as likely as other credit card customers to become seriously delinquent on their credit card during the next year. For all credit card users, the seriously delinquent rate is 6 percent while for payday loan borrowers in this sample, the rate is around 11 percent.[8]

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[4] Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans," April 1, 2008
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796

[5] Brian T. Melzer, "The Real Costs of Credit Access: Evidence from the Payday Lending Market," November 15, 2007
http://home.uchicago.edu/%7Ebmelzer/RealCosts_Melzer.pdf

[6] Michael S. Barr, "Financial Services, Savings, & Borrowing Among LMI Households in the Mainstream Banking & Alternative Financial Services Sectors," Federal Trade Commission, October 30, 2008.

[7] Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures," June 6, 2008
www.box.frb.org/economic/eprg/conferences/payments2008/campbell_jerez_tufano.pdf

[8] Agarwal, Sumit, Skiba, Paige Marta and Tobacman, Jeremy Bruce. Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles? (January 13, 2009)

Payday loans have a fifty-fifty chance of causing defaults in the first year of use. Researchers at Vanderbilt and the University of Pennsylvania examined a large sample of payday loan files at a Texas payday lender and found that over half (54 percent) of borrowers defaulted on loans during the first year. By the time loans are written off by the lender, borrowers have repaid fees equaling about 90 percent of their initial loan principal but are counted as defaults for the full amount of the loan.[9]

Using payday loans causes borrowers to file for bankruptcy. In a large Texas study, researchers found that payday borrowers were about twice as likely to file for bankruptcy in the next two years. They filed for bankruptcy at higher rates than similarly situated payday loan applicants who were turned down for payday loans. And, the bankruptcy impact was strongest on women, blacks and homeowners.[10] When they filed for bankruptcy, their payday loans accounted for about 11 percent of their total annual interest burden.

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http://ssrn.com/abstract=1327125

[9] Paige Marta Skiba and Jeremy Tobacman, "Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default," August 21, 2008.
http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=1636

[10] Paige Marta Skiba and Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" October 10, 2008
http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221