Written Testimony Submitted by Texas Appleseed

Senate Business & Commerce Committee Interim Hearing

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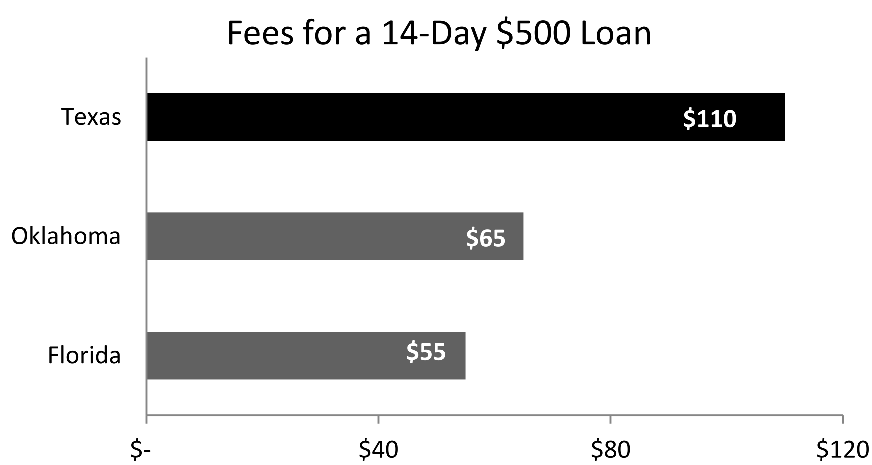
<u>Charge</u>: *Monitor implementation of legislation addressed in the 82nd Regular and Called Sessions, specifically HB 2592 and HB 2594 relating to payday lending and make recommendations for any legislation needed to improve, enhance, and/or complete implementation as well as any recommendations relating to consistency and coordination with local ordinances and federal law.*

Texas Appleseed would like to thank the Chair, Vice-Chair, and members of this committee for helping Texas take important first steps to address concerns regarding payday and auto title lending. The bills passed last session provide an important opportunity to document and assess lending practices by Credit Access Businesses (CABs) as well as inform future policy choices in Texas. State lawmakers in 2013 have an opportunity to explore how to address the high cost of payday and auto title loans and the cycle of debt that entraps too many borrowers who cannot realistically repay their payday and auto title loans in full in just two to four weeks.

Texans pay more for payday loans than borrowers in other states.

In July 2012, the Pew Charitable Trust released a national report entitled *Payday Lending in America: Who Borrows, Where They Borrow, and Why* documenting that Texans pay more than borrowers in other states.



Sources: Texas OCCC 1st and 2nd quarter CAB data; Okla. Stat. Tit. 59 §§ 3101 et seq.; Fl. Stat. Ann. §§ 560.402 et seq.; Pew Charitable Trust, Payday Lending in America 9 (2012).

According to the state's **Office of Consumer Credit Commissioner (OCCC)**, Texans paid an average of $22 in fees for every $100 borrowed for a two-week payday loan in the 1st quarter of 2012, Seventeen states cap payday loan fees at $10 to $15.50 for every $100 borrowed, according to the Pew study. Further, in 15 states, payday loans are capped at around 36% APR, mirroring the cap on loans to active members of military and their dependents prescribed by the federal Military Lending Act (MLA). In Texas, some payday lenders circumvent the federal 36% rate cap for military families by offering repayment terms of more than 91 days, the loan term threshold for the MLA protections.

New Self-Reported CAB Data: "Tip of Iceberg" in Loan Rollovers

Industry self-reported data, released by the OCCC for the 1st and 2nd quarters of 2012, provides some sense of payday and auto title loan volume and borrowing patterns. It is important to note that each quarter's data is only a snapshot in time. For example, the 1st quarter data shows Texas payday borrowers had to refinance their payday loans between two and three times, but it is impossible to tell how many times these loans were rolled over prior to or subsequent to the three-month time period.

Attachment 1 depicts borrowing trends and how much borrowers paid for payday loans, payday installment loans, auto title loans, and auto title installment loans in the first half of 2012. The data confirms what we already know:

- Most borrowers (around 70% to 75%) are unable to pay back their loans on time.

- On average, borrowers who rollover their loans pay at least $830 for a payday loan of $470, and are in debt to payday lenders over 65 days of each quarter.

- Despite their longer repayment terms of 98 to 145 days, installment loans have a mean of about 1.5 refinances per quarter.

- Texas auto title borrowers, who refinanced their loans, did so nearly two times on average in the 1st quarter of 2012, incurring more than $370 in fees on a $960 loan and staying in debt at least 82 days out of the quarter.

- About 1 in 10 borrowers (9%) lost a vehicle to auto title businesses in the first six months of this year. More than 17,000 vehicles were repossessed in the first half of 2012 alone.

Already, the self-reported CAB data from the first half of 2012, which is in line with the Texas-based surveys and numerous consumer stories shared last legislative session, supports **the need for meaningful, carefully reasoned legislation** to ensure that Texans are not charged more than borrowers across the country, and to prevent borrowers from becoming trapped in payday and auto title loan debt and losing the family vehicle.

New "Best Practices": No Substitute for Meaningful Regulation

CSAT's newest "best practices," in effect as of mid-August of 2012, are an important acknowledgement of the problems payday and auto title loans too often cause for borrowers. While the industry's initiative to rein in product features should be encouraged, "best practices" by their nature are **discretionary** and **unenforceable**. And in this case, CSAT's latest "best practices" **do nothing to lower loan costs for Texas borrowers,** who pay some of the highest loan fees in the country.

- **CSAT's repayment plan is hard for borrowers to access and significantly weaker than the national payday lenders' "best practices" standard.** Under the repayment plan option outlined in CSAT's "best practices," consumers are only eligible once every 12 months, after the borrower has already refinanced the loan four times, and if the borrower requests the plan *the day before* the loan is due. That means a borrower may have already paid $550 in fees alone on a $500 loan before she can elect a repayment plan. Further, requiring borrowers to request a repayment plan *the day before their loans are due* is an additional barrier for borrowers already struggling to repay the loan.

  Interestingly, the "best practices" standard published by the national association for payday and auto title lenders <u>does not require four refinances</u> before the lender should offer a repayment plan option to borrowers. Rather, under the Consumer Financial Services Association's (CFSA) best practices, "a customer who cannot pay back a loan when it is due has the option of entering into an Extended Payment Plan (EPP) . . . CFSA member companies provide this option to customers for any reason and at no additional cost." Again, Texans are being asked to pay more.

- **CSAT's "best practices" limits on loan amounts are not meaningful and far exceed loan limits prescribed by ordinances approved by the cities of Dallas, Austin, and San Antonio.** Limiting the size of a payday or auto title loan to an assessment of a borrower's capacity to repay can have a major impact on reducing the number of loan rollovers. The Center for Financial Services Innovation (CFSI) recently released a nationwide study showing that the ratio of loan size to income is one of the factors with the highest correlation to repeat refinancing of payday and auto title loans, which contributes to a "cycle of debt" for many borrowers. This correlation holds true irrespective of borrowers' socio-demographic and financial characteristics, according to CFSI.

  CSAT's latest "best practices" limit payday loan amounts to 35% of borrowers' gross monthly income and auto title loans to 70% of the vehicle value. That means a family earning $30,000 a year, taking out the maximum allowable $875 payday loan, would need to devote half their monthly income to pay off the loan given that high fees are charged every two weeks that the loan is not repaid in full. For auto title loans, the 70% threshold does not take into consideration borrower income, increasing the risk that the loan sets borrowers up to lose their vehicles. In contrast, the Dallas, Austin, and San Antonio ordinances limit payday loan amounts to 20% of borrowers' gross monthly income and auto title loans to 3% of borrowers' gross annual income or 70% of the vehicle's retail value, whichever is less. Under the city ordinances' limits, a family earning $30,000 income per year can borrow up to a $500 payday loan or a $900 auto title loan.

- **CSAT's "best practices" fall woefully short in prescribing a meaningful pathway to reducing borrower's loan principal through the repayment process.** The Dallas, Austin, and San Antonio ordinances only allow a maximum of three refinances of a single lump-sum payday loan and, just as importantly, require that proceeds from each refinancing are applied to reduce the principal by at least 25%. This provision puts a stop to the cycle of debt by allowing borrowers to repay loans over time, yet still preserves their option to pay off the entire amount at any point. In addition, the city ordinances limit the number of rollovers to four for installment loan products. In contrast, CSAT's "best practices" offer a 5% optional principal pay down provision *only for single-payment auto title loans*, which means borrowers would still have to pay fees for up to 20 loan renewals.

Surveys Show Low Compliance with State Law and CSAT "Best Practices"

Last session, state Rep. Ken Legler, a member of the House Committee on Pensions and Investments, shared his experience of walking into a number of payday and auto title stores in Austin. In most instances, he reported failing to observe any of CSAT's "best practices" implemented at those locations. With respect to the loan contracts, he noted, "I couldn't get a copy of the paperwork unless I signed the papers."

Inspired by his work, Texas Appleseed, in partnership with local organizations, conducted surveys in 2012 of payday and auto title locations in Austin and Dallas to assess compliance with new state requirements including posting of fees, posting of OCCC contact information, posting of warning notice, providing disclosure form, showing CSO registration, and complying with the federal Military Lending Act. We also surveyed compliance with CSAT's "best practices" (in place before the August 2012 update) including display of the CSAT membership seal, posting the CSAT best practices, and providing financial literacy materials.

In the Austin survey, conducted this past summer and included as Attachment 2, only one location complied with all of the standards assessed, and 24 stores did not comply with any. The Dallas survey, conducted by the Dallas Anti-Poverty Coalition in the spring of 2012, found that only one of the 37 stores visited complied with the all the best practices included in the survey, and 16 did not comply with any. Just as Rep. Legler experienced, none of the volunteers administering the survey could obtain any paperwork without first signing the loan papers.

The findings are detailed in the attached reports and are summarized below:

- Of the 40 surveyed locations in Austin, which covers 16 different payday and auto title businesses that collectively operate 90% of all payday and auto title locations in the city:
    - Only two locations complied with all of the state disclosure and posting standards.
    - Three locations did not comply with any of the state disclosure and posting standards.
    - Only one location complied with the assessed industry "best practices."
    - Twenty-four locations did not comply with any of the assessed industry "best practices."
    - The majority of annual percentage rates (APR) for payday and auto title loans among the 40 surveyed locations range are clustered between 450% APR and 750% APR.
- The Dallas survey covered 37 businesses, and its results mirrored the Austin survey findings.

The latest statewide and national data reveals that Texas borrowers are paying significantly more than borrowers in other states. The industry's latest "best practices" are inadequate to solving existing loan products' flaws and regardless, most CABs are not complying with assessed best practices. Together, these facts confirm the real need for meaningful reform of this industry.

We appreciate the opportunity to offer written testimony on this Interim Charge. Please contact Brett Merfish at bmerfish@texasappleseed.net with any questions or requests for additional information.