Senate Committee on Business and Commerce
Interim Hearing - October 9, 2012
Testimony of Stephen K. Reeves
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On Behalf of Texas Faith for Fair Lending Coalition

Good morning Mr. Chairman and members of the committee. Thank you for the opportunity to testify. My name is Stephen Reeves and I serve as Legislative Counsel for the Texas Baptist Christian Life Commission. We are the ethics and public policy agency of the Baptist General Convention of Texas. We speak to and with Texas Baptists about a wide range of ethical and moral issues.

I am also here representing Texas Faith for Fair Lending, a coalition including the Texas Catholic Conference and Texas Impact formed prior to last session to address concerns about payday and auto title lending in this state.

Thank you, Mr. Chairman for your work and for that of your staff on this issue last session. Thanks to each of you for voting the two bills that came over from the House out of this committee. The new laws resulted in real improvements in the licensing process, complaint collection process, in insuring the state has the ability to enforce the federal Military Lending Act and by providing for data collection and reporting.

I'll begin by making a few general points about this issue, then address the implementation of the bills passed last session and finally touch on what some of the data reporting has shown up to this point.

The members of Texas Faith for Fair Lending are concerned because the lending practices of this industry in Texas have caused great harm to members of our congregations and to those we seek to help through our benevolence ministries. In addition, we are each charged with speaking out against policies and practices that we see as immoral and to advocate for more just laws.

At the heart of this issue is usury. Each faith, denomination and church represented in our coalition has opposed usury based on both scripture and practice.

Historically there have been strong prohibitions against charging usurious interest rates. The Texas Constitution states that in the absence of legislation fixing maximum rates of interest all contracts for a greater rate of interest than ten per cent (10%) per annum *shall be deemed usurious*. At the time of this country's founding each original state had strong usury statutes which capped interest rates between 5% and 8%. Lending with no cap on rates or fees is a recent historic exception, not the rule.

Members of this industry, aided by a favorable ruling of the 5th Circuit in the case of Lovick v. Ritemoney have organized themselves to avoid Texas usury laws. Regulations including rate and fee schedules for small dollar loans found in the Finance Code under section 342 and written precisely for payday and auto title lending have been on the books for years. It is only by sidestepping these regulations that this industry is able to charge unlimited fees and an interest rate that when taken together often constitute an APR in excess of 700%.

While usury may be a lost term this day and age, polling commissioned by the two consumer advocate coalitions and conducted last summer, clearly shows that Texans understand its impact and want change in the small dollar lending market. 75% of all respondents support changing Texas law to cap the interest rates and fees that payday and title loan businesses can charge customers. That includes 68% of Republicans, 82% of Democrats and 82% of Independents. 85% of respondents believed that the appropriate rate for short-term loans in Texas should be 36% or less.

The structure of these loans makes them unique and particularly problematic. For traditional loans, lenders profit most when borrowers pay back the money borrowed, plus interest. They therefore take steps to insure the borrower's ability to repay in full. That is not the case in payday and auto title lending. Here there is a profit incentive for borrower failure. If a borrower cannot pay the entire amount owed in one lump sum when due, they simply pay the rollover or refinance fee again and again directly to the CAB/CSO. The more often a borrower cannot pay the full amount the more money the CSO makes. What we call the cycle of debt is the most profitable scenario for the payday and auto title lender. I suggest that this is the reason the industry is so hesitant to agree to regulations that would put an end to even the most egregious cases of

borrowers rolling over loans again and again, paying fees but never reducing the amount owed.

There are two terms central to this debate - *risk* and *default*. The high fees associated with these loans are justified, according to the industry because they are high risk loans. However, I have also heard industry representatives say that somewhere around 92% of borrowers pay back the loans. But how default is defined is critical. If a person takes out a $300 payday loan and is unable to pay the full principal, fee and interest of $366 in one lump sum when due, they then pay only the $66 fee to extend the time to repay by two weeks. This scenario can go on forever and often does go on many times over. If a borrower pays the fee 10 times, $660 on that $300 loan but never comes in and pays $366 in one lump sum, have they defaulted? At some point there is an end to the risk. What is the justification for high fees once a loan has been paid back in fees that amount to twice the principal or more?

Turning to the Implementation and rulemaking process, I want to commend Commissioner Pettijohn and her staff for their openness and responsiveness to our comments and concerns during the months following last session. The process they put in place of consumer advocates and industry representatives working together on the customer disclosure forms and data reporting requirements were particularly productive.

However, there are two areas of concern that I would like to mention. First, it should be mandatory that consumer disclosure forms are available in Spanish. Right now they are not.

Second, the Finance Commission should have exercised its explicit authority under H.B. 2594 section 393.622(b) and adopted rules that allow Commissioner Pettijohn and her staff to review, as part of an examination, any relevant contracts between the CAB and the third party lender. Very little is known about these entities and because they receive interest below Constitutional rate cap of 10% per year they are neither registered nor governed by any state agency or statute. The state should act upon any ability it has to insure that the proper legal parameters of the relationship between the CAB and third party lenders is being followed and they are not in violation of Texas usury statutes.

I'd like to now point out a few areas of concern with respect to the data that the OCCC has collected so far this year. First, there is a limitation to this data that must be noted. We still do not know the answer to a fundamental question - how many Texans use these loans? Because each location reports the number of borrowers they serve, customers are over-counted. If a borrower goes to multiple locations, even of the same company, or that of another company, they will be counted at each location. The aggregated total of consumers reported by the OCCC is a maximum, borrowers have no doubt been counted more than once. This results in an inflated perception of demand.

Second, the data could do a better job of collecting and reporting on the fees charged by lenders. CABs report the minimum, average and maximum fee charged per transaction, per $100 borrowed. The submission of maximum fee charged per transaction starts at less than $30. The vast majority fall into this bracket. For the minimum, the fees are broken down into $10 increments with over 60% falling within the $20 - $29.99 bracket. It would be more helpful to break it down further, into smaller increments. This is a concern for us because we see remarkable similarity in price across all lenders. While we now know the average, it would be good to know if there are many lenders out there offering loans below the average. The data could do a better job determining if market competition is driving down costs.

Finally, the information reported with regard to installment loans is particularly troubling. The data as reported for the first quarter shows the average CAB fee per $100 borrowed in an installment transaction is $130. That means that the average loan of $606 with an average term of 98 days costs the borrower $1398.29. This is equivalent to a single payment loan of $606 being refinanced 5.75 times. The second quarter data is even more alarming. The average CAB fee per transaction, per $100 borrowed is $202.96. Given the average loan, fee and term in the second quarter a borrower who borrows $558.99, in 98 days will pay back $1,693.52. That is three times the amount borrowed in only 3 months and a week, or the equivalent of a single payment loan of that amount being rolled over 8.89 times. Installment loans with these terms are only a way to guarantee the same fees as nearly six to eight rollovers. While

an installment contract may have an end point, at this cost they are not a better product for the borrower.

Moving forward, we believe that the work is not done on this issue. The experience with these products for the average borrow has changed very little since last session. I believe that the vast majority of what can be agreed upon by consumer advocates and members of the industry was incorporated into the two bills passed last session. Next session, we will be supportive of efforts to limit the fees charged to the borrower. Limitations on amount of fees as well as the number of times a fee can be charged will both help consumers succeed in paying off their loans and avoiding a cycle of debt.