THE PEW CHARITABLE TRUSTS

2005 Market Street, Suite 2800
Philadelphia, PA 19103-7077
P 215.575.9050
F 215.575.4939

901 E Street NW, 10th Floor
Washington, DC 20004
pewtrusts.org
P 202.552.2000
F 202.552.2299

Proponent Testimony on H. B. No. 123
Senate Finance Committee
Nick Bourke, Director, Consumer Finance, The Pew Charitable Trusts
June 21, 2018

Chairman Oelslager, Vice-Chair Manning, Ranking Member Skindell, and members of the Senate Finance Committee:

Thank you for undertaking this important review of the problems in the payday loan market in Ohio. My name is Nick Bourke and I lead the consumer finance project at The Pew Charitable Trusts. My testimony is informed by in-depth research Pew has conducted on the small-loan market since 2011. This research includes four nationally representative surveys of borrowers, 22 focus groups with borrowers of high-cost credit across the country, polls of the public, including in Ohio, extensive analysis of market and regulatory data, and the laws of all 50 states. We have published reports, briefs, and fact sheets available at www.pewtrusts.org/small-loans. I appreciate the opportunity to share these findings.

PROBLEM

Ohio has an extremely serious payday loan problem.

My colleagues and I have studied payday loan markets in all 50 states, and lenders charge higher prices in Ohio than in other states. Because lenders operate outside the statute the legislature created for them, Ohio borrowers do not have the consumer protections that are in place elsewhere. At the same time, there is no statute allowing sufficient prices to enable lower-cost small installment lending. Just six lenders control more than 90 percent of the small-dollar loan market in Ohio, using statutes that were not designed for this kind of lending. This combination of extremely high prices, unaffordable payments, few consumer protections, and the effective prohibition of competition from lower-cost lenders combine to make Ohio's small-loan market deeply harmful.

After the legislature passed a reform bill in 2008, and after Ohio voters overwhelmingly approved the 28 percent interest rate limit included in that bill, payday lenders sidestepped that law entirely. There are now no licensees under the Short-Term Loan Act (STLA) the legislature designed. Payday lenders have avoided the STLA and the law that Ohio voters overwhelmingly endorsed.

Rather than using the payday loan statute, payday lenders in Ohio have instead obtained licenses under a non-lending statute known as the Credit Services Organization (CSO) Act. It was designed to enable licensees such as credit counselors or nonprofit organizations to broker low-cost loans so that consumers could pay off higher-cost credit card and other debt, helping them improve their finances. But CSO payday loans are most definitely *not* helping Ohio families in that way.

The payday lender technically brokers the loan using a Credit Services Organization (or CSO) license, but it functions more like a lender because it provides the loan to the borrower and indemnifies the lender-ofrecord from loss. CSO payday loans can be extremely high-cost loans, such as a $500 loan for a fee of $125 per two weeks outstanding, or a $500 loan that lasts 18 months and carries $2,000 in fees.

This is what is happening throughout Ohio right now:

- Payday lenders have partnered with a nominal, third-party lender.

- The payday lender, using its license as a broker under the CSO Act, charges an Ohio consumer an up-front fee for originating the loan with the third-party lender. Because the CSO Act was never intended for this purpose, there are essentially no legal guidelines in place to govern it. That is why this fee can be—and almost always is—higher than those in other states.

- The third-party lender issues a loan to the Ohio consumer. Behind the scenes, the CSO payday lender has made an agreement to service the loan and guarantee it, meaning the nominal lender is not acting like a lender so much as facilitating the CSO payday loan broker to act like a lender.

- At the end of the day, this unnecessarily complex arrangement results in the Ohio consumer getting a loan that costs much more than payday lenders charge elsewhere and lacks standard consumer protections.

Ohio stands out not just because payday lenders charge more here than in other states, but also because Ohio is the only state that has payday loan stores that are not licensed under a lending statute. In short, Ohio's payday loan law is broken.

SOLUTION

The question before you today is how to fix Ohio's payday loan law. One point of view is that payday loans are so damaging they should be eliminated. 15 states have taken this approach. Another point of view, held mainly by the small number of payday loan companies that control Ohio's market today, is that there is no problem with payday loans or Ohio's payday loan law, so the legislature should make only cosmetic changes that have failed to protect consumers in other states. These views represent the polar opposites of this debate: either eliminate payday lending or do little about it. But in between these extremes is the HB123 option: improve Ohio's payday loan law to keep access to credit, bolster competition, and improve outcomes for Ohio families.

In other words, HB 123 is a compromise between Ohio's 2008 law, which would have effectively eliminated payday lending had lenders not found a way to make loans outside of the Short Term Loan Act, and today, where lenders operate without any of the key guidelines that are found in the legal code of every other payday loan state.

There is tremendous desire in Ohio to achieve the type of compromise to this problem that HB 123 represents. My colleagues and I have heard this point of view in conversations with members of the legislature and your colleagues elsewhere in Ohio government. Shortly after the one-year anniversary of the bill's introduction, the Ohio House of Representatives recently passed HB 123 with strong bipartisan support, with 71 voting in favor and only 17 opposed.

Many people who live, work, and own businesses throughout the state share the goal of solving the payday loan problem while maintaining access to credit. A poll showed that most Ohio voters—Republicans and Democrats alike —support by overwhelming margins the fixes found in the reform bill, as do payday loan borrowers themselves. You will hear today from industry representatives that payday loan customers are satisfied. Borrowers have explained to us that what that means is they appreciate credit in a tough time, but a majority also report feeling taken advantage of because payments are unaffordable and prices are so high.

What has emerged after more than two years of engaging with Ohio officials and community members is a consensus view that Ohio's payday loan law should be fixed, and that lawmakers should choose an approach that creates a way for small-dollar credit to flow. HB 123 would do this.

HB 123 is an extremely effective compromise because it is not rooted in the vexed question of whether payday lending should or should not exist. It does not ask whether payday lending is "good" or "bad." Instead, it presents a pragmatic solution to the problem so that payday and small-dollar lending can be better and provided by a larger variety of lenders operating in a more competitive marketplace. This compromise would improve Ohio's law in ways designed with the interests of both borrowers and lenders in mind, carefully crafted to use the simplest possible approach to improving outcomes. That is why Pew strongly endorses HB 123.

For example, HB 123 would allow lenders to continue to secure their loans by tying repayment to the borrower's checking account and income stream, and in exchange for that powerful legal right it requires that monthly installment loans be affordable, determined through the very simple approach of limiting the payment to five percent of the borrower's paycheck. This simple rule is a powerful consumer protection that is easy for lenders to implement because it requires no new types of documentation and is easy to automate, meaning it adds no cost to the loan origination process and helps the lender be profitable even at lower prices to the consumer.

This bill is earnest and well-thought-out. It is the best example of a workable compromise on the payday loan issue that I have seen. HB 123 will save Ohio families more than $75 million *each year*. But every day that passes without the enactment of HB 123 takes $200,000 from the pockets of Ohioans who are payday loan borrowers.

HB123

HB 123 would achieve reasonable reform by preventing payday lenders from using unintended statutes, giving borrowers time to repay in installments, and limiting prices to levels that are affordable for borrowers and profitable for lenders. It would require payday lenders to operate under the statute the legislature created, where no lenders do business today. With well-designed product safety standards, policymakers can align the interests of borrowers and lenders, ensuring an efficient marketplace with widespread access to credit.

In Colorado, where similar reform has been in place for nearly eight years, it has led to more than $300 million in savings. In several notable ways, HB123 improves upon the Colorado model with modifications that would grant additional flexibility to lenders and borrowers, while keeping the core elements the same, including payment size, loan structure, and typical APR.

The three complaints about Colorado's law have been that it is too complicated, its six-month minimum term is too long, and it backloads the revenue, so loans are unprofitable that are repaid within two months, while loans are too costly that run the full six months. HB 123 fixes all of these problems by setting no minimum or maximum loan term in the Short-Term Loan Act, using simpler rules than Colorado's law, and letting lenders begin earning the monthly maintenance fee on Day 1 of the loan, not on Day 60 like in Colorado.

HB 123 also would require no new paperwork to originate a loan. Today payday lenders require proof of income and a checking account to originate a loan. That would not change under HB123. To determine monthly installment payments, lenders could simply view the applicant's pay stub or account statement and set the installment payment at 5% of gross income or 6% of net income or deposits into an account.

Specifically HB 123 would ensure six key improvements:

1. **Affordable payments.** This reform would require affordable installment payments limited to 5% of a borrower's paycheck vs. the one-third that is consumed today. Research shows that payments of 5% of income are viable for efficient lenders and affordable for borrowers. This approach to ensuring affordable payments is simpler, more effective, and less costly than alternative approaches, such as setting fixed loan terms or requiring complicated paperwork (lenders already require proof of income, so no new requirements would be needed). Lenders would be free to structure loans for any duration so long as monthly payments do not exceed 5% of the borrower's income.

2. **Reasonable cost.** An interest rate of 28 percent and a standard monthly fee of $5 per $100 loaned, not to exceed $20 per month, provide enough revenue for efficient lenders to continue making credit available. **HB 123 is a compromise that would give lenders substantially more revenue than the 2008 revision to the Short Term Loan Act would allow**—for example, $120 more dollars on a 6-month, $500 loan. HB 123 would allow lenders to earn monthly fees immediately, giving lenders more revenue in the early months of the loan compared to the Colorado model.

3. **No front-loaded charges.** Similar to Colorado, HB 123 would remove incentives for lenders to refinance loans by prohibiting front-loaded charges like nonrefundable origination fees. This spreads costs evenly over the life of the loan and helps ensure that lending relationships are more transparent. HB 123 sets far simpler rules compared to Colorado's complicated pricing guidelines, making it easier for lenders to explain costs to their staff and customers, and simpler to program into computer systems.

4. **Enough time to repay.** HB 123 would ensure that borrowers have a reasonable time to pay off their loans in small installments. With no fixed minimum or maximum duration, HB 123 is more flexible than the Colorado law and its six-month minimum term.

5. **Limits on long-term indebtedness**. By limiting loan costs to no more than half of the loan principal it prevents loans with unreasonably long terms and excessive costs, without being too prescriptive about how loans are structured. (For example, total fees and interest on a $500 loan could not exceed $250, meaning lenders would not have an incentive to make the loan repayment period last too long.) Lenders are free to structure loans to last shorter or longer depending on a customer's needs.

6. **Efficient lenders—large and small—would provide access to credit across the state.** In Colorado, some stores consolidated but the remaining stores each serve twice as many customers, including in rural areas. Access to credit is virtually unchanged throughout the state and tens of millions of dollars have been returned to local economies.

HB123 is well-balanced compromise legislation. If it became law with no changes, payday lending would continue in Ohio. Lenders could earn $250 on $500 loans.

But if some officials prefer to make access to larger loans available, boost the revenue available under HB 123 further, or stimulate additional competition, there are three reasonable changes that would accomplish those goals. First: Raising the maximum monthly fee from $20 to $25 would enable lenders to earn more without putting borrowers at substantial risk. Second: Most states that allow payday lending cap loan sizes at $500 or lower, but raising the maximum loan size above $500 would not endanger consumers as long as all of HB123's other protections remain in place. And lastly: Authorizing banks and credit unions to offer these loans if they wish would bring new entrants into the small-loan market who could profitably lend at prices well below those authorized by HB 123.

FEDERAL REGULATORS WILL NOT SOLVE OHIO'S CSO PAYDAY LOAN PROBLEM

In October, The Consumer Financial Protection Bureau (CFPB) issued the first federal regulations for payday loans. The final rule, which has been scaled back from an earlier proposal, covers payday and auto title loans that have terms up to 45 days or carry a balloon payment. The federal regulation could not and does not limit interest rates and fees; state legislatures retain that authority to limit the fees of state-licensed lenders, and Ohio is one of the only states in the U.S. where payday lenders operate without rate limits. In Ohio, the increasingly common 300%+ APR payday and auto title installment loans lasting more than 45 days are mostly not covered by the regulation. The $500, 18-month loan with more than $2,000 in fees that lenders have advertised in Ohio is not covered, because it lasts more than 45 days. Ohioans will only be protected from these types of dangerous terms and gain access to better loans if this legislature acts.

APPROACHES THAT WOULD NOT PROTECT OHIO

Other states have attempted to curb borrower behavior by using databases, cooling-off periods, requiring no-cost payment plans, or regulating the lending process by setting underwriting requirements. These methods have proven ineffective—both because they protect consumers less, and burden responsible lenders more. Such approaches would not noticeably improve Ohio's payday loan law or fix where it is broken. State and federal regulatory data make clear that these lender-backed provisions have been ineffective.

I shall briefly review each of these approaches and why the are ineffectual. No-cost payment plans, or a pause on further interest and fees accumulating, are sometimes promoted as a means of allowing consumers trapped in debt to use an installment plan to repay. This may sound appealing, but it does not solve the problem that loans taking one-third of a borrower's next paycheck are routinely and predictably unaffordable for most borrowers in the first place. Besides, few borrowers become aware of these plans, and lenders discourage their use. In Florida and Michigan, where these plans are part of state law, fewer than 1 percent of loans are converted to them.

Another approach that is not effective is a rollover ban, preventing borrowers from paying a fee to buy two more weeks of credit. In states with this requirement, borrowers repay the loans on payday, when they have money, and then immediately re-borrow the loan to pay their bills. In this way "rollover" limits are easily avoided.

Lenders also sometimes promote financial literacy and disclosures as a solution to payday loan problems. While this can be a component of reform, it does not fix deficient laws or bolster consumer protection. The academic research on financial education has found it to be costly and largely ineffective. When consumers have few good options, and when the small-loan market is characterized by weak competition and insufficiently clear legal requirements like in Ohio, the prospects for financial education improving consumers' well-being are dim.

It is far better to put simple safeguards on loans so they work well than to leave dysfunctional products in place and try to regulate lenders' and borrowers' behavior. Lenders have succeeded in staving off reform in some states by putting forward proposals that are designed to sound like they could protect consumers but consistently fail to do so, like rollover bans, short minimum loan terms, or financial literacy initiatives. Those proposals have not reduced prices, improved affordability, or decreased consumer indebtedness, let alone rationalized underlying law.

I urge you to keep your attention on the primary opportunity before you: improving Ohio's law so that Ohioans have access to safer, more affordable small-dollar loans that help them and their communities.

I recognize some payday lenders have made dire claims about HB123. Lenders made similar claims about Colorado's reform 8 years ago, although access to credit has remained widespread there. If this proposal allowed only 28% interest and no fees, that would eliminate payday lending. HB123 isn't that. It allows a monthly service fee that boosts APRs far above the levels for even subprime credit cards. South Dakota chose to eliminate payday lending altogether in 2016 with a ballot initiative that had only an interest rate and no fees. But this bill is a compromise between those who would ban these loans and those who favor Ohio's unusually unregulated status quo.

With HB123, Ohio would no longer have much higher payday loan prices than other states, Ohio families would save more than $75 million annually, and that money would stay in the local economy. This is an urgent problem that is hurting your constituents, and the solution is this well-balanced legislation that achieves lower prices, affordable payments, and access to credit. I am happy to take any of your questions.

Thank you,

Nick Bourke
Director, Consumer Finance
The Pew Charitable Trusts
www.pewtrusts.org/small-loans

Appendices:

A. Summary of Payday Loan Research and Facts from Third Parties
B. HB 123 is a Compromise That Keeps Credit Available
C. Summary of Ohio Non-Depository Lending Statutes

Appendix A: Summary of Payday Loan Research and Facts—Third Parties

Quick Facts on Payday Lending

Payday loans are usually due on the borrower's next payday, typically about two weeks away. The average payday loan takes up one-third of a borrower's next paycheck. Most cannot afford to repay and cover expenses, but it is difficult to default because the lender holds access to the borrower's checking account on payday. So most borrow repeatedly, and 80 percent of payday loans are taken out in succession, within two weeks of a previous payday loan.
Sources: Federal Reserve Board; Consumer Financial Protection Bureau; University of New Mexico Law School

As a result, most borrowers pay more in fees than they received in credit. Even among those who ultimately default, most pay repeated fees.
Sources: Consumer Financial Protection Bureau; University of Pennsylvania & Vanderbilt Law School

Payday installment loans are due back over longer periods of time, and they are also secured by access to the borrower's checking account on multiple paydays. These loans often carry interest and fees that exceed the amount borrowed.
Sources: National Consumer Law Center; Speedy Cash; Rise Credit; Advance America

The average payday loan store serves just 500 unique borrowers per year. The substantial overhead of running a store and the small number of customers served explains most of why the loans are so expensive.
Sources: Federal Deposit Insurance Corporation (FDIC); Advance America

Lenders mostly compete on speed, customer service, and certainty of approval rather than price. This is because when loan-seekers are in financial distress, they focus on these factors instead of a loan's cost or the affordability of payments. That does not occur in most markets, and it explains why lenders mostly do not compete on price: if customers are price insensitive, there is little to gain by underpricing the competition.
Sources: Veritec Solutions, LLC; Elevate Center for the New Middle Class; FDIC; University of Florida

In conventional markets, when the price of a good is limited, supply is constrained. But in the payday loan market, when states have reduced allowable prices, loans have remained widely available, unless the prices are so low that lenders cannot operate.
Sources: Veritec Solutions, LLC; University of Chicago; Virginia Bureau of Financial Institutions; Auburn University

Colorado's legislature limited prices in 2010, resulting in average APRs of about 120 percent, with payments averaging 4-5% of borrowers' paychecks. Seven years after reform, the amount of credit extended and used in the state has not decreased. Instead, in the several years after reform, half of stores closed and remaining stores doubled their customer count, covering their overhead by serving more customers. Revenue per store is higher now than before reform, although prices are far lower.
Sources: Colorado Attorney General's Office; Colorado Financial Service Centers Association

In Colorado, payday lenders are still in business, borrowers fare far better, and the state's payday loan law has widespread, bipartisan support. Some of the same lenders operate in both Ohio and Colorado, but they charge Ohio residents four times more than Colorado residents. HB123 makes improvements on Colorado's law, and also matches its average APR, payment size, and maximum loan size.
Sources: Colorado Attorney General's Office; McClatchy Tribune; American Banker; ACE Cash Express; Check into Cash

State policy reform efforts fail to align the incentives of borrowers and lenders when they attempt to a) regulate borrower behavior i.e. limiting the number of renewals, or b) require no-cost payment plans. Florida, Michigan, and Oklahoma, allow lenders to make lump-sum loans and require them to offer installment plans but only a small share of loans are converted to installment plans. In Washington, where borrowers may request a no-cost installment plan at any time, only 10 to 13 percent of loans are converted. Instead, Colorado's loans have affordable payments from day one.

Sources: Washington State Department of Financial Institutions; Veritec Solutions LLC

Appendix B: HB 123 is a Compromise That Keeps Credit Available

2008 REFORM	COMPROMISE	STATUS QUO
28% APR	**28% + $20/month**	**Unlimited**
In 2008, the Ohio Legislature passed a bill (sub HB 545) capping interest rates on payday loans at 28%. Later that same year, voters overwhelming approved a referendum (5) reaffirming the 28% rate cap. Payday loan storefronts do not operate in states with similarly low rate caps.	HB 123 establishes a maximum interest rate of 28% plus a maximum monthly fee of 5% not to exceed $20. Borrowers make affordable payments over a longer period of time creating a pathway out of debt. The compromise bill uses a proven approach from other states to keep credit available at rates that are fair to borrowers but remain profitable for lenders.	Ignoring the intent of the legislature and the will of the voters, lenders identified a loophole in the 2008 law. Payday lenders abandoned the short-term lender statute and now operate under other unintended statutes. Lenders can broker loans to charge unlimited fees, so Ohioans pay much higher prices than borrowers in other states.

More about the Compromise

HB 123

- **Competitively priced loans:** Instead of charging Ohio borrowers fare more than they do in other states, lenders would operate more efficiently and remain profitable.
- **Reasonable time to repay:** Loans are paid back over time, rather than in one balloon payment on the borrower's next payday.
- **Affordable installment payments:** Borrowers spend no more than 5 percent of their monthly paycheck to repay the loan.
- **Credit remains available:** By establishing rates that are both fair to borrowers and viable for lenders, companies will continue to offer loans at the prices they charge in other states.
- **Ohioans save over $75 million:** Borrowers will save more than $75 million a year, money that will be reinvested locally, rather than sent to payday lenders' out-of-state corporate offices.

This page intentionally blank.

Appendix C: Summary of Ohio Non-Depository Lending Statutes

Short-Term Loan Act (STLA)

(Note: 0 licensees)

- APR: 28%
- Max. loan amount: $500
- 4 loans max.
- Min. duration: 31 days
- Title loans prohibited

Mortgage Loan Act (MLA)

- Max. interest: 21%
- Max. loan amount: n/a
- No min./max. loan duration
- Origination fee: $15 (loan≤$500), $30 ($500< loan<$1000), $100 ($1000≤loan<$2000), $200 ($2000<loan<$5000)
- Credit investigation fee: max. $10

Small Loan Act (SLA)

- Max. interest: 28% (≤$1000) or 22% (>$1,000)
- Origination fee: greater of $15 or 1 % (loan≤$500) or greater of $30 or 1% (loan>$500)
- Max. loan amount: $5,000
- No min./max. loan duration
- Check-cashing fee

Credit Services Organization Act (CSOA)

- No max. fees
- No min./max. loan duration
- *CSO licensees operate as brokers in connection with third-party lenders (payday lenders have obtained CSO licenses to issue loans through affiliated MLA and SLA licensees)*

Consumer Installment Loan Act

- Max. interest: 25%
- Max. loan amount: $5,000
- No min./max. loan duration
- Origination fee: $15 (loan≤$500), $30 ($500< loan<$1000), $100 ($1000 ≤ loan<$2000), $200 ($2000≤loan<$5000), and $250 on a $5,000 loan
- Credit investigation fee: max. $25 (a licensee must obtain a report)
- Refinance is allowed only after 120 days

This page intentionally blank.