3 May 2012

Pennsylvania House of Representatives
Consumer Affairs Committee
Rep. Robert W. Godshall, Chair
Rep. Joseph Preston Jr., Minority Chair

HB 2191: A bill to legalize payday lending in the Commonwealth of Pennsylvania

Testimony respectfully submitted by:

Greg Simmons
Compliance and Policy Manager
ACTION Housing, inc.
425 Sixth Avenue, Sute 950
Pittsburgh, PA 15219
412.281.2102 ext. 2011

ACTION Housing, Inc., a non-profit housing and social service agency located in Pittsburgh, Pennsylvania, would like to register its strongest objection to the legalization of payday lending within the Commonwealth as currently considered under House Bill 2191.

ACTION Housing is an agency dedicated to creating, improving, and preserving affordable housing in Western Pennsylvania.

In addition to managing 1500 units of senior and special needs housing, ACTION Housing administers the weatherization and crisis furnace repair/replacement programs for Allegheny, Washington and Greene counties, helping low-income homeowners reduce their energy usage to save money, and ensuring that families have safe, functioning heat in their homes during the winter. The weatherization programs also serve as an employment catalyst, providing opportunities for over thirty small, family owned HVAC and general contractors.

ACTION housing also provides a number of housing-related social services including a program to help young adults transition out of the foster care system; housing and rehabilitation for victims of domestic abuse; and home improvements for low-income senior citizens designed to preserve independent living.

ACTION Housing believes that payday lending robs consumers of the ability to manage their own finances.

Most germane to the discussion of payday lending, ACTION Housing is actively involved in improving the financial health of consumers through our foreclosure mitigation, family savings account, and homeownership pre-purchase counseling programs.

ACTION Housing has been actively involved with mitigating the effects of foreclosures for over thirty years. The agency helped create the Homeowners Emergency Mortgage Assistance Program (HEMAP), and in recent years has participated in the National Foreclosure Mitigation Counseling Program. Perhaps our greatest achievement has been establishing Allegheny County's Court Diversion Program which brings borrowers and lenders before a judge who mediates disputes and encourages viable long-term solutions to preserve both homeownership for the consumer, and also asset value for the lender.

A core component of these programs is helping consumers build responsible financial habits and encouraging them to understand the responsible use of credit.

We are opposed to the legalization of payday lending in Pennsylvania because we believe it robs consumers of the ability to manage their own finances. Payday lending, as envisioned in HB 2191 would allow payday lenders to repay themselves in full directly out of the consumer's checking account without any regard for affordability, and before the consumer has the opportunity to pay their own rent, mortgage, utilities, or even feed their families. This automatic repayment in full is likely to leave the borrower short of funds and likely to re-borrow again during the next pay period, creating a cycle of perpetual debt from what may have began as a simple short-term need such as a car repair or broken water heater.

Simply put, we are concerned that cash-strapped consumers – especially homeowners facing the possibility of foreclosure – will borrow from payday lenders in desperation, then compound their problems by continuing to borrow just to make ends meet. This phenomenon has been widely documented in states where payday lending has been legalized.

PENNSYLVANIA: UNEMPLOYMENT AND FORECLOSRE

Unemployment in Pennsylvania, at approximately 7.5%, is almost 100 basis points lower than the current official national rate, and between 150 and 450 basis points lower than housing-bubble states like Florida and Nevada. ACTION Housing believes this is due – in part – to Pennsylvania's relatively stable housing markets which have been somewhat insulated from the massive foreclosure waves that have impacted western and southern states.

This insulation is attributable to a number of factors including: a modest, sustainably manageable pace of home price growth; a strong community bank market presence delivering high-quality credit products; a strong pre-purchase homebuyer counseling network; and diligent attention to predatory lending practices by the Pennsylvania Department of Banking, as well as aggressive prosecution of malfeasance by the Pennsylvania Attorney General's office.

Nevertheless, Pennsylvania has not been entirely immune from negative trends in the housing market. In Allegheny County, which includes the City of Pittsburgh where ACTION Housing is located, foreclosures increased dramatically in the early 2000s, from an historical average of around 1,100 foreclosure filings annually (1990 -1999) to approximately 5,500 (2005) before falling back to around 4,000 foreclosure filings last year. The foreclosure rate remains in flux, as the effects of foreclosures that were backlogged during the "Robo Signing" debacle are yet to be fully understood.

Payday lending could drive people into delinquency or default and contribute to increased foreclosures.

ACTION Housing's fear is that any newly introduced presence of payday lenders could serve to further de-stabilize the finances of homeowners who are desperate to avoid foreclosure. Borrowers facing the prospect of losing their homes are vulnerable to marketing that offers "quick fixes" to complicated financial problems. A payday loan that introduces an additional and expensive debt burden during a home economic crisis could easily become the final nail in the coffin of foreclosure.

PAYDAY LENDING FEATURES

Payday lending is typically defined by core operational components.

- Short repayments terms – typically the borrower's next payday.
- High interest rates – typically in excess of 300% annually.
- Balloon payments with automatic repayment in full – typically by electronic transfer or by cashing a post-dated check.
- No underwriting – no review for the borrowers capacity to repay the loan.

HB 2191 would allow payday lenders to charge 370% interest rates, with no review of the borrower's ability to repay it.

Payday lenders make their profits by charging a combination of fees and interest on the loan. HB 2191 would allow lenders to charge $12.5 per $100 borrowed, plus a $5 convenience fee. In a typical $300 loan, the borrower would have to repay $342.50 on payday. Payday lenders will express those costs as fees only, but the cumulative annual percentage rate (APR) would be approximately 370% based on twenty-six pay periods.

The lack of underwriting and the automatic repayment-in-full makes payday lending a risky transaction. In traditional lending, an underwriter will review the borrower's income, debts and expenses to determine how much that borrower can afford to repay on a monthly basis. If the borrower cannot afford repayment the loan is not granted.

Income verification and affordability analysis have been written into national underwriting standards following a wave of foreclosures due to "stated income" loans that were unaffordable the day they were originated. Lenders must now examine the borrower's income and expenses to ensure that the repayment terms are affordable.

In contrast, payday lenders do not consider their clients' income against basic necessities such as rent, utilities or food. Instead, they repay themselves in full before the borrower has the opportunity to pay their regular household expenses. As a result, borrowers are likely to find themselves short on cash and likely to re-borrow again.

It is considered irresponsible for a lender to make a loan without regard for the borrower's ability to repay it.

As a result, the average borrower finds themselves in debt to the payday lender for over 200 days per year with 80% of payday loans made to repeat customers[1], and 87% of these repeat loans occurring in the very next pay cycle[2]. Although payday loans are marketed as a way to fill short-term financial needs, they quickly become long-term obligations.

---

1 U. King & L. Parrish; Payday Loans, Inc: Short on credit, long on debt; Center for Responsible Lending, March 2011

2 Short-Term Demand: Short-term due date generates repeat payday loans; Center for Responsible Lending, July 2009.

DEBUNKING THE CASE FOR LEGALIZATION

Veneering a payday lending legalization bill with so-called "consumer protections" is a tactic that has been used in many other states.

The United States Department of Defense, in a 2006 study on the effects of predatory lending to military personnel noted that Pennsylvania is among the states that ban payday lending before concluding:

"The other thirty-nine states have legalized payday lending using provisions such as mandatory databases, cooling off periods, attempts to stop rollovers and back-to-back transactions, and attempts to stop borrowing from multiple lenders. However, even with the addition of these "consumer bells and whistles", these laws do not stop the debt trap."[3]

> ***According to the U.S. Department of Defense, "... even with the addition of "consumer bells and whistles", these laws do not stop the debt trap."***

All of the so-called "Consumer Protections" that the Department of Defense downplayed as window dressing have been included in HB 2191. The bill purports to:

- **Regulate Internet Lending** – Internet lending is already illegal in Pennsylvania. Existing laws are in place to protect consumers from abusive lending.

- **Ban "Rollover" Loans** – Directly rolling over existing debt would be illegal under HB 2191. Instead, lenders would simply re-lend the next business day. This prohibition on "rollover" loans is ineffective at discouraging repeat loans in states (FL, OK) where it has been included in the regulatory framework.[4]

- **Limiting Loan Amounts** – HB 2191 would limit loan amounts to $1000 or 25% of the consumer's gross monthly income per loan. But, because most people are paid every two weeks, payday lenders would actually be allowed to lend up to 50% of gross monthly income.

- **Limiting Interest Rates** – The current bill would allow interest rates up to 28%, but additional allowable fees would bring the net effective interest rate to over 400% APR. A pending amendment would eliminate the interest rate, but still allow fees that total almost 370% APR.

---

[3] United State Department of Defense; Report on Predatory Lending Practices Directed at Members of the Armed Forces and their Dependents; August 2006.

[4] L. Parrish & U. King; Phantom Demand; Center for Responsible Lending, July 2009.

PROTECTIONS FOR MILITARY PERSONNEL

HB 2191 is misleading in asserting that it would provide special protections for active duty members of the armed forces.

As a result of the 2006 Department of Defense study, Congress passed legislation severely limiting the interest rates payday lenders are allowed to charge active duty soldiers. HB 2191 makes a show of creating specific protections for military personnel, but active duty ***soldiers, sailors, airmen and Marines already enjoy these protections under federal law.***

> ***HB 2191 would not add any new protections for active duty military personnel and would do nothing to protect veterans or reservists from abusive lending.***

On the other hand, ***nothing in existing law, or proposed under this bill would protect military retirees or reservists from abusive lending***. An army retiree, having put in twenty-years of service to his country could suddenly find himself in a position of having to pay 300% interest on a portion of his retirement benefits as a result of a short-term financial need such as a car repair.

PROTECTIONS FOR SENIORS AND THE UNEPLOYED

Predatory lenders of all stripes have a well-documented[5] history of aggressive marketing to senior citizens. Nothing in current law or in HB 2191 would prevent payday lenders from collateralizing virtually any form of fixed-income.

- Social Security income for our senior citizens.
- Unemployment checks
- Pensions
- Disability payments

Pennsylvania can do better than this for it's elderly, disabled, and people who are still unemployed in the recovering economy.

> ***HB 2191 would allow payday lenders to collateralize a senior citizen's Social Security check.***

[5] E. Schultz & T. Francis; High-Interest Lenders Tap Elderly, Disabled; Wall Street Journal 2/12/2008
R. Bourne, J. Frank, P. Smith, E.Schloemer; Big Bank Payday Loansl; Center for Responsible Lending, July 2011

THE CASE AGAINST LEGALIZATION

One of the core arguments in favor of legalizing payday lending is that some Pennsylvanians are already obtaining payday loans either over the Internet, or by traveling out of state.

The arguments in favor of regulating these loans rarely mention that creating a regulatory framework would also entail legalizing payday lending across the state.

As already noted, payday lending via the Internet is regulated under Pennsylvania's Consumer Discount Company Act. Any payday lender currently making loans in Pennsylvania is doing so illegally.

As for individuals traveling out of state to obtain a loan: The problem – if it exists at all - is likely overstated.

> ***Payday lenders argue: Pennsylvania should legalize 300% payday loans to protect consumers from 300% payday loans.***

The argument boils down to this: A few Pennsylvanians may be going to great lengths to get payday loans, either out of state or illegally online: Therefore we should legalize 300% payday loans throughout Pennsylvania in order to protect Pennsylvanians from 300% payday loans.

The best protection against abusive payday lending in Pennsylvania would be to simply leave the law alone.

This drive to legalize payday lending has not been undertaken to protect Pennsylvania consumers. Despite outlandish suggestions that payday lender have come to Pennsylvania to help regulate themselves, their goal – *their only goal* – is to legalize payday with the most favorable terms they can get. Payday lenders want nothing less than access to the paychecks of Pennsylvania's hard working men and women.

> ***The payday lenders' goal – their <u>only</u> goal –is to legalize payday lending in the Commonwealth and get access to the paychecks of Pennsylvania's hard working men and women.***

HB 2191 is not a consumer protection measure. The Pennsylvania Legislature should resist the entreaties of out-of-state payday lenders, and uphold the best consumer protection available: No payday lending in Pennsylvania.

CONCLUSION

ACTION Housing believes that payday lending should remain effectively illegal in Pennsylvania. Introducing potentially abusive, high-cost credit that takes advantage of working families – especially during a still fragile economic recovery – would be an irresponsible regulatory adjustment. We encourage the Pennsylvania Legislature to leave existing usury statutes under the Consumer Discount Company Act in place in their current form.

If it ain't broke, don't fix it.

We appreciate the opportunity to express our opinion to the House Consumer Affairs Committee, and would welcome any opportunity to discuss payday lending with any member of the committee.