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Financial Institutions, Real Estate, and Securities Committee
The Ohio House of Representatives, 128th General Assembly
Hearing on H.B. 209 – September 30, 2009 –
Testimony of David Rothstein, Policy Matters Ohio

Chairman Koziura, Ranking Member Mandel, and members of the Committee: My name is David Rothstein and I am a researcher with Policy Matters Ohio, a nonprofit, nonpartisan research group that provides analysis on economic issues that matter to low- and moderate-income families. My work centers on tax, asset building, and consumer issues in Ohio. Thank you for allowing me the opportunity to testify on this important piece of legislation regarding payday lending.

Policy Matters has conducted research on payday lending in Ohio for the last four years. Our initial research found that the payday lending industry grew from just over 100 stores in the mid-1990s to more than 1,600 stores in 2007. Stores were present in 86 of Ohio's 88 counties. Our concern with Ohio's prior Check Cashing Lending Law, legalizing payday lending in 1996, was that lenders could charge an annual percentage rate (APR) of 391%, $15 for every $100 borrowed. Our research found that a basic family budget for families making under $45,000 a year would leave them ill-equipped to pay back a payday loan given the short time frame and high cost of the loan. In fact, families facing a financial shortfall would barely have the money to pay back the principle of the loan in two weeks much less the principal plus high interest and origination fees.[1] In a statewide survey, we also found that certified Housing and Urban Development (HUD) financial counselors in Ohio would never recommend payday loans to their clients.[2]

Our concerns over the high fees and short time period for pay back were echoed by the Ohio General Assembly and Governor Strickland. By signing H.B. 545 in the last session, Ohio repealed the Check-Cashing Lender Act and replaced it with the Short-Term Loan Act. This was supported in a 2:1 ratio by Ohio voters in November when Issue 5 passed. This act instituted the following provisions:

- An APR cap of 28 percent on fees and interest regardless of amount borrowed
- 31-day minimum term
- A cap of four loans per year.

[1] David Rothstein and Jeffrey Dillman. "The Continued Growth of Payday Lending in Ohio," *Policy Matters Ohio and the Housing Research & Advocacy Center* (March, 2008): http://www.policymattersohio.org/ContinuedGrowthOfPaydayLending2008.htm.
[2] David Rothstein. "Wise Counsel: Credit Counselors Cite the Perils of Payday Lending" *Policy Matters Ohio* (October, 2008) http://www.policymattersohio.org/WiseCounsel2008.htm.

- A maximum of $500 borrowed at one time.

The reason that I am testifying before you today is that despite the Ohio General Assembly, Governor Strickland, and Ohio voters affirming their support for a 28 percent APR rate cap and 31-day minimum loan term, payday lending in Ohio remains virtually unchanged. In fact, as I will discuss in greater detail, many lenders are making loans at higher rates than before the law passed under the Ohio Short-Term Loan Act and Mortgage Loan Act.

These previously-existing laws have allowed payday loans to continue to be issued in Ohio, under the kind of exploitative terms that lawmakers and voters tried to abolish. Instead of registering and operating under the new law, lenders have simply circumvented the Ohio legislation and begun operating under laws intended for another purpose. Regarding transparency and cost, they may even have gotten worse. To better understand how payday lending functions in Ohio since the legislation, Policy Matters Ohio visited 19 and called 50 stores across the state of Ohio.[3] Nine total companies were evaluated in this study, which is attached to this testimony. Among our findings, it is crucial to note that not a single lender offered a loan longer than 14 days or at a rate near 28 percent APR. In fact, no $200 loan carried a rate under 200 percent APR. Over the phone, information was extremely difficult to get and in person many store employees told testers that the store computer could only give them payment and interest information after the store had processed a loan application. Our other findings included (see Table 2 in the attached report):

- The most common APR quoted was 10 times the maximum allowable rate affirmed by Ohio voters last November.
- All payday lenders surveyed continue to make loans due on the borrower's next payday, which is typically less than or equal to fourteen days away. This is not in compliance with the Short-Term Loan act, which guaranteed borrowers at least 31 days to pay back loans and established other consumer protections to keep borrowers out of the debt trap.
- Seven of the nine largest payday lenders issue the loan in the form of a check or money order and charge a cashing fee while another lender appears to be automatically including the fee and then issuing the loan in cash. By charging the borrower a 3 to 6 percent fee for cashing the lender's own out-of-state check (a check that presents no risk to the lender of insufficient funds), the cost of a $200 loan can climb to higher than 600 percent APR.

Borrowers often end up cashing the check in the store because banks would be unlikely to cash a check unless adequate funds are already in the bank account, in which case the borrower wouldn't need the high-interest loan. Although the stores charge a fee and banks do not, if immediate cash is desired, the bank is not an option.[4] Further, extra fees to cash the check, which might otherwise be partially justifiable because of a risk that the check might bounce, are not warranted when a company is cashing its own check.

[3] A full list of visited and called stores can be found in Appendix 1 of the attached report.
[4] Testers called Charter One Bank, KeyBank, and PNC bank and found that they don't charge fees for account holders, but they will not cash a check if funds in the account wouldn't cover it.

Let's look at one example of a payday lender with many Ohio stores and an online lending presence: Advance America. Before the new payday lending law, Advance America charged $575 for a $500 two week loan for an APR of 391 percent. Currently, they charge $547.18 for a $501 loan but issue the loan in the form of a check, a 240% APR. To cash the check, the fees range from 3 to 5 percent of the total amount. This can add another $15 at 3 percent or $25 at 5 percent. Thus, the loan has not substantially changed under this form of lending. In fact, depending on the store and check-cashing fee, it may be more expensive now than before the law passed (see Table 2 of the attached report). Other findings include:

- Online loans, brokered through stores, carry larger principles and are even more expensive. On a $200 loan, a borrower could pay between $24 and $34 more for a loan online than in the company's store (see Table 3 in the attached report).
- Seven of nine payday lenders surveyed accept unemployment, Social Security, or disability checks as collateral (see Table 4 in the attached report). This practice, of lending to those claiming public benefits is particularly egregious. Those who get these payments are some of the most vulnerable people in Ohio. When loans are taken against these benefits, less of the payment goes to the claimant.[5] Given Ohio's budget woes, the state can ill afford for public assistance payments to be diluted. Further, much of the exorbitant cost charged by lenders is attributed to the risks associated with payday lending. Of course there is very little risk in lending against these programs – the primary risk is that the borrower is misrepresenting his eligibility.

Our previous reports and testimony noted that neighboring states, Pennsylvania and West Virginia, do not have payday lending. Some 12 states now regulate payday lending to ensure lending below triple-digit interest rates. Certainly these states have low- and moderate-income families who have unexpected life events and financial needs. In these states, credit unions and financial institutions make small loans with longer installment terms, much lower interest rates, and often offer a "savings bucket" built into the loan payback. This is only part of the equation. The true alternative to the root cause of payday lending is for people to make living wages with adequate access to health and child care. Creating a fair and level playing field for lending is the other side of this equation.

Lending is not a bridge from paycheck to paycheck. It is a heavy anchor that drags families deeper into debt. After the first loan, there is very little choice for borrowers but to keep borrowing when they need to pay back the first loan and meet weekly expenses. In our study, every tester asked what could be done if a borrower needed an extension or more time on the loan. No lender mentioned a payment plan option outlined by the Community Financial Services Association (CFSA) "best practices."[6] Several stores suggested purchasing an additional loan from another store or using an online loan source for repayment of the original loan.

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[5] Ellen E. Schultz and Theo Francis, "High-Interest Lenders Tap Elderly, Disabled," *The Wall Street Journal*, (February 12, 2008).

[6] See best practice number 11, http://www.cfsa.net/industry_best_practices.html.

During the Ohio Attorney General hearings on payday lending, we were told by an industry lobbyist that the average payday borrower has over eight payday loan transactions every year and an industry researcher, who receives funding from payday loan associations, recently noted that the typical borrower uses payday loans for 18 to 24 months.[7] Based on data from state regulators, the vast majority of borrowers take out loans more than five times a year.

How can loans be improved?

Ohio should harmonize its small and short-term lending laws, reflecting the need and public desire for consistent and fair lending laws. The revised lending laws should require a minimum loan term of 90 days with no more than 28 percent APR, as suggested by the Federal Deposit Insurance Corporation (FDIC) guidelines on small loans.[8] The process of charging to cash a payday loan check by the lender after the loan is made should be outlawed or at least reflected in the APR of the transaction. Finally, Ohio should carefully review whether public assistance programs should be allowed as income for payday loans. Policy makers should consider restricting the ability to take out loans against these publicly-issued checks, just as we do for paychecks issued by the military under the 2008 Defense Authorization Act.

It is for these reasons that the Ohio General Assembly should support HB 209. Ohioans deserve fair lending and they voted in favor of it last November. Thank you for the opportunity to testify before you. I am happy to answer any questions at this time.

Respectfully Submitted,

David Rothstein
Researcher

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[7] Testimony of Darryl Dever of the Ohio Financial Services Association to Ohio Attorney General Marc Dann, p. 86. Testimony by Patricia Cirillo of Cypress Research Group to Ohio Attorney General Marc Dann, p. 183. Public Hearing on Payday Lending as Reported by Gordon Reporting, Inc.: December 6, 2007.

[8] See the FDIC's Financial Institution Letter FIL-50-2007, available at www.fdic.gov/news/news/financial/2007/fil07050a.html, for a discussion of affordable small loan guidelines. The FDIC suggests a 36 percent APR cap, however Ohio already passed a law with a 28 percent APR cap.