Testimony to Attorney General Marc Dann
Hearing on Payday Lending

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Mr. Attorney General, distinguished members of the community, thank you very much for the opportunity to appear before you today. I am David Rothstein, a researcher for Policy Matters Ohio, a nonprofit, nonpartisan organization that provides research on economic issues that matter to low- and moderate-income working families in Ohio. Policy Matters provides this research and education with the objective of fostering an economy that works for all Ohioans. We appreciate your invitation to discuss our research on payday lending in Ohio.

The Economy in Ohio

The economic situation for many Ohio workers is difficult. Policy Matters' research has shown that Ohio wages have been stagnant, employment has not recovered from the last recession, and those who do work are often without health care or retirement benefits.[1] This troubling economic climate is worsened by payday lending from companies who sell loans to working families at egregious rates, often 391% annual percentage rate for a two-week payday loan. These loans are part of a large "fringe-banking" landscape that preys on the working poor for repeat business, often without considering customers' ability to repay the loan.

Payday Lending Explosion in Ohio

In a recent report co-authored with the Housing Research and Advocacy Center, Policy Matters Ohio found that payday lending locations in Ohio had increased dramatically from 107 in 1996 to 1,562 in 2006. In those 11 years, there was a 1400% increase in lending locations across Ohio. What's more, our analysis found that while payday lenders

[1] Please refer to the report by Amy Hanauer of Policy Matters Ohio entitled "The State of Working Ohio," included with this testimony.

were concentrated in mostly urban areas at the beginning of our analysis, by 2006 they were in urban, suburban, and rural neighborhoods. The report, “Trapped in Dept,” maps the dispersal of lending locations from a small number of scattered locations in 1996 to 86 of Ohio’s 88 counties by 2006. [2] Large urban counties had the most payday lenders in absolute terms, but less populated counties had a greater number of lenders per capita. Payday lenders are so common throughout Ohio that by 2006, there were more payday lending locations than McDonalds, Burger King, and Wendy’s restaurants *combined*.

The sheer volume of payday lenders in Ohio is problematic because of the weak regulation of the industry. Ohio has a maximum limit of $800 per loan, with a maximum allotted charge of $15 for every $100 borrowed. The $800 limit is the third highest in the country. The Center for Responsible Lending (CRL) estimates that the vast majority of borrowers are repeat borrowers, taking out loans between seven and 14 times a year. States with reporting capabilities such as Michigan, Colorado, and Washington find that the majority of revenue comes from the repeat borrowers who take out more than 6 loans a year. Thus, the incentive for payday lenders is to keep customers borrowing.

In Ohio, borrowers cannot “roll over” their loans but can do back-to-back transactions. This means that after a 24-hour cooling off period, they can take out another loan from the lender. Before that 24-hour period, borrowers can also take out loans from additional storefronts without having repaid all of their existing loans. From our mapping, it is obvious that lenders cluster around each other, offering loans at the maximum rate and

[2] Please refer to the report by David Rothstein and Jeffrey D. Dillman entitled “Trapped in Debt: The Growth of Payday Lending,” in Ohio included with this testimony.

keeping the loan cycle in perpetual motion. Credit checks are not used nor are other sound methods to determine the ability of a borrower to repay an existing loan. This illustrates a considerable problem with payday lending in Ohio: there is little discretion by the lender regarding the borrower's ability to repay the loan.

Payday lending affects various demographic groups. Our analysis found little relationship between lending locations and areas of low- and moderate-income housing or African-American tracts. A recent study found that "lenders who cultivate more repeat business from existing customers will fare better financially than those who do not."[3] In the business of payday lending, all workers are potential clients regardless of race, income, or living area. In short, this is an issue that affects Ohioans.

Lenders in Ohio are mostly chains or franchises. The two most common operators are Advance America and Cashland Financial Service, with more than 100 locations each. The top 10 lending companies in Ohio account for more than 55 percent of all payday lenders in Ohio. One lender in Ohio, Buckeye Check Cashing, received substantial financing in grants and loans from the State of Ohio to expand operations in Ohio. The lending industry in Ohio is extremely volatile, with lending locations opening and closing frequently within a given year. For instance, in 2005, a total of 113 payday lending locations closed but 357 new locations opened. Twelve locations opened and then closed in that same year.

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[3] Michael A. Stegman and Robert Fairs "Payday Lending: A Business Model that Encourages Chronic Borrowing" Economic Development Quarterly (February 2003).

Payday loans are an expensive option. A $500 loan could carry an origination fee of $50 and interest charges of $25 for an effective APR of 391% for the two-week loan. The APR is actually larger if borrowers take out a loan for less than a two-week term because they do not receive an adjusted price for the shorter loan. Borrowers face an even more difficult situation when the loan comes due because their economic situation is often the same or worse than before, meaning they either need another loan to repay the first loan or they default on the post-dated check. Interest and fees continue to mount, especially when the lender cashes the post-dated check and it bounces. Thus, the cycle of borrowing can keep borrowers trapped in a constant state of debt.

The collection tactics by payday lenders and their affiliates can be extreme. A number of courts have ruled against lenders for abusive collection practices across the country. We urge the Attorney General to look through current complaints against payday lenders and take appropriate action. Additionally, many borrowers do not know that they have rights against abusive collection practices. The Attorney General's Office could expand on existing consumer complaint avenues such as advertising a toll-free phone number and distributing "borrowing rights" materials to protect borrowers.

Recommendations

In our report, we recommend that the protections extended to service members and veterans in the federal Talent-Nelson Amendment be extended to all working families. This is best represented in the bipartisan House Bill 333. Capping lending rates at 36 percent, while still a high APR compared to other loans and forms of borrowing, is a vast improvement over loans made in the 300 percent-plus range. The interest rate is the key problem that traps families in debt and is the part of this product that is flawed by design. Additionally, credit unions and banks should be offering competitive, fair, and responsible loan products to working families in their communities. In states where other reforms that do not deal with the interest rate are enacted, there is little improvement.[4] Financial education is a buzzword and in this instance it shifts the responsibility of the egregious interest rate from the lender to the borrower. Let me provide an analogy: If we provided everyone in Ohio with an abundance of driver's education classes but sold them all cars with no brakes, we would have huge numbers of accidents. It is not the education that is the problem here but rather the product that is designed to fail. Extended repayment option plans also do not work. Borrowers do not understand them and do not purchase them when available. Lenders still collect interest during the repayment but also do not widely market these plans. In the state of Washington, less than 1% of borrowers utilize the extended repayment plan option.

The problem in Ohio is not a lack of available credit. Before 1996, there were no payday lenders in Ohio and a market for small credit did exist. Nearby states, including New York, Pennsylvania and West Virginia, have banned payday lending because of its adverse affects on individuals and families. Fair and responsible lending is an economic and social benefit to the entire community. Payday lending drains financial assets from communities.

Conclusions

Mr. Attorney General, we thank you again for the opportunity to present our findings on the dangerous expansion of payday lending in Ohio. We strongly believe that our policy

[4] See Center for Responsible Lending, December 2007 report (forthcoming).

recommendations will lead to a better economic situation for everyone involved. We are happy to answer any questions at this time.