Center *for* Public Policy Priorities

TESTIMONY

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HB 846 A bill to regulate deferred presentment transactions

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The Center for Public Policy Priorities is a nonprofit, nonpartisan organization that researches policies affecting low-income Texans. I am here today because of the devastating impact so-called "payday" loans can have on low-income Texans and their families. While we support the intent behind CSHB 846—to regulate payday lenders—we cannot support the bill as filed. The proposed legislation does include several good provisions—broad disclosure, licensing requirements, limited loan renewals, and a payment plan option—that will prevent payday lenders from violating certain aspects of Texas' payday lending law. However, as drafted, the bill would fail to prevent lenders from exploiting the cash-strapped families who use these loans.

Why are payday loans such a bad deal for low-wage workers and their families?

People applying for these loans are struggling to get by paycheck to paycheck. Because the cost-of-living has outpaced the salaries of low-wage workers, many low-income families are engaged in a constant juggling act each month to make ends meet—balancing their bills against their resources, often forced to choose between paying rent, making a car repair, or paying the utility bill. This is why payday loans are so seductive to low-income Texans—and, arguably, for some families they may mean the difference between eviction and paying the rent. However, in the long-run, they are nothing but bad news. They trap consumers in a spiraling cycle of debt, which can leave a family in serious straights. As the payday lender extracts all their available cash, they may be forced to choose between rent, medicine, food or child care. CPPP recently documented these problems in a qualitative study called "Tough Choices" in which we interviewed in-depth low-income families about their struggles to make ends meet and the coping strategies they use when they can't. Many of our families reported using payday loans, only to fall further and further behind each month in their bills.

But, before I get to my specific concerns with the bill, I feel I should address an important question:

Is some regulation better than no regulation at all? Or, in other words, is an imperfect bill better than no bill at all?

The answer to both these questions is no, and here's why. The industry invites such legislation because federal regulators have started to crack down on so-called "rent-a-banks"—banks in states without usury caps that rent their charters to payday lenders in states with usury laws. Although federal law allows a bank to charge in every state the interest rates allowed in its home state, the Office of the Comptroller of the Currency (OCC) and the Federal Reserve recently severed ties between the banks they supervise and storefront payday lenders who claim the banks' rights to export home-state interest rates and to preempt state laws. Although the FDIC has indicated in guidance to its banks that such practices also should be curtailed because they are bad for banks as well as consumers, it has yet to take action and continues to permit its banks to partner with payday lenders.

Ideally, Congress should step in to stop federally insured banks from renting their rate exportation authority to payday lenders. In the meantime, several states have enacted legislation to close these loopholes. Given the prevalence of "rent-a-banks" in payday lending—eleven of the thirteen largest payday loan chains partner with ten state-chartered FDIC banks to make loans they cannot legally make on their own—the best way for Texas to protect consumers against usurious payday loans is to prohibit payday lenders from partnering with out-of-state banks in order to evade our strict usury laws. Over a thousand payday outlets in Texas use out-of-state bank arrangements to charge higher rates than Texas rules allow. Of the payday loans reported to the OCCC in 2000, 13,178 (less than 4% of total loans) were made by registered in state lenders (totaling $2,753,374), but another 353,903 were payday loans made through out of state banks. At the time, many lenders were **not** registered, which suggests that these data represent only a fraction of the actual volume of payday lending in Texas.

This brings me to the next question:

Will prohibiting payday lenders from partnering with out-of-state bank to evade Texas' strict usury laws invite a preemption charge?

Probably, *although there is clear consensus among courts, banking regulators and scholars that federal banking laws offer no protection to a non-bank alleged to be the de facto lender of a payday loan*. To give an example of an ongoing court case, Georgia passed a law last year that made it illegal for non-bank agents (payday lenders) to partner with out-of-state banks in order to get around Georgia's usury law. Several lenders filed suit, claiming, among other things, that federal law (Federal Deposit Insurance Act) preempts the right of states to prohibit a bank from "exporting" the interest rates of its home state. Most recently, the U.S. district court rejected this argument, focusing instead on a much narrower question: *whether the Federal Deposit Insurance Act, 12 U.S.C. § 1831d, preempts the right of the States to regulate the use of "agents" who purport to solicit loans from their citizens on behalf of FDIC-insured state banks*. The court upheld Georgia's law, arguing that FDIA does not cover non-bank agents who are subject to state usury and consumer protection laws.

In addition to preventing "rent-a-bank" arrangements that violate state usury laws, what else could be done to improve HB 846?

- The cap on finance charges should be lowered from $15 to $11 per $100. Payday lenders argue that these rates would put them out of business. However, other states have applied similar rate schedules and still have a thriving payday lending business. For example, Florida has capped rates at 10% of the loan amount (plus a $5 administrative fee). A recent report on Florida's market found that, on average, consumers took out over seven loans per year. As an alternative, consider a cap on finance charges that corresponds to the size of the loan. Typically, the greater the loan, the longer it takes the consumer to repay. A lower finance charge on a higher loan would help a consumer avoid the trap of interest-only payments that never make a dent in the principal.
- Limit the maximum loan to $300 and prohibit lenders from making more than one loan to a consumer at a time. If other loans are outstanding from other lenders, the maximum of these loans also should not exceed $300. Why? Even with a 45-day term, a $1,000 loan is equal to 75% of a minimum wage worker's gross salary during that time period. This would be like a middle-income family earning $40,000 (roughly the state's median income) taking out a $3,500 loan and being expect to repay it within a 45-day period.

- Prohibit lenders from making loans that exceed more than 25% of the consumer's net income for the term of the loan. For example, a person earning minimum wage--$206 per week ($5.15/hour @40 hours), approximately $164 after taxes—would be limited to a $41 loan. This would ensure consumers do not borrow more than they can reasonably be expected to repay within the term of the loan.
- Increase the required payment to 20% of the principal before a renewal is allowed.
- Consider lengthening the minimum term of the loan to correspond to the amount of the loan. For example, the National Consumer Law Center recommends a minimum term equal to not less than two weeks for each $50 of the loan amount.
- Permit consumers to make partial payments toward the loan.