KENTUCKY CENTER for ECONOMIC POLICY

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October 7, 2016

Director Richard Cordray
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Dear Director Cordray,

We are writing in reference to the Consumer Financial Protection Bureau's (CFPB) proposed rule to add safeguards for consumers of payday loans. The Kentucky Center for Economic Policy applauds the proposed rule but believes there are ways it could be strengthened further. In Kentucky, any changes to small-dollar lending would impact roughly 200,000 mostly low-income payday lending customers.

Payday Lending in Kentucky

Payday loans did not exist in Kentucky prior to the 1990's, as was the case in most states. While Kentucky law limits annual interest rates on financial products to a maximum of 36 percent, payday lenders were exempted from this rule in 1998, when "deferred-deposit transactions" became legal under check cashing licensees. Under this law, lenders can issue unsecured loans for $15 per $100 borrowed, on up to $500, often for a 2-week term. Borrowers are not allowed to have more than 2 loans out at any given point in time, but this still makes it possible for a single borrower to take out 52 loans a year – which, when annualized, results in over 390 percent APR. In fact, the average borrower pays $591 in interest and fees for an average principal of $341 according to the annual report by Veritec, the company that maintains the payday lending database created through legislation passed in 2010, and overseen by the Kentucky Department of Financial Institutions.

Although one unaffordable loan can be financially devastating, the biggest danger to Kentucky payday lending customers is rollovers, which are encouraged by the industry. When a borrower takes out a loan, they give the lender access to their account, either electronically or through a post-dated check. At the end of the loan period, the lender draws the principal and interest from that account, which often leads the borrower to take out another loan to fill the financial hole. This cycle then repeats itself such that the average Kentucky payday loan customer takes out 10.6 loans and is indebted over 200 days a year. Over 95 percent of all payday loans in Kentucky go to customers that take out 4 or more loans per year, while only 1 percent of payday loans go to single-use borrowers. This cycle is often referred to as the 'debt trap.'

There are 537 active "Check Cashing" licenses registered with the Department of Financial Institutions in Kentucky, most of which offer some kind of small-dollar, short-term, unsecured loans like payday loans. Cash Express, the largest payday lending company in Kentucky, operates 172 stores across almost every county in the commonwealth.

Advocacy for payday lending reform in Kentucky has been spearheaded by a broad coalition of 88 faith-based and non-profit organizations, known as the Kentucky Coalition for Responsible Lending. The coalition has been pursuing legislation to restore the 36 percent usury limit on payday loans, and has helped introduce legislation in the General Assembly to do so over the last 10 years. In addition to advocating for proactive legislation, the coalition has also defended Kentucky consumers from several dangerous products including longer term loans that would have added broker fees to a 36 percent loan product resulting in a 296 percent APR in 2014, and a so-called “Flex Loan” bill in 2016 that would have similarly increased the borrowing amount, added a daily customary fee of .7 percent, and become open-ended, potentially trapping consumers in a legally endless debt trap.

The CFPB Proposed Rule is a Good Start

Generally speaking, KCEP is very supportive of the proposed safeguards laid out in the new rule. While we understand that the CFPB cannot regulate interest rates, the safeguards it proposes limit predatory, short-term lending in two main ways:

1. Payday lenders would have to prove that the borrower has the ability to repay the loan while still being able to afford major financial obligations and basic living expenses like food, rent and child care, without needing to re-borrow within 30 days of the end of the loan term.
2. Payday lenders would be able to issue loans without determining a borrower’s ability to repay if their loan meets certain requirements:
    - Lenders would be limited to offering just 3 loans in quick succession, where the first loan is no more than $500, the 2nd loan is 2/3 the amount of the 1st, and the 3rd loan is 1/3 the amount of the 1st;
    - Lenders would only be able to offer a total of 6 loans or keep a borrower in debt for a maximum of 90 days total in any given 12-month period;
    - And lenders would not be allowed to take vehicle security on loans (often referred to as title loans, which are regulated in Kentucky beyond what the CFPB is proposing).

Creating roadblocks that slow the debt trap like limiting the amount of time indebted or requiring premiums decline over the course of three “rollovers” are laudable, but requiring that lenders prove their customers can repay the loan is an especially good standard. Ultimately the point behind pursuing an interest rate cap is to prevent lenders from trapping their customers in unpayable loans, which is why we’re so supportive of an ability-to-repay test: it accomplishes the same goal. Ensuring a borrower’s regular income and expenses leave him or her with enough to pay back a loan – if properly enforced — should prohibit unpayable loans by nature.

The CFPB Should Close Loopholes to Better Protect Borrowers

There are still several ways in which lenders could harm borrowers under this rule. Any rule should strike a balance between making credit accessible to low-income Kentuckians who need it and ensuring those same customers cannot be taken advantage of in times of crisis. Even one unpayable loan is enough to send a struggling family into a financial tailspin. Here are four changes that we believe meet those standards:

- Make the ability-to-repay test mandatory, not optional – While keeping the aforementioned safeguards in place (limiting the number of loans a borrower can take out, adding a cooling off period, decreasing premiums, etc.), we recommend also ensuring that the borrower can repay the loan without hindering his or her ability to cover normal living expenses after repayment. By making additional safeguards an optional alternative to determining whether or not a customer can afford the loan, there are still opportunities for borrowers to be taken advantage of.

- Strengthen the ability-to-repay test - As it stands, the rule allows lenders too much leeway in how they determine whether or not a borrow can afford a loan. For example, businesses could use general cost of living measures to determine if someone can afford a loan. Instead, each determination should be unique to the borrower’s financial situation. The burden of proof should be on the lender to prove that every borrower has enough money to live on after repaying the loan by requiring documentation of personal finances including both income and expenses.

- Improve protections against repeated flipping of loans - Return to the 60-day waiting period after each short-term loan as proposed in original outline. In Kentucky, over 6,000 borrowers take out

30 or more loans each year, which is where the real harm is done; by addressing repeat borrowing and disrupting the cycle of debt, we can ensure credit is a help, not a trap.

- Include other kinds of possible predatory, debt-trap loans under the scope of the rule – especially new unsecured, installment loans like "flex loans." If these kinds of loans are left out of the rule, payday lenders will use them as a way around it, as we have already seen in Tennessee where they have been allowed by law, and in many other states including Kentucky, where legislation has been pursued.

The Kentucky Center for Economic Policy will continue to pursue fair and effective consumer protections in Kentucky, alongside the KCRL and our allies. However, the proposed CFPB rule presents a real relief to the 200,000 borrowers and their families in the Commonwealth, especially if strengthened through the above measures. Communities thrive when people have the opportunity to live up to their potential, but right now that opportunity is stifled in part by usurious, predatory loans. We hope the CFPB will move forward quickly with a strengthened rule to protect our community and others like it across the country.

Sincerely,

Dustin Pugel
Research and Policy Associate
Kentucky Center for Economic Policy

The Kentucky Center for Economic Policy is a non-profit, non-partisan initiative that conducts research, analysis and education on important policy issues facing the Commonwealth. Launched in 2011, the Center is a project of the Mountain Association for Community Economic Development (MACED). For more information, please visit KCEP's website at www.kypolicy.org.