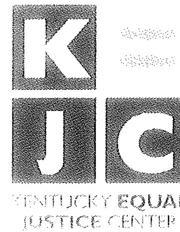

Kentucky Equal Justice Center
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August 30, 2016

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

Re: Kentucky Equal Justice Center comments on proposed rulemaking on payday, vehicle title, and certain high-cost installment loans

Docket number CFPB-2016-0025 or RIN 3170-AA40

Dear Director Cordray,

Kentucky Equal Justice Center submits these comments in response to the CFPB's proposed rule on payday, vehicle title, and certain high cost installment loans. Thank you for the opportunity to comment on this important subject. The rule is a critical step in stopping the harm caused by unaffordable loans, but it must be strengthened to ensure it stops the debt trap once and for all.

Kentucky Equal Justice Center (KEJC) is a small, statewide civil legal aid program with offices in Lexington and Louisville. We work closely with the four legal aid organizations in Kentucky and with other community partners across the state, focusing on all issues that affect low-income Kentuckians. These issues include health, public benefits, housing, immigration, workers' rights and consumer issues.

In general, we applaud the CFPB for studying the serious issue of the debt trap caused by high-cost lending, and appreciate the time and effort that went into creating this rule. We are very pleased that the rule adopts the basic premise and requirement that loans be affordable and that the lender ensure that the borrower has the ability to repay. While the rule needs strengthening, even in its current form it has the potential to significantly reduce the debt trap in Kentucky. Even if lenders mostly bypass the ability to repay rules for the exception loans, which we would anticipate, the limitations on the number of loans permitted, the cooling off periods, limits on days of indebtedness, exemptions for loans below 36% and added protections for borrowers' bank accounts are all very positive steps.

As outlined below, the rule needs to be strengthened by requiring lenders to determine ability to repay in *all* loans, in addition to the other requirements set out in the rule as

exceptions to ability to repay. The standards for determining ability to repay and when to allow refinancing should be more stringent. The number of permissible loans without ability to repay needs to be reduced. The FDIC standard of 90 days indebtedness should apply to all loans. All secured loans should be covered.

History of Payday and Other High-Cost Lending in Kentucky

In 1992, Kentucky passed a law requiring check cashing businesses to be licensed. The law did not specify maximum charges for cashing a check. The state licensing agency interpreted this law to include deferred deposit businesses. This allowed these businesses to begin making payday loans without any service fee or interest fee limit. In 1997, a federal court found that check cashers were actually engaged in lending and were in violation of Kentucky's general usury statute.

In 1998, Kentucky passed a law that for the first time allowed deferred deposit transactions. The law also capped the "service fees" a deferred deposit licensee could charge at $15 per $100 for 14 days. This effectively created an exception to the general usury laws for the payday lending industry. The law allows a maximum of two loans up to $500 at any one time. No rollovers are permitted, but there is no cooling off period.

In 2010, the payday loan law was amended to create a real-time database, designed to enforce the 2 loan limit up to $500 and to monitor how serious a problem payday lending had become. This Act did not change the $15 per $100 "service fees" permitted by payday lenders, which on an annual basis add up to 400% APR. Other efforts to amend the payday lending laws, by increasing the loan amount limit to $1000 and to authorize internet payday lending, have been rejected after vigorous protest by KEJC and others. Online payday lending is illegal in Kentucky, and any online loans made in Kentucky are void.

Kentucky also has a law that permit title pledge lending. This law allows one loan at a time, up to $4000. The maximum loan term is 30 days, but the law allows for 3 renewals up to 30 days each. This law was amended to limit fees to the same limits as those permitted for small consumer loans. The effect of this change was that lenders stopped making title pledge loans in Kentucky.

Kentucky began licensing consumer loan companies in 1960. That law allows loans up to $15,000, and limits the term of the loan to 5 years for loans up to $3000, and 10 years for loans over $3000. The interest rate was amended in 2014. The law now allows 3% per month interest on loans up to $3000. and 2% per month interest on loans over $3000. Loans may be secured, but no mortgage may be taken for loans over $3000.

In 2014, we became aware that a company was circulating a legislative proposal to allow a new type of installment loan – loans up to $3000 that could extend for 2 years. These loans would have charged 36% interest. However, in addition there would be a broker fee of $7.75 to $12.50 per $100 for each 2 weeks. For a year-long loan, the effective

interest rate would have been 296%. For a 2 year loan, the interest rate would have gone up to 592%. Our coalition was able to shed light on this proposal, and no bill was filed.

This year, a bill was filed to create what the industry called "flex loans". We called it "Payday Loans on Steroids" and "Son of Payday Loans." The bill would have allowed lenders to create a long-term, open-ended installment loans. It would have increased the maximum size of a payday loan from $500 to $1000. The lender would be allowed to charge 24% interest. In addition, the lender could charge "customary fees". These fees were unspecified in the bill, but a revised bill (never filed) would have allowed customary fees of .7% daily. With these fees added, the effective interest rate on these loans would have been 276% APR. The loans would have allowed lenders to keep borrowers in debt for months or years. For example, on a $500 loan, after 6 months, the borrower would have paid $648, and still owe $416 in principal. We were able to defeat this bill, but we are very concerned that the payday industry will continue to push for such longer-term installment loans at predatory rates. Significantly, these flex loans would not be secured by the borrower's bank account, and so would not be covered by the CFPB's current proposed rule.

Advocacy Efforts in Kentucky to End the Debt Trap

KEJC has been involved in monitoring payday lending laws for over 15 years. In 2009, a coalition was formed to seek reduced interest rates and reasonable regulation of payday loans. The Kentucky Coalition for Responsible Lending (KCRL) has grown to include a very broad membership of over 60 faith and community groups. Faith group members include CLOUT (Citizens of Louisville Organized United Together), BUILD (Building a United Interfaith Lexington through Direct Action), the Catholic Conference of Kentucky, Catholic Charities of Louisville, the Kentucky Baptist Fellowship, the Kentucky Council of Churches and the Jewish Community Relations Council (Louisville). Through these faith member groups, we have obtained endorsements or resolutions supporting a 36% interest rate cap from at least 25 other churches, districts, conferences, conventions and presbyteries.

In addition, our coalition includes diverse community and advocacy groups. These include KEJC, AARP Kentucky, the Kentucky Center for Economic Policy, the Kentucky Coalition Against Domestic Violence, Kentucky Youth Advocates, the Family Foundation, the Kentucky AFL-CIO, the Louisville Urban League, the Urban League of Lexington-Fayette County and Metro United Way. The coalition also includes many housing advocacy groups, such as the Metropolitan Housing Coalition, the Homeless and Housing Coalition of Kentucky, and the Louisville based Coalition for the Homeless. Members also include foundations, shelters and asset building groups.

Our coalition began working on payday lending reform in 2009. In 2010, we got a bill filed that would have limited interest to 36% and would have required a cooling off period and other protections. The bill ended up passing in substantially revised form. Instead, the legislature created a database so it could determine whether and how bad the problem of payday lending is, without making any substantive changes in the law. The

real-time database was also designed to prevent an individual from exceeding the maximum loan amounts and number of loans.

In 2010, KCRL published The Debt Trap in the Commonwealth. Using national data from the Center for Responsible Lending, we were able to summarize lending activity in each of our 120 counties, including number of loans, total fees, etc. Since then, KCRL has obtained reports on the database through open records requests every year. These numbers confirm what we already knew. In fact, each year the impact of predatory payday lending on Kentucky families has increased.

Every year since 2010, KCRL has gotten a bill filed to limit interest on payday loans to 36% APR. Only one year was this bill given a hearing. That year, the bill was heard in the House Banking and Insurance Committee, where it failed by three votes. In the past two years, we have tried filing a bill in the Republican Senate, but we have been unable to get the bill heard.

Payday Industry Opposition to Ending the Debt Trap

A large part of the reason our legislative initiatives have gone nowhere is the amount of money the payday industry provides to legislators in campaign contributions. Just one example: Gary McNabb, the owner of Cash Express, one of the five biggest payday lenders operating in Kentucky, has contributed more than $216,000 in recent years to legislators' campaigns. $140,000 of this money was evenly divided between the state's Democratic and Republican party campaign committees.

The payday industry has a large cadre of lobbyists working to ensure that interest rates on payday loans are not reduced. During the 2016 legislative session, the payday industry spent nearly $88,000 on lobbyists. The highest paid lobbyist, Bob Babbage, who earned $324,754 during the session, represents payday lender Cash Express. Mark Wilson, who represents Check into Cash, earned $156,616 in lobbying fees for his 29 clients. Renee Craddock earned $105,000 representing the Kentucky Deferred Deposit Association and 13 other clients. Gene McLean, another highly paid lobbyist, also represents the Kentucky Deferred Deposit Association. On any given day, several payday lobbyists are usually present.

The state regulatory agency, the Kentucky Department for Financial Institutions, does little to ensure that payday lenders comply with the current law. DFI has the authority to fine payday lenders up to $5,000 per day for each violation. It can also suspend or revoke a license. John Cheves, a reporter for the Lexington Herald-Leader, recently reported on violations by the top 5 payday lenders in Kentucky since 2010. Of a total of 435 violations, 291 of those involved one of the 5 largest lenders in Kentucky. DFI has only revoked a handful of licenses, never one of the big five. Violations by the major lenders often involved inputting incorrect Social Security numbers into the database so that they could (illegally) let borrowers exceed the dollar and loan amounts. The DFI Commissioner has stated that some of these violations appear to be mistakes, but others seem to be deliberate. Yet, for the 291 violations committed by the five lenders, they

have paid an average of only $1,380 in fines per violation. In essence, these fines are a modest cost of doing business that the industry is willing to pay to continue forcing borrowers into the debt trap.

Predatory Lending in Kentucky Today

In 2015, payday lenders stripped away $117.8 million in fees, a 12% increase since 2010. The average fees for a payday loan have increased nearly 12%, from $529 in 2010 to over $591 in 2015. The amount of time a borrower is stuck in the debt trap has increased too, from 160 days in 2010 to 201 days in 2015. The average borrower in Kentucky takes out 10.6 loans in a year. 95% of loans in 2015 were generated by borrowers taking out 4 or more loans. In 2015, nearly 6,100 Kentuckians were trapped in 30 or more payday loans.

All of these loans are supposedly short-term, usually for 14 days. There is a 60 day maximum term. However, since there is no cooling off period, or limit on the number of loans per year, the typical scenario is that an individual pays off one loan and writes a check for an additional loan (larger than the first loan to include financing of the "service fees"), thus perpetuating the debt trap. Because there is no cooling-off period, and borrowers can take out two loans at a time, an individual could actually take out 52 loans in one year. The threat of institutionalizing the debt trap, by passing the industry's open-ended high-cost installment loan proposal from last year, is disheartening. That measure would ensure that borrowers are stuck in debt, potentially for years.

As the statistics cited above show, the harm caused by payday lending has increased each year. The database enacted by the legislature in 2010 has failed to enforce the current limits on number and amount of loans. The debt trap continues, and it appears unlikely that KCRL will ever be successful in its efforts to effect change at the state level. Nor does it appear likely that DFI will step up its regulation and enforcement of the industry. These factors make the CFPB's proposed rule on payday lending all the more important.

Predatory Lending is Harming Kentuckians

The following stories of payday loan borrowers in Kentucky illustrate the harm that virtually unregulated payday lending is causing in our Commonwealth.

An elderly woman in eastern Kentucky got in trouble with payday lending after lending money to her son whose car needed to be repaired so he could get back and forth to work. He did not have the money to fix the car so he went to his elderly mother to borrow the money. After she loaned him the money, she was unable to pay her bills so she took out a payday loan. Because she could not afford the loan in the first place, she ended up having to take out several more loans "in order to pay off" the previous ones. This debt cycle pushed her further into financial crisis.

A young father found himself with bills he could not pay, and so in order to "do the right thing" and "take care of his family" he took out a payday loan. Because he could not afford to repay the loan, he subsequently had to take out multiple loans. The company gladly rolled his original loan over into another. In Kentucky, rollovers are technically prohibited, but an individual can pay off a loan and obtain a new loan for the same amount (but with additional fees) on the same day. This man eventually got so far in debt, he saw no way out. He had to ask his parents for the money to pay off his mounting payday debt. His parents helped him pay off the payday loan debt, but it put a financial strain on them. The result was that his parents had to delay their retirement because of the lost income.

A migrant worker needed cash to purchase some essentials, so he borrowed money from a friend. When he realized he was going to be unable to pay back his friend, he went to a payday lender to borrow money to pay back his friend. When he couldn't pay back the lender he borrowed money from another friend to pay back the lender. This cycle of borrowing more payday loans to pay off loans to friends went on for many months.

A young single mom took out a payday loan to pay some medical expenses after a car accident. She couldn't repay the loan in such a short time, and ended up having to roll that loan into another and then another. She ended up with seven loans all together. Kentucky law only allows two loans at a time up to $500. However, she obtained these loans on the internet, which is also not permitted in Kentucky. After five years she is still trying to pay them off. She still owes $5,000. She contracted with a debt consolidation company to work out repayment, but the company took her money and never paid anything on her loans. She has managed to pay off five of the seven loans, but has been forced to move home and live with her mother to try and save money so she can pay off the rest. The loan companies continue to send her threatening messages and letters. They have threatened to sue her in New York. They have also threatened to file criminal charges against her, which is illegal in Kentucky. They have jeopardized her employment by repeatedly contacting her employer.

A young woman took out a payday loan when she was having trouble meeting her expenses. She could not repay the loan after 14 days and the lender encouraged her to roll the loan over into another one. By the end of the year she had taken out more loans than she could remember or count. Instead, she continued to try and pay off the loans when she could. The lender would give her coupons and incentives to get other people to take out loans. They would reduce or waive some of her fees if she could bring others into the office and get them to take out loans.

A man in his forties got caught in the debt trap by having to take out a series of loans, each one to pay off a prior loan, each for an increasing amount. He has gotten so mired in the debt cycle he can't figure any way out. Instead, he has had to go home to live in

his parent's basement. He is in his forties and has become very depressed and discouraged that he will ever make it out from under the debt.

A church was helping a woman with a child who was trying to get out of an abusive relationship. She had been in the military and was receiving partial disability. She borrowed money from a payday lender so she would have enough money to leave her abuser. She used the money to get a motel room while she looked for an apartment. Unfortunately she was not able to find an apartment before the loan money was used up. She had to return to the payday lender, pay off the first loan and take out another so she had more time to find housing. This debt cycle continued until the church was able to provide financial assistance for the deposit and first month's rent. If the church had not been able to help her, she would have been stuck in that debt cycle, with the amount owed growing each time she had to take out another loan. Her situation only got worse before she was able to turn to the church for assistance.

Another church assisted a man whose wife was killed. He had to quit his over the road truck driving job so he could take care of his children. There was no life insurance. He took out a payday loan to get by until he found another job. He was unable to find a full time job right away. He managed to find part time work and made enough to pay the loan off but then he had to take out another one to pay the rent. This debt cycle continued and he got further and further behind, as each loan was larger due to the new fees which were included in the principal. He was evicted from his apartment and came to the homeless shelter after he ended up in his car with his kids. The church helped him with food and shelter while he continued to look for work. He eventually found full time employment but had to stay at the shelter until he was able to pay off the loans and save up enough money to get an apartment.

All of these stories illustrate the basic problem with payday lending. All of these individuals were in financial distress, and yet they turned to a payday lender who charged them 400% interest on a loan that had to be repaid in 14 days. In each case, the individual would have been better off incurring credit card debt, turning to their family or church or seeking advice from a credit counselor rather than taking out such a predatory loan. Many people experience financial hardship, and ideally payday lenders should not be able to charge more than other small consumer lenders. In Kentucky, as in many states, the maximum on such loans is 36%. Since unfortunately the CFPB does not have the authority to limit interest on these loans, we will continue to advocate for a 36% interest rate cap on payday loans at the state level.

The CFPB's solution, to require that the lender determine ability to repay, would have kept all of these individuals from taking out the first payday loan. Instead, they would have had to seek out the help from family or their church that they had to turn to anyway, before they had gotten themselves into the debt cycle. For this reason, we believe the CFPB should require the ability to repay determination in *every* payday loan transaction.

However, even if the CFPB allows payday lenders to alternatively utilize the exceptions to the ability to repay standard, in each of these cases those rules could have helped these individuals get out of the debt trap. They would have been limited to a reduced principal on the second and third loan, and a 30 day cooling off period after that. These rules would have limited their indebtedness to a total of 90 days in a year. These restrictions might have helped these individuals pay off their debts more gradually, without ending up in long-term debt. If they had still been unable to pay the loans under these conditions, they would have turned to their families or churches sooner, before the debt got totally out of control.

The CFPB Proposed Rule: What the proposal gets right

The best thing about the CFPB's proposed rule is that it adopts as its main tenet the ability to repay standard. This standard, which considers a potential borrower's income and expenses, is a long-standing principle of responsible lending that is ignored by payday lenders and other abusive small dollar lenders. It is particularly important with payday or car title loans, where the lender has the right to attach a borrower's bank account or repossess a car, when usually the borrower could not afford the loan in the first place.

We are pleased that the CFPB eliminated an exemption from the ability to repay rule in the draft proposal when a borrower's payment would not exceed 5% of the borrower's income, without consideration of expenses. As the CFPB's own research has shown, 28 to 40% of payday installment loans at that income level still default, which demonstrates that expenses have to be considered when determining ability to repay.

The CFPB correctly included both short term and longer term loans within the scope of the rule. We have seen in Kentucky, as is the case elsewhere, that lenders are turning more towards longer term installment loans, in an effort to avoid application of the rule. The flex loan proposed in Kentucky last year demonstrates how much deeper a debt trap an individual could get into with a longer loan, as it could mean paying 276% interest for two or more years.

While we would prefer them to be longer, the cooling off periods for short-term ability to repay and exception loans would significantly reduce payday lending volume and the debt trap in Kentucky. In particular, creating a limit of 3 short term loans, each one for a declining amount, followed by a mandatory 30 day cooling off period would break the cycle of debt, at least for a time. In addition, permitting a maximum of 6 short-term exception loans and limiting indebtedness to 90 days in a year would help in Kentucky, where typical borrowers take out 10 or more payday loans per year, and tend to be indebted for more than 200 days per year.

We are also encouraged by the long-term exception loan rules. In particular, the NCUA's payday alternative loan is a very good model which we would like to encourage lenders to use, as it would limit interest to 28% plus a small application fee up to $20. This model could encourage lenders to extend the typical payday loan term of 14 days to up to 6 months, which would allow individuals more time to repay. We also support excluding

long-term loans with fee inclusive interest up to 36% interest from the ability to repay requirements, although the permitted $50 origination fee is too high.

We also support the payment collection practices in the rule. It would be very helpful to consumers to have a few days' notice before a lender attempts to collect from a bank account, in order to avoid overdraft and insufficient fee charges. We also appreciate the requirement that the lender obtain a new authorization from the consumer after two failed attempts to collect from the borrower's bank account.

The CFPB Proposed Rule: Loopholes Need to Be Closed

While there are many features of the proposed rule that we like, there are many ways in which the rule needs to be improved. These improvements are essential to ensure an end to the high-cost loan debt trap.

First, we feel strongly that the ability to repay requirement should apply to *all* short-term and long-term high-cost loans. There is not be any valid reason why high-cost lenders should get a pass on such a critical responsible lending norm.

In addition, the standards the rule sets out as exceptions to the ability to repay standard should be required of all lenders, *after* they have determined ability to repay. In any case, some of these exception rules are too generous to the lender. In particular, allowing up to 6 short-term loans without any ability to repay test is too many. An individual can end up in a debt trap with just one unaffordable payday loan. And allowing an exception for loans up to 36% where the origination fee is up to $50 is too high. The $20 fee permitted in the NCUA model should apply here as well.

The rules should also prevent unaffordable short-term debt from becoming long-term debt. In particular, the CFPB rule should adopt the FDIC standard of 90 days maximum indebtedness per year to *all* short-term loans, not just exception loans. Also, we hope that the CFPB will change the cooling off period back to 60 days, as it was in the original draft proposal. This too would keep frequent short-term debt from becoming a debt trap.

With regard to longer-term debt, we encourage the CFPB to include in the rule loans that are not secured by an individual's bank account or car. In Kentucky, the proposed flex loan from last year would have created an open-ended unsecured loan with interest up to 276%. That type of loan, if passed, would be totally exempt from the CFPB rule as proposed. It is our belief that the payday industry designed the flex loan product specifically to exempt it from these rules.

In addition, we encourage the CFPB to extend the coverage of loans that are secured beyond 72 hours. At a minimum, *all* high-cost loans secured by a bank account or a vehicle should be covered by the rule. Additionally, loans secured by *any* personal property and those where the lender retains the right to garnish wages must be covered by the rule as well. This is a large loophole for unaffordable loans that, like payday loans, force individuals to reborrow to avoid repossession or garnishment.

We also urge the CFPB to make the protections against refinancing of long-term loans stronger, since refinancing is a strong indicator that the prior loan was unaffordable. In particular, in evaluating ability to repay, there should be a presumption of unaffordability if the current loan is delinquent, even by one day (as opposed to 7 days in the rule), or if the borrower has not repaid 75% of the principal. Further, only one refinancing of a long-term loan should be permitted. These changes would ensure that the lender does not simply flip the borrower from one unaffordable loan to the next unaffordable loan.

There are also some weaknesses in the proposed ability to repay test that need to be strengthened. The rule should not allow a lender to simply forecast a borrower's living expenses based on a percent of income or other factors. Instead, the lender should be required to consider documentation of actual expenses or at least objective assessments of a borrower's basic living expenses. In determining the ability to repay, the rule also allows as "reasonable" measures the lender's rates of delinquency, default and reborrowing. However, even low default rates or reborrowing rates are not sufficient evidence of ability of repay when lenders have direct access to borrowers' bank accounts. The proposal does not go far enough to ensure that borrowers will be able to pay their expenses and have enough money to live on after making the loan payment.

Unless the CFPB strengthens the rule, the exemptions and weak requirements outlined above will allow lenders to continue business as usual, and the rule will not achieve its stated purpose to end the debt trap. This could end up making things worse for consumers by implicitly endorsing lending practices that lead to the debt trap.

Conclusion

It is very important to Kentuckians that *all* high-cost loans be covered by the rule, whether secured or not. It is very important that the final rule requires lenders to determine ability to repay for *all* loans, based on actual income and expenses. It is also important that the rule limits the number of loans, limits excess fees, limits refinancing, and limits total days of indebtedness.

Thank you for this opportunity to comment. We appreciate the work that you have done so far to protect consumers and hope that this rule will become as strong as possible in order to truly end the debt trap. For further clarification on these comments, please contact Anne Marie Regan at 502-333-6012 or at amregan@kyequaljustice.org.

Sincerely,

Anne Marie Regan
Senior Staff Attorney
Kentucky Equal Justice Center