



Predatory

How Payday Lenders are Using Trojan Horse Tactics to Weaken Consumer Protections in Pennsylvania

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Overview

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The payday lenders are lobbying legislators in Harrisburg to weaken our state law. Just as in prior sessions, they claim their legislation would create a responsible credit product, but at the core of their business model and their proposal is a debt-trap loan. This year, the payday lenders have a new strategy: they are using the federal Consumer Financial Protection Bureau (CFPB) as a Trojan horse to bring their predatory loans into Pennsylvania.

A memorandum is being circulated in the Pennsylvania Senate to garner support for legislation to legalize a new loan product in Pennsylvania, called the “Pennsylvania Financial Services Credit Ladder.” The memo cites CFPB proposals as a model for the legislation, but fails to mention that, unlike Pennsylvania, the CFPB cannot set a limit on the cost of credit. Changing our state law by adopting the CFPB proposals in Pennsylvania will legalize high-cost payday loans.

The CFPB is working to combat the worst payday lending abuses nationwide, but it has one hand tied behind its back because it does not have the authority to issue a rate cap on interest and fees, the most effective way to curtail predatory lending. The CFPB has released a working draft of proposals it is considering for a forthcoming national rule. While the preliminary proposals have some strong provisions, they also contain loopholes that would allow payday lenders to continue making unaffordable, predatory loans in states where they are legal. The rule remains in development, and the CFPB should craft regulations that are broad and strong enough to put an end to debt-trap lending across the country.

Importantly, the national CFPB rule would not preempt or supersede Pennsylvania’s stronger state interest rate cap. Unless the payday lenders convince state legislators to use the CFPB rule as cover for significantly increasing the costs of credit in our state, our critical protection against predatory lending will remain.

Replacing Pennsylvania’s rate cap with the CFPB proposal would weaken our state law. That’s why the payday lenders, who oppose the CFPB rulemaking at the national level, appear to be supporting its implementation in Pennsylvania. State legislators should reject the payday lenders’ Trojan horse.



Payday Lenders' History of Seeking to Evade and Eviscerate Pennsylvania's Strong Law

Right now, our Commonwealth is free from payday loan storefronts peddling promises of "quick-cash" with loans that trap vulnerable Pennsylvanians in long-term debt. Pennsylvania has a strict cap on fees and interest for small-dollar loans that has effectively kept the payday lenders at bay.¹ Our law also protects state residents against predatory lenders who operate online.²

The payday lending industry has tried to find loopholes in our law, but failed. They have employed a variety of schemes in attempts to evade our state law including: posing as check cashers who would delay depositing checks for high fees; disguising loans as useless products; "renting-a-bank" as a front; launching a spurious "line of credit" product loaded with fees; and claiming the Internet provided a cloak of immunity. (Table 1.) Each time, courts and regulators saw through the ruse, and effectively stopped debt-trap lending. As a result, the payday lenders have set their sights on the state legislature in an effort to change our law.

For years, the out-of-state payday lenders have been working to bring their predatory loans into Pennsylvania by lobbying for legislation to weaken our existing state consumer protections. Each time, they have attempted to disguise their proposals by repeatedly rebranding payday loans as "short-term loans," "micro-loans," or "a fresh start," and by promoting their legislation as consumer protection.³ This tactic is currently being deployed in other states, under the rubric of "flex loans."⁴

Despite the rosy packaging, at the heart of each of their proposals was a predatory payday loan. The loan would have carried fees and interest over 300% annually and been made based on the lender's ability to collect it through direct access to the borrower's bank account rather than the borrower's ability to repay.

In states where payday loans are legal, borrowers become trapped in long-term debt through repeated refinancing, leading to a cascade of financial harms. Payday loans cause borrowers to fall behind on other bills,⁵ to delay medical care,⁶ to overdraft and lose their bank accounts,⁷ and even file for bankruptcy.⁸ The Department of Defense concluded that payday loans impair military readiness because of their harm to soldiers.⁹

The payday lending industry has a long history of trying but failing to evade our interest rate restrictions through a variety of schemes.

In a case involving the Banking Department's successful enforcement action against the payday lender Advance America, the Pennsylvania Supreme Court noted that "usury is generally accompanied by subterfuge and circumvention of one kind or another to present the color of legality."

Pa. Dep't of Banking v. NCAS of Del.,
596 Pa. 638, 652 n. 11 (2008).

Similarly, the payday lenders have employed subterfuge in their efforts to legalize their loans, disguising the predatory nature of their legislative proposals.



Given the destructive nature of their loans, it is no surprise that the payday lenders have employed subterfuge in their efforts to legalize their loans. The chart below chronicles and dispels the various claims the payday lenders and their allies have made over the course of the last decade in support of their legislation. (Table 2.)

The 2015-2016 session of the Pennsylvania General Assembly appears to be no different. Once again, the payday lenders have put a new wrapper on their predatory loans, calling them a “Financial Services Credit Ladder.” A sponsorship memorandum is circulating, citing forthcoming rules from the federal Consumer Financial Protection Bureau (CFPB) as a justification for the legislation.¹⁰

While a bill has not yet been filed, the public summary of the proposal and draft language that has circulated reveal that the payday lenders will be working to legalize long-term, predatory payday loans. This is a tactic they increasingly have employed in other states where high-cost lending is legal.¹¹

Long-Term Payday Loans: Another Unsafe Debt-Trap

Long-term payday loans are just another debt-trap product. They are structured to have multiple payments with a longer repayment period than the traditional, single balloon-payment payday loan, and usually have higher loan amounts. Despite their installment terms, they carry the same predatory characteristics as balloon-payment payday loans, with the potential to be even more dangerous to borrowers.

Long-term payday loans involve:

- **Extremely high costs.** Rates for long-term payday loans, taking into account both interest and fees, are generally over 200%. For example, the payday lender Check ‘N Go, which has actively lobbied to weaken Pennsylvania’s law, offers long-term payday loans in California. One example on its website is a \$3,000 loan, payable in 26 bi-weekly payments, carrying a 218% APR, with a total payback amount of over \$7,600.¹²
- **Lender access to the borrower’s bank account.** Payday lenders require borrowers to have an income stream and a bank account, and they obtain access to the bank account so they can ensure that they will get paid back first on the borrower’s payday. Although federal law prohibits lenders from requiring borrowers to preauthorize electronic repayments from their bank accounts, lenders circumvent this rule by failing to clearly explain other repayment options or by coercing consent through tactics like delaying delivery of the loan proceeds if a borrower does not agree to electronic repayments.¹³



- **Repeat Refinancing.** Repeat borrowing is common with long-term payday loans. In Colorado, nearly half of long-term payday loans over \$400 are refinanced loans, where the borrower repaid a loan early and then re-borrowed the same day.¹⁴ That's a strong sign of unaffordability. It also is a sign that lenders may be flipping borrowers into new loans to maximize fees and to keep borrowers indebted in bigger loans for a longer period of time.
- **Payments without Progress.** Loans can be structured so that borrowers are making payments over an extended period of time, but barely reducing the principal balance. These terms can make it more difficult for borrowers to get out of the high-cost loan by paying it off before it matures, while creating an on-going drain on an already financially-constrained borrower's income.
- **Increasing Risks.** A longer term loan also can increase the chances that a borrower, over the life of the loan, will experience loss of income or an unexpected expense that would lead to a default.¹⁵
- **Defaults.** Long-term payday loans eventually lead to delinquencies and defaults. For example, in the first half of 2015, the payday lender Cash America had more long-term payday loan balances that were delinquent than current in Texas.¹⁶ In 2014, Rise Credit reported charge-off rates of 29.2% in California and Cash Central had charge off rates of 21% of the loans it originated.¹⁷ The loans remain profitable to payday lenders because they can collect more in fees than the principal loaned long before the end of the loan term.¹⁸ In other words, the lender profits and succeeds while the borrower fails.

Payday lenders have migrated to these long-term loans to avoid regulations targeted at their traditional, balloon-payment payday loans.¹⁹ In a piece on payday lending for *Last Week Tonight*, comedian John Oliver described the situation as "legislative Whack-a-Mole." He explained, "Just when you think you've squashed them, they pop up somewhere else, wearing a completely different outfit."²⁰

The only way to prevent evasions is to have a comprehensive rate cap for consumer loans combined with vigorous enforcement, as we have done in Pennsylvania.²¹ When the Department of Defense conducted a study on predatory lending targeting military members, it recognized Pennsylvania's law as one of the strongest in the country.²² It then worked to pass a federal law to place a 36% rate cap on both fees and interest for loans made to active duty soldiers.²³ DOD initially applied the cap to loans of 90 days or less. Recognizing the harm caused by high-cost longer term loans, DOD recently modified its regulations to apply the 36% fees and interest rate cap to a broader range of consumer credit, including long-term payday loans.²⁴



Payday Lenders Employing the CFPB as a Trojan Horse

The federal Consumer Financial Protection Bureau (CFPB) is also engaged in rulemaking to rein in payday lending abuses. It has conducted research, field hearings, and supervisory examinations and found that payday loans are “debt-traps” causing substantial harm to consumers. In March of 2015, the CFPB published an outline of proposals it is considering for a national payday lending rule.²⁵

Unfortunately, the CFPB does not have the authority to institute a nationwide rate cap, which is the best way to curtail predatory lending practices.²⁶ The proposals under consideration, however, would be a federal floor for consumer protection.²⁷ States could have stricter laws and regulations, including restrictions on the cost of credit. As a result, the CFPB rules will not preempt or supersede Pennsylvania’s rate cap, leaving the most effective protection against predatory lending in place.

The CFPB preliminary proposal has some strong provisions, but it also contains troublesome loopholes. It is based on the fundamental principal that lenders should ensure that a borrower has the ability to repay the loan, taking into account both income and expenses. But, the preliminary proposal would give lenders the ability to avoid this requirement if certain conditions are met. For traditional short-term payday loans, lenders would be able to make up to three back-to-back predatory payday loans, and up to six a year. That doesn’t solve the debt-trap. It is the debt-trap. For long-term payday loans, lenders would have the option of making triple-digit interest rate, six-month loans without regard to a borrower’s other debts and expenses, enabling lenders to continue making unaffordable loans.

In addition, the underwriting and refinancing limitations for longer-term loans are not sufficiently robust. The preliminary proposal does not adequately address the fact that the longer a borrower is in a high-cost loan, the greater is the chance that the loan will become unsustainable. More stringent underwriting is warranted for long-term payday loans, with additional residual income requirements. Similarly, the preliminary proposal does not go far enough to limit repeat refinancing, particularly in cases where the borrower has made limited progress in paying down the loan principal.

The current CFPB proposal is simply a working draft of provisions it is considering for a national rule. As the CFPB continues to develop its rule, it should ensure that it

The CFPB has been charged with reining in payday lending abuses nationwide, but it does not have the authority to issue a rate cap on interest and fees, which is the most effective way to curtail predatory lending.

Pennsylvania’s rate cap will remain critical for protecting borrowers.

Changing our state law by adopting the CFPB rule in Pennsylvania will weaken it and expose residents to a dangerous loan product.



contains provisions that are broad and strong enough to put an end to some of the worst abuses caused by predatory payday lending.

Of course, the simplest and most effective way to protect borrowers against high-cost loans is to limit their cost, which is exactly what Pennsylvania has done. Given that the CFPB does not have that authority, a CFPB rule on payday lending should not be a model for our state. Changing our state law by adopting the CFPB rule in Pennsylvania will weaken it.

That's why the payday lenders, who oppose the CFPB rulemaking at the national level, appear to be supporting its implementation in Pennsylvania. Payday lenders are crafting state legislation to legalize their loans in Pennsylvania based on the loopholes in the CFPB's preliminary proposal that would allow high-cost, predatory loans, implying that the CFPB has given its "seal-of-approval" to these loans.²⁸

The CFPB, however, has not endorsed bringing these predatory payday loans into Pennsylvania. In fact, the CFPB's preliminary proposal specifically states that "[s]imilar to short-term loans, the unaffordable structure of these longer-term loans can create substantial risk of consumer harm."²⁹ Importantly, the portion of the proposal on long-term payday loans starts with the premise that loans above a 36% cap, inclusive of both fees and interest, are debt-trap products that bring harm to borrowers and warrant special protections.

Without the ability to cap interest rates on these loans, however, the CFPB has one hand tied behind its back as it seeks to combat predatory lending. While a strong, national CFPB rule on payday lending could augment and support our state law, it will not be a model for replacing it.

Recommendations

Study after study has documented how payday lending causes tremendous harm to borrowers. Pennsylvania is fortunate to have a strong cap on interest and fees for consumer loans. The best way for state policy makers to protect Pennsylvania residents against predatory lending is to keep our existing protections in place.

On the federal level, the CFPB should issue a strong rule that ends debt-trap lending nationwide. A weak national rule would threaten our existing protections, as we already have seen the payday lenders attempting to use loopholes in the preliminary proposal as leverage to legalize their loans in Pennsylvania. As the CFPB works to rein in predatory lending abuses in other states, it must be sure it is not providing unwarranted ammunition to the payday lenders trying to expand them into states like ours.

CLS calls on state and federal policy makers to take the following actions to protect our low-income clients.



Pennsylvania policy makers should:

- Reject attempts to weaken our state’s cap on fees and interest for consumer loans.
- Call on the CFPB to issue a strong national rule that enhances Pennsylvania’s protections against abusive lending practices and does not undermine our prohibitions on high-cost lending.
- Continue to take strong enforcement actions against lenders’ attempts to evade our strong state law.

The federal CFPB, which does not have the authority to institute a national interest rate cap, should issue a strong national rule that would:

- Bolster the enforceability of existing state consumer lending protections, such as Pennsylvania’s usury law, by making a violation of state lending laws, including a third-party’s facilitation of usury, an unfair, deceptive, and abusive act or practice.
- Require a meaningful “ability to repay” standard for all loans, without exceptions, and provide no safe harbors or legal immunity for poorly underwritten loans.
- Affirm that state interest rate caps are the most effective way to protect people from predatory payday loans and other high-cost credit.



Table 1: Payday Lenders’ Attempted Evasions and Effective Enforcement in Pennsylvania

Attempted Evasion	Effective Enforcement
<p>Check cashers claimed they were not making loans, instead they were just charging fees for delaying presentment of a check.</p>	<p>Courts saw through this ruse.</p> <p>Pennsylvania General Assembly prohibited the practice by statute. 1998, Feb. 18, P.L. 146, No. 22, § 505, codified at 63 P.S. § 2325 (a)</p>
<p>Payday lenders attempted to disguise the interest paid on the loan as a fee for purchasing a useless product or service.</p>	<p>AG and Banking Dept. action took action against Ace Pays. (2005)</p> <p><i>“It’s clear to us that the web-based membership program was a ruse to engage in an illegal payday loan operation....”</i></p> <p>-Tom Corbett, as Attorney General</p>
<p>“Rent-a-bank:” Payday lenders claimed to be only servicing the loan for a bank that does not have to comply with Pennsylvania law, but the bank’s only significant participation in the loan transaction was to “rent” its name and its charter to third parties seeking to avoid the usury limits in states where they operated.</p>	<p>Pennsylvania store fronts shut down when federal banking regulators took action against the banks.</p> <p>Todd Mason, <i>Payday Lenders are Squeezed by FDIC</i>, Philadelphia Inquirer (Mar. 10, 2006).</p>
<p>In 2006, after failing to pass legislation that would legalize payday lending, Advance America offered a “line of credit” product. It carried an interest rate of 5.98% and a \$149.95 monthly “participation fee,” making the total cost of the loan the same as triple-digit interest rate payday loans.</p>	<p>Pennsylvania Banking Department sued and the Pennsylvania Supreme Court unanimously held these were illegal loans.</p> <p><i>PA Dept. of Banking v NCAS of Delaware, LLC</i>, 948 A.2d 752 (Pa. 2008).</p>
<p>Payday lenders asserted that they could evade our law if they did not have a physical presence in the state and only made loans over the Internet to Pennsylvania residents.</p>	<p>Banking Department notified lenders that our law applies to loans made over the Internet to Pennsylvania residents, and Cash America sued the agency.</p> <p>The PA Supreme Court unanimously ruled that Pennsylvania law applies to loans made over the Internet to Pennsylvania residents, even if the lender is located in another state.</p> <p><i>Cash America Net of Nevada, LLC v. PA Dept. of Banking</i>, 8 A.3d 282 (Pa. 2010)</p>



Table 2: Payday Lenders’ Claims and the Facts

Payday Lenders’ Claim:	The Facts
<p>2005: Payday lenders and their allies claim rent-a-bank payday lending will continue in Pennsylvania as justification for legalizing payday lending in the Commonwealth.</p> <p>“[T]he bill’s sponsor, believes the banking partnerships will continue and said the bill is needed to address abuses...” Dave Davies, <i>Legit Lenders or Loan Sharks?</i>, Philadelphia Daily News (Jun. 21, 2005)</p>	<p>2006: Federal regulators crack down on the rent-a-bank scheme and payday storefronts close. The Pennsylvania Banking Department announces that it does not support legislation to authorize the loans, and the bill dies.</p> <p style="text-align: right;">Todd Mason, <i>Payday Lenders are Squeezed by FDIC and PA Senate Panel Shuns Bill Legalizing Payday Loans</i>, Philadelphia Inquirer (March 2006).</p>
<p>2012: Payday lenders and their allies claim payday loans have “gone to the Internet, where they are impossible for us to regulate.”</p> <p style="text-align: right;">Co-sponsorship Memo, HB 2191 January 17, 2012.</p>	<p>In 2010, the Pennsylvania Supreme Court held that Pennsylvania’s usury law applies to payday loans that are made over the Internet to Pennsylvania residents, and the Banking Department successfully stops Cash America from making illegal loans in Pennsylvania.</p> <p style="text-align: right;"><i>Cash America Net of Nevada, LLC v. PA Dept. of Banking</i>, 8 A.3d 282 (Pa. 2010)</p>
<p>2013: Payday lenders and their allies claim a new bill would create “micro-loans,” and the legislation “ends the practice of payday lending forever.”</p> <p style="text-align: right;">Co-sponsorship Memo, SB 975 May 7, 2013</p>	<p>SB 975 would have authorized 8 debt-trap payday loans. And, the 8 loan limit was no limit at all since it was never triggered if a borrower simply waited 3 business days before re-borrowing, thus allowing the cycle to continue without end.</p> <p>It also would have authorized high-cost, long-term payday loans made without regard to a borrower’s income and expenses.</p> <p style="text-align: right;">SB 975, 2013-14 Session</p>
<p>Payday lenders and their allies distribute a news article to some Pennsylvania legislators which describes a report from the Pew Charitable Trusts as “recommending changes to payday loans nationwide” and that “showcased Colorado as the way to reform payday lending,” without additional information clarifying that Pew did not recommend any changes to Pennsylvania’s law.</p> <p style="text-align: right;">Erin E. Arvedlund, <i>Your Money: Pew Urges Payday-loan Reform</i> The Philadelphia Inquirer, (Nov. 26, 2013.)</p>	<p>Staff from the Pew Charitable Trusts send a letter to members of the Pennsylvania State Senate stating, “Pew does not recommend law changes in the 15 states, including Pennsylvania, that do not have payday lending, because the bulk of evidence does not suggest that introducing high-cost lending will be beneficial to consumers.”</p> <p style="text-align: right;">June 11, 2014 Letter to PA State Senate Nick Bourke, The Pew Charitable Trusts</p>



¹ Pennsylvania's Loan Interest Protection Law caps interest at 6% annually for consumer loans under \$50,000, unless the lender is otherwise authorized to charge a higher rate. 41 P.S. § 201. Lenders who choose to obtain a license from the Pennsylvania Department of Banking can charge higher rates under the Consumer Company Discount Act ("CDCA"). 7 P.S. § 6201 et seq. The CDCA authorizes a mix of interest and fees for consumer loans under \$25,000. Charges will vary depending on the loan term, loan type (open or closed end), and whether the lender chooses to use discount interest and fees or interest on the amount outstanding, but generally for loans of one-year and longer, like that contemplated by the "Financial Services Credit Ladder" legislation, the total cost would be under 30% annually.

² *Cash America Net of Nevada, LLC v. PA Dept. of Banking*, 8 A.3d 282 (Pa. 2010)

³ PA General Assembly, HB 2191 (2011-2012 Session), Co-sponsorship Memo, Jan. 17, 2012, available at http://bit.ly/HB2191_Memo; PA General Assembly, SB 975 (2013-2014 Session), Co-sponsorship Memo, May 7, 2013, available at: http://bit.ly/SB_975Memo; "Fresh Start" amendment on file with CLS; see also, PA General Assembly (2013-2014 Session), Co-sponsorship Memo "90 Day Consumer Loan Program" (bill never filed), available at <http://bit.ly/SenCormanMemo>.

⁴ Laurie Roberts, *Payday Loan Sharks Showing their Teeth Again in Arizona*, The Arizona Republic (March 1, 2016), available at: http://bit.ly/AZ_FlexLoans.

⁵ Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, Quarterly Journal of Economics, 126(1), 517-555 (2011), available at: <http://qje.oxfordjournals.org/content/126/1/517.full>

⁶ *Id.*

⁷ Dennis Campbell, et al., *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures* (Dec. 3, 2008), available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=133587.

⁸ In a study, economists Professor Paige Marta Skiba of Vanderbilt University and Professor Jeremy Tobacman of the University of Pennsylvania found that payday borrowers are significantly more likely to file for bankruptcy than similarly-situated people who do not use payday loans. Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* (Oct. 10, 2008), available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215

⁹ U.S. Department of Defense, *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, Aug. 9, 2006, available at:

http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

¹⁰ PA General Assembly (2015-2016 Session), Co-sponsorship Memo, *Legislation Based on Consumer Financial Protection Bureau (CFPB) proposals to create a Financial Services Credit Ladder*, available at:

<http://bit.ly/CreditLadderMemo>.

¹¹ Diane Standaert and Peter Smith, *Payday and Car Title Lenders' Migration to Unsafe Installment Loans*, Center for Responsible Lending, Oct. 2015, available at http://bit.ly/CRL_LongTermPaydayLoans.

¹² Check 'N Go, Schedule of Charges, California, available at: <http://bit.ly/CheckNGoRates>.

¹³ Carolyn Carter et al., *Installment Loans: Will State Laws Protect Against the Next Wave of Predatory Loans?*, National Consumer Law Center, July 2015, available at http://bit.ly/NCLC_InstallmentLoans.

¹⁴ Standaert, *supra* note 11.

¹⁵ Carter, *supra* note 13.

¹⁶ Standaert, *supra* note 11, citing Cash America's 10-Q from July 30, 2015.

¹⁷ Paul Leonard, *Predatory Payday and Larger Installment Loans Overshadow Emerging Market for Smaller, Less Expensive Loans in California*, Center for Responsible Lending, Dec. 2015, available at http://bit.ly/CRL_CAdat.

¹⁸ Standaert, *supra* note 11.

¹⁹ Carter Dougherty, *Payday Lenders Evading Rules Pivot to Installment Loans*, Bloomberg Business, May 29, 2013, available at <http://bit.ly/PaydayLendersPivot>.

²⁰ John Oliver, Last Week Tonight, Aug. 10, 2014, available at <http://bit.ly/JohnOliverPaydayLoans>.

²¹ Carter, *supra* note 13.



²² U.S. Department of Defense, *supra* note 9.

²³ 10 U.S.C. §987.

²⁴ Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 80 Fed. Reg 43557, July 22, 2015, to be codified at 32 C.F.R. pt. 232.

²⁵ CFPB, *Outline of Proposal under Consideration and Alternatives Considered*, Small Business Advisory Review Panel for Potential Rulemakings for Payday, Vehicle Title and Similar Loans, Mar. 26, 2015, available at http://bit.ly/CFPB_Proposals.

²⁶ 12 U.S.C. §5517(o).

²⁷ CFPB, *Outline of Proposals*, *supra* note 25.

²⁸ Co-sponsorship Memo, *supra* note 10.

²⁹ CFPB, *Outline of Proposals*, *supra* note 25, at 22.