NCLC®
NATIONAL CONSUMER LAW CENTER®

BOSTON HEADQUARTERS
7 Winthrop Square, Boston, MA 02110-1245
Phone: 617-542-8010 • Fax: 617-542-8028

WASHINGTON OFFICE
1001 Connecticut Avenue NW, Suite 510, Washington, DC 20036
Phone: 202-452-6265 • Fax: 202-296-4062

www.nclc.org

February 24, 2015

Senator Sharon Nelson
Washington State Senate
Olympia, Washington

Re: HB 1922, SB 5889, high-cost consumer installment loans.

Dear Senator Nelson:

As you requested, this letter provides my analysis of Colorado's experience under its payday installment law and of the differences between that law and the installment loan bill currently proposed in Washington. I am the Associate Director of the nonprofit National Consumer Law Center® (NCLC®), where I direct NCLC's advocacy efforts in Washington, DC and specialize in small dollar loans and payments issues. Since 1969, NCLC has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. We publish a legal treatise on Consumer Credit Regulation and are currently conducting a 50-state analysis of state installment loan laws.

I have reviewed the data that Colorado has published on its experience under its small dollar loan laws, and I recently published an op-ed in American Banker describing why I do not believe that Colorado's law is a good model for payday reform.[1] Colorado publishes two sets of reports: a 2-page snapshot of unverified annual reports from the lenders and a longer statistical analysis based on examination data from a subset of lenders. The annual reports come out sooner and include some figures that are not in the longer report. But the statistical information is based on a more thorough examination of the lenders' records and is considered by the State to be more accurate. I have relied on the statistical information except for data not available in those reports. In brief, I have two main conclusions.

First, Colorado loans have significant default rates, rollovers, and other indicia of inability to pay and borrower distress. On a per borrower basis, the default rate is 38%, compared to the current 19% per-borrower default rate in Washington. One third of loans are flipped loans – taken out the same day as an early repayment. Flipping approaches 50% for loans close to $500.

Second, the proposed Washington bill is likely to result in more extensive harm to borrowers than in Colorado. Cost is much higher. APRs start as high as 214% and in practice will be much higher because the up-front fees make loan flipping more profitable than in Colorado. The Washington bill also permits much deeper high-cost debt, with bigger loans charging up to 214%. Colorado's payday installment loans are limited to $500; above $500, a different statute with rates of 36% or lower applies. Washington loans could also take a higher share of a low income borrower's scarce wages than in Colorado.

Colorado Loans Remain Dangerous and Unaffordable for Many Borrowers

In 2010, Colorado passed changes to its payday loan law. The changes capped rates and fees and encouraged longer-term loans with equal installment payments, while also trying to put some brakes on refinancings.

The cost of Colorado loans remains extremely high. Current Colorado law permits periodic interest of 45% per year plus origination and monthly fees that add significantly to the annual percentage rate (APR). The 2012 average loan contract carried a 188% APR.[2] While the average loan was repaid early with a lower actual APR of 129% for one loan, that rate does not take into account the same-day borrowing/loan flipping prevalent in Colorado (discussed below). The average Colorado payday installment loan borrower paid $341 per year over 11 months on the average loan of $398.

Colorado's payday loan industry continues to experience high default rates and to engage in repeat lending, two tell-tale signs of unaffordable lending. Lenders have no requirement and little incentive to assess borrowers' ability to repay. Experience shows that the loans remain dangerous and unaffordable for many borrowers.

High Default Rates

Colorado's 2013 data shows a 38% default rate on a per borrower basis.[3] (Defaults per loan are 20%.) Colorado does not have a database and the per borrower default rate does not consider consumers who juggle loans from multiple lenders, so the default rate is higher than what is reported. The 38% default rate is a shockingly high and intolerable default rate by any measure.

The defaults are especially high given that lenders have a coercive way of ensuring repayment of unaffordable loans: they hold the borrower's post-dated checks or electronic debit authorization. A borrower can default only if the check bounces – not just once, but every time it is re-presented; if the borrower pays hefty stop payment fees to stop all of the checks; or if the consumer goes so far as to close the bank account. All of those options carry serious repercussions and costs to the borrowers and risk losing access to a bank account entirely.

Indeed, the Colorado per-borrower default rates are nearly **double** the current rates in Washington. The default rate in Washington has been going down since the 2009 reforms. The most recent Department of Financial Institutions payday lending report indicates that the default rate among Washington borrowers is 19%.[4]

Many Colorado Borrowers Experience Significant Injury Even if They Do Not Default

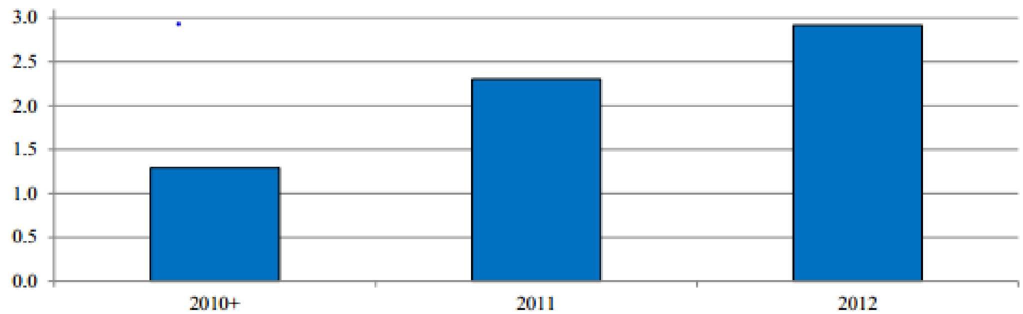
The 38% default rate is just the tip of the iceberg of Colorado borrowers' distress. The model of securing repayment through post-dated checks or preauthorized debits can injure consumers even if they do not default. Many consumers incur overdraft and insufficient funds fees from their banks when the payments are presented, have trouble paying for other expenses, or incur late fees on other bills. None of those measures are captured in the default rate.

Loan Flipping and Loans Per Year are Increasing

In another sign of unaffordability, most Colorado borrowers take out several loans per year and refinance mid-way through the loan term. Loans per year, same day refinances, and days per year in debt have all increased since the first year of loans under the new law, as lenders gain experience in maximizing the debt trap.

The number of repeat loans has increased over time, from 1.3 loans per consumer per year in 2010, to 2.3 loans in 2011 and 2.92 loans per consumer in 2012.

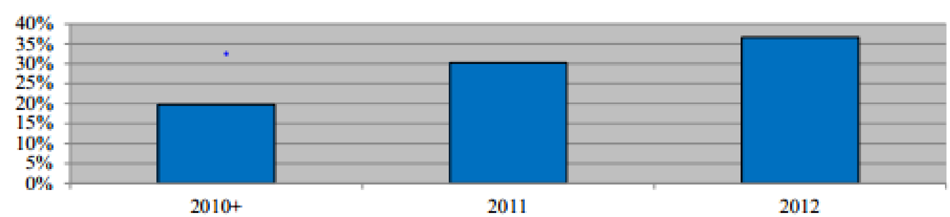
Colorado Payday Installment Loans Per Consumer Per Year



Source: Colorado 2012 Statistical Information at 18.

More than one third (36.68%) of loans in 2012 were taken out the same day as the previous one was paid off, up from 20% in 2010 in the first year of reformed loans. That is, as consumers pay down their loans, they appear to be re-borrowing in order to get cash to cover their payments, just as payday borrowers re-borrow to cover unaffordable loans.

Percentage of Post-HB10-1351 DDLA Loans that were "Same-Day-As-Payoff" Transactions

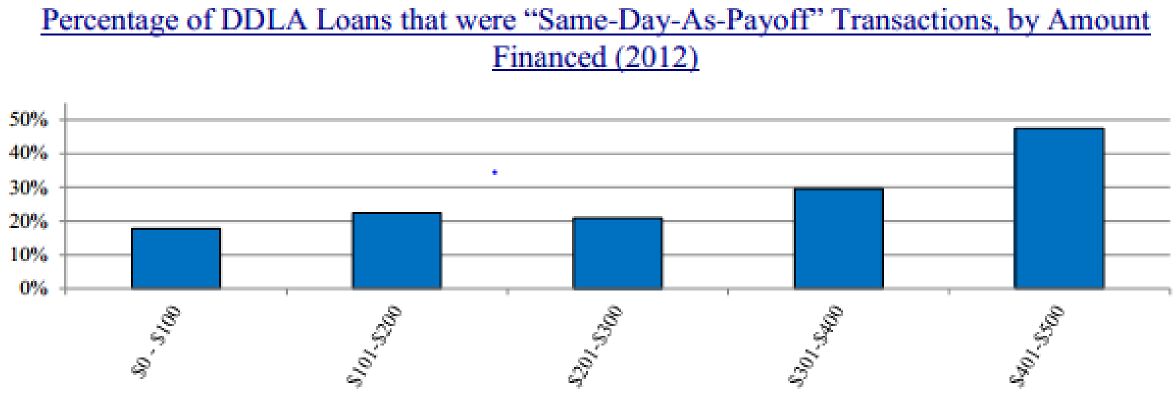


Source: Colorado 2012 Statistical Information at 25.

The same-day transactions are especially notable because the average loan is repaid in about three months, well short of the typical six-month term. In other words, these same-day transactions are not new loans taken out by consumers after fully repaying a prior loan. Rather, the re-borrowing is likely a sign of unaffordability as the consumer uses the proceeds of the new loan to pay off the old loan and to cover that month's payment (in addition to taking out additional cash).

The conclusion that same day repayment and re-borrowing indicate unaffordability is bolstered by the fact that the rate of same-day-as-payoff refinancing is even higher for larger loans. That is the same pattern as seen with traditional balloon payment loans.[5] In 2012, about 48% of loans from $401 to $500 (up from about 40% in 2011) were same-day-as-payoff transactions.

Loan flipping results in the Colorado loans being, in practice, much longer than the 6-month maximum or the 3-month average duration of an individual loan. Colorado reports that the average days in debt have now reached 333 days per year, or about 10.9 months.[6]



Source: Colorado 2012 Statistical Information at 25.

The Proposed Washington Bill Would Likely Permit Even More Unaffordable Lending

While the data discussed above show that the Colorado payday installment loans are unaffordable for many borrowers, the proposed Washington bill deviates from the Colorado model in significant ways. Thus, it is likely to result in even more dangerous lending than the Colorado law.

First, the bill permits higher rates than Colorado does. A $500 6-month loan under the bill could charge nearly 214% APR, compared to the average 188% contracted APR in Colorado for the same loan. The cost for that loan under the Washington bill would be $354 compared to $293 in Colorado.

Second, unlike in Colorado, the bill permits high rates on loans above $500, increasing the chances of significant harm to borrowers for whom the loans are unaffordable. For loans of $501 to $1000, a different Colorado statute applies, with rates capped at 36%; for amounts over $1000, the rate is 21%.[8] The Washington bill, in contrast, permits loans of $700 at 214% APR and loans of $1,000 at 189% APR.

Third, the structure of the loans under the Washington bill is likely to encourage even greater loan flipping and to increase expenses above and beyond the Colorado experience. Although both the Colorado law and the Washington bill permit extensive fees on top of the periodic interest rate, the Washington bill lacks Colorado's extensive rebate provisions. Lenders in Colorado cannot increase their fees or rates by encouraging borrowers to repay early and re-borrow. Under the Washington bill, by contrast, lenders could charge a new origination fee every time the consumer re-borrows, and can retain the monthly fee for a loan flipped immediately after the first month, dramatically increasing the cost and APR of the loan above even the high rates permitted.

Fourth, the payments would be even more unaffordable than in Colorado. Under the Washington bill, a borrower making $30,000 per year could have payments on a $750 loan that consume 8.5% of the paycheck.[9] That is a significant chunk of income for a family with very low income that is likely already living paycheck to paycheck with no slack in the budget. By contrast, payments in Colorado average 4% of income,[10] and even at that rate the Colorado loans experience significant defaults despite holding post-dated checks.

The Washington bill (like Colorado's law) has a misleading interest rate. The Washington bill permits interest of 36%. But the significant fees on top of the periodic interest result in a very confusing cost structure that obfuscates the cost of credit. The law should mandate a simple, clear interest rate without fees. While consumers may receive an APR disclosure in the fine print, a more transparent approach would put the entire cost of credit in the interest rate.

Neither Washington nor Colorado requires consideration of ability to pay. Neither the Washington bill nor Colorado law requires lender to consider whether the borrower is able to repay the loan on its terms while meeting other expenses. Borrowers whose expenses already exceed their income do not have the capacity to make loan payments and would be better off finding a solution other than high-cost credit. Credit cannot solve every problem and cannot make up for a fundamental lack of income.

If you have any questions, please feel free to contact me.

Yours very truly,

Lauren K. Saunders
Associate Director

---

[1] Lauren Saunders, "Colorado is No Model for a National Payday Rule," American Banker (Dec. 10, 2014), http://www.americanbanker.com/bankthink/colorado-is-no-model-for-a-national-payday-rule-1071579-1.html.

[2] Administrator of the Colorado Consumer Credit Unit, Colorado Payday Lending – Demographic and Statistical Information, July 2000 through December 2012 at 16-17 (April 10, 2014) ("2012 Statistical Information"), available at https://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/Colorado%20Payday%20Lending%202012.pdf.

[3] *See* State of Colorado, Office of the Attorney General, 2013 Deferred Deposit/Payday Lenders Annual Report at 1, available at https://www.coloradoattorneygeneral.gov/sites/default/files/uploads/2013%20DDL%20Composite%20FINAL_4.pdf. Rates are calculated by dividing the defaults by the number of borrowers.

[4] http://www.dfi.wa.gov/sites/default/files/reports/2013-payday-lending-report.pdf at page 9.

[5] *See* 2012 Statistical Information at 25.

[6] 2012 Statistical Information at 19.

[8] Colo. Rev. Stat. § 5-2-201(2).

[9] *See* Letter from Nick Bourke, Pew Charitable Trusts, to Washington State Legislature at 2 (Feb. 5, 2015).

[10] Pew Charitable Trusts, Payday Lending in America: Policy Solutions at 1 (October 2013), available at http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/PewPaydayOverviewandRecommendationspdf.pdf.