TACD Trans Atlantic Consumer Dialogue

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Resolution on protecting borrowers from predatory small loans

Introduction

Extremely high-cost short term small-dollar lending is rampant in the United States and some countries in the European Union. Typically called payday loans, their predatory terms and conditions cause harm especially to low and moderate income consumers who become trapped in cycles of debt. Payday loans, for relatively small amounts, are typically due in full on the borrower's next payday, conditioned on direct repayment from the borrower's next bank deposit of income or benefits, and carry a huge price tag in triple-digit annual interest rates. Payday loans are made at stores and via the Internet in many states in the US, in the UK and across Europe.

Problems caused by payday lending include cycles of repeat borrowing because most consumers cannot afford to repay the loan and fees out of one paycheck, loss of the borrower's bank account, financial hardship, inability to pay other bills and coercive debt collection tactics.[1] Research by Which? in the UK found that a third of borrowers said they experienced further financial difficulties as a result of taking out a payday loan and a quarter were hit with unexpected charges. Consumers who apply for loans online via marketing websites are subject to privacy and security risks and misuse of personal financial information for unauthorized withdrawals from bank accounts and fraudulent debt collection abuse.

Recommendations

TACD resolves that EU and US governments should:

1. Support legislation to limit the hidden and excessive cost of using and defaulting on small dollar loans. In countries with usury limits or interest rate caps, those protections should apply to all forms of small-dollar lending in order to protect consumers and prevent unfair advantage for some lenders. Close loopholes used to evade usury laws or rate caps in the borrower's jurisdiction.
2. Support needed legislation and enforcement of existing laws to safeguard consumers' funds in deposit accounts and prohibit the extension of credit conditioned on electronic

[1] CFA Fact Sheet, "Research Findings Illustrate the High Risk of High-Cost Short-Term Loans for Consumers," http://www.paydayloaninfo.org/elements/www.paydayloaninfo.org/File/CFA_Fringe_Loan_Product_Harm_Research.pdf

repayment. Prohibit use of remotely created checks (demand drafts) for payment of credit. Continuous payment authorities (or equivalent) with a right to cancel should be clearly explained to borrowers upfront. Existing rules and regulations to safeguard payment methods should be strengthened and enforced.

3. Require that the terms of small dollar lending are responsible, with loans based on ability to repay without renewals or extensions. Regulations need to be clearer about affordability assessments—adequate affordability should be defined as the ability of a borrower to repay the loan and fees when due without requiring a roll-over or further loans.
4. Investigate coercive and fraudulent debt collection tactics based on information from loan applications or borrower files. Regulators should take firm action against lenders acting coercively or fraudulently including the prompt suspension of licenses and fines for those found to act unfairly or coercively.
5. Vigorously enforce laws that require truthful disclosure of loan costs, the identity of lenders, and payment terms and conditions. Lenders should be required to disclose to consumers how they can lodge a complaint about the lender, their right to rescind the agreement where such a right exists, and a requirement to signpost borrowers to fee and independent debt advice.
6. Encourage the development and expansion of sound alternatives to high-cost short-term borrowing, including emergency savings accounts and safe small-dollar loan programs.
7. Enact rules to protect borrowers in the online market by prohibiting anonymous domain registrations for sites that collect loan applications, prohibiting lead generators from collecting loan applications, and requiring full physical contact information for lenders on credit websites.
8. Develop international information sharing agreements to facilitate the communication of supervision reports and enforcement actions, when appropriate or related to companies that operate in both the U.S. and E.U. member countries.
9. Prohibit terms in small dollar lending agreements that require the use of arbitration or any other non-judicial procedure as the method for resolving any controversy or settling any claims that arise out of the transaction.

Background:

Payday loans in the United States are authorized by thirty-three states under laws that permit single payment loans secured by access to the borrower's bank account at a typical cost of about 400 percent annual percentage rate. Online loans range in size from $100 to $1,500 at a cost of $20 to $30 per $100 or 520 to 780 percent APR for the typical two-week loan duration. There were approximately 19,000 store front lenders in the U.S. at the close of 2011 that had extended $29.8 billion in credit at a cost of $4.8 billion to borrowers, according to industry analyst Stephens Inc. In addition, lenders that operate via the internet extended $14.3 billion in credit at a cost of about $3.3 billion for a total payday loan market about $44 billion in size.[2]

In the United Kingdom, several companies offer loans ranging in size from £100 to £1,000 with loan terms typically of one month. *Which?* reported that consumers took out £1.9 billion in payday loans in 2010.[3] A £100 one-month payday loan in the UK typically costs between £25 and £30, equivalent to an APR of around 1,700% to 2,300% (360% APR U.S.).

Some payday lenders operate on both sides of the Atlantic. For example, Cash America's Enova Financial operates internet payday lending in the U.S. as CashNet USA and in the UK as QuickQuid and Pounds to Pocket. Dollar Financial Group operates in both countries. Think Finance, based in Texas, has recently bought a small lender in the UK.

Some states in the U.S. and countries in the EU maintain usury limits or small loan rate caps that make payday lending unavailable in those jurisdictions, such as Germany. However, high-cost small-dollar lending is growing quickly in many European countries. For example, Ferratum Group makes small loans of €50 to €1,000 via websites and mobile devices in countries across Europe[4]. In the UK, Dollar Financial Group is reported to be the largest payday lender owning brands such as The Moneyshop, Payday Express and Cash A Cheque[5]. The Moneyshop is the largest brand with profits in 2010 recorded at £33m and Payday Express tripled their profit to £4.9m in the same year[6]. Wonga offers loans of up to £1,000 and provided 2.4 million individual loans gaining revenue of £184.2 million for the year ending 31 December 2011, with revenue growing 224% over 2010.[7]

Government agencies at the state/federal level and the national/EU level are increasingly focused on problems caused by payday lending and the impact on borrowers and the economy. The Dodd-Frank Act created the U.S. Consumer Financial Protection Bureau and gave the new consumer protection agency authority to examine and supervise payday lenders of any size. The U.S. Federal Trade Commission has brought almost twenty actions against payday lenders or related support companies or collectors. In the U.K., the Office of Fair Trading has referred the payday loan market to the Competition Commission following an investigation, while Members of Parliament call for stronger protections.

Lenders have come under criticism for irresponsible and aggressive marketing of easy credit to vulnerable consumer segments. For example, U.K. lender Wonga was forced to delete a promotion of 4,000 percent payday loans instead of government-backed Student Loans that cost about 5 percent.[8]

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[2] Stephens Inc., "Consumer: Consumer Finance Industry Note, March 12, 2012.
[3] Which?, "The Loan Danger," October 2011, www.which.co.uk
[4] Ferratum loans are available in Finland, Sweden, Netherlands, Spain, Denmark, Czech, Slovakia, Poland, Estonia, Latvia, Lithuania, Bulgaria, Belgium, Croatia, and the United Kingdom. See www.ferratumgroup.com
[5] Sarah O'Connor (Dec 2011). 'Payday sector in search of new frontier', *The Financial Times.* See: http://www.ft.com/cms/s/0/e52da39e-2011-11e1-8462-00144feabdc0.html#axzz1wFI4Imdf
[6] Nick Sommerlad (Dec 2011). 'Moneyshop owner "forgiven" £1.5m interest on loan from his own payday loan firm', *The Mirror.* See: http://blogs.mirror.co.uk/investigations/2011/12/money-shop-owner-forgiven-15m.html
[7] http://www.credittoday.co.uk/article/14362/online-news/wonga-revenues-up-225-in-2011
[8] Simon Read, "OFT launches inquiry into payday loans," The Independent, February 25, 2012.

Research by Which? found that almost half of all payday loan users had received messages encouraging them to roll over loans and 57% were encouraged to take out further loans. Half of all borrowers in the Which? survey had received unsolicited marketing messages after signing an agreement with a lender.

One of the proposed solutions in dealing with harmful practices in the payday lending market is the implementation of a cap on the cost of credit. Views on usury limits or rate caps vary on both sides of the Atlantic. Some U.S. states maintain double-digit rate caps on consumer lending, and Congress set a 36 percent annual cap for loans to active-duty servicemembers and their families. In the UK, the Financial Conduct Authority (FCA), which will take over the regulation of consumer credit from April 2014, has been given powers to impose a cap on the cost of credit, The European Commission issued a consultation on interest rate caps in 2010 and found that the success of rate caps varied across countries and tended to be more successful in countries with comprehensive caps that included all mandatory charges. The Commission however also found that a cap invariably led to a contraction of supply of credit to borrowers on the lowest incomes.

Despite national and state differences on usury limits and rate caps for small dollar lending, no lender should be able to use deception and ruses to evade the protections that should apply. In particular, the implementation of a cap must include all mandatory charges, and regulators must be given the authority to restrict lenders from adding excessive behavioural fees (such as fees for reminder letters, missed payment fees or default charges). In the United States, some lenders claim to be located off-shore, to have tribal sovereign immunity from state enforcement, or hide behind the jurisdiction of their home states in an effort to avoid rate caps and state protections. Off-shore lenders are subject to U.S. federal laws when lending to consumers and state officials are challenging these jurisdiction and tribal claims.

Payday lenders in the US and EU countries often fail to accurately disclose the cost and terms of loans. *Which?* reported in 2011 that the online lenders Swiftmoney.co.uk and 4cashnow.co.uk did not display the APR on loans, which breaches the Consumer Credit Regulations (2010). Further breaches identified in recent research include the widespread failure of lenders to provide details on all charges that could apply in the course of the agreement and to inform consumers about their right to rescind a payday loan agreement within 14 days..

Recently the Federal Trade Commission in the U.S. filed a case against a major online lender, citing alleged violations of Truth in Lending Act for failing to disclose the total cost of repaying the loan under the default payment arrangement.[9] For a summary of FTC enforcement actions involving online payday lenders, please visit CFA's website.[10]

Consumers who apply online for payday loans may be providing their personal financial details to lead generators that sell completed applications to the highest bidder or to lenders with lax privacy policies, leading to repeat solicitations to borrow money and unauthorized withdrawals from borrowers' accounts. A survey of online lenders by CFA in the US found that *all but one* surveyed lender with a posted privacy policy shared information with third parties. Almost half of the surveyed lenders in the

[9] FTC v. AMG Services, Inc., et al, Case No. 2:12-cv-536

[10] CFA Summary of FTC Enforcement Cases, http://www.paydayloaninfo.org/internet-payday-lending#2

US recorded IP addresses and used cookies or web beacons or both to track visitors to the site.[11] In the UK, a survey of online payday lenders revealed the irresponsible use of 'discounts' on loans for successfully referring friends to lenders. The survey also found that many lenders automatically refer unsuccessful applicants to other lenders thus passing on personal information without the explicit consent of the borrower whilst bagging commissions from other lenders for successful referrals.

In addition to misuse of personal financial information for marketing purposes, consumers who apply for payday loans also are at risk from fraudulent debt collection tactics. Callers demand immediate payment for loans consumers never entered into and do not owe to the caller. Consumers believe demands because the callers have hold of personal financial information provided by consumers in online loan applications. The Federal Trade Commission has sued two such collection operations that used call centers in India to harass American consumers. The Office of Fair Trading in the UK fined one online lender for failing to check the identity of loan applicants, allowing fraudsters to use stolen information to obtain loans, and then pursuing debt collection with the ID theft victims.[12]

Contrary to claims by lenders that payday loans are intended to cope with emergencies, research in the US by Pew Charitable Trusts found that 69 percent of surveyed borrowers use payday loans to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food while only 16 percent used the loan for a car repair or emergency medical expense.[13] Research by Which? noted that 60 percent of people who took out payday loans used the money to pay for household bills or buying essentials such as food and fuel.[14] A quarter of payday loan users in the UK used their loans to repay other debts. Borrowing for routine expenses at triple-digit rates is a major contributor to the payday loan debt trap.

Research in the United States found that 76 percent of loans are due to debt churning, not actual demand for credit.[15] Recent research by Which? showed that 45% of borrowers roll over loans at least once. The typical U.S. borrower has 9 loans per year, and those who continue to use payday loans for a second year average 12 loans in their second year of borrowing.[16] The CCCS in the UK helped an average of 305 people per month in 2010 compared to 1,900 payday borrowers per month by late 2011. CCCS helped 2,000 people who had five or more payday loans in 2012, up from 716 in 2009, including 200 borrowers with at least ten loans each.[17]

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[11] Jean Ann Fox, Consumer Federation of America, "CFA Survey of Online Payday Loan Websites," August 2011, available at http://www.consumerfed.org/pdfs/CFAsurveyInternetPaydayLoanWebsites.pdf

[12] Lisa Bachelor, "OFT revokes payday lender license, but firm continues to lend," *Guardian*, August 9, 2012.

[13] The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow and Why," July 19, 2012, www.pewtrusts.org/small-loans Click on Research.

[14] "New Which? Research Exposes Payday Loan Failings," May 18, 2012.

[15] Center for Responsible Lending, "Phantom Demand," July 9, 2009. http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-date-generates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html

[16] Uriah King and Leslie Parrish, "Payday Loans, Inc.: Short on Credit, Long on Debt," Center for Responsible Lending, March 31, 2011, www.responsiblelending.org

[17] Dana Gloger, " 'It's like a heroin addiction': Payday loan borrower's warning as MP expresses fear over soaring 'toxic' debt cases," *Daily Mail*, October 20, 2012.

The unique and risky aspect of payday lending is the direct access lenders have to borrowers' bank accounts through electronic transfer or wage assignments, which may be difficult to revoke. Protections for bank account-based credit differ on both sides of the Atlantic. In the United States, payday lenders structure loans with a single payment which does not trigger the Electronic Fund Transfer Act ban on securing loans with a requirement to make payments electronically. Some lenders will create demand drafts (unsigned checks) to continue withdrawing funds when consumers attempt to cancel electronic access to their accounts. The Federal Trade Commission has brought several enforcement actions against online lenders and marketers, citing use of the borrower's bank account number to withdraw payment for unauthorized transactions.

In the UK, lenders are permitted to use continuous payment authority (CPA) repeatedly as a way of collecting a single sum. Some lenders misuse this payment method, for instance by retrieving different sums of money on dates other than the agreed dates or repeatedly resubmitting requests to take money from the consumer's account. Complaints about CPA abuses are increasing.[18]

Regardless of the current regulatory regime, consumers on both sides of the Atlantic should be protected against required electronic payment of loans, whether single or periodic in nature.

Loans secured by direct payment from deposit accounts also foster coercive debt collection activity. Wonga has been charged by the Office of Fair Trading for threatening arrest for non-payment of loans and accusing borrowers of fraud[19]. Payday lenders in the US have threatened arrest for failure to cover a check provided as security for the loan. Check-holding as a condition of extending credit gives lenders unfair collection leverage, since consumers basically are forced to refinance loans to avoid insufficient funds fees.

Conclusion: Consumers need stronger protections against exorbitantly expensive small dollar loans that put bank accounts at risk and trap borrowers in repeat debt. TACD urges the U.S. and EU consumer protection agencies to vigorously enforce existing rate caps, coordinate closely with existing enforcement and tax authorities and protections and to evaluate the unique risks posed by payday lending to enact further protections.

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[18] Financial Ombudsman Service, Ombudsman News Issue 109, April/May 2013, http://www.financial-ombudsman.org.uk/publications/ombudsman-news/109/109-payday-lending.html

[19] OFT (May 2012). 'OFT requires Wonga to ensure improved debt collection practices'. See: http://www.oft.gov.uk/news-and-updates/press/2012/40-12