STATE OF CALIFORNIA
OFFICE OF THE ATTORNEY GENERAL
KAMALA D. HARRIS
ATTORNEY GENERAL

December 21, 2015

The Honorable Richard Cordray, Director
Consumer Financial Protection Bureau
1700 G Street, N.W.
Washington, D.C. 20552

RE: Payday Lending

Dear Director Cordray:

I write to encourage and support the efforts of the Consumer Financial Protection Bureau (Bureau) to strengthen protections against harmful payday and small-dollar lending practices. Together with California's existing lending laws, the Bureau's proposals would bring needed protections to vulnerable California consumers who take out small-dollar loans, which too often are predatory and create a debt trap for fixed- and low-income borrowers. The Bureau's proposals will also encourage the development of new, constructive alternatives to traditional, high-cost payday loans. I strongly support the Bureau's proposals to require a meaningful "ability to pay" standard and curb payment collection abuses, and I also encourage the Bureau to consider additional measures that would protect vulnerable borrowers and their financial privacy in the small-dollar loan market. I urge the Bureau to move forward with creating the first nationwide regulatory floor for the payday lending industry, while maintaining the prerogative of states to further strengthen their consumer protection laws and regulations as they see fit.

Payday and Small-Dollar Lending in California

Payday loans are prevalent in California, and the debt traps are similar to those seen throughout the country. Californians who need short-term emergency access to cash are getting stuck in a destructive and unaffordable cycle of repeat high-interest loans that they cannot afford to repay. In 2014, 1.8 million California consumers took out 12.4

million payday loans, borrowing $3.38 billion.[1] The average payday loan was for $235, the average number of loans per individual customer during the year was 6.82, and the average annual percentage rate (APR) was 361 percent.[2] There are over 2,000 licensed payday loan locations in California[3] (substantially more than the number of McDonald's restaurants). Many locations are in counties with high poverty rates and low education levels.[4] Put simply, short-term loans with triple-digit interest rates are trapping vulnerable Californians in a crippling cycle of long-term, unaffordable debt.

California law provides some protections for borrowers who take out loans up to $2,500. In California, payday lenders can lend up to $300, including a maximum 15 percent fee, for a maximum 31-day term. (Cal. Fin. Code §§ 23035-23036.) Lenders typically make loans for a two-week term, and consumers pay a fee that can amount to an APR as high as 459 percent. Some structural protections exist. Lenders are prohibited from providing a payday loan to a consumer if the consumer has an earlier payday loan in effect (Cal. Fin. Code § 23036(c)), and lenders may not permit a consumer to pay off all or a portion of one payday loan with the proceeds of another (Cal. Fin. Code § 23037(a)). There is a maximum $15 fee for a dishonored check. (Cal. Fin. Code § 23036(e).) Additional restrictions and disclosures are required. (See Cal. Fin. Code § 23035 et seq.)[5] Under California's Finance Lenders Law, a graduated scale of interest rate caps applies to non-payday loans up to $2,500, with a maximum APR of approximately 30 percent. (Cal. Fin. Code § 22303 et seq.)

California's Department of Business Oversight has also developed an innovative pilot program to increase consumer access to responsible installment loans of $300 to $2,499 as an alternative to predatory small-dollar loans. The Pilot Program for Increased Access to Responsible Small Dollar Loans, which took effect on January 1, 2014, encourages innovation by allowing participating lenders to charge marginally higher interest rates than otherwise allowed under California law and requiring them to underwrite loans to determine ability and willingness to repay, report loans to credit bureaus, provide some financial education to consumers, and adhere to other provisions designed to protect consumers.

Comments on Proposals

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[1] California Department of Business Oversight (2014), "Annual Report: Operation of Deferred Deposit Originators Licensed under the California Deferred Deposit Transaction Law."
[2] *Id.*
[3] *Id.*
[4] Barth, James R., et al. (2013), "Where Banks Are Few, Payday Lenders Thrive: What Can Be Done About Costly Loans," Milken Institute.
[5] Payday loans are referred to as "deferred deposit transactions" under California's Deferred Deposit Transaction Law, and are secured by the consumer's personal check. (See Cal. Fin. Code § 23035 et seq.)

I support the Bureau's proposals to create a regulatory floor to curb small-dollar lending abuses. These proposals would complement California's existing small-dollar lending laws and provide additional protections for California borrowers against predatory lending practices. To best protect consumers, I recommend that, at a minimum, the Bureau's proposed rules:

- **Require a meaningful "ability to repay" standard.**

  Borrowers often cannot afford to both repay their loan and meet ongoing financial obligations, leading them to fall into a debt trap. I strongly support the Bureau's proposed "ability to repay" standard, which would require lenders to make a good-faith, reasonable determination that the consumer has the ability to repay the loan, after satisfying major financial obligations and living expenses, without reborrowing or defaulting. I also support the Bureau's proposed 60-day "cooling off" period between loans, which includes a presumption of inability to pay subsequent loans made within 60 days and requires a mandatory cooling off period after the consumer takes out three loans in a row.

  The Bureau is considering permitting lenders the option of making certain loans under an alternative standard without conducting an "ability to repay" determination. I believe requiring an ability to pay analysis for all payday and small dollar loans would better protect consumers by setting a clear regulatory expectation that lenders provide safer loans that consumers can afford.

- **Implement an "off-ramp" to taper off indebtedness.**

  Under the proposed alternative standard for short-term loans, rollovers would be capped at two—three loans total—followed by a mandatory 60-day cooling off period, and other screening requirements and structural protections would be required. As part of the alternative standard, the Bureau is considering requiring lenders to provide affordable repayment options. The Bureau is considering either 1) requiring lenders to offer a no-cost extension—an "off-ramp"—if the consumer is unable to repay after the third loan, to allow the consumer to pay the loan off over time without further fees, or 2) requiring that the principal amount of each loan decrease over the three-loan sequence, to create an "amortization" of the loans.

  In the event the short-term alternative loan becomes part of the proposed rules, I would support increasing the screening requirements and structural protections, and potentially phasing alternative loans out over time as lenders become more efficient at ability to pay underwriting. I also would support an "off-ramp" requirement, rather than amortization, for creating a pathway out of debt. Requiring lenders to provide an extended payment plan so consumers can repay the loan over additional installments without incurring additional cost could have a substantial impact on avoiding a long-term debt trap. I also support the Bureau's proposals to require lenders to notify consumers of their right to take the off-ramp, to prohibit lenders from pursuing collections before offering the off-ramp, and to prohibit lenders from making false or misleading statements about or discouraging use of the off-ramp. The "amortization" proposal, on the other hand, may have the unintended consequence of incentivizing consumers to initially borrow more than they need or would otherwise borrow. Because the amortization alternative ties the availability of subsequent loans to the amount of the initial loan, borrowers may initially borrow a higher amount—and pay interest and other fees accordingly—so that they can maximize the amounts of subsequent loans they may want to take out. The amortization alternative also would effectively limit funds available to consumers on second and third loans, but not the fees and costs lenders may charge for those loans.

I also encourage the Bureau to consider requiring lenders to provide a no-cost extension or "off-ramp" after an initial rollover, not just after a second rollover in a series of alternative loans. There should be a presumption that the consumer lacks the ability to repay a subsequent alternative loan, just as there is for loans under the ability-to-repay standard. Because the alternative standard does not include underwriting requirements that would allow a lender to determine a change in circumstances to rebut that presumption, a no-cost extension should be available.

I further encourage the Bureau to consider including the additional structural protection of a no-cost extension or "off-ramp" for loans made under the "ability to repay" standard. This could provide added protection against prolonged indebtedness, provide an affordable way out of debt, help ensure that at the end of a loan or loan sequence the consumer does not face an unaffordable financial obligation, and help further ensure that ability-to-repay determinations at the outset are meaningful.

- **Curbing harmful payment collection practices.**

  Reforms to lender collection practices are critical. I strongly support the Bureau's proposals requiring notification before attempting to collect payment from consumers' accounts, and limiting lenders to two attempts to collect payment unless they obtain new authorization in order to limit unsuccessful withdrawal attempts that lead to excessive account fees.

- **Protect consumer privacy.**

  I encourage the Bureau to consider consumer privacy, particularly in connection with the proposed commercially available reporting systems that contain information about consumer borrowing history on covered loans across lenders. I encourage the Bureau to require strict limitations on the information entered into the databases, as well as on access to and use of that information. Lenders should include in the databases only essential information such as identification information and the time period of the loan, and use should be restricted to confirming eligibility for new loans. Borrowers should receive notice that their data will be collected and stored in the database. In addition, I encourage the Bureau to recommend that the databases contain, at minimum, a two-factor authentication for users and heightened security standards to protect information.

I encourage the Bureau to take these and other steps to protect consumer privacy. Amassing sensitive, confidential consumer information could lead to abusive lender practices and other misconduct. For example, unscrupulous lenders and data brokers could—and have been known to—illegally sell consumer information or use that information to bombard consumers with solicitations. Limitations on information collected and use of the databases are important to protect consumer privacy.

- **Permit states to adopt more restrictive laws and regulations.**

I encourage the Bureau to take steps to clarify that the Bureau does not intend to preempt or undermine state and local laws that govern payday and small-dollar loans. To the contrary, the Bureau's detailed investigation and reporting on payday lending abuses and the need for the new rule could and should encourage discussion and debate about the appropriateness and need for additional state restrictions on predatory lending and more robust consumer protection in this area. The proposed rules do not address all harmful practices, and triple-digit interest rates will continue to be problematic. The full range of legislative and regulatory options, including outright bans, rate caps and other consumer protection regulations of small-dollar loans, should remain available to the states and local jurisdictions to further protect consumers.

Thank you for your continuing efforts to protect consumers. I strongly support the Bureau's efforts to implement meaningful reforms in the payday and small-dollar loan market.

Sincerely,

KAMALA D. HARRIS
Attorney General