Testimony of Jeffrey D. Dillman
On House Bill 209
Before the Financial Institutions, Real Estate, and Securities Committee
September 23, 2009

Chairman Joseph Koziura, Ranking Member Josh Mandel, and members of the Committee: My name is Jeffrey Dillman, and I am the Executive Director of the Housing Research & Advocacy Center, a fair housing and fair lending organization based in Cleveland, Ohio. I am here to testify regarding HB 209, the Issue 5 Enforcement Act.

The Housing Research & Advocacy Center, or "Housing Center" has conducted research on the payday loan industry in Ohio for the past four years, releasing three separate reports on this topic.[1] Our earlier research found that the payday lending industry grew from just over 100 stores when the practice was legalized in Ohio in the mid-1990s to 1,638 stores in 2007, with stores in 86 of Ohio's 88 counties. The reports also documented the extremely high interest rates lenders charged under Ohio's prior Check Cashing Lender Law: for a two-week loan of $500, lenders were allowed to charge an annual percentage rate (APR) of 391%. The reports also documented that many borrowers became trapped in a cycle of debt, often obtaining repeated loans over the course of the year.

In response to the widespread concern of the residents of Ohio, in 2008 the General Assembly worked in a bipartisan fashion to pass House Bill 545, in an attempt to regulate the payday lending industry. House Bill 545 aimed to protect consumers from the harmful fees and terms of payday loans by repealing the previous Check-Cashing Lender Act and replacing it with a new Short-Term Loan Act. Under this new law, the fees and interest charges on short-term loans were to be capped at a 28% APR. In addition, loans under this new law could not be for a term of less than 31 days, allowing borrowers a greater chance to improve their financial situation and repay the loan without needing to obtain another one.[2] The payday lending industry responded by putting an initiative on the ballot – Issue 5 – that would have repealed the majority of H.B. 545. This industry attempt to repeal H.B. 545 was overwhelmingly rejected by Ohio voters.

Although the Ohio legislature, Governor Strickland, and Ohio voters all affirmed their intent to cap short-term lending at an annual percentage rate of 28%, our research shows

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[1] Housing Research & Advocacy Center, "New Face of Payday Lending in Ohio" (2009); Housing Research & Advocacy Center and Policy Matters Ohio, "The Continued Growth of Payday Lending in Ohio" (2008), and Housing Research & Advocacy Center and Policy Matters Ohio, "Trapped in Debt: The Growth of Payday Lending in Ohio" (2007).

[2] House Bill 545 was passed by the legislature on May 20, 2008, and signed by Governor Ted Strickland on June 2, 2008. Because of an attempt by the payday lending industry to repeal the law through an initiative placed on the ballot, the law did not become fully effective until after the November 2008 election. H.B. 545 also limits borrowers to a maximum of four short-term loans per year, requires the Superintendent of Financial Institutions to establish a statewide database to track all loans made by lenders holding Short-Term Loan licenses once that number reaches 400, and set up the Financial Literacy Education Fund to increase adult financial literacy programs and educate Ohioans on their rights and responsibilities as consumers. O.R.C. 1321.21 and 1321.46.

that the vast majority of payday lenders have continued to operate in Ohio, often making loans at rates *higher* than under the old law.[3] Payday lenders have accomplished this by obtaining licenses to lend under the Small Loan Act and/or the Mortgage Loan Act and virtually ignoring the new Short-Term Loan Act enacted by the Ohio legislature in 2008: as of February 18, 2009, there were only 19 active licenses statewide under this law.[4]

Between May of 2008, when the legislature passed H.B. 545 capping the APR of short-term lending, and February of 2009, lenders in Ohio obtained 632 new licenses under the Small Loan Act (SLA) and 653 new licenses under the Mortgage Loan Act (MLA). Some stores have more than one license, so as of February 2009, there were 1,020 new storefronts making high-cost short-term loans under these two laws in Ohio.[5]

Under the SLA, interest and fees on a $100.00 loan are even higher than under Ohio's former payday lending statute, with an APR of 423% on a 14-day loan.[6] Under the MLA, interest and fees on a $100.00 loan can be $26.10, with an APR of 680% on a 14-day loan, 24 times the rate contemplated by the legislature and the people of Ohio and nearly one and three-quarters the previous rate of 391%.[7]

Payday lenders have proven to be particularly adept at exploiting technicalities in these laws in their attempts to obtain the maximum amount of profit from Ohio consumers. For example, some payday lenders making loans under the Small Loan Act originate loans at $505.00 or $501.00, rather than $500.00.[8] The lenders do this because the law allows an origination fee of $30.00 for loans of more than $500.00, but only $15.00 if the

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[3] Housing Center, "The New Face of Payday Lending," (2009). *See also* Sheryl Harris, "Time for a true fix to payday problem." *Cleveland Plain* Dealer, February 22, 2009; Marc Kovac, "Payday Lenders finding loopholes," *Ashland Times-Gazette*, February 23, 2009; Jim Siegel, "Fixing payday-loan law is legislators' job, state says," *The Columbus Dispatch*, February 20, 2009.

[4] This small number is not enough to trigger the provision of the law for a statewide database to track the loans made under the statute.

[5] This does not include stores that *previously* held licenses to lend under the Small Loan Act or the Mortgage Loan Act but only new licenses issued to operators of former payday lending stores or others in Ohio since May 2008. Of the 632 new SLA licenses, six were issued to companies located outside of Ohio. Of the 653 new MLA licenses, 45 were issued to companies located outside of Ohio. The 1,020 storefronts include only new storefronts in Ohio offering loans under the SLA and/or the MLA and not license-holders under the Pawnbroker Act, the new Short-Term Loan Act, or the out-of-state license-holders.

[6] Under the Small Loan Act, an individual obtaining a $100.00 loan for 14 days – a typical term for a payday loan – would be required to pay up to $15.00 in an origination fee and $1.24 in interest, for a total payment of $116.24. This amount works out to an annual percentage rate of 423%, which is higher than the 391% allowed under Ohio's former payday loan law. Loans with terms shorter than 14 days would have higher APRs, while loans of longer than 14 days would have lower APRs. *See* O.R.C. 1321.01, *et seq.*

[7] Under the Mortgage Loan Act, an individual making a $100.00 loan for 14 days – a typical term for a payday loan – would be required to pay up to $15.00 in an origination fee, $10.00 in a credit investigation fee, and $1.10 in interest, for a total payment of $126.10. This amount works out to an annual percentage rate of 680%, which is substantially higher than the 391% allowed under Ohio's former payday loan law. Loans with terms shorter than 14 days would have higher APRs, while loans of longer than 14 days would have lower APRs. See O.R.C. 1321.20, 1321.21, 1321.51-1321.60, and 1321.99.

[8] *See* Check 'n Go, "Ohio SLA: Store Training," November 6, 2008, p. 1, noting that the company makes loans in amounts from "$100 to $200 in $5 increments or $505." By increasing the loan amount by $5.00, the origination fee increases by $15.00 and the APR jumps from 107% to 185%.

loan is $500.00 or less. By refusing to offer a loan of $500.00 and increasing the loan amount by $5.00, these lenders are making an additional profit of $15.22 per loan and increasing the APR paid by the borrower from 107% to 185%.[9]

There are legitimate uses for such licenses in Ohio; however, the majority of stores that obtained these licenses in the past year have utilized them to continue making payday loans at excessive interest rates, in contrast to what the laws originally intended. Interestingly, payday lenders began obtaining these licenses in large numbers in May 2008, even before Governor Strickland signed H.B. 545 and well before the industry's unsuccessful campaign to allow lenders to continue operating under the prior law: From May 1, 2008, through November 4, 2008 (election day), lenders obtained 569 licenses under the Small Loan Act and an additional 387 license under the Mortgage Loan Act.

Although the total number of storefronts offering payday loans has decreased from 2007 to February 2009, such stores remain in 81 of Ohio's 88 counties. The counties with the most storefronts are Cuyahoga (121), Franklin (116), and Hamilton (87). Per 10,000 residents, the counties with the most storefronts are Fayette, Washington, and Hancock. This distribution of stores is consistent with the findings of our previous research: while the most populous counties have the most stores overall, on a per capita basis, more stores are located in less populated, rural counties in the state.

In addition, some lenders appear to be further increasing fees by issuing a check to individuals, rather than offering them their loans in cash.[10] In doing so, these businesses are then offering to cash the check for these individuals for another fee. Charging this extra fee – which was not done under prior law – represents another example of payday lenders exploiting provisions of the Ohio law to obtain the highest possible profits at the expense of Ohio consumers.

In 2007, the top 10 payday lenders in Ohio operated a total of 906 stores. In the past year, none of these stores obtained a license to lend under the Short-Term Loan Act. Instead, these companies obtained a total of 978 licenses to loan under the Small Loan Act and the Mortgage Loan Act and an additional 114 licenses under the Pawnbroker Act.

The recommendations that we noted in our February 2009 report, and which we believe continue to remain important, are:

(1) **Increase the minimum term of loans under the Small Loan Act and Mortgage Loan Act to 90 days** so as to allow legitimate loans to be made under those statutes, while requiring payday lenders to use the Short-Term Loan Act for loans of between 31 and 90 days. In passing H.B. 545, the legislature made clear that short-term

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[9] These calculations assume that the origination fee of $15.00 is financed in the loan, as is permitted under the Small Loan Act. On a loan of $500 (with an additional $15.00 origination fee) the annual interest payment at 28% APR is $144.20, or $0.40/day. For 14 days, this corresponds to $5.53 in interest, making the total cost of the loan $520.53. The total cost of a loan of $505 is $540.75.

[10] Sheryl Harris, "Time for a true fix to payday problem." *Cleveland Plain* Dealer, February 22, 2009.

loans must have a term of at least 31 days and have an APR (including fees) of no more than 28%. Increasing the minimum term of loans made under the SLA and MLA would allow legitimate lenders to continue using those laws to make short and medium-term loans while making all loans of between 31 and 90 day subject to Ohio's Short-Term Loan Act. This 90-day minimum term is consistent with guidance from the Federal Deposit Insurance Corporation (FDIC) on small loans which "encourage[s] institutions to utilize a reasonable time frame for the repayment of closed-end credit, e.g., at least 90 days."[11] Furthermore, increasing the loan term under these laws will also have the effect of decreasing the APR of loans made under them. For example, a $100 loan made under the SLA for 90 days would have an APR of 66%, compared to the 423% for a 14-day loan under the same law.

(2) **Prohibit payday lenders from issuing a loan in the form of a check and then charging a borrower an additional fee to cash that check**. News reports indicate that payday lenders in Ohio have exploited every opportunity to "nickel and dime" their customers, issuing them loan checks and then charging them to cash those checks. Charging 3% of the value of a $100.00 check to cash it can make the cost of a $100 loan reach 502% (under the Small Loan Act) to 759% (under the Mortgage Loan Act).

(3) **Extend the protection of the Consumer Sales Practices Act to loans made under the SLA and MLA to provide greater protection to Ohio's consumers**. Ohio's Consumer Sales Practices Act is intended to ensure that consumers in the state are not unfairly taken advantage of by unscrupulous businesses. In enacting H.B. 545, the legislature explicitly made the CSPA applicable to lenders making loans under the Short-Term Loan Act, believing that this would ensure that all lenders making such short-term loans were covered by the law. Payday lenders in Ohio have evaded these restrictions, which provide important protection to Ohio consumers, by not obtaining licenses under this statute. Amending the CSPA to extend its application to SLA and MLA license-holders can help protect Ohio consumers from unfair and deceptive practices and will enable the Ohio Attorney General to have the means to enforce the full spectrum of Ohio's consumer laws against businesses that attempt to deceive consumers. Such a change is consistent with the recommendations of a recent report by the National Consumer Law Center which noted that by "excluding most lenders," Ohio's law has "significant gaps in coverage."[12]

For these reasons, we believe that the legislation proposed by Representative Lundy in HB 209 deserve the support of the Ohio legislature. Thank you for the opportunity to testify before you. I would be happy to answer any questions you might have.

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[11] FDIC, "Affordable Small-Dollar Loan Guidelines," Press Release, June 19, 2007, available at www.fdic.gov/news/newspress/2007/pr07052a.html. Although the guidance is not binding on payday lenders, who are not FDIC-regulated, the principles behind it are equally applicable to all short-term lenders.

[12] Carolyn Carter, "Consumer Protection in the States: A 50-State Report on Unfair and Deceptive Acts and Practices Statutes," National Consumer Law Center, February 2009, p. 14.