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REPORT ON LEGISLATION BY THE CONSUMER AFFAIRS COMMITTEE AND CIVIL COURT COMMITTEE

A.1113-A	**M. of A. Heastie**
S.3999-A	**Sen. Farley**

AN ACT to amend the banking law, in relation to enacting the "short-term financial services loan act."

THIS LEGISLATION IS OPPOSED

The Civil Court and Consumer Affairs Committees submit these comments in opposition to A.1113-A/S.3999-A, the "Short-Term Financial Services Loan Act." This bill would allow check cashers to make small, short-term loans of between $300 and $2,000. The stated purpose of the bill is to "address[] the unfulfilled need of New Yorkers for an affordable, small-dollar, short-term installment credit product." The Committees, however, believe that the proposed loans would prove to be unaffordable for New York residents, particularly those who are low- or moderate-income. The bill creates a huge and unwarranted loophole in New York's longstanding 25% usury cap and, if passed, it will be detrimental to the residents of our state.

FEATURES OF THE BILL

Some key provisions of the proposed legislation are as follows:

1. The bill would specifically exempt the proposed loans from the existing New York usury laws that would otherwise impose a 25% interest rate cap on these loans.[1] At the same time, the bill would purport to cap interest at an annual percentage rate of 25%, but would in fact also allow additional interest in the form of fees, such as a $25 "application fee" and $15 "monthly maintenance fee[s]." The bill would also allow check cashers to charge a "processing fee" of up to $20 each time a borrower had insufficient funds to honor a scheduled payment toward a loan.

2. The bill would eliminate the prohibition in the Banking Law against check cashers making loans and affirmatively permit licensed check cashers to offer small, short-term loans requiring payments that are tied to a borrower's paydays.

[1] N.Y. Gen. Oblig. Law § 5-501, N.Y. Banking Law § 14-a, N.Y. Penal Law § 190.40.

3. The bill would limit a borrower to one re-financing of a short-term loan, but would not limit the number of serial loans that a borrower could take out.

DISCUSSION

The bill is a huge departure from longstanding consumer protection policy and would expose New York residents to the high costs associated with payday loans in other states. Despite the sponsors' claims to the contrary, the bill would allow loans similar in many respects to payday loans: high-cost loans with short repayment terms, made without assessing the borrower's ability to repay, and requiring payments tied to a borrower's paydays. Most notably, the bill would specifically exempt check cashers from New York's usury laws.

The longstanding usury law in New York places a maximum interest rate of 25% on loans to consumers, including the type of short-term loans proposed by this bill. Knowingly charging, taking, or receiving interest at a rate greater than 25% is a felony under New York law. This criminal usury cap has been effective in keeping the abuses of payday loans, which carry interest rates well above 25%, out of New York.

As a recent *New York Times* editorial noted, "New York is one of 15 states that have banned the predatory, high-interest loans that payday lenders commonly use to pillage low-income borrowers."[2] Indeed, New York's prohibitions on usury date back to the late 18th century, and have survived in a substantially similar form to the present day.[3] New York has similarly recognized that high-interest loans made to low-income borrowers are often predatory and take advantage of individuals in desperate circumstances.[4] In February 2013, Governor Andrew M. Cuomo announced that the Department of Financial Services had issued letters to all debt collectors in New York stating that it is illegal to attempt to collect on payday loans, as such loans are illegal in New York. Governor Cuomo noted that "[s]tudies clearly show that payday loans are not a solution for people with low incomes, but rather a high cost debt trap. That's why

[2] Editorial, Bleeding the Borrowing Dry, N.Y. Times (Mar. 3, 2013), *available at* http://www.nytimes.com/2013/03/04/opinion/bleeding-the-borrower-dry.html (last visited May 1, 2013). *See also* Nathalie Martin & Ernesto A. Longa*, 2012 Symposium: The Continuing Effects of the Mortgage Crisis on Consumers: Feature Article: High-Interest Loans and Class: Do Payday and Title Loans Really Serve the Middle Class?*, 24 Loy. Consumer L. Rev. 524, 525 n.3 (2012) (citing the National Consumer Law Center and noting that the states that ban or cap payday loans are Arkansas, Arizona, Connecticut, District of Columbia, Georgia, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, Virginia, and West Virginia).

[3] *See* An Act for preventing Usury (Feb. 8, 1787), *reprinted in* Laws of the State of New-York, Revised and Passed at the Thirty-Sixth Session of the Legislature, Volume 1, 64; *see also* The Revised Statutes of the State of New York, pt. 2, ch. 4, tit. 3, § 1 (1829); *compare with* N.Y. Gen. Oblig. Law § 5-501.

[4] *See, e.g.*, 72 N.Y. Jur. 2d *Interest & Usury* § 52 (2012) ("The ostensible object of [usury] legislation is to protect the weak, the needy, and the unwary from the rapacity of the avaricious. The purpose of usury laws, from time immemorial, has been to protect desperately poor people from the consequences of their own desperation. Law-making authorities in almost all civilizations have recognized that the crush of financial burdens causes people to agree to almost any conditions of the lender and to consent to even the most improvident loans."); *see also*, *Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 Colum. L. Rev. 167 (1966).

they are illegal in New York, and the State will continue to protect consumers from these misleading loans."[5]

Though the bill purports to cap the annual interest rate at 25%, it is evident that when the application and monthly maintenance fees are taken into account, the *true* annual interest rate for loans made pursuant to this bill could be as high as 204%. New York law provides that "[t]he rate of interest . . . shall include as interest any and all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender in consideration for the making of a loan or forbearance as defined by the superintendent . . . ."[6] The purpose of this provision is to "curb the use of points and other charges which increase the lender's return."[7] Case law indicates that fees such as loan origination fees, processing fees, commissions, incentive fees, and other fees may be considered interest for purposes of determining whether a loan's interest rate exceeds the civil or criminal usury cap and is therefore usurious.[8] That the additional compensation may be dubbed a particular kind of "fee" instead of "interest" does not prevent it from being taken into account as interest; "substance, not form, is decisive."[9]

Accordingly, we believe that the $15 monthly maintenance fees – which, over 90 days, the shortest loan term possible under the bill, would total $45 – and the $25 application fee constitute interest. Accompanied by these fees, a loan bearing an interest rate of 25% on its face would in reality carry an interest rate much higher than 25%. For example, the *true* annual

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[5] Press Release, N.Y. State Dep't of Fin. Servs., Governor Cuomo Announces Department of Financial Services Notifies Debt Collectors Not To Seek Collection on Illegal Payday Loans (Feb. 22, 2013), *available at* http://www.dfs.ny.gov/about/press2013/pr1302221.htm (last visited May 1, 2013).

[6] Banking Law § 14-a(2). In turn, the Banking Board provides that "[t]he term interest...when applied to any [ ] loan or forbearance [other than one secured primarily by an interest in real property improved by a 1 or 2-family owner occupied residence], shall mean all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender which would be includible as interest under New York law as it existed prior to the enactment of chapter 349 of the Laws of 1968." 3 NYCRR 4.2(b).

[7] *Freitas v. Geddes Savings & Loan Ass'n*, 471 N.E. 437, 441 (N.Y. 1984) (quoting Memorandum of New York State Banking Dept., Bill Jacket, L. 1968, ch. 349, p. 4) (internal quotes omitted). This echoes the concerns Congress aimed to address in enacting the federal Truth in Lending Act (TILA), which sought to guarantee the accurate and meaningful disclosure of the true costs of consumer credit, and thereby enable consumers to readily compare different credit terms and avoid abusive lending. Because creditors could "compound the camouflaging of credit by loading on all sorts of extraneous fees, such as exorbitant fees for credit life insurance, excessive fees for credit investigation, and all sorts of loan processing fees that rightfully should be included in the percentage rate statement so that any percentage rate quoted is completely meaningless and deceptive," 109 Cong. Rec. 2027, 2029 (1963) (remarks of Sen. Douglas), TILA requires that any calculation of the annual percentage rate include credit-related charges as well. 15 U.S.C. §§ 1605(a), 1606; Regulation Z, 12 C.F.R. § 226.4(a).

[8] *See*, *e.g.*, *Lugli v. Johnston*, 912 N.Y.S.2d 108 (App. Div. 2d Dep't. 2010); *Palmiero v. Cayenne*, 889 N.Y.S.2d 883 (Sup. Ct. Kings Cty. 2009); *Weiss v. Screen Arts Corp*., 2009 N.Y. Misc. LEXIS 4705, 2009 N.Y. Slip Op 31045(U) (Sup. Ct. N.Y. Cty. 2009); *Funding Group, Inc. v. Water Chef, Inc.*, 852 N.Y.S.2d 736 (Sup. Ct. N.Y. Cty. 2008); *Rosner v. ESIC Capital Corp.*, 48 B.R. 538 (E.D.N.Y. 1985).

[9] *Rosner*, 48 B.R.at 547.

interest rate for a $300 loan taken out for 90 days would be 204%.[10] For a $300 loan taken out for 180 days, it would be 175%.[11] It is telling that while the bill on its face caps the annual interest rate at 25%, it also explicitly exempts the proposed loans from our usury laws. This underscores the reality that the annual interest rate would exceed our criminal usury cap.

Also, while the bill limits borrowers to one loan renewal, it does not limit the number of serial loans that a borrower may take out. Numerous federal agencies have noted that so-called "short-term" loans often become long-term debt traps for borrowers. The Comptroller of the Currency determined that "payday loans that are renewed multiple times can be an exceedingly expensive form of borrowing that may be unsuitable for some borrowers over the long term."[12] The Federal Deposit Insurance Corporation (FDIC) found that "[w]hen used frequently or for long periods, the costs can rapidly exceed the amount borrowed and can create a serious financial hardship for the borrower,"[13] adding that "providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending."[14] The U.S. Department of Defense concluded that states that have adopted statutes with features similar to those proposed by the bill – such as mandatory databases, cooling off periods, and prohibitions against borrowing from multiple dwellers – "do not stop the debt trap."[15] In addition, the Consumer Financial Protection Bureau (CFPB) issued a report on April 24, 2013, in which it concluded that "a sizable share of payday loan . . . users conduct transactions on a long-term basis, suggesting that they are unable to fully repay the loan and pay ther expenses without taking out a new loan shortly thereafter."[16] The CFPB further concluded that "[its] findings raise substantial consumer protection concerns."[17] According to media reports, the FDIC and the Comptroller will begin regulating payday loans offered by banks and tied to checking accounts

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[10] This analysis assumes six fully amortizing installment payments over the 90-day loan term, with the $25 application fee paid up front, and the $15 monthly fee paid $7.50 at a time, assuming two installment payments are paid each month.

[11] The same assumptions noted in footnote 10 apply.

[12] Comptroller of the Currency, OCC Advisory Letter AL 2000-10, 1 (Nov. 27, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf (last visited May 1, 2013).

[13] Press Release, FDIC, FDIC Revises Payday Lending Guidance (Mar. 3 2005), *available at* http://www.fdic.gov/news/news/press/2005/pr1905.html (last visited May 1, 2013).

[14] *Id.*

[15] U.S. Dep't of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* 47 (Aug. 9, 2006), *available at* http://www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf (last visited May 1, 2013). The Report noted, for example, that "even with loan restrictions and enforcement tools, the average borrower in Florida takes out eight loans per year and the average borrower in Oklahoma takes out nine payday loans per year." *Id.*

[16] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* 43 (Apr. 24, 2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf (last visited May 1, 2013).

[17] *Id.* at 44.

by imposing more stringent requirements and requiring an assessment of the consumer's ability to repay the loan.[18]

States where high-cost, short-term loans are permitted have made similar findings. A 2011 study by Washington State, which has a statute with some of the features in this bill, found that short-term loan borrowers end up borrowing repeatedly: over half of borrowers took out three or more loans per year.[19] A 2007 study by California similarly reported that "almost half (48%) of [lenders'] business [came] from customers who had obtained between 2 and 9 loans during the 18 month study period."[20]

The bill also does not require check cashers to conduct a true analysis of a borrower's ability to repay. Though the sponsors claim that check cashers would be required "to lend money only to qualified borrowers based on income and their ability to repay such loans," in fact the bill mandates only that the loan amount not exceed 25% of the borrower's gross monthly income and that no scheduled installment payment exceed 10% of the borrower's gross monthly income. But what if a borrower has other debts? We are mindful that one of the characteristics of predatory consumer lending is that lenders make loan decisions based not on a borrower's ability to repay, but on expected interest payments and fees.[21]

We also question the efficacy of the bill's purported "consumer protections," which include prohibiting a borrower from re-financing a loan more than once and requiring that a check casher verify that an applicant has no other outstanding loan from a check casher before approving a loan. While these "consumer protections" have been employed in other states largely in an attempt to make high cost loans appear more palatable, consumer advocacy groups such as Consumers Union, the Consumer Federation of America, the National Consumer Law Center, and the Center for Responsible Lending have all concluded that these supposed safeguards fail to adequately protect consumers.[22]

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[18] Jessica Silver-Greenberg, *Regulators to Restrict Big Banks' Payday Lending*, N.Y. times, Apr. 23, 2013, http://dealbook.nytimes.com/2013/04/23/crackdown-expected-on-big-banks-payday-loans/?nl=todaysheadlines&emc=edit_th_20130424 (last visited May 1, 2013).

[19] Washington State Department of Financial Institutions, *2011 Payday Lending Report*, 7, 10 (2011), *available at* http://www.dfi.wa.gov/cs/pdf/2011-payday-lending-report.pdf (last visited May 1, 2013).

[20] Applied Management & Planning Group, *2007 Department of Corporations Payday Loan Study,* 27 (Dec. 2007; Updated June 2008), *available at* http://www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf (last visited May 1, 2013).

[21] Consumers Union, Consumer Federation of America, National Consumer Law Center, *Small Dollar Loan Products Scorecard–Updated*, 2 (May 2010) [hereinafter *Small Loan Products Scorecard*], available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/cu-small-dollar-scorecard-2010.pdf (last visited May 1, 2013). Notably, the Washington State Department of Financial Institutions reported that after a federal 36% annual percentage rate cap on short-term loans to military personnel took effect in October 2007, the majority of payday lenders in Washington State ceased lending to these consumers and the number of military borrowers dropped from nearly 10,000 in 2007 to 359 in 2011. *See* State Department of Financial Institutions, *supra* note 8, at 11-12.

[22] *Small Loan Products Scorecard*, supra note 18, at 3 (citing Uriah King & Leslie Parrish, Center for Responsible Lending, *Springing the Debt Trap: Rate Caps Are Only Proven Payday Lending Reform*, December 2007, *available*

We also do not believe, as the bill's proponents argue, that because "unregulated" short-term loans are available online, New York should allow check cashers to make "regulated" short-term loans. New York should not allow usurious loans to be made to its residents in any manner, whether online or from storefronts located within the state. The Department of Financial Services recently made clear that online payday lending is just as unlawful as payday lending done from a storefront in New York.[23] Moreover, even to the extent that high-cost, short-term loans are available online, this is a far cry from allowing licensed check cashers to make high cost, short-term loans from physical storefronts in low- and moderate-income communities throughout the state.

Recent studies by the Pew Charitable Trusts also belie the sponsors' claims that the proposed loans are necessary because New Yorkers are turning to online payday loans and overdraft protection products. One Pew study found that in states like New York that have outlawed payday lending, 95% of would-be borrowers choose not to use payday loans at all, and only 5% borrow online or elsewhere,[24] demonstrating that our usury protections are working. Another Pew study found that 27% of payday loan borrowers actually incur overdraft fees as a direct result of payday lenders' withdrawals from the borrowers' accounts.[25]

We note that there are financial institutions, including credit unions, which are increasingly succeeding in bringing affordable, small-dollar loan products to the public.[26] The FDIC's two-year Small-Dollar Loan Pilot Program showed that financial institutions "can profitably offer affordable small-dollar loans as an alternative to high-cost credit products such as payday loans . . . ."[27] The FDIC found that "[t]he most prominent product elements bankers linked to the success of their program were longer loan terms, followed by streamlined but solid

at http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf (last visited May 1, 2013).

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[23] *See supra* note 5.

[24] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, 22 (July 2012), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf (last visited May 1, 2013).

[25] The Pew Charitable Trusts, *Payday Lending in America: Report 2, How Borrowers Choose and Repay Payday Loans, February* 2013, 32, *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf (last visited May 1, 2013).

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[26] National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't*,19 (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf (last visited May 1, 2013).

[27] *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program*, 4 FDIC Q 28, 28 (2010), *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf (last visited May 1, 2013). The Committees note, however, that the annual interest rate of 36% permitted by the pilot program, while significantly lower than those associated with the short-term, high-cost loans proposed by the legislation, is far higher than what is recommended by consumer advocates.

underwriting[;]"[28] the average loan amount under the program was $700 and the average loan term was 10 to 12 months.[29] New York should work to increase the availability of affordable, small-dollar loans, and not permit usurious loans that would harm its residents, particularly those who are low- or moderate-income.

CONCLUSION

Creating a carve-out in New York's longstanding usury laws for short-term loans made by check cashers would set a dangerous precedent that could open the floodgates to other unaffordable, high-cost loan products in our state. Studies show that the most effective way of protecting people against abusive lending is through a cap on the interest rate.[30] In the past few years, several states that had previously exempted short-term lenders from existing double-digit interest rate caps have rolled back the exemption, and some states that had no interest rate caps on short-term loans have imposed them.[31] North Carolina, which has successfully driven out all storefront payday lenders, found that the decision to ban payday lending created "a net benefit to households."[32] It would be a shame for New York to regress. New York has always been in the forefront for its protections against unfair, high-cost, short-term loan products, and it should maintain that position.

Thank you for the opportunity to comment on this legislation. Should you have any questions, please do not hesitate to contact us.

Respectfully submitted,

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Chair, Consumer Affairs Committee

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Chair, Civil Court Committee

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[28] *Id*. at 32.

[29] *Id*. at 30.

[30] *Small Loan Products Scorecard*, *supra* note 18, at 3.

[31] See Uriah King & Leslie Parrish, Center for Responsible Lending, *Payday Loans, Inc.: Short on Credit, Long on Debt*, 12 (March 2011). For example, New Hampshire recently enacted a 36% rate cap on payday loans.

[32] Center for Community Capital, *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*, 18 (Nov. 2007), *available at* http://www.nccob.gov/public/docs/News/Press%20Releases/Archives/2007/NC_After_Payday.pdf (last visited May 1, 2013).