From:	Stephen Fischmann
To:	Liu, Sunny
Cc:	Ona Porter; Holly Beaumont; Bill Soules; McSorley, Cisco; Patricia Roybal Caballero
Subject:	Comments on Consumer Lending Practices Report
Date:	Tuesday, November 10, 2015 2:08:29 PM

Sunny,
For your consideration.

General Comments:

1. The report does not evaluate industry claims that across the board interest caps might harm borrowers - especially the poor. This is a major omission.

Arkansas, Connecticut, Maine, Maryland, Massachusetts, Montana, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia all have strict across the board interest caps and should provide valuable information on the validity of this industry assertion. An analysis of their experiences is a must for a useful report.

2. As I read the report, it appears that total small loan volume across all categories has increased substantially since the 2007 law was passed. But that is unclear from the way the data is presented. Suggest you total the loan data so the bigger picture is clear.

3. The list of regulatory faux pas by other states is very helpful.

Factual inaccuracies and misleading representations in the report include:

Page 9. "Interest rate caps require companies to provide longer and larger loans to meet APR ceilings. The term and size of these products have higher total dollar costs than short term products."

This is a demonstrably false industry assertion that should be removed from the report. 12%-36% APR no credit check products provided by True Connect, Community Loan Center, GECU, One Source and many credit unions all allow prepayment of loans with no penalty. Borrowers are not forced to hold onto loans longer than needed.

The total cost of no credit check loans currently available under 36% APR are substantially lower than products offered by storefront loan operators no matter how long they are outstanding. For example, the typical $1,000 title loan offered in Las Cruces costs $250 in interest for the first month and a total of $3,000 for a full year. A no credit check True Connect loan at 24.9% costs just $20 in interest for the first month and $142 for the full year and does not put the borrower's vehicle ownership at risk.

Page 9. "Traditional installment lenders like Sun Loan Company, Springleaf Financial Services, World Acceptance Corporation and Check 'N Go underwrite loans and reject, on average, half of all applicants during the loan making process."

This industry assertion creates the impression that the lenders are being responsible. The facts say otherwise. As of June of this year, Louis Gomez" sole

income was $733 in monthly SS disability, but he was left with a net living income of just $170 after monthly installment loan payments of $533. **Sun Loan, World & Check 'N Go** all had outstanding loans with Louis that had been refinanced between 3 and 8 times over the past 18 months. The fact that all three companies were treating Louis the same way is a strong indication that this is common industry practice. Louis is spending about $7,000 annually in interest and fees on $3600 in "traditional" installment debt that never gets paid down.

Many similar examples are available. An accurate representation of what is happening would include a statement that, despite the credit rejections, many borrowers cannot repay the debt.

Pg 9. "A 2009 Federal Deposit Insurance Corporation working paper found fixed operating costs and high loan loss rates justified a large part of the high APR charged on payday advance loans."

This context free fact supports the industry myth that unreliable borrowers make it necessary to charge high interest rates. As noted above, there are many alternate loan models that enable sub- 36% interest rates and help minimize defaults. Closer examination shows that high interest rates are necessitated not by unreliable borrowers, but by high overhead business models that encourage defaults.

Hope this helps,

Best,
Steve

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CONSUMER LENDING PRACTICES IN NEW MEXICO

REPORT OF FINDINGS AND RECOMMENDATIONS

BY SUNNY LIU OF NM LFC

RESPONSE BY CILA OF NM

CILA welcomes the report by the NM Legislative Finance Committee as containing a good, if brief, survey of both facts and opinions relating to the possible need for enhanced regulation of Small Dollar Credit in the state, and wishes to highlight and comment on certain findings and recommendations.

1. Fair lending
   Just as a transaction, to be considered fair, must be fair to both parties, so the terms of a loan must be fair to both parties also, and so must any laws affecting such loans. When the report mentions the importance of providing "a healthy economic environment for both lenders and consumers," it states what should be obvious to all.
   Unfortunately this is a point the ironically named NM Fair Lending Coalition has failed to grasp. Any proposals for further regulation should contain, as a necessary condition, provision for what the report calls "lenders' operability," in other words sustainable pricing, free of any artificial market-distorting subsidies.
   This does not mean that every current business model is equally worth sustaining, but there is by now a fairly strong consensus on what features are essential in the best products, the maintenance and sustainability of which should be the starting point for further regulation. Essential features include: loans made based on the borrower's ability to repay not the lender's ability to collect (in the words of Director Cordray); payable in equal installments of principal and interest, to fit within a monthly household budget: and reported to the credit bureaus to help borrowers establish or build credit. The Traditional Installment Loan, as made by CILA members, meets all these criteria. In addition, there are no prepayment penalties and unearned interest is refunded in the event of repayment, unlike with payday loans.
2. APR caps
   Certain basic facts need to be understood about APR when it comes to small dollar credit, without which it is not possible to have an intelligent conversation about rates. 1. Rates are chiefly a function of the size and duration of a loan, thus an arbitrary cap cuts off access to loans smaller and shorter than a certain amount. 2. There is an inverse relationship between the cost of a loan and its rate. The lower the rate, the higher the cost, and vice versa. Thus rate caps also cut off access to the lowest cost, the cheapest loans. There is also an inverse relationship between the TIP rate (total interest paid as a percentage of principal) and the APR. 3. APRs were only ever intended to help borrowers compare loans of equal size and maturity and are useless when looking at loans of different sizes and terms. It appears that the authors of the University of New Mexico study, referred to in the report, who complained about consumers' failure to understand the significance of APR, have failed to understand it themselves.

Nevertheless, CILA understands the emotive nature of the discussion about APRs and how prevalent this misunderstanding is, and is therefore willing to back certain APR caps. 36 is absurd and unsustainable for the smallest loans, but CILA would support a high of 175% for the very small loans, or, say, 100% for loans of $1,000 or more. We are comfortable with the idea that such a cap would certainly catch and render obsolete the kinds of loans which led to the New Mexico, ex rel., King v. B&B Investment Group case, where the rates were around ten times these amounts.

3. Complaints

   Given that Traditional Installment Loans are fair, safe and affordable, it is hardly surprising that there are few complaints about the product or its providers. The CFPB data is particularly interesting. TILs are lumped in with payday and title loans, and yet these categories together attract far fewer complaints than do bank products, which themselves lag far behind mortgage products. Mortgage loans remain the main problem, regardless of the fact that they have the lowest APRs. Of the 6% of complaints, which were made against payday etc, two thirds were about online payday. The main complaint against Traditional Installment lenders seem to be, ironically, that they did not give a loan to all who applied, in other words, that we tested the borrower's ability to repay.

   CILA welcomes a close study of complaints data, which has the potential to show the absurdity of placing further constraints on an industry, which enjoys strong and loyal support from customers.

   Similarly, the record of examinations by the FID, centered on loans over 175%, is interesting, but only if one remembers that Traditional Installment loans, as made by CILA members, have APRs that do not exceed 175 anyway. The data given for "installment loans" must therefore include hybrid products offered by former payday companies, which do not contain all the same safeguards as CILA loans.

4. Unintended Consequences

   CILA welcomes the report's comments about the unintended consequences of overreaching regulation, namely the tendency of lenders to go outside the law if it is unworkable, and for many borrowers to suffer by losing access to safe, affordable state regulated forms of credit. We also welcome the observation that 44.4% of NM households are "asset poor, and 56% of US consumers have subprime credit scores. " Legislators, academics and journalists who have never needed these loans need to understand that many do, and that their numbers far exceed the appetite or capacity of a few charitable groups and community lenders.

   The language in the report about the FDIC study is polite, but it is our understanding that no bank was able to make a profit on small consumer loans at 36%, and that representatives of both the banking and credit union national associations recently repeated to the CFPB that they had absolutely no interest in making such loans in future.

5. CFPB

   The CFPB has published its outline of a proposed rule on payday, title and other similar products. The payday and title loan associations have reported that this rule will decimate their industries. All the bad products will disappear. That is what the Bureau has pledged to accomplish. The challenge for state legislatures, in a post CFPB Rule world, is no longer to worry

about such bad products. Instead it will be to ensure that their consumers and voters retain access to products which the Bureau has decided are safe and affordable, including at the very least, those offered by CILA members.

NM Report – Points for consideration

1. Key Findings (page 1): The focus seems to be how the payday lenders moved into the small lender niche which kind of leads the reader to assume all lenders operating under this act function in the same manner. It may help to differentiate the types of lenders so the reader has a reference point for each industry (see attached). Otherwise, the end result may be the perception that all small lenders are "bad" and that broad stroke fixes are needed without consideration for the fact that there are responsible lenders in the mix that have tougher underwriting and verification standards, low charge-offs, and affordable, fixed-rate payment schedules.

2. Options & Alternatives (pages 1-2): It appears the purpose of these sections is to explain the differences in approaches suggested by consumer groups and industry. There are some key terms that would probably benefit from further clarification:

    a. The DoD model is referenced but then "alternatives" are listed that include an "all in rate cap." It seems a bit redundant and may be confusing to the reader without explaining ""all in" or the differences between credit and ancillary products.

        i. It would help if the discussion about MILA notes that the Military All-In (MAPR) is in direct conflict with the Truth In Lending Acts (TILA) definition of APR; which never included credit or ancillary products.

    b. The statement, "...borrowers may be denied credit altogether or the ability to purchase debt protection," can be interpreted that this type of coverage could be mandated...which it has never been. Lenders will never deny the opportunity to qualify for a loan based on willingness to purchase credit or life products.

    c. The section stating that industry supports conducting "...an underwriting process based on a consumer's ability to repay the debt.." probably needs to be drawn out a little more to indicate how the process is important to determine not only the ability to repay, but also to assess the willingness to repay.

    e. The summation of this section would be a great place to differentiate the issues that surface as a result of securing short-term, high-interest loans as opposed to the greater stability presented by longer term, lower interest rate lenders. Without giving the reader a reference, he is left with the notion of a one-size-fits-all fix.

3. Background & Consumer Complaints (pages 2-4): This is a fair discussion of the lending industry. It would also probably help the reader to understand that traditional installment lenders (like Springleaf) have been leaders in this highly regulated industry with higher customer satisfaction and very low charge-off rates. Otherwise, the section purports that "lenders" in general are bad players garnering numerous customer complaints with inadequate regulations. We'd really appreciate this opportunity to educate the reader that we're not the pariah consumer groups have tried to project.

4. New Mexico Findings (pages 4-5): With reference to Appendix A, regarding the definitions of consumer loan products; you may wish to add a section describing Traditional Installment Loans explaining that it's the only product that involves extensive underwriting practices and assesses the ability/willingness to repay long-term, fixed-payment loans. Without this reference, the reader simply believes that all loan products available to subprime consumers are limited and border on abusive.

a. Based on the activists' perspective, it's easy for the reader to come away with the false impression that people who are targeted and apply for these loans are under-educated, low income, renting minorities who lack the ability to understand the impact of taking out a high interest small loan. While the demographics are questionable, the important thing to impress upon the reader is that traditional installment lenders use underwriting tools to determine ability and willingness to repay. They also make sure the customer understands the terms of the loan and any products they may wish to add.

5. Consumer Interest Group Positions (pages 5-8): Without an explanation regarding all-inclusive rate caps and the way the MARP conflicts with the federal definition of APR, this section leads the reader to think all-inclusive loans, as advocated by the military model, are the only way to control lender abuse. As a result of the 2014 Supreme Court case, Judge Vigil's ruling included his belief that charging a percentage rate above 15% is "unconscionable." It's important to clarify that Vigil's statement has no legal standing and was only a directive to the lower court to consider action; which they have not done. Without clarification, the reader is left to believe that legal precedence for a 15% APR has already been established.
    a. Regarding the Colorado payday reform law; the reader is going to believe this model appears to be quite effective and payday lenders are functioning well assisting subprime consumers. They are not, and were forced to pull out of the state leaving these consumers with little, if any, recourse.
    b. On page 8, payday alternatives have been listed as suggested by the consumer activists. For the most part, these alternatives and unrealistic and arguably offer no assistance to applicants who are low sub-prime rated and most in need. Consumer groups need to submit quantifiable statistics to back up these (and any other) claims. The Pew group is not a viable source without verifiable source annotations.

6. Lending Industry Group Positions (pages 8-11): This is fairly and well written; however, is Check N'Go really considered a traditional installment lender?

    a. In talking about the ancillary products (pages 9-10), it's important to clarify they are not calculated in APR and that the MAPR is in direct conflict with the federal definition under the Truth in Lending Act (TILA). It might be helpful to point that out in this section so the reader clearly understands the difference. If the reader understands the reason for the TILA definition it will make more sense. Wikipedia, in defining APR, explains "effective APR has been called the "mathematically-true" interest rate for each year." (https://en.wikipedia.org/wiki/Annual_percentage_rate)

    TILA views APR (defined above) as the best method for consumers to compare the true cost of a loan. In essence, they know exactly what they're getting, as opposed to MAPR which includes the cost of additional products and charges.

From:	Jay Santillanes
To:	Liu, Sunny
Cc:	Matejka Santillanes
Subject:	Re: Updates to New Mexico House Memorial 131 Study Group
Date:	Tuesday, August 11, 2015 4:19:55 PM
Attachments:	Summary HB356 SB527.docx SB0527CTS.pdf HB0356RPS.pdf

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Dear Mr. Liu,

I realize that you requested information by August 7, 2015, but I hope you will accept the following information.

MJS Consulting represents several clients that offer Refund Anticipation Loans. Our clients are locally owned and do business only in New Mexico.

During the 2015 Regular Legislative Session, we worked worked with Representative Jane Powdrell-Culbert and Senator Clemente Sanchez on legislation that would regulate Refund Anticipation Loans. The identical bills are House Regulatory And Public Affairs Committee Substitute For HB356 License Tax Refund Loan Providers (.200311.1) and Senate Corporations And Transportation Committee Substitute For SB527 License Tax Refund Loan Providers (.200310.2)

The two bills propose amending the Small Loan Act of 1955 by requiring disclosures of fees and interest associated with tax refund anticipation loans and establishing requirements, permitted charges and prohibited acts for tax refund anticipation loans.

Attached is a copy of the identical bills along with a summary. HB356 and SB527 did not make it through the legislative process before it's adjournment. HB356 passed the House of Representatives and was scheduled to be heard in Senate Judiciary Committee before moving on to the Senate floor.

During the 2015 Regular Legislative Session, we worked with the Industry on legislation to regulate all loans under the NM Small Loan Act. During those discussions, it was determined that Refund Anticipation Loans would not work within the format that was being drafted. The drafted bill would only work for short term or long term installment type loans. Refund Anticipation Loans are a 1-time payback that encompasses anywhere between three months and a few days, and cannot be an installment loan.

Our recommendation is that any legislation drafted as a result of the Study Group, be crafted with subsections that would regulate all forms of lending. The attached bill(s) could be used to begin the subsection on Refund Anticipation Loans.

Attached please find the two bills for your file.

Sincerely,

Jay & Matejka Santillanes

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On Monday, August 10, 2015 6:28 PM, "Liu, Sunny" <Sunny.Liu@nmlegis.gov> wrote:

To the New Mexico House Memorial 131 Study Group:

LFC staff would like to thank all of the individuals and groups that have participated in the field interviews and those that are scheduled for one soon. Listening to your concerns and suggestions firsthand was very helpful and informative. I have received additional guidance on the expectations for this report, so the direction of this memorial study group will be changing. The outline of the draft report will now include a section for recommendations from members of this study group. I will be sending a follow up email with instructions and a template for input. Please complete the questionnaire, if applicable, by close of business on Thursday, August 20, 2015.

Thank you,

Sunny Z. Liu
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PAYDAY LOAN ALTERNATIVE PROGRAMS

- The past two decades has seen a number of government sponsored initiatives intended to encourage banks and credit unions to make small-dollar loans at rates that are less than it costs non-bank lenders to make similar loans.
- Despite persistent claims of success, there is *no evidence* that any of these loan programs have been successful in balancing safety and affordability with a sustainable business model for either banks or credit unions.
- These government-inspired programs are aimed at addressing the cycle-of-debt problem associated with payday and title loans, but ignore the fact that a viable small dollar consumer finance option already exists in the form of traditional installment loans.
- So-called alternative loan programs often feature some form of tax-payer funded subsidy that allows banks and credit unions to offset their losses, subverting the market and putting non-bank lenders at a competitive disadvantage. This affects all forms of non-bank lending, including traditional installment loans, which are generally considered safer and more affordable than payday or title loans.
- Though government-sponsored small dollar loan alternatives have existed in various experimental forms for decades without success, **President Obama's 2017 budget** contains what appears to be the latest effort, providing taxpayer money to Community Development Financial Institutions (CDFIs) to enable them to make small dollar loans at a loss, free from the consequences of bad lending decisions.

FDIC Small Dollar Loan Pilot Program

- A high-profile 2008 pilot program by the **Federal Deposit Insurance Corporation (FDIC),** involving 28 banks, was described as, *"…a case study designed to illustrate how banks can **profitably** offer affordable small dollar loans",* despite an absence of statistical evidence that any of the banks involved made loans profitably, and plenty of evidence that they did not.
- Once banks started reporting loan results, the FDIC dropped its initial stated goal of demonstrating profitability from subsequent pronouncements about the programs success.
- One of the banks in the FDIC program, Liberty Bank, in Louisiana, chose to continue its small-dollar loan program after the pilot ended, making more than 1,200 small, short-term loans totaling $1 million in 2013. This resulted in a $17,000 loss for the program.[i]
- The FDIC's own report[ii] on its pilot program falls short of explicitly claiming that these loans were profitable for any of the participants, saying instead,

> *"Program and product profitability calculations are not standardized and are not tracked through regulatory reporting* [and can be] *highly subjective, depending on a bank's location, business model, product mix, cost and revenue allocation philosophies…. Moreover, many of the banks … indicated they either cannot or choose not to expend the resources to track profitability…".*

The report also notes

> *"…given the small size of* [small dollar loans] *the interest and fees generated are not always sufficient to achieve robust short-term profit- ability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products."*

- All the evidence in the FDIC report points to incentives for banks to make these kinds of loans that are unrelated to profitability, positioning loan programs as:

  > *"[an] important tool in building and retaining customers"*

  and indicating that the programs:

  > *"…can be eligible for favorable Community Reinvestment Act (CRA) consideration, and could help bank's consistency with regulatory guidance regarding offering customers alternatives to fee-based overdraft protection programs".*

- The FDIC has not allowed independent financial evaluation of the success or otherwise of its program, yet the implications in its own report are clear: No bank in the FDIC pilot was able to field a small dollar loan program in a way that was commercially sustainable.

Credit Union Payday Loan Alternatives

- Alongside the FDIC small-dollar loan program, a small number of **Credit Unions** (around six per cent of Credit Unions) have offered so-called alternative loan programs, often described in terms of a "salary" or "deposit" advance".

- Much like the FDIC program, and despite regular claims to profitability, no evidence that stands up to close-scrutiny is available to show that programs for any of these loans, made at an artificially low interest rate, have ever turned even a reasonably small profit.

- A 2010 report by the **National Consumer Law Center (NCLC)**[iii] highlights a number of serious problems with the Credit Union's alternative loans, saying,

  > *"…a number of credit unions, banks, and bank prepaid cards offer triple-digit, short-term products that are payday loans, plain and simple. Whether they are called payday loans, "direct deposit account advances," or something else, these loans pose the same dangers of repeat lending and an escalating debt trap. Some of these triple-*

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> *digit loans are even offered by federal credit unions that manipulate the APR to conform to their 18% legal usury cap."*

The NCLC report describes a number of dubious practices among credit union providers of small dollar alternatives, including one that evades the 18 per cent "usury cap" to which it is subject as a Federal Credit Union, by:

> *"…charging a $39.95 application fee for each of its standard $400 14-day loans on top of 15% annual interest. The application fee is charged each time, even for repeat borrowers, making the APR with fees 362%. Clearly, the credit union is collecting most of its profit through the "application" fee, not the interest."*

- In 2010, a report[iv] from the **University of California, Davis**, showed that despite much lower nominal loan APRs, credit union payday loans often have total fee/interest charges that are quite close to (or even higher than) standard payday loan fees.

  The same study also highlights the fact that these loans are significantly harder to qualify for. The combination of similar charges and tighter credit requirements has to call into question their fundamental for consumers.

- A particularly distorted picture of an alternative loan process is painted by the **North Carolina State Employees Credit Union (SECU)**, whose Salary Advance Loan (SALO) has been widely and repeatedly acclaimed as an example of a successful payday loan alternative.

  Hard evidence that supports claims that the SALO loan is highly profitable is hard to come by, but a 2007 paper[v] by Michael A. Stegman, Director of Housing and Policy at the John D. and Catherine T. MacArthur Foundation, suggests that it achieves profitability in exactly the same way a payday loan does, noting:

  > *"…. the combination of low price and high need has led to about two-thirds of SALO customers to take out advances every month of the year – the equivalent of 11 rollovers in the conventional payday loan market."*

  Nowhere does Stegman explain how a new loan every month differs from a "rollover".

  The example of SECU and the evidence from the NCLC's 2010 report indicates that far from providing safe and affordable alternatives to payday loans, government programs have, in fact, created a whole new category of lenders whose loans differ very little from payday products.

- San Francisco has become a center for government-assisted efforts to provide banking services, including small dollar credit, for the unbanked. The city operates its own small-dollar loans program, **Payday Plus**, with some area credit unions.

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Despite a warm reception from policymakers everywhere, the pilot program has remained small, with just several hundred loans made, indicating an inability on the part of the credit unions involved to scale the program.

Kymberli Roberts, consumer lending manager at San Francisco Federal Credit Union, one of the participating financial institutions in the Payday Plus program, described it as *"…not a money-maker…. Breaking even is just fine"*

- It is clear that banks and credit unions have not been successful as sources of small-dollar credit, requiring close support and even funding from government to come anywhere close to being an accessible affordable and sustainable source for small dollar credit.

- Like a cramming a square peg in a round hole, forcing banks to make small dollar loans through CRA mandates or bailing out their losses with taxpayer money, is unlikely to result in a sustainable new form of small dollar lending, even as it decimates non-bank lenders. The net result will be the opposite of what proponents of small dollar alternative loans desire: less access to safe credit and more reliance on riskier more expensive types of debt.

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[i] *Can Banks provide an Alternative to Payday Loans?* Times- Picayune (May 7, 2014)
[ii] A Template for Success: The FDIC's Small-Dollar Loan Pilot Program (2010)
[iii] Stopping the Payday Loan Trap NCLC (2010)
[iv] Are Credit Unions Viable Providers of Short-Term Credit (2010)
[v] Payday Lending – Journal of Economic Perspectives (2007)