Written Testimony of Eric E. Wright, Staff Attorney for the Maine Bureau of Consumer Credit Protection

Submitted to the Senate Special Committee on Aging
Wednesday, July 24, 2013, 2:00 p. m.
Room 562, Dirksen Senate Office Building

Chairman Nelson, Ranking Member Collins, and members of the Senate Special Committee on Aging: I am Eric E. Wright, the Staff Attorney for the Maine Bureau of Consumer Credit Protection. The Bureau is a Maine state governmental agency with responsibilities, given by the Maine Legislature, to administer and enforce laws in some two dozen areas relating to consumer credit and other consumer financial services. We appreciate your invitation to have our Bureau participate in this hearing.

Payday loans are short-term, extremely high-interest rate loans, generally of less than $1000, and most often between $200 and $500, secured by lender access to consumers' bank accounts. Payday lending has been around for longer than anyone can probably say for sure. The name is derived from the manner in which the payment is obtained by the lender from the consumer. Historically, workers borrowed money on a given day, a Monday, provided a post-dated check to the borrower, which coincided with the borrower's payday, and the lender, after holding the check until that next payday, Friday, and cashed it at that time.

The means by which today's payday loan industry on a national scale operates have changed. Today, Internet-based payday lenders require that borrowers, as a condition of borrowing, provide their bank account and routing numbers so that the lenders can, by automated clearing house (ACH) transactions, periodically debit the accounts of borrowers after they electronically deposit the loan amount in the consumer's account. That mode of operation is both an unsurprising reflection of modern technology and an invitation for abuse by the unscrupulous. These transactions present problems for regulators. Today, every day, there exist problematic payday loan transactions. It is only these Internet-based payday lenders that I am referring to today.

The essential problem is that consumers, too often unaware of fees, finance charges, automatic rollover provisions, and interest associated with payday loans, wind up paying back many times the principal amounts they have borrowed. Being unable as a practical matter to pay off the principal because lenders refuse to assign payments to that, borrowers face the prospect of being required to pay back still more and more, with no end in sight. The results: consumers are plunged further into debt, and the lenders rake in unseemly amounts of money.

It is these lenders that I characterize as unscrupulous, for several reasons. First, the money these companies are making must be considered by any fair measure as hideously large. Second, in addition to these lenders making profits that seem well beyond reasonable, they do so without regard for the licensing and interest-rate limitation laws of the states in which the consumers live. Third, they do so without apparent concern for the impact on consumers. While the payday loan industry maintains that it meets a need—to assist individuals who are unable to obtain affordable loans from more traditional sources—the industry has to know very well that what it is doing is making enormous amounts of money from those least able to afford it.

There have been studies done about the demographics of borrowers. There is some truth to a commonly held three-fold perception of borrowers—lower income, poor credit, and an attendant, critical need—but not necessarily as much as one might assume. Studies in the last few years, including by the Pew Charitable Trusts, have found the more likely borrowers are white women, parents, divorced or separated, between 25 and 44 years old, and making less than $50,000 a year. Payday loans are attractive not just to those with lower incomes: while 25% earn less than $30,000, 22% earn over $60,000 and $15% over $100,000. One in five borrowers is over 50. Four out of 10 payday loan borrowers are homeowners.

We pay considerable attention to what has happened and how we can help, certainly more so than abstract demographics. Nevertheless, Maine's experience is that payday loan arrangements often aggravate the depletion of resources of those who are already financially vulnerable. In our experience, payday loans feed on the desperation of people in need. No one has ever told me that he or she took out a payday loan because one *wanted* to, but only because one felt one *needed* to.

Our Bureau currently licenses only seven payday lenders, including a few located out of state, and one in Maine with seven locations. They do not present problems, because they obey the law. Maine requires payday lenders to be licensed as "supervised lenders" (a category that applies to all high-rate, unsecured lenders) and to post a surety bond. Maine law limits finance charges, calculated *per annum*. On unsecured loans of less than $2000, Maine limits the interest rate to 30% APR. Because of the very short-term nature of payday loans, these charges would be slight, and in recognition of the complexities of calculating APRs with payday loans, the model Uniform Consumer Credit Code in 1974 provided as an alternative a flat fee to be imposed on short-term loans. Maine adopted this approach in 1975. These fees are strictly limited in Maine—for instance, $25 on a loan of $250 or more.

It is the unlicensed, Internet-based companies that we hear about from consumers. These payday lenders, which I am addressing today, do not want to be licensed by the state of Maine, because they do not want to adhere to our fee limitations. These are illegal loans because the lenders are unlicensed and exceed Maine's finance charge restrictions. We have issued publically accessible Cease & Desist orders against some of these companies that, we hope, will at least warn consumers away.

To be sure, borrowers, sadly, do not always take out just one loan. Multiple loans are not unusual. More than one consumer I have dealt with has had 10 or 12 or more at the same time. Some people take out a second or third to pay off a first or second—or, more precisely, to pay off *the interest and fees* on those prior loans. In a case I recall in particular a Maine consumer borrowed $200 and wound up paying back $1400. (We managed to get that consumer's $1200 back for her, but I do not recall how, and that result is a rare turn of good fortune.) In another, a Maine consumer borrowed $300, repaid $360, and then was told he still owed another $593.84. In the year 2012 alone, our Bureau handled 86 formal complaints against payday lenders, and in addition took many more calls from consumers with questions.

The annual percentage rates that come with these loans have been reported to *average* 470%. A 2011 study of one state, Kansas, found six lenders charged between 378% and 780%. The APRs have been found to be as high as 1825% with one well-known lender. If one is charged $25 per $100 per week, the equivalent APR is 1300%. After just two months, the consumer will have paid $200 in interest on an original debt of $100, with the entire principal debt still due. Unless one pays back the loan, including interest, when it is first due, the finance charges quickly spin out of control. Consumers seldom can repay fully, and so suffer enormous shock when they finally realize how much they are required to pay.

Finally consumers in these predicaments call our Bureau. Too often they do not know how much they have paid back, but they have a gnawing sense that maybe their debt should be regarded as sufficiently repaid, or they simply want to know what their rights are. These consumers inevitably have been pushed more deeply into debt by their payday loans. We take such calls on a nearly daily basis. Many callers tell us of unseemly efforts to get them to pay more than the consumers can understand they owe.

The calls are frustrating because these companies do not want consumers and regulators to know where they are located and are mostly just unresponsive to us. These companies typically do not list a physical or mailing address in the websites or, when they occasionally communicate by fax, on their stationery. The locations of some have been found—all across the United States, and in Canada, the Caribbean, and even Malta. I suspect many of the problematic companies of whom I speak actually are not truly located anywhere, other than somewhere to maintain computer terminals to send the loan to an individual's account and then to make ACH withdrawals, seemingly endlessly, from consumers. They tend to mask their phone numbers so the numbers do not appear on caller IDs. Even when we know how to reach a company, the lender normally will just ignore us if we try to intervene on behalf of the consumer.

These companies certainly do not want to abide by the finance charge or interest rate limitations of the states in which the borrowers live. If there is some truth to the notion that the astronomically high fees associated with payday loans are explained by a higher than ordinary default rate among borrowers, there is also this: the unwillingness of lenders to comply with licensing requirements of states is precisely because the lenders, if licensed, would then be constrained by the limitations on how much they can charge, and this they do not want to do. In short, these lenders are not motivated by an altruistic sense of helping those in some difficulty, but more certainly are driven by pure greed.

There are related issues. First, there are efforts at collection of debts, whether by third-party debt collectors whose activities are governed by the Fair Debt Collection Practices Act, or by the lenders themselves. These efforts begin either because the consumer does not have sufficient funds in his or her account to cover the next charge to be taken by the lender, or because the consumer has closed his or her bank account, so the lender cannot take more money.

I have long thought that honey works better than vinegar, but too many collection efforts involve threats and intimidation of innocent consumers who know no better than to worry when they hear:

- that they must pay by credit card by 2:00 p. m. today
- that will be arrested and jailed
- that a court case will be filed against them for defrauding a financial institution
- that their wages will be garnished
- that they will be dealt with to the fullest extent of the law
- that their privileges to drive will be taken away

—or that any of these things may happen to a family member. Too often these calls are made, improperly, to employers or others in one's family. Some calls come from phony collectors where, in fact, there has never been a loan taken out by the consumer who is subjected to a call. A favorite tactic is to pretend the caller is an officer of the Federal Bureau of Unpaid Debt, or some such nonexistent agency. Or a written notice will arrive with something mimicking a seal used by a federal agency.

Consumers generally do not know how to respond to these aggressive, illegal tactics. That they *are* scared and distraught simply proves they are vulnerable to such techniques. When they call us we can satisfactorily advise them that nothing bad is going to happen because they are protected by our state's laws and court rules. In Maine, wages cannot be garnished without a court order. People cannot be arrested for civil debts. These companies cannot—and as a practical matter, are unable to—maintain a court action in Maine if they are not registered with the Secretary of State as a foreign (out-of-state) company. No payday lender has ever used the Maine court system to advance its claim that a consumer owes it still more money.

The phone calls impose a real emotional toll, however. I suppose our advice—close your account so they cannot take any more money from you, but get ready for some nasty calls, and tell your family and your employer to get ready for nasty calls—is similar to that provided by other consumer protection agencies in other states. In a number of cases, the lenders start calling even before the principal has been paid—thereby revealing that the charges being imposed are not being applied to payment of principal, but to all the other imaginable costs. And worse: sometimes lenders cause consumers' bank accounts to become overdrawn by making withdrawals so often.

Second, there are possible credit report consequences. Under the Fair Credit Reporting Act, creditors can report to credit (or consumer) reporting agencies. Those national agencies have a duty to report accurately. The national credit reporting agencies have told me that they do not accept reports of payday loan debts because they consider them notoriously unreliable. But I cannot say that this is uniformly the case. And even if it is true that the national credit reporting agencies do not, or do not always, report payday loan debts, this is most tellingly an acknowledgement that borrowers do not, or should not, owe the amounts the lenders claim.

Third, we have seen more and more lenders who claim to be associated with or adjuncts of Native American Tribes that have been given sovereign immunity by Congress by, for example, the Indian Reorganization Act of 1934. Such lenders assert that they are governed solely by tribal laws and that states have no authority to regulate them. At least seven federally-recognized Tribes own or are associated with payday lending companies. This is an added feature that some lenders assert allows them to avoid licensing laws and finance charge restrictions.

Of these lenders, some are legitimate creations of a Tribe, but by others this is just a ruse. The Chief of a small Tribe in Oklahoma, when asked where his payday loan operation was located, said, "somewhere in Kansas." Most prominently, one person, well known to regulatory authorities especially in western states, owns as many as nine Internet-based payday lending companies, all of which, he has claimed, are entitled to the sovereign immunity of the Native American Tribe of which he is a member, solely by virtue of his membership and his residence on the Tribal land. Yet the Supreme Court has said that "the doctrine of sovereign immunity . . . does not immunize individual members of [a] Tribe." *Puyallup Tribe, Inc. v. Dept. of Game of Washington,* 433 U.S. 165, 171-72 (1977).

In any event, in our view sovereign immunity is, at best, a defensive and protective legal device, not a tool that gives one the right to affirmatively come into Maine and violate our nondiscriminatory state laws. Even if sovereign immunity does not allow us to require that tribal lenders obtain a license, those lenders should not have *de facto* license to violate our laws. The Supreme Court has said: "There is a difference between the right to demand compliance with state laws and the means available to enforce them." *Kiowa Tribe of Oklahoma v. Manufacturing Technologies, Inc.,* 523 U.S. 751, 755 (1998). And: "Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State." *Mescalero Apache Tribe v. Jones,* 411 U.S. 145, 148-49 (1973).

There are others who know far more than I do, and who have written scholarly law review articles, about sovereign immunity for Native American Tribes. Several states and the Federal Trade Commission have litigated these issues. I do not minimize the complexities of a legal abstraction. But there are real consequences to the status. Given that tribal sovereign immunity, "developed almost by accident," *Kiowa Tribe,* 523 U.S. at 756, as the Court has said, it seems reasonably clear that Congress has authority to act to modify the immunity that allows many payday lenders associated with tribal entities to continue to flout state loan fee and interest rate laws. *See* Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?,* 69 Wash. & Lee L. Rev. 751 (2012).

If, as the United States Court of Appeals for the Second Circuit held just last week, the tribal entity that owns and runs Foxwoods Resort and Casino in Connecticut is liable to pay state tax on personal property—slot machines it leases—because such a tax is an important feature of the uniform application of the state's tax system (*Mashantucket Pequot Tribe v. Town of Ledyard,* Nos. 12-1727-cv(L) & 12-1735-cv(CON) (2d Cir. July 15, 2013)), then surely Congress can legislate in the area of interstate payday lending under the authority of the Indian Commerce Clause and ensure that payday lenders abide by nondiscriminatory state legislation. This calls for a global, legislative approach that will be much more efficient and effective than trying to fight these battles a case at a time in court or in the administrative process.

If one were able to get a handle on the size of APRs, fees, and rollover provisions associated with Internet-based payday lenders, the worst of the abusive practices of those lenders could be eliminated. I end many calls with consumers who are up against, from their perspective, who-knows-what-kind of trouble, by telling the consumers, “Promise yourself you will not do this again.” Uniformly, they say they never will. They are not clamoring to take out new payday loans.

On behalf of the Maine Bureau of Consumer Credit Protection, thank you for inviting me to testify. I hope these remarks contribute to focusing the Committee’s attention on this troublesome financial practice.