Statement of the Community Financial Services Association of America

United States House of Representatives
Financial Services Committee Subcommittee on Consumer Protection and Financial Institutions
Hearing on "Ending Debt Traps in the Payday and Small Dollar Credit Industry"
April 30, 2019

Chairman Meeks, Ranking Member Luetkemeyer and members of the Subcommittee, thank you for the opportunity to submit a statement for the record for today's hearing on the small-dollar, short-term credit industry. My organization, the Community Financial Services Association of America (CFSA), is the leading national association representing regulated, non-bank, small-dollar lenders, and we appreciate the chance to provide our views.

We take issue with the title of the hearing, as it presupposes small-dollar loans are, in fact, debt traps and that such a characteristic is unique only to this type of credit. We would challenge the subcommittee to consider what type of credit is **not** a debt trap. The Schumer Box on a consumer credit card statement with a $9,000.00 balance discloses a payoff period of 25 years if only the minimum monthly payment is made. I would submit to you that is indeed a debt trap.

There is a larger problem with consumer credit in this country, and it doesn't start with small-dollar loans. This industry is an easy target because of common misperceptions, blatant mischaracterizations by our critics and patronizing dialogue from those who believe they are better equipped to make decisions about how and when certain consumers access credit. This patronizing dialogue asserts that consumers of small-dollar loans are predominantly low-income, minorities who are "financially unsophisticated" and are desperately in need of protection by the government. This is simply not true.

Small-dollar loans are an easy target for criticism because they are not the loans that policymakers in Washington are availing themselves of, but rather are seen as a detached, unconventional and objectionable form of credit that only a desperate, vulnerable and uneducated consumer would seek out. Unfortunately, in this country, the average consumer does not have the savings to support a financial hiccup or disruption of their cash flow. Credit bridges those gaps.

Small-dollar lenders serve a very real need in the communities in which they operate – many of which are underserved with respect to credit or are rural communities. According to the Federal Deposit Insurance Corporation, more than 30 million Americans were unbanked or underbanked in 2017. At the same time, the Board of Governors of the Federal Reserve found that 40 percent of Americans either could not cover or would struggle to cover an unexpected expense of $400. Small-dollar loans provide a valuable source of credit for millions of Americans and often are the least expensive option for consumers who need to bridge financial gaps, particularly when compared to overdraft fees and bounced check fees.

Millions of consumers use small-dollar loans as a short-term cash flow solution the way millions of others use credit cards. However, product comparisons can be misleading when viewed through the lens of annual percentage rates. A small-dollar loan is a closed-end transaction with a short duration, typically two weeks. Customers pay a one-time, flat fee that is anywhere from 15 to 20 percent of the loan amount. These one-time, flat fees are lower than other options such as NSF and bounced check fees, or overdraft protection fees. The true valuable comparison is the dollars expended on the underlying credit, whether we speak of credit cards, overdraft fees or other instruments used to enable borrowers to meet demands for which regular income is not available.

When compared to other financial products, small-dollar loan terms are better disclosed, more transparent and better understood by consumers. Yet for our critics, unlike with other forms of credit, transparent disclosure for small-dollar loans is not enough. As required by the Truth in Lending Act (TILA) small-dollar lenders also disclose their one-time fee as an annual percentage rate (APR) which distorts the true cost to the consumer and is the target of disproportionate criticism. By comparison, the APR on a $100 small-dollar loan with a $15 one-time fee is 391%, a $100 overdraft with a $23 fee is 600%, a $100 bounced check with a $48 fee is 1251%, and a $29 late fee on a $100 credit card balance is 756%. When faced with the choice, millions of consumers choose a small-dollar loan.

Small-dollar loan critics often claim that customers do not fully understand the terms and costs of taking out a small-dollar loan, but this cannot be farther from the truth. In fact, it insults the intelligence of the millions of Americans who use small-dollar loans every year to help manage their short-term credit needs. A 2016 Global Strategy Group/Tarrance Group survey of 1,000 small-dollar loan customers found that virtually all borrowers – 96 percent – say they fully understood how long it would take to pay off their loan and the finance charges they would pay before taking out the loan. The vast majority of borrowers also reported that their lender clearly explained the terms of their loan and what would happen if the loan was not paid back in time. The survey also reported that small-dollar loans have been useful to them personally, and three-quarters of borrowers would recommend small-dollar loans to their family or friends.

The CFPB's own customer complaint data has reflected that small-dollar loan consumers understand the terms of their loans better than consumers of other financial products. CFPB data has consistently shown a very low level of complaints against small-dollar loans, which are dwarfed by complaints regarding other financial products. In fact, of the 1,258,275 complaints the CFPB has received through the end of March 2019, less than two percent pertained to small-dollar loans. By contrast, financial products such as mortgages (21.9 percent) and credit cards (10.7 percent) have received far more consumer complaints.

A 2016 CreditCards.com analysis of more than 2,000 credit card agreements on file with the Consumer Financial Protection Bureau (CFPB) found that most agreements are written at the 11th grade reading level, which is "still too hard for at least half the population to readily understand." In a corresponding Princeton Survey Research Associates International survey, it was found that consumers most frequently associated their credit card agreements with the words "confusing" and "complex." Student loan borrowers, too, report greater confusion with the terms of their loans than CFSA member company customers. A recent survey by LendingTree found more than half of student loan borrowers erroneously believe that interest on student loans does not accrue while they are still in school, and a similar percentage believes that their federal student loan payments are automatically income-based rather than fixed over a 10-year term until they apply for a different payment plan.

In 2016 more than one million small-dollar loan customers submitted comments opposed to the CFPB's proposed small-dollar loan rule – hundreds of thousands of whom sent handwritten letters telling personal stories of how small-dollar loans helped them and their families. Unfortunately, the Bureau ignored these customers when it crafted its original rule. We are pleased that the CFPB is proposing to rescind part of its 2017 final rule and to delay the compliance date, and we appreciate that the Bureau has recognized some of the critical flaws of the final rule as promulgated during former Director Richard Cordray's tenure. The Bureau seems to have come to realize what we have long known, that consumers understand the costs and risks associated with short-term loans, they make reasoned and informed credit decisions and choose the products that best serve their needs. We hope the Bureau will give weight to the comments submitted by consumers during the current comment period speaking out on why these loans are important to them. Unlike its previous rulemaking, the CFPB must craft a rule that appropriately balances consumer protection with access to credit.

CFSA members are committed to serving the credit needs of their customers and abide by a strict set of 15 mandatory Best Practices to hold themselves to a higher standard of responsible lending and help customers make informed financial decisions. Last year, CFSA modernized its Best Practices to further enhance consumer protections and address the evolving credit needs of small-dollar loan customers. The modernized Best Practices include new ability to repay and consumer privacy provisions, as well as enhanced customer disclosures and a broader extended payment plan that covers all small-dollar loans offered by our members. CFSA member companies also provide their customers with unparalleled transparency; each store prominently displays full and clear loan disclosures, including the cost of a loan expressed in both dollars and as an annual percentage rate.

The demand for credit will exist whether or not small-dollar loans are legally available, and it is important for regulators and lawmakers to consider the impact that restricting this vital source of credit will have on consumers and communities across the country. It has become more apparent, through the CFPB rulemaking process, that the issue with small-dollar lending is less about the product itself and more about the lender offering the product. The very idea that banks can enter this field is, in some sense, a validation of small-dollar lending. We encourage the competition banks bring to this lending sector. Sound regulation and policy should not pick winners and losers, nor should it be based on hidden, preconceived agendas. CFSA welcomes balanced regulations that offer meaningful consumer protections, promote consumer choice and responsible lending, and foster innovation and competition.

Thank you again for the opportunity to submit a statement for the record for today's hearing on the small-dollar, short-term credit industry. We are happy to provide you with any additional information and answer any questions you may have about the industry and the important services we provide.

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