

September 18, 2014

United States Senate
Senate Committee on Banking, Housing, and Urban Affairs

By Electronic Delivery

**RE: Hearing: “Assessing and Enhancing Protections in Consumer Financial Services”
(September 18, 2014)**

Chairman Johnson, Ranking Member Crapo, and Members of the Committee:

I am pleased to be here with you today to discuss protections in consumer financial markets. As a senior director at the Pew Charitable Trusts, I lead a portfolio of work that rigorously assesses and, where warranted, promotes non-partisan, evidence-based solutions to improve the safety and transparency of consumer financial markets and the financial health of the American family. We focus on families' ability to borrow and manage their funds safely and wisely, to save for the future and to move up the economic ladder. Included in our work is an extensive body of research examining the current financial condition of diverse families, the effect of employer benefits on household financial security and the connection between financial capital—especially emergency and retirement savings—and economic stability and mobility.

Chairman Johnson, I would like to thank you for holding this important hearing and—as you prepare to leave the United States Senate at the end of the year—applaud your strong efforts to ensure that the nation’s financial markets function in an open and fair manner so that consumers and businesses have an opportunity to thrive.

Since Pew launched our safe credit cards project in 2007, we have focused on better understanding household financial needs and experiences, identifying policies that improve consumer outcomes and promoting a marketplace and regulatory environment that allow businesses to innovate and better meet consumer needs. We employ a data-driven approach, working to inform policymakers with a detailed empirical analysis of industry practices and their effects on consumers.¹ Along with the work of a number of organizations, senior Members of Congress from both parties and President Obama, Pew’s research on the credit card marketplace contributed to the passage of the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act and the adoption of rules by the Federal Reserve that have effectively implemented this groundbreaking and effective law. A 2013 academic study, authored by professors from New York University’s Stern School of Business and the University of Chicago’s Booth School of Business, concluded that the CARD Act is saving

¹ For example, Pew conducted a comprehensive scan of all credit cards offered by dominant card issuers, which found that 100 percent of the products had at least one feature that federal regulators later deemed to be harmful or deceptive. Just two of these practices – which were later eliminated by the CARD Act – were costing American consumers at least \$10 billion per year. The Pew Charitable Trusts, *Still Waiting: “Unfair or Deceptive” Credit Card Practices Continue as Americans Wait for New Reforms to Take Effect* (Oct. 2009), http://www.pewtrusts.org/~media/legacy/uploadedfiles/wwwpewtrustsorg/reports/credit_cards/PewCreditCardsOct09Final.pdf.

consumers more than \$20 billion annually, with little to no reduction in access to credit.² Last October, the Consumer Financial Protection Bureau (CFPB) released a report concluding that the CARD Act had eliminated the deceptive and unfair credit practices it had targeted and that the total cost of credit paid by consumers had declined by two percentage points between 2008 and 2012. The CFPB also found that, while the amount of card credit declined during the financial crisis, creditworthy consumers still had access to \$2 trillion of credit lines.³

Pew's current consumer financial efforts focus on the transaction accounts that Americans rely on every day to manage their finances, including checking accounts, prepaid cards and mobile payments, and on small-dollar loans.

Our [consumer banking initiative](#) began in 2010 with market research on consumer experiences with checking accounts, analyzing the offerings of the nation's largest banks. Our work on checking accounts has focused on disclosures, overdraft and dispute resolution policies.

We've also conducted extensive research on general purpose reloadable (GPR) prepaid cards, which are a relatively new consumer financial product that is growing in popularity. In our most recent survey of prepaid card users, Pew found that 5 percent of adults (implying roughly 12 million people) used these prepaid cards at least monthly. Consumers load money onto the cards and are not required to undergo a credit check before purchasing them. These cards are a versatile financial tool for the 10 million households in the United States that lack a checking or savings account; that cannot obtain a credit card because of poor credit histories; and that want to supplement checking or credit card accounts with one dedicated to saving or paying for something without the temptation of buying it on credit. U.S. consumers loaded more than \$64 billion onto these cards in 2012, according to the Mercator Advisory Group, up from \$56.8 billion in 2011.

The increasing popularity of the cards is good news for consumers who want an alternative to traditional checking or credit accounts—particularly because these cards have become more affordable over the past year and, in many cases, offer lower and fewer fees than basic checking accounts. The bad news, however, is that there are no federal laws or regulations that directly protect consumers from hidden fees, liability for unauthorized transactions similar to Regulation E, or insurance against loss of funds in the event of an issuing institution's failure. Nor are there federal rules requiring these cards to provide disclosures of fees, terms, conditions, or dispute resolution practices. Federal Reserve Board checking account rules that require consumers to affirmatively opt in to overdraft service also do not apply to GPR cards, and there are no rules preventing other credit products such as a line of credit from being attached to prepaid cards. These omissions are troubling because Pew's research shows that most GPR prepaid cardholders do not want overdraft features to be available on their cards. Instead, they want a safe and useful financial tool that helps them maintain financial discipline.

Considering the growing use of these cards as an alternative or complementary product to the traditional checking account, it is important for consumers to be able to keep the funds on their GPR prepaid cards secure and perform transactions without risk of losing money or going into debt. Though our research finds that the providers are competing for business by lowering some fees and are facing pressure from new entrants in the market, including retail banks and established financial

² Johannes Stroebel, Neale Mahoney, Sumit Agarwal and Souphala Chomsisengphet, *Regulating Consumer Financial Products: Evidence From Credit Cards*, (Aug. 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330942.

³ The Consumer Financial Protection Bureau, *CARD Act Report*, (Oct. 2013), http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf.

services companies, current consumer protection measures clearly lag behind similar products such as debit cards linked to checking accounts.

With regard to checking accounts, Pew's most recent research shows that the marketplace has improved in some respects, with more banks and credit unions using a summary document to disclose key checking account fees, terms, and conditions. In 2011 after analyzing account information from the ten largest banks and finding that the median length of the disclosures was 111 pages we developed a summary disclosure "box," consumer-tested and promoted its adoption among financial institutions. As of September 2014, 20 banks, including 11 of the 12 largest, and 8 credit unions, including the three largest, have worked directly with Pew to adopt this model document. Additionally, the box appears to be evolving into an industry standard, with many institutions adopting a box without collaborating directly with Pew. A sample of the nation's 50 largest banks found that the number with a disclosure box adhering to Pew's recommendations increased from 23 percent in 2013 to 54 percent in 2014.

We've also studied the disclosures that are included with the purchase of general purpose reloadable (GPR) prepaid cards. Currently, most consumers shop for prepaid cards in a store and only have access to the complete fees, terms and conditions for a card after purchasing it and opening the card packaging. This makes it impossible for these consumers to comparison-shop for the card that best meets their needs prior to purchase. Based on the current "clamshell" packaging, we were able to develop a disclosure document that consumers could open in a retail establishment to help them choose the card that will best meet their needs. Since a GPR prepaid card can be used as a replacement for a checking account, we developed this prepaid disclosure box based on our checking account model, allowing consumers to not only comparison shop among prepaid cards, but also making it easy to compare these products to checking accounts.

JP Morgan Chase was the first company to adopt a prepaid disclosure box, for its Liquid card. We have also worked with Visa on a new designation that identifies safe cards that meet significant consumer protection standards. To receive the designation, cards must have the following features: no overdraft charges, a simplified fee structure with a flat monthly fee; clear cost disclosures; deposit insurance by the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration (NCUA); and no customer liability if the card is lost or stolen. Cards must also be in compliance with most aspects of Regulation E of the Electronic Fund Transfer Act. Cards that qualify will receive a special Visa insignia that will be visible on card packaging and materials, allowing consumers to identify and easily select them.

We also continue to focus on overdraft policies as part of our research and advocacy on checking accounts. Previous Pew research examining the financial stability of low-income Hispanic households in the Los Angeles area during the Great Recession showed that more of these families had a checking account involuntarily closed—or closed the account themselves—because of hidden fees (31 percent) than because of a reduced income (27 percent). Our research also showed that families with a checking account weathered economic problems better than those without and were able to save more money.

Since research shows that overdraft policies are a large factor in causing consumers to leave the banking system, Pew has focused on working with financial institutions to reform bank overdraft policies and practices. For example, we provided advice to Bank of America as they developed their Safe Balance account, a new product that does not include overdraft as an option. Effective marketing by Bank of America will be the key to ensuring that large numbers of consumers are aware of and can choose this account option.

Another area of our focus is small-dollar credit. Pew's small-dollar loans project focuses on payday, auto title, and traditional installment loans, as well as emerging alternatives to these products. In 2011, when Pew began work in this area, we shared the concerns that some policy makers and other stakeholders expressed that the small-dollar loan market showed signs of harmful practices and market failures. Yet research on the often-complicated motivations behind consumer use of these types of products was limited, as was data about borrower experiences and attitudes. This lack of fundamental knowledge made it difficult to assess the potential effectiveness of policy solutions. Therefore, Pew embarked on an extensive research project. We completed the first-ever nationally representative survey of payday loan borrowers, and conducted an exhaustive analysis of regulatory data and academic papers.

Pew's research, which has been published in our *Payday Lending in America* series,⁴ demonstrates that there are serious failures in the small-dollar loan market and shows how new policies can help lenders provide access to credit that leads to better consumer outcomes. Key findings of our work include:

- 12 million Americans take out payday loans each year, spending approximately \$7.4 billion annually. The average loan is \$375.
- A payday loan is characterized as a short-term solution for unexpected expenses, but the reality is different.
 - The average borrower is in debt for five months during the year, spending \$520 in interest to repeatedly reborrow the loan.
 - 69 percent of first-time borrowers use the loan for recurring bills (including rent or utilities), while just 16 percent deal with an unexpected expense such as a car repair.
- Payday loans are unaffordable.
 - Only 1 in 7 borrowers can afford the more than \$400 needed, on average, to pay off the full amount of these lump-sum repayment loans by their next payday.
 - Most borrowers can afford to put no more than 5 percent of their paycheck toward loan payment and still be able to cover basic expenses. Yet in the 35 states that allow lump-sum payday loans, repayment requires about one-third of an average borrower's paycheck.
- Most payday loan borrowers have trouble meeting monthly expenses at least half of the time.
- 41 percent of borrowers have needed a cash infusion, such as a tax refund or help from family or friends, to pay off a payday loan.
- Payday loans do not eliminate overdraft risk. Most borrowers also overdraw their bank accounts.

⁴ The Pew Charitable Trusts, *Payday Lending in America*, www.pewtrusts.org/small-loans.

- A majority of borrowers say payday loans take advantage of them. A majority also say they provide relief.
- Borrowers want changes to payday loans.
 - By almost a 3-1 ratio, borrowers favor more regulation of the loans.
 - 8 in 10 borrowers favor a requirement that payments take up only a small amount of each paycheck.
 - 9 in 10 favor allowing borrowers to pay back the loans in installments.

CFPB Efforts to Date on Transaction Accounts and Small-Dollar Loans

The CFPB is required by law to ensure a safe and transparent consumer financial marketplace, which includes mandates to address unfair, deceptive and abusive practices and to ensure consumer access to financial services. It is empowered under the Dodd-Frank Act with rulemaking, enforcement and supervision powers to achieve these goals, as well as a mandate to collect and respond to individual complaints about products and services and to engage and educate consumers. Significantly, it has authority to oversee the business conduct of virtually all depository institutions and designated large non-bank financial services companies in a uniform manner. This allows the Bureau to write consistent rules that cover similar products offered by different types of financial services providers —such as prepaid cards or small-dollar loans. This approach has benefits for both financial services companies and their customers, ensuring a level regulatory playing field for industry and equivalent protections for consumers, no matter what type of company they seek out or product they use.

Research

The CFPB is also required under the Dodd-Frank Act to put research and analysis at the center of its work and to carefully balance the interests of industry and consumers. For example, it is required to monitor consumer financial markets to assess risks to consumers and the impact of existing regulations on financial institutions and small businesses in order to reduce burdensome requirements and minimize the impact of new rules. Since it opened its doors over three years ago the CFPB has published many research papers that document activity that is occurring in various consumer product markets and provide an evidence base—along with the work of research-oriented institutions like Pew—for any regulatory actions the Bureau proposes to take. For example, the CFPB found in its July, 2014 Data Point that 8 percent of customers incur 75 percent of overdraft fees.⁵ Similarly, Pew found in a recent survey of consumers who had overdrawn their checking account with a debit card that that 7.3 percent of customers are responsible for 49 percent of the overdraft fees charged.⁶ This data demonstrate that consumers who repeatedly overdraw are not only providing a substantial part of overdraft revenue but are also sustaining very high aggregate fees, putting their financial security at risk.

⁵ The Consumer Financial Protection Bureau, *Data Point: Checking Account Overdraft*, (July 2014), http://files.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf.

⁶ The Pew Charitable Trusts, *Overdrawn: Consumer Experiences with Overdraft*, (June 2014), http://www.pewtrusts.org/~/media/Assets/2014/06/26/Safe_Checking_Overdraft_Survey_Report.pdf

The CFPB also found in this Data Point that the propensity to overdraft is higher for younger account holders, with 10.7 percent of the 18-25 year old age group having more than 10 overdrafts per year. Pew's survey research found that a 25 year-old is 133 percent more likely to pay an overdraft penalty fee than a 65 year-old. The CFPB's Data Point also concluded that most consumers who overdraft bring their accounts into the black quickly, with more than half achieving a positive balance within three days and 76 percent within one week. Correspondingly, Pew's research has found that most consumers who overdraft had negative balances for four or fewer days. Finally, the CFPB found that the median size of debit card transactions that result in an overdraft fee is \$24 and that the median fee is \$34. If put in terms of an annualized loan interest rate, a typical overdraft carries a 17,000 percent APR. Based on this data, we can conclude that overdraft programs offer expensive, very short-term loans that are disproportionately used by younger customers who are new to the banking system.

In the case of small-dollar lending, the CFPB has taken a methodical approach to studying the market. In April of last year, the Bureau published findings of a year-long study of usage data obtained through its supervision of conventional and bank deposit advance payday loan providers. The Bureau found that the structure of payday loans created substantial risk of harm to consumers. This is because payday loans require borrowers to pay several hundred dollars out of their next paycheck to lenders that have a priority payment position, allowing them to reach directly into borrower checking accounts before other bills are paid. The Bureau found that a sizable share of payday loan users conduct transactions on a long-term basis (two-thirds of borrowers use seven or more loans per year, mostly in rapid succession), suggesting that they are unable to fully repay the loan and pay other expenses without taking out a new loan shortly thereafter.

In March of this year, the Bureau followed up with a second report that revealed new usage data, showing for example that the vast majority (80 percent) of payday loans originate within two weeks of a previous loan, suggesting how important consecutive repeat usage is to the payday loan business model. With these studies, the CFPB used its unique access to market data to release definitive research that confirms findings by Pew and other researchers,⁷ that the vast majority of payday loans (and therefore lender revenue) result from long-term, repeat usage. This lending is often predicated on leveraging access to the borrower's checking account to collect payment on loans that many cannot afford, leading to repeat borrowing to make ends meet.

Enforcement and Rulemaking

The CFPB has said that it will propose rules this year on prepaid cards. In 2012, the CFPB released an advanced notice of proposed rulemaking, asking about significant consumer protection issues for consumers using these cards, including disclosure, unauthorized transactions and product features, specifically overdraft or credit linked to these cards.⁸

The CFPB has also stated its intention to issue rules governing the payday and small-dollar loans market. In November of 2013, the Bureau took its first enforcement action against a payday lender that was allegedly engaging in inappropriate collections activity.⁹ More recently, the Bureau

⁷ Robert DeYoung and Ronnie J. Phillips, *Payday Loan Pricing*, (Federal Reserve Bank of Kansas City, Economic Research Department, Feb. 2009), 7, <http://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf>.

⁸ The Consumer Financial Protection Bureau, *Advanced Notice of Proposed Rulemaking*, (May 2012), http://files.consumerfinance.gov/f/201205_cfpb_GPRcards_ANPR.pdf.

⁹ See <http://www.consumerfinance.gov/blog/our-first-enforcement-action-against-a-payday-lender/>.

sanctioned another lender for “pushing payday borrowers into a cycle of debt.”¹⁰ Notably, the Bureau found that the company in question had “created and leveraged an artificial sense of urgency to induce delinquent borrowers with a demonstrated inability to repay their existing loan to take out a new [company] loan with accompanying fees.” This, the CFPB concluded, took unreasonable advantage of consumers’ inability to protect themselves, and was an abusive practice under applicable law.

Problems that Remain in the Transaction Account and Small-Dollar Loan Markets

Although much progress has been made by Congress and the CFPB in recent years in addressing problems in consumer financial markets, a great deal of research by Pew and the Bureau itself demonstrate there are still significant safety and transparency problems that need to be addressed.

Checking Accounts and Prepaid Cards

One area of particular concern regarding checking accounts is consumer confusion about whether they have opted in for overdraft coverage when using their debit card for a purchase or at an ATM. In 2010, the Federal Reserve implemented new rules requiring that consumers affirmatively choose to “opt in” to overdraft coverage, but our most recent survey of checking account consumers who had incurred an overdraft in the last year showed that over half were not aware that they had chosen coverage.¹¹

Unfortunately, this situation has not improved. We asked the same question in a 2012 survey of consumers who overdrafted and got a similar result. The CFPB’s research into overdraft further elucidated the problems with this market. Their 2013 “Study of Overdraft Programs” found that of opt-in rates varied dramatically for the banks they examined, ranging from less than ten to more than 40 percent. The CFPB study suggests that the manner in which each institution describes or sells overdraft options to new customers varies considerably. We have urged the CFPB to write new rules requiring financial institutions to provide account holders with clear, comprehensive, and uniform pricing information for all available overdraft options so that each consumer can make an informed decision about this product. This could be accomplished by modifying the Federal Reserve’s “safe harbor” opt-in form to ensure that consumers understand all of their options and the implications of their choices.

Furthermore, “high-to-low” transaction reordering remains a serious concern. This involves financial institutions manipulating the order that transactions post to an account in order to deplete the balance more quickly, leading to more overdrafts and additional fees.¹² In its 2013 study, the CFPB found that debit posting orders vary considerably from institution to institution and, in fact, no two banks studied use the same approach.

Pew’s research shows that somewhat fewer banks are engaging in high-to-low transaction reordering in the last year. Our latest analysis found a small decrease in the proportion of banks that reorder transactions from high to low, from 54 percent in our 2013 report to 49 percent in 2014. While this indicates some progress, it’s important to note that all of the banks that we surveyed state

¹⁰ See <http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-acc-cash-express-for-pushing-payday-borrowers-into-cycle-of-debt/>.

¹¹ The Pew Charitable Trusts, *Overdrawn*, 5.

¹² For a data visualization of this practice, see <http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/checks-and-balances>; The Pew Charitable Trusts, *Checks and Balances* (Apr. 2014), 21. <http://www.pewtrusts.org/~media/Assets/2014/04/09/ChecksandBalancesReport2014.pdf>.

in their disclosures that they retain the right to change their practices at any time. Pew has urged the CFPB to write new overdraft rules that prohibit the reordering of transactions to maximize fees, in favor of posting deposits in a fully disclosed, objective, and neutral manner. Without a rule forbidding this practice, even banks that no longer reorder transactions have the ability to reinstate this practice at any time. Given the extremely high cost of overdrafts described above, we have also urged the Bureau to require all financial institutions to make penalty fees reasonable and proportional to a bank's costs in covering the overdraft transaction.

General purpose reloadable cards are relatively new financial products. As a result, they do not carry the same consumer protection requirements as checking accounts, despite the similarity in how they can, and are being, used. Comparing the data from our two market scans published in 2013 and 2014 we have observed that the fee structure of these cards is shifting to more closely resemble checking accounts.¹³ Per transaction fees are not as common as they were in Pew's 2013 report, and monthly fees, like those associated with checking accounts, are more prevalent.

Additionally, our survey research finds that a primary reason consumers use GPR cards is to avoid unexpected or hidden fees, like overdraft, associated with traditional checking accounts.¹⁴ We found that 66 percent of prepaid consumers use the cards so that they do not spend more money than they actually have.¹⁵ In fact, 63 percent report having paid checking account overdraft fees and 41 percent say they have closed or lost a checking account because of these fees.¹⁶ In our 2014 market scan we found that only one card in the marketplace offers overdraft, demonstrating that this feature is not necessary to make the product financially viable. For these reasons, we have urged the CFPB to prohibit overdraft or other automated or linked lines of credit on GPR cards. In addition, we have recommended that the Bureau extend important protections under The Electronic Fund Transfer Act (EFTA) that apply to checking accounts to prepaid cards. These Regulation E protections include requirements that financial institutions: investigate unauthorized transaction claims, place limitations on the liability of consumers, credit the account for the amount of a disputed transaction while the dispute is pending, and provide consumers access to periodic statements and past transaction information. Given the substitutability of these products it makes sense for consumers to expect and receive similar protections.

Another important protection for consumers is the requirement that funds on GPR prepaid cards be FDIC insured. Currently, while most cards are covered by federal deposit insurance, non-bank prepaid card providers that do not carry a Visa or MasterCard logo are not required to make sure that these funds are federally insured should the company go out of business. Rather, the card provider can choose to comply with state money transmitter laws, which do not offer the same level of protection for consumers as federal insurance. As stated above, the CFPB has broad authority to ensure that similar products are regulated consistently. The Bureau should require that all funds loaded onto prepaid cards are covered by this insurance.

Both checking accounts and prepaid cards need clear, concise, and easy-to-understand disclosures. This information should be accessible both online and when consumers purchase the cards at bank or credit union branches (for checking accounts) and retail locations (for prepaid cards) to enable the consumer to shop among different providers. While we applaud the many banks and credit

¹³ The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards* (Feb. 2014), 2.

http://www.pewtrusts.org/~media/legacy/uploadedfiles/pes_assets/2014/PrepaidCardsStillLoadedReportpdf.pdf.

¹⁴ The Pew Charitable Trusts, *Why Americans Use Prepaid Cards* (Feb. 2014), 8.

http://www.pewtrusts.org/~media/legacy/uploadedfiles/pes_assets/2014/PrepaidCardsSurveyReportpdf.pdf.

¹⁵ *Ibid.*, 14

¹⁶ *Ibid.*, 8

unions that have voluntarily adopted clear checking and prepaid card disclosures, consumers will only have access to uniform information that allows them to easily compare the terms and conditions for all checking account and prepaid providers if the CFPB requires it.

Finally, in December 2013, the CFPB's report, "Arbitration Study Preliminary Results," found that larger banks tend to include mandatory arbitration clauses in their consumer checking contracts, while midsized and smaller banks and credit unions do not. Interestingly, the Bureau estimates that only about 8 percent of banks include arbitration clauses in their checking account contracts but that these clauses cover 44 percent of insured deposits. Mandatory pre-dispute binding arbitration clauses present several risks. They prevent consumers from choosing the option of challenging unfair and deceptive practices or other legal violations in court, potentially allowing some abusive practices to spread without legal or public scrutiny. They also deprive consumers of important legal remedies—including a jury trial—curtail judicial civil procedures and due process protections, such as the ability to appeal a decision, and raise serious conflict-of-interest concerns if the companies that provide arbitration services provide repeat business to the financial institutions that mandate it.

In Pew's 2012 report, "Banking on Arbitration: Big Banks, Consumers, and Checking Account Dispute Resolution," we also found that the larger the financial institution the more likely an account agreement contains a clause requiring mandatory binding arbitration. We determined that financial institutions that require arbitration are much more likely to ban class-action lawsuits. In our most recent "Checks and Balances" report, we found that more banks have added class-action and jury trial waivers along with mandatory binding arbitration clauses to their account agreements, all of which limit a consumer's options during a dispute.¹⁷ In a separate report on prepaid cards, we found that 51 of the 66 cards studied (77 percent) have contractual clauses that require cardholders to submit to mandatory binding arbitration. Fifty cards (76 percent) also disclose that cardholders are not permitted to participate in class action litigation involving that card.¹⁸ As a result of this research, Pew has recommended to the CFPB that mandatory arbitration clauses in checking accounts and prepaid card contracts be prohibited.

Small-Dollar Loans

As you know, the CFPB has the power to regulate some non-bank financial entities, such as payday lenders, which is the first time these institutions will be under federal oversight. Though the Bureau has not yet issued rules to govern this market, it has stated its concern over the potential harms in this market, and its intention to use its powers to address those harms. Similarly, after several years of intensive study, Pew has concluded that the CFPB must issue broad new rules to govern the entire small-dollar loan market.

Pew's research conclusively shows that payday loans are unaffordable for most borrowers. The loans require payments equal to one-third of a typical borrower's income, far exceeding most customers' ability to repay and meet other financial obligations without quickly borrowing again. Payday lenders have a unique legal power to withdraw payment directly from borrowers' checking accounts on their next payday, prompting those without enough money left for rent or other bills to return to the lenders, repay the loans, and pay an interest-only fee to quickly re-borrow, resetting the due date to the next payday. This extraordinary form of loan collateral allows lenders to thrive even as they make loans to those who cannot afford them. The average borrower is in debt for nearly half the year, and the vast majority of lender revenue comes from those who borrow consecutively.

¹⁷ The Pew Charitable Trusts, *Checks and Balances, 2014 Update*

¹⁸ The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards*

Payday lenders achieve profitability only when the average borrower is in debt for months, even though the product is promoted as a short-term bridge to the next payday. These facts demonstrate a significant market failure.

Based on our research findings on small-dollar loans we developed policy recommendations urging the CFPB to:¹⁹

- **Ensure that the borrower has the ability to repay the loan as structured.** The key to achieving this goal will be to require lenders to more carefully consider a borrower's ability to repay the loan, as structured, without having to borrow again to make ends meet. Payments on a payday loan currently take more than one-third of the borrower's next paycheck, and that is an unreasonable amount. Pew's research provides a clear benchmark for identifying a more reasonable payment—for most borrowers, monthly payments above 5 percent of gross monthly income are unaffordable. The CFPB should treat loans requiring payments above this threshold as unreasonable unless the lender can clearly demonstrate, through proper underwriting, that the borrower can afford more. With such a clear benchmark in place, the CFPB could eliminate a broad array of harms while giving honest lenders a clear and low-cost way of making safer credit available.
- **Spread loan costs evenly over the life of the loan.** Front-loading of fees and interest creates incentives for lenders to refinance loans and extend overall indebtedness (sometimes called loan flipping). Any fees should be paid evenly over the life of the loan. Sensible rules to limit lender incentives for loan flipping should be part of any small-dollar loan rule.
- **Guard against harmful repayment or collections practices.** Borrowers need stronger rights to protect their checking accounts against unscrupulous lenders or debt collectors, and banks should be held more accountable for honoring their customers' requests to stop payments or cancel automatic electronic withdrawals. Sensible safeguards can preserve the integrity of the electronic payments system and help honest lenders make affordable loans to those who need them.
- **Require concise disclosures of periodic and total costs.** Consumers need accurate information to make good decisions.
- **Continue to set maximum allowable charges.** Research shows loan markets serving those with poor credit histories are not price competitive.

Pew has also recommended that policy makers protect against excessively long loan terms and have developed a formula based on borrower income and the size of the loan to prevent this costly practice. The formula can be included in laws or regulations in conjunction with other legal requirements, or can be used as a benchmark by financial institution examiners.

Pew has shown empirically that enacting such measures can yield much better consumer outcomes with almost no loss in consumer access to credit, in a way that works for lenders.²⁰ Access to credit

¹⁹ The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (Oct. 2013), 44-47.

http://www.pewtrusts.org/~media/legacy/uploadedfiles/pes_assets/2013/PewPaydayPolicySolutionsOct2013pdf.pdf.

²⁰ See The Pew Charitable Trusts, *Payday Lending in America*. The report includes a case study of Colorado's 2010 payday loan reform, which required all payday loans to become six-month installment loans and included many features that approximate Pew's policy recommendations.

remains virtually unchanged after a recent legal reform in Colorado, but borrowers spend less, and payments are far more affordable.

Conclusion

The CFPB, which was created in the wake of the financial crisis to make consumer financial markets safe, efficient and transparent, has a crucial role to play in the next few years in enhancing consumer protections for transaction accounts and small-dollar loans. The CFPB clearly has the authority and jurisdiction it needs to effectively and fairly address the serious problems I have identified today. It has also demonstrated that it will take a methodical approach to understand and address problems in these markets. In particular, the CFPB's research and initial enforcement actions on transaction accounts and small-dollar loans have been thorough and deliberate. These important early moves provide a basis for the CFPB to propose effective new rules in the months ahead that eliminate unfair, deceptive or abusive practices, while also allowing scrupulous financial services companies a fair chance at serving consumers profitably. It is now up to the CFPB to seize this historic opportunity. We applaud the committee for its attention to and oversight of the CFPB's work in these areas and urge you to continue these efforts to ensure that the Bureau acts in a timely, effective and balanced manner.

Thank you for the opportunity for Pew to participate in this discussion. My colleagues at The Pew Charitable Trusts and I would welcome the opportunity for further conversations at any time.

Sincerely,

A handwritten signature in black ink that reads "Travis B. Plunkett". The signature is written in a cursive style with a large, sweeping initial "T".

Travis B. Plunkett
Senior Director, Family Economic Stability
tplunkett@pewtrusts.org
www.pewtrusts.org

