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HOUSE COMMITTEE ON FINANCE
The Honorable Sylvia Luke, Chair
The Honorable Ty J.K. Cullen, Vice Chair

S.B. NO. 537, S.D. 2, PROPOSED H.D. 3, RELATING TO CONSUMER PROTECTION

Hearing: Wednesday, April 3, 2019, 2:00 p.m.

The Office of the Auditor has **no position** regarding S.B. No. 537, S.D. 2, Proposed H.D. 3, which proposes, among other things, registration of "check cashers" and "small dollar lenders" who conduct business in the State and requires the Office of the Auditor conduct a "sunrise analysis of the regulation of payday lenders and deferred deposit transactions and its impact on consumer protection in the State." **However, we offer the following comments.**

First, we note that the Hawaiʻi Regulatory Reform Act, Chapter 26H, Hawaiʻi Revised Statutes (HRS), requires any new regulatory measure that would subject unregulated professions and vocations to licensing or other regulatory controls be referred to our office by concurrent resolution. *See* Section 26H-6, HRS. We assess the probable effects of the proposed regulatory measure and whether the proposed regulation is consistent with the policies in Section 26H-2, HRS.

S.B. No. 537, S.D. 2, Proposed H.D. 3, requires us to specifically examine the following areas:

1. The increasing impact of out-of-state internet lenders who operate in the State;
2. Data regarding consumer complaints;
3. The impact of Chapter 480F, HRS, on consumers within the State over the past fifteen years; and
4. Any further measures necessary for increased consumer protection in the State.

However, we note that, under the Hawaiʻi Regulatory Reform Act, our analysis of proposed regulatory measures is based on statutory criteria identified in Section 26H-2, HRS.

The information requested in the bill appears to seek an analysis of the overall impact of legislation on consumers and further measures necessary for increased consumer protection rather than an analysis of proposed legislation that would subject unregulated **professions and vocations** to licensing or other regulatory controls. We note in previous testimony the Division of Financial Institutions suggests that the interests of Hawaiʻi's consumers and the public at large would be well served by the enactment of legislation to regulate in this area and has offered suggested language to various committees. We believe the Division of Financial Institutions may be better equipped to gather this information and recommend any further legislation that may be necessary.

Thank you for considering our testimony related to S.B. No. 537, S.D. 2, Proposed H.D. 3.

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Testimony of the Department of Commerce and Consumer Affairs

Before the
House Committee on Finance
Wednesday, April 3, 2019
2:00 p.m.
State Capitol, Conference Room 308

On the following measure:
S.B. 537, S.D. 2, Proposed H.D. 3, RELATING TO CONSUMER PROTECTION

Chair Luke and Members of the Committee:

My name is Iris Ikeda, and I am the Commissioner of Financial Institutions for the Department of Commerce and Consumer Affairs' (Department) Division of Financial Institutions (DFI). The Department appreciates the intent of this bill and offers comments.

The purpose of this bill is to encourage transparency and increase consumer protection in the payday lending industry by: (1) transitioning from lump sum deferred deposit transactions to installment-based small dollar loan transactions; (2) specifying various consumer protection requirements for small dollar loans; (3) beginning January 1, 2020, requiring licensure for small dollar lenders that offer small dollar loans to consumers; (4) specifying licensing requirements for small dollar lenders; and (5) authorizing the DFI to establish and hire two full-time equivalent (2.00 FTE) permanent examiners to carry out the purposes of the small dollar installment loan program, funded via an increase to the ceiling of the Compliance Resolution Fund (CRF).

The Department notes that proposed H.D. 3 appears to contain conflicting language. Section 2 of the bill appears to create a licensing scheme supervised by the DFI that would provide for use of the Nationwide Multistate Licensing System (NMLS) to license small dollar lenders and allow the DFI to regulate, supervise, and examine licensees and investigate complaints. This section also has some internally inconsistent language and terms not used in the small dollar lending industry.

In addition, proposed H.D. 3 may treat in-state small dollar lenders differently than internet small dollar lenders by requiring in-state small dollar lenders to pay a higher licensing fee based on the number of branches in the State. In contrast, internet lenders do not have in-state branches.

Section 11 of proposed H.D. 3 provides for appropriations but does not specify any CRF appropriation amount. As noted in the Department's prior testimony, the Department requests an appropriation of $220,941 from the CRF to establish the two permanent examiner positions, including employee benefits. This timing will allow the DFI to set up the program in fiscal year 2020 and open the application process on January 1, 2020. During this period, the DFI will reach out to the industry and provide education about Hawaii's laws. Meanwhile, the companies in the application process can continue to operate under the new laws while the DFI reviews the application.

The Department suggests the following amendments to provide clarity and efficiency in implementing the small dollar lending licensure program:

- Page 9, line 8: Replace "National Credit Union Share Insurance Fund" with "National Credit Union Administration" to maintain consistency with Hawaii Revised Statutes (HRS) chapter 412 (Code of Financial Institutions), article 10 (Credit Unions);
- Page 30, lines 11-15: Move the language in subsection (c) to a new section entitled "Unique Identifier" to require all small dollar lenders to use a unique identifier, not just internet small dollar lenders;
- Page 30, lines 19-20: Delete "savings and loan or building and loan association," as these organizations are no longer recognized as financial institutions;

- Page 30, line 20: Add “financial service loan company”, which is recognized as a financial institution;
- Page 32, line 14: Add “as defined in section 412:1-109” after “A financial institution”, to maintain consistency with HRS chapter 412 (Code of Financial Institutions);
- Page 37, line 6: Add “state or” before “federal” to allow disqualification of an applicant who is guilty of a felony in another state;
- Page 43, lines 1-2: Add a non-refundable fee of $100 for the change of physical location or mailing address for each branch office or principal place of business;
- Page 55, lines 11-18: Delete subsection (f), as the DFI does not pre-qualify applicants prior to application;
- Page 66, lines 8-11: Delete the provision requiring the licensee to waive the privilege of subpoena or discovery, as the DFI is the entity that determines confidentiality of the information or material provided to the Nationwide Multistate Licensing System;
- Amend the definition of “collection agency” in HRS section 443B-1 (Definitions) to clarify that small dollar lenders are not subject to HRS chapter 443B (Collection Agencies):

> "Collection agency" does not include licensed attorneys at law acting within the scope of their profession, licensed real estate brokers, and salespersons residing in this State when engaged in the regular practice of their profession, nor banks, trust companies, building and loan associations, savings and loan associations, financial services loan companies, credit unions, companies doing an escrow business, individuals regularly employed on a regular wage or salary in the capacity of credit persons or in other similar capacity for a single employer who is not a collection agency, nor any public officer or any person acting under an order of court[.], nor small dollar lenders provided in chapter ___ (section 2 of proposed H.D. 3).

Sections 12 through 16 of the bill appear to allow deferred check cashing with a voluntary payment plan if certain conditions exist. This appears to be a

registration with either the DFI or the Office of Consumer Protection (OCP). It is not clear if enforcement of HRS chapter 480F would occur and which agency would be responsible for the enforcement.

Section 17 of proposed H.D. 3 provides that the State Auditor shall conduct a sunrise analysis of the regulation of payday lenders and deferred deposit agreements and its impact on consumer protection in the State. The Department respectfully submits that a sunrise analysis is not necessary or required by HRS chapter 26H, whose purpose at enactment was to address the "growing concern over the rapid proliferation of licensing boards and commissions. . . ." (Act 70, Session Laws of Hawaii 1977). This industry is comprised of companies, not individuals, and is neither a profession nor a vocation.

Finally, proposed H.D. 3 provides an effective date of July 1, 2050, provided that the licensing requirements for small dollar lenders established by section 2 of the Act take effect on January 1, 2051, and that Part II shall take effect on July 1, 3000. The Department requests amending the effective date as follows: "This Act shall take effect on July 1, 2019; provided that the licensing requirements for small dollar lenders established by section 2 of this Act shall take effect on January 1, 2020." This tiered effective date will allow the DFI sufficient time to hire a staff person to establish the program and allow the industry time to create the required disclosures.

Thank you for the opportunity to testify on this bill.

LATE

To: Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Committee on Finance

From: R. Craig Schafer, President / Money Service Centers of Hawaii, Inc.

April 3 2019
In support of SB537 SD2 HD3 with amendments.

Money Service Centers of Hawaii, Inc. is a locally owned and operated money service business (MSB) headquartered in Kapaa, Kauai. We operate fee-based money service centers throughout the State under the trade name PayDayHawaii. Over the past 19 years we have provided check cashing services to over 44,000 Hawaii residents. We provide safeguards not required by law to encourage the responsible use of our short-term credit product. We offer free financial education on our website and mobile devices, 24/7, to help Hawaii's working families in times of financial stress.

SB537 SD2 HD3 adds the following important consumer reforms to Hawaii's check cashing law, HRS 480F which we strongly endorse:

1) Require a notice to the consumer that a payment plan option is available after three consecutive deferred deposit transactions. The payment plan option is designed to stop repeat borrowing and avoid the cycle of debt. The option is available anytime, to consumers in financial hardship.
2) Limits deferred deposit transactions to one per consumer at a time from all sources, including internet lenders. Though part of the current law, it needs clarification and enforcement.
3) Require posting and written notice of the Annual Percentage Rate (APR), along with the current requirement to post the fees.
4) Require posting of information on where to obtain financial education and credit counseling. Consumers must be informed in signage and on the printed contract that deferred deposit transactions are not suitable for long-term borrowing.
5) Require a written notice of a 24 hour right of rescission on deferred deposit transactions. This provision gives consumers an opportunity to read the "fine print" without feeling rushed so they can completely understand the transaction.
6) Limits the fee incurred for a dishonored check to a fee no greater than the fee incurred by the check casher from its financial institution.
7) Removes the exemption (480F-5-1) to protect consumers from any entity, other than banks and financial institutions, cashing checks for a fee. Since the law was originally passed, retailers who cash

checks over $1000.00, such as Wal-Mart, are required to register as a Money Service Business (MSB) with the U.S. Treasury Department under the Patriot Act.

8) Requires the State Auditor to conduct an updated sunrise analysis of the regulation of payday lenders and deferred deposit agreements and its impact on consumer protection in the State. In conducting the analysis, the state auditor shall examine the following:
   a) The increased impact of out-of-state internet lenders who operate in the State;
   b) Data regarding consumer complaints;
   c) The impact of chapter HRS 480F on consumers within the State over the past fifteen years; and any further measures necessary for increased consumer protection in the State.
9) The auditor will submit a report of findings and recommendations, including any proposed legislation, to the legislature no later than twenty days prior to the convening of the regular session of 2020.

While SB537 SD2 HD3 does not replace deferred deposit transactions, it adds an unproven installment loan product. While we are in favor of adding an affordable installment loan option for credit challenged consumers, we are concerned that the plan as written is neither business nor consumer friendly. We think there are better credit building installment loan options, which should be considered that would not lead to increased consumer debt.

This unproven installment loan scheme would be expensive to administer and enforce. This bill is not just bad for our business, it is bad for consumers because it allows multiple installment loans of up to $1000. It creates long term indebtedness with monthly fees with high interest. We appreciate the bill's intent to provide affordable credit. We would support a well thought out credit building installment loan bill similar to California's Pilot Program for Increased Access to Responsible Small Dollar Loans.

SB537 SD2 HD3 requires licensing to offer installment loans. We note that the Hawaii Regulatory Reform Act requires any new regulatory measure that would subject unregulated professions and vocations to licensing or other regulatory controls be referred to the State Auditor by concurrent resolution:

> **HRS 26H-6 New regulatory measures**. New regulatory measures being considered for enactment that, if enacted, would subject unregulated professions and vocations to licensing or other regulatory controls shall be referred to the auditor for analysis. Referral shall be by concurrent resolution that identifies a specific legislative bill to be analyzed. The analysis required by this section shall set forth the probable effects of the proposed regulatory measure and assess whether

its enactment is consistent with the policies set forth in section 26H-2. The analysis also shall assess alternative forms of regulation. The auditor shall submit each report of analysis to the legislature.

We note that the licensing scheme proposed for installment lenders in SD537 SD2 HD3 has funding problems. DFI has testified that is will require funds of over $220,000 to hire two positions to set up the program and to appropriately supervise, regulate and examine licensees. In addition, the program would need to generate revenues sufficient to cover the additional staff members. The 11 storefront companies operating in Hawaii will only generate a little over $47,000 in licensing fees. The leaves $173,000 to be funded by an unknown number of out-of-state lenders.

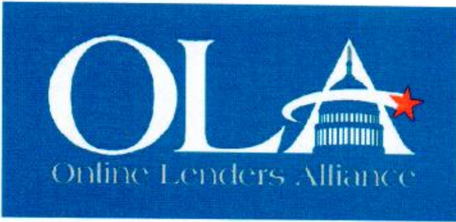
In addition, license fees as proposed in SB537 SD2 HD3 favor our-of-state internet lenders over local lenders with multiple locations, by charging them higher licensing fees. While some out-of-state internet lenders currently operate in Hawaii legally, many ignore Hawaii law and account for all but one complaint to the DCCA. We have identified 30 internet lenders operating in Hawaii who are not registered to pay GET taxes. We find it is difficult to believe those lenders who currently ignore their tax obligation, would readily apply for a license.

We note that the 2005 Sunrise Analysis* is now over 15 years old and should be updated so that we have more up-to-date data for Hawaii, including the increased impact of out-of-state internet lenders. We urge the committee to amend this bill by removing the installment loan provisions and reconsidering the matter in the next session after the State Auditor has had a chance to study the matter

** Sunrise Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans). A Report to the Governor and the Legislature of the State of Hawaii, Report No. 05-11, December 2005.*

Sincerely, R. Craig Schafer, President, Money Service Centers of Hawaii, Inc.

LATE



FIVE PERCENT PAYMENT CAP DENIES 86 PERCENT OF CREDITWORTHY LOANS

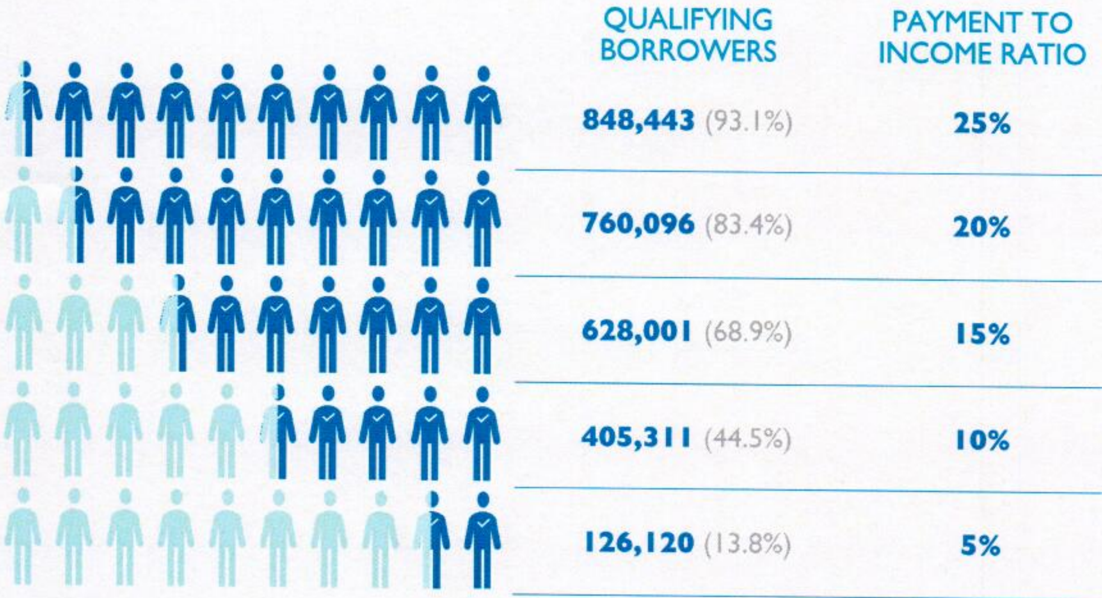
Lenders review a borrower's payment-to-income ratio along with a variety of other measures that help manage risk and predict the likelihood of repayment, particularly for non-prime applicants. Living costs and other debt payments, for example, will bear heavily on a borrower's ability to repay.

The Pew 5% proposal utilizing the payment-to-income ratio is a bright line test restricting access to credit is fundamentally flawed and is more harmful to consumers than helpful.

The 2015 study[1] by Navigant Economics, LLC examined more than 900,000 small-dollar installment loans to determine the effects of payment-to-income restrictions. It demonstrated that **this ratio has little or no bearing on whether loans are paid off** and that imposing such restriction could prohibit **86 percent** of creditworthy borrowers from accessing needed credit.

PEW'S 5% PAYMENT CAP DENIES 86% OF CREDITWORTHY LOANS

Applying payment-to-income restrictions to a sample of 910,985 approved installment loans, researchers showed that hundreds of thousands of borrowers could be denied access to credit.



QUALIFYING BORROWERS	PAYMENT TO INCOME RATIO
848,443 (93.1%)	**25%**
760,096 (83.4%)	**20%**
628,001 (68.9%)	**15%**
405,311 (44.5%)	**10%**
126,120 (13.8%)	**5%**

Additionally, loans meeting a payment-to-income limit of 5 percent have a payoff rate of 73.6 percent, only fractionally higher than the 72.9 percent payoff rate for all loans for which payment-to-income ratio can be calculated.

The full study can be accessed here: http://onlinelendersalliance.org/policy-resources/research/

1.Beales, Howard and Goel, Anand Mohan, Small-Dollar Installment Loans: An Empirical Analysis (March 20, 2015). Available at http://onlinelendersalliance.org/policy-resources/research/

Last updated: October 26, 2018

April 2, 2019

House Committee on Finance
Chair Sylvia Luke
Vice Chair Ty J.K. Cullen

Re: SB 537 HD3 Proposed - Opposition to Restrictions on Small-Dollar Lending, Call for Study

Dear Chair Luke, Vice Chair Cullen, and Members of the House Committee on Finance:

The Online Lenders Alliance ("OLA")[1] would like to submit this letter to raise our serious concerns with the installment loan provisions of Hawaii Senate Bill 537 HD3 ("SB 537"). **OLA strongly urges the Hawaii legislature to undertake a thoughtful and comprehensive study of small dollar installment lending and engage stakeholders before setting lending parameters that can disproportionately harm Hawaiians that are already underserved when it comes to credit access.**

STUDY INSTALLEMENT LENDING

OLA believes the legislature must consider any structural changes to the lending marketplace in a deliberate fashion, only after careful and comprehensive study, to understand the potential impact on Hawaii's underserved consumers. For this reason, OLA has been supporting HB332 HD3, which would implement various consumer protections for consumers relating to check cashing. OLA strongly supports the sunrise analysis of payday lender and deferred deposit regulation called for in HB332. We believe the analysis can provide a sound factual foundation for ensuring Hawaii consumers enjoy the protection they deserve and have access to credit options they need.

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[1] OLA is the first trade association for lending, technology and innovation, representing the growing industry of companies offering loans online and companies which provide services to online lenders. OLA members abide by a rigorous set of Best Practices to ensure their customers are fully informed and treated fairly. ¬OLA represents some of the most innovative financial technology companies committed to the highest standards of conduct, offering online consumer loan products and services with transparent terms that are fully compliant with all federal and state laws.

OLA sets industry standards for our members, ensuring that consumers have access to the most responsible, innovative products in the market. We also monitor and police the web for violations of our Best Practices to members and non-members alike. OLA also serves as a resource to federal and state policymakers on issues related to access to credit. Beyond our role in serving our members, OLA provides resources including a consumer hotline, which is a portal to report fraud, and consumer tips.

Expanding the study to include installment lending - and in particular online lending - would be crucial given the rapid advances in the online financial technology (or FinTech) sector since the Hawaii legislature's last study in 2005.

Those FinTech advances have opened opportunities for creditworthy non-prime consumers who, until recently, have been unfairly shut out.

PLACE OF BUSINESS

OLA supports a modern, well-regulated, and enforceable regulatory structure. However, SB 537's requirement that lenders maintain a principal place of business in Hawaii serves as an impediment to the online lending and competition that would benefit Hawaiian consumers. Mandating a principal place of business does not materially enhance consumer protection, supervision or enforcement and is unnecessary in the modern marketplace.

INCOME

In current form, SB 537 would reorder Hawaii's small dollar lending market. Significantly, it would create a marketplace where unsecured, small dollar installment credit is available only to consumers at the preferred end of the credit spectrum. Meanwhile thousands of Hawaiians who are creditworthy, but nonetheless have lower credit ratings, will effectively be shut off from access that many others take for granted.

OLA is very concerned about SB 537's arbitrary 6% gross monthly income (GMI) limit for borrowers. The goal of all lenders is for their customers to repay their loans by minimizing defaults. Lenders review a borrower's payment-to-income ratio along with a variety of other measures that help manage risk and predict the likelihood of repayment, particularly for non-prime applicants. Living costs and other debt payments, for example, will bear heavily on a borrower's ability to repay. Limiting access to loans that meet the 6% GMI ratio without any consideration of a borrower's expenses and debt expenses is fundamentally flawed and may be more harmful to consumers than helpful.

These concerns are borne out by a study that reviewed over 900,000 unsecured installment loans. ***If a 5% payment-to-income cap to those loans were applied to those loans, eighty-six per cent would have been denied.*** SB 537 calls for a six to seven percent cap, but the marginal increase would still leave far more than half of otherwise approved borrowers cut off from deserved access, as the study demonstrates (see attachment).

An arbitrary payment-to-income cap without regard to other considerations does not protect consumers, as the study demonstrates. Instead, it merely serves as another barrier to credit access for the underserved and undermines credit inclusiveness.

RATE CAP

SB 537 would impose a 36% annual percentage rate (APR) on small dollar, short term consumer loans. While on its face a 36% APR may sound reasonable, a closer look at how a cap like that would function with short-term, small dollar unsecured loans demonstrates why lenders are unable to create a sustainable credit market to serve nonprime consumers at essentially just 3% per month. Most economists agree that using a 36% APR for these short-term, small-dollar

consumer loans really does not make economic sense, especially since many of these loans have terms of only 4 to 6 weeks. An annual rate on a 4-week loan has little to no relevance for consumers in comparing actual costs of loans with a longer term.[2] Many proponents of a 36% APR cap hold that higher charges are predatory, even though these fees are not deceptive and the payment terms are clearly understood by consumers. In contrast, even sophisticated borrowers might not be able to calculate the actual cost of credit for a 4-week, $300 loan based on a 36% APR.

While smaller dollar installment loans are generally for longer periods, the same economics bear out. Instead, restrictive rate caps, such as SB 537's 36% APR limit, pose a serious impediment for nonprime borrowers seeking credit. The costs and risks of providing small-dollar, short-term credit to nonprime borrowers are not warranted under a 3% per month rate cap regime. To illustrate, a decade ago the Federal Deposit Insurance Corporation (FDIC) oversaw a Small Dollar Loan Pilot Program that sought to keep rates below 36% APR. The program ran its course, but lenders have not continued to make these loan products generally available to nonprime borrowers because they were simply not profitable for the financial institutions.

It is also important to understand the cost associated with providing credit to nonprime consumers. Based on studies, short-term consumer lenders must make at least $12-$15 per $100 of principal loaned just to cover its basic costs of doing business, even before lenders make any profit. To put this into perspective, a 36% APR cap would equal $1.38 per $100 for a 2-week loan. The industry opponents know that lenders cannot offer a loan product to consumers using a 36% APR, and it is our belief that their true goal is not to meet the consumers' financial needs but to simply put these lenders out of business.

A good example of what it takes to serve this market is a new loan product offered by U.S. Bank. In 2018, federal banking regulators approved a small-dollar, short-term loan offered by U.S. Bank. ***In order for the loan program to be sustainable, U.S. Bank is charging interest rates between 71% and 88% APR, more than double the 36% APR proposed by SB 537.*** Moreover, U.S. Bank is only able to offer the loans at that rate because it enjoys pricing advantages and risk mitigation generally not available to non-bank lenders, including lower cost of capital; no marketing costs (product is only offered to pre-existing customers); and fully automated underwriting (U.S. Bank would reportedly lose money if a loan officer spent any time on the loan). In sum, U.S. Bank's small-dollar loan offering demonstrates that even under the most favorable circumstances, lenders would be unable to provide small-dollar, short-term credit access to Hawaii's nonprime population. Rather than considering these loans "predatory," we expect that U.S. Bank will find its customers clearly understand the fees associated with these loans and are simply making an economic decision that the cost of these loans is cheaper than

[2] For instance, the Financial Conduct Authority (UK's regulator of payday loans), in establishing rules and guidance for payday lending in the UK, concluded that APRs on short-term loans were not useful: "We decided not to specify our proposed cap in terms of APR (the annual percentage rate of charge) as, while it is useful for comparing the basic cost of loans of the same size and duration that are paid back on time, it is not easy to compare loans of different size and length – for example, a shorter loan that costs the same as a longer one would have a much larger APR." (*Proposals for a Price Cap on High-Cost Short-Term Credit*, Consultation Paper CP14/10, Financial Conduct Authority (July 2014)).

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any alternative solution that is actually available to them. That has been the experience that has driven strong growth in the online lending sector.

There have been several government agencies that have honestly considered the economics associated with providing small-dollar loans to consumers before passing similar legislation. In the United Kingdom, the Financial Conduct Authority (UK's chief regulator of payday loans) conducted an in-depth review of payday lending operations, and they concluded that a reasonable fee would be 0.8% per day (i.e., 24% per month) of the amount borrowed, plus an additional default charge, with the total amount charged not to exceed 100% of the amount originally borrowed. The United States has not engaged in any similar unbiased research in an attempt to address this type of consumer lending, which has an ever-growing consumer demand for the product.

GENERALLY

Over the last 10 years or more, there has been a consistent demand from consumers for short-term, small-dollar loans. As the legislature noted in this bill, in May of 2018, the Federal Reserve System issued its *Report on the Economic Well-Being of U.S. Households in 2017* noted that four in 10 of adults in the U.S. would not be able to cover the cost of an unexpected expense of $400 without selling something or borrowing money to cover the expense. Unfortunately, traditional financial institutions do not commonly offer $300 loans to consumers with poor credit history and no savings. Therefore, these consumers are left with few options.

For example, a consumer in Hawaii who might have an unexpected $300 car repair would have few options, which might include (1) enter into a deferred deposit transaction (cost of approximately $52 under HI Stat. §480F-1 *et seq.*), (2) bounce a few checks that would incur overdraft fees (cost of approximately $60 for two returned checks), (3) obtain a cash advance on a credit card (if available), or (4) obtain a loan from a family member or non-profit organization. Based on these real-world choices, many consumers would choose a $52 fee related to a deferred deposit transaction instead of a $60 bank overdraft fee and the associated embarrassment with the payee. Most consumers prefer to avoid asking a family member or a charity for a loan. The reality is that most consumers do not have the option of going to their local bank to take out a $300 loan. In addition, consumers in Hawaii are well aware of the least expensive alternatives that are available to meet their cash needs.

CONCLUSION

We encourage the legislature to more closely analyze the possible effects of the installment lending aspects of this legislation before moving forward with the bill or any similar legislation. Due to the potential consumer harm and other unintended consequences of this legislation, we encourage the legislature to consult with unbiased research sources to fully understand the affects to the consumer lending industry before passing restrictions that could possibly constrict the consumer lending options for hardworking Hawaiians. OLA is committed to working with you as your committee and the legislature look to ensure Hawaiians have access to safe and reliable credit opportunities.

We appreciate the opportunity to provide input on this legislation. If you have questions or need additional information, please feel free to contact me at mjackson@oladc.org.

Very Truly Yours,

Mary Jackson
President and CEO

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April 2, 2019

Honorable Sylvia Luke, Chair
Honorable Ty J.K. Cullen, Vice Chair
Committee on Finance
House of Representatives
415 S. Beretania Street
Honolulu, Hawaii 96813

Re: SENATE BILL NO. 537, PROPOSED HOUSE DRAFT 3 RELATING TO CONSUMER PROTECTION

Dear Chair Luke, Vice Chair Cullen and Committee Members:

On behalf of Dollar Financial Group ("DFG"), we respectfully submit the following testimony relating to Senate Bill No. 537, Proposed House Draft 3 (SB 537), which will be heard by your Committee on Finance on April 3, 2019 DFG OPPOSES Part I, but SUPPORTS Part II of Proposed House Draft 3.

As discussed below, in lieu of Part I of Proposed House Draft 3, DFG supports House Draft 1, because House Draft 1 makes the changes necessary for an economically viable installment loan market to develop in Hawaii. DFG opposes Part I of House Draft 3 because of our concerns that it ultimately will leave non-prime consumers without any sources of credit. In addition, Sections 6, 7, 8 and 10 in Part I of Proposed House Draft 3 directly conflict with the provisions contained in Part II of Proposed House Draft 3, and these sections should be deleted.

The purpose of SB 537, relating to consumer protection, is to transition Hawaii's non-prime lending market from single-pay deferred deposit transactions (so-called "payday loans") to include lower priced, longer term installment loan transactions.

Currently, deferred deposit transactions, which are authorized under chapter 480F, Hawaii Revised Statutes, represent the only available source of small dollar, short-term credit to the underserved, non-prime borrowers in Hawaii. These non-prime consumers, approximately 160 million in the US and Canada, now represent a larger customer segment than prime consumers but are not able to be serviced and underwritten with traditional prime lending products. Non-prime consumers, including thousands of residents of Hawaii, struggle with unexpected financial hardships daily—many of them are shut out of the traditional financial services market, unable to obtain credit from banks or credit unions.

- A recent Federal Reserve report found that nearly half of the people surveyed said they could not cover a hypothetical emergency expense of $400, and the CFPB's first national survey on financial well-being found that more than 40% of U.S. adults struggle to make ends meet. For years, millions of Americans have relied on small-dollar loans to weather unexpected expenses such as medical bills or car repairs.
- According to a recent survey by a strategic research firm, 94% of small-dollar loan borrowers consider obtaining such loans to be a rational decision when they are faced with these unexpected expenses or to avoid far more expensive alternatives, including bank fees (including overdraft protection and bounced checks), cancellation or late charges (including penalties for late bill payments) and unregulated or illegal loans.

Because credit pricing is determined by repayment risk and this non-prime market segment has a substantially higher credit risk than that of prime consumers, the pricing of non-prime credit products necessarily must be higher than prime credit products in order to support a viable non-prime lending market. In addition, the credit products tailored for this non-prime consumer segment present unique risk underwriting, information technology, compliance, customer need and operational challenges and requirements that differ substantially from traditional credit products offered to prime consumers. As a result, other lower credit risk lenders (e.g., banks) have been unwilling, and, in many respects, unable, to service this non-prime market. From previous testimony, we understand that both Bank of Hawaii and First National Bank of Hawaii agree with this assessment. DFG and most industry observers do not expect this to change. The alternative financial products available to this non-prime market segment, such as check overdrafts, unregulated internet lending or loan sharks, can be costlier and overall less desirable than appropriately structured deferred deposit and installment lending products. Without adjustment to SB 537, non-prime consumers in Hawaii will likely be left with only these options.

DFG currently is the largest non-prime, small-dollar lender in the State of Hawaii, with 8 places of business, employing 32 employees, with over 21,000 customers within the state. DFG is a leader in the US and Canada in the transition from payday loans to small dollar installment loans. Over the last three years, installment lending, as a percentage of DFG's overall loan portfolio, has increased from 25% to 81%. DFG has recent experience in other U.S. states, including California and Florida, and in nearly every province in Canada, with the introduction of new, small dollar installment loans similar to what is proposed in SB 537. DFG's subsidiary, Aspen Financial Direct, began operations in 2018 and offers installment loan products online in 13 states. Aspen is licensed and regulated in each state in which it does business. Non-prime consumers in Hawaii would greatly benefit from access to installment lending products such as those DFG has begun providing in these other jurisdictions.

Based on its recent experience, DFG strongly believes that the optimal regulatory framework is one that enables the delivery of appropriately priced products best suited to the needs of its non-prime customers. Depending on the customer's circumstances, a small dollar short term loan may be the best

option and, in other cases, a larger, longer term installment loan may be more appropriate. Contrary to the views of many, non-prime customers are capable of making rational and informed loan product choices that suit their particular requirements. When access to small-dollar loans is restricted, consumers are harmed.

- Recognized and respected academic studies have shown that when small-dollar loans are removed as an option, consumers bounced more checks, complained more about lenders and debt collectors, and filed for Chapter 7 bankruptcy at higher rates.
- Recent interpretations by regulators of studies previously relied upon to justify stricter regulatory treatment of small dollar loans now indicate that there is not "a sufficiently robust and reliable basis" to support the view that consumers fail to understand the risks and requirements of these loans or their ability to repay them.

DFG would support the implementation of a new small dollar installment loan program in Hawaii, such as that proposed by SB 537, provided that, as contained in House Draft 1, certain limited changes are made to SB 537 to harmonize the installment lending terms with those DFG is complying with in other jurisdictions (in both its retail and online businesses) and, thereby, enable and support an economically viable non-prime lending market in Hawaii.

The economic reality is that there is greater risk associated with lending in this non-prime credit market segment and longer term credit products will introduce even greater degrees of credit risk. This is one of the reasons that other, prime-focused financial institutions are unwilling to extend credit to this market segment and would be even less willing to provide longer term, and greater risk, installment loans. Without a few adjustments to SB 537, the credit risk associated with this market segment is likely to make the desired small dollar installment loan program economically unsustainable and cause current lenders to this non-prime customer base to substantially curtail lending operations or cease operating in Hawaii entirely. Based on DFG's modeling and its loan loss experience with the non-prime market in Hawaii, for each dollar of installment loan debt, the interest and fee revenue permitted under the current terms of SB 537 would barely cover the loan loss reserve that would be necessary for this customer credit class in Hawaii. After accounting for the lender's own cost of funds, its other operating costs and expenses and an expected level of early prepayments, the SB 537 installment loan product as currently configured becomes an unattractive product to any lender in Hawaii (even to a financial institution with extremely low funding costs).

Based on DFG's experience in the other U.S. states (including with its online lending business) and Canada, the following limited changes, which are contained in House Draft 1, are necessary to make the small dollar installment loan framework viable in Hawaii:

1. Maximum Loan Amounts: increase from $1,000 to $2,500
2. Affordability Requirements: increase the verified gross monthly income and verified net monthly income maximums by 1%

3. Monthly Fee Caps: change as follows:

   - Loans up to $300: $20
   - Loans between $300 and $499: $30
   - Loans of $500 or more: $40

4. Installment Lending Transition Period: provide for an 18-month period for the transition from deferred deposit transactions to small dollar installment loans by making elimination of deferred deposit transactions effective on January 1, 2021.

Maximum Loan Amount and Affordability Requirements. With respect to the increased loan amount, because SB 537 includes requirements limiting the amount of monthly payments to specified percentages of the borrower's income, borrowers will be protected against over-extending themselves (DFG's own underwriting controls are also designed to prevent against this). The change will also provide greater flexibility for customers and will more closely align the SB 537 installment lending terms with those for suitable and viable lending products that we now, and are now required to, provide in other jurisdictions. Our recent experience has shown that only when a viable, new installment loan product can be provided to our non-prime customers, can the lending market provide those customers with suitable alternatives to, and facilitate a diversification away from, payday-type products. Based on our risk underwriting and loan loss experience with this particular borrower class, an increase of 1% to the two income affordability measures would not be unreasonable and would appropriately expand access to this needed credit product and provide greater depth to the local lending market.

Fees. As mentioned above, this type of installment credit product (as distinguished from the existing deferred deposit transactions) has substantial and extensive operational, compliance, IT and customer service requirements that would justify a moderately higher fee structure and render the product viable for a responsible lender at the authorized interest rate. DFG is a market leader in implementing operations and systems enhancements to make the delivery of credit products to its customers more efficient. Substantial investments in operational improvements, technology and proprietary risk analytics optimized for the non-prime market enable DFG to more effectively scale its lending operations and provide compliant lending products at the most competitive pricing in the industry. DFG believes that only the most operationally sophisticated and efficient lending organizations will be able to participate in a new installment lending market in a compliant manner in the future and we are the most capable non-prime lender in Hawaii in this regard. However, without an increase to the authorized fees, installment loan revenue will only cover expected loan losses and provide little, if any, additional margin to cover costs and expenses associated with the business.

Implementation Period. If deferred deposit transactions are completely eliminated, then a transition period will be necessary to avoid a total market disruption in Hawaii because SB 537-compliant installment loans will require a substantial investment in operational, IT, compliance and customer service enhancements before the product can prudently be brought to market. Lenders will need time not only to comply with the licensing requirements contained in SB 537, but to successfully

bring about and test the enhancements described above. Similar legislation (including federal CFPB, California, Florida and various provinces throughout Canada) have provided for 12-18-month transition periods. Without a longer transition period, the Hawaii non-prime lending market will shut down for extended periods of time with adverse effects on consumers.

For the reasons we have set forth above, DFG believes it would be inadvisable to completely remove deferred deposit transactions from the marketplace and inevitably force many non-prime consumers into a credit product that may not best suited for their immediate requirements. A regulatory regime that forces non-prime consumers to take loans in larger amounts, repayable over longer periods of time in those cases when a smaller, shorter-duration single payment loans may be most appropriate, will not be beneficial for consumers or the marketplace. The non-prime consumer has substantially higher needs for short term credit support than the typical prime consumer. With appropriate regulatory modifications, both short term single payment loans and longer term, installment loans can serve as suitable credit options for non-prime consumers. Numerous other jurisdictions, including California, Florida and many Canadian provinces, have successfully done just this and permit, and regulate, both non-prime installment loans (which provide longer term credit solutions) and the equivalent of deferred deposit transactions (which address immediate and short term financial stresses, emergencies and other immediate needs of non-prime consumers).

In summary, without the modifications to SB 537 contained in House Draft 1, a new market for non-prime installment loans will not be sustainable in Hawaii under the proposed regulatory scheme. As presently proposed, SB 537 would eliminate deferred deposit transactions without making a viable credit alternative available to Hawaii's non-prime consumers. This, in turn, is likely to force these borrowers to use less attractive (and oftentimes illegal) alternatives such as check overdrafts, unregulated internet lending or loan sharks. However, with the changes we propose, responsible and operationally efficient non-prime installment lenders could support a viable non-prime lending market in Hawaii and more effectively serve the needs of the non-prime consumers in the state. In the long run, a more effective non-prime lending market can help these borrowers by providing better tailored credit products and enabling them to develop better credit histories, which ultimately will reduce their cost of credit when they are able to access lower credit risk products.

Thank you for your consideration of our testimony.

Very truly yours,

DOLLAR FINANCIAL GROUP

James Odell
Executive Vice President and General Counsel

LATE

To: Representative Sylvia Luke,, Chair
Representative Ty J.K. Cullen, Vice Chair
Committee on Finance

From: Pattiann Lacio, Branch Manager, PayDayHawaii Stadium Mall

April 3, 2019
In opposition to SB537 SD2 HD3

My name is Pattiann Lacio. I have over 19 years' experience with short-term credit under HRS 480F. I became the Manager of Stadium Mall store under Mr. Cash brand in 2001 and the Branch Manager under the PayDayHawaii brand since 2007. No one in Hawaii has more experience working with Hawaii's short-term credit consumers than I do.

SB537 SD2 HD3 would replace deferred deposit transactions authorized under the check cashing law with an unproven installment loan scheme. This bill is bad for consumers because it allows multiple loans by removing the one transaction per consumer provision. The bill encourages long term indebtedness and will increase the fees charged to the vast majority of consumers who currently use deferred deposits responsibly.

Under current law a consumer may only have one deferred transaction at a time and may not pay off a deferred deposits with the proceeds of another deferred deposit. So a consumer is only charged a single 15% fee on a single transaction even if it takes them months to pay it off. So no consumer can ever owe more than the original principle and fee of up to $600.

However, SB537 SD2 HD3 says, "A lender shall not lend an amount greater than $1,000 nor shall the amount financed exceed $1,000 by any one lender at any time to a consumer." So a consumer can get as many short-term loans as they wish. They can borrow over and over again even while they are still paying off their original transaction.

Many consumers who live paycheck to paycheck habitually spend what they make each pay period. They are not in the habit of saving. So imagine what will happen when they find themselves short of cash and have access to 11 storefront lenders and 35 or more internet lenders operating in Hawaii. They can easily pile up thousands of dollars in principle, interest and monthly fees.

The average credit card debt in the United States is about $5000 with 18% interest and a $125 annual fee. Under SB537 SD2, the average consumer can easily pile up $5000 in installment debit with 36% interest and $250 in <u>monthly</u> fees! The two most important contributors to bankruptcy filings are credit card debt medical bills. So think about how this bill will contribute to Hawaii's homeless problem! This is not what I want for my customers.

I appreciate the bill's intent to provide affordable installment credit, but there are better alternatives such as California's Pilot Program for Increased Access to Responsible Small Dollar Loans. The California law not only helps consumers build credit but provides financial education to help improve spending and savings habits.

I agree that HRS 480F can be improved by adding protections such as payment plans and access to financial education. But the wrong approach is to remove a protection that already exists under current law. Let's not make the mistake of ignoring the one transaction per customer principal that protects consumers and makes HRS 480F better than the law in most other states.

Sincerely, Pattiann Lacio

CATHOLIC CHARITIES HAWAIʻI

LATE

TESTIMONY IN SUPPORT OF SB 537 SD1 HD2 HD3: Relating to Consumer Protection

TO: Representative Sylvia Luke, Chair, Representative Ty Cullen, Vice Chair; and Members, Committee on Finance
FROM: Betty Lou Larson, Legislative Liaison, Catholic Charities Hawaiʻi
Hearing: Wednesday, 4/3/19; 2:00 pm; CR 308

Chair Luke, Vice Chair Cullen, and Members, Committee on Finance:

Thank you for the opportunity to provide testimony **in Strong support** of **SB 537 Proposed HD3**, which provides various consumer protection requirements for small dollar loans. I am Betty Lou Larson, with Catholic Charities Hawaiʻi.

Catholic Charities Hawai`i (CCH) is a tax exempt, non-profit agency that has been providing social services in Hawai`i for over 70 years. Our mission is to provide services and advocacy for the most vulnerable in Hawai`i. CCH's advocacy priority is reducing poverty in Hawaiʻi. This bill provides comprehensive protections making payday loans more manageable for consumers, thereby helping them to avoid a debt trap.

House Draft 3 of this bill closes the loophole that created unaffordable payday loans in 1999. It provides a regulatory structure that will enable our residents to acquire loans without being "set up to fail" with loan payments that they are unable to pay. **Setting the cap for interest at 36% is particularly critical**. Not only are more than 4 out of 5 payday borrowers unable to repay these loans on time, but attempts by lenders to debit payments from their checking accounts can lead to substantial penalty fees. Rolling over these loans and penalty fees mean that the majority of borrowers now pay more in fees than they received in credit!

In Hawaiʻi many people are struggling with the high cost of living and may resort to these loans. People living below the poverty line are especially hard hit in Hawaii, with the highest cost of shelter in the country. A family of four in Hawaii pays 68% more for food than families on the mainland[1]. The January 2018 "ALICE" report from Aloha United Way found **that nearly half of isle households are living on a survival budget**, with barely enough to cover basic needs, much less save for an emergency. This population is frequently teetering at the brink of homelessness. Any change to their financial situation like a decrease in wages or increase in rent might tip them over into homelessness. Some may use a payday loan to get by.

It is critical that action be taken to resolve the debt trap often created by these loans. The high interest on these loans (e.g 459% APR) threaten families' housing stability.

We urge your support. We appreciate this opportunity to discuss one of the challenges faced by people living with low wages and low incomes. Please contact me at 373-0356 or bettylou.larson@catholiccharitieshawaii.org, if you have any questions.

[1] Based on the U.S. Department of Agriculture's Thrifty Food Plan, which is used as the basis for Supplemental Nutrition Assistance Program benefits. See http://www.cnpp.usda.gov/usdafoodplanscostoffood.htm.