



Senate Committee on Commerce and Consumer Protection
Public Hearing Regarding S.F. 1635
February 28, 2023

Dear Members of the Committee:

I am writing in support of S.F. 1635, interest rates regulation for consumer short-term and small loans. Thank you for the opportunity to submit testimony for today's hearing.

My name is Yasmin Farahi, and I am Deputy Director of State Policy and Senior Policy Counsel with the Center for Responsible Lending (CRL), a non-profit, non-partisan policy and research organization dedicated to building family wealth through curbing abusive financial practices. CRL is affiliated with Self-Help Credit Union, a national community development financial institution that provides access to safe, affordable financial services to low-income communities and borrowers.

Although payday and other predatory lenders claim to provide consumers quick and easy cash for occasional needs, the evidence of harm to consumers from these loans is well established and vast. In reality, they cause a long-term cycle of debt. Payday lenders in Minnesota charge high annual percentage rates (APRs) of 200%, making no assessment of whether the loan is affordable in light of a borrower's income and expenses, and seizing money directly from borrowers' bank accounts.

Trapping people in a cycle of debt, payday lenders stripped away over \$4 million from Minnesotans in 2021, predominantly from low-income communities and communities of color. Nationally, 75% of fees are generated by people stuck in more than 10 loans a year.¹ According to data from the 2021 Minnesota annual report, the average payday loan borrower was stuck in 9 loans a year, and almost two-thirds of borrowers had 5 or more loans. The average is up from 7 in 2020, suggesting that any dips we saw due to the unusual economic conditions and stimulus funds during the height of the COVID-19 pandemic were not sustained, and the average borrower is returning to a longer debt trap. It is this debt trap which is the core of the business model.

It's not just the short-term consequences of the debt trap that are concerning. Long-term consequences are also quite severe. Payday loans increase the likelihood that borrowers will experience bank penalty fees, bankruptcy, and bank account closures, driving people further out of the mainstream financial marketplace. When payday borrowers default, often after renewing the loan multiple times and paying as much or more in interest as the original loan, they are pushed into deeper financial distress, often facing aggressive debt collection practices,

lawsuits and wage garnishment, as well as increased difficulty meeting other expenses and obligations. This also makes it harder for borrowers to obtain more affordable loans, thus reducing access to better credit and increasing reliance on more abusive products.

Policy trends at the state and federal level for decades have been toward reining in the harms of the unsafe loans, ranging from Congress' 2006 passage of the 36% rate cap in the Military Lending Act to voter-enacted 36% rate caps in Nebraska, Colorado, and South Dakota in 2020, 2018, and 2016, respectively. In addition, state legislatures in Illinois and New Mexico have passed interest rate cap bills in 2021 and 2021, respectively. S.F. 1635 would put Minnesota in line with the Military Lending Act and 18 states and the District of Columbia. Collectively, these protections in other states reach over 115 million people and save residents of these states billions a year in fees that would otherwise be drained from low-income consumers.ⁱⁱ

To understand what happens upon the enactment of a rate cap like the one that protects active-duty military, and those in place in over a third of the states, we can look to the experiences of the military and these 18 other states to confirm that, indeed, the sky does not fall. Many states without payday loans have never had them and have repeatedly rejected proposals to legalize them in their states. For other states that once had payday loans but now do not, former payday loan borrowers report being glad to see gone this product that looked easy to get into but was in reality hard to get out of, and they describe a range of other options to deal with financial shortfalls. More importantly, we hear from many former borrowers who have now been able to build assets such as purchasing a car or a home, which was not possible while buried under payday loan debt.

Communities also feel the reprieve when predatory payday loans are no longer entrapping people in a cycle of debt. Payday lenders' high-cost loans strip millions of dollars per year from the communities in which they are located, diverting resources not only from people's pockets, but from other businesses and charities. After rate cap measures, charitable organizations that used to spend significant resources digging people out of the debt trap are now able to better meet people's needs directly, rather than having to pay the payday lender first. Military relief societies have reported the same, saving hundreds of thousands of dollars of aid after the military rate cap was enacted.

As more states pass interest rate caps to stop the debt trap in their states and reign in predatory lending, some predatory lenders have sought ways to avoid state interest rate limits. One scheme has been the "rent-a-bank" scheme. Under this scheme, a non-bank lender finds a bank willing to be the nominal originator of the non-bank lender's high-cost loan, because banks are generally exempted from complying with state interest rate laws. Predatory lenders evade state consumer protections through these schemes charging triple-digit interest rates even in states with reasonable usury caps. Only a few bad actor banks are willing to lend their names to this kind of abuse, but the high-cost lenders who rely on this evasion saddle consumers in Minnesota and elsewhere with extremely high-cost debt burdens that are difficult to escape. State regulators, state attorneys general, and consumers have had success in the

courts stopping these schemes based on a legal doctrine referred to as the “true lender” doctrine, and there are only a handful of rent-a-bank schemes underway today.

The anti-evasion language we understand will be amended into the bill in today’s hearing is designed to prevent nonbank lenders from evading state lending laws by laundering their loans through banks or other entities exempt from those laws, when the nonbank lender is actually the true lender. In the past few years, three states have adopted laws that prohibit rent-a-bank evasions: Illinois,ⁱⁱⁱ Maine^{iv} and most recently New Mexico.^v The language in those states’ statutes is similar to a Georgia law adopted in 2004,^{vi} which has been upheld in the courts.^{vii} Some other states also have older statutes incorporating true lender principles in their deferred deposit transaction or other lending statutes. The anti-evasion language proposed today will ensure that different forms of predatory lending products cannot reach communities through evasive attempts to skirt the rate cap.

We strongly urge you to adopt S.F. 1635. Consumers in states with rate caps save money, have numerous ways to deal with the financial shortfall, suffer fewer negative consequences such as bankruptcy and bank account closures, and remain supportive of the state’s cap. The most effective way for Minnesota to address the harms of payday lenders’ excessive interest rates is to follow the lead of the military and 18 other states to cap the rate on these predatory products, as S.F. 1635 would do.

Once again, thank you for the opportunity to provide these written comments and for your attention to this issue. Should you have additional questions, please contact me at 919-313-8537 or yasmin.farahi@responsiblelending.org.

Sincerely,

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ⁱ Consumer Financial Protection Bureau. “Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings” (2013). 201304_cfpb_payday-dap-whitepaper.pdf (consumerfinance.gov)

ⁱⁱ D. Davis, C. Rios, and D. Standaert, Center for Responsible Lending, Payday and Car-Title Lenders Drain Nearly \$8 Billion in Fees Every Year, updated April 2019, <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-statebystate-feedrain-apr2019.pdf>.

ⁱⁱⁱ 815 Ill. Comp. Stat. Ann. 123/15-5-15(b) (effective Mar. 23, 2021).

^{iv} Me. Stat. tit 9-A, § 2-702 (effective Oct. 18, 2021).

^v N.M.S.A. 58-15-3(D)(3) (additional anti-evasion language in (D)(1) and (2) (effective Jan. 1, 2023).

^{vi} Ga. Code Ann. § 16-17-2(b)(4).

^{vii} BankWest, Inc. v. Baker, 411 F.3d 1289 (11th Cir. 2005) (upholding Georgia statute deeming a purported agent of a bank to be the de facto lender if it has the predominant economic interest), *reh’g granted, op. vacated*, 433 F.3d 1344 (11th Cir. 2005), *op. vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006).