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MARKETS | FINANCIAL REGULATION

Payday Lending: Some States Think They Have Answer

Consumer watchdog readies national standards

Consumer Financial Protection Bureau Director Richard Cordray *PHOTO: LARRY DOWNING/REUTERS*

By **YUKA HAYASHI**
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DENVER—As the federal government gears up to regulate high-interest "payday" lending, some states maintain they already have the matter in hand.

The federal Consumer Financial Protection Bureau plans this spring to issue the first

national standards for the $38.5 billion payday-lending industry, which supplies very short-term loans at very high interest rates.

Though some states, including Colorado and Indiana, say they have found a balanced approach designed to keep the payday option while regulating it heavily, the CFPB has signaled a desire for a tougher crackdown.

Where the CFBP comes down could transform the industry and how it deals with its 12 million customers annually.

Payday loans are quick credits of a few hundred dollars, with effective annual interest rates ranging between 300% and 500%. Loans are due in a lump sum on the borrower's next payday, a structure that often sends people into cycles of debt by forcing them to take out new loans to repay the old ones.

Interest rates on payday loans range between 300% and 500%. *PHOTO: GARY TRAMONTINA/BLOOMBERG NEWS*

The issue symbolizes the challenge that has dogged the federal agency since its 2011 inception. With rules and enforcement actions in credit-card marketing and auto loans, the CFPB has been lauded by consumer advocates as providing much-needed intervention to curb corporate malfeasance. Critics say the agency is driving up costs and reducing consumer choice through overregulation.

It is a conflict that will play out repeatedly this year, as the agency rolls out a host of rules for areas like check-overdraft fees and arbitration.

Colorado, one of the few states that have tried to regulate payday lending without effectively banning it outright, provides a window onto the payday debate. Many people

on multiple sides of the issue praise the state's rule for slashing effective interest rates by two-thirds and curbing the frequent pace that lenders roll over loans.

"Colorado has the most consumer-friendly payday-loan market in the country," said Nick Bourke, director of the small dollar loans research project at Pew Charitable Trusts, a nonprofit public-policy organization. "It is the model the CFPB should accommodate."

But some consumer advocates say the Denver system still leaves consumers vulnerable —and CFPB leaders have in recent comments suggested they agree.

"In Colorado, there is still evidence of repeat reborrowing and high default rates," said Diane Standaert, director of state policy at Center for Responsible Lending, a consumer advocacy group.

Fifteen states effectively ban payday loans by imposing tight caps on interest rates. Colorado took a different approach. Legislators here looked for ways to curb high-interest loans while keeping them available to consumers in some form.

The resulting bipartisan legislative compromise required that loans have a duration of at least six months, and that all fees and interest payments be spread out evenly over the duration of the loans, rather than requiring upfront payment. If the borrowers repay early, their fees get reduced.

Since passage, the average annual interest rate has dropped to 121% in 2014, the latest data available—still a lofty level but much lower than the 319% before the rule change, according to state data.

Chad Gentry, executive director of mpowered, a Denver credit counselor, said that before 2010, he often saw families saddled with a dozen or so payday loans, all from different lenders. "They would spend the whole day Saturday, driving all over town rolling over payday loans," he said. "We don't see that anymore."

The law has driven many lenders out of business. The number of payday stores statewide has dropped to 188 this year from 486 before 2010, according to state data, more than Starbucks Corp. and McDonald's Corp. locations in the state combined at that time.

Some have managed to survive after cost cutting and diversification. Check Into Cash, a Tennessee-based lender, has closed nearly two-thirds of the 76 stores it had in the state

before the rule change.

“Colorado has been the most challenging state to do business,” said Liz Aiken, a regional manager who has worked in the payday business in eight states. “We are still trying to figure out how to make it work,” she said, as she surveyed a store in a busy suburban strip mall where the staff cheerfully greeted a steady stream of lunch-hour customers who came to make loan payments or cash checks.

Colorado’s rule focuses on limiting the amount of each payment but doesn’t require underwriting, or checking on the borrower’s ability to repay the loan. Currently, many of the state’s payday lenders simply ask borrowers to show their pay stubs and proof of checking accounts.

The CFPB is expected to require underwriting, a change advocates say could steer some borrowers away from loans they can’t afford, advocates say. State and industry officials say it would also drive up costs for lenders and choke off credit to vulnerable consumers who don’t have access to credit cards or bank loans.

“If we are able to at the state level regulate in a way that allows the market to continue… and to reduce the harm to consumers, then why not let us continue that?" said Colorado Attorney General Cynthia Coffman, who wrote a letter in October to CFPB director Richard Cordray calling on the agency to adopt her state’s approach.

CFPB officials have said that its new regulation wouldn’t pre-empt state rules but would increase consumer protection.

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