# Predatory Payday and Larger Installment Loans Overshadow Emerging Market for Smaller, Less Expensive Installment Loans in California

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Predatory consumer lending is still flourishing in California. Payday lending continues to be pervasive, capturing borrowers who were sold a short-term loan in a long-term cycle of debt. But high-cost debt trap lending has expanded rapidly in the past few years to much larger loans, including some which are secured by and put a borrower's car at risk. At the same time, some new lenders are demonstrating that larger consumer loans can be made with lower interest rates and with lower likelihood of defaults and charge-offs, but additional consumer protections are still warranted.

It is critical for policymakers, regulators and stakeholders to understand these market dynamics as they consider reforming California consumer lending laws that both protect consumers from predatory lending products while preserving and expanding access to safe and responsible lending.

Recent reports published by the California Department of Business Oversight (DBO) reveal some important trends in consumer lending in California.[1]

## High-Cost Debt Trap Payday and Installment Lending Flourishes

Payday loans, with 459% annual percentage rates (APRs) that trap borrowers in cycles of debt continue to account for the largest volume of loans made by non-depository lenders in California, though their volumes have been flat over recent years. Federal and state regulations could substantially disrupt the cycle of debt that drives payday loan volume by establishing meaningful ability to repay standards for all loans, backstopped by limits on the timing and duration of borrower indebtedness. State policymakers have the broadest array of tools to end the payday debt trap. The best option for this would be establishing a limit on the total annual interest rate of 36 percent, inclusive of all fees and charges. Other states have established annual limits on the numbers of loans that lenders can provide to individual borrowers.

Larger installment loans —greater than $2,500—and similarly sized car title loans, where a borrower pledges their car title as security for a triple-digit interest rate loan, represent the fastest growing segment of the small dollar loan market. Triple-digit interest rate car title loans are growing rapidly, nearly tripling between 2011 and 2014. California law provides no limits on the interest rates that lenders can charge for these loans, and as a result, many lenders routinely charge APRs of more than 200%, and most charge greater than 100% interest, for these larger, longer-term loans. With longer

[1] *2014 Annual Report: Operation of Deferred Deposit Originators Licensed under the California Deferred Deposit Transaction Law,* http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/CDDTL_Annual_Report_2014.pdf; *2014 Annual Report: Operation of Finance Companies Licensed under the California Finance Lenders Law, http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/CFLL_Annual_Report_2014_FINAL.pdf; June 2015 Report of Activity Under Small dollar Loan Pilot Programs,* http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/Pilot%20Program%20Report%202015%20Final.pdf

terms and very high costs, these loans can often become their own form of a debt trap for many borrowers.

## Less Expensive Alternatives Are Emerging

Despite the continued prominence of high-cost debt-trap lending, some new small-dollar loan providers have begun to make loans to borrowers with thin or no credit files. These loans have APRs that are just a fraction of those levied by payday, car title and high-cost installment lenders. Much of this lending is happening under California's Small Dollar Loan Pilot Program, which requires some underwriting to establish that borrowers have the ability to repay their loans, some refinancing limits and requires lenders to report repayment activity to a major credit bureau.

The number of unsecured loans under $2,500 – most with APRs below 50% and no ancillary credit insurance products – now roughly equals the number of unsecured loans between $2,500 and $5,000, which often have triple-digit APRs. In 2014, there were just under 350,000 unsecured loans below $2,500 and approximately the same number between $2,500 and $5,000. Yet most of these larger loans carry APRs at least two to four times greater than the smaller unsecured pilot loans.

## Implications for Policy

Understanding the dynamics of consumer lending is particularly important in light of expected forthcoming federal and state regulatory actions as well as potential state legislative reform. Both the federal Consumer Financial Protection Bureau (CFPB) and the state DBO are expected to issue proposed regulations in coming months addressing payday lending. CFPB rules will also likely cover car title lending and other forms of high-cost installment lending. In addition, state legislators are convening a stakeholder group to explore reforming the California Finance Lender's Law (CFLL), which sets the rules for consumer finance lending other than payday. In an environment with so much potential regulatory and legislative action, it is important that all stakeholders understand the key trends in lending activity that are happening.

The current fragmented regulatory structure has payday lending, small dollar installment loans and larger installment loans each operating under radically different rules with regards to allowable interest rates, minimum and maximum loan durations, and a variety of other consumer protections. All consumer loans should come with a core set of consumer protections including: underwriting standards that ensure that borrowers can afford to repay the loans; fair and reasonable limits on interest rates; limitations on debt trap refinancing and reborrowing; effective enforcement authority by the Department of Business Oversight; and requirements to submit and publicly report lender-specific data that will allow all stakeholders to understand the lending activity of all licensees.

The remainder of this paper will provide a fuller explanation and data documenting these key trends.

## I. Payday Traps California Borrowers in High-Cost Debt, Even As Totals Level Off

DBO reports that 1.8 million borrowers took out 12.4 million payday loans in 2014, for an average of nearly 7 loans per borrower. More than three-quarters of all payday loans go to borrowers who take out 7 or more loans in a year. The overall volume of payday loans has remained relatively flat at 12. 4 million between 2011 and 2014, though the number of payday borrowers has increased by 4.6 percent over the same period. DBO data also show that payday borrowers have limited means, with median incomes between $20,000 and $30,000.

These loans generally only require the borrower to have a pay stub and a post-dated check to be able to attain a loan of no more than $255, payable in full at the borrower's next payday. Lenders make these loans because they can deposit the borrower's post-dated check on the borrower's next payday if the borrower does not repay the loan in person. Lenders can make these expensive loans without verifying the borrower's ability to afford to repay the loan without defaulting on other expenses or having to reborrow because the post-dated check provides priority access to the borrower's checking account. Payday lenders typically charge APRs of 360-459 percent.[2]

### A. The Payday Lending Business Model Relies on Repeat Borrowing

DBO conducted a survey of payday lender licensees to assess the frequency of repeat lending of payday loans during calendar year 2013.[3] Lenders were asked to report how many of their borrowers received 1, 2, 3 and up to 10 or more loans in each period. An analysis of the findings shows that repeat borrowers are the core of the payday lending business model, contradicting the industry's marketing claims that the loans are short-term loans to address emergency needs.

1. Payday lenders rely on borrowers who get stuck in a cycle of repeat borrowing.[i]
   - 76% percent of all payday loan fees are due to borrowers stuck in 7 or more payday loans per year.
   - 60% of payday loan fees are from borrowers with 10 or more loans in a year.
2. The long-term debt trap is the most typical borrower experience.[4]
   - Borrowers taking out 7 or more loans in 2013 accounted for 45% of borrowers.

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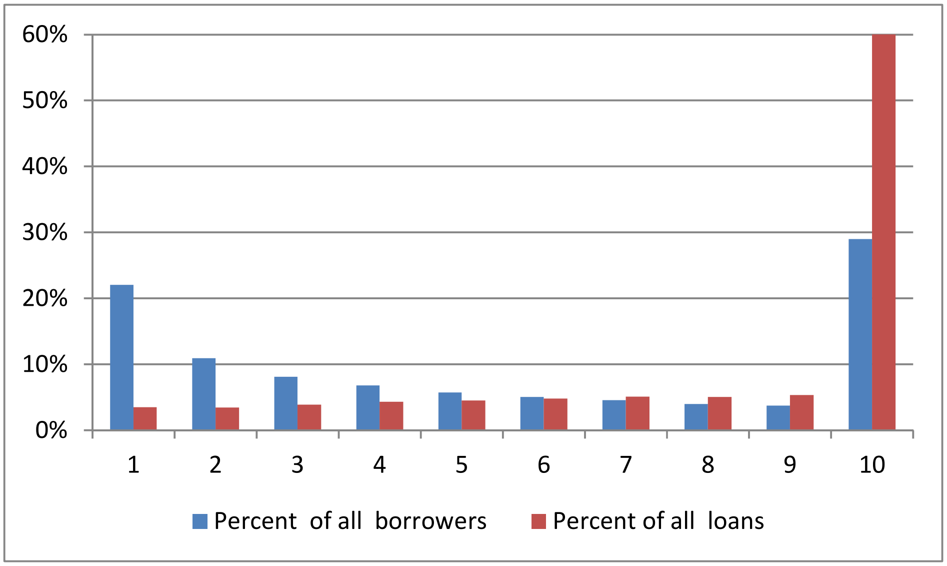
[2] DBO reports the 2014 average APR at 361% (p. 8); however, the standard 2-week payday loan would bear an APR of 459%.

[3] Unfortunately, DBO omitted these questions from the 2014 version of their industry survey. As a result, we are reprinting our findings from *Analysis: New State Data Show California Payday Lenders Continue to Rely on Trapping Borrowers in Debt*, October 9, 2014, http://www.responsiblelending.org/payday-lending/research-analysis/CRL-Analysis-CA-Payday-Lenders-Rely-on-Trapping-Borrowers-in-Debt.pdf

[4] These are conservative estimates of the debt trap. The DBO survey does not take into account borrowers who use multiple lenders over the course of the year. A borrower who takes out 3 loans from one lender, might also be taking out 8 or 10 borrowers from one or more other lenders. Because each lender would report only their own data, this would under count the total number of loans for that borrower, and potentially over count the number of borrowers in the more occasional use categories.

- The "10 or more" loan category was the single largest, accounting for 29% of all borrowers alone. Conservatively, borrowers in this category received an average of 13 loans annually, or more than one loan per month.

**Figure 1: California Distribution of Payday Loan Usage 2013 Percent of Borrowers vs Percent of All Payday Loans, by number of Transaction**



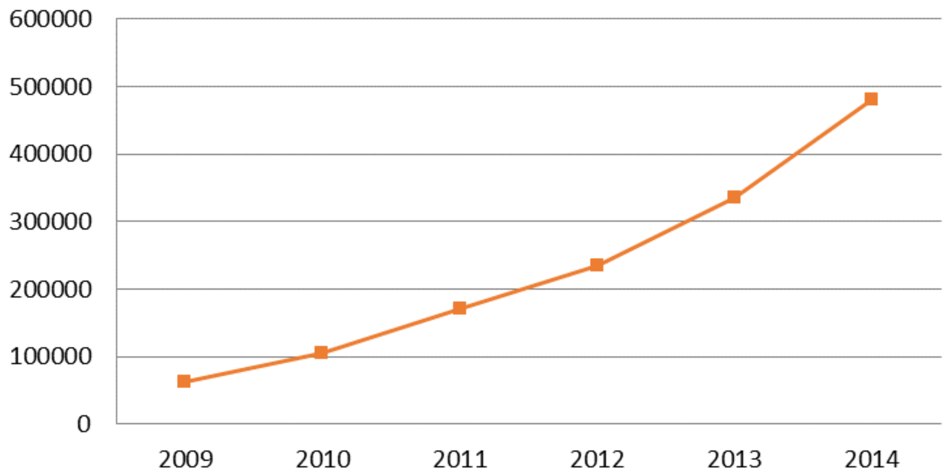

Source: CRL Calculations based on CA Department of Business Oversight 2013 Survey of CDDTL Licensees

## II. Sharp Growth in Larger High-Cost Installment and Car Title Loans is Cause for Concern

Recent years have seen an extremely sharp increase in installment and car title loans of more than $2,500, from 63,000 in 2009 to more than 480,000 in 2014 – an increase of 659 percent. As noted above, the CFLL does not provide any limits on the interest rates lenders can charge on loans greater than $2,500. Many of these loans rely on direct access to the borrower's checking account through the Automated Clearing House (ACH) electronic payments network and would thus likely be covered under the CFPB's proposals for longer-term installment loans released to the Small Business Review Panel in March 2015.[5]

[5] http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf

**Figure 2: CFLL Loans $2,500 - $4,999**




Source: DBO CFLL Annual Reports

### A. Most Larger Installment Lenders Charge Triple-Digit Interest Rates

Lenders in the $2,500-$5,000 loan space fall into two cost categories, those with APRs generally below 40% and those with all or most loans with APRs in excess of 70 percent. The largest lender, Oportun, provides 95 percent of their borrowers with APRs below 40 percent. Springleaf and Apoyo Finaciero also offer all or the vast bulk of their loans with APRs below 40 percent. Unlike Oportun or Apoyo, Springleaf routinely adds in credit insurance premiums which significantly increase the cost of the loan to the borrower.

**Table 1: Top CFLL Lenders, $2,500 - $5,000**

| Top CFLL Lenders, $2,500 - $5,000 | Number of Loans Made |
|---|---|
| Oportun (PROGRESO FINANCIERO) | 82,901 |
| Check N Go (SOUTHWESTERN PACIFIC SPECIALITY FINANCE, INC) | 70,733 |
| Rise Lending (LENDING STREET OF CALIFORNIA, LLC) | 37,866 |
| SPRINGLEAF FINANCIAL SERVICES, INC. | 28,811 |
| CASHCALL, INC. | 20,605 |
| CASH CENTRAL | 16,600 |
| CASH4RENT, INC. | 14,315 |
| AVANTCREDIT OF CALIFORNIA, LLC | 13,299 |
| SPEEDY CASH | 13,253 |
| APOYO FINANCIERO, INC. | 10,833 |
| TOTAL | 349,796 |

Source: DBO data provided to author.

Most lenders in the $2,500 - $5,000 space adopt a much higher-cost lending model. Higher cost lenders include Check ‘n Go, Rise Lending, CashCall, Cash Central, Avant Credit, Cash4Rent and Speedy Cash. Table 3 below shows the terms of loans shown on the lender’s website, or gathered directly from the lenders. For example, Check ‘n Go advertises a standard one year $3,000 loan product available online, with an APR of 219%. A borrower repaying the loan over the full term would repay a total of $7,655 for a $3,000 loan.[6] Similarly, Rise Lending advertises a common loan of $2,600 in California over 18 months charging an APR of 224%. Under this loan, a borrower would make 36 payments of $236, for a total repayment of $8,509 to repay a $2,600 loan.[7]

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[6] Checked August 11, 2015 from https://www.checkngo.com/wp-content/themes/cng/assets/stateDisclosures/California_ILP/schedcharges__ILP___CA___online_.jpg

[7] September 10, 2015 from https://www.risecredit.com/how-online-loans-work#WhatItCosts. The most common RISE loan in the state of California is $2,600 with 32 bi-weekly payments of $241.44 (last payment may vary), and an APR of 224.36%.

| | Loan Amount | Term in Months | Number of Payments | Payment Amount | Total Repayment | Finance Charge | APR |
|---|---|---|---|---|---|---|---|
| **Oportun (Progreso Financiero)** | $2,525 | 19 | 39 | $85 | $3,303 | $778 | 37% |
| **Check 'n Go** | $3,000 | 12 | 26 | $294 | $7,655 | $4,655 | 219% |
| **Rise Lending** | $2,600 | 16 | 32 | $241 | $7,726 | $5,126 | 224% |
| **Springleaf** | $2,600 | 24 | 24 | $158 | $3,787 | $1,187 | 39% * |
| **CashCall** | $2,600 | 47 | 47 | $294 | $13,840 | $11,239 | 135% |
| **CashCentral** | $2,501 | 24 | 52 | $183 | $9,568 | $7,067 | 186% |
| **LoanMe (Cash4Rent)** | $2,600 | 47 | 47 | $388 | $18,255 | $15,655 | 184% |
| **SpeedyCash** | $2,600 | 47 | 91 | $137 | $12,464 | $9,864 | 132% |
| **Apoyo** | $2,600 | 12 | 24 | $134 | $3,205 | $605 | 42% |

*Springleaf APR does not include costs of credit insurance which is frequently sold with their loans.
Source: Lender Websites and lender data provided to author.

## Many High-Cost Installment Lenders Also Experience High Levels of Defaults

Not only do these high-cost lenders charge high rates, but several of them report high charge-off rates, the percentage of loans that do not repay and are written off by the lender. High charge-off rates raise questions about how effectively these lenders are evaluating their borrowers' ability to repay their loans. Regulations under the California Finance Lenders Law require all lenders to assess the borrower's ability to repay their loans, but does not specify what such an assessment should entail. The regulation simply states: *A finance lender making or negotiating a loan must consider a borrower's ability to repay the loan when determining the size and duration of the loan.*[8]

Extremely high interest rates on larger-balance loans allow lenders to benefit despite making loans that ultimately harm borrowers. Lenders often do not lose money when they charge-off a loan. Because of the extremely high rates and longer amortization periods, lenders can recover the full amount of the loan principal after a relatively limited number of payments.

As an example, the typical $2,600 loan of Rise Lending has a $241 bi-weekly payment. After just 11 payments, or about than one-third of the full loan term, Rise will have recovered $2,651 – more than the original principal amount. Every subsequent payment provides earnings above the original principal amount. If a borrower were to default after, say, 20 payments, Rise will still have generated $4,820 in revenue from that loan, equivalent to the full principal plus $2,220. This borrower would have experienced substantial harm: payment of the full principal plus an additional 85 percent of the original

[8] (Cal. Admin. Code tit. 10, §1452)

principal in interest, substantial damage to their credit score, and the likelihood of being subject to ongoing collection efforts when the charged-off debt is sold to a debt buyer.[9]

Measured as a percentage of the number of 2014 loan originations, Rise Lending reported charge-off rates of 29.2 percent, or nearly one of every three loans made in 2014. Rise charged off 12,292 loans in 2014, while originating 37,866. Similarly, CashCentral charged off 21 percent of the number of loans originated in 2014, while Check 'n Go charged off 16 percent of the loans they originated in 2014.[10]

Not all lenders in this space experienced such high levels of charge-offs. Oportun, which typically charges APRs below 40 percent for loans above $2,500 with no ancillary fees or credit insurance premiums, reported charge-offs of 8.2 percent. LoanMe, another very high-cost lender in this space, reported charge-offs of only 2.9 percent of originations.

By contrast, most traditional forms of lending, even unsecured lending, have much lower charge-off rates. For example, the Federal Reserve reports 2014 national credit card charge off rates for all banks at just 3.2 percent.[11] Hence the CFLL lenders identified above are reporting charge-off rates that were 7 to 10 times as large as the largest alternative source of unsecured credit in the market place.

**Growth in Car Title Loans Poses Unique Risks**

Car title loans are a subset of CFLL loans, mostly all for amounts greater than $2,500 with contract terms of two to three years. More than half of all car title loans between $2,500 and $5,000 charged interest rates in excess of 100 percent APR in 2014, with some charging APRs of as much as 150 percent. Virtually all car title lenders – 95 percent – charged APRs in excess of 70%. Since DBO began tracking car title loans separate from other categories, the number of loans grew nearly three-fold, from 38,000 in 2011 to more than 106,000 in 2014.

Some car title lenders have started marketing their loans in payday lender storefronts. For example, 1-800 LoanMart, California's largest car title lender in 2014, has agreements with Ace Cash Express and Check N Go to get referrals to prospective car title borrowers.

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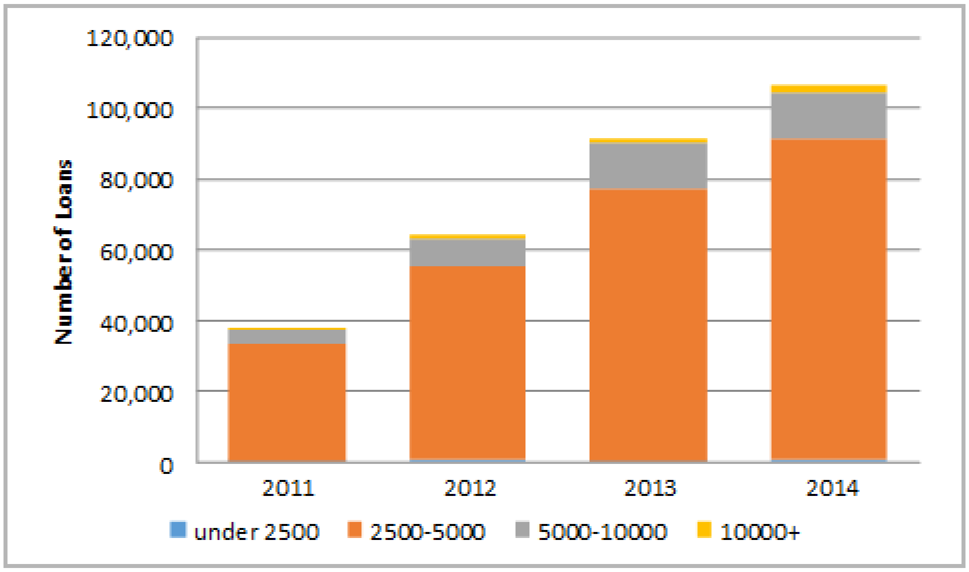
[9] Rise Lending reports that they do not sell charged-off debts to debt collectors, but many lenders do.

[10] Available DBO data (from Schedule N of the Annual reports that licensees submit to DBO) provide some limits on the analysis of charge-offs that can be undertaken. First, company annual report data aggregate loans by type (unsecured, personal property, auto title), without breaking them out by size. Second, DBO does not require reporting of charge-offs by loan cohort. CRL has calculated the percentage of charge-offs based on the number of charge-offs reported in 2014 divided by the number of new originations in that year. An alternative measure of the percentage of charge-offs, the number of charge-offs divided by the average monthly balance of loans outstanding produced much larger percentages of charge-offs.

[11] "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks" Board of Governors of the Federal Reserve, available at http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm. The comparison here is for all credit card borrowers and are not risk adjusted.

**Figure 3: California Title Lending 2011-2014**




Source: DBO CFLL Annual Reports, 2011 – 2014.

**Repossessions Pose Serious Problems for Borrowers**

These loans can be particularly problematic for borrowers, since they rely on their cars to get to work and earn a living. A car can be repossessed for a single missed payment. 1-800 LoanMart, reported repossessing 6,977 cars in 2014, leaving those borrowers without their vehicles for some period of time. In some cases, borrowers can be assessed hefty additional fees to reclaim their auto from the lender after catching up on past due payments. Measured as a percentage of the average monthly number of loans on their books in 2014, Loan Mart repossessed one of every five cars. As a share of 2014 car title originations, 1-800-LoanMart conducted repossessions on than half of all new loans.[12]

Not all borrowers are able to reclaim their cars. Several of the largest car title lenders also appear to have exceptionally high levels of charge-offs, a serious indication that borrowers may not have the ability repay the loan over its full term. 1-800-Loan-Mart, led the way in charging off bad loans, with 5,217 charge-offs – this amounted to 53.1 percent of the number of loans originated in 2014 and 15.6 percent of the average annual loan balance that year. Several other car title lenders reported high repossessions and charge-offs. For example, Wilshire Consumer Credit reported repossessing and charging off nearly 1,600 car title loans in 2014, equivalent to nearly one of five (18 percent) of the number of loans originated that year.

[12] Wheels Financial Group, CFLL 2014 Annual Report, Schedule N, obtained from CA Department of Business Oversight.

**Table 3: Top 10 Car Title Lenders**

| Top 10 Car Title Lenders | Number of Loans Made |
|---|---|
| 1-800 LoanMart (WHEELS FINANCIAL GROUP, LLC) | 9,827 |
| FAST AUTO AND PAYDAY LOANS, INC. | 9,508 |
| CHECK INTO CASH | 9,153 |
| WILSHIRE COMMERCIAL CAPITAL, LLC | 8,662 |
| SPEEDY CASH | 8,622 |
| CCS | 7,790 |
| USA CHECKS CASHED | 5,247 |
| RPM LENDERS | 4,332 |
| CALIFORNIA CHECK CASHING STORES, LLC | 3,432 |
| CITY TITLE LOAN, LLC | 3,276 |
| **Total** | **106,373** |

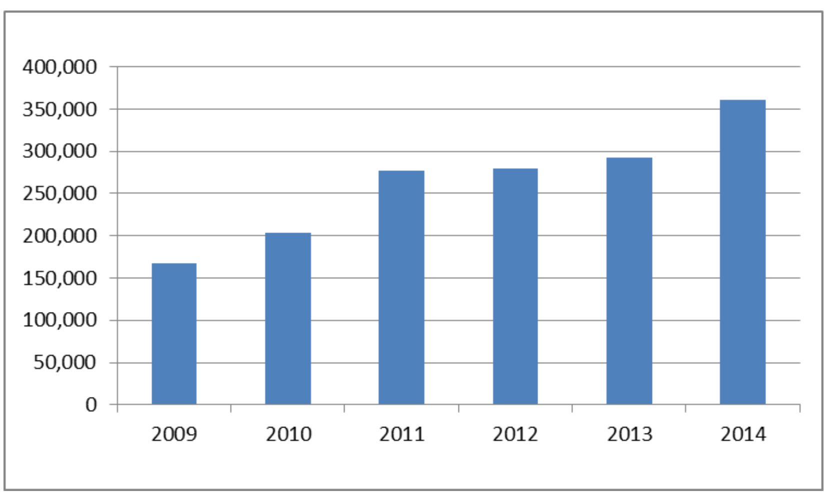
Source: DBO data provided to author.

## III. Surge of Small Loans between $250 and $2,500 Shows Promising Possibilities

There is a widespread perception among policymakers that there is little lending that occurs between the 400% APR $255 payday loans and uncapped triple-digit interest rate installment loans greater than $2,500 allowed under California law.

Yet from 2009 to 2014, the number of California Finance Lenders Law (CFLL) loans below $2,500 grew from more than 167,000 in 2009 to more than 361,000 in 2014, a growth of some 116%. Figure 4 below shows the steady growth in small dollar CFLL lending since 2009. The most significant increases in these loans occurred upon the enactment of the two California Small Dollar Pilot Loan programs.

**Figure 4: Number of CFLL Loans Under $2,500**




Source: DBO CFLL Annual Report Data

**Terms of Small Dollar Loans Under the California Finance Lenders Law**

There are two sets for rules governing loans of this size: those made under the California Finance Lenders Law (CFLL) and those made under the Small Dollar Loan Pilot Program.[1]

There are two interest rate options for loans made under the CFLL, though in practice only one, the Step Rate structure, is use to any significant extent.[1] The so-called Step Rate structure is shown below:

| Unpaid Principal Balance | Allowed Rate | Annual Rate |
|---|---|---|
| First $225 | 2.5% per month | 30% |
| Over $225, less than $900 | 2.0% per month | 24% |
| Over $900, less than $1650 | 1.5% per month | 18% |
| Over $1,650, less than $2,500 | 1.0% per month | 12% |

In addition to the interest rate, lenders are allowed to charge borrowers the lesser of 5% of the loan amount or $50 as an Administrative fee, in addition to the sale of ancillary products such as credit insurance

The Small Dollar Pilot programs were authorized to stimulate greater amounts of lending in the $250 - $2,500 space. The existing pilot allows more generous interest rates and fees, in exchange for requiring some threshold ability-to-repay underwriting requirements and mandatory reporting of lending activity to major credit bureaus. The allowable interest rates under the pilot under the pilot:

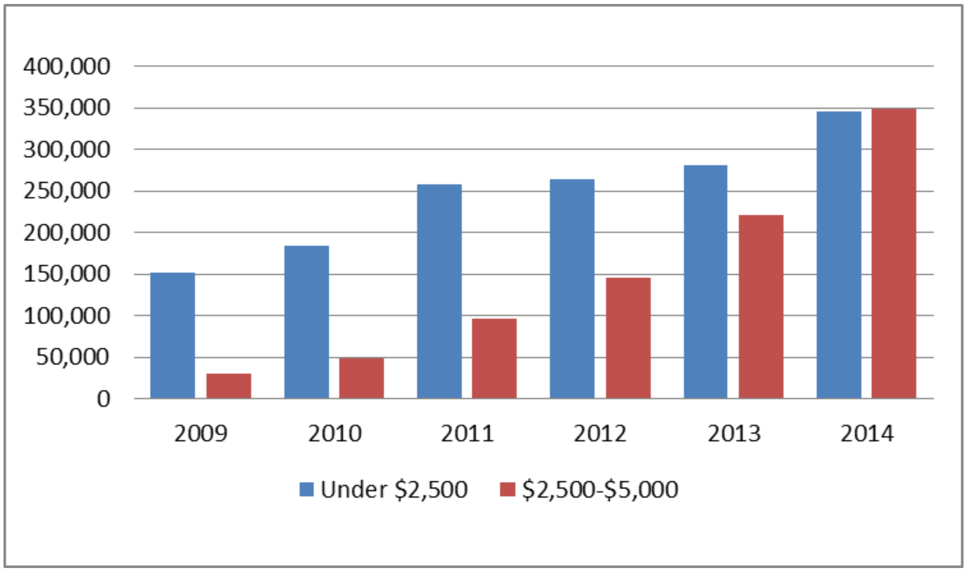
| Unpaid Principal Balance Amount | Rate |
|---|---|
| Up to $1,000 | Lesser of 36% or U.S. Prime rate plus 32.75% |
| Over $1,000, less than $2,500 | Lesser of 35% or U.S. Prime rate plus 28.75% |

In addition to the interest, lenders may charge an administrative fee of the lesser of $7% or $90 on the first loan made to a borrower, the lesser of 6% or $70 for subsequent loans, though a lender may not charge the same borrower an administrative fee more than once in any 4-month period. In addition, the pilot establishes minimum terms: 90 days for loans under $500, 120 days for loans greater than $500 and less than $1,500; and 180 days for loans between $1,500 and $2,500.

Using the shortest allowable loan terms and maximum allowable rates and fees, the maximum APR for a three-month $499 loan would be 99 percent. A four-month $1,000 loan could have a maximum APR of 90 percent and a 6-month $1,600 loan would have a maximum APR of 75 percent. Because virtually all pilot loans have substantially longer terms than the minimums allowed, DBO's first assessment of the pilot shows that virtually all pilot loans to date have APRs of less than 50 percent.

While many argue that the CFLL's interest rate limits have constrained lending below $2,500, it is striking to note that unsecured lending with tight interest rate limits below $2,500 exceeded the number of unsecured loans of $2,500-$5,000 — where there are no interest rate constraints — for every year until 2014, when the number of these two categories of CFLL loan types converged.

**Figure 5: Number of Unsecured CFLL Loans**

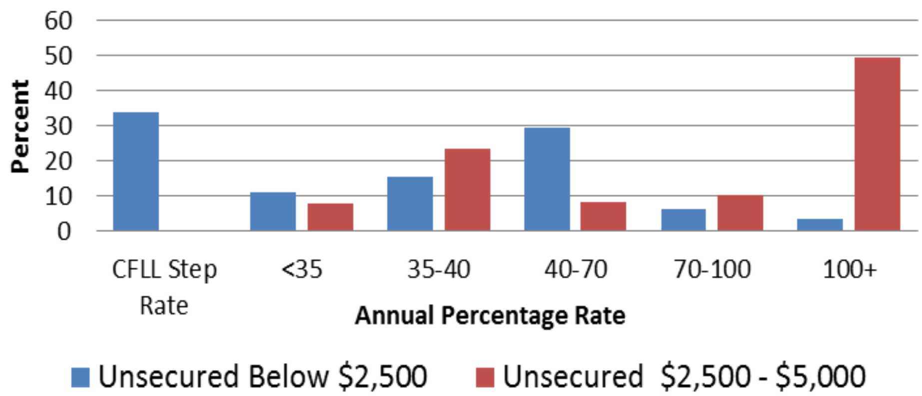



Source: DBO CFLL Annual Report Data

There is a great disparity in the interest rates charged on these loans, as shown in Figure 6 below. On loans below $2,500, APRs are concentrated in the CFLL step rates, where the maximum interest rates are 30% and in the 40-70% range. By contrast, unsecured loans between $2,500 and $5,000 skew very heavily towards much higher interest rates. Half of all these loans have APRs in excess of 100% and an additional 10 percent of these loans have APRs between 70 and 100 percent.

Importantly, a third of these larger unsecured loans have APRs of less than 40 percent, indicating that some lenders are adopting business models that allow them to make these larger loans with interest rates that are a fraction of those charged by the higher-rate lenders in this segment.

**Figure 6: Distribution of APRs on Unsecured CFLL Loans**




Source: DBO 2014 CFLL Annual Report Data

**Small Dollar Pilot Producing Sharp Increase in Small Loans:** Part of the increase in loans below $2,500 stems directly from the California legislature's enactment of two successive Small Dollar Loan Pilot Programs. In both cases, the bills attempted to stimulate greater levels of lending activity by allowing somewhat higher interest rates than allowed by current law, while requiring 1) lenders to adopt some underwriting standards to ensure that borrowers are likely to be able to repay their loans and 2) report loan repayment activity to credit reporting bureaus to give borrowers the opportunity to build their credit scores with successful repayment.

Underwriting standards include required verification of income, pulling a credit report, and applying a 50 percent debt-to-income ratio cap including the payment associated with the pending loan application. Current underwriting standards do not require verification of major household expenses, like rent, that do not generally appear on a credit report, though in practice pilot lenders do include a borrower's reported rent payments or an estimated rent proxy in their underwriting models. Payday loans are generally not reported to the credit bureaus, nor included in the calculation of the borrower's credit score, unless the borrower defaults on the loan, at which point this information harms a borrower's credit score. Some lenders making larger installment loans report all payment activity to credit bureaus, while some only report loan defaults.

One lender has taken full advantage of the Small Dollar Pilot Program, with others making a small number of loans or just entering the market. The primary lender participating in the Small Dollar Pilot Program is Oportun, formerly known as Progreso Financiero. Opportun has driven particularly sharp growth following the enactment of the second small dollar pilot in 2013, raising allowable interest rates to 36% for the first $1,000 and 35% for subsequent amounts up to $2,500, plus origination fees. Analysis of CFLL annual reports submitted to the DBO indicates that Oportun's pilot lending grew sharply in 2014 – by more than 30 percent over 2013 – with the enactment of the most recent interest rate adjustments allowed under the second pilot program. Further Oportun's report indicates charge-off rates of approximately 8 percent as a percentage of 2014 originations, a level of defaults well below those of many larger installment lenders, though still well above average credit card defaults.

The other largest consumer lenders in the below $2,500 category were not making loans under the Small Dollar Pilot Program. Table 1 shows the 10 largest CFLL lenders making loans below $2,500. These included Adir Financial, which provides product financing for Southern California based retailer Curacao, and LendUp, an online lender which offers both payday loans and installment loans under the CFLL. Under the CFLL, LendUp offers primarily short-term loans of less than $500. Approximately 80% of all LendUp CFLL loans have APRs greater than 70 percent, and 17 percent of their loans have APRs in excess of 100%, though mostly with loan terms shorter than the three months minimum required by the Pilot. In addition to CFLL loans, LendUp reported making approximately 138,000 payday loans in 2014 with APRs as high as 459 percent.

**Table 4: Top 10 2014 CFLL Lenders Below $2,500**

| Top 10 2014 CFLL Lenders Below $2,500 | Number of Loans |
|---|---|
| Oportun (PROGRESO FINANCIERO) | 164,300 |
| ADIR FINANCIAL, LLC | 114,347 |
| LendUp (FLURISH, INC). | 35,833 |
| SHERIFFS' RELIEF SERVICES INCORPORATED | 7,696 |
| SNAP-ON CREDIT, LLC | 7,297 |
| JCB INTERNATIONAL CREDIT CARD CO., LTD. | 6,479 |
| CE PAYDAY ADVANCE, LLC | 6,350 |
| SPRINGLEAF FINANCIAL SERVICES, INC. | 3,489 |
| DE LAGE LANDEN FINANCIAL SERVICES, INC. | 2,516 |
| OneMain Financial, Inc. | 1,489 |
| **TOTAL** | **349,796** |

Source: Department of Business Oversight data provided to author.

**Regulatory Environment in Flux**

Understanding the dynamics of California's consumer lending is particularly important in light of expected forthcoming federal and state regulatory actions as well as potential state legislative reform:

- The federal Consumer Financial Protection Bureau (CFPB) is expected to issue proposed regulations for public comment later this year or next year covering payday, car title and other installment lending where the lender has direct access to the borrower's account for repayment. In March, the CFPB published a set of proposals for review by a small business review panel.[13] These proposals would establish certain requirements for lenders to assess a borrower's ability to repay a loan before making it or to adhere to other requirements, and to be subject to supervision and enforcement of applicable consumer financial laws and regulations.

[13] See the Center's analysis of the CFPB's proposal here: http://www.responsiblelending.org/payday-lending/research-analysis/cfpbs-preliminary-proposal-to.html

- California's Department of Business Oversight is also considering regulatory changes for payday lending under the California Deferred Deposit Transaction Law. DBO has requested comments on three proposals over the last several years that would establish new regulations restricting the use of electronic payments, including disbursement of proceeds onto debit or prepaid cards, and the requirement for lenders to collect a paper check for every payday lending transaction consistent with current statutory authority. DBO's most recent draft would:
    - Prohibit the use of electronic repayments through ACH;
    - Prohibit the use of prepaid debit cards in the disbursement or repayment of payday loans; and
    - Create a real-time electronic database to enforce the existing statutory requirement that a payday borrower may only take out one payday loan at a time across all lenders.

- The California Small Dollar Pilot program expires on January 1, 2018 unless extended by the legislature and the Governor. If the Pilot expires with no extension or modification, pilot lenders would have to abide by the terms of the core CFLL. A sunset would likely end a large portion of the recent growth in the under $2,500 market that has occurred in recent years, and the presence of a sunset could be having an impact on new lenders' decisions to participate in the program. On the other hand, it is too early to tell how consumers are faring with these new products.

- Finally, the California Assembly Banking and Insurance Committee Chairman is convening a stakeholder group to explore reforming the California Finance Lender's Law, which sets the rules for consumer finance lending other than payday.

Our analysis herein makes clear that state legislative reform efforts should be more expansive, and include adding important consumer safeguards for payday loans, loans between $250 and $2,500, and loans larger than $2,500. At a minimum, all these consumer loans should include:

- Underwriting standards to ensure that lenders evaluate a borrower's ability to repay a loan, including income and expenses for all loans across both payday loans and CFLL lending. It is likely that CFPB will establish some basic standards for underwriting. Once those standards are finalized, the legislature will have to determine whether they are sufficient for California;
- Fair and reasonable interest rate limits and caps on other fees of 36% APR or less;
- Prohibitions on the sale of credit insurance and other ancillary products;
- Limits on reborrowing and refinancing that prevent lenders from putting borrowers into debt traps;
- Prohibitions on balloon payments, prepayment penalties or irregular payment schedules that can prevent borrowers from reasonably paying off their loans;
- Expand and make consistent reporting of lending data by licensee and requirements that such data is publicly available;

- o Require that the state regulator have the ability to assess the performance of consumer lenders with regard to excessive levels of defaults, charge-offs and repossessions and have sufficient tools to take effective enforcement actions where necessary.

In an environment with so much potential regulatory and legislative action, it is important that all stakeholders understand the key trends in lending activity that are happening. Each of these regulatory proposals would have substantial implications for consumer lending in California. The CFPB's rules will set the foundation and floor for regulatory requirements covering payday, car title and installment lending. However, the CFPB is prohibited from regulating interest rates so that any adjustments to interest rates for payday loans under the California Deferred Deposit Transaction Law or installment loans under the California Finance Lenders Law would require state legislative action.

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[i] Center for Responsible Lending calculations based on Summary Report: California Deferred Deposit Transaction Law – Industry Survey, Page 6. The total number of loans, is assumed to the 12.2 million, as reported in the DBO 2013 Annual Report
http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2014_CDDTL_Industry_Survey_Summary_Report_Letter.pdf

| | Borrowers | Percent of all borrowers | Cumulative Percent of all borrowers | Number of Loans | Percent of all loans | Cumulative Total of Loans | Cumulative Percent of all loans | Reverse Cumulative Percent of all loans |
|---|---|---|---|---|---|---|---|---|
| 1 | 425,464 | 22.1% | 22.1% | 425,464 | 3.5% | 425,464 | 3.5% | 100.0% |
| 2 | 210,852 | 10.9% | 33.0% | 421,704 | 3.5% | 847,168 | 7.0% | 96.5% |
| 3 | 156,881 | 8.1% | 41.1% | 470,643 | 3.9% | 1,317,811 | 10.8% | 93.0% |
| 4 | 130,772 | 6.8% | 47.9% | 523,088 | 4.3% | 1,840,899 | 15.1% | 89.2% |
| 5 | 110,339 | 5.7% | 53.6% | 551,695 | 4.5% | 2,392,594 | 19.7% | 84.9% |
| 6 | 97,495 | 5.1% | 58.7% | 584,970 | 4.8% | 2,977,564 | 24.5% | 80.3% |
| 7 | 88,447 | 4.6% | 63.3% | 619,129 | 5.1% | 3,596,693 | 29.6% | 75.5% |
| 8 | 76,809 | 4.0% | 67.2% | 614,472 | 5.1% | 4,211,165 | 34.6% | 70.4% |
| 9 | 72,413 | 3.8% | 71.0% | 651,717 | 5.4% | 4,862,882 | 40.0% | 65.4% |
| 10 | 559,535 | 29.0% | 100.0% | 7,300,950 | 60.0% | 12,163,832 | 100.0% | 60.0% |
| Total | 1,929,007 | 100.0% | | 12,163,832 | 100.0% | | | |