

Memo

To: Interested Parties
From: Mitchell Kent, Director of Legislative Policy
Department of Consumer Affairs
CC: Cassandra Perez, Legislative Representative
Office of the Mayor
Date: May 19, 2011
Re: Follow-up regarding Short-Term Financial Services Loan Act,
S3841/A7047

Thank you for your interest in the City's opposition to the Short-Term Financial Services Loan Act, S3841/A7047. Below in this memorandum are a number of common questions and answers about the legislation.

Question 1

Wouldn't New York's existing interest-rate cap apply under the bill, since the bill just limits the interest on small loans to the maximum rate under regulations?

No. In fact, the legislation would make an end-run around New York's long-standing interest-rate cap, the most important consumer protection New Yorkers enjoy. Qualifying short-term loans would be subject to a new maximum interest rate, set by the Superintendent of the Banking Department. The bill states:

The superintendent shall by rule establish ... the maximum rate of interest and fees that may be imposed upon short-term financial services loans, including, but not limited to, loan origination, monthly maintenance and late fees.

Question 2

What rates of interest could check cashers charge New Yorkers for the loans?

No rate is specified. For legislation which is quite specific in almost every respect, it is surprising that the bill is silent on the rate of interest. However, some clues can be drawn from the provisions instructing the Superintendent how to set rates:

In the establishment of the maximum rate of interest and fees ... the superintendent shall consider ... ***the interest rates and fees imposed by lenders in other states for the same or similar services...*** (emphasis added).

This is evidence of intent to rely on rates outside of New York in order to circumvent the interest rate cap that exists in New York. Lenders offering short term payday loans in other states typically charge about 400% annual interest.

The probability of very high interest rates is reinforced by the provision requiring the Superintendent to consider “the income, costs and expenses of ... [check cashers], ***including loss and default rates***, and the reasonable ***profit*** ... from the offering and provision of short-term financial services loans.” That is, it requires the Superintendent to set a rate that ensures a profit for check cashers (notwithstanding any consideration of responsible lending, since the Superintendent would factor in their loss and default rates).

Question 3

Would the rate be subject to change?

Once initially set, the bill would permit the Superintendent to amend the maximum rates and fees, but only upon the petition of a substantial portion of the check casher industry. This means that any review of applicable interest rates would have a built-in bias in favor of higher rates, which is significant cause for concern.

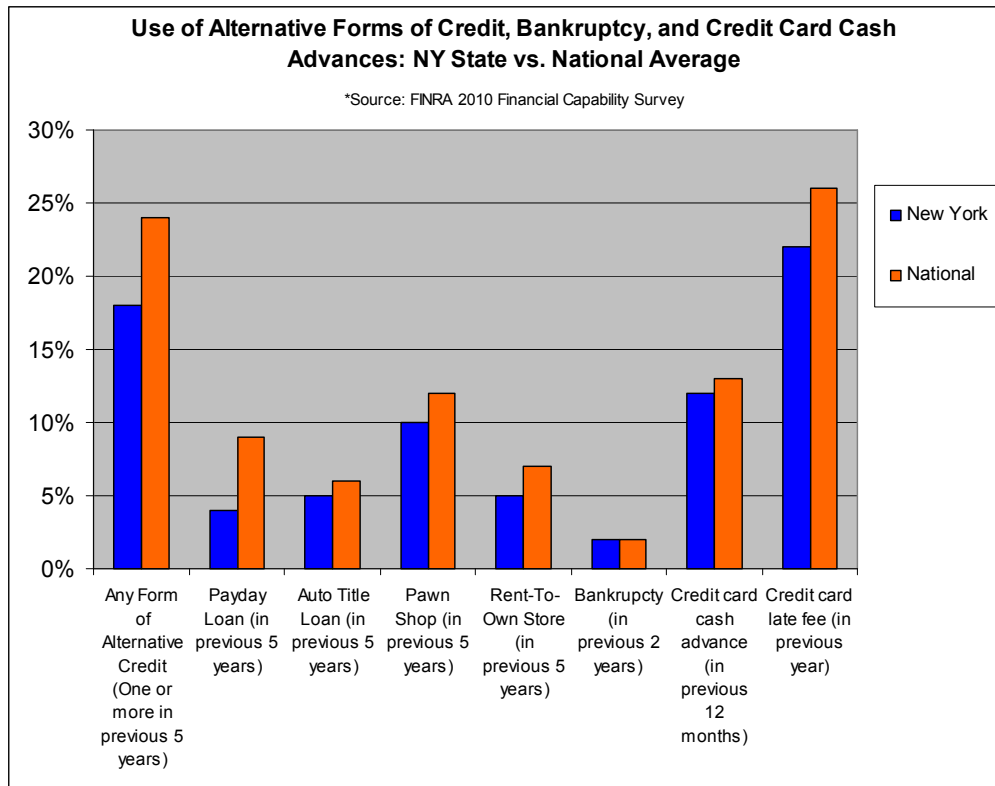
Question 4

What type of loans do low-income individuals and communities actually need?

Communities need access to *responsible* lending, not loans made without regard to ability to repay, which tend to trap borrowers in a cycle of debt. As discussed more completely below in our answer to Question 5, check cashers are not regulated or supervised with safety and soundness or responsible lending in mind. Small-dollar lending should be encouraged through financial institutions that are supervised for safety and soundness and should not be encouraged through check cashers.

Efforts to help New Yorkers in these tough economic times cannot take away the greatest benefit they enjoy—the state’s interest rate cap of 25%. Recently released Financial Industry Regulatory Authority (FINRA) data show that New Yorkers are better protected than others across the nation from abusive credit.

- Data shown graphically on the following page show that a lower share of New Yorkers—18%—have used alternative credit in the past 5 years, as compared to the national average—24%. The contrast is greatest with regard to payday lending (four percent compared with nine percent), which is a natural result of the State’s interest rate cap.



- The same share of New Yorkers surveyed filed for bankruptcy in the previous two years as the national average, suggesting that New Yorkers are able to weather hardships with at least the same success as those who do have access to payday loans.
- A smaller share of New Yorkers have made a cash advance or have incurred a late fee on their credit cards, which may suggest the State’s ban on payday lending has collateral benefits and is not driving residents to other high-risk forms of lending.

Question 5

What regulations apply to check cashers in New York?

A check casher is a “money-services business” engaged in the cashing of checks, drafts or money orders. Check cashers are licensed by the Banking Department and regulated by statute and regulation to ensure licensing, disclosures and reasonable fees, but **not** safety and soundness.

A check casher must post its license and “conspicuously and continuously” post the fees charged. Fees currently are capped at the greater of 1.64% of the amount of the check or \$1. And check cashers are prohibited from engaging in lending or tax preparation.

This legislation would for the first time allow check cashers to make loans, even though the State’s supervision is not set up to ensure the safety and soundness of such lending. The Banking Department itself does not believe this new lending authority would be appropriately placed with check cashers.

Question 6

Do we have data regarding branch location?

This is **not** about access to banks. It's about predatory, irresponsible credit. Research commissioned by the City shows that residents in unbanked communities are much more likely to hold credit cards than a bank accounts. In other words, they have access to credit. They don't need access to additional unregulated, predatory credit. Access to banks and access to credit are not the same thing, and the fact that check cashers happen to fill one need does not qualify them to fill the other.

Moreover, a study released by the City in 2008 found no clear relationship between bank account usage and the density of bank and credit union branches. That is, as the number of branches per 10,000 residents increased, there was no discernable impact on the actual use of bank products and services by the community. The Neighborhood Financial Services study found that "the concentration of bank branches is virtually unrelated to the percentage of residents with bank accounts." The two communities studied—Melrose in the Bronx and Jamaica, Queens—have very high concentrations check cashers, and the City has been working hard through its access-to-banking initiatives to minimize reliance on these "fringe" providers of financial services.