



COMMONWEALTH OF KENTUCKY  
OFFICE OF THE ATTORNEY GENERAL

JACK CONWAY  
ATTORNEY GENERAL

December 10, 2010

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FRANKFORT, KENTUCKY 40601

Honorable David Williams  
President of the Senate  
702 Capitol Ave  
Annex Room 236  
Frankfort KY 40601

Honorable Gregory D. Stumbo  
Speaker of the House of Representatives  
702 Capitol Avenue  
Annex Room 303  
Frankfort, KY 40601

Re: Payday Lending

Dear President Williams and Speaker Stumbo:

The Consumers' Advisory Council<sup>1</sup> has undertaken a review of payday lending in Kentucky in order to determine whether legislation imposing a 36% interest rate cap is necessary and appropriate to restrict what consumer advocates contend is an unconscionable consumer loan product.

As you are aware, Kentucky first imposed regulations on the "deferred deposit" industry in 1998. During hearings on that original legislation, concern was expressed regarding customers being "rolled over" from one high interest loan to the next with the result that consumers ended up paying exorbitant amounts in interest and fees making it increasingly difficult for them to pay off the loan. Accordingly, the legislature imposed a limitation of two loans for a total of \$500 per customer due in no less than 14 days. One of the stated goals of the legislature by imposing these restrictions was to reduce the incidence of "roll over" loans, which over time create a mountain of debt for consumers, often leading to bankruptcy.<sup>2</sup>

As evidenced by data gleaned from the Department of Financial Institution's new database, the limitations imposed in KRS 286.9 have not eliminated the "roll over" problem. Rather, the data show that the average consumer is trapped in a debt cycle. According to the data, 83% of payday loans went

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<sup>1</sup> The Consumers' Advisory Council is appointed by the Governor pursuant to KRS 367.140 "to act in an advisory capacity on consumer affairs as the council deems necessary and as directed by the Governor, the Attorney General or the legislative branch of government." Pursuant to that authority, at the request of the non-profit group CLOUT, Attorney General and the Council staged 3 public forums on payday lending during October and November, 2010 in Louisville, Lexington and Newport. The forums consisted of presentations by the Department of Financial Institutions concerning the new database as well as presentations by CLOUT and the Kentucky Coalition for Responsible Lending. Citizens affected by the payday lending industry also provided testimonials. The payday lending industry declined to participate in the Louisville and Lexington forums but attended and presented at the Newport forum. Newspaper accounts reporting on the forums are attached.

<sup>2</sup> See attached October 2010 study indicating persons taking payday loans are twice as likely to declare bankruptcy as other similarly situated consumers.



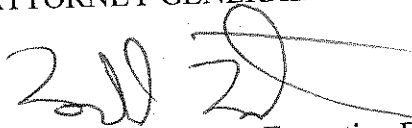
to consumers who took out five or more loans at an APR of 391% during a five-month period. On a typical loan of \$255, this amounts to \$90 in fees per month.<sup>3</sup> What is offered to a consumer as a short-term, stop-gap loan, often becomes an insurmountable financial burden due to the high interest rate of this product.

The Council has listened to the arguments from the payday lending executives that it would be unfair to limit their interest and fees because similarly high fees that are imposed by other businesses and financial institutions are unregulated. The industry insists that it is meeting a need unmet by conventional financial institutions, and that borrowers will turn to less savory unregulated sources for loans if a rate cap of 36% is imposed and they are "forced" to leave the market. However, in the Council's opinion, limiting fees on this product to a more reasonable level in line with other consumer financial products is warranted.

After considering arguments from consumer advocates, payday lending customers and industry representatives and reviewing data from the new database maintained by the Department of Financial Institutions, the Council concluded that a 36% cap is in the best interest of Kentucky and therefore recommends such legislation be enacted in the 2011 legislative session. This is the same rate that the federal government enacted for the protection of military service men and women and has been enacted in 15 states.<sup>4</sup> In addition, the Council believes that further measures to require additional customer disclosures, allow for extended payment plans and imposing a cooling-off period between loans may also provide some consumer benefit and should be considered. However, based on the experience in other states that have enacted similar legislation, these additional measures appear to be ineffective at addressing the most important harm created by payday lending, which is consumers' inability to get out of a debt cycle caused by the high interest rates of payday loans.

The Council urges passage of legislation to curb the debt cycle caused by payday loans and appreciates the opportunity to advise you on this issue.

Respectfully,  
JACK CONWAY  
ATTORNEY GENERAL

  
Todd E. Leatherman, Executive Director  
Office of Consumer Protection

c: Sen. Tom Buford, Chair, Senate Banking and Insurance  
Rep. Jeff Greer, Chair, House Banking and Insurance

<sup>3</sup> See attached study submitted to the Council by the Mountain Association for Community Economic Development.

<sup>4</sup> Arizona, Arkansas, Connecticut, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, West Virginia.