ORIGINAL

IN THE SUPREME COURT OF OHIO

OHIO NEIGHBORHOOD FINANCE, INC.,	:	
	:	Case No. 2013-0103
Plaintiff-Appellant,	:	
	:	Appeal from the Ninth Judicial
vs.	:	District Court of Appeals
	:	Case No. 11CA010030
RODNEY SCOTT,	:	
	:	
Defendant-Appellee.	:	

REPLY BRIEF OF AMICI CURIAE NORFLEET (BILL) RIVES AND DANIEL OGLEVEE IN SUPPORT OF APPELLANT OHIO NEIGHBORHOOD FINANCE, INC.

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REPLY

Amici Rives and Oglevee, members of the faculty of the Fisher College of Business at The Ohio State University, have reviewed the amicus brief filed by the Legal Aid Society of Cleveland and those joining with it (the "Legal Aid" brief) and the amicus brief filed by the Center For Responsible Lending and those joining with it (the "Center" brief) (collectively, the "Scott Amici") and offer the following assessment of the positions they assert.

1. The Need For Short-Term Consumer Credit In Ohio Is Consumer Driven, Not Lender Driven, And Meets The Actual Needs Of Borrowers With Limited Options

The Scott Amici suggest the growth of Mortgage Loan Act lending in Ohio is the result of the "predatory" pricing such lenders can obtain. But they miss the obvious point: consumer need for this type of loan is what drives this growth, not the desire of lenders to loan money.

A short-term loan providing same day cash may be needed in a myriad of circumstances: emergency medical needs, an inoperable car needing emergency repairs, even money needed for food or rent. The Scott Amici suggest Ohioans in such circumstances should borrow from friends or relatives instead of seeking a consumer loan, but perhaps those in need don't have such alternatives available or perhaps they have exhausted them. And if such alternatives are available, who is to say that Ohioans needing short-term cash should be required to beg from relatives or friends if they wish to pursue a commercially available alternative?

Short-term consumer borrowers who obtain loans from Mortgage Loan Act lenders must be employed or have a regular source of income and must have an established bank checking account. Nonetheless, they may confront circumstances requiring immediate cash that is not otherwise available to them. In such circumstances, a "payday" loan may be a less expensive alternative for dealing with the exigency confronting them.

For example, a borrower who is employed but cannot otherwise pay his winter gas bill can borrow $250 from a Mortgage Loan Act lender for approximately $28. Alternatively, if he is unable to pay the bill and Columbia Gas shuts off his gas, his home is not only cold but he can also incur $377.00 of additional costs:

(1) $52 Reconnection Charge

(2) $325 Security Deposit (130% of $250 unpaid bill)

Source: *http://www.columbiagasohio.com/docs/reference-docs/rights-and-responsibilities-reading-13.pdf?sfvrsn=2*. And while he still has to repay the $250 loan (just as he would have to still pay the $250 gas bill), he saved $349 by obtaining the loan.

Or, another example: a $250 loan that allows a borrower to avoid charges for non-sufficient funds ("NSF") that a bank imposes when her checking account balance is insufficient to cover a check she has written. Amici have undertaken a study of commercially available alternatives to short-term consumer loans that is described in more detail in Section 2. That study reflects that a typical 14 day NSF fee charged by an Ohio bank for a single $250 bounced check would cost the consumer approximately $107. A 14 day Mortgage Loan Act advance to cover the checking account shortfall would cost less than $28 so the borrower would save $79.

The point is not that every borrower makes good economic decisions. But it is true that a substantial need exists in Ohio for immediately available short-term consumer loans and Mortgage Loan Act loans are often the best and most cost-effective alternative available to the consumer. Contrary to the suggestion of the Scott Amici, the short-term immediate cash lending business model exists because it meets a genuine need of Ohioans.

2. <u>Pricing Of Short-Term Consumer Loans Under The Mortgage Loan Act Is Approximately Equal To That Charged By Other Alternative Sources Of Equivalent Credit</u>

a. <u>Amici's "Predatory" Label Is Not Supported By The Facts</u>

The Scott Amici repeatedly characterize the pricing of Cashland's short-term consumer loans as "predatory." [Center Brief at 5, 12, 28, 29] No facts are offered to support this characterization. The facts that do exist, however, reflect that the "predatory" characterization is simply not accurate.

Amici Rives and Oglevee undertook an Ohio-based study of alternative sources of consumer lending, and the terms under which short-term credit was available from each. Their study was funded by a grant from the Ohio Consumer Lenders Association. They completed their work in January, 2013 so the study data are timely and fresh.

In their study, the two faculty members compared the cost of short-term consumer loans available under the Mortgage Loan Act to the cost of eight other commercially available alternative sources of short-term consumer credit in Ohio. For each of the nine alternative sources, Amici examined the role the loan product plays in providing short-term consumer credit and how each product is structured. They then determined the typical cost to the Ohio consumer of each such credit product.

Based on total cost, *bank overdraft charges are the most expensive type of short-term consumer credit available to Ohioans* while pawnshop loans (that are fully secured by the pawned property deposited with the lender) are the least expensive. The following chart reflects the findings of the study:

Product Category	Loan Amount	Basic Unit of Time in Days	Total Charges[1]	Charge Rate[2]
Banking Services Overdraft (Sustained)[3]	$ 250.00	14	$ 107.00	42.8%
Banking Services Overdraft (Basic)[4]	$ 250.00	5	$ 35.00	14.0%
Short-term Consumer Loan (Unlicensed)	$ 250.00	14	$ 46.51	18.6%
Short-term Consumer Loan (MLA Licensed)	$ 250.00	14	$ 27.64	11.1%
Credit Union – State	$ 250.00	30	$ 39.22	15.7%
Credit Union – Federal	$ 250.00	30	$ 26.21	10.5%
Advance Deposit Loan[5]	$ 250.00	30	$ 25.00	10.0%
Bill Payment Assistance (Household)[6]	$ 250.00	30	$ 24.29	9.7%
LMI Credit Cards[7]	$ 250.00	30	$ 17.69	7.1%
Pawn Shop (secured by pawned property)	$ 250.00	30	$ 16.50	6.6%

1 – Total Charges include fees at loan origination and applicable interest cost.
2 – Charge rate shows actual total cost of the loan over the loan's term, expressed as a percent.
3 – Overdraft resolved within 14 days.
4 – Overdraft resolved within 5 days.
5 – Allows a bank customer to borrow against the customer's next direct deposit (i.e., paycheck, social security benefits, unemployment benefits).
6 –This relatively rare product pays a customer's bills and then is repaid within thirty days. The Total Charge on the $250 advance was estimated because the maximum advance amount is typically $200.
7 – Low and Moderate Income credit cards may require a security deposit before the card is issued.

As these figures reflect, the cost of a short-term, unsecured consumer loan from a lender licensed under the Ohio Mortgage Loan Act (such as Cashland) is roughly equal to, or in some cases less than, the cost of equivalent credit from the other available sources.

b. Unlicensed Internet Lenders Will Likely Fill The Void For Consumers With Higher Cost Loans If Regulated Mortgage Loan Act Loans Are Not Available

The study also disclosed another important reality about the credit alternatives available to Ohioans needing a short-term cash advance. Unlicensed (and therefore unregulated) short-term consumer lenders impose higher costs than lenders like Cashland that are licensed under the Mortgage Loan Act. Unlicensed lenders make loans over the Internet, typically depositing the loan proceeds in the borrower's bank account on the same or next business day the loan application is submitted. These lenders avoid both state and federal regulation of their fees and business practices by locating offshore (non-US based) or on Indian reservations which, under treaty, are exempt from state regulation.[1] To the extent states attempt to regulate them, these unlicensed Internet lenders can simply ignore laws the states attempt to apply. *See* "Online Lenders Are Sued By New York," *Wall Street Journal*, August 13, 2013 at C3 ("a group of 16 tribes that offer short-term loans over the Internet sent a letter to . . . [New York] saying they wouldn't comply with cease-and-desist orders . . . issued last week"), *http://online.wsj.com/article/SB10001424127887324769704579009052208997232.html?KEYWORDS=Online+lenders*; "New York Attorney General Sues Internet Lenders," *http://www.ag.ny.gov/press-release/ag-schneiderman-sues-western-sky-financial-and-cashcall-illegal-loans-over-Internet*.

The growing trend of Internet borrowing is attractive because of the ease of obtaining money quickly. But the lack of regulatory control of these lenders results in higher costs and inadequate disclosure of loan terms compared to transactions involving lenders licensed under the Mortgage Loan Act. And scams resulting from Internet communications with unlicensed lenders are a growing concern in Ohio according to the Cleveland *Plain Dealer*. *Source:* *http://www.cleveland.com/consumeraffairs/index.ssf/2013/08/consumers_hounded_for_payday_l.html* The Ohio Department of Commerce could shut down Mortgage Loan Act lenders if they engaged in such conduct, but is without recourse against offshore or tribal-land based Internet operators. But, if Mortgage Loan Act lenders such as Cashland are forced out of Ohio

[1] These unlicensed lenders should be distinguished from licensed domestic companies that engage in online lending and are regulated by and comply with state law.

as the Scott Amici propose, the need for short-term, immediately available cash loans will nonetheless remain. Ohioans with no convenient alternative could logically be expected to increasingly turn to these unlicensed Internet lenders in such circumstances.

c. Other Lenders Do Not Offer Timely Lending Of Cash For Immediate Consumer Needs

The Ohio-based study conducted by Amici Rives and Oglevee also disclosed that a number of the alternative sources of short-term credit – banks, credit unions and LMI credit cards – require a significant period of time to complete their application and underwriting process, even if the customer has good credit. To obtain a credit union loan, for example, a borrower must have been a credit union member for at least one month (federally chartered institutions) or four months (state chartered institutions). The underwriting process for Advance Deposit Loans, while shorter than state credit union membership requirements, still typically requires the consumer to have an established checking account, with direct deposit arrangements in place, for at least three months. And an application for a LMI credit card typically takes 7 to 10 days for approval. Thus none of the bank or credit union alternatives provides the immediate, same-day cash that is available from Mortgage Loan Act lenders.

The study reflects what Amici would expect: although short-term consumer lenders are criticized for having "high" borrowing costs, their borrowing costs cannot be judged in isolation. To fairly evaluate borrowing cost, consideration must be given to (1) a lender's operating cost, (2) the risk to the lender that a borrower may default, and (3) the cost a default imposes on the lender. Other things being equal, the higher the operating costs and the greater the risks of default, the higher the cost to the borrower. Thus, not surprisingly, all of the other varieties of higher risk, unsecured credit products available to Ohioans charge roughly the same costs as Mortgage Loan Act lenders charge.

3. The Scott Amici's Focus On Federal APR Does Not Accurately Represent The Real Cost Of Short-Term Consumer Borrowing Under The Mortgage Loan Act

Amici Center characterizes this case as being about "680% APR loans under the MLA." Center Brief at 2, 24. Amici Legal Aid claims an Annual Percentage Rate ("APR") of 235.48% on the Scott loan. Legal Aid Brief at 5. While the lower APR asserted by Legal Aid is correctly calculated under federal Truth In Lending ("TILA") disclosure requirements, both numbers grossly misrepresent the real cost of a loan such as that Mr. Scott received.

a. Amici's Asserted APR Assumes The Same Loan And Fees Are Unrealistically Refinanced Twenty-Five Times

Under the Mortgage Loan Act, Cashland is permitted to charge statutory interest of 25%, R.C. 1321.571, plus an origination fee (here, $30 because of the size of the Scott loan, but as little as $15 or less on smaller loans), and a credit investigation fee of $10. R.C. 1321.57(H)(1)(c), (J)(1)(b). Under federal TILA disclosure, the two statutorily permitted fees are required to be included in the federal APR calculation in addition to the interest to be paid. The total is then annualized. Thus in the case of a two week loan such as that Cashland made to Mr. Scott, the fees are multiplied 26 times (two weeks x 26 = one year) to calculate the 235.48% APR under TILA mandates. But this calculation simply does not reflect real cost to the borrower when applied in the context of a two-week Mortgage Loan Act loan. And it is misleading to suggest, as the Scott Amici do, that it does.

TILA's mandatory methodology for calculating federal APR applies an assumption, as a way of annualizing the calculation, that the Scott loan is refinanced every two weeks for an entire year -- with the same loan origination fee of $30 being charged again each of the 25 additional times the loan is refinanced. This assumption results in the addition of $750 of loan origination fees in the federal APR calculation because, to annualize the calculation as TILA requires, the formula assumes (i) that the two-week loan will be outstanding fifty-two weeks and (ii) that Cashland could and will charge the same $30 loan origination fee 25 additional times. But neither assumption is correct or even permitted in the context of Mortgage Loan Act consumer loans.[2]

But not even the Legal Aid amici contend these loans are typically outstanding for a 52 week period; their argument is that payday loan customers "typically took out eight loans per year." Legal Aid Brief at 7. While the statistical reliability of the studies upon which they rely is questionable (see Section 4), no one suggests that the loan will be re-borrowed 25 times in sequence as the federal APR methodology assumes. Regardless of whether the Legal Aid amici are correct that eight loans a year is typical or whether Cashland's internal records showing an average length of loan in 2012 from origination to payoff of only 21 days is correct, TILA's APR calculation methodology requiring an assumption that the loan will be outstanding an entire year again creates an inflated measure in percentage terms that does not fairly reflect the true cost of the loan.

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[2] This APR calculation methodology originated under TILA as a sensible and appropriate consumer protection in the context of long-term (15-30 year) mortgage loans for the purchase of a residence. In that context, the APR spreads (or amortizes) real loan costs and fees over the duration of the house loan so the borrower gets an accurate picture of the true annual cost of the credit she is borrowing.

b. The Mortgage Loan Act Does Not Even Allow Origination Fees For Such Refinancings

Another reason why Amici's reference to the federal APR is misleading: Cashland could not charge the loan origination fee 25 additional times as the federal APR methodology assumes because *Cashland is precluded by law from doing so*. The Mortgage Loan Act allows only a single loan origination fee of $30 or less on a loan comparable to the one Mr. Scott obtained, regardless of how many times the loan is refinanced. R.C. 1321.57(J)(2) ("[i]f a refinancing occurs within ninety days after the date of the refinanced loan, a registrant may not impose loan origination charges on the portion of the principal amount that is applied to the unpaid principal amount of the refinanced loan"). TILA nonetheless requires the addition of $750 of phantom "financing cost" when calculating the federal APR even though it can never be charged by an Ohio Mortgage Loan Act lender. Whatever merit the APR may have in jurisdictions permitting lenders to charge full loan origination fees upon each loan refinancing, it is simply meaningless in determining the true cost of a loan under the Ohio Mortgage Loan Act.

c. The True Cost Of Mr. Scott's Unsecured $500 Loan Was $45.16

The accurate and fair assessment of the true cost of an unsecured, short-term loan under the Mortgage Loan Act is reflected in the actual fees and interest expense necessary to obtain and service the loan. The one-time loan origination fee of up to $30 is comparable to or lower than the loan origination fee charged by alternative lenders on a loan comparable to the one at issue here. The $10 credit investigation fee is similarly comparable to or lower than that of alternative lenders. Neither is unreasonable in the context of the inherent risk of an unsecured loan and the overhead involved in maintaining an office to service the customer and the staffing necessary to facilitate same day cash loans. And the statutorily imposed maximum interest rate of 25% is applicable only during the time the loan is outstanding.[3] Thus, if Mr. Scott had repaid his loan as he promised, interest would have totaled $5.16 and the total cost of the $500 loan, including all fees and interest, would have been $45.16. These are the numbers that should be highlighted and considered in reviewing the Scott loan, not the federal APR figures on which the Scott Amici attempt to focus the Court.

4. Claims As To "Cycle Of Debt" Are Unsubstantiated And Contrary To Real World Business Practices

Amicus Rives, in addition to having earned a Ph.D. in economics from Duke University, has completed post-doctoral coursework in statistics and mathematical demography as a Research Fellow in the Woodrow Wilson School of Public and International Affairs at Princeton University. He therefore is intimately knowledgeable about the statistical reliability of reports and studies purporting to summarize customer behavior. Having reviewed each of the publications and reports relied upon by the Scott Amici to support their assertion that recipients of short-term consumer loans become trapped in a "cycle of debt," Amicus Rives concludes with a high degree of certainty that:

a. Amici's Cited Reports Are Not Statistically Reliable

First, the reports cited by the Scott Amici as support for their claim that payday loans result in a "cycle of debt" are not statistically reliable nor could they successfully withstand peer review. None is based on a sufficiently large body of data to permit a statistically valid conclusion to be drawn. None states the statistical rate of error inherent in its conclusions, and

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3 This 25% interest rate is exactly the same maximum rate that can be charged by banks, credit unions, and retail merchants.

none provides sufficient data to permit its margin of error to be independently determined or to draw any valid conclusions. It therefore is impossible to know whether the conclusion the Scott Amici draw from the reports – that small loan customers become trapped in a cycle of debt – accurately reflects a widely existing situation or merely reflects a situation subject to sampling error or experienced by a few statistical outliers.

b. Amici's Cited Reports Are Not Based On Ohio Data

Second, the reports cited by the Scott Amici to support their claim regarding the "cycle of debt" suffer another common flaw that makes their conclusions about consumer lending practices in Ohio even more suspect: none is based exclusively (or even significantly) on Ohio data.[4] Rather, each is more broadly based on national data (potentially including data relating to unlicensed Internet lender transactions), or is focused exclusively on data expressly identified as derived in another state. None of the national data offers any breakdown of the geographic dispersion of its sample. So, like the data involving other specifically identified states, it tells us nothing about Ohio borrowers.

The demographics of borrowers vary by locale, so national studies or reports about circumstances in other states provide no basis for determining what is happening in Ohio, particularly in a highly regulated arena like short-term consumer lending where each state regulates differently. For example, while Alabama, California, Hawaii, Kentucky, Missouri, Nebraska, South Carolina, and Tennessee still allow lender fees of at least $15 per $100

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4 The Legal Aid brief cites three separate reports authored by Policy Matters Ohio. Brief at 8, 14. None contains any independently derived, Ohio-based statistical support for the "cycle of debt" claim. Rather, each does nothing more than identify the number of payday locations in Ohio and otherwise merely cites other reports which lack Ohio statistical support in an attempt to buttress the author's "recommendations." None of the three reports reflect rigorous academic work.

borrowed, the Ohio Mortgage Loan Act caps total fees and interest at approximately 40% less than these states permit on a $500 loan, and 80% less for refinancings. And then other states, including Delaware, Idaho, Nevada, and Utah, have no cap at all on rates lenders charge. As such, conclusions based on national sampling involving widely variable regulatory approaches among states simply fail to provide any information that is methodologically reliable in the specific context of Ohio Mortgage Loan Act lending practices.

c. Most Of Amici's Cited Data Is Outdated And Does Not Reflect Ohio's Reforms

Third, a corollary of the lack of the necessary geographic limitation on source data in the reports the Scott Amici cite regarding the alleged "cycle of debt" is that a number of their citations are based on antiquated data (which again was not limited to data specifically focused on Ohio even when initially published). Information pre-dating the shift by Ohio consumer lenders from licensing under the Check Cashing Loan Act, R.C. 1315.35 to 1315.44 (repealed in 2008 but which permitted interest of 5% per month plus lender fees of $5 per $50 borrowed up to $500) to lending under the more limited strictures of the Mortgage Loan Act simply does not provide a reliable basis for measuring realities of the Ohio market today. Thus, even if the pre-2009 reports had been based on Ohio data that was statistically reliable (and none was), the substantial reduction in fees and interest charged after the shift to licensing under the Mortgage Loan Act in December of 2008 makes earlier reports unreliable in assessing today's consumer lending environment.

d. Amici's Cited Reports Ignore Cashland's Extended Payment Plan, Which Adds No Fees Or Interest

Fourth, the reports cited in support of the Scott Amici claims about a "cycle of debt" are also of doubtful reliability because none explores the impact, or even acknowledges the existence of, the mechanism Cashland makes available to assist borrowers who are unable to repay when the loan comes due. As the Loan Agreement signed by Mr. Scott states, he is entitled to request an "Extended Payment Plan" if he is unable to repay his loan. Appellant's Supp. at 2. Under this option, Mr. Scott could have elected to repay his loan in four equal monthly payments without any additional fees or interest merely by requesting to do so. But not one of the reports the Scott Amici cite even mentions such Extended Payment Plan options or examines whether a "cycle of debt" arises when lenders provide these options to borrowers.

In sum, the reports cited by the Scott Amici to support their asserted "cycle of debt" lack sufficient empirical support to be statistically reliable studies of short-term consumer lending in Ohio. None could qualify to be successfully peer reviewed; none presents sufficient data from which even a statistical expert can determine the margin of error inherent in its conclusions; none meets even minimal requirements for a statistically reliable sample focused on Ohio Mortgage Loan Act borrowers.

e. Amici's "Cycle Of Debt" Model Would Be A Bad Business Plan For Any Lender

Amicus Oglevee joins Amicus Rives in two additional conclusions about the Scott Amici's claims concerning consumer debt. First, the cycle of debt assertions are conceptually illogical (in addition to being unsupported by statistically reliable data). The claim that "the payday loan industry only profits when borrowers fall into a cycle of refinancing the high-fee loans, one after another," Center Brief at 28-29, makes no business sense for a lender licensed under the Ohio Mortgage Loan Act. As explained above, that law does not permit multiple origination fees; loan refinancings therefore generate significantly less revenue than do new loan originations, but still require substantially the same overhead per transaction. Thus, the economic incentive of lenders is just the opposite of that claimed by the Scott Amici: short-term consumer lenders doing business under the Mortgage Loan Act have a much greater motivation to generate new first-time borrowing than they do to refinance earlier loans.

Second, the "cycle of debt" claim simply fails to comport with business world realities. If Mortgage Loan Act lenders receive approximately $15.00 in fees and interest on a refinanced loan comparable to that made to Mr. Scott, the lender's risk of loss of the $500 principal substantially exceeds the value of the marginal revenue generated by the loan refinancing. It is simply counterintuitive to suggest that lenders want to "take advantage of borrower's inability to pay the loan when due," Center Brief at 30, when the failure of the borrower to repay the principal of the loan is the worst possible outcome for the lender. Rather, the business incentive is clear: make loans to people who repay the principal, not those who cannot. A "cycle of debt" business model would simply lead to the financial ruin of any lender adopting it.

CONCLUSION

Amici Rives and Oglevee teach students of the Fisher College of Business at The Ohio State University that decisions regarding financial choices need to be analyzed based on accurate information and hard facts. The Amici offer their views regarding the need of Ohioans for short-term cash loans and the alternatives available to them to obtain it, in the hope that they can assist the Court in having a more accurate picture of the realities of short-term consumer loans in our state.

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PROOF OF SERVICE

The undersigned hereby certifies that a copy of the foregoing was served via U.S. mail, postage prepaid, this 16th day of August, 2013 upon Appellee Rodney Scott, 250 13th Street, Elyria, Ohio 44035, and each Amici of record by service upon their counsel of record.

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