The Payday Loan Industry in Missouri

A Study of the Laws, the Lenders, the Borrowers and the Legislation

Executive Summary

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Purpose Of This Study

One of the Better Business Bureau's responsibilities is to inform the public of questionable or unfair practices in the marketplace. In the past few years the payday loan industry, termed by many as "predatory lending," has grown significantly, both nationally and in Missouri. In 1996 there were an estimated 2,000 payday loan outlets nationally, and by 2008, that number grew to an estimated 22,000. During 2008, 2.8 million payday loans were made by 1,275 lenders licensed in Missouri, according to the Missouri Division of Finance. This study examines current Missouri laws regulating payday loans and how these laws compare with those of other states. The study also looks at the status of pending legislation and the effects of past legislation on the industry.

Sources used in this study include Missouri Division of Finance; 2001 Performance Audit by State Auditor Claire McCaskill; current state laws; Form 10-Ks filed by some companies with the U.S. Securities & Exchange Commission; interviews with officials; National Consumer Law Center; bills introduced in the Missouri Legislature and Congress; Web sites of lawmakers; FDIC Center for Financial Research; AARP; court suits; Consumers Union; Missouri Secretary of State; PACER and Case.net (the court case tracking systems of federal and Missouri courts respectively); Arkansas Supreme Court; Consumer Federation of America; Center for Responsible Lending; the Community Financial Services Association of America (CFSA); and BBB staff visits to nursing homes.

Current Missouri Laws

In 2001, then-Missouri Auditor Claire McCaskill issued a Performance Audit regarding the payday loan industry. She noted that statutes at that time did not limit the interest rates lenders charge and that an annual percentage rate (APR) of 391% was common. While not recommending a specific interest rate that the Legislature should impose, the audit did recommend that the number of renewals of loans be reduced.

The next year, the Legislature passed laws that would allow a lender to charge fees and interest up to 75% of the amount of the loan. On a two-week loan, that translates into a 1,950% APR, the highest allowed among the 43 states that have either banned or set APR caps on payday loans. There are no APR caps in the seven other states. The new laws also allow up to six renewals of loans. Since enactment of the laws, payday loans made to consumers average more than 400% APR, according to the Division of Finance. Missouri's usury law is ineffective in policing exorbitant interest rates as the Division notes on its Web site: "It applies to very little anymore because there are so many exceptions." Also on the site, the Division characterizes the current state laws as consumer friendly in that they "subject this type of lender to a host of consumer safeguards, i.e., places a 75% cap on interest and fees on the initial loan and renewals, limits renewals to no more than six . . . ."

Obtaining a payday loan license in Missouri is a simple process. All that's required is an application and payment of a fee. There is no background check or determination of financial capability, a Division spokesman said.

Missouri's Laws Compared With Those Of Other States

The laws enacted by the Legislature in 2002 require the Division of Finance to report biennially to the Legislature several facets of the payday loan industry. Responses by lenders to the biennial request are not sworn statements. Among the requirements of the report is that a comparison be made with states adjoining Missouri. The Jan. 14, 2009, report to the Legislature shows that of the nine contiguous states, only Missouri allows renewals of payday loans, allowing up to six renewals.

The lax payday loan laws in Missouri have made the state attractive to lenders. Among the nine contiguous states, only Tennessee has more payday loan locations (1,481) than Missouri (1,275) with the next highest being Kentucky with 785, according to the Division of Finance's report. The report also shows that the APR allowed by Missouri's statutes of 1,950% based on a two-week loan of $100 is by far the highest of the nine contiguous states. The next highest was the Arkansas law which allowed an APR of 520%, but that law was declared unconstitutional by the Arkansas Supreme Court on Nov. 6, 2008, because it allowed "usurious" rates of interest in violation of the state's constitution. The rest of the states' laws based on a two-week payday loan of $100 allow APRs of 390% except for Illinois which allows 403%.

The Lenders

While the number of payday loan licenses in Missouri may seem large, there are only 24 companies with 10 or more licenses. They operate at 719 locations, or 56% of the total number of locations in the state. Seventeen of these larger lenders are based out of state. Their headquarters are in Arkansas, Texas, North Carolina, Georgia, Tennessee, Ohio, Colorado, Pennsylvania, Kansas, Alabama and Illinois. There are also 34 out-of-state online companies that are licensed payday lenders in Missouri.

The three largest companies licensed to provide payday loans in Missouri are:

- QC Holdings, Inc., a publicly traded company which does business under the name Quik Cash, headquartered in Kansas City, Kan.;
- Advance America, Cash Advance Centers, Inc., headquartered in Spartanburg, S.C., also a publicly traded company; and
- Bn'T Loan, LLC, of Springfield, Mo., which has licenses at various retail locations.

The three companies operate 292 payday loan locations in Missouri or about 23% of the total number of locations. Missouri accounted for 30% of QC Holdings' total branch gross profits last year, while Illinois accounted for 7%. The Form 10-Ks filed with the U.S. Securities & Exchange Commission reveal that Cash Advance and Quik Cash made a combined $5.5 billion in payday loans nationally in 2008. The primary business of both companies is payday lending, and both companies began operations as the payday lending industry began its great expansion, QC Holdings in 1992 and Advance America in 1997. Bn'T Loan, LLC was created in 2002.

As the phenomenon of payday loans soared, the reputation of companies making them declined. Said one large lender, "Certain banks have notified us and other companies in the payday loan and check-cashing industries that they will no longer maintain bank accounts for these companies due to reputation risks. . . ."

Nursing Homes Have Payday Loan Licenses

Two allied groups headquartered in Sikeston, Mo., operate 62 nursing homes in Missouri with payday loan licenses. Principals in the two allied groups are James and Judy Lincoln, Sikeston; Mathias P. Dasal, Eldon, Mo.; Gary Crane, Rogers , Ark.; and Timothy Drake, Pascagoula, Miss. The sole director of a third group of 30 nursing homes is Don Bedell, Sikeston, who also is sole director of a payday loan company that has licenses at the homes. Nursing homes have regularly made loans to their employees at high interest rates, deducting the payback of the loans from the employees' next paycheck.

In September 2006, then-Gov. Matt Blunt announced that nursing homes would no longer be allowed to make payday loans to their employees, saying, "Employers should not be making money off the wages they pay their hardworking long-term care facility employees."

A spokesman for the Department of Health and Senior Services said that since then, the department has been in negotiations with the nursing home owners, and that the negotiations "became serious" this year. In April, he said the department and nursing home owners reached an oral agreement, which will allow a parent company of nursing home subsidiaries to hold a payday loan license and to conduct payday loan operations at nursing homes that it owns, with payback of the loans being deducted from the employees' paychecks. Employees will take out a loan through computer terminals at the nursing homes, the spokesman said. The transition to the system, which in essence changes the present system very little, will be completed by late September, the spokesman said. Department officials said loans were made only to employees and not to residents of the homes.

The Borrowers

As might be expected, the definition of the typical customer taking out a payday loan differs widely between companies that make them and consumer advocates. Two large payday loan companies or their trade association say that borrowers are under 45 years old, a large percentage have incomes of at least $40,000, nearly half are homeowners, at least 87% have high school diplomas and more than half have attended college.

That picture of the typical borrower is in sharp contrast to that painted by officials and consumer advocates. The Consumer Federation of America says that "payday loan borrowers are typically female, make around $25,000 a year, are renters, and more likely to be minorities than the general population." Former Missouri State Auditor Claire McCaskill said in an audit that "title and payday consumers are generally lower income individuals. Title and payday lenders estimated 70 percent of their consumers earned less than $25,000 annually."

In a press release from the office of U.S. Rep. Luis Gutierrez (D-Ill.), who introduced a bill that some say is friendly to the payday loan industry, it was noted: "Concentrated in low-income and minority neighborhoods, payday lenders typically offer short-duration loans, waiving the credit history requirement imposed by traditional banks. Unfortunately, those who most need these loans are often the least able to repay them."

The Missouri Division of Finance conducted a study in 2007. The survey of about 3,700 borrowers showed that the average age of consumers taking out payday loans was 43 and income was $24,607. Borrowers were classified by vocation with 21% being "labor," and 12% classified as "secretarial/clerical." The survey showed that 439 loans or 12% were made to consumers on Supplemental Security Income (SSI) or disability. On its Web site, AARP has this to say about the elderly and payday loans: "As studies show that older people are incurring greater debt than ever before, and are filing for bankruptcy in record numbers, they may find that their usual sources of credit are no longer available. They may join the ranks of other low- and moderate-income consumers (who) turn to non-traditional credit sources for very expensive loans."

In a press release announcing his filing of a bill, U.S. Sen. Richard J. Durbin (D-Ill.) said, "These excessive rates are often hidden and can have crippling effects on those individuals who can afford it least."

Last year, customers of payday loan companies filed 473 complaints with BBBs alleging wrongdoing on the part of their lenders.

Bane Or Boon?

As with the identity of the typical borrower, the question of whether payday loans are beneficial or not receives widely disparate answers from the industry and consumer advocates. The Community of Financial Services Association of America (CFSA), the trade association for the industry, says on its Web site, "Typically, a customer uses a payday advance to cover small, unexpected expenses between paydays to avoid expensive bounced-check fees, late bill payment penalties, and other less desirable short-term credit options." A major lender notes, "We believe that our customers choose the payday loan product because it is quick, convenient and in many instances a lower-cost or more suitable alternative for the customer than the other available alternatives." Another major lender says, "We believe customers use cash advances as a simple, quick and confidential way to meet short-term cash needs between paydays while avoiding the potentially higher costs and negative credit consequences of other alternatives."

Consumer advocacy groups think differently. A study by the Center for Responsible Lending noted: "Despite attempts to reform payday lending . . . lenders still collect 90 percent of their revenue from borrowers who cannot pay off their loans when due, rather than one-time users dealing with short-term emergencies." In comments to the Federal Trade Commission, the Consumer Federation of America stated: "The essential features of a payday loan make them a debt trap for borrowers" because the loans are made without considering the borrower's ability to repay and interest rates are exorbitant. The Center for Responsible Lending said in another survey that "the entire payday lending industry relies on a business model that encourages chronic borrowing."

The consequences of the "debt trap" may be severe. A study made under the auspices of the Federal Deposit Insurance Corp. (FDIC) was titled "Do Payday Loans Cause Bankruptcy?" The researcher concluded: "We find that payday loan applicants approved for their first loans file for Chapter 13 bankruptcy significantly more often than rejected first-time borrowers." And several consumer groups, in a letter to the sponsor of an industry-friendly bill in Congress, said, "Using payday loans doubles the risk a borrower will end up in bankruptcy within two years."

Borrowers who cannot pay off a payday loan also may find themselves as defendants in court actions. One of the largest lenders in Missouri has filed more than 100 small claims suits in Missouri to force borrowers to pay.

A Center for Financial Responsibility study listed the cost of payday lending to borrowers who have five or more loans per year in the 50 states and the District of Columbia. California topped the list at $365 million, while Missouri ranked second with $317 million.

Legislation

A bill introduced in the U.S. Senate by Sen. Durbin began by saying that governments have been trying "to prohibit usurious interest rates in America since colonial times."

Currently, there are four pending bills in Congress and two were introduced in the recently concluded Missouri Legislature. But if the past--when several bills both at the state and federal level died in committee or were not assigned to a committee--is any indication of the future, the prospects of meaningful regulation of payday lenders is questionable. Bills were introduced in the U.S. House or Senate in 2005, 2006, 2007 and 2008. And in Missouri bills were introduced in the House or Senate in 2006, 2007 and 2008. Only one of the bills was enacted into law--a bill passed by Congress in 2006 for military service members and their families that placed an APR cap of 36% on several consumer credit products including payday loans. Only two of the bills introduced this year provide protection against extremely high interest rates.

These bills have been introduced:

- U.S. Senate Bill 500 – Introduced on March 19, 2009, by Sen. Durbin. The bill would cap interest rates on several consumer credit products including payday loans at a 36% APR and would provide a penalty for violation of the law of a year in prison or a fine of $50,000.
- U.S. House of Representatives Bill 1608 – Introduced on March 19, 2009, by Rep. Jackie Speier (D-Calif.). This bill is identical to Senate Bill 500.
- U.S. House of Representatives Bill 1214 – Introduced Feb. 26, 2009, by Rep. Gutierrez. The bill would cap

fees and interest at 15 cents per dollar, an APR of 390% on a two-week loan. Twelve consumer advocacy groups sent a letter to Rep. Gutierrez opposing the bill, saying it would "stall or stop the significant progress that has been made at the state level to curb usurious lending" and that "legalizing payday lending at triple-digit rates runs counter to President Obama's promise to cap payday lending and other loans at 36 percent annual rates."

- U.S. House of Representatives Bill 1846 – Introduced April 1, 2009, by Rep. Joe Baca (D-Calif.). One of the main provisions of the bill is that it would preempt state laws on payday lending, including those in states that have banned payday lending entirely. The bill also calls for a 390% APR.
- Missouri Senate Bill 20 – Pre-filed Dec. 1, 2008, by Sen. Rita Heard Days (D-St. Louis). The bill allows a 390% APR (based on a two-week loan) for the first 30 days of a loan and an APR of 36% thereafter. The bill also prohibits renewal of payday loans. The legislative session ended with no action taken on the bill or its companion bill, Missouri House Bill 150, pre-filed by Rep. Mary Still (D-Columbia).

Effects Of Past Legislation

More and more states are clamping down on the payday loan industry with legislation that either bans payday lending entirely or provides stiff regulation of the industry. More than 200 bills have been introduced in state legislatures in recent years. And as laws are enacted, payday lending companies have ceased operations in those states. "In states where a 36% cap is mandated, without additional fees, we are unable to operate at a profit," said QC Holdings in its 10-K report filed with the Securities & Exchange Commission. And Cash Advance said in its 10-K, "Any federal law that would impose a national 36% APR limit on our services, like that proposed in the Durbin bill, if enacted, would likely eliminate our ability to continue our current operations." The company also noted that since 2007 it has closed or will close payday loan outlets in Arkansas, New Mexico, New Hampshire, Oregon and Pennsylvania. Not only is the industry facing the possibility of prohibitive legislation at the federal and state levels, local governments have entered the picture by restricting payday lending through zoning and permit laws.

In addition to the prospect of increased regulation by federal, state and local governments, payday loan companies also find themselves as defendants in court actions. Class action suits are pending against two of Missouri's largest payday lenders in Arkansas, California, Florida, Georgia, North Carolina, Pennsylvania, South Carolina and Missouri. Class action suits have been filed in St. Louis County Circuit Court and the U.S. District Court in Jefferson City, Mo. Both suits are pending appeal regarding procedural matters. The suit in St. Louis County alleges that QC Holdings (Quik Cash) violated Missouri law by renewing loans more than six times, by failing to determine the customer's ability to repay the loans, and by charging interest and fees which were more than 75% of the face amount of the original loan.

Conclusions

Missouri's weak payday loan laws have attracted major out-of-state lenders to engage in predatory lending, costing Missourians who can least afford it millions of dollars a year. Because the continually increasing debt owed to payday loan companies is so onerous, some consumers are caught in the "debt trap," unable to pay the loan off or meet other needs such as utilities, rent and food. Bankruptcy is the only answer for some of these consumers. The bill introduced in Congress by Sen. Durbin and its companion bill in the House, if enacted, would appear to halt the usurious practices, not only in Missouri but nationally as well. The Missouri Legislature has not joined the parade of states which have taken action recently to either prohibit or severely restrict payday lending. Payday loans are banned in 12 states while three others have adopted restrictive laws. The two bills introduced in this session of the Missouri Legislature, while forbidding renewals, would still allow an APR of 390% on a two-week loan. Payday loan companies have ceased operations in states that have enacted strict regulations on payday lending, including placing a 36% or less APR cap on interest and fees.

BBB Researcher: Robert H. Teuscher, July 2009

MO PAYDAY LOANS   COMPANY ON LINE ADS

http://www.checksmart.com/Services_Missouri.aspx

MO INFO CONSUMER
http://www.paydayloaninfo.org/chelp.cfm
MO PAWNSHOPS
http://www.pawnshops.net/state_page.php?stateid=MO

EZ MONEY STORE
http://www.loanspayday.info/companies/EZ_Money/

INDIANA POLICY
http://www.inpolicy.org/
* ***"Defining and Detecting Predatory Lending,"*** by Federal Reserve Bank of New York Research Officer Donald P. Morgan, January 2007, located at:
http://www.newyorkfed.org/research/staff_reports/sr273.pdf
** ***"Payday Lending and Public Policy: What Elected Officials Should Know,"*** by Tom Lehman, Ph.D., adjunct scholar of the Indiana Policy Review Foundation and professor of economics at Indiana Wesleyan University, located at:
http://www.inpolicy.org/index.php?option=com_content&task=view&id=211&Itemid=26
CATHOLIC NEWS SERVICE
http://www.catholicnews.com/data/stories/cns/0903382.htm

PAYDAY LOAN IND REFORM
http://www.pliwatch.org/news_article_060914A.html

KC STAR 2007 WARNING PAYDAY LOANS
http://www.allbusiness.com/legal/trial-procedure-suits-claims/12046550-1.html
http://www.allbusiness.com/crime-law/criminal-offenses-cybercrime/12684585-1.html

UNSECURED LOANS OF FIVE HUNDRED DOLLARS OR LESS

Introduction & Overview

Sections 408.500 to 408.506 are the governing authority for specific types of small, unsecured loans. The primary body of law covering these loans is found in the regulations, 4 CSR 140-11.030 and 4 CSR 140-11.040. These are short-term, typically single payment loans commonly referred to as "Payday" loans.

The following is a quick reference guide for 408.500 to 408.506, and the related regulations.

408.500.1	Requires loans to be unsecured and $500 or less. Requires a license from the Division of Finance with an annual fee of $300. Excludes consumer credit lenders and pawnbrokers from licensing. Requires Truth in Lending and Regulation Z disclosures, and requires the borrower's signature on all loans, extensions, or renewals.
408.500.2	Provides for simple interest and fees in accordance with 408.100 and 408.140. Establishes a penalty provision for violations of the section.
408.500.3	The cost of collection expenses are not considered as a fee or charge for the purposes of this section. Limits collection costs to court costs and attorney fees awarded by the court.
408.500.4	Requires the lender to conspicuously post the maximum annual percentage rates currently being charged and a statement concerning the short-term nature of the loans.
408.500.5	Requires a notice to the borrower containing the language in 408.500.4 and a statement that the loan may be canceled by the borrower by returning the funds by the end of the lender's next full business day. The statement must be acknowledged by the borrower's signature.
408.500.6	Limits the number of renewals to six and requires a five percent reduction of the original principal amount commencing with the first renewal.
408.500.7	Lenders must consider the borrower's ability to reasonably repay the loan and must retain records for at least two years.
408.500.8	A licensee must notify the director to request an examination 10 days prior to ceasing operations. The licensee must retain records for at least two years.
408.500.9	Permits the director to suspend or revoke licenses subject to a hearing.
408.500.10	Permits the director to issue cease and desist orders enforceable by fines of not more than $1,000 per day.
408.505.1	Establishes coverage of the section for lenders licensed, or who should have been licensed, pursuant to 408.500, lenders who are deemed to have disguised loans to evade the section, and lenders who have engaged in subterfuge to avoid the section.
408.505.2	Creates minimum and maximum loan terms of 14 and 31 days respectively.
408.505.3	Permits only interest and fees as provided for in 408.100 and 408.140 and limits the total amount of accumulated interest and fees to 75% of the initial loan amount for the life of the loan including all renewals.
408.505.4	Defines completed and renewed loans.
408.505.5	Prohibits a loan from being repaid by a loan from the same lender or an affiliate and limits the aggregate of loans from a lender and affiliate to the same borrower to $500. The lender may comply with this section by having the borrower sign a statement certifying that the above conditions are true.
408.505.6	No functional applicability.
408.505.7	Prohibits the enforcement of any contract in violation of the terms of this section.
408.505.8	Restricts the crime of passing a bad check to accounts closed before the negotiation date and checks for which payment was stopped.
408.505.9	Prohibits a lender from disguising transactions with the purpose or result of evading the provisions of this section.
408.505.10	Limits the provisions of this section to entities subject to 408.500 and this section.

The following is a quick reference guide for each of the regulations relating to 4 CSR 140-11.030 and 4 CSR 140-11.040.

4 CSR 140-11.030 (1)	Requires the license to be prominently displayed.
4 CSR 140-11.030 (2)	Requires the lender to conspicuously display the notice provided for in 408.500.4 and also requires the notice to include the name, address, and phone number of the Division of Finance.
4 CSR 140-11.030 (3)	Places certain restrictions on the licensee's location.
4 CSR 140-11.030 (4)	Requires a separate license for each location.
4 CSR 140-11.030 (5)	Requires the lender to provide the borrower with a copy of the contract, and to retain a copy for the file.
4 CSR 140-11.030 (6)	Details how interest and fees are earned.
4 CSR 140-11.030 (7)	Provides certain restrictions and limitations for post-dated checks held by the lender.
4 CSR 140-11.030 (8)	Defines renewals and the renewal process.
4 CSR 140-11.030 (9)	Sets forth procedures for collection by Automated Clearing House.
4 CSR 140-11.030 (10)	Requires a receipt be given for each payment made in currency.
4 CSR 140-11.030 (11)	Provides penalty provisions for violations of this rule.
4 CSR 140-11.040 (1)	Establishes minimum recordkeeping requirements.
4 CSR 140-11.040 (2)	Requires the lender to maintain a cash journal.
4 CSR 140-11.040 (3)	Requires the lender to maintain a general ledger, a trial balance sheet, and a profit and loss statement.
4 CSR 140-11.040 (4)	Requires the lender to maintain an individual account ledger.
4 CSR 140-11.040 (5)	Establishes certain record maintenance requirements and permits examiner access to records.
4 CSR 140-11.040 (6)	Prohibits erasures on individual ledgers.
4 CSR 140-11.040 (7)	Establishes a record retention requirement.
4 CSR 140-11.040 (8)	Requires paid notes to be returned to the borrower.
4 CSR 140-11.040 (9)	Provides penalty provisions for violations of this rule.

The following is a cross-reference guide to some of the more fundamental sections of 408.500 to 408.506 and the various regulations governing these loans.

Additional Fees	408.500.2, 408.505.3
Examination Authority	4 CSR 140-11.040 (5)
License Display	4 CSR 140-11.030 (1)
Loan Term	408.505.2
Maximum Loan Amount	408.500.1, 408.505.1(1)
Notice Display	408.500.4, 4 CSR 140-11.030 (2)
Paid Notes	4 CSR 140-11.040 (8)
Post Dated Checks	4 CSR 140-11.030 (7)
Principal Reduction	408.500.6, 4 CSR 140-11.030 (8)
Rates	408.500.2, 408.505.3, 4 CSR 140-11.030 (8)
Record Retention	4 CSR 140-11.040 (7)
Renewals	408.500.6, 4 CSR 140-11.030 (8)

O.C.G.A. § 16-17-1 ET SEQ. NOT VOID FOR VAGUENESS. --The trial court did not err in rejecting both the defendants' equal protection and vagueness challenges to O.C.G.A. § 16-17-1 et seq., after they were charged with violating O.C.G.A. § 16-17-2, as both the defendants as in-state lenders, were not similarly situated with out-of-state banks designated in O.C.G.A. § 16-17-2(a)(3), and hence were subject to state regulation restricting high interest rates on loans, whereas the out-of-state banks were not; the Georgia legislature had a rational basis for creating a class based on those in-state payday lenders who were subject to state regulation, and moreover the prohibition against **payday loans** in whatever form transacted, was sufficiently definite to satisfy due process standards. Glenn v. State, 282 Ga. 27, 644 S.E.2d 826 (2007).

--CORPORATE OFFICERS

Under the Illinois Consumer Fraud Deceptive Business Practices Act, 815 ILCS 505/1 et seq., corporate officers can be liable for a corporation's tortious conduct if they actively participate in the wrongful conduct. Hartke v. Illinois **Payday Loans,** Inc., F. Supp. 2d , 1999 U.S. Dist. LEXIS 14937 (C.D. Ill. Sept. 13, 1999).

In an action alleging that "**payday loans**" or short- term loans issued at high interest rates violated 815 ILCS 505/2, by charging exorbitant interest rates and failing to make proper disclosures on the loan documents, a named individual satisfied the requirements of Rule 23(b), F.R.Civ.P. for class certification for persons with Illinois addresses who signed a request for a loan within the statute of limitations for the action. Taylor v. Halsted Fin. Servs., Llc, F. Supp. 2d , 2000 U.S. Dist. LEXIS 384 (N.D. Ill. Jan. 13, 2000).

17. Borrower's claims against a bank and its servicing agents, arising from **payday loans** secured by the borrower, were subject to arbitration, based on a clause in the loan application, the note, and the disclosure statement, as on balance of the borrower's claim under the New Jersey Consumer Fraud Act, N.J. Stat. Ann. § 56:8-1 et seq., and the competing public policy favoring arbitration, arbitration was favored where there was no unenforceability of the arbitration contract shown because the parties had agreed to permit the issues to be resolved in an arbitration forum; similarly, the borrower's claims under the New Jersey Racketeering and Corrupt Organizations Act, N.J. Stat. Ann. § 2C:41-1 et seq., were subject to arbitration. Muhammad v. County Bank of Rehoboth Beach, 379 N.J. Super. 222, 877 A.2d 340, 2005 N.J. Super. LEXIS 228 (App.Div. 2005), reversed by 189 N.J. 1, 912 A.2d 88, 2006 N.J. LEXIS 1154 (2006).

Borrower in "**payday loan**" transactions, involving small amounts of money for short time periods, was entitled to compel lender to answer discovery demands despite arbitration clause in loan contracts, since such clause may be set aside on sufficient grounds such as unconscionability, and discovery sought by borrower pertained to matters such as impartiality of arbitrator, relationship between arbitrator and lender, and lender's conduct inconsistent with bona fides of clause. Hayes v County Bank (2000, Sup) 185 Misc 2d 414, 713 NYS2d 267.

94. Various freedoms preserved by Wis. Const. art. I, § 1, are substantially the equivalent of the due-process and equal-protection-of-the-laws clauses of the Fourteenth Amendment to the U.S. Constitution. Where the court granted summary

judgment to a city in a claim by a business owner that a city ordinance violated its equal protection and due process rights under the U.S. Constitution, the court also granted summary judgment on the owner's claim that the ordinance violated the Wisconsin Constitution because there was no difference between the federal and state constitutional provisions. **Payday Loan** Store of Wis., Inc. v. City of Madison, 333 F. Supp. 2d 800, 2004 U.S. Dist. LEXIS 17577 (W.D. Wis. 2004).

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Defining and Detecting Predatory Lending

Donald P. Morgan

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Abstract

We define predatory lending as a welfare-reducing provision of credit. Using a textbook model, we show that lenders profit if they can tempt households into “debt traps,” that is, overborrowing and delinquency. We then test whether payday lending fits our definition of predatory. We find that in states with higher payday loan limits, less educated households and households with uncertain income *are* less likely to be denied credit, but are *not* more likely to miss a debt payment. Absent higher delinquency, the extra credit from payday lenders does not fit our definition of predatory. Nevertheless, it is expensive. On that point, we find somewhat lower payday prices in cities with more payday stores per capita, consistent with the hypothesis that competition limits payday loan prices.

Key words: predatory, payday, consumer

Morgan: Federal Reserve Bank of New York (e-mail: donald.morgan@ny.frb.org). The author thanks John Caskey, Gerhard Fries, Andreas Lehnert, Ryan Morgan, Karen Pence, Ian Wallace, and Jeremy Stein for comments and assistance and extends special thanks to Song Han and Sam Hanson for their collaboration, Jean Ann Fox and Stephen Graves for data, and the Stockholm Institute of Financial Research for hosting Morgan.

"There is no definition of predatory lending. I don't know how we can hope to address the problem before we have decided what it is." (Senator Phil Gramm, *American Banker*, August 24, 2000).

1 Introduction

"Predatory" is how reformers–consumer advocates, journalists, lawyers, legislators and some bank regulators–condemn lending practices in the booming subprime credit market. The alleged predators are sub-prime mortgage and payday lenders. Their prey? The lower income, less educated households on the demand side of these growing consumer credit markets.[1]

Concern about predatory lending is mounting (Figure 1). The term began appearing in *American Banker* in 1994. Appearances were rare until 2000. By 2004, weekly and even daily appearances were common.

Despite growing concerns about predatory lending, and even regulation to curb it, there seems to be no general definition of predatory lending. The usual criticism is of "unaffordable" credit–loans made at such high rates or in such large quantities that borrowers cannot afford to repay the credit without sacrificing their future standard of living, or in the worst case, their home.

To economists, this predator-prey concept of credit seems foreign. If credit is so expensive that lenders are earning abnormal profits (given their risks and costs), why don't new lenders enter the market to compete rates down to fair levels. "Unaffordable" credit also sounds peculiar; how can lenders profit if borrowers cannot repay?

This paper essays predatory lending from an economists' perspective. We define predatory lending as a welfare *reducing* provision of credit. That definition seems general enough to cover some of the specific practices–overlending and overcharging, deception, targeting certain consumer segments –condemned by reformers. We show how households can be made worse of by a voluntary credit transaction if lenders deceive households about some variable that increases households' demand for credit, like their income.

[1] For a critique of the predatory aspects of payday lending, see King, Parrish, and Tanik (2006)

Information asymmetries are common in credit market models, but the usual assumption, at least in commercial lending, is that borrowers are the better informed party and that lenders have to screen and monitor to assess whether firms are creditworthy. The opposite asymmetry, as we assume here, does not seem implausible in the context of consumer lending. "Fringe" borrowers are less educated than mainstream borrowers (Caskey 2003), and many are first-time borrowers (or are rebounding from a failed first foray into credit). Lenders know from experience with large numbers of borrowers, whereas the borrower may only have their own experience to guide them. Credit can also be confusing; after marriage, mortgages are probably the most complicated contract most people ever enter. Given the subtleties involved with credit, and the supposed lack of sophistication of sub-prime borrowers, our assumption that lenders know better seems plausible.

While lenders might deceive households about several variables that influence household loan demand, we focus on income. We suppose that lenders exaggerate household's future income in order boost loan demand. Our borrowers are gullible, in the sense that they can be fooled about their future income, but they borrow rationally given their beliefs. Fooling borrowers is costly to lenders, where the costs could represent conscience, technological costs (of learning the pitch), or risk of prosecution. The upside to exaggerating borrowers' income prospects is obvious–they borrow more. As long as the extra borrowing does not increase default risk too much, and as long as deceiving borrowers is easy enough, income deception and predatory–welfare reducing–lending may occur.

After defining predatory lending, we test whether *payday* lending fits our definition. Payday lenders make small, short-term loans to mostly lower-middle income households. The business is booming, but critics condemn payday lending, especially the high fees and frequent loan rollovers, as predatory. Many states prohibit payday loans outright, or *indirectly*, *via* usury limits.

To test whether payday lending qualifies as predatory, we compared debt and delinquency rates for households in states that allow payday lending to those in states that do not. We focus especially on differences across states households that, according to our model, seem more vulnerable to predation: households with more income uncertainly or less education.

We use smoking as a third, more ambiguous, proxy for households with high, or perhaps hyperbolic, discount rates. In general, high discounters will pay higher future costs for a given, immediate, gain in welfare. Smokers' seem to fit that description. What makes the smoking proxy ambiguous is that smokers may have hyperbolic, not just high, discount rates. Hyperbolic discount rates decline over time in a way that leads to procrastination and self-control problems (Laibson 1997). The hyperbolic discounter postpones quitting smoking, or repaying credit. Without knowing whether smokers discount rates are merely high, or hyperbolic, we will not be able to say whether any extra debt for smokers in payday states is welfare reducing.[2]

Given those proxies, we use a difference-in-difference approach to test whether payday lending fits our definition of predatory. First we look for differences in household debt and delinquency across payday states and non-payday states, then we test whether those difference are higher for potential prey. To ensure that any such differences are not merely state effects, we difference a third time across time by comparing whether those differences changed after the advent of payday lending circa 1995. That triple difference identifies any difference in debt and delinquency for potential prey in payday states after payday lending was introduced.

Our findings seem mostly inconsistent with the hypothesis that payday lenders prey on, i.e., lower the welfare of, households with uncertain income or households with less education. Those types of households who happen to live in states that allow unlimited payday loans are less likely to report being turned down for credit, but are *not* more likely, by and large, to report higher debt levels, contrary to the overborrowing prediction of our model. Nor are such households more likely to have missed a debt payment in the previous year. On the contrary, households with uncertain income who live in states with unlimited payday loans are *less* likely to have missed a debt payment over the previous year. The latter result is consistent with claims by defenders of payday lending that some households borrow from

[2]Consistent with a high discount rate, Munasinghe and Sicherman (2000) discover that smokers have flatter wage profiles and they are willing to trade more future earnings for a given increase in current earnings. Gruber and Mulainathan (2002) find that high cigarette taxes make smokers "happier," consistent with hypberbolic discount rates (because taxes help smokers commit to quitting). DellaVigna and Malmendier (2004) show how credit card lenders can manipulate hyperbolic discounters by front-loading benefits and back-loading costs.

payday lenders to avoid missing payments on other debt. On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand.

We find some interesting differences for smokers, but those differences are harder to interpret in relation to the predatory hypothesis without knowing *apriori* whether smokers are hyperbolic, or merely high, discounters.

We also find, using a small set of data from different sources, that payday loan rates and fees decline significantly as the number of payday lenders and pawnshops increase. Reformers often advocate usury limits to lower payday loan fees but our evidence suggests that competition among payday lenders (and pawnshops) works to lower payday loan prices.

Our paper has several cousins in the academic literature. Ausubel (1991) argues that credit card lenders exploit their superior information about household credit demand in their marketing and pricing of credit cards. The predators in our model profit from their information advantage as well. Our concept of income delusion or deception also has a behavioral flavor, as well, hence our use of smoking as a proxy for self-control problems. Brunnermeier and Parker (2004), for example, imagine that households *choose* what to expect about future income (or other outcomes). High hopes give households' current "felicity," even if it distorts borrowing and other income-dependent decisions. Our households have high hopes for income, and they make bad borrowing decisions, but we do not count the current felicity from high hopes as an offset to the welfare loss from overborrowing.

Our costly falsification (of household income prospects) and costly verification (by counselors) resemble Townsend's (1979) costly state verification and Lacker and Weinbergs' (1989) costly state falsification. The main difference here is that the falsifying and verifying comes before income is realized, not after.

More importantly, we hope our findings inform the current, very real-world debate, around predatory lending. The stakes in that debate are high: millions of lower income households borrow regularly from thousands of payday loan offices around the country. If payday lenders raise household welfare by relaxing credit constraints, anti-predatory legislation may lower it.

2 Payday Lending

Payday lenders make small, short-term loans to households. The typical loan is about $300 for two weeks. The typical fee is $15 per $100 borrowed. Lenders require two recent pay stubs (as proof of employment), and a recent bank account statement. Borrowers secure the loan with a post-dated personal check for the loan amount plus fees. When the loan matures, lenders deposit the check.

Payday lending evolved from check cashing much like bank lending evolved from deposit taking. For a fee, check cashiers turn personal paychecks into cash. After cashing several paychecks for the same customer, lending against $future$ paychecks was a natural next step.

High finance charges is the main criticism against payday lenders. The typical fee of $15 per $100 per two weeks implies an annual interest rate of $15x365/14$, or 390 percent. Payday lenders are also criticize for overlending, in the sense that borrowers often refinance their loans repeatedly, and for "targeting" women making the transition from welfare-to-work (Fox and Mierzewski 2001) and soldiers (Graves and Peterson 2004).

Despite their critics, payday lending has boomed. The number of payday advance offices grew from 0 in 1990 to $14,000$ in 2003 (Stegman and Harris 2003). The industry originated $8 to $14 billion in loans in 2000, implying 26-47 million individual loans. Rapid entry suggests the industry is profitable.

Payday lenders present stiff competition for pawnshops, even though the internet, namely E-bay, significantly foreclosure costs for pawnshops (Caskey 2003). The number of pawn shops in the U.S. grew about six percent per year between 1986 and 1996, but growth essentially stalled from 1997 to 2003. Prices of shares in EZCorp, the largest, publicly traded pawn shop holder, were essentially flat or declining between 1994 and 2004, while Ace Cash Express share prices, a retail financial firm selling check cashing and payday loans, rose substantially over that period (Figure 4). EZCorp CEO, Joseph Rotunday, blamed payday lenders for pawnshops' dismal performance:

> The company had been progressing very nicely until the late 1990s.... (when) a new product called payroll advance/payday loans came along and provided our customer base an alternative choice. Many of them elected the payday loan over

the traditional pawn loan. (Quoted by Caskey (2003) p.14).

Payday lending is heavily regulated (Table 1). As of 2001, eighteen states effectively prohibited payday loans *via* usury limits, and most other states prices, loan size, and loan frequency per customer (Fox and Mierzwinski 2001). Note that the payday loan limit ranges from 0 (where payday loans are illegal) to 1250. Nine states allow unlimited payday loans.

Payday lenders have circumvented usury limits by affiliating with national or state chartered banks, but the Comptroller of the Currency–the overseer of nationally chartered banks—recently banned such affiliations. The Federal Deposit Insurance Corporation still permits payday lenders to affiliate with state banks, but recently restricted those partnerships (Graves and Peterson 2005).

Regulatory risk–the threat of costly or disabling legislation in the future–looms large for Payday lenders. The Utah legislature is reconsidering its permissive laws governing payday lending. North Carolina recently drove payday lenders from the state by expressly outlawing the practice.

Heavy regulation increases the cost of payday lending. High regulatory risk increases limits entry into the industry and increases the expected return required by industry investors. Driving up costs and driving away investors may be exactly what regulators intended if they view payday lending as predatory.

3 Defining Predatory Lending

We define predatory lending as a welfare reducing provision of credit. Households can be made worse off by borrowing if lenders can deceive households into borrowing more than is optimal. Excess borrowing reduces household welfare, and may increase default risk.

We illustrate our concept of predatory lending in a standard model of household borrowing. Before we get to predatory lending, we review basic principles about welfare *improving* lending, the type that lets households maintain their consumption despite fluctuations in their income.

The model has two periods: today (period zero) and payday (period one. Household income goes up and down periodically, but not randomly (for now): income equals zero today and y on payday. If households consume C_t in period t, their utility is $U(C_t)$.Household welfare is the sum of utility over both periods: $U(C_0) + \delta U(C_1)$, where δ equals the household's time rate of discount. Households with high δ value current consumption highly relative to future consumption. In other words, high discounters are impatient.

A digression here on discount rates serves later discussion. In classical economics δ is constant. If δ changes over time, so does household behavior, even if nothing else changes. If $\delta(t)$ is hyperbolic, households will postpone unpleasant tasks until current consumption does not seem so precious relative to future consumption (Laibson 1997). With hyperbolic discounting, that day never arrives, so hyperbolic discounters have behavioral problems: they procrastinate. They may never repay debt, much less begin saving. Hyperbolic discounters who start smoking may never quit.

Returning to the model, if the marginal utility of consumption (U') is diminishing, households will demand credit to reduce fluctuations in their standard of living. Households without credit, however, must fend for themselves (autarky). Welfare under autarky equals $U(0) + \delta U(y)$. The fluctuations in consumption for households without credit make autarky a possible worst case, and hence, a good benchmark for comparing cases *with* credit.

If households borrow B at interest rate r, welfare equals $U(B) + \delta U(y - (1+r)B)$. Borrowing increases utility in period zero, when the proceeds are consumed, but lowers utility in period one, when households pay for their borrowing. Rational, informed households trade off the good and bad side of borrowing; they borrow until the marginal utility of consuming another unit today just equals the marginal, discounted *dis*utility of repaying the extra debt on payday:

$$U'(B) = \delta(1+r)U'(y - (1+r)B). \tag{1}$$

Equation (1) determines household loan demand as a function of their income, their discount rate, and the market interest rate: $B(y, \delta, r)$. For standard utility functions, household loan demand is increasing in income and decreasing in the discount factor and interest rate: $B_y > 0; B_\delta < 0; B_r < 0$. Household welfare with optimal borrowing equals $U(B(y, r, d)) + \delta U(y - (1+r)B(y, r, \delta))$. As long as households follow (1), their welfare with positive borrowing must be higher than without (autarky).

The welfare gain from borrowing depends on the cost of credit production. Suppose the cost of lending $\$B$ to a particular household equals $(1+\rho)B + f$, where ρ represents the opportunity cost per unit loaned and f is the fixed cost per loan. Think of f as the cost of record-keeping and credit check required for each loan, however large or small the loan may be. If the going price for loans is $(1+r)$ per unit borrowed, the lenders' profits equal $(r-\rho)B - f$.

With perfect competition among lenders, the loan interest rate is competed down until it just covers the costs of the loan: $r = \rho + f/B$. Equilibrium r and B are determined where that credit supply curve equals demand (1).

Equilibrium in the payday credit market is illustrated in Figure (3). If fixed costs per loan are prohibitively high, the market may not exist. Perhaps the payday lending technology lowered the fixed cost per loan enough to make the business viable.[3] Before the advent of payday lending, households who applied to banks for a very small, short-term loan may have been denied.

Fixed costs per loan imply that smaller loans will cost more per dollar borrowed than larger loans. That means households with low credit demand will pay higher rates than households with high loan demand. Loan demand is increasing in income, so high income households who demand larger quantities of credit will enjoy a "quantity" discount, while lower income households will pay a "small lot" premium, or penalty. That price "discrimination" is not invidious, however; the higher cost of smaller loans reflects the fixed costs of lending. The high price of payday loans may partly reflect the combination of fixed costs and small loan amounts (Flannery and Samolyk 2005).

A usury limit lowers household welfare. Suppose the maximum legal interest rate is $\overline{r}$. At that maximum rate, the minimum loan that lenders' cost is $f/(\overline{r}-\rho) = \underline{B}$. Low income households with loan demand less than $\underline{B}$ face a beggar's choice: borrow $\underline{B}$ at $\overline{r}$ or do not borrow at all. Such households would be willing to pay more to to avoid going without credit, so raising the usury limit would raise welfare for those households.

Competition is another key determinant of how much households gains from borrowing.

[3] Alternatively, or additionaly, the demand for small, short term loans may have increased in the mid 1990s. The welfare reform then almost certainly increased demand for such credit as households who once "worked" at home for the government were forced to go to work in the market.

Even with no competition – monopoly–households cannot be worse off than under autarky. The monopolist raises interest rates until the marginal revenue from higher rates equals the marginal cost from lower loan demand:

$$B(y,r) = -(r-\rho)B_r(y,r). \tag{2}$$

At that monopoly interest rate, r^m, household loan demand equals $B(y,r^m)$.Household welfare under monopoly equals $U(B_r(y,r^m)) + \delta U(y-(1+r^m)B_r(y,r^m))$. Welfare is lower under monopoly because credit costs more and their standard of living fluctuates more (because costly credit reduces their demand for credit) If households borrow from the monopolist, however, they must better off than without credit.

In sum, welfare for rational households is highest if credit is available at competitive prices. If households choose to borrow, they must be at least as well off as they were without credit. Limiting loan rates cannot raise household welfare and may reduce it. Monopoly lenders lower household welfare, but even with a monopolist, households cannot be worse off than without credit.

The high cost of payday lending may partly reflect fixed costs *per* loan. Before payday lending, those fixed costs may have been prohibitive; very small, short-term loans may not have been worthwhile for banks. The payday lending technology may have lowered those fixed costs, thus increasing the supply of credit to low income households demanding small loans. That version of the genesis of payday lending suggests the innovation was welfare improving, not predatory.

3.1 Predation by Income Deception

In the textbook model household welfare cannot be lower than under autarky because households are fully informed and rational. Here we show households how can be made worse off than without credit if predatory lenders can delude households about their (households') future income.

Suppose that by spending $C(\tau)$, lenders can convince a prospective borrower that her income on payday will be $y+\tau$. The cost C can be interpreted variously as the cost of a guilty conscience, the risk of prosecution, or the resources spent conning households into believe τ. Households are increasingly skeptical as deception increases: $C'(\cdot) > 0$ and $C''(\cdot) > 0$. $C(\tau)$ might be lower for more gullible households and higher for the more skeptical ones. For the fully rational borrower, the costs of deception are infinite: $C(0) = \infty$.

Our model of costly income deception takes us far from, and in some ways behind, current techniques for modelling information asymmetries. Borrowers here not fully informed, as they operate under the assumption that next period equals $y + \tau$, and that is plainly wrong.[4]

Our income deception story is closer to the facts than it is to theory. In a study of households' choice of credit cards plans, Agarwal, Chomsisenghat, Liu, Souleles (2005) find that about 40 percent of households choose sub-optimal plans. Ausubel (1991, 1999) and Shui and Ausubel (2004) find evidence that credit card holders systematically *underestimate* how much they owe or how long they (will) owe it. Underestimating borrowing is not much different from *overestimating* future income.[5]

Though gullible, households borrow optimally given their perceived income. That means they are on their demand curve for credit, where their demand reflects their deluded income expectations. Thus, profits for a predatory lender are $(r-\rho)B(y+\tau, r) - C(\tau) - f$. Optimal τ is determined by the first-order condition

$$(r - \rho)B_y(y + \tau, r) = C'(\tau), \tag{3}$$

The predator exaggerates income to the point where the marginal revenue from exaggerating household income (due to increased loan demand) equals the marginal cost of exaggeration.

[4]The models in Townsend (1979) and Lacker and Weinberg (1989) feature costly income verification and falsification (respectively), but we reverse the timing and roles. Here it is the financiers who falsify, not the borrowers, and the deception occurs before deals are done. Alternatively, one could model the information asymmetry here as an adverse selection problem where households know that some creditors misrepresent households' creditworthiness, but the mis-representers are hard to distinguish from the honest creditors. While that might be an interesting problem, if subprime borrowers can solve that subtle inference problem, why worry about them?

[5]Income deception is also a common charge against another class of lenders accused of predatory lending: subprime mortgage lenders. In a survey by Stock (2001) of households with foreclosed subprime mortgages in Dayton, Ohio, 42 percent reported that mortgage lender encouraged them to borrow more than they initially intended.

Note that the incentive to exaggerate income is increasing with the interest spread on loans. In a perfectly competitive loan market spreads are zero so lenders would have no incentive to falsify. Indeed, they could not *afford* to falsify; the costs of falsification would require higher spreads to compensate, so borrowers would switch to cheaper, honest lenders. Costly predation can occur only if imperfect competition enables predators to charge higher than competitive spreads.

A predatory-*monopolist* gets to set the loan rate as well. The first- order condition for r is:

$$B(y+\tau,r) = -(r-\rho)B_r(y+\tau,r). \tag{4}$$

The predatory-monopolist raises interest rates until the marginal revenue from higher rates equals the marginal cost in terms of lower loan demand.

The predatory-monopolist does *not* always charge a higher loan rate than an ordinary monopolist. To see this, express (4) in elasticity terms:

$$\frac{r-\rho}{r} = -\frac{B(y+\tau,r)}{r}\frac{1}{B_r(y+\tau,r)} = \frac{1}{\varepsilon_r\left(y+\tau,r\right)}$$

where $\varepsilon_r\left(y+\tau,r\right)$ is the elasticity of loan demand with respect to r. Let r_{pm} and r_m denote the optimal r charged by a predatory-monopolist and ordinary monopolist, respectively. Then $r_{pm} > r_m$ if and only if

$$\frac{r_{pm}-\rho}{r_{pm}} > \frac{r_m-\rho}{r_m},$$

or equivalently,

$$\varepsilon_r\left(y+\tau,r_{pm}\right) < \varepsilon_r\left(y,r_m\right).$$

For households with CRRA utility, the elasticity of loan demand with respect to r does not vary with income, i.e., $\varepsilon_r\left(y+\tau,r\right) = \varepsilon_r\left(y,r\right)$.[6] CRRA households with higher income are no less averse to high interest than those with lower income, so when dealing with CRRA households, a predatory-monopolist *lends* more than an ordinary monopolist but charges the same interest rate.

For other utility functions, exponential for example, the predatory-monopolist lends more *and* charges higher interest rates than an ordinary monopolist. The exception for CRRA

[6] If $U\left(c\right) = (c^{1-\gamma}-1)/(1-\gamma)$, (1)implies $B\left(y,r\right) = y\cdot b\left(r\right)$.

utility is important, nonetheless, as it implies predators are better detected by how much they lend, rather than how much they charge. We use that result later when we test whether payday lending is predatory.

3.1.1 Uncertain Income

When household income is uncertain, predators have another angle: they can exaggerate the probability the household income will be high, thus boosting household loan demand. Uncertain income also means default is possible. If predators accentuate the positive enough, they may push borrowers to the brink of default.

Suppose future income is high (Y) or low (y) with odds π and $1-\pi$. Expected utility on payday depends on the risk of default, and hence, π. It turns out that households with π below some threshold limit their borrowing to avoid that risk. In deriving household's loan demand below, we impose the no-default constraint that $B \leq y/(1+r)$, but then show that the constraint will not bind for households with π below some threshold. Low π households limit their borrowing to avoid owing all their income on when their pay is low. We then show how predators, by exaggerating π, can push households to the brink of default.

Household's choose B to maximize the Lagrangian function:

$$U(B) + \delta[\pi U(Y-(1+r)B) + (1-\pi)U(y-(1+r)B)] + \lambda[y/(1+r) - B],$$

The FOC for B is

$$U'(B) - \delta(1+r)[\pi U'(Y-(1+r)B) + (1-\pi)U'(y-(1+r)B)] = \lambda. \tag{5}$$

The no-default constraint is slack ($\lambda = 0$) if and only if

$$\pi < \overline{\pi} \equiv \frac{U'(y/(1+r))/\delta(1+r) - U'(0)}{U'(Y-y) - U'(0)}. \tag{6}$$

Granting that, household loan demand increases with π: $B_\pi(Y, y, \pi, r) > 0$. The higher odds of a high paycheck decreases the expected marginal disutility of owing money when pay is low, so households borrow more today.

Suppose predatory lenders can exaggerate π by τ at cost $C(\tau)$. Predators' exaggeration cannot exceed $\overline{\pi} - \pi$, or else households would borrow to the hilt ($B = y/(1+r)$) and default would be possible. Default is not necessarily bad for the lender if they raise rates to compensate, but once default is possible, household loan demand *decreases* with π. It seems implausible to imagine predators that exaggerate π to increase loan demand, then attenuate π to increase loan demand even further. "Jerking" borrowers around would surely tip them off.

The predator maximizes the Lagrangian function

$$(r-\rho)B(Y, y, \pi+\tau, r) - C(\tau) - f \quad + \mu(\overline{\pi} - \pi - \tau). \tag{7}$$

The FOC for τ is

$$(r-\rho)B_\tau(Y, y, \pi+\tau, r) - C'(\tau) - \mu = 0. \tag{8}$$

Optimal $\tau = \overline{\pi} - \pi$ if and only if the marginal revenue from exaggerating π exceeds the marginal cost at that point: $(r-\rho)B_\tau(Y, y, \overline{\pi}, r) > C'(\overline{\pi} - \pi)$. In that case, predators exaggerate π until households borrow $y/(1+r)$, putting them at the brink of default whenever their pay is low. Absent predation, low π households would never default. Thus, when household income is uncertain, the overborrowing elicited by predators increases the probability of default. We test that prediction later.

3.1.2 Does Risk Deter Predation?

If the probability of default is increasing in the amount households owe (unlike in the model above), lenders incentive to exaggerate income is diminished. Risk may not deter that incentive altogether, however. Suppose household income is distributed $f(y)$, with cumulative distribution $F(y)$. If a household owes $(1+r)B$, they default with probability $F[(1+r)B]$. At the margin, the incentive to exaggerate income depends on the *hazard rate* of default: $f[(1+r)B]/\{1-F[(1+r)B]\}$. If that hazard rate is sufficiently flat at the household's optimal debt level (given the true distribution of income), predators still profit from exaggerating household's income prospects.

3.1.3 Equity Stripping

If lending is secured by an asset, home equity for example, the incentive to prey increases. Lending another \$ to a household with home equity of \$E does not increase risk to lenders' at all, even if the extra unit of borrowing puts household debt service costs beyond current income or cash flow. As the borrower misses a payments, home equity lenders can charge penalties and raise interest rates until the household owes \$E - ϵ, where ϵ represents foreclosure costs. If a predatory lender can con households into borrowing more than their current income affords, predators can eventually strip homeowners' equity.

3.1.4 Can Credit Counselors Deter Predators?

We have also considered a credit *counselor* can *correct* borrowers' income beliefs, at some cost, and thereby raise borrower welfare by reducing their borrowing to the optimal level. Credit counseling may deter predation, but it does not necessarily eliminate it. Credit counseling may not be profitable because it entails lending smaller amounts at a higher rate (because counseling is costly). Predation can occur in equilibrium if the welfare loss from predation is less than the cost (to a credit counselor) from eliminating the loss.

4 Is Payday Lending Predatory?

Critics condemn payday lending as predatory partly because of the high finance charges. However, the high price of payday credit could reflect high fixed costs per loan, and/or, monopoly power. Nor does a predator-monopolist always charge higher prices than ordinary monopolists. Thus, higher prices are neither necessary or sufficient to conclude that a certain class of credit is predatory.

The other criticism of payday lenders is the frequent rollover of loans. Instead of repaying their loan after two weeks, a substantial fraction of households rollover their loans for many weeks. Those frequent rollovers come closer to our concept of predation *ala* overborrowing.

If payday lending tempts certain households into over-borrowing, that should be detectable as differences in debt and delinquency rates in states with more liberal payday lending laws.

4.1 Empirical Strategy and Data

Using data from the SCF (Survey of Consumer Finance), we compare credit access, debt, and delinquency rates for households in states with more liberal payday laws. We focus on differences for those particular households who, according to our model, are more most vulnerable to manipulation by predatory payday lenders, i.e. "prey." To identify differences that are more likely associated with payday lending, we compare the differences for prey in payday states before and after payday lending arrived on the consumer credit market.

We want to control for a host of other variables that might affect credit supply or demand, so we compute the differences using multi-variate regression analysis. Using SCF data on household h in state s, we estimate regressions of the form:

$$D_{hs} = f(PREY_{hs} \cdot PAYDAY\ LIMIT_s \cdot 2001, CONTROLS_{hs}) + \epsilon_{hs}. \tag{9}$$

D equals one of three dependent variables: DENIED, DEBT_NM, and DELINQUENT. DENIED equals one for households who reported being denied credit over the year before the survey (0 for other households).[7] DEBT_NM equals non-mortgage debt owed by households. DELINQUENT equals one of households that reported missing any debt payments over the year before the survey (zero for other households).

DENIED and DELINQUENT are discrete variables so we estimate those regressions *via* Probit. DEBT_NM, though continuous, is truncated zero, so that regression is estimated *via* Tobit.

The key independent variables are the interactions: PREY$_{hs}$·PAYDAY LIMIT$_s$·2001 PREY$_{hs}$ is one of three indicators of potential marks for predators, discussed momentarily. PAYDAY LIMIT$_s$ equals the limit on payday loans in state s. We include another dummy, UNLIMITED, equal to one for states that allow unlimited payday loans (zero for

[7] More precisely, DENIED =1 for housholds reporting that they were turned down for credit previous year, given less credit than they demanded, or did not apply for credit because they expected to be denied. DENIED = 0 otherwise.

other states). The dummy variable 2001 equals one for households surveyed in 2001 or zero for households surveyed in 1995.[8] Thus, the coefficients on $\text{PREY}_{hs} \cdot \text{PAYDAY LIMIT}_s \cdot 2001$ indicate whether any difference in dependent variable D for prey in states with higher payday loan limits changed between 1995 and 2001.[9]

PREY_{hs} is one of three indicators of potential marks, i.e., households must vulnerable to predatory lending. UNCERTAIN INCOME equals one for households who reported being uncertain about their future income (0 for other households). NO COLLEGE DEGREE equals one for households without a college degree (0 for households with a degree). Less educated households and households with uncertain income may be easier to fool, so those two prey proxies follow more or less from our model.

Our third proxy is more *ad hoc*. SMOKER equals one if the head of the household reported being a smoker (0 if not). If smoking implies hyperbolic discounting, then smokers may be vulnerable to predatory lending. However, if smoking implies high, but not hyperbolic discounting, then payday lenders cannot prey on smokers, even though they may help smokers satisfy their high demand for credit.

CONTROLS is a long list of financial variables (income, squared, assets), demographic variables (age, marital status, family size, race, gender, urban, job tenure), economic variables (county unemployment), attitudinal variables ("thinks credit is a bad idea") bank concentration (local market bank herfindahl), bank regulatory history (years since branching and interstate banking were permitted), and lastly, household bankruptcy exemptions. Our control set is essentially as in Gropp et al. (1997) except we use bankruptcy exemptions as of 1999 from Lehnert and Maki's (2002).

[8] Caskey (2002) figures there were fewer than 200 payday lenders at the at the beginning of the 1990s. Rotunday, the CEO of EZ Corp (a pawnbroker) did not notice competition from payday lenders until the late 1990s (see above). Based on those observations, we compare household debt and delinquency from the SCF in 1995 ("before payday lending") and 2001 ("after payday lending").

[9] In econometric terms, we are conducting difference-in-difference-in-difference analyses. First we estimate differences in dependent variable D for households that are potential prey, dD. Then we estimate the difference in dD for prey living in states that allow higher payday loans, ddD. That second difference might be significant all the time, just by coincidence, so we estimate the difference in ddD between 1995 and 2001, $dddD$. That third difference indicates whether differences in dD for prey *changed* after Payday lending arrived on the market.

Table 2 reports provides summary statistics for all the regression variables.[10] Twenty-one percent of households were denied credit in the year before the survey. Sixteen percent of households missed a payment. Mean debt (non- mortgage) was $11,500, but median debt was only $2300.[11] Note the prevalence of potential prey: 68 percent of households lacked a college degree, 31 percent were uncertain about their income, and 29 percent smoked. Fifty-six percent of households lived in states with payday lending, but just three percent of households lived in states with unlimited payday loans.

4.1.1 Identification

Our strategy is to compare debt and delinquency for certain subsets of households that *a priori* seem more susceptible to predation. But what if Payday lending represents an increase in the supply of credit? How can we distinguish predatory, i.e., artificial, increases in loan demand from legitimate increases in loan supply?

Our key identifying assumption is that if indeed Payday lenders increase credit supply, they increase supply to all households, not just potential prey (see Appendix). That is not a strong assumption. It merely means payday lenders do not discriminate one way or another against $non - prey$. Granting that, we can identify any excess debt or delinquency among

[10] The SCF in 1995 and 2001 covered 2,780 and 2,917 households, or 5,697 households in total. We study the area-probability sample that excludes the "list sample" of wealthy housholds (as wealthy households seem less subject to predatory lending). Household's state of residence are not publically available, so all our statistics and regressions were calculated by authorized analysts in the SCF Group at the Federal Reserve Board of Governors. Note that this confidential dataset contains 4,449 households whereas the public version only includes 4,442 households. This is due to the exclusion of 7 extremely wealthy households from the public dataset for disclosure reasons. The SCF actually comprises 5 separate datasets or "implicates" wherein missing data are multiply imputed. All our estimates and standard errors are computed using the Repeat Imputation Inference (RII) techniques. See Montalto and Sung (1996) for an accessible introduction to RII.

[11] We also ran our regressions for low (below median) income. Non-mortgage debt for that sample averaged $6700, so a $300 difference associated with payday lending might be detectable. We did not find any such difference, however. The SCF does not ask households about payday loans specifically. We experimented with debt from "finance and loan companies," a category that should comprise payday lenders, but because the subset of households with debt from such institutions was so small, the Tobit estimates did not converge.

prey as evidence that payday lenders artificially boost credit demand.

4.2 Regression Results (Table 3)

Column 1 reports *dprobit*(DENIED) regression coefficients. *Dprobit* calculates the change in probability(DENIED = 1) as the indicator variables switch on or off. Risky households (with uncertain income) and less educated households (without a college degree were) surveyed in 1995 were 5.4 percent and 6.6 percent more likely to have been denied credit than their safer, more educated counterparts. Given all the other controls, those differences suggest that riskier, less educated households were more credit constrained in 1995. Those constraints were certainly no looser in states that would (eventually) allow unlimited payday loans. On the contrary, risky households in unlimited payday loan states surveyed in 1995 were more likely to be denied credit than their counterparts in other states. By 2001, however, risky households and less educated households living in states with unlimited payday loans were 14.1 percent and 15.0 percent *less* likely to have been denied credit. That pattern of differences and the change over time suggests that payday lending, at least in unlimited quantities, has increased credit access for riskier, less educated households.

Roughly the same differences and changes over time are apparent for smokers. Smokers surveyed in 1995 were 4.3 percent more likely to be turned down for credit, regardless of their state. Smokers surveyed in 2001 were significantly less likely to be turned down, the higher the limit on payday loans in their state. A one standard deviation increase in the PAYDAY LIMIT ($234) reduces the probability(DENIED) by 6.3 percent.

Column 2 reports *Tobit*(DEBT_NM) regression coefficients. Less educated households in states unlimited payday loan states were were surveyed in 2001 had higher debt than their counterparts in states with limited payday loans. That difference, though only marginally significant, is consistent with the predatory hypothesis.

Column 3 reports dprobit(DELINQUENT) regression coefficients. In general, delinquency rates were not higher for *prey* surveyed in 2001, even those living in states with higher or unlimited payday limits. On the contrary, risky households (with uncertain income) surveyed in 2001 were nine percent *less* likely to have missed a payment if their state allowed unlimited payday loans. [12]

In sum, our findings suggest that riskier, less educated households, and smokers, were less likely to be turned down for credit if their state allowed unlimited or larger payday loans. That might indicate that payday lenders relax credit constraints, or, that the limits on payday loans do in fact bind. Debt is significantly higher for households with uncertain income in payday states in 200. That difference, though only marginally significant, seems consistent with the predatory hypothesis.[13] However, higher payday loan limits are *not* associated with higher delinquency rates for less educated households, riskier households, or smokers. If anything, we find the opposite: risky households surveyed in 2001 in states with unlimited payday loans were marginally *less* likely to have missed a debt payment.

5 Does Competition Work in Payday Lending?

The main complaint against payday lenders are their high fees. The 390 percent annual rate implied by a $15 fee per $100 per two week loan strikes critics as usurious or unconscionable, hence the many states with usury limits on payday loan prices. Economists might expect competition among payday lenders and pawnshops to drive prices down to the level that just covered the costs of producing the loans. This section presents evidence consistent with the hypothesis that competition works ; using a small data set of "found" data, we find lower payday prices in cities with more payday lenders and pawnshops per capita.

The data on payday loan prices are from 2001 survey conducted by the U.S. Public Interest Research Group (PIRG) and the Consumer Federation of American of 235 payday lenders located in 62 cities and twenty states (and D.C.)[14] In their analysis of the data,

[12]Regressions estimated over the set of households with low (below median) income yielded qualitatively similar differences (same signs and magnitudes) to those noted in Table 3 and 4, though in some cases the differences were less significant, particularly the differences associated with unlimited payday loans. The fraction of households live in states with unlimited payday loans was small, and the fraction of low income households in those states was even smaller, so the loss of significance mostly refects higher standard errors in the estimates, not smaller coefficients.

[13]Payday loans are very small so it is not necessarily inconsistent to find looser credit constraints in payday states without finding higher debt.

[14]Most surveys were conducted by employee or volunteer visits to payday offices, although some were

Fox and Mierzwinski (2001, p. 14) observed that about half the lenders charged fees at or above the usury limit set by the states. "If competition were really working..., " they conclude, "we would expect many more firms to offer and advertise lower rates." The PIRG survey lacked a measure of competition, however, so they did not test their conclusion that competition fails in payday lending.

Our data on the number of payday stores in various cities are from Graves and Peterson (2005). Their study pinpoints the location of payday stores by zip code in twenty states with military bases to see if payday lenders "target" soldiers. They demonstrate conclusively that payday lenders do cluster around bases; for example, the 92054 zip code comprising Camp Pendelton had 22 payday outlets, 17 more than expected given the population in that zip.

To see if competition works in the payday credit market, we matched Graves and Petersons' (2005) data on the number of payday lenders with PIRGs' (2001) data on payday loan prices and fees. The number of cities that overlapped in the two studies was 37 (Table 4A).[15]

These "found" data are biased against the competition hypothesis for at least two reasons. First, the number of payday *stores* tabulated by Graves and Peterson (2005) will overstate competition if some stores have the same owner. Second, more stores per capita might also signal higher *demand* for payday loans (and hence, higher prices) rather than higher supply.[16]

The regressions in Table 4B (and Figure 3) indicate that payday prices decline as the number of payday stores per capita increases. An extra 50 payday stores/10000 (about

conducted by phone. The surveyors did not borrow from the payday lenders; they simply looked for signs posting fees or asked store clerks to quote fees.

[15]PIRG's (2001) survey covered multiple payday lenders per city. We use the average loan rate and fee for payday lenders in the same city. We obtain similar results using medians instead of means.

[16]That second bias is distinctly possible here, because Graves and Petersons' (2004) study covered states with military bases, and soldiers may have high demand for payday loans. A third possible source of bias: payday prices are from 2001, but the numbers on stores are from 2004-5. Stores in 2004 should be correlated stores in 2001, but the cities where payday stores grew fastest in the interim may be those with the highest prices in 2001 (hence inviting new entry).

one standard deviation) is associated with a $0.50 drop in the loan price (column 1).[17] Payday store prices also decline as the number of *pawnshops* per capita increases (column 2), consistent with other evidence that payday lenders pawnshops are in competition. In fact, we cannot reject the hypothesis that the more pawnshops per capita has the same effect on payday prices and more payday stores.

6 Conclusion

"Predatory" is an inflammatory term used to condemn high prices, excessive lending, and other allegedly dubious practices by payday lenders and subprime mortgage lenders. However, even reformers admit that "predatory" is hard to define, so that is where our paper starts. We define predatory lending as a welfare *reducing* provision of credit, and we show how a voluntary transaction can make borrowers worse off if lenders contrive to increase loan demand by exaggerating households' income prospects. Predation in our model resembles advertising; advertisers accentuate how much pleasure their product brings, while predators attenuate how much a loan will cost (in terms of future well-being). We show that lenders will prey as long as the extra revenue from larger loans exceeds the cost of fooling households into overborrowing and any associated increase in default risk.

Our concept of predatory lending may not correspond to the specific practices of payday lenders and subprime mortgage lenders that reformers condemn, but it comes close. Both lenders are accused of entrapping borrowers in a cycle of refinancings and delinquency by lending more than households can afford. The predators in our model lend excessively, and the extra debt leads to higher risk of delinquency. Reformers also condemn payday lenders for "targeting vulnerable consumers" (PIRG 2001) that are less sophisticated. The predators in our model naturally prey on households that are easier to fool.

Our model helps distinguish *predatory* lending from the other kind of lending, the kind that helps households maintain consumption even as their income fluctuates. While reformers tend to focus on the interest rates charged by alleged predators, our model shows that

[17] Without the extreme (fee = $30) observation, the coefficient on P*ayday lenders/100,000* equals .0074. (p = 0.091).

predators do not always charge more than ordinary lenders. Predators always lend more, however, and the extra debt may push borrowers to the brink of default. If payday lenders were exploiting gullible households, we would expect to find higher debt and delinquency rates among easier- to-fool-households (prey) in states with higher payday loan limits. While we do find higher debt for one such set of households, we do *not* find higher delinquency. On the contrary, delinquency rates were marginally lower for risky households in states with unlimited payday loans. Risky households and less educated households were also less likely to report being turned down for credit if their state allowed unlimited payday loans.

Those findings of lower delinquency and looser credit constraints applies for only to the very small subset of households in are sample, but they are still tantalizing; despite its high cost, perhaps payday loans help risky households better manage their finances? It will take more data to confirm that particular conjecture, however. In general, we caution that our data are very indirect since we cannot specifically identify households who borrowed from a payday lender.

The differences we find for smokers are interesting, but harder to interpret in terms of predatory lending. Smokers in states with higher payday limits are less likely to be turned down for credit. The looser credit constraints could mean that smokers have high loan demand (because they have discount rates) and that payday lenders help satisfy that urge, or it could mean that smokers have *hyperbolic* discount rates (that make them procrastinators) and that payday lenders exploit that (we do not find higher delinquency rates for smokers in payday states, however). We cannot distinguish those interpretations without further tests.[18]

While reformers often advocate usury limits on payday lending, we find some evidence that competition among payday lenders (and pawnshops) may obviate usury limits. Using a small set of data, we find that payday loan rates and fees decline significantly as the number of payday lenders and pawnshops increase. Despite their alleged naiveté, payday borrowers appear sophisticated enough to shop for lower prices. The problem of high prices may reflect too *few* payday lenders, rather than too many. If scrutiny and prosecution risk

[18]Smoking might also simply be a better way to identify the socieconomic class that borrows from payday lenders.

limit entry into payday lending, the lack of competition may drive rates higher. In the end, the simple fact that payday lenders have triumphed over pawnshops suggests that payday lending raises household welfare by providing a preferable alternative.[19]

[19] The extra (or more convenient) credit can be welfare reducing only for households with behavioral problems that make them borrow too much to begin with.

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6.1 Appendix: Identification Algebra

Suppose loan demand and supply for household h in state s equals

$$B^d_{hs} = -ar_{hs} + bP_s + cp_{hs} + \tau P_s p_{hs} + z_{hs} \tag{10}$$

$$B^s_{hs} = +dr_{hs} + eP_s + fp_{hs} + \tau' P_s p_{hs} + \eta_{hs}, \tag{11}$$

where P_s equals one if state s allow payday lending and p_{hs} equals one if household h in state j is potential prey, e.g., a household with uncertain income. The coefficients a and d measure the interest sensitivity of loan demand and supply, respectively. We assume $a \geq 0$ and $d \geq 0$. The coefficients c and f allows for any inherent and legitimate differences in loan demand and supply for prey. The coefficients b and e allows for any general, legitimate differences in loan demand and supply in states with payday lending. We make no assumption about c, f, b, and e.

The equilibrium quantity of debt for household h in state s equals

$$B_{hs} = \frac{(db - ae)P_{hs} + (dc - af)p_{hs} + (d\tau - a\tau')P_h p_{hs} + dz_{hs} - a\eta_{hs}}{d - a}. \tag{12}$$

The difference in debt for prey in payday states for prey equals

$$\frac{\delta^2 B_{hs}}{\delta P_s \delta p_{hs}} = \frac{d\tau + a\tau'}{d + a} \tag{13}$$

The predatory hypothesis implies $\tau > 0$. We can identify whether $\tau > 0$ by comparing debt levels for prey across payday and non-payday states as long as $\tau' = 0$, i.e.,as long as payday lenders are equally willing to supply credit to prey and non-prey alike.

Figure 1
Growing Predatory Concerns

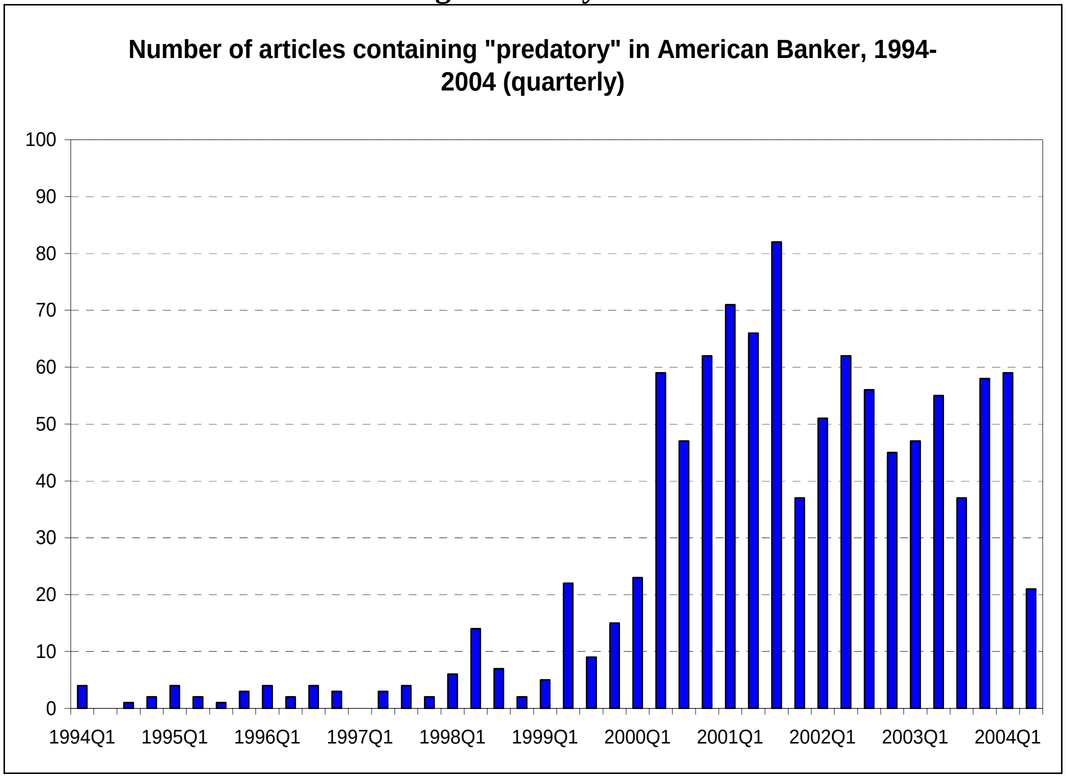
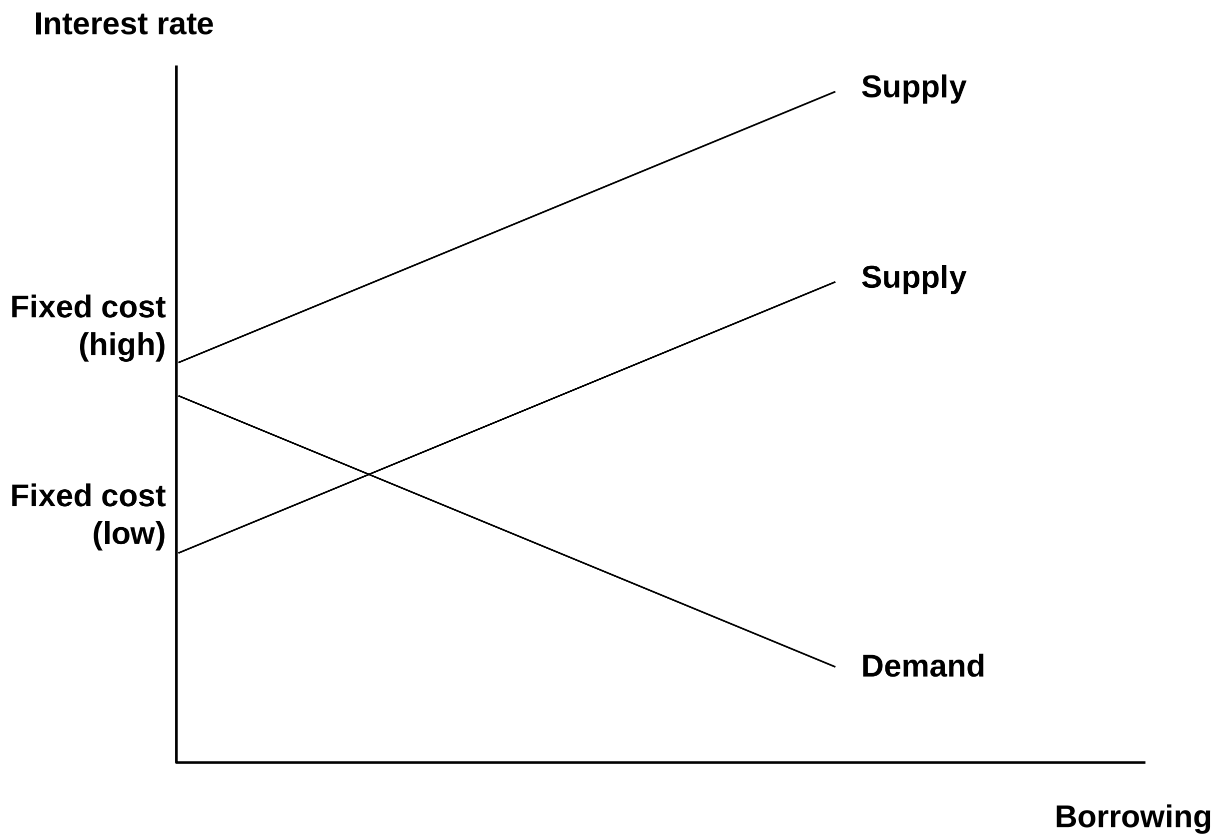


Figure 2

Payday share prices (AACE) have risen. Pawnshops (EXPW) have fallen

Figure 3



Interest rate
Supply
Supply
Fixed cost (high)
Fixed cost (low)
Demand
Borrowing

Figure 4
More Payday Stores--Lower Payday Prices

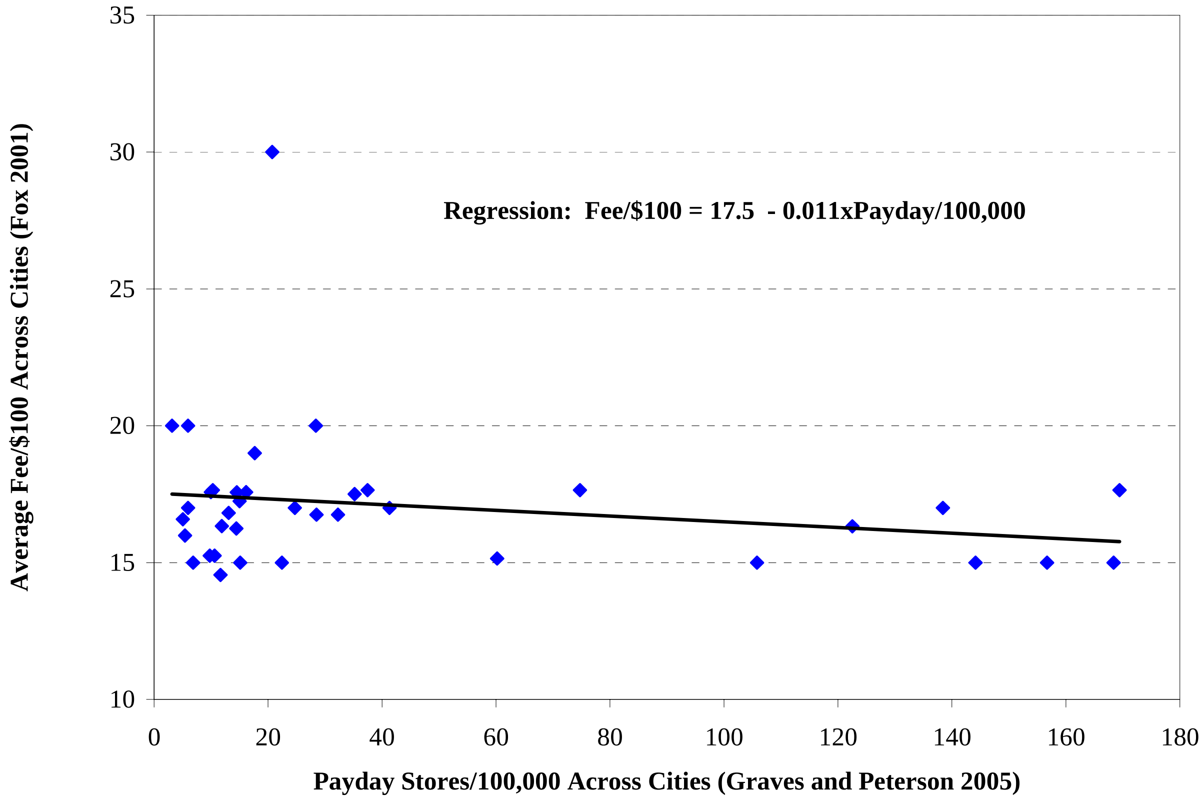


Table 1: State Limits on Payday Lending in 2001

State	Allows Payday?	Payday Loan Limit
Alabama	No	0
Alaska	No	0
Arkansas	No	0
Connecticut	No	0
Georgia	No	0
Indiana	No	0
Maine	No	0
Maryland	No	0
Massachusetts	No	0
Michigan	No	0
New Jersey	No	0
New York	No	0
North Carolina	No	0
Pennsylvania	No	0
Rhode Island	No	0
Vermont	No	0
Virginia	No	0
West Virginia	No	0
California	Yes	300
Hawaii	Yes	300
Montana	Yes	300
South Carolina	Yes	300
Louisiana	Yes	350
Minnesota	Yes	350
Texas	Yes	350
Illinois	Yes	400
Mississippi	Yes	400
Arizona	Yes	500
Colorado	Yes	500
Florida	Yes	500
Iowa	Yes	500
Kentucky	Yes	500
Missouri	Yes	500
Nebraska	Yes	500
North Dakota	Yes	500
Ohio	Yes	500
Tennessee	Yes	500
Washington	Yes	500
Oklahoma	Yes	730
Kansas	Yes	860
District of Columbia	Yes	1000
Nevada	Yes	1250
Delaware	Yes	No Limit
Idaho	Yes	No Limit
New Hampshire	Yes	No Limit
New Mexico	Yes	No Limit
Oregon	Yes	No Limit
South Dakota	Yes	No Limit
Utah	Yes	No Limit
Wisconsin	Yes	No Limit
Wyoming	Yes	No Limit

Table 2 Sample Statistics

Statistics calculated over 5,697 households in area-probability samples in 1995 and 2001 Survey of Consumer Finance

Variable	Units	Mean	Std. dev.	Median
Dependent variables:				
Denied Credit in Last Year?	Yes = 1; No = 0	0.21	0.41	0.00
Non-mortgage Debt	($10,000)	1.15	3.25	0.23
Delinquent on Any Debt Payment in Last Year?	Yes = 1; No = 0	0.16	0.37	0.00
State Payday Lending Regulations				
Payday Loan Limit	($)	230.12	234.31	300.00
Unlimited Payday Loans?	Yes = 1; No = 0	0.03	0.18	0.00
Payday Loan Permitted?	Yes = 1; No = 0	0.56	0.50	1.00
Proxies for "Prey:"				
Uncertain Income?	Yes = 1; No = 0	0.31	0.46	0.00
No College Degree?	Yes = 1; No = 0	0.68	0.46	1.00
Smoker?	Yes = 1; No = 0	0.29	0.45	0.00
Control variables:				
Years Since State Permitted Intra-state Branching		16.64	8.13	16.00
Years Since State Permitted Interstate Branching		12.15	3.55	13.00
Local Market Herfindahl	max = 100	14.71	8.59	13.17
Bankruptcy Exemption	($10,000)	11.15	23.65	3.00
Bankruptcy Exemption X Assets		5.18	40.54	0.36
Household Age	Years	47.04	16.84	44.00
Age^2	$Years^2$	2,496.54	1,756.62	1,936.00
Income	($10,000)	5.25	9.42	3.62
Income Squared	($100,000,000)	116.28	2,319.81	13.13
Assets	($1,000,000)	0.34	1.72	0.11
Married?	Yes = 1; No = 0	0.59	0.49	1.00
Family Size	persons	2.43	1.40	2.00
Non-White?	Yes = 1; No = 0	0.24	0.42	0.00
Male?	Yes = 1; No = 0	0.72	0.45	1.00
Rural?	Yes = 1; No = 0	0.25	0.43	0.00
Years at Current Employer		6.65	9.23	2.00
Thinks Credit Is Bad Idea?	Yes = 1; No = 0	0.30	0.46	0.00
County Unemployment Rate		5.08	1.83	4.70

Table 3 Differences in Denial, Debt, and Delinquency in States with Higher Payday Limits

Reported are regression coefficients (robust standard errors). DENIED = 1 for households who were denied credit in year before survey (0 otherwise). DEBT_NM equals household's non-mortgage debt. DELINQUENCY = 1 if households reported missing debt payment in previous year. PAYDAY LIMIT = state limit on payday loans (0 to $1250). UNLIMITED = 1 for the nine states without limits, 0 otherwise states. 2001 = 1 for households surveyed in 2001 (0 for households surveyed in 1995). Regressions estimated over 5697 households in 1995 and 2001 SCF.

	Dependent Variable (model)		
	DENIED (DProbit)	**DEBT_NM (Tobit)**	**DELINQUENT (DProbit)**
Payday Limit X Uncertain X 2001	*-6.84E-06* *(9.18E-05)*	*2.33E-04* *(9.42E-04)*	*-8.39E-05* *(9.16E-05)*
Unlimited X Uncertain X 2001	*-0.141**** *(0.029)*	*-0.241* *(1.200)*	*-0.090** *(0.052)*
Payday Limit X No College X 2001	*9.60E-05* *(9.80E-05)*	*0.001* *(0.001)*	*3.61E-05* *(8.93E-05)*
Unlimited X No College X 2001	*-0.150**** *(0.026)*	*2.722** *(1.479)*	*0.036* *(0.134)*
Payday Limit X Smoker X 2001	*-2.74E-04 **** *(9.31E-05)*	*2.18E-05* *(8.04E-04)*	*-4.71E-05* *(8.63E-05)*
Unlimited X Smoker X 2001	*0.054* *(0.153)*	*-0.798* *(1.207)*	*-0.036* *(0.086)*
Payday Loan Limit	2.17E-05 (6.29E-05)	9.72E-04 (6.82E-04)	1.67E-05 (5.34E-05)
Unlimited Payday Loans?	-0.125*** (0.039)	0.039 (0.801)	0.001 (0.069)
Uncertain Income?	0.054** (0.024)	-0.081 (0.203)	-9.61E-04 (0.023)
No College Degree?	0.065*** (0.022)	-0.151 (0.247)	0.009 (0.021)
Smoker?	0.043* (0.023)	-0.400** (0.189)	0.034 (0.024)
2001 Dummy	-0.007 (0.037)	-0.168 (0.410)	-0.072** (0.033)
Payday Limit X 2001	4.29E-05 (8.67E-05)	-5.84E-04 (0.001)	7.46E-05 (7.32E-05)
Unlimited Payday X 2001	0.404* (0.208)	-1.689 (1.270)	0.049 (0.124)
Uncertain X 2001	-0.012 (0.030)	-0.308 (0.312)	0.044 (0.035)
No College X 2001	0.003 (0.034)	-0.373 (0.441)	0.024 (0.032)
Smoker X 2001	0.035 (0.034)	0.442 (0.269)	0.033 (0.033)
Payday Limit X Uncertain	8.02E-06 (6.50E-05)	-9.56E-05 (6.96E-04)	2.95E-05 (6.68E-05)

Table 3 continues . . .

Table 3 (continued)

Unlimited Payday X Uncertain	0.308** (0.137)	0.163 (0.904)	0.103 (0.109)
Payday Limit X No College	-1.04E-04 (6.95E-05)	-4.35E-04 (7.25E-04)	-6.62E-05 (6.26E-05)
Unlimited Payday X No College	0.081 (0.124)	-0.571 (0.859)	-0.019 (0.071)
Payday Limit X Smoker	8.22E-05 (6.41E-05)	-3.56E-04 (5.54E-04)	1.65E-05 (6.27E-05)
Unlimited Payday X Smoker	0.119 (0.122)	0.475 (0.798)	0.038 (0.086)
Age (years)	0.002 (0.002)	0.113*** (0.026)	0.004** (0.002)
Age Squared	0.000*** (0.000)	-0.002*** (0.000)	0.000*** (0.000)
Income	-0.011*** (0.003)	0.114*** (0.034)	-0.005** (0.002)
Income Squared	0.000*** (0.000)	0.000** (0.000)	0.000** (0.000)
Assets	0.006 (0.005)	0.129 (0.107)	0.012*** (0.004)
Married?	-0.027 (0.018)	0.576*** (0.186)	-0.026 (0.017)
Family Size	0.017*** (0.004)	0.005 (0.049)	0.020*** (0.004)
Non-White?	0.090*** (0.014)	-0.252** (0.120)	0.039*** (0.013)
Male?	-0.024 (0.016)	0.120 (0.146)	-0.003 (0.016)
Rural?	-0.029** (0.013)	-0.099 (0.127)	0.023* (0.014)
Years at Current Employer	-0.003*** (0.001)	0.022*** (0.007)	0.000 (0.001)
Thinks Credit Is Bad Idea?	-0.003 (0.011)	-0.302** (0.119)	0.006 (0.010)
County Unemployment Rate	0.003 (0.003)	0.031 (0.033)	0.001 (0.003)
Years Instate Branching Permitted	0.002** (7.22E-04)	0.002 (0.008)	6.84E-04 (6.75E-04)
Years Interstate Branching Permitted	-9.59E-04 (0.003)	0.054 (0.042)	0.002 (0.003)
Local Market Herfindahl	0.000 (0.001)	-0.001 (0.006)	-0.001 (0.001)
Bankruptcy Exemption	0.000 (0.000)	0.002 (0.003)	0.001** (0.000)
Bankruptcy Exemption X Assets	0.000 (0.001)	0.004 (0.006)	0.000 (0.000)

Table 4A Statistics on Payday Loan Prices and Stores across 37 U.S. Cities[4]

	Mean	Median	Std. Dev.	Min	Max
Price (per $100 borrowed)[1]	17.1	16.8	2.6	14.6	30.0
Payday Stores (per 100K)[2]	43.6	17.7	52.1	3.2	169.4
Pawnshops (per 100k)[3]	30.0	12.0	47.1	1.0	240.3
Population	31.2	10.2	64.2	.21	3,695

[1] Fox and Mierzwinski (2001) [2] Graves and Peterson (2005) [3] Yellowpages.com.
[4] Overlapping cities in Fox and Mierzwinski (2001) and Graves and Peterson (2005).

Table 4B More Payday Stores…Lower Payday Prices?

Ordinary least squares coefficient estimates (robust standard errors). Dep. Var. = Price per $100

	(1)	(2)	(3)	(4)
Payday Stores	0.013**	-	-0.009	-
	(0.005)		(0.007)	
Pawnshops	-	-0.013**	-0.006	-
		(0.006)	(0.006)	
Payday Stores + Pawnshops	-	-	-	-0.008**
				(0.003)
Population	-0.007**	-0.006**	-0.007**	-0.007**
	(0.003)	(0.003)	(0.003)	(0.003)
Constant	17.86***	17.66***	17.66***	17.83***
	(0.710)	(0.648)	(0.714)	(0.703)
R^2	0.069	0.059	0.073	0.073
P value for F-Test: (Payday Store = Pawnshop)			0.86	

*** Significant at the 99% level ** Significant at the 95% level

PAYDAY LENDING FACTS

PAYDAY LENDING RATES ARE NOT EXCESSIVE

The average payday loan fee is 2.3 times less expensive than bank and credit union overdraft charges! Customers find that the lower fees charged by payday lenders are a bargain compared to late fees, utility reconnect fees, and other more costly charges they would otherwise pay. If the APR on payday loans was capped at 30% APR (Annual Percentage Rate), a lender could only charge $1.15 on a $100.00, two-week loan. At that rate a lender could not cover expenses such as rent and payroll, let alone losses from bad debt. No lender, not even banks or credit unions can offer short-term loans at 30% APR and remain profitable. Payday loan rates are a much less expensive alternative to overdraft protection and NSF fees, utility reconnection penalties, and late fees.

Uses of Annual Percentage Rates to compare short term loans are misleading. However, payday loans are far better values than alternative short term credit sources or costs facing consumers:

	$100 PAYDAY ADVANCE	$100 OVERDRAFT PROTECTION	CREDIT CARD LATE FEE ON $100 BILL	LATE/DISCONNECT FEE ON $100 UTILITY BILL	$100 BOUNCED CHECK NSF/MERCHANT
FEE	**$15.00**	**$30.00**	**$29.00**	**$50.00**	**$25.00**
APR	**391%**	**782%**	**756%**	**1304%**	**652%**

Banks and credit unions are exempted from disclosing their fees for overdraft protection and NSF charges as an APR. Rates, terms, and the APR of all loans are required to be conspicuously posted in each location. Consumers know the cost associated with their loans and choose to use them because it saves them money.

The Center for Responsible Lending claims borrowers pay $4.2 billion dollars in fees every year, but fails to mention that consumers receive $40 billion in credit for the fees. To put it in perspective:

- Consumers will pay $4.2 billion in ATM service charges in 2006 to withdraw their own money(1)
- Consumers pay an estimated $22 billion in NSF fees to banks and credit unions(2)
- Banks collect an estimated $10.3 billion annually for overdraft protection services(3)
- In 2000, consumers paid credit card interest of more than $87 billion(4)
- An estimated $57 billion in late bill payment fees were collected by businesses in 2003, more than 140 percent of the total estimated payday lending volume in the United States(5)
- Credit card late fee penalties totaled over $11 billion in 2005(6)

(1) Bankrate.com Fall 2006 Survey
(2) Contrasting Payday Loans to Bounced Check Fees, Consumer Credit Research Foundation, Thomas E. Lehman, Ph.D., 2005
(3) Overdraft Fees Can Overwhelm, Washington Post, June 26, 2005
(4) Public Interest Research Group, 2002
(5) Sizing NSF-Related Fees, BAI Banking Strategies Magazine, Bill Stoneman, January-February, 2005.
(6) CreditCards.com, November 2006

STATES STRICTLY REGULATES PAYDAY LENDING

States' payday loan laws are restrictive and most do not allow for "rollovers" which consumer groups claim is the basis of their "cycle of debt" arguments. Most states limit the number of loans a customer may have outstanding and they must affirm that fact when they make a loan.

PAYDAY LENDING FACTS

Payday rates are strictly regulated and among the lowest in the country.

Arizona	15% Max Fee; $500 max loan; 3 rollovers
California	15% Max Fee; $300 max loan; No rollovers
Colorado:	20% Max Fee on first $300, 7.5% on next $200; $500 max loan; 1 rollover;
Kansas:	15% Max Fee; $500 max loan; No rollovers;
Missouri:	75% of loan amount Max Fee; $500 max loan; Up to 6 rollovers;
Nebraska:	15% Max Fee; $500 max loan; No rollovers;
Nevada	No Limit; 25% of gross income max loan; None beyond 60 days for original due date;
Oklahoma:	15% Max Fee up to $300, 10% above $300; $500 max loan, No rollovers
Oregon:	No Limit; Subject to net income max loan; 3 rollovers
Washington:	15% on the first $500, 10% to $700 max fee; $700 max loan loaned; No rollover.

- Consumers have a 24 hour right of rescission without paying any fees.
- Each loan agreement must comply with the Truth In Lending Act, disclosing all loan costs.
- Disclosures are written in both English and Spanish.
- Consumers can not be criminally prosecuted for writing bad checks unlike regular merchants.
- Pay day loans are straight forward, easily understood and do not contain junk and late fees to artificially reduce the APR.
- Each state audits every payday loan company. They receive few complaints about licensed payday lenders. The large majority of complaints payday lenders were about unlicensed and internet payday lenders.
- The Community Financial Service Association had protections for military borrowers included in their member charter several years before they were enacted by Congress. In each bill introduced by the CFSA includes these protection is not already enacted.

PAYDAY LOANS ARE NOT PREDATORY LENDING

The Federal Reserve Bank of New York concluded in their 2007 study that payday loans are not predatory lending.

<u>Payday loans are not welfare reducing, or "predatory"</u>

"We define predatory lending as a welfare reducing provision of credit."

"Our findings seem mostly inconsistent with the hypothesis that payday lenders prey on, i.e., lower the welfare of, households with uncertain income or households with less education."

"On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand."

<u>Payday loans may enhance the welfare of households</u>

"Credit delinquency rates are not higher for households in states with higher payday loan limits."

"Households with uncertain income who live in states with unlimited payday loans are less likely to have missed a debt payment over the previous year…consistent with claims by defenders of payday lending that some households borrow from payday lenders to avoid missing other payments on debt."

PAYDAY LENDING FACTS

"Those types of households who happen to live in states that allow unlimited payday loans are less likely to report being turned down for credit, but are not more likely, by and large, to report higher debt levels…"

Price does not make payday loans "predatory": limiting access raises prices

"Higher prices are neither necessary nor sufficient to conclude that a certain class of credit is predatory."

"We find somewhat lower payday prices in cities with more payday stores per capita, consistent with the hypothesis that competition limits payday loan prices…The problem of high prices may reflect too few payday lenders, rather than too many."

"Before payday lending…very small, short-term loans may not have been worthwhile for banks. Payday lending technology may have lowered those fixed costs, thus increasing the supply of credit…That suggests the payday innovation was welfare improving, not predatory."

STATE DATABASES HARM CONSUMERS AND DO NOT LIMIT EXCESSIVE PAYDAY LOANS

There is a large demand for short term credit. Instituting a database that limits state licensed lenders from making loans does not eliminate or reduce the overall number of payday loans. The majority of payday loans are done on the internet mostly by unregulated, offshore companies outside the reach of state regulatory agencies. The demand for these loans is not going away. That demand will be satisfied by customers in border towns getting their loans in other states or turning to the unregulated internet.

- Fees are high and disclosure inadequate; rates are typically $20 to $300 per $100 dollars lent; and frequently no TILA or other required disclosures
- Consumer are exposed to privacy and security risks; systems are unsecured and bank accounts vulnerable
- Online Lenders are unknown, faceless entities, often leaving consumer with no risk
- States have little ability to control or discipline on-line lenders that they can't find
- Most state banking departments confirm a majority of consumer complaints stem from internet payday lenders

FACTS ABOUT OUR CUSTOMERS*

- The average payday advance customers earn $40,000 annually
- 68% are under 45 years old; only 4 percent are over 65, compared to 20% of the population
- 94% have a high school diploma or better, with 58% have some college or a degree and 19% have a college degree
- 41% percent own their own homes
- 85% have access to other credit, including savings accounts
- 77% of the customers were satisfied with their experience
- 92% of customers think payday lenders offer a valuable service
- 90% of customer are satisfied with their understanding of the terms and conditions of the loan
- 100% have steady incomes and active checking accounts, both of which are required to receive a payday advance

PAYDAY LENDING FACTS

*Sources: The Credit Research Center, McDonough School of Business, Georgetown University, Gregory Elliehausen and Edward C. Lawrence. "Payday Advance Credit in America: An Analysis of Customer Demand", April 2001. Cypress Research Group, "Payday Loan Customer Satisfaction Study", April 2004.

CONSUMERS DO NOT WANT FURTHER GOVERNMENT REGULATION OF PAYDAY LOANS

The Cyprus Research Group study discovered that over 80% of payday loan customers do not want the government placing further restrictions on their ability to get cash advance/payday loans. The findings of this study have been supported by a recent petition drive where over 20,000 Utah citizens asked their elected officials not to place further restrictions on their ability to use cash advance products.

Over eighty-six percent (86%) of a Wichita "Eagle" poll, published in the internet form of the newspaper, conducted in December 2006 said that they opposed further restrictions on payday loans in Kansas.

PAYDAY LENDERS SUPPORT CREDIT EDUCATION FOR CONSUMERS

The best customer for payday lender is an educated customer. Payday lenders believe that they best serve their customers as an infrequent resource for emergencies and unexpected needs for cash. Consumers who are having long-term financial difficulty will not be able to pay their payday loans. Thus, most payday lenders have information in their operations that explain the details for payday loans.

About Answers, etc.®

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Answers' PowerCheck32 software serves as a point of sale for processing check cashing, payday advances, lottery tickets, phone cards, stamps, etc. while our hardware provides the robust multi-user network environment needed to run financial service centers seamlessly. With a well-trained and dedicated staff of Technicians and Programmers, Answers is geared toward total customer support to allow business owners to focus on growth of their operations. For more information, visit www.answersetc.com.

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Regulating Predatory Payday Lending:

A State-by-State Analysis

Roosevelt Institution at Yale
Center on Economic Policy

Alexander Bartik, Lulu Cheng, Brandon Fong, Gregory Geusic, Jacob Koch, and Benjamin Lazarus

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Contact:
yale-economics@rooseveltinstituion.org
www.rooseveltinstitution.org/yale

Introduction

Payday lending undermines the economic security of working individuals and families. Each year, five million borrowers find themselves caught in cycles of debt because of inadequate policies that have allowed the payday loan industry to grow from a $10 billion in 2000[1] to $28 billion in 2006.[2] Some states, including Connecticut, have successfully cracked down on payday lenders, making it illegal for them to offer short-term, high-interest loans. Most states, however, have not been so successful in preventing predatory payday lending practices, and the problem persists.

Payday loans are cash advances, usually of a small amount and for a short period of time. Many low-income workers, lacking the credit history and collateral needed to obtain a traditional loan but still in need of quick cash, are forced to borrow from payday lenders who require only a bank account. The borrower gives a postdated personal check to the lender in return for cash. The lender holds the check for the duration of the loan, usually one or two weeks, most likely until the borrower's next paycheck. The loan is then due in full.

In most cases, however, borrowers are unable to fully repay their debt, and consequently, they incur repeated bounced check fees. To avoid defaulting, the borrower will either pay a fee to keep the loan outstanding, a process called "rolling over, " or he/she is forced to take out various other loans in order to pay off the original loan. The rolled-over long-term loans have annual percentage rates (APRs) of interest ranging on

[1] Keith Ernst et al., *Quantifying the Economic Costs of Predatory Payday Lending*, (Durham, NC: The Center for Responsible Lending, February 24, 2004), 2.
[2] Uriah King et al., *Financial Quicksand*, (Durham, NC: The Center for Responsible Lending, November 30, 2006), 3.

average from 391% to 443%.[3] The most recent report from The Center for Responsible Lending finds that the typical borrower pays back $793 on a loan of $325. In aggregate, this means $4.2 billion per year in excessive fees—which represents 90% of the industry's revenues.[4]

Payday loans target the economically insecure. In fact, predatory payday lenders regularly targeted military personnel until federal reforms prohibited the practice in 2006. The 109th Congress, acknowledging the gravity of the situation, passed the Talent-Nelson Amendment (SA 4331) to the 2007 Defense Authorization Bill (S2766), capping APR rates for military personnel at 36 percent. This serves as an acknowledgement by Congress that payday loans represent a serious threat to vulnerable consumers, and that prohibitory regulations are needed. Aside from soldiers, payday lenders target minorities, prompting condemnation from Julian Bond, Chairman of the NAACP. Payday loans are a particularly insidious debt trap, and its lenders can be found easily in low-income areas of any non-regulated city, or on the internet.

By exploring how Connecticut has managed to confront this issue, this report will offer recommendations for how other states may do the same. Eliminating this ugly practice, and replacing it with safe alternatives for low-income borrowers, is an important step in making America work for working families.

The State of Payday Lending in Connecticut

Due the limited availability of information regarding the current state of payday lending practices in Connecticut, the Center on Economic Policy of the Roosevelt

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[3] Ibid., 3.
[4] Ibid., 3.

Institution at Yale conducted its own research. Using telephone calls as a primary investigative tool, we took a sample of seventy two different lending locations. Posing as customers needing fast cash, we asked about the availability of payday loans and the requirements to obtain one. Not a single lender responded positively, with almost every call resulting in a flat denial. When pressed further and asked for a referral to another source, most said that payday lending was "illegal" in Connecticut and some referred the caller to other states. Some lenders invited the caller to come into the store and see whether they could qualify, but none would offer specifics of what payday products they might be able to offer the consumer. Though not exhaustive, the sample polling left the distinct impression that Connecticut's regulatory statutes are going a long way towards preventing predatory payday lending in the state.

According a 2001 report by the Consumer Federation of America and the U.S. Public Interest Research Group in a breakdown of state by state "Payday Loan Authorization", Connecticut falls into a small category of "States that prohibit payday loans due to small loan interest rate caps, usury laws, and/or specific prohibitions for check cashers."[5] The state laws place a cap on the rates of small loans. The cap is 30.03% APR, as well as caps of fees at $17 per $100 up to $600; $11 per $100 up to $1,800.[6]

Since it is apparent that Connecticut's regulatory statutes have been largely effective, it is important to look at some of the specifics of the laws which curb payday lending. The applicable statutes fall under Chapter 668, Nondepository Financial

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[5] Fox, Jean Ann. (2001) *Rent-A-Bank Payday Lending*.
[6] Retrieved from http://www.paydayloaninfo.org/state_detail.cfm?id=CT

Institutions, of the Connecticut General Statutes. Part III, Small Loan Lenders, contains the specific regulations regarding payday loans.

Important provisions of the statute:[7]

- Loan businesses must have a proper license, issued by the state.
- There are specific requirements that must be met before a license is to be issued, the state must find that "the experience, character and general fitness of the applicant, and of members thereof if the applicant is a partnership, limited liability company or association, and of the officers and directors thereof if the applicant is a corporation, are satisfactory." And if these conditions are not met, the state has the authority to deny the application for a license.
- There is an $800 application fee for a small loan lender license. Licenses must be renewed, and there is a renewal fee as well. Specific deadlines for applications must be met, and failure to do so results in additional fees on the part of the applicant.
- Licenses cannot be transferred to "cover a place of business not located in either the same or an adjacent city or town." Licenses must also be kept in a public, easily viewed spot in the place of business.
- Separate licenses must be obtained for each place of business. Chain stores may not apply one license to multiple locations.
- There are specifics to what other types of business may be conducted in conjunction with the making of loans.

[7] Statutes retrieved from http://www.cga.ct.gov/2005/pub/Chap668.htm#Sec36a-563.htm

Section 36a-563 of Connecticut State Code describes specific small loan caps, which effectively prohibit predatory payday loans in the state:

> "**Sec. 36a-563. (Formerly Sec. 36-233). Charges. Loan restrictions.** (a) Every licensee under sections 36a-555 to 36a-573, inclusive, may loan any sum of money not exceeding fifteen thousand dollars, excluding charges, and may charge, contract for and receive thereon charges at a rate not to exceed the following: (1) On any loan which does not exceed one thousand eight hundred dollars, excluding charges, or on any unsecured loan or on any loan secured only by credit life insurance, seventeen dollars per one hundred dollars on that part of the cash advance, not exceeding six hundred dollars, and eleven dollars per one hundred dollars on any remainder when the loan is made payable over a period of one year, and proportionately at those rates over a longer or shorter term of loan; (2) on a loan which exceeds one thousand eight hundred dollars, excluding charges, and which is secured by property other than credit life insurance, eleven dollars per one hundred dollars on the entire cash advance when the loan is made payable over a period of one year, and proportionately at that rate over a longer or shorter term of loan. Such charges shall be computed at the time the loan is made on the full amount of the cash advance for the full term of the loan contract, notwithstanding any agreement to repay the loan in installments. Such charges shall be added to the cash advance and the resulting sum may become the face amount of the note. All payments made on account of any loan, except those applied to default and deferment charges, shall be deemed to be applied to the unpaid installments in the order in which they are due."

Payday Lending in Illinois: [8]

The state of Illinois provides an example of a state that has unsuccessfully attempted to regulate the abusive practices of payday lenders. Illinois has been plagued by predatory payday lending in recent years, with the number of stores growing to number 625 in February 2004. By comparison, there are only about 250 McDonald's restaurants in the entire state. Much like in other states, payday lenders in Illinois charge triple-digit interest rates and regularly trap customers in endless cycles of debt through repeated loan rollovers. In response to this growing problem, the Illinois legislature

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[8] Greed: an in-Depth Study of the Debt Collection Practices, Interest Rates, and Customer Base of a Major Illinois Payday Lender. Monsignor John Egan Campaign for Payday Loan Reform. 2004. 10 Jan. 2007 <www.citizenaction-il.org/issues/payday/greed_report.pdf>.

enacted reforms targeting predatory payday lenders. First in 2001 and again in 2005, the state passed laws which were supposed to protect consumers by limiting loan size and rollovers. In both cases, the industry quickly adapted, slightly modifying existing lending practices in order to evade regulation.

Illinois Laws[9]:

Illinois has state usury laws to limit the interest rates charged on loans at 20 percent APR. This law, however, provides an exemption for licensed lenders, including payday lenders. As a result, payday lenders are free to charge any interest rate on these short term loans. Regulation has focused on limiting fees and rollovers rather than simply capping the allowable interest rates on loans. Additionally, regulation has dealt with specific types of loans so that laws only apply when certain criteria are met. These criteria have primarily focused on loan length, making regulations easy to avoid merely by altering loan duration.

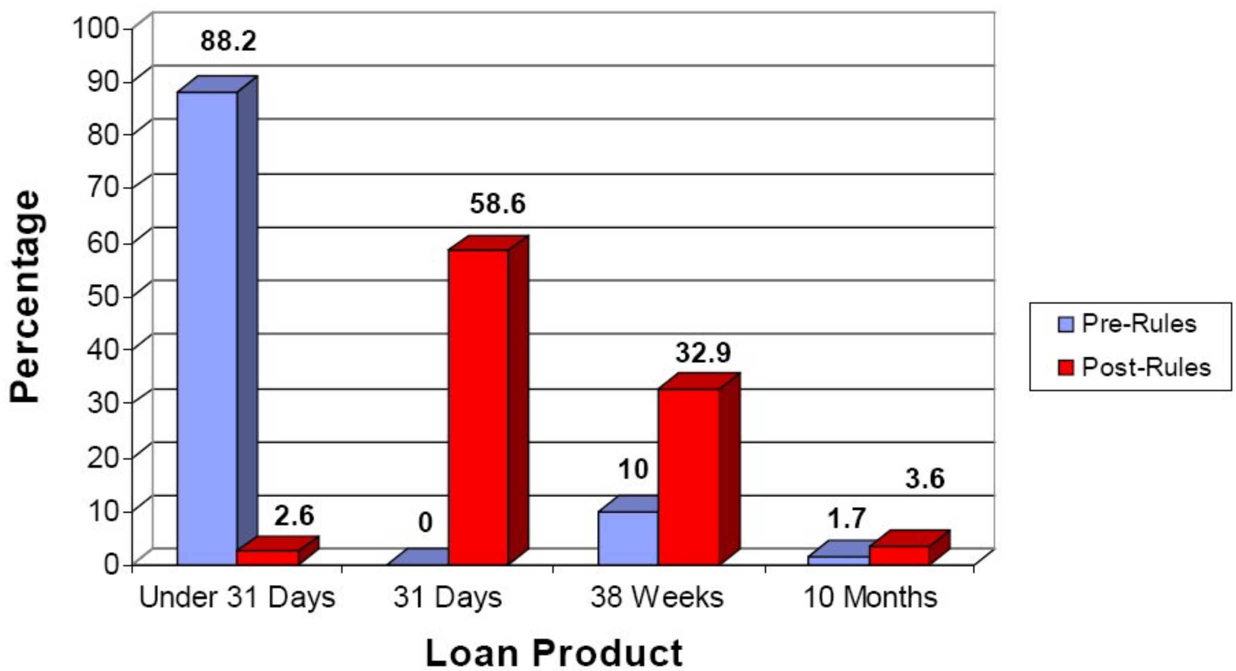
2001 Reforms[10]:

On August 1, 2001, the Illinois Department of Financial Institutions (DFI) established new regulations for payday lenders after the state General Assembly authorized them to do so earlier in the year. These regulations were intended to limit abusive practices and protect vulnerable consumers. The reforms included a $400 limit on individual loans, a ban on multiple loans at the same time, a limit of two rollovers on the same loan, and a 15-day cooling off period the fulfillment of an outstanding loan and the issuance of a new one. All of these restrictions, however, only apply to loans of 30

[9] Ibid.
[10] Ibid.

days or less. After these reforms were enacted, the industry quickly adapted, extending the duration of traditional 14 day loans to 31 days or longer. As a result, lenders were able to continue with their abusive practices, outside of the sphere of DFI regulation. From 1991 until the new regulations too effect in 2001, 88 percent of the payday loans issued in Illinois were for 14 days or less. During 2002 and 2003, 45 percent of loans were for 31 days. The rest were for different terms, but nearly all loans fell outside of the DFI's regulation of 30 day loans. Because loans evaded regulation, the average value of an installment loan was $784.05, despite the fact that DFI rules prohibited loans greater than $400. Figure 1 below illustrates that nearly all payday loan companies quickly changed the terms of their loans to avoid DFI regulation.

Figure 1: Illinois Payday Loan Duration



2005 Reforms[11]:

After the failure of the DFI's 2001 regulations, the Illinois General Assembly passed the Payday Loan Reform Act (PLRA) in 2005. Though this act has been more successful than the 2001 regulations and has reduced the average APR on payday loans significantly, payday lenders have also been able to evade this law and continue with predatory practices. Just like the 2001 reforms, the PLRA only applies to loans with certain characteristics. In this case, the law applies only to loans with interest rates greater than 36 percent APR and terms shorter than 120 days.

For these loans, the following new restrictions apply:

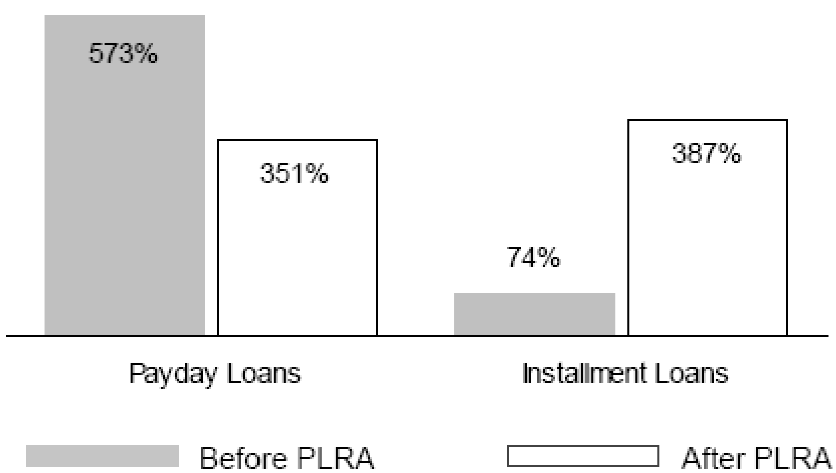
- Fee cap of $15.50 per $100 borrowed
- Loan principle cap of 25 percent of borrowers income or $1000
- Repayment plan or no-loan period required after 45 days of continuous debt
- 7 day no-loan period between loans to prevent rollovers
- Available fee-free repayment plan
- Limit on garnishing of wages for military personnel

In order to evade these regulations, payday loan companies developed new loan products. One such product is called an installment loan. These loans have equally spaced payments like a mortgage, and have durations of 121 days or more. Other loans have regular interest payments with a final balloon payment after 121 days or more. These loans are, in effect, regular payday loans with several built-in rollovers. In both cases, the

[11] Hunting Down the Payday Loan Customer: the Debt Collection Practices of Two Payday Loan Companies. Monsignor John Egan Campaign for Payday Loan Reform. 2006. 10 Jan. 2007 <http://www.citizenaction-il.org/issues/payday/PayDayLoan_Report_Oct2006.pdf>.

121 day duration allows loan companies to avoid PLRA regulations. Since the passage of the PLRA, the average APR on traditional payday loans in Illinois has decreased from 573.18 percent to 351.17 percent. As lending companies have begun to replace traditional payday loans with installment loans, the average APR of installment payday loans has increased from 74.38 percent to 387.42 percent. Once again, lending companies have successfully avoided regulation and continued to demonstrate predatory practices. In Figure 2 below, it is clear that these laws have not been successful in eliminating predatory payday lending in Illinois.

Figure 2: APRs of Traditional and Installment Payday Loans in Illinois



Predatory Lending in Wisconsin

Wisconsin is an example of a state that has no substantive payday lending laws or regulations. This lack of any payday lending laws serves as an example of what happens when payday lending is allowed unfettered. Wisconsin is one of “two […] states (Wisconsin and New Mexico) [that] permit payday lending by licensed lenders with no substantive regulations."[12] In Wisconsin the Department of Financial Institutions is the state agency that licenses payday lenders. However, this agency imposes no substantive regulations upon these companies. [13] Wisconsin has no limit on the minimum or maximum term of payday loans, no limit on the maximum amount of a payday loan and no limit on the interest rate that payday-lending companies can charge.[14]

The lack of usury and payday lending law has led to an explosion of payday lending companies in Wisconsin. Between January 1996 and July 1999 the number of payday lenders in Wisconsin increased from 17 to 200. Interest rates on a $100, 14 day loan in Wisconsin range from 390% to 780%.[15]

The website for the Wisconsin Department of Financial Institutions does contain information for the public regarding the dangers of payday loans. The website contains a warning that payday loans are "not an effective solution for your long term monetary needs" and informs viewers that "In Wisconsin, there are no laws that limit the interest rate that a lender can charge".[16] However, there is no evidence that there is a significant education campaign targeted towards those low-income families most likely to take out payday loans.

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[12] Fox, Jean Ann. *Unsafe and Unsound: Payday Lenders Hide Behind DIC Bank Charters to Peddle Usury.* Consumer Federation of America. March 30, 2004

[13] State of Wisconsin, Department of Financial Institutions, <http://www.wdfi.org/ymm/brochures/financing/payday_loans.htm>

[14] Legislative Reference Bureau. *Regulation of Payday Loan Providers*. May, 2004.

[15] US PIRG. *Show Me the Money! A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures* < http://www.uspirg.org/home/reports/report-archives/financial-privacy--security/financial-privacy--security/show-me-the-money-a-survey-of-payday-lenders-and-review-of-payday-lender-lobbying-in-state-legislatures>

[16] State of Wisconsin, Department of Financial Institutions <http://www.wdfi.org/ymm/brochures/financing/payday_loans.htm>

Alternatives to Predatory Payday Loans

In contrast to industry rhetoric, alternatives to predatory payday loans do exist. When faced with credit or debt problems, a consumer's first course of action should be to seek professional debt counseling, particularly from established agencies such as the National Foundation for Credit Counseling and other non-profit organizations. These groups have extensive experience helping consumers with debt problems, and are well aware of applicable options for consumers in need. Some options are listed below.

A more complete understanding of the gravity of a debt cycle may encourage potential debtors to first seek loans from friends or family as well as pay advances from employers. Many who find themselves in a debt situation do not have access to employee advances or similarly lack resources from family members, but it is important to first test these options. Most importantly, before seeking a loan, consumers should always attempt to deal directly with the debt itself, by establishing a payment plan or a payment deferral from creditors.

If the consumer is a member of a credit union, a social service program, or the military, emergency financial assistance may be available. Many credit unions offer short-term loans in smaller amounts that cost much less than typical payday loans, often with quick approval on an emergency basis, as well as free credit counseling.

Military programs are available to both active-duty and retired military personnel and can also offer emergency loans at lower risk and rates than payday lending, although due caution should be taken in properly researching these venues before committing to their contracts.

Finally, charities and faith-based initiatives may also exist to assist families in financial crises. Programs found in states such as North Carolina or Arkansas, for example, give small federally funded sums ($100 - $300) to families for housing or utilities in emergency situations.[17]

Under the federal Low Income Heating Energy Assistance Program (LIHEAP), all states provide assistance to low-income individuals for paying winter heating bills, a common factor behind payday lending demand. Many areas also have emergency funds available to help pay unanticipated heating and cooling bills. Utility companies often provide payment plans or repayment matching programs to further assist low-income individuals and households avoid financial crisis as a result of energy prices.[18]

In the event that the consumer in need of cash has exhausted these options, he or she should pursue a loan that meets the following criteria to avoid being victimized.

- Sufficient repayment term: Very short term loans are often difficult to repay because an individual is not able to plan ahead and budget in the cost of repayment. Longer-term loans, on the other hand, allow consumers to budget the cost of repayment into future financial planning, reducing the risk of rollover payments and debt traps.
- Repayable in installments: Allows for more flexibility for gradual and steady repayment of a loan. This makes it easier for the debtor to repay the loan since the payments due are smaller and more spread out over time.

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[17] http://www.ncdhhs.gov/dss/workfirst/wfea.htm
[18] http://www.sustainable.doe.gov/

- No mandatory arbitration clause: [19] Many lenders demand mandatory arbitration clauses that require secrecy of proceedings, often inhibiting the debtor from participating in most class action lawsuits, and binding debtors to the finality of arbitration results in the event of a debtor's inability to repay. These arbitration procedures tend to cost more than regular public court proceedings, and they offer the consumer no alternative to private arbitration. A dangerous provision of this clause is that the private arbitrators are neither bound by certain legal constraints nor obligated to justify their decisions.
- Reasonable fees and APR: Although many debtors accept high fees because of poor credit history, consumers should compare options and find the best available rates. For example, even credit card interest payments are considerably lower than predatory payday lending rates and fees in most unregulated states.
- Verifiable establishment: Many payday lenders operate through the internet to avoid government regulation. Possible debtors must make sure the creditors are legitimate institutions to avoid fraud.

A good ways to avoid the hidden risks and exorbitant fees of predatory lenders is to seek out more established venues such as credit cards or small consumer loans. [20]

- Credit cards: While they may also have high fees and rigid repayment schedules, they are often available even to those without a solid credit history. Moreover, they frequently have lower interest rates than predatory payday lenders, as well as more regulated procedures.

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[19] "Mandatory Arbitration Clauses Devestating Consumer Rights." National Consumer Law Center. Jan 2007. National Consumer Law Center. 26 Jan 2007 <http://www.consumerlaw.org/initiatives/model/arbitration.shtml>.

[20] "Alternatives to Payday Loans." Payday Lending. Jan 2007. Center for Responsible Lending. 26 Jan 2007 <http://www.responsiblelending.org/issues/payday/briefs/page.jsp?itemID=29573161>.

- Small consumer loans: These are also cheaper than payday loans, usually with an APR from 25 - 36%. A good credit history is not always required, and consumer loans for smaller amounts are more easily obtained than typical bank loans.

Policy Recommendations

Based on their demonstrated success, Connecticut laws serve as a solid foundation and model for successful state predatory lending regulations.

For the handful of states like Connecticut that have successfully implemented rigid regulations and reasonable caps on fees and interest rates, more emphasis should now be placed on public education and awareness. The general public should be well-informed about the dangers of borrowing at exorbitant fees and learn to report any illegal loan providers to appropriate enforcement authorities. Additionally, legislators should be wary of attempts by the lending industry to create exemptions from small lending laws, and existing laws should continue to be vigorously enforced.

Many states, like Illinois for example, have established regulations that have been largely unsuccessful in preventing predatory payday lending. Their primary effort should be directed toward closing the loopholes exploited by the lenders by imposing a cap on interest rates and fees under the state small loan law. In Connecticut, regulation extended to all small loans, regardless of length or repayment structure, in order to prevent lending companies from evading regulation with minor changes in loan terms.

In Wisconsin and New Mexico, the two states where specific regulations protecting consumers against predatory lenders and extravagant fees have not yet been implemented, the obvious priority should be to put clear restrictions and acts, such as in

Connecticut's Chapter 668, Part III: Small Loan Lenders, in place. In Wisconsin, an education program has proven insufficient to prevent the rampant and unfettered growth of predatory lending. While education is an important component of public protection, it falls short of making a substantial impact without concrete legal support.[21]

State regulations on short-term loans should include the following stipulations: [22]

- Cooling-off Period:[23] Borrowers in emergency situations should be limited to one payday loan at each time, with a minimum period of 15 days in between loans, in order to facilitate the reorganization of finances
- Fees and APR Limitations[24]: The issue of high fees and APRs must be addressed, with regulations on reasonable fee amounts. Because fees are compounded by rollovers, the number of rollovers should be capped at two, and be allowed only when the initial loan has been largely repaid. In the interests of the borrower, flexibility should also be allowed through the option of a payment plan.
- Sufficient definition of terms: The definition criteria for predatory lenders and their loans must be broad enough to encompass most variations, such as loans secured by slightly different means (e.g. post-dated checks) or different repayment periods (e.g. creating loans for over 31 days when rules apply only to 30-day loans.) This is where Connecticut usury laws should serve as a model.

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[21] "Predatory Small Loans: A Form of Loansharking." Low-Income Consumer Initiatives. Jan 2007. National Consumer Law Center. 26 Jan 2007 <http://www.nclc.org/initiatives/payday_loans/pay_menu.shtml>.
[22] "New Terms for Payday Loans." Woodstock Institute Apr 2004: 7-8.
23 "New Terms for Payday Loans." Woodstock Institute Apr 2004: 7.
24 "Predatory Small Loans: A Form of Loansharking." Low-Income Consumer Initiatives. Jan 2007. National Consumer Law Center. 26 Jan 2007 <http://www.nclc.org/initiatives/payday_loans/pay_menu.shtml>.

- Well Implemented Regulations[25]: Regulations need to be strictly and fully enforced. This can be done by keeping a database of payday borrowers to ensure that the cooling off period is being observed, or keeping track of a variety of other consumer records and public information.

25 Ibid.

Blunt, Missouri GOP Again Fail to Answer the Call on Payday Lending

By Howard Beale

Created 09/18/2007 - 9:37pm

Jay Nixon, Rita Days and others want to see some legislation passed that would put a stop to the usurious practices [1] that have become commonplace on the part of payday lenders in our state. Among other reforms...

They want to cap payday loan interest rates at 36 percent and eliminate the practice of renewing loans, which they say is prohibited in other states.

I'm sure payday lenders will find a way to stay in business even if they can charge "only" 36% interest. But apparently, Matt Blunt and key Republican legislators have little interest in helping protect vulnerable Missourians from predators:

Nixon challenged Gov. Matt Blunt to join in supporting the reform legislation.

Messages left for a spokeswoman for Blunt, and for Sen. Delbert Scott, R-Lowry City, chairman of the Senate Financial Governmental Organizations and Elections Committee, were not immediately returned. Senate President Pro Tem Michael Gibbons was on vacation and unavailable, his spokeswoman said.

So none of these GOP leaders, all usually eager for the spotlight, bothered to weigh in on the subject of payday lending reform.

I can't for the life of me figure out why that might be [1].

I guess Missourians will just have to wait for a Democratic majority in the assembly before common-sense restrictions on payday lending get passed. On the plus side, the wait might not be long.

Source URL: http://www.firedupmissouri.com/gop_absent_on_payday_loan_reform

Links:

[1] http://www.businessweek.com/ap/financialnews/D8RO35C01.htm

Payday Loans in Missouri

Nathaniel Albers

Report 1-2008
January 2008

Institute of Public Policy
University of Missouri
137 Middlebush Hall
Columbia, MO 65211

Payday Loans In Missouri

Nathaniel Albers*

Introduction

Payday loan outlets across the U.S. offer short term loans with high interest rates in comparison to credit cards and other consumer credit. Generally, low income and military families are served by payday loan outlets while wealthier consumers have access to lower interest loans. Missouri has some of the most lax regulations according to the Missouri Attorney General and *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns.*[1] A Missouri payday loan customer can be charged as much as a 1,950% Annual Percentage Rate (APR) in comparison to 12.71% APR on the average credit card.[2] The average APR Missouri customers will pay is around 420%, but the 1,950% APR demonstrates the extreme that is possible under current Missouri law. Other states, such as Oregon, cap the APR payday lenders can charge at 153%.[3]

Payday Loan Overview

The terms payday loan, cash advance, and fringe banking all describe the same phenomenon: someone who needs to obtain $100 to $500 goes to an outlet, writes a post-dated check for the desired amount plus a fee, and walks out of the store with the cash. These stores provide small, short term loans to approximately nine million customers each year.[4] Generally, the fees range from $15 to $18 per $100 loan per fortnight across the country, for an annual percentage rate of 391% to 468%.[5] These short term loans are incredibly expensive when compared to the 12.71% APR of an average credit card.[6]

Payday loan enterprises generally locate in poor urban neighborhoods, near military bases, and in other places underserved by traditional banks or other financial services. They advertise themselves as an occasional place to go when an individual needs temporary financial help and/or a place to cash a payroll or government check but the average customer is a repeat customer, using these services seven to eleven times a year.[7] Additionally, 90% of payday loan store's revenue comes from repeat borrowers who cannot pay off their loans on the due date.[8]

Furthermore, the *New York Times* estimates that approximately 26% of all military personnel use these services [9] while the industry states that 3.69% of active duty military personnel have taken a loan in the past 5 years.[10] The New York Times estimates that approximately 598,000 members of the armed forces use this service[11] while the trade group Community Financial Service of America (CFSA) estimate is about 85,000. Clearly there is a discrepancy between these two sources. At any rate, recent federal legislation limits the interest rates that can be charged of military personnel.

The Federal Trade Commission issued a consumer alert describing pay day loans as "very expensive credit," and urging consumers to seek alternative sources of credit and budget appropriately to avoid needing credit.[12] According to the FTC, credit unions and small community oriented banks generally provide better loan service for low income people than payday loan operations.[13] Furthermore, the FTC suggests credit counselors and similar entities educate people about payday loan debt and how to avoid it.

How Payday Loans Work - Worst Case

Presented below are two examples of how payday loans can work. The first describes how repeated loan renewals affected one couple in Washington while the second presents a hypothetical calculation to demonstrate the cost of payday loans.

> Example 1: A young Navy couple stationed in Washington borrowed $500 for a fee of $75 for less than two weeks. When they could not pay back the loan they extended their loan continuously until they soon owed $4,000 and were under threat of foreclosure.[14]

> Example 2: If a customer who makes Missouri's current minimum wage ($6.65 per hour or $13,832 per year)[15] takes out one $300 loan at 15% per fortnight and takes out loans or renews the original loan for the ten times that the typical customer takes out a loan over a year, he would owe $450 in fees or 3.25% of his annual income.[16] Therefore, that customer pays more in fees to the loan office than he or she would pay for basic phone service.[17]

The cases above illustrate how much money can be spent on payday loan fees, especially by regular users. Chronic users of payday lenders would pay even more in fees. States such as Washington keep track of the number of loans individuals get in a year. In 2004, 4,402 payday loan customers each took out 27 loans. At an average fee of $49.79 per loan in Washington, 27 loans would cost a customer $1,344.33 in interest and fees.[18] Because of this, some states have tried to cap the number of loans one could have.[19]

Industry Proponents

Supporters of the payday loan industry state that these operations generally meet consumer demand and specifically meet the following needs.

1.Payday loan stores offer financial services to low income residents in areas where traditional banks will not locate.
2.Payday loan stores offer credit to higher risk customers that could not receive credit from other financial institutions.[20]
3.Payday loan stores offer quick and simple credit to people who find themselves in emergency financial situations.[21]

In addition, proponents state that fees for one 2 week loan can be lower than overdraft charges at traditional banks.[22] The Community Financial Services Association of America (CFSA), an industry trade group that represents about half

*James Harrington provided research support for this brief.

Table 1. Fee comparison across loan types[23]

Institution	Loan Amount	Typical Fee	Annual APR
Payday loan	$100	$15	391%
Bounced Check	$100	$54 - Insufficient funds merchant fee	1,409%
Credit Card	$100	$37 - late fee	965%
Utility Bill	$100	$46 - late/reconnect fee	1203%

of all payday lenders provides the following comparison (Table 1) for how a typical pay loan compares to other credit offers.

Industry proponents such as the CFSA also believe there are unscrupulous payday lenders that should be put out of business but argues that legitimate service providers do not deserve the wrath of consumer organizations and do not require government regulation.[24] Proponents state that the population served by the industry cannot establish traditional lines of credit available to their wealthier banking counterparts and payday lenders fill that void. The higher fees are justified by the idea that the loans are riskier because the customers generally have low credit ratings.[25] Furthermore, other hard-to-find financial services are available to low income people through these outlets including check cashing, money transfers, pre-purchase debit cards, and long distance phone services. However, in order to get most payday loans, customers have to provide evidence that they have a checking account.

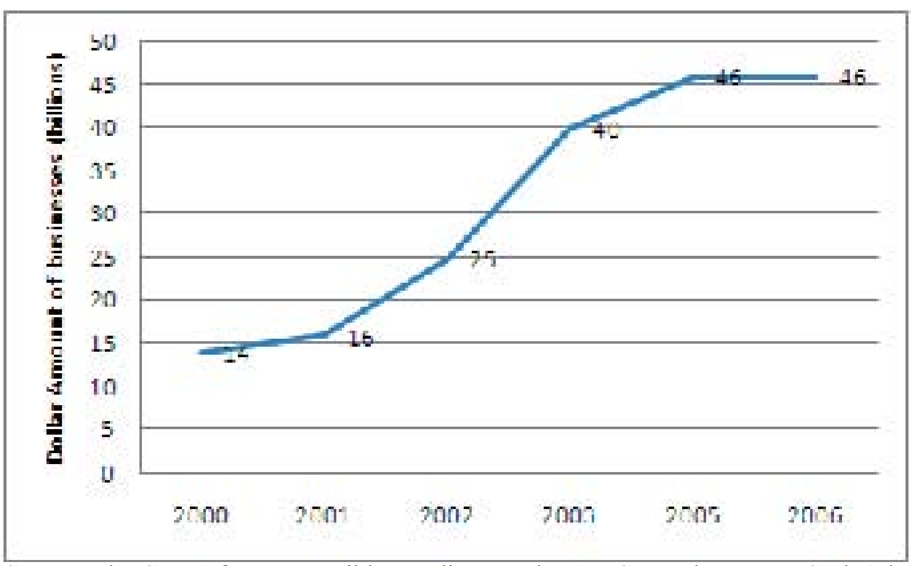
One common critique of the industry is that it preys on the poor, elderly, and other groups with limited resources. The CFSA refutes this, stating the following results from studies of its clientele.[26]

- The majority of payday advance customers earn between 25,000 and $50,000 annually;
- Sixty-eight percent are under 45 years old; only 4 percent are over 65, compared to 20 percent of the population;
- Ninety-four percent have a high school diploma or better, with 56 percent having some college or a degree;
- Forty-two percent own their own homes;
- The majority are married and 64 percent have children in the household; and,
- One hundred percent have steady incomes and active checking accounts, both of which are required to receive a payday advance.

Payday Loan Industry and the Market

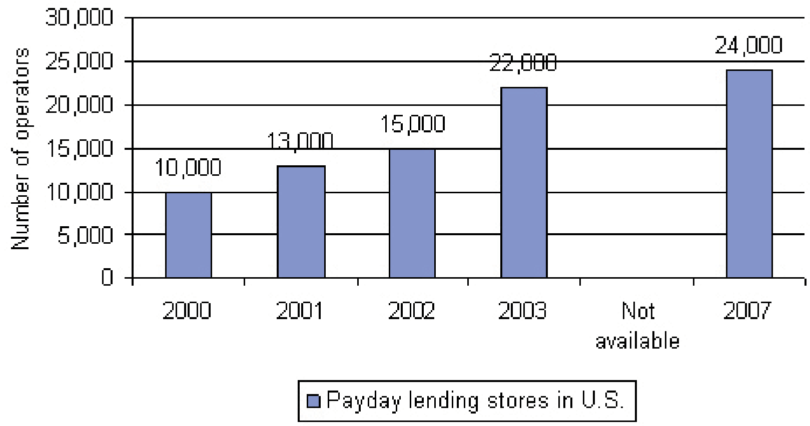
The growth of the industry in recent years demonstrates the demand for these financial service products. According to Stephens, Inc., an investment banking firm that monitors the payday loan industry, The Center for Responsible Lending, a Durham, NC based organization that monitors lending practices, and National Public Radio, the payday loan business has increased exponentially from 2000 to 2007. In 2000 pay day loans were a fourteen billion dollar industry nationwide. By 2003 it was a 40 billion dollar industry but has since stabilized at about $46 million peryear (see Figure 1). Similarly, in 2000, there were 10,000 payday outlets operating in the U.S .[27] By 2007 there were 24,000 outlets[28] making payday loan stores

Figure 1: Gross Revenue of Payday Loan Operations in the US, 2000-2006



Source: The Center for Responsible Lending, Durham, NC; Payday Loans Cash Advance Consumer Guide; PayDay Loan Consumer information. Comparable data not available for 2004.

Figure 2: Number of Payday Lending Stores in the US, 2000-2007



Source; Stephens Inc, Little Rock, AK, The Center for Responsible Lending, Durham, NC, and National Public Radio, Washington D.C. (2007)

more common than McDonald's restaurants across the country (see Figure 2).[29]

One of the things driving the trend is the number of large traditional banking and investment firms that have gotten into this business. Some banks have started to open up payday loan stores under different names such as Union Bank in California, and larger operations such as Citibank play a less direct, but profitable role, acting as underwriters for payday companies like Dollar Financial's initial public offering of stock.[30] Many traditional lenders have not gotten into the business of payday lending overtly, while becoming directly involved in the industry. Richard Hartnack, Vice-Chairman of Union Bank of California explains why his bank is interested in payday lending. He stated when he looks at one of his bank branches in a poor San Francisco neighborhood "I can say without hesitation it's never made money. Poor neighborhoods just don't yield enough big account balances to support a conventional branch."[31] That branch stays open only because that is a requirement of California banking regulators. While the Vice-Chairman laments having to keep that bank branch open, he is optimistic about his bank's entry into the check cashing and loan business in lower income neighborhoods.[32] The fees charged to this "untapped market"[33] provide healthy profits for his company. Furthermore, if their experience is similar to payday loan stores in Colorado, the default rate on payday loans will be lower than the defaults on credit card debt, making the business even more profitable.[34]

Another indication of the expansion of payday lending is the number of payday loan operations that have started to go public over the last few years and have started to market their services overseas. These public companies have grown each year expanding their operations exponentially and boosting profits. For example, QC Holdings Inc., (QCCO) which owns 613 stores in 25 states had $23.7 million dollars in profit in 2002, $36.1M in 2003, and $48M in 2004.[35] By 2006, QC Holdings had a gross profit of $152.35 million. This growth was fueled by an increase of 123 outlets. Not all payday lenders have seen this kind of profit increase, but many large brokerages such as Bank of America, and Vanguard see payday lending as profitable investments as evidenced by their recent holdings in payday loan companies such as QC Holdings.[36] Large institutional investment firms invest heavily in other publicly traded payday loan companies. It should be noted that not all payday lenders are publicly traded companies and some of the larger names in the industry such as Check into Cash and CNG Financial (Check n' Go) are privately held firms.

While there was steep growth in the first part of this decade in this industry, the growth seems to be slowing both in terms of numbers of outlets and in terms of the success of the companies. There is limited information available about private companies, but four of the five largest publicly traded payday loan operations doubled their stock price in 2003 indicating the growth of this market in the first part of this decade. However, since that time the stock price of these companies seems to be more varied with some such as Dollar (NYSE symbol DLLR) experiencing an 80% increase in stock price since from 2004 to 2007. Advance America, the largest publicly traded payday operation in the US experienced a decline of 62% in that same time frame (see Figure 3).[37]

State Regulation of Payday Loans

Payday loan establishments and similar enterprises are regulated by state governments and no two states are completely alike in how they regulate the industry. Some states, such as New York, have stringent requirements and regulations for these establishments while states like Delaware and South Dakota provide little oversight, encouraging national chains to establish business in these states.[38] New York has specifically prohibited these establishments since 2000 and North Carolina prohibited them starting in early 2007.[39] New York's Attorney General has sued out-of-state establishments that attempted to set up shop in New York under the premise that they could operate in New York under their home states' laws not New York laws.[40]

States can be grouped into three broad categories concerning how they regulate the industry.

1.States that have specific payday loan statutes separate from the more general usury statues (22 states)
2.States that require payday lenders to comply with usury restrictions in the state's small loan and usury statutes (20 states – Missouri falls under this category)
3.States that allow payday lenders to charge any interest rate they want without any payday lender statutes specifically limiting rates (8 states)[41]

Many states do not specifically regulate the payday loan industry. A review of Missouri's neighboring state's statutes shows that Kansas, Illinois, and Iowa specifically mention "payday loans" while Nebraska, Oklahoma, Arkansas, Tennessee, and Kentucky do not. Kansas clearly states how much can be charged for a payday loan, and pegs the charges to the loan amount. The more a customer borrows, the more the fee. Illinois states that payday lenders must report the payment history of every lender to the credit reporting bureaus (Equifax, Transunion, and Experian) but offers little oversight of the industry in terms of fees or direction as to how they conduct business.

Nationally, limits have been placed on the payday loans for military personnel. Senators Jim Talent (R-MO) and Bill Nelson (D-FL) amended the 2006 Defense Authorization Bill to impose a cap of 36% annual percentage rate (APR) on payday loans purchased by military families.[42/43] Earlier in 2006 Representative Sam Graves (R-MO) introduced legislation to cap the APR payday lenders could charge to military families at 36% but his legislation did no pass. In early 2007, nineteen state legislatures proposed over 50 different pieces of legislation aimed at regulating the payday loan industry.

Payday Loans in Missouri

Missouri posts the name and location of every payday lender in the state on the Missouri Division of Finance website.[44] As of January 2007, there were 1,545 licensed payday lenders in Missouri or one for every 3,781 people in Missouri. In comparison, there are 335 state and nationally chartered banks in the state. Because payday loan operations are looked at as a substitute for traditional financial institutions, it is useful to compare the two. However, trying to compare the payday loan statistics to the number to traditional bank and credit union institutions in Missouri is difficult. However, Graves and Patterson estimate that there are 2,193 banks in Missouri which includes branches and banks regulated by the federal government.[45]

Similar to the rest of the country, the Payday Loan Industry in Missouri has expanded the number of outlets providing their services. Figure 4 shows that from 2002 to 2006, the Missouri Division of Finance issued 69% more payday loan licenses.

The increase in licenses has lead to an increase in the number of loans provided and also an increase in the number of defaulted loans. Figure 5 shows that 60,000 more payday loans defaulted in 2006 than they did in 2002. Out of the 2.87 million total loans made in 2006

Figure 3: Five Publicly Traded Payday Loan Companies Stock Prices January 7, 2005 – January 7, 2008

Figure 4: Number of Licenses Issued by the Missouri Division of Finance

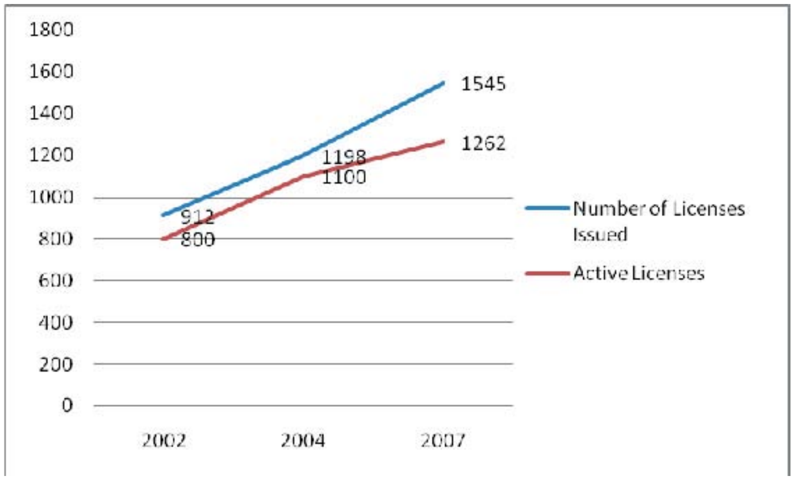


Figure 5: Number of Loans in Default Compared to Total Loans Made– Missouri

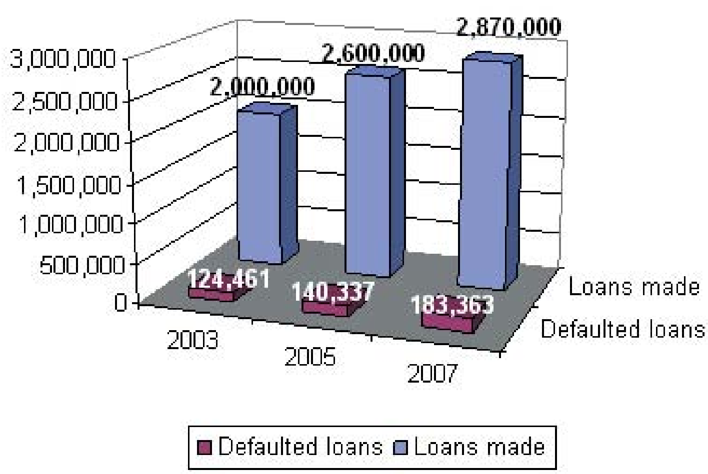
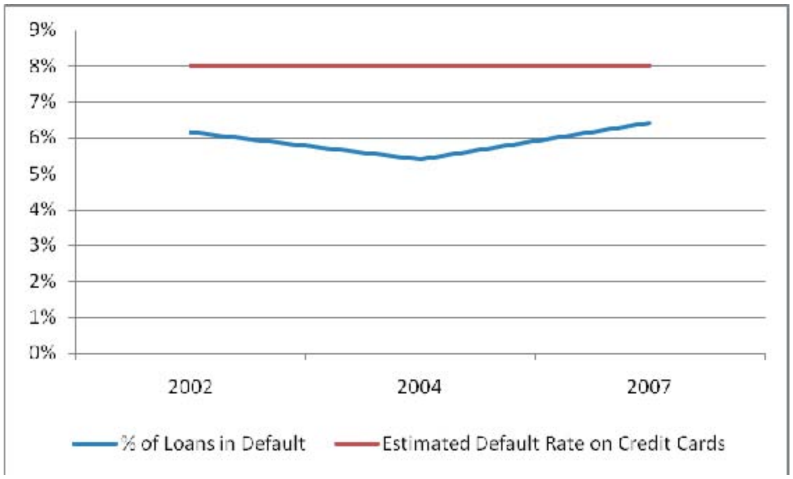


Figure 6: Percent of Payday Loans in Default - Missouri



6.39% defaulted (see Figure 5), compared with the 2 million loans made in 2002 of which 6.22% defaulted. While the default rate does not seem to be changing significantly since statistics have been collected on payday loans, the number of loans and access to these loans continues rise dramatically. This means that more people are using these loans and more people are defaulting on relatively small loans that quickly balloon into large loans.

Figure 6 demonstrates that the risk associated with high interest payday loans may actually be less than the default rate on the average credit card. Standard and Poor's estimated that credit card debts were as high as 8% at the end of 2001.[46]

Missouri has some of the most lax laws (RSMo 408.500) in the country concerning payday loans resulting in potential annual interest rates that could charge customers as much as 1,950% in interest annually.[47] This rate is the highest potential rate in the country for continuous customers of these establishments. Furthermore, Missouri usury laws do not impact the payday loan industry, or any loans, in any meaningful way according to the State Division of Finance, because of the plethora of exceptions.[48] Legislation passed in 2002 capped the interest a lender could earn on a loan to 75% and required the Division of Finance to start collecting data about the industry but did not offer regulation in terms of a cap on fees, where they can locate, or how they conduct business. Also, the 75% limit on a loan can be renewed up to 6 times and an individual could simply move the loan between lenders, effectively resulting in more than 6 loans. This is how one could potentially be charged with an APR of 1,950%. While this rate would be exceptional and would only happen in isolated cases, the mere possibility of this rate circumvents other banking and lending legislation which caps interest rates that can be charged. No other state's regulations allow rates to be as high as 1,950%.

State representative John Burnett (D-KC) introduced HB 1462 in the Missouri House during the 2008 legislative session that will cap interest that payday lenders could charge to $15 for the first $100 of principal for the first 30 days of the loan and not more than 3% thereafter. This equates to an APR of 36% which is more in line with what credit card companies' offer. The bill also:

•Prohibited renewals of loans to circumvent interest rate restrictions;
•Granted jurisdiction to the Attorney General to issue cease and desist orders against violators;
•Allowed the Attorney General to sue for injunctions, rescission of loan contracts and restitution, and civil penalties for violations; and
•Clarified that the limitations apply to all lenders, whether or not they are properly licensed pursuant to Chapter 408, RSMo.[49]

On April 8, 2008, voters in Kansas City approved an ordinance that requires payday loan operators to pay an annual permit fee of $1,000.[50] The proposal passed with 63.5% of the vote. Kansas City has approximately 110 payday loans establishments, so this ordinance will generate annual revenues of $110,000. The revenue will be used by the Regulated Industries Divisions to reduce administrative costs associated with payday loans permit process.

Conclusion

Payday lending is a relatively recent phenomenon that has experienced growth both nationally and in Missouri over the last seven years, albeit that growth has slowed over the last three years. These organizations market their services to low and middle income people and military personnel and charge interest rates higher than any other form of credit available.[51] The federal government through the Federal Trade Commission warns against the use of payday lending. Other states financial regulators issue warnings to consumers to avoid payday lenders. States such as New York and North Carolina have passed legislation aimed specifically at keeping payday lenders out of their state because payday loans offer "usurious rates of interest."[52]

Another interesting phenomenon regarding payday lending is the relatively low risk the lender takes on in the relationship with the consumer despite what industry proponents state. Former CEO of ACE Cash Express Donald Neustadt argues that check cashers offer a much-needed service in the community and that their fees are justified because of the costs they must assume. Besides, says Neustadt, "Banks don't want these people in their lobbies."[53] The payday lenders on average charges off about 5.4% of all loans due to their customer's refusal to pay, inability to pay, or irresponsible behavior. The 5.4% loss rate Neustadt experiences is similar to the default rates Missouri lenders have seen from 2003 – 2007 (see Figure 5) This is less than the 8% of loans credit card companies were thought to charge off in 2002 according to a Standard and Poor's 2001 prediction.[54] One study demonstrated that the payday loan industry only charges off 2.6% of all loans.[55] Still, the CFSA states that it is expensive to run a payday operation and refer to a Federal Reserve Bank study that indicated the cost for a small bank to originate and maintain a loan for one month is $174.[56]

Financial services may be needed in low income areas; industry proponents and critics seem to agree on this point. However, providing high interest loans that are difficult to pay back in the time allotted may not be the most appropriate service. Credit unions, community banks, and micro loan programs available through local and state government entities may better help people get out of a financial predicament. Some local governments and libraries also offer financial planning classes and education workshops that attempt to keep people from needing high interest loans. According to the Federal Trade Commission, these types of institutions and agencies are better solutions to financial emergencies than consumer advocacy groups such as Consumers Union and the Consumer Federation of America.

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Author Biography

Biography
Nathaniel Albers holds a Masters Degree in Geography from the University of Missouri – Columbia, and was a Research Analyst with the Institute of Public Policy at the Harry S Truman School of Public Affairs. Mr. Albers has been involved in program evaluations and research in the areas of criminal justice, domestic violence, and traffic safety.

James Harrington is a graduate research assistant in the Institute of Public Policy at the Truman School of Public Affairs, University of Missouri-Columbia. He is currently pursuing his Master of Public Administration, and is specializing in Public Policy and Public Management

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Institute of Public Policy
137 Middlebush
University of Missouri
Columbia, MO 65211
http://www.truman.missouri.edu/ipp

QC HOLDINGS, INC.
9401 Indian Creek Parkway, Suite 1500
Overland Park, KS 66210

Tom Linafelt *(913) 234-5237*
Director – Corporate Communications *tom.linafelt@qchi.com*

Payday Loans:
A Necessary Product, Delivered Responsibly, To Reasonable People

Recent independent studies show that:

- By extending credit where there would otherwise be none – payday loans are not predatory but instead actually HELP the households they serve.*

- Stricter regulation of payday lending has the adverse and unintended consequence of reducing credit options for those who may have few alternatives.**

- Policymakers should encourage competition in the small loan market, as competition controls prices.**

* ***"Defining and Detecting Predatory Lending,"*** by Federal Reserve Bank of New York Research Officer Donald P. Morgan, January 2007, located at: http://www.newyorkfed.org/research/staff_reports/sr273.pdf

** ***"Payday Lending and Public Policy: What Elected Officials Should Know,"*** by Tom Lehman, Ph.D., adjunct scholar of the Indiana Policy Review Foundation and professor of economics at Indiana Wesleyan University, located at: http://www.inpolicy.org/index.php?option=com_content&task=view&id=211&Itemid=26

FACTS ABOUT PAYDAY LENDING

Consumer Demand for Payday Loans is Strong & Rational

- Most Americans and Missourians have accumulated little savings or assets

- Banks and Credit Unions do not offer short-term, small-dollar loans
    - Bounced check fees and overdraft "protection" are highly profitable

- Many aren't comfortable borrowing from family or friends, pawning or bouncing a check

- Responsible payday lenders have helped millions of American families make ends meet when facing unexpected expenses such as auto repairs, medical expenses or unusually exorbitant bills.

<u>The Three Biggest Myths about Payday Lending</u>

<u>Myth #1:</u> Payday Loan Companies Take Advantage of the Poor

- **Reality:** Our Customers are the heart of America's Working Middle Class

  - All have bank accounts and jobs or steady sources of income
    - Majority make between $25,000 and $50,000 a year
    - Average income is about $42,000 annually
    - About 20% make MORE than $50,000 a year

  - Majority have credit cards, are married and have children
    - 42% are homeowners

  - 94% have a high school diploma

<u>Myth # 2:</u> Payday Loan Customers are Trapped in a So-Called "Cycle-of-Debt"

- **<u>Reality:</u>** Our customers understand our fees, and the vast majority of them meet their loan obligations without financial difficulty. (And we provide solutions for those who do find themselves in financial difficulty.)

  - Vast majority of customers – more than 90% -- use our products responsibly and pay their loans off according to loan terms

  - For the small minority who – for whatever reasons – find themselves unable to meet their loan obligations, the new CFSA Extended Payment Plan provides a safety valve for any customer, at any time, for no charge.
    - Individual payday loan companies have always worked with their customers to create extended payment plans

  - The small minority unable to meet their loan obligations typically have deeper financial management issues unrelated to payday lending
    - For those people, we suggest credit counseling and financial literacy programs

<u>Myth #3:</u> Outrageous Payday Loan Fees Generate Exorbitant Profits

- **<u>Reality #3</u>: Payday Loan Fees -- and Profits -- are Average and Often Lower than Banks & Credit Unions**

APRs are irrelevant to short-term loan products

- Industry critics regularly confuse "APR" with "interest"
  - $17 fee for a $100 loan = 17% interest

- **APRs for Competitive Credit Products**
  - $100 payday advance with a $15 fee = 391% APR
  - $100 bounced check with $54 NSF/merchant fees = 1,409% APR
  - $100 credit card balance with a $37 late fee = 965% APR
  - $100 utility bill with $46 late/reconnect fees = 1,203% APR

No payday loan customer would ever experience such exorbitant APRs

- To do so, one would have to roll the loan over every two weeks for a year
  - Not only is that impossible to do, it is against Missouri state laws and CFSA Best Practices, which limit all customers to 4 rollovers

Payday loan industry profit margins are comparable to – and in many cases less than – those of other industries.

- Payday loan industry profits are average: 6.6% net income as a percentage of revenue
- Ironically, the payday lending industry's profit – or net income for every $1 of revenue received – is lower than other financial services companies, including our chief critic – credit unions
- Banking industry profit margins can be four times as high as the payday loan industry average (US Bank, 36%; Bank of America, 30%, Wachovia, 26%)

<u>Payday Loans: The Product & The Process</u>

Payday loans are a convenient, short-term financial solution

- Customers are overwhelmingly satisfied with their payday loan product and experience
- Customers appreciate having the credit option and fully understand and accept the associated fees
  - No hidden fees such as those associated with debit card overdrafts, ATM fees and others

Loan cost is a fee, not interest

- Customers consider our fees to be about $15 per $100 loaned for two weeks

    - Reasonable for customers facing higher fees associated with bounced checks, insufficient fund “protection” fees or fees associated with overdrawn debit cards and late bill payments.

<u>CFSA’s New Customer Pledge</u>

- A $10 million Public Education and Awareness campaign, designed to encourage consumers to use payday loans responsibly, launched in February 2007

- A $2 million pledge to support financial literacy campaigns includes partnerships with minority and community-based organizations

- Revised “Best Practices” that include advertising requirements and restrictions and – most importantly – an Extended Payment Plan that gives any customer, at any time – for any reason – more time to pay off their loan.

Revised “Best Practices”

- Customer Notice on all advertising emphasizing the short-term nature of the product

- Restrictions on advertising for “frivolous” uses such as gambling and vacations

- **Extended Payment Plan: any customer, at any time, for any reason can get more time to pay off their loan at NO EXTRA COST**
    - Eliminates the so-called “cycle-of-debt” issue by enabling payday loan customers to pay off their loans without taking another loan

<u>Recent Research Supports a Vibrant, Competitive Payday Lending Industry</u>

Federal Reserve Bank of New York (January 2007)

- Payday loans are NOT predatory

- By providing a source of credit where otherwise there would be none, payday loans actually ENHANCE the welfare of customer households

- In their rush to put stricter regulations on payday lending, legislators often rush to label payday loans as “predatory” without having defined what “predatory” means

Indiana Policy Review

- Increasingly restrictive payday lending regulation has the adverse and unintended consequence of reducing credit options for those who may have few alternatives

- Policymakers should encourage competition in the small loan market, as competition controls prices

Wall Street Journal, April 2 editorial

- "…crackdowns on payday lending) looks like another illustration of how to hurt working Americans in the name of helping them."

- "Payday loans offer a valuable service to moderate income workers."

- "Payday loans are cheaper than most alternatives for those facing short-term financial distress."

- The effect of a ban on payday lending in Georgia "has been to increase consumer credit costs and inconvenience for Georgia consumers."

- "Banning payday loans might please competing banks, credit unions and so-called consumer advocates, but it's hard to see how actual consumers would benefit."

PAYMENT OF UTILITY BILLS: ISSUES

ROOMMATE LIABILITY: The Legality of Conditioning Utility Service on Payment of a New Roommate's Old Debt

colton roger2001 09
roommates-debt.pdf

THIRD PARTY LIABILITY: **Limiting The "Family Necessaries" Doctrine as a Means of Imposing Third Party Liability for Utility Bills**

RColton2001 07
Necessaries.pdf

- LEVEL, BUDGET BILLING
- PAY PLANS
- BAR ON PAYDASY LENDING STORES AS

Comments from Roger:

Three big issues seem to predominate as we go into the winter heating season (I'm going to set aside issues such as remote disconnections, service limiters, and other similar issues raised by "smart meters" as being non-seasonal, but worthy of some future conversation, if we can).

1. The availability of levelized budget billing. Actually, if the world were the "world according to Roger," we would do what you guys did in Tennessee with your mandatory budget billing. Short of that, however, it seems that everyone agrees that budget billing is a "good thing." But then utilities begin to set up hosts of barriers which prevent the very people who would most benefit from budget billing from getting on budget billing. I am attaching the "recommendations" section out of a credit and collections paper I did in Indiana that addresses this issue in part. (You can ignore the other parts.)

2. Payment plans. Payment plans are like budget billing. Everyone agrees that we want customers who are in arrears to enter into deferred payment plans. In addition, virtually every state I have ever examined has regulations that set forth a series of factors that a utility "shall" consider in negotiating a payment plan. One of those factors is "ability to pay." But, regulators (and NASUCA offices) do not seem to seek to enforce those regulations governing payment plans. And, then people sit around and wonder (a) why payment plans so often do not work; and (b) why people do not rush to enter into payment plans. I am attaching a copy of a presentation I just made in Florida the week before Thanksgiving about "putting the negotiation back into negotiated payment plans."

3. The exercise of discretion. Many, many utility commission regulations would seem to require a utility to exercise some sort of discretion. Imposing a deposit "not to exceed" twice the average. Providing a payment plan of "at least" 12 months. But, utilities seem to have been able to gain acceptance of the notion that they can arbitrarily set their practices at the maximum (deposits AT twice the average) or the minimum (payment plans of EXACTLY and ONLY 12 months). If a utility is required to offer a payment plan of AT LEAST 12 months, that would mean that SOME payment plans would be more than 12 months. If a utility is required to cap is deposits at twice the monthly average, that would mean that SOME deposits are set less than twice the monthly average. It is not the regulations that are in error. . .it is the ENFORCEMENT of the regulations. That merits some discussion.

As an aside, I'd like to make a pitch to talk with NASUCA folks, too, about what Arizona did with utilities using check cashing stores and pay day lending stores as bill payment centers. Utilities may no longer use pay day lending stores in Arizona as a bill payment center. That's worth a lot of money to low-income households. It will become an important consumer protection issue. Along those lines, we could talk about the use of PayScan (see, http://www.payscanamerica.com) as a bill payment option. This whole issue seems to merit a conversation.

predatory lending (or fringe banking) industry, which includes
check cashing outlets, payday loan companies, rent-to-own stores, high cost second mortgage
companies, sub-prime auto lenders, traditional pawn shops and the growing business of auto title
pawn companies.

State Assembly Bill 2511

SHOW ME THE MONEY!
A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES

SECTION 1: EXECUTIVE SUMMARY AND RECOMMENDATIONS FOR REFORM

EXECUTIVE SUMMARY

Throughout the 1990s, the state PIRGs and the Consumer Federation of America (CFA) have documented the effects of financial deregulation on American consumers. One consequence of deregulation of interest rates, high credit card interest rates and high bank fees has been the rapid growth of the so-called predatory lending (or fringe banking) industry, which includes check cashing outlets, payday loan companies, rent-to-own stores, high cost second mortgage companies, sub-prime auto lenders, traditional pawn shops and the growing business of auto title pawn companies. This report examines payday lending in detail.

The report [Section 3] updates a 1998 CFA survey[1] on the consumer costs of payday lending and includes a survey of 230 payday lenders found in 20 states[2]. It finds that payday lenders continue to make short term consumer loans of $100-400 at legal interest rates of 390-871% in states where payday lending is allowed. More disturbingly, the report finds that payday lenders are exploiting new partnerships with national banks to make payday loans in states, such as Virginia, where the loans are otherwise prohibited by usury ceilings or other regulations.

Second, the report [Section 4] examines the status of payday loan laws and proposed legislation around the country.[3]

Finally, the report takes a detailed look [Section 5] at payday lender lobbying and influence peddling in three state legislatures. Disturbingly, the report finds that the payday lenders are following the same lobbying strategy that the rent-to-own industry successfully used in the 1980s and early 1990s to enact its preferred version of legislation in nearly every state.[4] Payday lenders are hiring high-priced hired guns to seek enactment of weak, pro-industry legislation. So far, the strategy is working. Already, the payday lenders have been granted a safe harbor from usury laws in 23 states and the District of Columbia and flourish in states with no usury laws to prevent rate gouging.

If the payday lenders win, consumers, especially low-income consumers, lose. The predatory lenders' goal is to enact state legislation exempting their high-cost, high-risk loans from laws that apply to small loans. Although the report documents how the payday lenders have so far been successful in nearly half the states, increased scrutiny may slow their rapid growth.

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[1] See the 8 state survey "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry," Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, November 1998, < http://www.stateandlocal.org/loanshar.html>

[2] In the summer and fall of 1999, PIRG and CFA surveyed 25 states and the District of Columbia. We document payday lending in 20 states and didn't find payday lending in the other six. No inference should be drawn about payday loans in the other 24 states, which were not surveyed due to lack of volunteers.

[3] See "Safe Harbor for Usury: Recent Developments in Payday Lending," Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, September 1999 <http://www.consumerfed.org/safeharbor.pdf>

[4] At least 46 states have enacted strongly pro-industry rent-to-own laws. Vermont's law is more balanced. New Jersey's legislature remains the primary rent-to-own battleground. In January, 2000, the state legislature again declined to consider a pro-industry bill despite intense lobbying. Personal communication, Jerry Flanagan, legislative director, NJPIRG, 18 Jan 2000.

RECOMMENDATIONS: The state PIRGs and CFA urge the following reforms:

- States should retain and enforce small loan rate caps and usury laws to protect consumers from exorbitant small loan rates charged by payday lenders.
- States with no small loan or usury cap should enact a cap on small loans and keep licensed lenders under state credit laws. States that have already legalized payday lending should, at a minimum, lower permissible rates and strengthen consumer protections based on the CFA/National Consumer Law Center (NCLC) model act.[5]
- Congress should stop the national bank regulators, notably the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS), from allowing nationally-chartered banks and thrifts to provide protection for payday lenders from state consumer protection laws, especially since no federal law regulates their activities. Even better, Congress should close the bank loophole, either by enacting a federal usury law that applies to banks or by prohibiting FDIC-insured financial institutions from making loans based on personal checks held for deposit. To set minimum standards for state laws and to rein in the banks, Congress should enact the "Payday Borrower Protection Act of 1999" (HR 1684) sponsored by Rep Bobby Rush (D-IL).[6]
- More states should enact tough campaign finance reforms and lobbying disclosure laws. States should put the data on the Internet to enable citizens to evaluate influence peddling by special interests.

SECTION 2: INTRODUCTION

The state PIRGs and CFA have fought for years to ensure that banks and other lenders treat their customers fairly. Banks continue to raise the fees they charge consumers for bank accounts—gouging some consumers, who pay over $200 per year in checking account fees according to the state PIRG's 1999 Big Banks, Bigger Fees report. As CFA reports have indicated, high cost credit card interest and aggressive marketing of credit cards continue to saddle millions of consumers with expensive credit card debt.

Unfortunately, the failure of the banking industry to serve all consumers fairly has created a void in the marketplace that the predatory lending industry is rapidly filling. According to the most recent government data, 13.2% of families do not even maintain a checking account and 83% of those families have incomes less than $25,000.[7] Many families without bank accounts go to check cashing stores where they pay high fees to cash checks and buy money orders to conduct basic financial transactions.

Consumers seeking small loans find that banks no longer make small loans—if you don't qualify for a credit card, you are forced to go elsewhere. Although traditional small loan companies still make loans for less than $1,000, the industry has shifted its attention to larger loans. Payday lenders seek to fill the demand for small loans by making short-term small loans

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[5] For a copy of the CFA/NCLC Model State Deferred Deposit Loan Act, contact CFA, 1424 16th St. NW, Suite 602, Washington, DC 20036.

[6] United States House Resolution 1684, introduced May 5, 1999, and based on model legislation written by the National Consumer Law Center and the Consumer Federation of America. Also see Marcaurelle, Myra, "Payday Lending Practices Spark Federal Legislation," 4 Pub. Int. L. Rep., No. 3, Nov 99, pages 7-9, Loyola University Chicago Law School.

[7] Kennickell, A. et al, "Results From The 1998 Survey of Consumer Finances," Federal Reserve Bulletin, January 2000, Page 1.

based on personal checks held for later deposit.

Some consumers in the fringe financial market may have errors on their credit reports that cause their denial of traditional credit. Many others have experienced bad credit or no credit, due to either financial hardship or job dislocation. While many people will presume that these predatory lenders (or fringe banks) are "ma-and-pa" stores such as local pawn shops, increasingly they are part of national chains, or may be partnered with banks, or may even be “sub-prime” affiliates of a bank.

The predatory lenders include rent-to-own stores, “traditional” pawn shops, auto title pawn lenders, payday lenders, and sub-prime mortgage and auto loan companies. In our view, and in the view of Congress, all consumers who borrow money or purchase goods over time are entitled to the same rights, no matter what lender they go to. These rights include the right to compare the cost of borrowing over time on the basis of an annual percentage rate (APR) and the right to take advantage of state interest rate or usury ceilings, if applicable, and other state prohibitions on unfair lending practices. Although the two trade groups representing payday lenders told a December forum convened by Senator Joseph Lieberman that payday loans are subject to federal Truth in Lending, model state legislation backed by payday loan trade groups removes these transactions from state credit laws. And, as the surveys illustrate, some payday loan stores continue to claim that these are not “loan” transactions and fail to accurately quote the true Annual Percentage Rate when asked.

Salary lending at the turn of the last century led to a wave of reform to battle “loan sharking” that included state small loan laws and usury caps. In response to the last round of sleazy and deceptive loan practices in the 1960s, Congress passed the Truth In Lending Act and states enacted state Retail Installment Sales Acts, which often included usury ceilings and other rules on small loan practices. Although usury ceilings have been whittled away by deregulation at the federal level, many states have maintained anti-usury and other unfair practices laws designed to prevent interest rate gouging.

How Payday Lending Works

Pay day lenders make small advances based on personal checks held for future deposit, at interest rates approximating 300% APR or higher. For example, you write a check for $115, and receive $100, and the lender agrees not to cash your check until your next payday. The actual cost of that loan for two weeks is $15, which works out to an APR of 390%. If you can’t afford to pay it back, in many states you can simply pay the finance charge, or $15, to “roll it over”, still owing $115 at the end of the month, ratcheting your total finance charges up to $30 for a $100 one month loan. Section 3 reports on a survey of payday lenders in 19 states and the District of Columbia.

Payday Lending Legislative Strategy Part 1: Safe Harbor From Usury

The payday lending industry is following the same strategy as the rent to own industry did in the 1980s—it is aggressively asking state legislatures to pass pro-industry legislation that treats their product as a check cashing transaction or service, not as loans. The industry seeks to obtain a safe harbor from coverage by the usury laws that apply to other small loans.

When the industry fails to win safe harbor from usury laws, it often resorts to subterfuge. For example, in response to aggressive enforcement in Texas, some payday lenders have attempted to “sell” consumers certificates in “catalogs.” Others claim to “buy” home appliances from consumers, then lease them back for a “rental fee.” The courts and enforcement agencies treat these transactions as loans subject to state laws and the federal Truth In Lending Act’s required loan disclosures.[8] See Section 4 for an updated legislative status of payday lending in legislatures around the country.

Payday Lending Legislative Strategy Part 2: Hide Behind National Bank Charters

When the payday lenders fail to enact their preferred legislation, or seek to quickly move into a new state that may prohibit their activities, they are using a new approach. The payday lenders are forming partnerships with nationally-chartered banks. The firms argue that national banks may export deregulated interest rates from the bank's home state and are exempt from state interest rate regulation in the state where the consumer receives the loan. See Section 4.

SECTION 3: RESULTS OF A SURVEY OF PAYDAY LENDERS

In the summer and fall of 1999, PIRG and CFA staff and volunteers surveyed payday lenders in 25 states and the District of Columbia.

Nationally, the legal status of payday lending can be broken down into three general categories (See Appendix 1 for detailed list of states):

Category 1: Payday lending is generally banned by a low usury ceiling (interest rate cap) applicable to small loans. [19 states nationally, although as a result of court injunctions (AL) or regulatory interpretations (MI), payday lending is allowed for some entities in at least two ban states. Most recently, Indiana's Attorney General issued an opinion that payday lending is subject to Indiana's state interest rate limits and criminal loansharking laws.[9]]

Category 2: Payday lending is not prohibited because there is no usury ceiling on small loans. [8 states.] In these states, such as Oregon or Illinois, loans are made by licensed lenders, subject to state credit laws and supervision by regulators. The deregulation of interest rates permits payday lenders in these states to charge interest rates that far exceed the typical small loan rate cap.

Category 3: Payday lending is authorized by a specific law that grants safe harbor from usury or interest laws and typically sets maximum fees, size and length of the loan, and other terms. [23 states and the District of Columbia.]

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[8] See Consumers Union ,"Wolf In Sheep's Clothing: Payday Loans Disguise Illegal Lending," Austin, Texas, February 1999. < http://www.consumer.org/finance/txloans/txloans-1.htm> On 17 December 1999, the payday lender Cash Today settled a lawsuit brought by Texas Attorney General John Cornyn and agreed to pay $1 million in restitution to Texas consumers and end their loan business known as "deferred deposit" or "payday lending." See press release of Attorney General John Cornyn, 17 December 1999, < http://www.oag.state.tx.us/> (Texas v Cash Today, Tex. Dist. Ct., No. 99-02673, 12/17/99).

[9] Modisett, Jeffrey A., Attorney General, Official Opinion No. 2000-1 Applicability of Statutory Usury Ceilings upon Small-Dollar, Short-Term Loans, January 19, 2000.

RESULTS OF THE SURVEY [INCLUDED AS APPENDIX 2]

Overall, surveyors contacted 230 payday lenders doing business in 19 states and the District of Columbia. Surveyors were not able to locate payday lenders in an additional six states and did not conduct surveys in the other 25 states.

PAYDAY LOANS ARE BEING MADE IN STATES DESPITE USURY CEILINGS

-- Surveyors made calls into 10 of the 19 Category 1 states where payday lending is effectively banned by a usury ceiling on small loans.

-- In 5 of the 10 Category 1 states surveyed (AZ, GA, MD, PA, and VA) payday loans are being made, despite small loan interest rate caps. In some cases, lack of enforcement resources may be the problem. In other cases, out-of-state banks export deregulated loan rates into these states. For example, in Virginia, all payday lenders were doing business through a partnership with a national bank. See below for additional discussion of national bank issues and see Section 4 for additional analysis.

-- Interest rates charged for a $100, 14-day loan in states with usury caps ranged from 416% to 858% in Maryland, 429% to 650% in Arizona, 780% to 988% in Georgia, 390% to 455% in Pennsylvania, and 455% in Virginia.

-- In the other 5 Category 1 states surveyed, no payday loans were found despite 5-10 phone call attempts (MA, NJ, NY, RI, and VT). Surveyors also made calls into NH during 1999, finding no payday loans. Effective 1 Jan 2000, New Hampshire repealed its usury ceiling, so payday loans may be made there now. New Hampshire is included as one of the 8 Category 2 states, above.

PAYDAY LENDERS USING NATIONAL BANK CHARTERS TO AVOID STATE REGULATION

-- Increasingly, payday lenders in several states also seek to subvert the effect of state usury ceilings by making loans through partnerships with national banks, which assert that state laws do not apply to them. The following results should be considered preliminary, as most stores refused to even answer the question, or claimed they did not know.

-- At least 17 payday lenders reported making loans through national banks, thrifts or state industrial loan companies known to use their bank charters to avoid either usury ceilings (category 1 states) or other payday lending restrictions (category 2 or 3 states).

-- At least ten payday lenders in Arizona, the District of Columbia, Ohio, Pennsylvania, and Virginia reported partnering with Eagle National Bank of Pennsylvania. These include payday lenders in at least 3 states where payday lending is banned by usury or other statutes, including AZ, PA, and VA. [See Section 4]

-- The payday lender "Fast Funding" in both Florida and New Mexico reported doing business through County Bank of Delaware.

-- Two payday lenders in Pennsylvania reported doing business through Crusader Savings Bank, a nationally-chartered thrift in Pennsylvania.

-- Finally, some of the Checkstop payday lenders, which were surveyed in Arizona, Colorado and New Mexico, reported partnering with Web Bank, a Utah-chartered industrial loan company.

STORES DID NOT QUOTE APR ON PAYDAY LOANS

The federal Truth in Lending Act applies to payday loans, according to all the court decisions that have ruled on this question and confirmed by the Federal Reserve Board's published proposed amendment to the Reg Z Official Staff Commentary. Yet, many payday lenders surveyed claim that they are not in the business of making loans and therefore that none of the fees paid for their services are interest. So, it is difficult for surveyors, or potential customers, to obtain information to compare the cost of a payday loan.

-- Nationally, only 85 of 230 (37%) payday lenders quoted even a nominally accurate Annual Percentage Rate (APR) when asked over the telephone. Others claimed they "didn't know," or that the APR was equal to the fee for a two-week loan. [Credit was given if the APR quoted was at least 100%, although actual APRs calculated by PIRG ranged substantially higher.][10]

PAYDAY LENDERS APPEAR TO EXCEED FEE LIMITS

-- In 7 of the 11 states surveyed where payday lending fees are capped by law, 23 out of 151 payday lenders (15%) appeared to charge fees higher than the maximum allowed by the law in that state.

-- In CA, DC, FL, LA, MO, MT, and OH at least one lender quoted fees above allowable maximums. In CO, MN, NC, and TN all lenders' quotes were at or below allowable APRs [allowing 0.1% rounding error].

BOUNCED CHECK (NSF) FEES

Payday lenders routinely compare the cost of their loans to the perceived higher costs of bouncing a check.

-- Yet, over 70% of the payday lenders (161/230) in this survey replied with a specific bounced check fee averaging over $22 which they impose if a payday loan check is returned for insufficient funds. The quoted bounced check fees ranged from $7.50 to $40. The most common charges were $25 (34% of respondents) and $20 (34%). Only 6% of respondents said that they wouldn't impose bounced check fees. (Tennessee's law does not permit payday lenders to impose any additional fees for bounced checks.) A payday loan customer's bank would impose an additional bounced check charge.

[10] Quotes provided over the phone are not formal Truth In Lending disclosures. Actual loan paperwork would be required to verify the accuracy of APRs disclosed to customers. Surveyors did not get loans.

MOST COMMON APRs

-- Nationally, the average APR found was 474%. Because different states have different laws setting different fee caps that result in varying APRs, it is not generally appropriate to rank the states. The following data are provided for illustrative purposes.

-- PIRG-calculated APRs for a two week, $100 loan in the survey ranged from a minimum of 195% to 1092%. Both the high and the low were found in Montana, whose fee cap of 25% of the face value of the check allows a fee of $33.50 per $100 check which results in APRs of 871% for a loan repayable in two weeks. Before adopting its payday loan cap in 1999, Montana had no usury limits at all on loans.

-- The most common APR calculated, based on quoted fees, was 390%, charged by 30% of payday lenders, followed by 650%, charged by 13% of lenders.

-- A total of 56% of lenders charged 400% APR or more. Of all lenders, 35% charged more than 500% APR.

-- Fees charged by the same lender varied from state to state. For example, Advance America outlets quoted fees ranging from $14 to $25 to borrow $100. Ace Cash Express outlets quoted from $12.50 to $30 for a $100 loan.

-- In states with no usury cap, interest rates for a $100 14-day loan ranged from 260% to 572% in Illinois, from 416% to 650% in New Mexico, 273% to 520% in Oregon, and 390% to 780% in Wisconsin.

COST OF LOAN CONFUSED BY FEES BASED ON TOTAL CHECK OR TOTAL LOAN

-- Although most payday lenders quote their fees on the basis of a check for $100, some lenders include the cost of the loan in the $100 check.This practice, authorized by some state laws, makes it harder for consumers to determine the true cost of a loan and easier for lenders to charge a higher finance charge than consumers expect. For example, when a consumer calls to find out the cost of borrowing $100, many lenders will respond "$15" when their actual fee to borrow $100 would be $17.65. It works this way-- you write a check for $100, and the lender actually gives you only $85. So, the fee to borrow $85 is $15 (or 17.65% of $85. To borrow $100, you would need to write a check for $117.65.) Some of the payday loan costs reported in this survey may actually be understated due to this factor.

SECTION 4: THE PAYDAY LENDING INDUSTRY
Structure, Review of state legislative activities in 1999, and the role of National Banks

STRUCTURE AND SIZE OF THE INDUSTRY:
Over 10,000 payday loan outlets are operating and one trade group representative projects over $2 billion in payday loan revenue by next year. The Tennessee Department of Financial Institutions reported to its legislature that licensed payday lenders earned over 30% return on investment in the first nine months of legal operation. Stephens Inc., a Little Rock company, forecasts a potential mature market for 25,000 stores generating $6.75 billion in fees annually in 2002. Stephens also forecasts that annual volume of business will total 180 million transactions with $45 billion dollar volume of loans to produce that $6.75 billion in fee volume.[11]

Payday loans are offered through a wide variety of outlets, ranging from national chains of stand-alone payday loan companies, to established check cashing locations, to convenience stores, gas stations, pawn shops, and via Internet or 800-number faxed offers[12]. Payday loans through ATM terminals are expected. Consolidation in the industry is underway, such as Advance America's buy-out of National Cash Advance.

PAYDAY LOANS RESULT IN HIGH COSTS, PERPETUAL DEBT, AND COERCIVE COLLECTIONS

The most obvious problem caused by payday loans is the high cost for borrowers. The $15 to $33.50 fee per $100 permitted in some states, coupled with the extremely short-term of the loans, results in triple-digit interest rates for small loans and escalating finance charges if loans are not repaid in full on the borrower's next payday. The payday loan industry compares its fees to the cost of deliberately bouncing checks. CFA instead compares payday loan costs to other sources of quick cash loans available to consumers with less than perfect credit ratings. For the Senate forum on payday lending in 1999, CFA's actuary calculated the cost to borrow $200 and repay it in one month and in three months. **SEE CHART ON NEXT PAGE.**

These loans are designed to keep consumers in perpetual debt. Payday loans are single-payment loans for relatively small amounts (typically $50 up to $500) and for very short periods of time (a few days up to two weeks or the borrower's next payday). A borrower has to repay the loan and finance charge in full on the next payday or roll-over the loan by paying the fee and extending the loan until the next payday. In 1999 Indiana's Department of Financial Institutions inspected 47 licensed lenders, reviewing a total of 5,350 customers' files and a total of 54,508 loans. Indiana found an average of 10.19 payday loans per year per customer, with the ten largest lenders averaging 12.05 loans per person per year.[13] Indiana found that 77% of payday loans are roll-overs of existing loans. The Illinois Department of Financial Institutions also conducted a study of licensees and found that the average customer had 13 loan contracts

[11] Stephens Inc., "The Developing 'Payday Advance' Business: The Next Innings: From Emergence to Development, September 28, 1999, page 9.
[12] We found numerous payday loan ads on the Internet. At least one payday lender, Checkstop, is making payday loans on the Internet through an FDIC-insured institution, Web Bank. See <http://www.checkloan.com/>.
[13] Indiana Department of Financial Institutions, Summary of Payday Lender Examinations Conducted from 7/99 thru 10/99.

present in files. The Illinois DFI report to the Illinois Senate concluded that customers are "captive" when unable to end the cycle of rolling over their accounts due to the excessive cost.[14]

Escalating triple-digit debt causes financial disaster for some families. The Nashville *Tennessean* reported: "Bankruptcy officials said 'payday' lending companies increasingly are showing up as creditors in bankruptcy cases here and around the country in states where legislatures have legalized triple-digit interest rates. Of some 12,400 chapter 13 bankruptcy cases pending in Middle Tennessee, 413 show debts to 'payday loan' businesses, records show."[15]

Payday Loan Cost Comparision

To Borrow $200 and Repay in One Month:

Type of Credit	Terms	Finance Charge	APR	Total Payment
Credit Card Cash Advance	19.99% APR No grace period 2.5% Fee $2.50 Minimum	$8.41	50.46%	$208.41
Small Loan Loan	36% APR Cap	$6.00	36.00%	$206.00
Payday Loan	**$17.50/$100 15-day term w/ 1 rollover**	**$70.00**	**457.00%**	**$270.00**

To Borrow $200 and Repay in Three Months:

Type of Credit	Terms	Finance Charge	APR	Total Payment
Credit Card Cash Advance	19.99% APR No grace period 2.5% Fee $2.50 Minimum	$11.86	35.25%	$211.86
Small Loan Loan	36% APR Cap	$12.10	36.00%	$212.10
Payday Loan	**$17.50/$100 15-day term w/ 5 rollovers**	**$210.00**	**457.00%**	**$410.00**

Chart calculated by CFA actuary.

[14] "Short Term Lending Final Report." Illinois Department of Financial Institutions, 1999, p. 31.
[15] Sheila Wissner, "'Payday loans' cited in bankruptcies," *The Tennessean*, April 18, 1999 p.1.

Lenders can and do use coercive collection practices because a personal check is the basis for payday loans. These tactics range from deliberately depositing a check although funds are not available which triggers both the bank's and the lender's bounced check charges, to bringing civil charges for bad check-writing to get triple damages, to threatening or bringing criminal hot-check prosecutions.

Any default on a payday loan, by definition, involves a worthless check. Some state credit laws provide for triple damages when a bad check is used in a retail transaction. Payday lenders in Ohio, for example, sue under the "Civil Damages for Crime Victims" statute O.R.C. §2307.61 which provides triple damages to victims of theft offenses, including bad checks. Inspection of court records in Dayton Municipal Courts Division over eight months in 1999 found 381 actions by five payday lenders. Defaulting customers were charged triple damages, 10% interest on the damages, and court costs. The total dollar amount for the judgments from all 381 cases was $285,406. In 60% of the cases, wages were garnished.[16]

A Tennessee federal judge ruled in 1999 that a check cashing outlet violated the Tennessee consumer protection law by deceptively threatening to prosecute a delinquent customer. The *Turner* court found that the transaction did not involve the passing of a "bad" check since the lender knew the consumer did not have sufficient funds in the checking account when the loan was made to cover the cash advanced.[17] Texas Consumer Credit Commissioner Leslie Pettijohn testified at Senator Lieberman's forum that more than 13,000 criminal complaints were filed in one year in a single precinct in Dallas County by payday lenders.

The Iowa Attorney General provided an informal advisory opinion to guide regulators on this issue.[18] The Colorado Attorney General's "Report of the Uniform Consumer Credit Code Revision Committee" issued in October noted: "In addition, criminal fraud by check provisions do not apply to bounced deferred deposit loan checks since the lender knew at the time the borrower entered into the transaction that the borrower did not have the funds in his or her checking account to pay the loan. The required intent to defraud is lacking."[19] An Ohio court found "egregious conduct" on the part of a collector of a payday loan that violated the Fair Debt Collection Practices Act. The collector identified himself as a police officer and threatened criminal prosecution.[20] The Cook County State's Attorney in Chicago and the Illinois Department of Financial Institutions settled a Consumer Fraud Act case against Nationwide Budget Finance Inc. which was accused of mailing out letters threatening criminal hot check prosecution to consumers behind on their loans.[21]

Consumers trying to make ends meet by getting a quick cash advance on a personal check pay usurious interest rates, often become mired in perpetual debt, and are exposed to coercive collection practices.

STATE LEGISLATIVE ACTIVITY IN 1999 AND PROSPECTS FOR 2000

In September, CFA released a detailed report on payday lending activities in state legislatures in 1999.[22] As the report notes, "the majority of state legislatures grappled with

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[16] Letter, Legal Aid Society of Dayton, Inc., December 21, 1999, describing law student research.
[17] *Turner v. E-Z Check Cashing of Cookeville, TN, Inc.* 35 F. Supp.2d 1042 (M.D. Tenn. 1999).
[18] Iowa Department of Justice, Informal Advisory #87 (Feb. 18, 1999), Clearinghouse No. 52,156.
[19] Laura E. Udis, Administration of the Uniform Consumer Credit Code, "Report of the Uniform Consumer Credit Code Revision Committee, October 8, 1999, p. 22.
[20] Boyce v. Attorney's Dispatch Service, 1999 U.S. Dist. LEXIS 12970 (S.D. Ohio April 27, 1999)
[21] Illinois v. Nationwide Budget Finance, Inc., Final Judgment and Consent Decree, Circuit Court of Cook County, Illinois, December 17, 1999.
[22] See "Safe Harbor for Usury: Recent Developments in Payday Lending," Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, September 1999 <http://www.consumerfed.org/safeharpr.pdf>

legislation impacting the fast-growing payday loan industry in 1999 and legislation to establish minimum standards for state laws was introduced in Congress."

The state by state battle over the legality and limits on payday lending continues as legislatures convene in 2000. As of mid-January, payday loan legislation is filed or expected in a dozen states. Financial regulators in two states, **New Mexico** and **Illinois**, completed required studies of high cost credit and filed reports.

The **Illinois** report on Short Term Lending found a heavy concentration of high cost lenders in heavily populated urban centers. The average APR for payday loans in Illinois was 533% and the average customer earned $25,131 annually, and had 13 loan contracts on file per lender. The report concluded: "the high expense of a short term loan depletes the customer's ability to catch-up, therefore making the customer "captive" to the lender." At least two bills have been filed in Illinois. SB 1275 authorizes short-term loans with no limit on fees or interest. Payday loans may be for up to $500 with two roll-overs permitted if the original outstanding balance has been reduced by 25%. HB 2900 would set a 24% APR rate cap on short-term loans in a state that presently has no usury limits. Representative Poe's bill also requires that advertising must include the annual percentage rate for loans. A third bill is expected from Rep. Thomas Dart.

The **New Mexico** study report concluded that better consumer education was sufficient to address unrestricted payday loan and car title loan rates. A minority statement, filed by AARP and New Mexico Public Interest Research Group, called for a usury cap and tougher consumer protections. No inspection of current payday lenders was conducted for the report.

Legislative battles take up where they left off last year in several states. **California**'s Senator Perata has amended his bill to tighten the terms of California's law permitting payday loans. Key features include a payment plan spread over five paydays, better reporting to state regulators, and application of the fee to the loan amount, not the total check. The California payday loan industry is shopping for an author for their model bill.

Colorado is revamping its Uniform Consumer Credit Code. Senator Dave Owen filed SB 144 to set a 20% fee cap for payday loans with three roll-overs. Under this bill, for a two-week loan, Colorado would permit 520% APR. Currently, under Colorado's UCCC Rule 7 that allows two payday loans outstanding at one time, lenders split a request for a $200 loan into two $100 loans and charge $25 on each for a total finance charge of $50. Under SB 144 filed in Colorado, the effective fee will be higher than current rules permit once the loan principal exceeds $250. This change to a percentage fee cap in Colorado will also provide an incentive to make larger loans, adding to repayment problems for borrowers.

The payday loan industry is trying again in **Indiana** to get a "deferred presentment" bill enacted. SB 287 allows an 18% fee on loans of up to $500 and three roll-overs of loans. Indiana's Attorney General issued an opinion January 19 that raises the stakes for industry legislation. Mr. Modisett opined that payday lenders cannot avoid Indiana's loansharking statute by referring to their charge as a "service fee" rather than interest. Indiana's small loan cap of 36% also applies. A lender violates the loansharking law by charging more than double the regulated rate. Since Indiana payday lenders charge more than 72% APR, the legal status of the industry is under threat under both laws.

Competing bills are filed in **Florida.** The industry's HB 553 would set fees at 15% of the loan, with a $500 maximum loan and a two-roll-over limit. Opponents of payday lending support HB 661 which clarifies that cash advanced on a personal check held for deposit is a small loan transaction, capped in Florida at 30% APR. Florida's money transmitter regulations that open the door for one-time payday loans by licensed check cashers would be overruled by this bill.

Wisconsin held a hearing in November on Senator Robson's SB 96 to impose a 36% APR cap on payday loans. Amendments to SB 96 set a 5% cap on loan fees and on subsequent roll-overs and set a minimum loan period of 30 days. Industry supported Assembly Bill 612 merely requires disclosures such as telling customers that a payday loan should only be used in an emergency, and comparing what it would cost to pay off a loan in full after one pay period with what it would cost after eight rollovers. Rep. Tim Hoven's bill contains no rate caps or other restrictions. (See Section Five for more information about Florida, Illinois, and Wisconsin.)

In **Kentucky**, Representative Jack Coleman is renewing his effort to reign in the payday loan industry. HB 73 as originally filed makes payday lending subject to the Kentucky small loan act. Observers expect the bill to be amended to at least apply the fee cap to the loan, not the total check.

Several states where small loan laws and usury caps prevent triple-digit payday lending will be battlegrounds to legalize this form of credit. Industry bills are expected **in Arizona, Alabama, and Virginia.** Carry over legislation in **Georgia** has been amended to authorize payday loans with a 15% cap on up to $500 loans, with one renewal. Georgia HB 515 sets no minimum loan term and does not prevent serial loans (where the borrower pays off one loan and immediately writes a new check to start over.)

In **Maryland**, consumer advocates are seeking legislation to strengthen enforcement tools and funding for the Financial Commissioner. An opinion from the Maryland Attorney General's office held that payday lending is subject to Maryland's small loan law[23], but little enforcement of Maryland's 33% APR small loan cap has been attempted. Industry legislation to legalize payday loans is expected in Maryland.

Michigan's Attorney General filed a Notice of Intended Action against a national payday loan company in 1999. A public hearing on HB 4808 to legalize payday loans was held in October, but no further action has occurred. The Michigan industry bill would cap fees at 18% of the loan for up to $500 with four roll-overs and serial loans are authorized.

PAYDAY LENDERS PARTNER WITH BANKS TO EVADE STATE LAWS[24]

Partnerships between banks and companies in the fringe banking market are a growing trend in the payday loan field. As an investment advisor newsletter to the industry notes, "we see a trend afoot to utilize some sort of national bank charter lending program to permit the product in states that are unwilling to act on legislation to allow the product."[25] One such partnership between a national bank in Pennsylvania and the nation's second largest chain of check cashers is being challenged in a national RICO class action suit filed in federal court in Los Angeles. The *Phanco* case alleges that Eagle National Bank has "rented" its national bank charter to allow Dollar Financial Group's check cashing outlets to circumvent otherwise applicable state law restrictions.[26] Eagle is making payday loans in at least three states, Arizona, Texas and Virginia, where these loans are illegal for state-licensed lenders. The *Phanco* case also alleges that Eagle makes loans that do not comply with state payday loan laws, such as California's.

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[23] Rowe, Kathryn M., Assistant Attorney General, Letter to The Honorable Thosmas L. Bromwell, November 24, 1999.

[24] This section adapted and updated from "Safe Harbor for Usury."

[25] Stephens, Inc. "The Emerging Business of Deferred Presentment," April 1, 1999, p. 6.

[26] Phanco v. Dollar Financial Group. Case No. CV99-1281 DDP (C.D. Cal., filed Feb. 8, 1999).

The legal theory underlying the use of national banks to make payday loans is "exportation." As currently interpreted, a 1978 Supreme Court decision is being used to argue that banks with certain kinds of privileged charters are able to ignore the usury laws in the borrower's home state. By chartering the bank in a deregulated state, the bank claims the right to export its home state's lack of regulation all across the country irrespective of whether their practices would be illegal for payday lenders in the borrower's home state.

Texas's Consumer Credit Commissioner testified in mid-December that "There is no judicial precedent that directly supports this concept of using the theory of exportation of interest rates to make payday loans."[27] When banks market credit cards nationally, consumers deal directly with the bank in response to card offers. In payday lending, the consumer only contacts the local outlet, such as a pawn shop or check casher, to apply for and receive the loan.

In a letter[28] to the nation's chief national bank regulator, Comptroller of the Currency John Hawke, CFA, U.S. PIRG, Consumers Union and other consumer organizations noted that Eagle's activities appear to violate the intent of the Riegle-Neal Act. A central premise behind interstate banking as allowed by Riegle-Neal was that national banks would comply with state laws. The Conference Report[29] noted "utmost concern" for the ability of states to protect its citizens. The letter charged that Eagle's use of its bank charter to export its activities without regard for state law ignores Riegle-Neal.[30]

On 30 November 1999, the Comptroller replied that although "payday loans raise significant consumer protection concerns," he believes that "In the final analysis, there may, practically speaking, be little that bank regulators can do to eliminate abusive payday lending practices that comply with existing law." Hawke takes the view that national banks, and state banks, may "export their home state interest rates and other finance charges" and that his agency, the OCC, "simply does not have the authority to set maximum interest rates." The Comptroller concludes that instead of OCC action on national bank participation in payday lending, the solution is "consumer education."

The **Pennsylvania** Attorney General condoned the use of national bank charters to circumvent Pennsylvania's Consumer Discount Company Act in settling a case involving McKenzie Cash Advance, the Cleveland, Tennessee-based company which operates two payday lending chains in that state. Instead of agreeing to cease making loans in violation of Pennsylvania's small loan act as other payday lenders have done, National Cash Advance agreed to affiliate itself with a federally insured financial institution and to register as a Pennsylvania loan broker.[31] National Cash Advance uses Crusader Savings Bank, a federally chartered thrift in Philadelphia, to make loans that would otherwise be illegal under Pennsylvania's small loan act.[32] Pennsylvania banks are exempt from small loan laws and there is no limit on fees that Pennsylvania banks may charge for loans.

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[27] Pettijohn, Leslie, Texas Consumer Credit Commissioner, Testimony for Senate Forum on Payday Lending, December, 1999.

[28] For a copy of the 27 July 1999 letter, see < http://www.stopatmfees.com/newpage61.htm>

[29] Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, H.R. Conf. Rep. No. 651, 103rd Cong., 2d Sess., at 53 (1994)

[30] California Reinvestment Committee, Consumer Federation of America, Consumers Union, Greenlining Institute, National Community Reinvestment Coalition, National Consumer Law Center, U. S. Public Interest Research Group, Woodstock Institute, Letter Re: Eagle National Bank and "Payday Loans," Addressed to The Honorable John D. Hawke, Jr., Comptroller of the Currency, July 27, 1999.

[31] Press Release, Attorney General Mike Fisher, Pennsylvania, April 22, 1999.

[32] www.nationalcashadvance.com

Comments filed with Treasury by Consumer Federation of America and the National Consumer Law Center in an Advance Notice of Proposed Rulemaking proceeding indicated that banks are partnering with check cashers, pawn shops, and other fringe bankers to provide "voluntary" EFT'99 accounts through which the federal government can electronically distribute federal benefits to recipients. An informal survey of accounts across the country noted that these entities were expecting to make payday loans to federal recipients, secured by anticipated deposit of social security checks and other benefits.[33]

A start-up bank applied in 1999 for a Delaware bank charter to provide nationwide electronic banking, including payday loans. Axcess Bank plans to "only" charge 200% interest for advances secured by anticipated deposits of social security benefits as one of several account options for unbanked or underbanked consumers[34]. The Delaware Community Reinvestment Action Council expressed concerns about Axcess Bank's planned high-cost payday loans at a public hearing before the Delaware Bank Commissioner although the bank organizers offered some concessions in the design of the overdraft loans.[35]

On 15 December 1999, US Senator Joseph Lieberman (D-CT) held a public forum on payday lending. In that event, Lieberman called the doctrine of interest rate exportation "wrong."[36] Other bank/payday lender partnerships mentioned at the Lieberman forum include Utah-chartered industrial loan company Web Bank, Banco Popular which makes payday loans through Texas check cashing outlets, Goleta National Bank of California (partnership with Ace Cash Express), and County Bank of Delaware (Fast Cash Funding, Cash Reserve, and the now-defunct Delaware Bank Card).

Other Consumer Banking Preemption Battles: Lifeline Checking and ATM Surcharge Bans: The doctrine of interest rate exportation is one area where national banks and the OCC are abusing stronger state consumer laws. National banks, supported by the OCC, have also used other preemption theories in their efforts to ignore state low-cost lifeline banking laws. Although in 1995 the OCC announced, as required by Riegle-Neal, that it was reconsidering its preemption of the 1992 New Jersey Checking Account law, it has failed to act further and its preemption determination remains in place. More recently, national banks and the OCC have mounted vigorous opposition to the enforcement of state and local ATM surcharge bans, despite the lack of federal regulation on either matter and clear language in the Electronic Funds Transfer Act allowing states to regulate ATM fees.[37] In our view, it is especially critical that the several states retain the authority to protect their consumers better, in circumstances such as these where the federal government has failed to protect them at all.

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[33] Comments to the Treasury on ANPRM 31 C.F.R. Chapter II RIN 15055—AA74, National Consumer Law Center, Consumer Federation of America, et.al. April 1999.

[34] Epstein, Jonathan, "Banks for non-bank account working people," Wilmington News-Journal, June 24, 1999.

[35] Epstein, Jonathan, "Axcess Bank gains support for plans," Wilmington News-Journal, July 7, 1999.

[36] "However you feel about payday lending, this legal two-step around state law is wrong, and I'd like to examine ways to prevent it." Statement of Sen. Joseph Lieberman, 15 Dec 99, <http://www.senate.gov/member/ct/lieberman/general/r121599b.html>

[37] For detailed analysis of preemption issues pertaining to the OCC, see PIRG's "OCC Watch" web page at <http://www.stopatmfees.com/toppage3.htm>

SECTION 5: INFLUENCE PEDDLING BY HIGH COST LENDERS
Legislative Activities of Payday Lenders In 1999
In Florida, Illinois, and Wisconsin

Finally, this section of "Show Me The Money" looks in greater detail at the legislative activities of payday lenders in 3 states that were active battlegrounds in the last year.

CASE STUDY—FLORIDA

Despite Florida's Consumer Finance Act, which has a small loan interest rate cap of 30%, payday lenders, with their triple- and quadruple-digit interest rate figures, are operating there.[38] Here's how it works: while state law caps the annual interest chargeable on loans of less than $2000 at 30%, licensed check cashers are permitted to charge up to 10% of a check's face value to cash a personal check, along with an additional $5 fee for "verifying identity."[39] Therefore, Florida payday lenders have chosen to dub their service check cashing, advancing money on post-dated checks at up to 419% APR, more than 13 times the legal interest limit for small loans.

Where the distinction between check cashing and payday lending occurs, Comptroller Bob Milligan feels, is when the loan is rolled over and a loan transaction is indicated.[40] When payday lenders in Florida allow rollovers, Milligan deems them to making loans without a license, not cashing checks. "He's between a rock and a hard place, between what consumers need and what they can get," says Sunny Phillips, in reference to the lack of quick cash options.[41]

Although payday loans are made in Florida through a Comptroller's regulation for money transmitters, the industry wants a "deferred presentment" law to remove any legal uncertainty and to authorize higher rates and roll-overs. Payday lenders in Florida last year began to flex their moneyed muscles to win such a law. Along with the check cashing industry, they contributed at least $50,000 to legislators in the 97/98 cycle,[42] and hired a stable of well-connected lobbyists, including James Bosser, former fundraiser for Florida Gov. Jeb Bush turned lobbyist for payday lender Advance America. Check Into Cash, which didn't even have any offices in Florida, hired lobbyists including S. Curtis Kiser, former state senator, James Daughton, former assistant chief of staff for Gov. Lawton Chiles, Sam Choate, a prominent lobbyist nationally on the rent-to-own industry, and Martha Barnett, president-elect of the American Bar Association.[43]

With the help of these lobbyists, the payday loan industry did its best to get legitimacy in the 1999 legislative session. House Bill 2127 and its companion bill, Senate Bill 2294, would have specifically allowed payday lending in the state at interest rates of 15-20% per loan period, translating into annual interest rates of 391% and higher.

In efforts to pass these bills during the first four months of 1999, payday lender lobbyist Robert Levy of the Florida Check Cashers Association reported lobbying expenditures of $9,500.

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[38] Florida Consumer Finance Act, Florida Statutes Chapter 516.
[39] Money Transmitters' Code, Florida Statutes Chapter 560
[40] Conversation with Sunny Phillips, Legislative Director for Florida State Comptroller Bob Milligan, August 6, 1999. Also, see Dyckman, Martin. "Loan Sharks, Then and Now," *St. Petersburg Times*, April 25, 1999, page 3D.
[41] Conversation with Sunny Phillips, Legislative Director for Florida State Comptroller Bob Milligan, August 6, 1999.
[42] According to campaign contribution records available online from the Florida Division of Elections at: http://election.dos.state.fl.us. Also, see "Feeding Frenzy," *The Orlando Sentinel*, April 1, 1999.
[43] According to lobbyist registration records available online from the Florida Legislative Information Services Division, Lobbyist Registration Office at: http://www.leg.state.fl.us

This amount, spent in the first four months of 1999 alone, is more than he reported spending in the entire years of either 1997 or 1998.[44] However, both bills died in committee.

In the House, once state Rep. Bob Starks persuaded the House Financial Services Committee to amend HB 2127 to limit the interest rate cap on payday loans to 10% of the check's face value[45], the industry lost interest in supporting the bill, saying that it then "did nothing" for them.[46] In the Senate, Sen. Walter Campbell postponed action on his bill, saying that it still needed too much work.[47] Sen. Campbell, who is known for being consumer-friendly, reportedly dropped the bill because he realized the extent of the damage it would do to consumers.[48]

Fortunately for consumers, this was not a good session for the payday lenders to try to get legitimacy. The 1999 session was rife with controversy over another form of fringe lending—auto title pawn lending.[49] The *Orlando Sentinel*, hometown newspaper for both State Rep. Sublette, who is very active in working to regulate title lending, and Senate President Toni Jennings, ran editorials almost every single day on the fringe lending industry's habit of preying on the poor.[50] So, the payday lenders did not find a sympathetic ear for their argument that 391-591% interest annually was an appropriate small loan interest rate.

In 1999, the Florida legislature did not enact legislation sanctioning payday lending.

CASE STUDY-ILLINOIS

In Illinois, even Benny the Bull is getting in on payday lending.

The popular Chicago Bulls mascot has appeared in newspaper advertisements promoting the grand opening of eight new Chicago locations of the national payday lender chain Check Into Cash. When questioned about the arrangement, a spokesperson for the Bulls called Check Into Cash a "sponsor" of the team.[51]

In Illinois, payday lending by licensed lenders occurs in the absence of an annual interest rate cap on small loans. State law says that creditors lending under $10,000 can charge any interest rate to which both parties agree, and while the state has criminal usury laws prohibiting the charging of excessive interest, licensed lenders in the state are exempted from these laws.[52] Before 1997, there were few such lenders in the state; as of April 1999, there were more than 400, and the numbers continue to grow.[53]

In 1998, the state Department of Financial Institutions established a task force to study the fast-growing payday loan industry. However, consumer-friendly participants were noticeably

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[44] According to lobbyist expenditure records obtained from the Florida Legislative Information Services Division, Lobbyist Registration Office.

[45] The standard the payday lenders were already operating under using the state's check cashing laws.

[46] Gelbart, Marcia. "House Panel Tightens Payday Lending Bill," *The Palm Beach Post*, April 14, 1999, page 13A. Also, see Dyckman, Martin. "Loan Sharks, Then and Now," *St. Petersburg Times*, April 25, 1999, page 3D.

[47] Pfankuch, Thomas. "Lawmaker Kills Payday Loan Legislation," *The Florida Times-Union*, April 21, 1999, page B-3.

[48] Conversation with Mark Ferrulo, Florida Public Interest Research Group, July 27, 1999.

[49] For a detailed survey of auto title pawn lending, see the 1998 Florida PIRG title pawn survey. http://www.pirg.org/floridapirg/consumer/loan98.htm PIRG is preparing a detailed report on title pawn lending nationally.

[50] Conversation with Mark Ferrulo, Florida Public Interest Research Group, July 27, 1999.

[51] Coffey, Raymond. "Even Benny in on Payday Loan Act," *Chicago Sun-Times*, March 23, 1999, page 31.

[52] Bakke, Dave. "Lawmakers Studying Payday Loans," *The State Journal-Register*, March 29, 1999, page 1.

[53] According to May 1999 list of all Consumer Installment Loan Act licensees, obtained from the Illinois Department of Financial Institutions by Dan Edelman.

absent—while there were 20 industry representatives present, no consumer advocates were allowed a voice in the proceeding.[54] When the law firm Edelman and Combs discovered the task force, it sought to be included as consumer representatives. Edelman and Combs refused the Department of Financial Institutions' participation conditions, and sued under Illinois' open meetings law. While the suit was initially rejected, when the attorneys appealed the ruling the Department disbanded the task force rather than include non-industry voices in the task force.[55] .

In late 1998, release of a survey of lender practices conducted in the state by the Illinois Public Interest Research Group and the Champaign-Urbana Predatory Lending Coalition, in conjunction with the release of a Consumer Federation of America report on the payday loan industry, created a storm of media coverage on the issue.[56] The Coalition picketed the grand opening of Campus Cash near the University of Illinois. Legislators began to respond. State legislators, such as Rep. Thomas Dart and Sen. Patrick O'Malley, chair of the Senate Financial Institutions committee, started to speak up about payday lending, and the industry was listening.

The payday loan and check cashing industry gave candidates around $163,000 in just part of the 97/98 election cycle, almost double what they gave in the entire 95/96 cycle and wanted some results for their money.[57] When Rep. Thomas Dart introduced HB 2704 in early 1999 to cap annual interest on payday loans at the prime rate, the industry sprang into action.

In 1999, the payday lending and check cashing industries had 13 lobbyists registered in the state.[58] This stable included such well-connected persons as a former House Majority Leader Gerald Shea, a judge of the Illinois Court of Claims, Andrew Raucci, a former U.S. Attorney, Anton Valukas, and a former county State's Attorney, Dallas Ingemunson.

While Rep. Dart's bill was in the House Consumer Protection & Product Regulation committee, it became obvious to him that it was doomed. "The industry had bottled up the committee to the point where the bill wasn't going to get anywhere," Dart says. The industry had, with the help of their 13 lobbyists, "reached" the leadership of the House and Senate. Industry lobbyists paid a visit to Dart as well, [59] pleading that his bill would effectively shut down their industry. While Rep. Dart says he had no intention of retaining the amendment once HB 2704 reached the floor, he worked with the industry on an amendment that completely changed the character of his bill. This industry amendment allowed charges of up to 20% of the face amount of the loan, resulting in an annual percentage rate "cap" of 520%, and allowed three consecutive rollovers of the loan.[60]

Consumer groups quickly met with Rep. Dart after they heard about industry amendments to HB 2704 to determine what had happened to the consumer-friendly version of the bill.[61]

After meeting with the consumer coalition, Rep. Dart withdrew HB 2704 and introduced House Resolution 164, creating a House commission to "conduct a study of the business of

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[54] Conversation with Dan Edelman, Edelman & Combs, August 3, 1999. See also, Coffey, Raymond. "Payday Loan Places Proliferate," *Chicago Sun-Times*, March 5, 1999.
[55] Conversation with Dan Edelman, Edelman & Combs, August 3, 1999.
[56] "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry," Consumer Federation of America, November 1998.
[57] According to campaign contribution records available from the Illinois Campaign for Political Reform website at: http://www.ilcampaign.org.
[58] According to lobbyist registration records available from the Illinois Secretary of State Index Department at: http://www.sos.state.it.us/depts/index/division.html.
[59] Conversation with Illinois State Representative Thomas Dart, August 3, 1999.
[60] Amendment #1 to House Bill 2704.
[61] Conversation with Gail Parsons, Illinois Public Interest Research Group, August 4, 1999.

making payday loans." According to the Representative, he preferred the weight of a commission behind the idea of payday lending reform, as opposed to just his name as a sponsor. Dart also expressed concern about repercussions in the future if the industry form of the bill passed, making him the instigator of the Illinois government's sanctioning of payday lending practices in the state.[62] Starting in the summer of 1999, hearings have been held in different parts of the state as part of the House commission set up by House Resolution 164. Representative Dart is preparing the final report from the hearings and has filed a shell bill for this legislative session. Meanwhile a coalition has emerged in Chicago that is concern with the payday loan industry. Chaired by Monsignor John Egan, the coalition is composed of consumer groups, governmental agencies, religious organizations, university officials and consumer lawyers.

In the Senate, Sen. O'Malley, chair of the Senate Financial Institutions Committee, introduced a similar resolution, SR 42, which ordered the Department of Financial Institutions to study payday lending, and report back to the Senate. As reported in Section 4 above, The Illinois report on Short Term Lending found a high concentration of short term lenders in heavily populated urban centers. The average APR for payday loans in Illinois was 533% and the average customer had 13 loan contracts on file per lender. The report concluded: "the high expense of a short term loan depletes the customer's ability to catch-up, therefore making the customer "captive" to the lender."

At least two bills have been filed in Illinois in 2000. SB 1275, introduced by Senator O'Malley, authorizes short-term loans with no limit on fees or interest. HB 2900, introduced by Represeniatives Poe and O'Connor, would set a 24% APR rate cap on short-term loans in a state with no usury limits.

Alderman Toni Preckwinkle of the 4th ward of Chicago, has moved forward with other actions to take on the industry, which she believes has a disproportionate negative impact on her district. On 29 September 1999, Preckwinkle and The Illinois Consumer Justice Council, Inc. filed suit against the Director of the Illinois Department of Financial Institutions to invalidate a secret Department of Financial Institutions rule that permits payday lenders to accept postdated checks. Preckwinkle also won passage of a city zoning ordinance that changed the zoning classification of payday lenders to a special use designation which allows the alderman to hold a hearing when a payday lender wants to open up in a ward.

The City of Chicago government has also weighed in on the payday loan issue with the city's suit against the Payday Loan Store of Illinois, the first suit of its kind. The city alleged that the Payday Loan Store failed to comply with Illinois lending laws when the store failed to disclose the annual percentage rates for its loans.[63] The case, being pushed by Department of Consumer Services Commissioner Caroline Shoenberger, is in settlement negotiations.[64]

Encouragingly, the state legislature did not enact industry-supported legislation in 1999. The results of the Short Term Loan report point to the need for consumer-oriented reform in 2000.

[62] Conversation with Illinois State Representative Thomas Dart, August 3, 1999.
[63] Manor, Robert. "City Sues Payday Loan Firm," *Chicago Sun-Times*, February 19, 1999, page 52.
[64] Personal communication, Gail Parson, Consumer Advocate, Illinois PIRG, 18 Jan 2000.

CASE STUDY—WISCONSIN

"The payday lenders are literally moving in by the day here," says Wisconsin PIRG director Kerry Schumann. "We're watching it happen."[65]

There were 17 payday lenders in the state of Wisconsin in January 1996. A little over a year and a half later, in August 1997, the number had grown more than tenfold,[66] and as of July 1999, there were almost 200 payday lenders in the state.[67]

All this growth is the result of the lack of a small loan interest rate cap in the state. Because the interest rates they can charge are not limited by law, payday lenders thrive at rates of 438% and higher.[68] State regulators limit Wisconsin pawnbrokers to an interest rate no greater than 36% annually,[69] According to Jean Plale of the state Department of Financial Institutions, in 1998 alone, payday lenders in Wisconsin made 630,300 loans totaling more than $147 million, an astronomical leap from the 1996 figures of 80,000 loans totaling $11.2 million.[70] In December 1998, two class action lawsuits were filed in Wisconsin against two of the country's largest payday lenders--the national chains The Cash Store and National Cash Advance.[71] As of June 1999, the number of plaintiffs in the suit against the Cash Store was up to about 10,000.[72] Lawyers for the Center for Public Representation, who, along with the Legal Aid Society of Milwaukee and a Madison law firm, filed the suit, said that payday lenders in the state were taking advantage of the poorest and the most vulnerable consumers.[73]

In failing to disclose in a conspicuous manner the 500% plus annual percentage rate on loans made to consumers, the suit said, the payday lenders violated state and federal law. The suit also alleged that because of the plaintiffs' inability to do anything but agree to the lenders' unreasonable terms, the contracts between the lenders and the plaintiffs were unconscionable.[74]

In the case against National Check Advance, the Eastern District federal court upheld the state law unconscionability claims, paving the way for class certification. The Cash Store case was settled.

One week after the filing of the lawsuits, state Representatives Tim Hoven and Dean Kaufert publicly announced that they would be looking into ways consumers could be protected from the perils of payday loans. The representatives did not propose a small loan interest rate cap to protect borrowers from usurious rates, but simply called for "education" of consumers and perhaps a limit on the number of loans a consumer could take out at one time.[75]

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[65] Conversation with Kerry Schumann, Executive Director of Wisconsin PIRG, July 1999.
[66] "'Payday Loan' Companies Increasing in State," *Wisconsin State Journal*, August 22, 1997, page 8B.
[67] Conversation with Lisa Lee, Wisconsin Department of Financial Institutions, July 9, 1999.
[68] According to survey conducted by Wisconsin PIRG for U.S. PIRG.
[69] Pommer, Matt. "Special Interests Skirt Finance Laws; Cash Poured Into State Races," *Capital Times*, April 1, 1999, page 4A. Also, Romell, Rick. "Filling a Need," *The Milwaukee Journal Sentinel*, February 6, 1996.
[70] 1998 figures obtained from message left by Jean Plale in response to request for information. Also, 1996 figures from: Segall, Cary. "More Control Sought Over Payday Loan Companies," *Wisconsin State Journal*, December 26, 1998, page 1A.
[71] Segall, Cary. "More Control Sought Over Payday Loan Companies," *Wisconsin State Journal*, December 26, 1998, page 1A.
[72] Segall, Cary. "Joint Suit filed vs. Loan Firm," *Wisconsin State Journal*, June 3, 1999, page 1B.
[73] Segall, Cary. "Suit Accuses Wisconsin Loan Companies with Excessive Interest Rates," *The Wisconsin State Journal*, December 23, 1998.
[74] Segall, Cary, "Lawsuits Seek to Stop Two Companies that Make 500 Percent Loans to Poor," *The Wisconsin State Journal*, December 22, 1998, page 1A.
[75] Segall, Cary. "More Control Sought Over Payday Loan Companies," *Wisconsin State Journal*, December 26, 1998, page 1A.

Not surprisingly, Hoven and Kaufert's pledge was not received enthusiastically by industry representatives like Pat Essie of the Wisconsin Deferred Deposit Association, the state's payday lender lobbying group. Citing the high cost of making short-term, unsecured loans, Essie touted the usefulness of such a "service," and said that the interest rates charged are reasonable.[76]

Rep. Hoven received at least $1900 from the payday loan industry in the 1997/98 cycle. Only $500 of this money was from an in-state contributor; the rest was from out-of-state national chains like The Cash Store[77]—the very same payday lender being sued in the class-action suit that supposedly inspired Hoven's ire. Asked about this seeming contradiction in Hoven's words and his actions in receiving money from the industry, research assistant Michael Welsh said, "It's a business, and he understands that."[78]

Representative Hoven introduced Assembly Bill 612, legislation on payday lending, in the fall of 1999. Components of the bill include a four or five time rollover limit, as well as several "education" measures such as a pamphlet drafted by the state Department of Financial Institutions that would be handed out to payday borrowers. What the bill will not do is cap the exorbitant interest rates—upwards of 400%—that payday lenders are charging in the state.[79]

On January 19, 2000 the Assembly Financial Institutions Committee held a hearing on AB 612. It quickly became apparent that AB 612 was an industry measure, shown by the number of industry lobbyists and spokespeople who turned out to support the bill. Consumer advocates testified in opposition to the bill, calling it a bill that "did nothing to address the real problem of the payday lending industry: exorbitant interest rates." Throughout the hearing, consumer advocates were verbally attacked repeatedly by members of the committee. Even a witness who came to tell her story about being in debt to lenders for two years was badgered by members of the committee.

A stronger effort to regulate the industry was presented in April 1999 in the form of Senate Bill 96, introduced by state Sen. Judy Robson. The bill originally placed a 26% interest rate cap on payday loans, a huge decrease from the rate of 520% currently charged by many lenders in the state.[80] Far from a death knell for the industry, Robson says, "I assume someone could do very well [at 26%]."[81] Early on, SB 96 was amended to set a 36% cap in an attempt to compromise with the payday industry. However, the industry continued to oppose SB 96.

Currently, SB 96 is in the Financial Institutions committee, which held a public hearing in late 1999. After that hearing, Senator Jon Erpenbach, Committee Chair, revised the bill again in an attempt to make it less objectionable to the payday industry. Consumer advocates supported those changes, but considered the bill much weaker than the original 26% interest rate cap. In recent conversations with Senator Erpenback's office, the Center for Public Representation was told that Erpenback planned to compromise the bill again. At this point, according to WISPIRG's Kerry Schumann, "As advocates for the public we can't support legislation that does not cap interest rates at a reasonable rate. If SB 96 is compromised any further, it will no longer have the teeth to protect consumers." Both the President of the Senate and the state Attorney General are on record supporting the original version of SB 96. Groups

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[76] Segall, Cary. "More Control Sought Over Payday Loan Companies," *Wisconsin State Journal*, December 26, 1998, page 1A

[77] Data from the Wisconsin Democracy Campaign, www.wisdc.org.

[78] Conversation with Michael Welsh, Wisconsin state Representative Timothy Hoven's office, July 20, 1999.

[79] Conversation with Wisconsin state Representative Timothy Hoven, July 20, 1999.

[80] Pommer, Matt. "Special Interests Skirt Finance Laws; Cash Poured Into State Races," *Capital Times*, April 1, 1999, page 4A.

[81] Squires, Susan. "Wisconsin Lawmaker Wants to Cap Interest on Payday Loans," *The Post-Crescent*, April 13, 1999.

like AARP, Wisconsin PIRG, the Center for Public Representation, and the Wisconsin Bar Association's Public Interest Section are supporting the bill; however, industry representatives have made it known that they are drafting their own legislation. Not surprisingly, the industry legislation is not expected to include an interest rate cap.[82]

CONCLUSION AND RECOMMENDATIONS FOR CONSUMERS:

The growth of the payday lending industry over the last several years has resulted in increased public scrutiny of its practices. The findings of this report provide a blueprint for state governments and the Congress to fight back against usurious payday lenders and, ideally, roll back some of the gains they have made in legislatures around the country. It is also critical that Congress, even if it does not enact the Rush legislation to set minimum state standards for payday lending, force the OCC to revoke the perceived ability of banks to participate in payday lending in defiance of state law. Congress can close the national bank loophole by either enacting a federal usury law or by prohibiting FDIC-insured financial institutions from making payday loans.

In addition, we urge public policymakers to be forewarned that another high-cost, predatory lending industry is beginning to flex its muscles to enact similar legislative safe harbors for its practices. In many ways, the auto title pawn industry, which offers similar small loans secured not merely by a check but by the title to your car (and often a copy of the keys), offers a greater threat to low-income consumers than even the payday lenders.

PIRG and CFA recommend that cash-strapped consumers avoid the high costs and risks of using payday loans. Consumers with short-term cash needs should try to solve their immediate problems without borrowing money, such as asking for more time to pay a utility bill. If a loan is unavoidable, shop for the lowest cost credit available, comparing both the dollar finance charge and the Annual Percentage Rate. Cash advances on credit cards and traditional small loans are less expensive than a typical payday loan. Consumers with on-going financial problems can seek help with budgeting and debt management from local non-profit consumer credit counseling agencies or their credit union. Payday loan customers should only borrow what they can afford to repay on their next payday without having to borrow again before the next paycheck arrives.

[82] Conversation with Kerry Schumann, Executive Director of Wisconsin PIRG, July 19, 1999.

APPENDIX 1: STATUS OF STATE PAYDAY LENDING LAWS (1 page)

APPENDIX 2: SURVEY OF PAYDAY LENDERS (10 pages)

METHODOLOGY

In the summer and fall of 1999, state PIRGs and CFA members surveyed 25 states by telephone, calling check cashers, small loan companies and payday lenders listed in local phone books. 230 payday lenders were identified in 19 states and DC. No payday lenders were found in the other 6 states surveyed (MA, NH, NJ, NY, RI and VT). No conclusions can be made about payday lending in the other 25 states, which were not surveyed due to lack of resources.

Surveyors asked questions that consumers shopping for deals would ask and sought rate quotes on payday loans. Many lenders were evasive and some hung up the phone. It was particularly difficult for surveyors to obtain information about whether the store allowed roll-overs and how roll-overs work. Lenders were also evasive about their partnerships with banks.

PARTICIPATING PIRGs and CFA STATE AND LOCAL ORGANIZATIONS

AZ-Arizona Consumers Council and US PIRG;
CA-California PIRG;
CO-Colorado PIRG;
DC-US PIRG:
FL-Florida PIRG;
GA- US PIRG;
IL-Illinois PIRG;
LA-US PIRG
MD-MARYPIRG and Womens' Law Center of Maryland;
MN-Minnesota PIRG;
MO-Missouri Credit Union System and Missouri PIRG;
MT-Montana PIRG;
NC-North Carolina PIRG and North Carolina Consumer Council;
NM-New Mexico PIRG;
OH-Ohio PIRG;
OR-Oregon State PIRG;
PA-Mercer County Community Action Agency and Pennsylvania PIRG;
TN: CFA and US PIRG;
VA-Virginia Citizens Consumer Council;
WI-Wisconsin PIRG.
[Also surveying, with no payday lending identified: Massachusetts PIRG (MA, NH, RI), New Jersey PIRG, New York PIRG and Vermont PIRG.

APPENDIX 1
Status of State/Territory Payday Loan Law[83]

CATEGORY 1: States that prohibit payday loans due to small loan interest rate caps, usury law, and/or specific prohibitions for check cashers (19 states, PR, VI)

Alabama[84]	Alaska	Arizona	Connecticut
Georgia	Indiana[85]	Maine	Maryland[86]
Massachusetts	Michigan[87]	New Jersey	New York
North Dakota	Pennsylvania	Puerto Rico	Rhode Island
Texas	Vermont	Virginia	Virgin Islands
West Virginia			

CATEGORY 2: States that permit payday loans: no small loan rate cap or usury limit / min. finance charge (8 states)

Delaware	Idaho	Illinois	New Hampshire
New Mexico	Oregon	South Dakota	Wisconsin

CATEGORY 3: States with specific payday loan laws or regulations that permit payday loans (23 states and DC)

Arkansas	California	Colorado	Florida[88]
Hawaii	Iowa	Kansas	Kentucky
Louisiana	Minnesota	Mississippi	Missouri
Montana	Nebraska	Nevada	North Carolina
Ohio	Oklahoma[89]	South Carolina	Tennessee
Utah	Washington	Wyoming	District of Columbia

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[83] Source: Consumer Federation of America, January 2000.

[84] Loans currently permitted under terms of court injunction in case pending between Alabama Banking Department and the Alabama Check Cashers Association. .

[85] Opinion issued by Attorney General Jeffrey A. Modisett, January 19, 2000 found that lenders violate Indiana law when they offer supervised loans at finance charges that exceed Indiana's 36% APR limit and violate loansharking statute if lender charges an interest rate greater than twice the authorized finance charge in the consumer credit code.

[86] Maryland Office of Attorney General issued an opinion November 24, 1999 to Senator Bromwell finding that payday lending is subject to Maryland small loan law that caps interest on loans under $6,000 at 33% APR.

[87] Michigan Financial Institutions Bureau has stated that companies are not required to be licensed under the Regulatory Loan Act if they charge no more than 7% per annum interest plus the check casher's fee for cashing personal checks. Check cashing rates are not regulated in Michigan. The Michigan Attorney General filed a Notice of Intent to take action against a stand-alone payday lender in late 1999.

[88] Florida money transmitter regulations permit licensed money transmitters to cash post-dated checks at same fee as cashing personal checks. Roll-overs or extensions of loans violate Florida usury and/or consumer finance act.

[89] Oklahoma permits loans of under $101.97 as single-pay one-month loans. Any loans for $102 or more have a minimum term of 60 days.

Utilities And Payday Lenders: Convenient Payments, Killer Loans,
A Report by the National Consumer Law Center Written and researched by:
Rick Jurgens, Consumer Advocate (June 2007)

Utility services – light, heat, a telephone – are necessities of life. Paying bills for those services are everyday transactions for many consumers.
But each transaction that occurs in a payday lending store has the potential to bring an unwary or vulnerable utility customer with an urgent need for money face to face with a "sympathetic" agent paid a commission to sell an ultra-high-cost loan. A payment choice made for convenience could be the first step on a path to crippling debt.

♣

Utility regulators should ensure that customers are not directed to high-cost lenders to pay bills for heat, light or telephone service. Financial regulators should ensure that payday and other ultra-high-cost lenders don't use bill payment services to market predatory loans. And utilities should work to ensure that their customers do not resort to predatory payday loans in order to come up with the money needed to pay bills.

♣

Breaking the chain of transactions that link utilities to payday lenders is a task that belongs on the agendas of advocates working to protect the interests of low income
utility customers as well as those working to oppose predatory lending. In an era when many regulators have embraced an ideology of deregulation and lean over backwards to be friendly to business, it will require concerted and persistent action by advocates and public support to end this potentially abusive practice. (.p 4)

CONSUMER ACTION

Stop payday loans at utility bill payment centers
Support State Assembly Bill 2511

Low income consumers living paycheck to paycheck often pay their utility bills in cash and go to check cashing outlets to make payments. But using these services can result in huge fees that put consumers at further risk of not being able to pay their bills.

Now California Assemblywoman Salas has introduced Assembly Bill 2511 which would phase out the use of payday lenders and check cashers in order to pay utility bills, specifically for gas and electric bills.

California utilities have regularly been referring their customers to payday lenders for the payment of their utility bills. Unfortunately, this has led to situations where economically vulnerable individuals have been seduced into securing payday loans to pay their bills. This can begin a cycle of debt that adds to families' money management problems and make it even harder to pay their bills

Instead of directing utility customers to high-cost lenders to pay their utility bills, the utilities should provide their customers with safe and authorized payment locations. This will help ensure that they are not tempted to resort to predatory payday loans. Financing utility payments at the exorbitant rates (400% or more) charged by payday lenders only increases the burden of debt.

Other states (notably Arizona) have taken action to ensure that predatory payday lenders are not used utility bill payment sites.

AB 2511 would require that utilities should stop contracting with payday lenders as payment centers and develop alternate authorized payment locations. Each utility would be required to submit a report to the California Public Utilities Commisson (CPUC) every six months with the number of payday lenders in their authorized payment location network. The reporting would continue until all payday lenders have been removed from their network. The utilities would be required to complete the transition to non-payday lenders by Jan. 2, 2011.

Tuesday, August 05, 2008

A Victory Over Predatory Payday Lending (by Tom Allio)

The people of Ohio won a big victory over the predatory payday lending industry this June when a new state law banned the sky-high interest rates that had trapped many poor Ohioans, as Tom Allio describes in the August issue of Sojourners. Below, Allio, who is chair of the coalition of faith-based consumer, labor, and human services groups that won the June law, describes the ongoing fight against the industry's attempts to reverse the law.

The payday lending industry is intent on rolling back the consumer-protection legislation promoted by the Ohio Coalition for Responsible Lending (OCRL), which was signed into law on June 2 by Gov. Ted Strickland. The industry is seeking two ballot initiatives for the November election. One would completely overturn H.B. 545. The second initiative would eliminate the central section of the bill, which prevents payday lenders from charging exorbitant interest rates -- rates that amount to an astounding 391 percent APR for the typical two-week loan. And, as OCRL spokesman Bill Faith put it, "The industry is now using high-priced lawyers and misleading language to mask its efforts to legalize 391 percent interest." The misleading language is in the "summaries" of the referendums -- the words that payday lenders asked to use when gathering petition signatures to get their referendums onto November's ballot. The industry's wording, which was neither clear nor concise, omitted information about key consumer protections -- and did not even mention that both the referendums would repeal the 28 percent interest-rate cap that is the centerpiece of this June's anti-payday-lending law!

Under state law, summary language must be judged acceptable by Ohio Attorney General Nancy Rogers before the industry is allowed to begin circulating petitions. In June, Rogers rejected the proposed language of the first referendum because of its inaccuracy. Later, she rejected the industry's revised try at a "summary" because it was 17 pages long (only two pages shorter than the referendum itself).

The summary language for the second referendum petition has been approved, and the trade group for the industry has provided $850,000 for the Reject H.B. 545 Committee to assist in the hiring of the petition circulators and for other contracted services.

One thing remains clear in this ongoing "David and Goliath" battle in Ohio: The payday lending industry will do anything in its power to maintain its privileged, and predatory, position in the marketplace. Rumors are rampant that they are prepared to spend upwards of $15 million in this fight for their survival.

Tom Allio is chair of the Ohio Coalition for Responsible Lending and a board member of Sojourners.

Filed Under: Ohio, payday lending, payday loans, predatory lending

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Category: Debt

Celebrating the National Housing Trust Fund (by Andrew Wilkes)

http://blog.beliefnet.com/godspolitics/2008/08/a-victory-over-predatorypayda.html

Voice of the Day: Melba Maggay

The Financial Sky Is Falling

70

rate or flag this page

By Jerilee Wei

Bert Knew What To Do

Bert the Turtle

I grew up in the "duck and cover" generation and it wasn't pretty. As a child, learning and singing the words to Bert's song, held little joy and a lot of anxiety. Our kindergarten day started with the teacher leading us in both sing and acting out:

There was a turtle by the name of Bert
And Bert the turtle was very alert;
When danger threatened him, he never got hurt
He knew just what to do...
He ducked! And covered!
Ducked! [**And covered! He did what we all must learn to do**

You!
And you!
And you!
And you!'
Duck, and cover!'
For those of you who are younger, this cartoon form of brainwashing, was the norm during the cold war era (late 1940s and 1950s and even early 1960s). The film's purpose was to teach children to duck down low, in-case the atomic bomb or a hydrogen bomb, was dropped on us. This era of fear was a sign of those times. It went far beyond daily school drills, when:
People built bomb shelters (fallout shelters);
Communities held emergency preparedness talks;
Disaster planning was a dinner time topic;
Disaster supplies were gathered routinely;
Emergency preparedness wasn't just for Boy-scouts.

Ideas Formed While Hiding Under the Desk

Duck and Cover Original Airing (1950)
Fallout Shelter

Is your financial sky falling?

Top of Form

- Yes
- No

Bottom of Form

See results without voting

Always Being Afraid

At home, I had a double reason for always being afraid. My dad was one of the hysterical minority, that took the emergency preparedness concepts to the extreme. Our childhood realities were rooted in the fact that:
He built a bomb shelter in our backyard;
He conducted late night disaster survival drills, by timing how long it took us to wake up, get out of bed, and run to the shelter in the dark (Mind you, this included rounding up our two dogs who thought this was a fine game);
He taught disaster preparedness and disaster survival at the dinner table and at our local community college.

Much like **Chicken Little**, the sky seemed to always be falling in my father's eyes. Who could blame him? He was a child of the Depression, so he knew first hand about hunger and being homelessness Then, as a young man in the Air Force, he had been present for the atomic bomb testing in 1945. No doubt, the following year, when he was on one of the planes that photographed the bombing of Hiroshima on August 6, 1945 -- he had some lasting impressions of the awfulness that seemed to be lurking around every political corner.

Today's Sky Is Raining With Reasons to Worry

You begin to wonder if the financial sky is falling when you consider:
The energy crisis;
The price of gas;
The price of food;
Foreclosures all around you;
The price of everything else skyrocketing;
Airline's no longer being numerous and the ones remaining charging for every little thing......
Then, suddenly it seems everywhere you look:
Businesses are either for sale, closed up, or changed hands;
Your neighbor was laid off;
The guy across the street moved out in the middle of the night;
Cable and satellite TV companies are now billing you two months in advance;
The satellite TV company that you switched from to another, could come out to install the equipment -- but now, **you** get to uninstall it from the roof and mail it back to them or be billed for the equipment;
Telephone companies are now billing you two months in advance;
The homeless begging on the major intersections are no longer just broken men, more and more we are seeing women.
Now personally, it didn't bother me too much when the local Star Bucks closed down (I don't drink coffee). Additionally, here in the land of tourism, we could do without quite so many choices in where to eat or shop. Now there are less Linen's n' Things, Steak and Ale's, and Bennigans, but this isn't nearly as distressing as what I noticed next because:
That gut feeling I had as a child, peaking out from under my school desk, came out the other day when I went to pay our utility bill. Now, I am worried about America, as we knew it, more than ever.

A Victory Over Predatory Payday Lending (by Tom Allio)
Chernobyl Disaster
The nuclear disaster at Chernobyl has been an environmental nightmare. The fallout from this event was catastrophic. Many people have experienced long term health problems as a result and the whole are has...

Concrete Homes as Your Hedge against Disaster
Emergency Preparedness for Disaster Survival
What would you do if there was a disaster in the next five minutes? If you only had 10 minuites to get out of your home do you know what you would take? Where you would go? How you would survive?
Emergency Survival Kits for the Family
This is something that we don't talk enough about- Emergency Survival Kits for the Family. With record breaking disasters happening daily around our globe, it's more imperative than ever to make sure that we...
Global Warming 15--A Disaster Epic in Slo-Mo
Disaster Epic
PayDay Loans|PayDay Loans Tips
Preparing for a Disaster
Slash your electric bills
Ten Tips for Lowering Your Electric Bill

Help With Utility Bills

A kiddie solution in lowering your utility bills
Audit Insulation to Lower Utility Bills
Lower Utility Bills by Ordering an Energy Audit
Every household feels the need to save more money to answer for other necessities and prepare for plans in the future. However, budgeting the money can be a headache when expenses and bills get too high. No...
Lower Utility Bills with the Energy Efficient Toilet...
Many people complain over high utility bills that they have to pay monthly. Utility services don't come cheap, thus making bill payments quite a headache. Rather than keep complaining over this matter, it is...
Money matters in settling utility bills
The Dynamics of Using Gift Certificates to Pay Utility Bills

The Line Trailed Out the Door

At our local utility company, people were lined up clear outside the door to make arrangements to delay, partially pay, get their services reconnected, or make other special arrangements with their utility bill. I'd never seen so many people looking desperate.
I don't know if it works the same in other areas, but here you pay the local electric company for all of your utilities. So, your bill can seem larger than life when you consider it is the electric, water, recycled gray water, trash pick up, and sewage -- all rolled into one bill. Added to that, are all sorts of assessment fees, and taxes. Failure to pay by the 7th day after the due date, results in cut-off. There is no such thing as a utility bill being more than a week old, before that reality happens.
Therefore, it was more than a little shocking to receive the printed handout. It seems that our county is going to save over $520,000 a year by closing down the customer service department. Moreover, all of the employees that normally wait on customers are out of a job. Now, if you prefer to pay your bill in person or have a problem, you will have no one you can talk to face-to-face. However, rest assured -- you can call them on the phone. We all know of course what that means -- that we're going to be locked into that timeless American tradition, of talking to a computer, or be put on hold by that computer.
If you want a receipt (as I do) for paying your utility bill, you get to go to your nearest Amscot **Payday Loan** Corporation-- and it costs your utility company an extra dollar for the privilege of taking your money and gifting you a receipt! The utility company assures us that they are paying the $1, but who do they think they are kidding? Their $1 comes from us, the customers.
I will concede that these places are a necessary evil, and a Godsend if your back is against the wall in a short term financial emergency when you have **no other options**. However, they are not the safest places in the world to be visiting.

Just check out who often hangs out in some of their parking lots and the human dramas inside of these businesses. There is a reason the workers are behind bullet proof glass! There is a reason why they are located in poorer parts of neighborhoods.

Adding Insult to Injury

If that new development wasn't bad enough, a few days later we received a letter from our local utility company that read:

"**We are informing you that a recent** *audit* **of our records indicates that you are eligible** *(like this is an award or something?*) **for a** *deposit* **increase."**

You see, here in Florida where people move in and out of state constantly. You have a security deposit on your utilities, at an amount fixed at two times the average monthly bill. So apparently, despite the fact that you pay you bill on time every month -- they feel the need to collect even more security deposits as they regularly increase your bills.

Our increase amounts to $320.00 that we will be billed for next month on top of our regular bill!

It kind of makes you feel like every business entity you deal with these days is doing anything and everything to get even more money from you and you have to wonder why?

Comments

I don't know much about the business of payday lending and have never used one. But won't these laws force payday lenders out of business? Maybe that's a good thing, I don't know. There's obviously a market for payday lenders and quick cash. Are people better off without getting the quick cash or with high interest rates? It doesn't seem like an open-and-shut case to me.

I could be missing something here. I don't like exhorbitant interest rates any better than anyone else.

Posted by: Eric | August 5, 2008 2:02 PM

Tom:

I was hit up by petitioners at a bus stop in Columbus late last week, along with others waiting for a ride. They're using deceptive tactics in getting signatures. They say they're trying to "save 6,500 jobs in Ohio." They said nothing a bout preserving the right to charge almost 400% interest.

I remember two years ago when petitioners used deceptive tactics to try and "sell" people on signing petitions for gambling promotion and for smoking in public places. I think Ohio needs a "truth in petition advertising" law that requires petitioners to be honest about the proposal they're promoting and that also would require them to disclose all funding sources.

Eric:

I believe lending companies can stay in business without charging these kinds of rates; they of course want us to believe otherwise. True, they are lending to a risky population, for the most part, and higher rates help cover their losses. But are they providing a legitimate service, or are they exploiting the working poor? And are there other avenues for people to receive quick cash when needed? And where are the services that can help these people with budgeting, so they don't find themselves out of cash so frequently?

Further, you need to know that when the consumer protection legislation was originally proposed, the legislature went to the lending companies and asked them what they could reasonably live with. The lenders basically told the legislators they didn't want any restrictions and that they weren't going to participate in the process. This all-or-nothing approach on the part of the lenders is the main reason why the legislature passed the most restrictive proposal. In a sense, the lenders did it to themselves.

Peace,

Posted by: Don | August 5, 2008 2:41 PM

Eric,
The article states that some lenders were charging a 391% APR over a two week period. Check out the biblical injunctions against usury. [How come we've dropped that one as opposed to other commands?]
This is an open and shut case. The lenders were legalized loan sharks.
Perhaps you are wondering about how folks might have enough to live payday to payday without needing to take loans in order to eke out survival.
Peace,
DUH-SCIPLE

Posted by: Duh-sciple | August 5, 2008 2:45 PM
When I was in the Service, I was a "loan shark" and charged a flat fee instead of interest. Even so, I was accused of usury and was threatened with a court Marshall hearing.
What I did in no way was as outrageous as these "payday predators" and I cannot understand how they can be considered legal or just in any state of mind. They are Legalized extortion and as evil as organized money lending of the crime syndicates.
Posted by: Paul, seeking wisdom | August 5, 2008 2:58 PM

I don't know much about the business of payday lending and have never used one. But won't these laws force payday lenders out of business?
Yes, and that's the point; my own church started a credit union because of the legal loan-sharking that often takes place in its neighborhood. A friend of mine noted that, for a number of reasons, some people often can't open regular bank accounts so they have to resort to patronizing such places.
Posted by: Rick | August 5, 2008 3:07 PM
Tom:
Thanks for the great post, and thanks to all of those who responded. I am helping Tom and his team with the media campaign to keep Ohio's new payday lending reform law in place. We are hearing many examples of people who were asked to sign the petitions under false pretenses. If you believe that you were given false or misleading information when asked to sign the petition, please send an email to questions@cohhio.org.
Thanks,
Sandy Theis
Posted by: Sandy Theis | August 5, 2008 3:07 PM

I'm a lender on the website Prosper.
I've found that there are certain classes, and they tend to fit the stereotypes, who aren't likely to repay me. If I lend, I am beginning to think I practically have to consider it a gift to a stranger. But to cover my losses from them, I only need to charge about 18% interest to everybody else.
Not 300%, 400, or 500%--and the refund anticipation loans for income tax refunds can charge an effect rate of over 1000%. That's really something that needs to be regulated.
Posted by: Rob | August 5, 2008 3:08 PM
Don,
Thanks for the insight from Ohio. The tactics of the lenders don't sound like they're constructive and the dishonesty they're apparently using to gain support for their initiative doesn't reflect well on them either.
Your questions about services to help people who need quick cash and to learn about budgeting are goods ones. Perhaps Gov. Strickland can address those issues too. This would also be a good chance for local churches to step in. Our church offers microloans to Africa. Why not in our local community too?
I agree with Duh-sciple and Rob that rates of 300 percent or more are usurious, and I'm aware of what the Bible says about it (no need to get snide Duh-sciple). But many people think that rates of 15% are usurious too and want to go after credit cards companies next. That's when it really starts to hit people like me who use credit cards responsibly. If lenders are forced by the government to only offer lower-interest loans, similar to a mortgage, I would think the ability to get credit and borrow money is going to greatly decrease.

There has to be some element of personal responsibility here. If you're taking out a loan at 400% and you know you can't pay it back it's not really a good idea to take the loan out. Where's the foresight?
Posted by: Eric | August 5, 2008 3:37 PM

This is good news but a small step in getting these lenders to do better. I work in a lot of urban communities and can rarely find a bank but the payday loan and check cashing places are all over the place. The entire nature of the business perpetuates an anti-savings mindset and keeps people confined to unhealthy spending, saving and budgeting habits. The government should make these lenders fund and provide some kind of financial education seminars in poor communities but that would go against everything they are trying to do, which is exploite the conditions of poor people. Isn't it interesting how everything seems to be more expensive in poor communities. Grocery stores carry lower quality food, gas stations charge more, etc. Some people need an underclass to exploite and benifit from their bondage. Good to know atleast somethings being done.
Posted by: Rev. Tune | August 5, 2008 4:46 PM
Years ago I fell into the viscious circle of payday lending. All is takes is one small problem and they seem like the perfect place to go when you need money in a hurry. Yes there is an element of personal responsibility to it but when you need money and you need it fast they are about the only place to go for it. They make it all so easy to get the money you need, even if you don't have a checking account. Right now I don't remember exactly how I got out of the circle but I'm reasonably sure part of it involved defaulting on the loan. Not because I wanted to but because it was necessary to get out of the trap they put you in. Since then I have never used one as I know now how horribly easy it to can get entangled in it. A few years ago a former friend of mine got a title loan on her van and they repossesed it and she was mad and put rocks in the gas tank to mess with them. I told her when she got the title loan that she had made a big mistake. I learned my lesson about that type of lender years ago.
Posted by: Kathy G | August 5, 2008 4:57 PM

These one arm bandits really prey on the poor and desperate . Also needing attention are the practices of banks with their service fees and guidelines for using them . many people go pay check to paycheck occuring the ame problem as with these pay day loan sharks . Something very wrong about the poorest and neediest people paying a couple hundred dollars every month to intee or fees , and yet they own nothing .
Posted by: politicsmakeusthisway | August 5, 2008 5:35 PM
Pay-day loans are predatory. Predatory by definition means preying on the weak or defenseless. [from Encarta Dictionary on-line: greedily eager to steal from or destroy others for gain; extremely aggressive, determined, or persistent]
Desperate people take desperate measures and this temporarily legal option for quick cash may look better than stealing or some criminal activity. However, the poor become poorer with outrageous interest costs increasing the downward spiral of loss of buying power and loss of self-sufficiency. Wasn't it Tennessee Ernie Ford that sang "Another Day Older and Deeper In Debt"?
Gambling, another wealth robber, at least has to tell you the bad odds of playing. I hope the Ohio group holds on to its legal success and can be a model for the nation.
We are our brother’s keeper; looking out for the widow and the orphan with just weights and measures.
Posted by: Bruce Draper | August 5, 2008 5:39 PM

So, the state of Ohio is in the business of price fixing?
Posted by: Bradley | August 5, 2008 10:16 PM
So, the state of Ohio is in the business of price fixing?
Nope, just to keep people from being ripped off due to their need. That's a Scriptural principle.
Posted by: Rick | August 5, 2008 11:50 PM

The scriptural principle opposing payday lending applies to both parties, so this isn't a black and white issue. That said, I have no problem with laws against usury, because usury is unbiblical, and I think it is valid to enact laws against that which defies scripture.
Posted by: kevin s. | August 6, 2008 1:07 AM

Question: for the sake of easy math, lets say they are charging 400% APR. That's ANNUAL percentage rate. What would that translate to in dollars in interest paid back for a 2 week loan?
Yep, I'm bad at math. That's why I refuse to own a credit card.
Posted by: paul W | August 6, 2008 7:43 AM

Do not predatory lenders make lots of money without doing any work or producing anything? I am not against financial companies making money, however, there's a big difference between 400% and 18%. The recent sub-prime loan crisis is what happens when we carry deregulation to the extreme. I am very concerned that some of you appear to be defending loan sharking-- an injustice the prophets railed against.
Where are the theological conservatives with the doctrine of original sin? In our Lutheran liturgy we confess that "we are in bondage to sin and cannot free ourselves" and that's why we need Christ to set us free.
One of the purposes of the law is to reign in sinfulness. When you don't have law to have some political control of human beings- you see the result. Even followers of Christ, in the process of growing into the likeness of their Master, frequently blow it. Count me as pro-regulation.
Duh-sciple
Posted by: Duh-sciple | August 6, 2008 8:21 AM

As personally repugnant as the "payday-to-payday loan" business is to me, with its high interest rates and its appeal to the working poor, I would rather see the church step up to the plate and do its job, even if that means that the local churches get into the lending business according to scriptural principles, than government regulation of yet another area of life that, in the final analysis, requires someone to walk in the door of the business and ask for the money. The business and the customer should have the right to "do" a contract, if both of them have their eyes open, even if the result is a worldly situation where one loses, and loses badly.
However, the church can do things differently, if only we will. Maybe, instead of the new 100,000 suare foot addition to the community center, we ought to consider opening a "local church lending center' where the working poor can come, and borrow at low (or no) interest. Yes, the church will "get taken." That will be the problem of those who take us, not our problem.
Posted by: joekc | August 6, 2008 8:50 AM

Tom mentioned that the trade group, CFSA, has already donated $850,000 to the campaign to overturn HB 545. That amount is only likely to escalate dramatically in the next couple of months. CFSA and the payday lending industry has already spent $8.7 million collecting signatures and duping voters in Arizona for a November initiative and the industry successfully bought HIGHER interest rates (592%) in Virginia from the state legislature for $20 million. Tom says $15 million - that's probably close to being right on target. Must be nice to be able to buy an election - they're certainly going to try! So goes Ohio, so goes the Nation!
Posted by: John | August 6, 2008 9:29 AM

The world would probably be better off without these payday loan places, but I'm sure there are a number of people that have benefited from their existence. And the obvious merits utterance, If you pay off the loan on time, you don't pay the ridiculous interest rates.
It's not accurate to say that these companies are charging these high rates so they can just pocket the huge profits. Their lending is extremely risky. They lend to people that have no real particular need or concern for their credit scores (they would just get a credit card if they had decent credit scores). And damaging a credit score is a lending institution's only weapon against people defaulting on unsecured loans that small (they could sue, but the loan would have to very large to be worth the legal fees of suing a debtor.)
With all that said I do think these payday loan joints are damaging and probably sinful. But I don't think we can regulate everything we feel is sinful. And, yes, Rick it is price fixing. You may feel it's for the best, but it's price fixing nonetheless.

As it has been pointed out, the real goal should be for people not to have the need to go to these places. I agree with this, although I'm sure I would differ with most of the people on here how it should be done.
Posted by: DITE | August 6, 2008 10:11 AM

Well, I'm pleased. We didn't get the expected knee-jerk "don't expand the government, let the church take care of the problem" retort until 18 responses down the thread. The social Darwinist libertarians are asleep at the wheel.
Snarkiness aside, activists for the poor should look into asking their state governments to support local asset-building and earned income credit outreach coalitions. Volunteer Income Tax Assistance (VITA) sites provide free tax return services and in some cases, they cooperate with credit unions to provide refund anticipation loans that charge a very low rate (although the latter practice is controversial among advocates). The coalitions also promote opening up of bank accounts and offer courses in financial literacy.
My state of Michigan currently has a statewide initiative to do all of this. I am involved with it and we are seeing quite a bit of success. The website is www.MichiganEIC.org --take a look if you think this is something your own states could benefit from doing.
All that being said, community-level and faith-based outreach will not solve the entire problem. Regulation and restrictions from the top down are the only way to take a real bite out of this practice, and I salute Ohio for passing a law with some real teeth.
Posted by: I and I | August 6, 2008 10:20 AM
The world would probably be better off without these payday loan places, but I'm sure there are a number of people that have benefited from their existence. And the obvious merits utterance, If you pay off the loan on time, you don't pay the ridiculous interest rates.
The overriding principle is whether the people who own and operate those places actually live in the neighborhoods they "serve" -- I'll bet that they don't. See, part of the problem is capital leaving the neighborhood because shop owners have no real connection to it, which doesn't give folks who live there the opportunity to "create" wealth (I use the term figuratively because wealth cannot really be created).
Posted by: Rick | August 6, 2008 10:42 AM

Maybe, instead of the new 100,000 square foot addition to the community center, we ought to consider opening a "local church lending center" where the working poor can come, and borrow at low (or no) interest.
As I mentioned before, my church has done just that, but it's in a poor neighborhood so it can directly serve it in the way you envision. The real challenge will come to the suburban/exurban mega-churches that the poor can't even get to because, realistically, you have to have $$$ to live anywhere near them (or at least own a vehicle).
Posted by: Rick | August 6, 2008 10:55 AM
concern for their credit scores (they would just get a credit card if they had decent credit scores). And damaging a credit score is a lending institution's only
Back in the 1980s (that was when Reagan was president, the decade was called the decade of greed for a reason), I new a guy whose ex-wife's father's lover had to visit a payday lender because he got himself into a tough spot. He had to pay rates of over 350% (this was after Republicans got rid of all banking regulation to keep black people from ever getting to the middle class). When he didn't pay the loan back, the local Republican club called on some of their most extreme conservatives to come and physically threaten him. That's what conservatives like to do. All of them.
But then my evangelical church stepped in. By the way, it's not one of those bad suburban mega-churches. It's a true Christian church that actually ministers to people's needs. We have people from all races there. It’s lovely and really what the Kingdom of Heaven would look like.
We did as much as we could, but then the big-money, conservative, libertarian, Darwinist think tanks in Washington got in the way and ruined all our best-laid plans. Do you know how they get their money? They have a shady network of people that try to recruit minorities (they once did this to me back in the ‘80s). They argue for lower taxes and then, when the rich get richer they ask them to donate to their cause. It's all so corrupt compared to how Progressive think tanks do their work.
Don't you see how bad conservatives (and Reagan, Goldwater, Gingrich, Friedman, Buckley, ect) are!? This is why everyone in the black community hates them.

Posted by: Rick N. | August 6, 2008 11:23 AM

I think you'd be surprised at who all uses these places. One thing we all can do is educate people not to use them. They're just not an option.

Posted by: frankie | August 6, 2008 12:23 PM

I understand that 300% sounds like a lot, but realize that we are talking say $70 on a two week loan of $600. I suspect that an interest rate like this is probably not to far off. Essentially I think they are saying that if 1/9 loans default they are breaking even. I don't know the real statistics, but I would assume for the payday loan population this doesn't sound out of line. With that said of course something needs to be done, although I am not sure government is the answer. How about picketing? How about changing public opinion? How about financial education and counseling? How about getting our hands dirty and changing lives rather than trying to fix a symptom. The problem is people trapped in cycles of poverty and addiction, payday loans aren't the problem.

I like the sound of churches getting involved or non profits that form relationships, lend money, teach, save, and inspire. Now those are steps towards a real solution.

Right on joekc and others a long the same path.

Posted by: The Happy Rock | August 6, 2008 12:57 PM

"but you get the point, right?"

Yes and no. That is also satire, but I agree with what you wrote...which was meant to be satire.

Posted by: DITE | August 6, 2008 1:55 PM

I feel like I am in the middle of this argument because my neice works for one of these types of lending places and my son uses these places more often than I like.

I liked the idea someone mentioned about 'where is the foresight'? It seems to me that the people who use these payday lenders are lacking in that area. Many of them, my son is included in this group, have never learned to budget money and to save for things they want. He works everyday, rarely misses a day of work, but his pay is $10/hr. and he is not able to support his family on this amount because he wants to live a lifestyle beyond his means. Thus, he resorts to borrowing and gets himself even more financial trouble.

What is the answer? More education or getting rid of payday lenders exhorbitant fees? Maybe our legislators can provide a public service announcement that would educate people about how much money they waste by using these types of lenders? But, something needs to be done to help educate people about these types of loans because many who use them may be unaware of the trouble they are borrowing.

Posted by: Jacqueline | August 6, 2008 4:53 PM

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Posted by: Jacqueline | August 6, 2008 4:53 PM

I enjoy Rick's comments generally, but the satire was kinda funny. People have issued worse posts under my name, and I have been parodied (and worse) as well.

"What is the answer? More education or getting rid of payday lenders exhorbitant fees? "

I think the latter. Our economy succeeds, in part, by virtue of the buffer created by an offer of credit. This is not a new development by any stretch, nor is it essentially problematic.

Given this fact, it is in our best interest to control the price of credit. Credit institutions are not protected by the constitution, and scriptural precept argues against usury. As such, governments are free to act in the interest of controlling the credit industry.
The counterargument here is that credit prices are tied to risk. While this argument is correct, it is unpersuasive. The benefit of credit is that it allows a purchaser to secure funds that allow otherwise prohibitive purchases, such as homes, small businesses, and cars.
All of these purchases facilitate further purchases. Without a car, one cannot take on a demanding job. Small businesses employ workers. Home ownership results in a variety of purchases.
Payday loans either accelerate the purchase of lifestyle items or, at best, facilitate the purchase of necessities. Neither circumstance benefits the economy or the borrower.

Posted by: kevin s. | August 6, 2008 5:48 PM

Good article and comments.
For the Record, Illinois passed a landmark Payday Loan Act in 2005 which protects borrowers against abusive practices.
Posted by: Dan W. | August 6, 2008 6:02 PM
To "the church should do it" crowd:
Please try to be biblical in your applications. What would a scriptural lending institution look like? The church is commanded to be discriminatory in it's fiscal practices. Worse yet, people who lie on applications would face the threat of death by the Holy Spirit. Another thing, how come you "church should step up to the plate" people never advocate selling all you have and laying it at the apostle's feet?
Pastor Jeff
Posted by: Pastor Jeff Staples | August 7, 2008 8:57 AM

I and I: "But I appreciate the rest of your post--maybe you're not as bad as I thunk you was." Oh, there's a sense of humor, even some irony, in there somewhere. Kevin does his darnedest to keep it hidden, but occasionally can't help himself.
Posted by: carl copas | August 7, 2008 3:17 PM
Okay, so the post impersonating Rick stays up, but my post asking for it to be removed gets removed. Go figure. (And MonsterLad or whatever his name was says the blog only removes posts by conservatives.)
Posted by: I and I | August 7, 2008 5:39 PM

I and I: "MonsterLad or whatever his name was"
ROFL
Posted by: carl copas | August 7, 2008 5:43 PM
Ohio should never have allowed predatory payday lending in the first place! The payday lending industry conned the Ohio General Assembly into exempting them from our state's usury laws and it's a good thing that political leaders in Ohio had the backbone to admit they made a mistake and to right it!
The industry is sending in the big guns with the big dollars, but I suspect Ohio voters will not be fooled by their commercials and antics!
Posted by: Craig | August 8, 2008 11:57 AM

I applaud the desire to keep people from preying upon the poor in our country. However, this may be an example of treating the symptoms and not the disease. The problem is there is a group of people who because of their foolish decisions lands them in a position where the only people who will lend them money are loan sharks--legal or otherwise. What they really need is a community of people who will live alongside them not only to provide money for legitimate needs, but will also provide example and counsel in avoiding future problems. I have found that a local church is an excellent way to do this. Our church regularly gives about a third of the total offerings to help families in our community who are unable to meet their needs. The offerings from the congregation are strictly free will offerings given in the name of the needy person. As such the giver forgoes any tax-deductibility for the gift. To qualify for the offering the recipient must be in the process of completing an approved Bible Study/financial

counseling class, meet weekly with their budget coach, and attend church. We have provided $4000 to aid people released from prison to help them clear tickets and enable them to obtain their driver's license. We have supported single mothers with $300 to $500 a month to cover the loss of child support, and $1000 to $2000 to tied a family over during unemployment. The program is as flexible as we need it to be and as restrictive as it wisdom seems to dictate. Because it is a free-will offering it is completely without compulsion and as many or few can give as dictated by their own heart and pocketbook. Over 10 years, we have never had a need go unmet by our congregation. Did I mention, our congregation is made up of about 30 people?
Posted by: Charles McClelland | August 8, 2008 1:37 PM
Kudos, Charles
Pastor Jeff
Posted by: Pastor Jeff Staples | August 8, 2008 2:21 PM

Charles, I applaud your church for its commitment to outreach in this area. More churches need to do this, and that will certainly help prevent people from making foolish decisions. However, top-down legislation is still needed. It is both/and, not either/or.
Posted by: I and I | August 8, 2008 5:19 PM
Hi Everyone. There are many books out there regarding the predatory practices of the banking industry as a whole. Educate yourselves before you sign for that next loan, credit card, etc. Read the FINE print! People are losing their homes, going into bankrupcty, etc. all due to the predatory practices of the banking industry. People are having to chose between paying the MONTHLY interest charges, late fees, over-the-limit fees, etc. over food and utility bills because they have a SINCERE desire to keep a good credit standing. Many people end up in debt not because of luxuries purchased but because they lost their job and need the credit cards to carry them until they get back on their feet again. Many also find themselves in debt because of an unexpected medical crisis. The banking industry is making record earnings of approximately $400,000 per QUARTER (not per YEAR) off the backs of people in distress! And more sadly, our government stands by and does NOTHING because these banking corporations make HUGE political contributions and receive FAVORS in return. Write your representatives! The banking industry may have money but we have something that they dont have....VOTES! As a public accountant by profession, I say FIGHT back against these criminal corporations.
Posted by: Justice for All | August 17, 2008 12:36 PM

Sorry but I made a mistake. The comment "The banking industry is making record earnings of approximately $400,000 per QUARTER (not per YEAR) off the backs of people in distress!" should say $414 million per QUARTER!!
Check Capital One's earnings announced on September 30, 2004 if you don't believe what you are reading.
Posted by: Justice for All | August 17, 2008 1:55 PM