

Comments

To the Federal Trade Commission

Regarding the

Fair Debt Collection Practices Act

Collecting Consumer Debts: The Challenges of Change

By the

Consumer Federation of America

June 20, 2007

I. Introduction

Consumer Federation of America (CFA) appreciates the Federal Trade Commission's interest in protecting borrowers as evidenced by the inquiry into debt collection practices and the adequacy of laws meant to protect consumers from abusive tactics. In planning the Workshop agenda, we request the FTC to include a panel to examine the unique debt collection risks caused by the design of high cost payday and car title loans marketed principally to low and moderate income or credit impaired consumers. In addition to routine debt collection tactics, consumers who use these products are subject to risks when they take out loans secured by or based on soliciting checks written without funds on deposit, providing authorization to electronically access a bank account, or signing over the title to the family's vehicle to borrow a fraction of the car's value.

For the last ten years, CFA has studied and reported on high cost, high risk lending to vulnerable consumers, including payday loans and car title loans/pawns.¹ These loans have several characteristics in common:

- Extremely high interest rates
 - Payday loans cost 390 to 780 percent APR for two-week loans.
 - Car title loans average 300 percent APR for one month loans.
- Little consideration of ability to repay
 - Payday loans are made without a credit report or information about other obligations. Lenders typically only use a specialized data service, such as Teletrack.
 - Title loans are based on the value of the vehicle, not the creditworthiness of the borrower. Title lenders do not usually obtain credit reports or report payment to mainstream credit reporting services.
- Unaffordable repayment terms
 - Payday loans are single payment, balloon loans, due in full on the borrower's next payday. The typical loan is around \$350, due in two weeks.
 - Car title loans for hundreds to thousands of dollars are due in full at the end of one month but are easily renewed by paying the finance charge and extending the debt another month without reducing principal.

¹ See CFA Reports posted at www.consumerfed.org. Also, see www.paydayloaninfo.org

- Risk losing a valuable family asset
 - Every payday loan is based on a personal check written on the borrower's bank account and held for future deposit or on authorization to electronically debit the account to collect payment. Failure to make good on the check can lead to escalating insufficient funds and overdraft fees, loss of the bank account or interruption of check writing privileges.
 - Title loans are secured by the title and, often, a duplicate set of keys, to the borrower's paid-for vehicle. Failure to pay can result in repossession and, in some states, deficiency balances.

- Risk coercive collection tactics due to security for loan
 - Some payday lenders threaten criminal sanctions for failure to repay the loan.
 - Repossession threats by some title lenders coerce repeat loan renewals without paying down loan principal.

- Vulnerable borrowers
 - Payday loan borrowers are typically female, make around \$25,000 a year, are renters, and more likely to be minorities than the general population. Payday lenders have clustered around military bases, in low to moderate income neighborhoods, and in predominantly minority areas. The Department of Defense reported to Congress that high cost lenders target military bases.²
 - Title loan customers are described by a few state studies. Missouri's Auditor reported that 70 percent of payday and title loan customers earned less than \$25,000 per year.³ Illinois title loan users had average salaries of less than \$20,000 according to a Department of Financial Institutions study in 1999.⁴ New Mexico regulators report that the average income of title loan borrowers, as reported by licensees for 2004, was \$21,818.⁵ For many borrowers, the family vehicle is their most valuable asset and provides necessary transportation to work, school or healthcare.

II. Payday Loans

Payday loans are small cash advances for less than \$1,000, typically in the \$300 to \$500 range, based on the borrower's personal check or electronic access for the amount of the loan and the finance charge. To get a payday loan, a borrower must have an open bank account, a source of income, and identification. Loans are due and payable in full on the

² See, www.paydayloaninfo.org for Research and Reports on borrower demographics.

³ Missouri Auditor Report No. 22001-36, at 3.

⁴ Illinois DFI 1999 Short Term Lending Report at 27.

⁵ New Mexico Summary of Title Loans, 2004, on file with author.

borrower's next payday and typically cost 390 to 780 percent APR for two-week terms. Finance charges are typically expressed as dollars per hundred borrowed, in the \$15 to \$30 per \$100 range. On the next payday, a borrower can bring in cash and "buy back" the check, the check can be deposited for payment, or the borrower can pay only the finance charge and renew the loan for another pay cycle without reducing the principal. Most checks are never deposited and are bought back by customers who are then encouraged to take out another loan. Industry analysts estimate that about five percent of American consumers have taken out at least one payday loan.⁶

Payday Loans are Big Business

The modern payday loan industry emerged in the last decade but dates back to "salary-buying" in the early 20th Century.⁷ Payday loans are made by mono-line payday lenders; by check cashers, pawn shops and rent-to-own stores; and online through electronic funds transfer. Recent analysis of state regulatory and industry data by the Center for Responsible Lending found that 24,803 payday loan outlets made over \$28.2 billion in loans in 2005, up over 100 percent in five years. Consumers paid almost \$5 billion for loans.⁸ Industry analysts report a larger volume of business and higher fees paid by borrowers. According to Stephens Inc., a Little Rock investment bank that follows this sector, loan volume in 2006 was \$42 billion and fee revenue grew eight percent to \$6.5 billion.⁹

Check-Holding Risk to Borrowers

The essential features of a payday loan make them a debt trap for borrowers and susceptible to collection abuses. These loans meet the criteria for predatory lending.¹⁰ Loans are made without consideration of the borrower's ability to repay. Interest rates are exorbitant, starting at around 400 percent annual interest. Loans come with balloon payments, due in full on the borrower's next payday, not in affordable installments. In fact, payday lenders do not allow installment payments, recent industry proposals notwithstanding, because the business model is predicated on forcing people to pay their entire loan balance plus fees or pay to renew the full loan. The average borrower has eight to twelve loans per year at the same lender.

⁶ Michael A. Stegman, "Payday Lending," *Journal of Economic Perspectives*, Vol. 21, No 1, at 170.

⁷ Jean Ann Fox, Testimony, Lieberman Payday Loan Forum, December 1999. On file with author.

⁸ Uriah King, Leslie Parrish and Oxlem Tanik, "Financial Quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year," Center for Responsible Lending, Nov. 30, 2006, 9-11.

⁹ Dennis Telzrow, "Payday Loan Industry," Industry Report, Stephens Inc. Investment Bankers, March 27, 2007 at 13.

¹⁰ FDIC's Office of the Inspector General (OIG), Challenges and FDIC Efforts Related to Predatory Lending, Audit Report No. 06-011, June 2006. "Characteristics potentially associated with predatory lending include, but are not limited to, (1) abusive collection practices, (2) balloon payments with unrealistic repayment terms, (3) equity stripping associated with repeated refinancing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan." Payday lending is listed as an example. "Payday Loans are small-dollar, unsecured, short-term advances that have high fees relative to the size of the loan. When used frequently or for long periods, the total costs can rapidly exceed the amount borrowed."

Check/debit holding sets up coercive collection tactics as some lenders threaten or imply that the borrower will be “in trouble” for failure to make good on the check. A key characteristic of a payday loan is the use of a personal check or electronic access to a bank account as security, payment device, and collection tool. Every loan involves a potential unfunded check/debit that will trigger a bounced check fee at both the payday lender’s outlet and the consumer’s bank. Checks can be re-deposited to trigger multiple fees, with paper checks resubmitted as electronic transactions. Elliehausen notes that the postdated check used to get a payday loan provides an incentive to repay the loan, reducing the probability of default and the expected value of collection costs.¹¹ While check holding benefits lenders, this device puts bank account ownership at risk for consumers, as well as the ability to write checks at retailers if repeat defaults are reported to ChекSystems where black marks stay on the record for five years.

Payday Loans are Modern Wage Assignments

Securing payment of a debt by the borrower’s next paycheck to be deposited in the bank or electronic authorization to access pay deposited into an account is the modern banking equivalent of a wage assignment. Federal law makes void any loan with a wage assignment to an enlisted Service member. The Federal Trade Commission ruled decades ago that a wage assignment that could not be withdrawn was an unfair trade practice under the Credit Practices Rule. The FTC Credit Practices Rule outlaws credit contract provisions analogous to check holding, such as wage assignments, confessions of judgment, and the taking of a non-purchase money security interest in household goods. Holding the consumer’s signed check is even more advantageous for a lender than holding a confession of judgment. With the check, the creditor goes directly to the bank to collect without filing suit or going to court to get a writ of execution. Since so many paychecks are now direct deposited, a loan based on access to the funds that will be deposited into the account on the next payday is very close to a wage assignment.

The Electronic Funds Transfer Act prohibits conditioning the extension of credit on requiring electronic payment of debts for periodic payment loans, but is silent on the single payment electronic payday loan model. Some payday lenders use remotely created demand drafts to collect directly from bank accounts when consumers exercise their rights to revoke access to accounts under the EFTA. (See examples below)

Check/debit holding a powerful collection mechanism

While consumers may not believe they can be imprisoned for failure to repay loans, they do fear the consequences of failing to “make good” on personal checks. Our legal system is not supposed to permit incarceration for failure to pay a debt. A federal court in Tennessee ruled that threats to bring criminal prosecution for failure to repay a payday loan constituted an unfair trade practice. The court noted that the lender knew full well that the borrower had no money in the bank at the time the loan was made and could not

¹¹ Gregory Elliehausen, “Consumers’ Use of High-Price Credit Products: Do They Know What They Are Doing?” Working Paper, Networks Financial Institute at Indiana State University, May 2006 at 5.

later claim to be the victim of a fraudulent “hot” check.¹² The court found that the loan did not involve a “bad” check and that threatening to take an action the lender had no legal right to take constituted an unfair or deceptive act.

Despite industry codes of conduct promising otherwise¹³ and state laws prohibiting threats or use of criminal prosecution for unpaid payday loans, some payday lenders threaten or imply criminal sanctions when borrowers are unable to make good on the checks used to get cash advances. Some state laws treat the unpaid payday loan as a civil bad check, triggering multiple damages, attorneys’ fees and court costs, while a few apply criminal sanctions for failure to make good on the check used to get the loan under limited circumstances.

Basing loans on personal checks or agreements to permit electronic access to borrowers’ bank accounts compounds collection problems for vulnerable consumers. Following are illustrations:

Unfair payment terms facilitated by access to bank accounts

1. First Bank of Delaware “Consumer Installment Loan Agreement” for loan sold by a payday lender to a Service member stationed in California

The loan of \$1,500 cost \$1,448.64 in finance charges and 450.12% APR and was to be repaid in eight \$368.58 bi-monthly payments for total payments of \$2,948.64. The lender took a security interest in “ACH Debit Authorization and Remotely Created Check Authorization.” This also was the method of repayment. A borrower who exercised her rights under the Electronic Funds Transfer Act to revoke authorization to debit the bank account would not be able per the terms of the contract to close off access to her bank account. The contract required that a demand draft (an unsigned paper check prepared by the lender and presented to the borrower’s bank) be used. “If you revoke your ACH debit authorization, then you authorize us, and our agents, successors, and assigns, to submit a Remotely Created Check to your Bank Account for each payment that you owe under this Loan Agreement.” The contract later states “Your typed name shall constitute your authorized signature fully reflecting your intent to authenticate these Remotely Created Checks, which are also known as demand drafts, telechecks, preauthorized drafts, or paper drafts.” If the bank returns either an ACH or demand draft payment, the lender charges a \$35 insufficient funds fee.

2. Internet payday loans build loan flipping into the payment structure. For example, MTE Financial Services, operating as Quickest-Cash-Advance.com loaned \$300 to a

¹² Turner v. E-Z Check Cashing, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999)

¹³ Community Financial Services Association Best Practices include: “7. Appropriate Collection Practices. A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member’s practice in this area. 8. No Criminal Action. A member will not threaten or pursue criminal action against a customer as a result of the customer’s check being returned unpaid or the customer’s account not being paid. See www.cfsa.net/industry_best_practices.html

Virginia consumer, charged a \$90 finance charge or 782.143 percent APR. Per the contract, the loan would be automatically renewed with payment of only the finance charge. At the fifth renewal and every renewal thereafter, the loan principal would be paid down by \$50. In other words, this borrower would have paid \$450 in finance charges BEFORE starting to pay down the \$300 principal.

3. In another example of a payday loan contract with a demand draft provision, ZipCash LLC loaned an Illinois consumer \$200 at a cost of \$60 or 1564.286 percent APR in March 2006. The Promise to Pay section of the contract included the disclosure that the borrower may revoke authorization to electronically access the bank account as provided by the Electronic Funds Transfer Act. However, revoking that authorization will not stop the lender from unilaterally withdrawing funds from the borrower's bank account. The contract authorizes creation of a demand draft which cannot be terminated. "While you may revoke the authorization to effect ACH debit entries at any time up to 3 business days prior to the due date, you may not revoke the authorization to prepare and submit checks on your behalf until such time as the loan is paid in full."

If the ZipCash borrower defaults, the loan contract includes this threat: "I understand and accept if my account is turned over to the ZipCash LLC collections agency and they are unable to collect the amount owed ZipCash LLC will then pursue every action granted to them under the law, including but not limit to criminal prosecution and garnishment."¹⁴

4. Check 'n Go of Washington, Inc. was charged by the Washington Department of Financial Institutions with collecting multiple checks from borrowers to secure single payday loans (in violation of a 2004 DFI policy), charging excessive fees, and collecting personal identification numbers without the borrower's knowledge. When multiple checks for a single loan were returned unpaid by the bank, the lender imposed multiple NSF fees on the borrower, in violation of Washington's maximum one-time fee of up to \$25 for an unpaid check on a single payday loan. DFI announced in August 2006 that it intended to revoke Check 'n Go's license to make payday loans and to impose fines of \$333,700.¹⁵ A Consent Order issued in December 2006 imposed a fine of \$82,000, restitution of \$69,675 to consumers plus investigative costs. Check 'n Go agreed to comply with the law and discontinue practices that led to the complaint.¹⁶

5. An Indiana consumer had insufficient funds to repay a \$300 payday loan plus \$35 finance charge on its due date. The lender's first electronic funds draft was returned for insufficient funds. The lender then broke the debt into three parts and submitted three electronic drafts for \$167.50, \$167.50 and \$20, respectively. The Promissory Note stated "I authorize **an** electronic funds transfer as detailed in this note," raising the question of

¹⁴ Loan Supplement (ZipCash LLC) Form #2B, on file with CFA.

¹⁵ Washington Department of Financial Institutions, Press Release, "State Files Largest Case Against Payday Lender," August 16, 2006.

¹⁶ Consent Order, Washington Department of Financial Institutions, In the Matter of Determining Whether there has been a violation of the Check Cashers and Sellers Act of Washington, by Check 'N Go of Washington, Inc., d/b/a Check 'N Go, December 8, 2006.

whether two of the three transactions were unauthorized. The borrower's bank charged a \$26 "bounce protection" charge for each item which overdrew his account.¹⁷

Threats of "hot check" legal actions

1. Letter from All American Cash Advance in Albuquerque, NM

"You have borrowed money from our company and we have allowed you to pay that loan off with a personal check. Your bank for lack of funds has either returned this check or the account has been closed. You have ignored all our previous efforts to collect these funds. Passing worthless checks is a criminal offense in the state of New Mexico. In accordance with the instructions of the State Attorney's office, we are hereby putting you on a **TEN-DAY NOTICE OF INTENT TO TAKE LEGAL ACTION...**In the event that you decide to ignore this letter by the prescribed date, we shall send this matter to our legal department. You will then be responsible for all costs involved in collections and legal procedures¹⁸."

2. A Florida consumer told a legal services attorney about threatening payday loan collection calls. "On May 24, 2007, she received a call from "Sharon Jackson at (name of company)" ...They told her they were collecting the payday loan she owed...Ms. Jackson told her she had exactly one hour to wire her the money owed which she claimed to be \$650 on a \$430 debt. Ms. Jackson said if payment was not received within the hour they were sending out a squad car to have her arrested. They told her the failure to pay her debt was a felony.¹⁹"

3. A threatening payday loan collection email is posted at attorney Bud Hibb's website, www.budhibbs.com/payday.html. The email sent April 3, 2007 from "Legal Department" on behalf of National Payday Advance states, in part:

"You have defrauded National Payday Advance. A prompt reply to this communication will demonstrate your intent to remedy the current violations. If you do not respond within 72 hours of receipt of this email I will be forced to assume that your intentions were illicit. **Civil** and probable **Criminal Charges** are pending. I have already opened a line of communication with your local District Attorney's office and I have been informed they will get a Grand Jury indictment for any criminal charges brought against you." Signed "Criminal Investigator" with an email address at bankfraud@cash-advance.us.

4. *Storer v. Buckeye Check Cashing of Virginia, Inc.* alleges a "campaign of relentless harassment by the Defendant, a Payday Lender, that included false and specifically prohibited threats of criminal prosecution, in violation of the Virginia Payday Loan Act." A collector allegedly left a taped telephone message stating "We are going to continue calling, and eventually what is going to happen is our legal department is going to press

¹⁷ On file with CFA.

¹⁸ Collection letter on file with CFA.

¹⁹ Electronic communication from Lynn Drysdale, Jacksonville Area Legal Aid.

charges against you.” The plaintiffs are Social Security recipients whose checks are protected by federal law from assignment, levy, garnishment or other legal process.²⁰

5. Florida’s Attorney General won final default judgment in 2007 against debt collection firm Ellis Crosby & Associates, Inc. and Ted Ellis Crosby individually, for illegally collecting payday loan debts from thousands of consumers across the country. The charges are summed up as follows:

“Defendant ECA and Defendant CROSBY illegally contacted consumers at work, engaged in harassing, oppressive and abusive conduct, failed to identify themselves as collections agents, falsely represented themselves as law enforcement officers or attorneys, falsely threatened legal action, falsely threatened criminal arrest, threatened violence, misrepresented that the consumer had committed a crime, falsely represented the amount due, falsely implied they were government investigators, falsely stated their office is in a federal building, falsely claimed that an Order of Homeland Security prevented disclosure of their address, falsely threatened to seize computers, falsely stated that non payment would result in arrest, and falsely stated that the sum owed could only be paid in full.”²¹

6. In 2007 Advance America, Cash Advance Centers Inc. settled a debt collection case with the West Virginia Attorney General by agreeing to stop contacting consumers at their homes and leaving door hangers for consumers when attempting to collect alleged debts. The company agreed to stop contacting people listed as references in most instances. Advance America affiliates in Kentucky, Ohio, Tennessee, and Virginia within fifty miles of West Virginia signed the agreement. The Attorney General brought the case following complaints alleging that Advance America employees attempted to coerce payment by threatening criminal charges, making unauthorized collection calls to third parties and visiting borrowers’ homes in West Virginia.²² In an earlier West Virginia case, the Attorney General settled a case with National Payroll Advance, an Ohio payday lender accused of using threatening collection tactics, including a loan agreement and billing statements which stated “We Prosecute Bad Check Writers to the Fullest Extent of the Law.”²³

7. The Arizona Attorney General ordered Check Center, a Tucson payday lender, to refund all funds collected from consumers who were sent letters that illegally threatened them with jail and criminal prosecution for failure to repay loans. The 2004 consent order was issued by Pima County Superior Court. The collection letters cited by Arizona officials alleged that borrowers had committed a crime by writing checks for payday

²⁰ Donald Storer and Gail Storerer v. Buckeye Check Cashing of Virginia, Inc., d/b/a CheckSmart, Complaint and Demand for Jury Trial, Circuit Court for Isle of Wight County, Virginia, filed with the American Arbitration Association on May 14, 2007.

²¹ State of Florida v. Ellis Crosby & Associates, Inc., Complaint for Declaratory Relief, August 24, 2005 at 2.

²² Press Release, “McGraw Reaches Agreement with Advance America,” West Virginia Office of Attorney General, March 13, 2007. “State, payday lender reach agreement,” Gazette-Mail, March 14, 2007.

²³ Attorney General of West Virginia, In the Matter of Black-Frymyer Company, Inc. d/b/a National Payroll Advance, Assurance of Discontinuance, December 17, 2003.

loans and included the claim that the merchant was an authorized agent of the Pima County Attorney's Office. One letter threatened the consumer with penalties including six months in jail, a \$3,500 fine, twice the face amount of the check and attorney's fees.²⁴

8. Payday loan customers around the country received letters in late 2001 from Check Protection Services (CPS) in Indiana Wells, CA regarding unpaid loans to a payday lender. CPS claimed to have "assumed the original creditors rights," and warned "Please be advised that the check in our possession may be referred to the District Attorney's Bad Check Restitution Program for prosecution if you do not contact us immediately." The letter went on to state: "A crime report may be filed accusing you of a violation of Penal Code Section 476A (Passing a worthless check) by the creditor if you fail to respond by the requested date," and was signed on behalf of "Bad Check Division."²⁵

9. Washington Department of Financial Institutions cited Pacific Financial Holdings, d/b/a Fast Cash Loans and Loan Ex, of abusive debt collection practices in 2004. Of fifty customers interviewed by state regulators, thirty-two said Fast Cash collectors represented themselves as fraud investigators and threatened consumers with criminal prosecution for felony check fraud. In a few cases, borrowers were told they would lose custody of their children or their children were told the parents would go to jail for nonpayment.²⁶

10. Last year the Department of Defense filed a report with Congress detailing the impact of predatory lending on Service members and their families. The following excerpt from testimony by Lynn Drysdale, Jacksonville Area Legal Aid, before the Senate Banking Committee hearing on the Department of Defense Report illustrates the coercive consequences of basing loans on personal checks held for deposit:

- Mr. Hubbell and his wife are both service members. You may have seen their story on a recent ABC News program. Due to the costs of his wife's illness and her inability to work, they took out a payday loan which led to thousands of dollars in outstanding loans from both payday lenders and installment loan companies. The more they paid, the more they owed and have repaid tens of thousands of dollars. One loan led to another because they had to keep borrowing more money *to avoid the threats of criminal prosecution and the consequences of the lender contacting Mr. Hubbell's command*. Over a five-year period of time, they were forced to borrow just over \$10,000 and still have a monthly payday loan debt of just over \$3,500. The Hubbells still owe over \$12,000 on loans, most of which only went to pay off other loans and provided no benefit to the Hubbells except for digging them deeper into debt. Mr. Hubbell is an air traffic controller

²⁴ Mary Vandevaire, Arizona Daily Star, July 3, 2004.

²⁵ Collection letter on file with CFA.

²⁶ Candace Heckman, "State Accuses Paycheck Lender of Collection Abuses," Seattle Post-Intelligencer, September 28, 2004.

and felt he had no option but to stay on this debt treadmill because of his fear of the real danger of losing his security clearance and his rank.²⁷

11. A Texas consumer filed a lawsuit against a payday lender illustrating the coercive collection tactics made possible due to securing loans with a personal check held for future deposit. A loan company representative left a business card at his door with a hand-written admonition to call about this “hot check.” She also left a document which bore the seal of the McLennan County Criminal District Attorney and stated “writing hot checks is a type of theft” and “the hot check writer can also be charged additional expense of the fine and court costs which could run into hundreds of dollars or could be sentenced to jail or prison.”²⁸

Multiple electronic attempts to collect payday loans

1. On January 3, 2003 a Service member was charged \$200 for ten returned check fees as a result of repeated attempts to debit his account to collect on one payday loan. The credit union charged \$20 per returned debit. The payday lender’s contract authorized its \$20 returned check fee in addition to the credit union fees. The original \$300 loan cost a \$45 finance charge and 342.19% APR and listed the personal check as “security” for the loan.²⁹

2. A Pennsylvania consumer had insufficient funds to repay a \$455 loan from County Bank of Rehoboth Beach, Delaware in 2003. The loan cost 782.14% APR. On April 4, 2003, her bank statement showed five attempts to collect the same “Cashnet Collection” transaction, triggering five \$19 NSF item fees. Again on April 18, 2003 the same transaction was presented and bounced seven times for a total of \$133 in returned item fees that day. The lender attempted collection three times each on March 7 and March 21, and twice on February 21. The consumer was charged more in NSF fees to her own financial institution than the amount financed for the original loan.³⁰

Lenders sue for treble damages for “hot checks”

1. The California Attorney General filed charges of deceptive business practices and fraud against now defunct Fast Cash loan service in Arcadia. The complaint filed in Pasadena Superior Court sought \$2 million in civil penalties, including \$350,000 in restitution for borrowers. The Attorney General said that Fast Cash threatened lawsuits, tried to squeeze settlements from borrowers and deceived the courts about the checks written to secure loans. In violation of California law, Fast Cash sued more than 400 payday loan customers for treble damages for checks passed on insufficient funds.³¹

²⁷ Lynn Drysdale, Jacksonville Area Legal Aid, Testimony, Senate Committee on Banking, Housing and Urban Affairs, September 14, 2006.

²⁸ Robby Ellison v. Advance America Servicing of Texas, L.P. d/b/a Advance America, Plaintiff’s Original Petition and Request for Disclosure, District Court of McLennan County, TX, Jay 12, 2005.

²⁹ Loan and credit union documents on file with Consumer Federation of America

³⁰ On file with CFA.

³¹ Gary Scott, “Payday Loan Firm Faces Charges,” *Pasadena Star-News*, August 2, 2006.

Payday lenders employ wage assignments.

1. An Illinois consumer entered into an Internet payday loan with Northway Financial Corporation Ltd for a \$200 loan that cost \$54 finance charge and 657 percent annual interest. The lender claimed that the law of the Republic of Malta governed the transaction. The contract gave a security interest in “your ACH debit in the amount of Total of Payments, plus applicable NSF, collection and reasonable attorney fees.” NSF fees cost \$29 each. The contract included a “Declaration of Wage Assignment,” which stated in part “I acknowledge this instrument as an absolute, irrevocable, and unconditional assignment and sale of the said amount of my wages.”³²

Recommendation:

The following practices should be declared unfair trade practices by the Federal Trade Commission:

Basing or securing loans with the borrower’s check held for future deposit.

Holding electronic authorization to access the borrower’s bank account as security for payment of a loan.

Creating demand drafts or remotely created checks to repay loans

The Federal Trade Commission should investigate the payday loan industry and bring cases to stop the use of mandatory wage assignments and threats of criminal prosecution and other threats of unfounded legal consequences for failure to repay loans.

III. Car Title Loans or Pawns

Quick cash loans secured by the title to the borrower’s vehicle owned free and clear expose borrowers to the risk of repossession if consumers are unable to repay one-month loans at 300 percent annual interest. The form of title lending varies, depending on state law requirements and business models. Title loans are authorized in about half the states. In Georgia and Alabama, title loans are made under the pawn laws with lenders not required to return surplus funds when repossessed cars are sold. In Virginia and Kansas, title loans are structured as open end credit to avoid the Kansas closed end small loan rate cap and to take advantage of Virginia’s legal vacuum for open-end credit providers. In some jurisdictions, title lenders seek to collect deficiency balances if the loan and fees are not covered by sale of the repossessed car.³³ For a full discussion of title loans, reports from CFA and the Center for Responsible Lending are posted at CFA’s web site.³⁴

³² On file with CFA.

³³ Settlement Agreement, In the Matter of Anderson Financial Services, LLC, d/b/a Loan Max and LoanSmart, LLC, Virginia Attorney General, June 8, 2007. Lender agreed not to seek deficiency balance from defaulting borrowers whose cars were repossessed.

³⁴ Jean Ann Fox and Elizabeth Guy, “Driven into Debt: CFA Car Title Loan Store and Online Survey,” Consumer Federation of America, November 2005. Also, see Amanda Questor and Jean Ann Fox, “Car

Car Title Loans Pose Repossession Risk

A few state regulators report information about car title loan repossessions. A 2004 report from the New Mexico Financial Institutions Division found almost two thousand vehicles were repossessed by New Mexico lenders and less than a thousand were reclaimed by consumers who were able to pay the balance and repossession costs.³⁵ New Mexico regulators did not report the total number of loans made during the year, but less than 20,000 title loans were outstanding at the end of calendar year 2004 compared to over one thousand consumers who lost vehicles to repossession that year.

The Tennessee Department of Financial Institutions (DFI) reported on title lenders early in 2007, based on a survey of licensed lenders. The Department reported that 92,489 title loan transactions were made during the year ended June 30, 2006. The 2007 report noted industry data that 10,933 vehicles were repossessed during the same year.³⁶ An earlier report from Tennessee DFI found that the average borrower had seven title loan transactions during the year.³⁷ If there were no title loan renewals or repeat loans to the same customer during the year, this results in a repossession rate of 12 percent. If every customer had only three title loans/renewals during the year, 35 percent of borrowers' cars were lost to repossession. If every title loan borrower averaged seven transactions during the year as indicated by DFI studies, over half of all cars pledged for loans were eventually lost to repossession.

One title loan company in Virginia sends its repossessed cars to auction the first Saturday of every month, according to the auction's web site. A partial list of LOAN MAX and LOAN SMART vehicles listed for sale on February 3, 2007 totaled 37 cars and trucks.³⁸

The threat of repossession is a powerful collection device or incentive to keep consumers paying the finance charge without reducing principal. Recently an Alabama consumer reported to CFA that a title lender cut the lock off the gate to her yard to repossess a truck whose title secured a loan for \$3,500. Although she had make payments during the year, the balance owed was still \$3,500. Despite her bad experience, to keep from losing her husband's truck, the desperate consumer took out two additional title loans on other vehicles to raise funds to reclaim the truck.

Title Lending: Driving Borrowers to Financial Ruin," Center for Responsible Lending and Consumer Federation of America, April 2005. www.consumerfed.org

³⁵ Summary of Title Loans, New Mexico Financial Institutions Division, October 4, 2005. On file with CFA.

³⁶ "Report on the Title Pledge Industry: A Supplement to the 2006 Report to the Tennessee General Assembly," Tennessee Department of Financial Institutions, February 12, 2007. See, also

³⁷ "Report to the Tennessee General Assembly, Pursuant to Public Chapter 440, Acts of 2005, Section 7(e)," Tennessee Department of Financial Institutions, February 1, 2006 at 6.

³⁸ Bryan Buchanan Auto Auction, Inc., Auction Schedule 2007, posted at www.bryanbuchananauction.com/schedule.htm, visited January 27, 2007.

Recommendation

The Federal Trade Commission should define high cost loans secured by title to the borrower's vehicle as an unfair trade practice per the FTC Credit Practices Rule. The Commission should investigate the repossession and collection practices of the title loan industry and take action to ensure compliance with the Fair Debt Collection Practices Act, the Credit Practices Rule, and the Federal Trade Commission Act for loans collected by the lender.