



**Consumer Federation of America**

**“Breaking News” in Payday Lending**

Jean Ann Fox, Director of Consumer Protection  
Consumer Federation of America

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**Payday lending is big news.** Cash advances based on access to the borrower’s checking account are the fastest growing, most expensive form of borrowing in America. Consumers are enticed to write checks for which they have insufficient funds at the time to cover (or grant electronic access to their account to the lender) in exchange for immediate cash. These single payment loans of \$100 to \$500 are due in full on the borrower’s next payday.

The unique and troubling nature of payday lending generates front-page news reports and editorials. Some of those features....

**Payday loans are tailor-made to snarl needy borrowers in perpetual debt.** No credit check is run to see if borrowers can afford the extra debt. The loans are due in full on the next payday, setting loan terms of a day or two up to two-weeks. The fees are quoted based on \$\$ per \$\$\$ advanced, so consumers don’t learn the APR until the deal is done, if ever. Since loans are for such a short period of time and for small sums, the fee does not set off alarm bells. The legal fees for \$100, 14-day payday loans range from 390% APR to 871% APR in states that limit fees at all, with the sky the limit in eight states and for any payday lender using a federally-insured depository institution to front the loans.

**Loans foster coercive collections.** Because lenders hold a personal check or authorization to credit the bank account through the ACH system, consumers are easily coerced into repeated refinancing and multiple loans to avoid bounced checks and the resulting multiple fees and the risk of civil or criminal “hot check” charges. Not to mention, wage garnishment, collection harrassment, court marshall for violation of the Uniform Code of Military Justice, and loss of the bank account or check writing privileges.

**Payday lenders target vulnerable borrowers.** The customers of payday lending are the very consumers who can least afford these loans. The average customer makes

less than \$25,000 a year. By definition, payday loan borrowers must have a bank account in reasonably good standing and a steady source of income. Welfare reform has produced a growing body of the working poor, consumers who have a job and now have a bank account but have very little savings and little access to credit. The industry counts on attitudes that favor convenience, the “hands-tying” idea of loans that have to be paid back right away, and impulse shopping.

**Payday lending is a fast growing phenomenon.** Although no federal agency keeps records, investment advisors report that 6% of Americans use payday loans and that almost 10,000 stand-alone and multi-product stores make loans. Stephens, Inc., a Little Rock investment bank, estimates that 41 million payday loan transactions will be made in 2000, generating \$1.4 billion in fees. Oregon reports that 155 lenders made \$64 million in payday loans by mid 2000. Nevada does not track loan volume but notes rapid growth. On the other hand, Louisiana and Washington report that the market is saturated and the number of licensed lenders has not grown this year. The loan volume in Washington over the last three years was \$145 million in 1997, \$281 million in 1998, and \$494 million in 1999.

**Payday lending continues to be very controversial** in public policy arenas, with consumer advocacy organizations and credit/financial counseling and assistance programs, and with consumer attorneys and protection officials. In some states, there is virtually no supervision or enforcement of credit laws. In others states, lawmakers and financial regulators are considering new laws and tougher enforcement of old laws. The payday loan phenomenon is symptomatic of the two-tiered financial market that traps many consumers in high-cost, high-risk credit.

### **Making a federal issue of payday lending**

Banks claim the right to “export” loan terms from home states, a loophole that is being exploited by payday lenders to peddle triple-digit interest rate loans without regard for state consumer protection, usury, or small loan laws. A growing number of bank-payday lender partnerships are springing up as lenders move into states such as Virginia, Pennsylvania, and Georgia that still enforce small loan interest caps. Banks, such as Eagle National Bank, Goleta National Bank, County Bank, Web Bank, and others, are making payday loans in partnership with check cashers, gas stations, pawn shops, and payday loan operations.

The claimed ability of banks to export interest rates across state lines thwarts state consumer protection enforcement and puts pressure on state legislatures to legalize payday lending for non-bank lenders. State banking commissioners and credit administrators have the job of protecting consumers in the small loan market. Payday lenders who partner with national banks to evade state usury limits are not subject to parallel federal protections. This legal no-man’s land exposes consumers to abusive interest rates and threatens the safety and soundness of federally insured institutions.

A case in point: New York has a 25% penal code usury limit. The NY Banking Supervisor has issued two letters clearly stating that payday lending is subject to that limit. Yet, out-of-state payday lenders using bank charters to export higher interest rates are doing business in New York. For example, County Bank of Rehobeth Beach, Delaware, loaned a New York consumer \$200 and charged \$70 in interest. The APR on repeated roll-overs of this loan ranged from 638% to 1,825%. Since this type of lending is illegal in New York, the loan was advertised on radio, the consumer called a toll-free number and was faxed the loan application which she signed and faxed back.

The Chairman of the FDIC has criticized these “rent a charter” deals and is investigating banks involved. The Comptroller of the Currency continues to give banks that make payday loans “Satisfactory” CRA ratings. Settlement of a national class action suit is pending court acceptance in California. Dollar Financial Group has reported to the SEC a tentative \$5.5 million settlement in the Phanco case.

States are trying various measures in an effort to restrain bank loan sharking. Massachusetts shut down the local Mail Boxes, Etc. outlet that was making payday loans in Boston for County Bank in Delaware. State regulators cited their small loan law that applies to brokers as well as lenders. Tennessee is seeking to apply its deferred presentment law prohibition on licensees making contracts to exceed the terms of the law. Some state regulators have written to bank lenders to demand a halt. And, Colorado this year adopted a payday loan law to apply to banks except for the interest rate cap and licensing requirements.

But, only Congress and the federal bank regulators can stop usury-by-bank charter. Two federal bills address the role of banks/checks drawn on federally insured depository institutions. HB 1684, introduced in 1999 by Rep. Bobby Rush, would require banks to comply with the payday loan law of the state in which the consumer receives the loan. Senator Lieberman held a forum on payday lending last December and was very critical of this legal two-step around state regulation.

Rep. John LaFalce, ranking member of the House Banking Committee introduce HR 3823 to prohibit loans based on checks drawn on federally insured depository institutions. By preventing FDIC-insured financial institutions from directly or indirectly making payday loans, Rep. LaFalce’s legislation preserves the power of state small loan regulators to enforce usury laws and rate caps in their states.

This bill also protects the safety and soundness of federally insured depository institutions. Banks have no business enticing other banks’ accountholders to write checks for which there is no money in the bank. Payday loan customers pay finance charges over and over to avoid default, or borrow from one lender after another to keep loans afloat. Eventually this house of cards crumbles for many consumers who simply cannot afford interest rates of 390% or higher. When consumers can no longer roll-over or repay these loans, the checks bounce. Account ownership is threatened by bad credit reports, such as ChexSystems’ five-year reporting of accounts closed due to bounced checks.

Senator Paul Wellstone attempted to amend the bankruptcy bill to prohibit recovery through bankruptcy for any credit that costs consumers more than 100% APR. The amendment failed on a 44 to 53 vote.

### **News Flash on Payday Loan Legislation and Regulation**

After several years of little resistance at state legislatures, the payday loan industry hit better-organized opposition in 1999 and 2000 sessions. In 1999, only two states legalized payday lending (Hawaii and Arkansas.) In 2000, only Arizona made the loans legal, while Colorado exchanged regulations for specific legislation with slightly lower cost limits. The payday loan industry failed to move safe harbor bills in Alabama, Florida, Georgia, Virginia, Maryland, Indiana, Oklahoma and Michigan. An industry attempt in Kentucky to rewrite legislative history failed. But, they will be back!

Both payday loan trade associations and consumer organizations provide lawmakers “model” state legislation. States are beginning to accommodate payday loans under state UCCC/small loan laws, not in check cashing, safe harbor legislation.

- Colorado retains UCCC licensing and supervision of lenders and requires banks to comply with the all terms except the fee cap and licensing requirement.
- The Texas Finance Commission adopted regulations to permit small loans based on personal checks held for future deposit under the provisions of the Texas small loan act. Unfortunately, the permitted \$10 administrative fee plus 48% APR interest for loans as short as 7-days will result in very expensive credit. On the other hand, Texas regulators responded to consumer comments to permit the \$10 fee to be applied only once per 30 days and to prohibit the use of criminal worthless check collections. Lenders are required to consider the borrower’s ability to repay the loan.
- Alabama is proposing rules under the Mini-Code and the Alabama Small Loan Act to set a minimum 30-day loan term for regulated small loans and to add to Mini-Code regulations the threat of criminal prosecution for worthless checks as an unreasonable collection tactic.

Several states that legalized payday lending a few years ago amended their laws to curtail some of the abuses. For example, Mississippi clarified that sale-leaseback and catalog sales are subject to the Mississippi payday loan law. A Kentucky bill attempted to lower costs and tighten requirements, but ultimately died after being high-jacked by an industry amendment attempting to rewrite legislative history. The California legislature adjourned without passing either of the competing bills from consumer groups or the industry.

The Washington Department of Financial Institutions issued a directive to licensed lenders that multiple checks may not be used for the same loan. Apparently, lenders were requesting multiple checks in order to impose multiple bounced check fees when loans default. Ohio amended its laws to prevent payday lenders from suing defaulting borrowers under the victims of crimes bill. Instead of asking that borrowers be

prosecuted under criminal bad check laws, payday lenders were suing borrowers in civil court, arguing they were victims of fraudulent checks.

Frustrated with inaction in Florida, local governments have started enacting payday loan ordinances. Seminole County adopted an ordinance in August, based on the NCLC/CFA model law. The ordinance has a delayed effective date until after the next session of the legislature and caps rates at 18% APR plus a \$5 one-time fee. Other Florida counties are considering similar ordinances.

### **News Flash on State Enforcement**

Enforcement of state payday loans laws varies widely. No government agency licenses or supervises check cashers who make payday loans in Hawaii. A few states conduct routine examinations and take disciplinary action against violators.

States that retain small loan interest rate laws or usury caps have stepped up enforcement activity directed at payday lending. The long-term result may be industry pressure for state safe harbor legislation. In the short-term, some state directives are being litigated.

- Maryland Financial Commissioner is enforcing small loan rate caps and has alerted consumers that they do not have to repay illegal payday loans. Maryland also is working to prevent the use of criminal worthless check laws to collect payday loans.
- Indiana Attorney General's opinion that licensed lenders must comply with the 36% APR small loan rate cap when charging the \$33 minimum finance charge for loans was challenged in court by the industry trade group and one chain lender to prevent implementation by the Department of Financial Institutions. It is expected that the Indiana Supreme Court will have to resolve the interpretation of law.
- Alabama's long-running court fight over enforcing 150 Banking Department cease and desist orders to payday lenders isn't over yet. Although summary judgment was argued by state officials in late 1999, the judge has yet to rule. Meantime, the Alabama legislature has refused to legalize payday lending.
- The North Dakota Attorney General and Banking Commissioner issued an August letter to payday lenders warning that anyone making unlicensed loans or charging more than interest laws allow risks criminal prosecution.

### **States Take Action on Abusive Collection Tactics**

Payday lenders treat the personal check on which the loan is based as both a loan document and as the payment mechanism. When borrowers can't cover the checks, some lenders use civil bad check laws to sue for triple damages, attorney's fees and interest. For example, an analysis of court records in Dayton Municipal Court found that payday lenders routinely sue borrowers for triple damages under Ohio's "Civil Damages for Crime Victims" statute. Judgements in 381 cases totaled \$285,406, with wages garnished in 60% of the cases.

In the aftermath of the Indiana Attorney General's opinion that payday lending violates Indiana's small loan and loansharking laws, local courts were reported in a quandary about how to handle claims for triple damages under Indiana's bad check laws. Hundreds of lawsuits had been filed in Evansville under the bad check statute with triple damages.

The Idaho Department of Finance implemented new rules on payday loan remedies in January. "Unlike situations in which a merchant holds a check given in exchange for merchandise, a check transferred in a payday loan is intended as a loan instrument, and the transaction is regulated as a regulated consumer loan...The Department believes that the treble damages remedy available for collection of dishonored checks ...is not available to payday lenders who hold a dishonored check taken in a payday loan transaction."<sup>1</sup> Iowa's policy on checks prevents the use of civil or criminal "hot check" enforcement.

**Payday lenders' ace-in-the-hole debt collection tool is to threaten criminal bad check charges.** A payday lender who solicits a check knowing funds are not on deposit to cover the check cannot claim to be the innocent victim of fraud when the check later bounces. Although court decisions and some state Attorneys' General directives hold that criminal hot check laws do not apply to payday loans, consumers are being threatened with prosecution.

The Texas Credit Commissioner testified at a Senate forum in December that 13,000 criminal complaints were filed in one year in a single precinct in Dallas County by payday lenders.

The Cook County States Attorney and the Illinois Department of Financial Institutions recently settle a case against a payday lender allegedly mailing out fake warning letters to delinquent borrowers. The Cook County State's Attorney quoted a page from Nationwide Budget Finance Inc. manual that instructed company employees to call all personal references and warn them that Nationwide would have a warrant issued for the customer's arrest.

The Georgia Court of Appeals upheld a conviction against the operators of two payday lending companies who were found guilty of violating the state RICO law, including thirteen counts of perjury for swearing out of arrest warrants for the offense of "bad check," threats of violence and arson.

In the credit counseling client survey compiled by Consumers Union, 20% of clients had been threatened with criminal prosecution. Also, 74% of counseling agencies reported to CFA having clients who had been threatened with criminal prosecution and 18% had clients who had criminal charges filed.

A Florida credit counselor wrote about a client who got caught up in payday loans and car title loans in an effort to prevent foreclosure on her house and to care for her

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<sup>1</sup> Idaho Department of Finance, Enforcement Policy #99 – 1, December 16, 1999.

daughter with cerebral palsy. “Ms. Jones” was paying \$644 a month to roll-over payday loans, more than her mortgage payment. When she let one of the payday loans lapse, the check bounced. She got a letter threatening to turn over the check to the State Attorney for criminal prosecution.

A California payday lender that makes payday loans in partnership with a bank sent a delinquent customer a letter threatening to file a “worthless document report” with the local police department, to report the debt to TRW to stay on the credit report for up to ten years, to report the returned check to Tele-Check, a company used by retail stores to screen customers who pay by check, and to notify the Social Worker for welfare or social security of unreported income.

A class action lawsuit filed in Arkansas<sup>2</sup> alleges threats made by a payday lender to turn over the consumer to the Prosecuting Attorney and that legal action would be taken if she did not continue making payments to the company. To avoid these consequences, the consumer paid \$832.73 in interest on her \$300 loan without any reduction in principal.

### **Film at Eleven**

Payday loan legislation, regulation, enforcement, and litigation makes for a fast moving story. Attached is a list of reports and information available online. Please check with the Consumer Federation of America web site for the latest reports. We are at [www.consumerfed.org](http://www.consumerfed.org). If you go to Press Releases, you will find links to our reports.

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<sup>2</sup> Graham vs. Horizon Financial Services, Circuit Court of Garland County, Arkansas, Dec. 17, 1998.

## **Status of State/Territory Payday Loan Authorization**

### **States that prohibit payday loans due to small loan interest rate caps, usury laws, and/or specific prohibitions for check cashers**

Alabama <sup>3</sup>	Alaska	Connecticut	Georgia
Indiana <sup>4</sup>	Maine	Maryland	Massachusetts
Michigan <sup>5</sup>	New Jersey	New York <sup>6</sup>	North Dakota
Pennsylvania	Puerto Rico	Rhode Island	Vermont
Virginia	Virginia Islands	West Virginia	

### **States with no small loan/usury cap for licensed lenders**

Delaware	Idaho <sup>7</sup>	Illinois	New Hampshire <sup>8</sup>
New Mexico	Oregon	South Dakota	Wisconsin

### **States with specific laws or regulations that permit payday loans**

Arizona	Arkansas	California	Colorado
Florida <sup>9</sup>	Hawaii	Iowa	Kansas
Kentucky	Louisiana	Minnesota	Mississippi
Missouri	Montana	Nebraska	Nevada
North Carolina	Ohio	Oklahoma <sup>10</sup>	South Carolina
Tennessee	Texas	Utah	Washington
Wyoming	District of Columbia		

Source: Consumer Federation of America

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<sup>3</sup> Loans currently permitted under terms of court injunction in case pending between Alabama Banking Dept. and the Alabama Check Cashers Association. Payday loan legislation failed at 1999 and 2000 session of Alabama legislature.

<sup>4</sup> Indiana Attorney General issued an opinion that licensed lenders who charge the minimum \$33 finance charge must also comply with Indiana's 36% small loan rate cap. The industry is challenging enforcement of that opinion.

<sup>5</sup> Michigan Financial Institutions Bureau issued a declaratory ruling April 25, 1995 re: Oak Brook/Cash Now Partners d/b/a Cash Connection finding that deferred presentment was a loan subject to Regulatory Loan Act of 1963 and violated the Usury Act (MCL § 438.31) and the Criminal Usury Act (MCL 438.41 et seq.)

<sup>6</sup> New York Bank Superintendent issued an All Institutions letter June 13, 2000 confirming enforcement of New York's 25% APR criminal usury cap (§ 190.40 New York State Penal Code.)

<sup>7</sup> Idaho Enforcement Policy #99-1 "Fraudulent and Unconscionable Conduct in Payday Loan Transactions" spells out Department of Finance policy on payday loans made by licensed lenders. December 16, 1999

<sup>8</sup> Small loan rate cap repealed effective 1/1/00. No payday lenders are licensed to date in New Hampshire.

<sup>9</sup> Florida Money Transmitter regulations permit cashing post-dated checks at same fee as cashing personal checks. Roll-overs or extensions of loans violate Florida usury and/or consumer finance act.

<sup>10</sup> Oklahoma permits loans of under \$101.97 as single-pay one-month loans. Bill to authorize full-scale payday lending failed in 2000 session of the Oklahoma legislature.



## **Reports and documents about payday lending available on-line.**

**“Show Me The Money,”** report by Consumer Federation of America and the US Public Interest Research Group, February 2000  
[www.pirg.org/reports/consumer/payday/index.html](http://www.pirg.org/reports/consumer/payday/index.html)

**“Safe Harbor for Usury: Recent Developments in Payday Lending,”** Consumer Federation of America, September 1999  
[www.consumerfed.org/safeharbor.pdf](http://www.consumerfed.org/safeharbor.pdf)

**“The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry,”** Consumer Federation of America, November 1998  
[www.stateandlocal.org/loanshar.html](http://www.stateandlocal.org/loanshar.html)

**“Unregulated Payday Lending Pulls Vulnerable Consumers Into Spiraling Debt,”** Woodstock Institute Reinvestment Alert, March 2000, Number 14  
[www.woodstockinst.org/Alert.pdf](http://www.woodstockinst.org/Alert.pdf)

Press releases, testimony and reports from Consumers Union, publisher of Consumer Reports, including:

**“Wolf in Sheep’s Clothing: Payday Loans Disguise Illegal Lending,”** Consumers Union Southwest Regional Office, February 1999  
[www.consumersunion.org/finance/ipayday.htm](http://www.consumersunion.org/finance/ipayday.htm)

**“Payday Loans Don’t Pay,”** AARP consumer fact sheet, March 2000  
[www.aarp.org/confacts/money/paydayloans.html](http://www.aarp.org/confacts/money/paydayloans.html)

NCLC/CFA Model State Payday Loan Law  
[www.nclc.org/PayDayLoans/Pay%20Day%20Loans.htm](http://www.nclc.org/PayDayLoans/Pay%20Day%20Loans.htm)

**NCLC Payday Loans: A Form of Loansharking: The Problem, Legislative Strategies, A Model Act**  
[www.nclc.org/PayDayLoans/pay-menu.htm](http://www.nclc.org/PayDayLoans/pay-menu.htm)