



Consumer Federation of America

Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury

A Report on Devices Used by Payday Lenders to Evade
State Usury and Small Loan Laws

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Executive Summary

- ? Banks continue to play a major role in enabling payday loan chains to evade state usury, small loan and payday loan laws. Ten state-chartered FDIC supervised banks are the only financial institutions known to be partnering with pawn chains, check cashers, and payday lenders, following regulatory action by the Comptroller of the Currency, Office of Thrift Supervision, and Federal Reserve.
- ? The Federal Deposit Insurance Corporation, the last bank regulator to issue payday loan enforcement guidelines for banks that partner with payday lenders, has taken no payday loan guideline enforcement action involving state-chartered FDIC supervised banks. Since the FDIC guidelines were issued in July 2003, three more FDIC regulated banks have entered into partnerships with payday lenders. The FDIC permitted a Federal Reserve-member bank to switch regulators in order to continue its lucrative payday loan business.
- ? The payday loan industry's goal is safe harbor legislation in every state. Currently 33 states and the District of Columbia authorize payday loans by law or regulation, and two additional states have no usury limits for small loans by licensed lenders. Fifteen states prohibit payday lending through operation of usury or loan laws and a growing number of states prohibit retailers from brokering loans for out-of-state banks.
- ? Payday lenders face growing resistance from state legislatures, especially in states where loans are not legal. In 2004 the Michigan Governor vetoed a safe harbor bill and Georgia legislators passed a tough anti-payday loan enforcement bill.
- ? Industry analysts in early 2003 reported a 50 percent increase in the number of payday loan outlets as of since year-end 2000 and double the fee revenue. Growth in industry size is fed by additional states authorizing payday lending, expansion of lending into states through rent-a-bank arrangements and other devices as well as repeat borrowing by current customers.

- ? Despite legal status in more states, some lenders use thinly-veiled retail transactions to make payday loans that exceed state limits. Internet rebate plans, rebates with phone card sales, and other subterfuges are employed to evade consumer protections.

Introduction

Consumer Federation of America has reported on the payday loan industry, its growth and impact on cash-strapped consumers, litigation and enforcement actions targeting check-based lending, and legislation adopted by states to permit or prohibit payday lending. We have also described the use of bank partners by lenders determined to make loans where prohibited or restrained by states by claiming the bank's right to export its home-state interest rates. Earlier reports issued by CFA and US PIRG included surveys of payday loan fees and charges and information disclosure.¹

This 2004 report updates information on the legal status of payday lending in the states, the growth of the business, and the continued use of thinly-veiled retail transactions to obscure small loan transactions. It also updates recent federal bank regulatory actions regarding rent-a-bank payday lending and the failure of the Federal Deposit Insurance Corporation to come to grips with the misuse of federally insured state depository institutions by non-bank entities to make loans that don't pass legal muster for the non-bank lender. Finally, we recommend actions for state and federal policymakers to close the loopholes used to peddle usurious small loans to financially vulnerable consumers.

Payday Loans Are Predatory Usurious Loans

Payday loans are small cash loans based on borrowers' personal checks held for future deposit or on electronic access to borrowers' bank accounts. Loans of \$100 to \$500 cost triple-digit interest rates, typically 390% to 780% annual interest rates for two-week loans with \$15 to \$30 finance charges per \$100 borrowed. Single-payment loans are due in full on the borrower's next payday, typically in two weeks. Borrowers are generally required to have a bank account in relatively good standing and a source of income or benefits to qualify for loans.

¹ See, "**Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections,**" report by Consumer Federation of America and the U. S. Public Interest Research Group, November 2001 www.consumerfed.org/paydayreport.pdf

"**Show Me The Money,**" report by Consumer Federation of America and the U. S. Public Interest Research Group, February 2000 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

"**The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry,**" Consumer Federation of America, November 1998 www.stateandlocal.org/loanshar.html

Payday lenders encourage cash-strapped bank account holders to write checks without funds on deposit and then use those checks to coerce repeat transactions or collections. The combination of relatively large loan size, expensive finance charges, short loan terms, and check holding results in loan flipping that traps many vulnerable consumers in perpetual debt. A report issued by the Coalition for Responsible Lending estimated that 91% of all payday loans are made to borrowers with five or more payday loans per year and nearly one in three customers receive twelve or more loans per year.² Iowa regulators report that the average customer in 2003 had 12.31 loans at the same lender and almost 50 percent of customers had 12 or more loans in 2003 at the same lender.³

Payday lending is inherently unsafe and unsound because loans are made without regard for the borrower's ability to repay. As noted by the FDIC, payday lenders do not obtain or analyze information on the borrower's debt burden or get credit reports from major national credit bureaus (Equifax, Experian, and TransUnion). "The combination of the borrower's limited financial capacity, the unsecured nature of the credit, and the limited underwriting analysis of the borrower's ability to repay pose substantial credit risk for insured depository institutions."⁴

Payday lending is not a new phenomenon.⁵ The practice of extending cash based on a personal check held by the lender was branded early on as a ruse to avoid usury laws. During the Great Depression, the term "loan shark" was coined to describe lenders who used the purchase of wages or salaries as a vehicle for usury and charged interest rates from 240% to 1000% for short-term loans. The Georgia Court of Appeals issued an opinion in 1930 describing the abuse of wage buying as a "scheme or device to evade the laws against usury."⁶ Today's salary buyers have won legal status in many states, yet persist in a pattern of shams and ruses to peddle their loans in states without legal authorization or to exceed limits set by state law. Everything old is new again.

Payday Lending is Big Business

The payday loan industry has grown rapidly in the last two years, partly from more states authorizing loans and from growth in the number of lenders and repeat business. CFA's most recent comprehensive payday loan report⁷ noted projected loan volume for 2000 of 41 million transactions, generating \$1.4 billion in fees, with 7,000 stand-alone outlets and 5,000 other locations such as check cashers or pawn shops.⁸ By October 2001, industry analysts reported 65

² Center for Responsible Lending, "Quantifying the Economic Cost of Predatory Payday Lending," Dec. 18, 2003, p.2.

³ Iowa DD Exam-Survey History, received Feb. 8, 2004, on file with author.

⁴ FDIC Guidelines for Payday Lending, Significant Risks, p. 1, www.fdic.gov/regulations/safety/payday/index.html

⁵ See Testimony by Jean Ann Fox, Senate Hearing conducted by Senator Lieberman, Dec. 15, 1999.

⁶ Statement of Sidney R. Barrett, Jr., Senior Assistant Attorney General, Georgia, Hearing on the Payday Loan Industry, House Banking and Finance Committee, December 3, 2003.

⁷ CFA and USPIRG, "Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," November 2001, www.consumerfed.org/paydayreport.pdf

⁸ Stephens Inc., "Payday Advance – The Final Innings: Standardizing the Approach," September 22, 2000, p. 5. "Non-Bank Financial Services," Industry Notes, March 23, 2000, p. 3.

million transactions to 8 to 10 million household, producing \$2.4 billion in fee revenue.⁹ According to Stephens, Inc., a Little Rock, Arkansas investment bank, by close of 2002, roughly 15,000 licensed payday loan stores made 95 to 100 million loans to 9 to 14 million U. S. households. The report estimated \$25 to \$27 billion in loan transaction volume in 2002, generating between \$4.0 and \$4.3 billion in fees.¹⁰ Data for 2003 loan volume has not been made public by Stephens or the industry and no federal agency collects this data.

Growth is also evident from states where payday lending recently became legal. The Virginia legislature authorized payday loans effective July 1, 2002. By close of the first six months, state regulators reported that 49 companies with 377 licensed locations made over 600 thousand loans worth \$165,659,916 to 124,362 consumers.¹¹ The first year that payday lending was subject to authorizing legislation in Indiana, 86 companies with 374 branch locations were licensed.¹² Within five months of Oklahoma's payday loan law taking effect, over three hundred forty outlets had opened, with 95% having out-of-state owners.¹³

Payday Lenders Face Opposition to State Safe Harbor Laws

Payday lenders are small loan companies, subject to state usury laws or small loan rate caps absent safe harbor legislation. Fifteen states prohibit payday loans through small loan rate caps or state usury ceilings. These states include major markets, such as New York, New Jersey, Pennsylvania, Michigan, and Georgia. (CFA counts Texas in the ranks of states that authorize check based loans at triple digit rates, although the industry categorizes Texas as unfriendly.)

Thirty-three states and the District of Columbia provide safe harbor for payday lending while two additional states (Wisconsin and New Mexico) permit payday lending by licensed lenders with no substantive regulations. (See Appendix A.)

The Community Financial Services Association, a trade group for payday lenders, set a goal of 50 state laws, so the industry would be viewed as "a legitimate, independent industry, national in scope and regulated by the states."¹⁴ The industry has run into strong opposition this year in states where usury and small loan laws are still on the books.

So far in 2004, Governor Jennifer Granholm of Michigan vetoed industry safe harbor legislation as too expensive for consumers. The legislature has not voted to override her veto. The bill was opposed by a coalition of consumer, labor, and community groups.

Georgia enacted the toughest anti-payday loan bill in the country. On the Governor's desk, SB 157 passed by wide margins in both House and Senate, and clarifies that payday loans

⁹ Robinson, Jerry L., "The Deferred Deposit Industry: Payday Advance Product Overview," FiSCA, October 2001.

¹⁰ Robinson, Jerry L., "Update on the Payday Loan Industry: Observations on Recent Industry Developments," September 26, 2003, p. 11-12.

¹¹ "Supplement to the 2002 Annual Report of the Bureau of Financial Institutions, Payday Lender Licensees," Virginia Bureau of Financial Institutions, December 31, 2002.

¹² Indiana Department of Financial Institutions Annual Report, "Licensees and Registrants," p. 54.

¹³ <http://www.okdocc.state.ok.us/ROSTERS/rosters.php>, "Deferred Deposit Lenders."

¹⁴ Komar Storey, Charlene, "New CFSA President Says State Legislation Remains Goal," *Cheklis*, Fall 2002, p. 58.

are subject to Georgia's small loan law. The bill strengthens small loan enforcement and anti-racketeering tools, prohibits choice of law contract terms and closes the door on lenders brokering loans for banks. The Georgia bill includes protections specifically for members of the military, following testimony from Navy and Army spokesmen about abuses by check-based lenders against military personnel.

An industry-authorizing bill in West Virginia got no support in 2004, and a legislative interim committee unanimously recommended that West Virginia outlaw check-based lending altogether. A Pennsylvania bill to legalize payday loans is opposed by the Secretary of Banking¹⁵ and has not been scheduled for a hearing. PA HB 2150 is stalled due to opposition from labor, consumer, and community groups as well as the Secretary. Weak safe harbor legislation is opposed by consumer, senior and community groups in Alaska and Wisconsin.

A pair of Massachusetts payday loan authorizing bills failed in 2003. The Division of Banks testified in opposition to both bills, noting that "payday loans are another form of predatory lending," and that the current small loan act was enacted during the late 19th century to combat the practice of loan sharking, concluding that "we see no public policy or regulatory reason to exempt payday loans from this statute."¹⁶

Payday lending's legal status is under assault in Arkansas. Despite adverse rulings from the Arkansas Supreme Court that provisions of the 1999 payday loan act "were an invalid attempt" to evade the usury protections of the Constitution, the state continues to license payday lenders. A lawsuit was filed on behalf of Arkansas citizens against the Arkansas State Board of Collection Agencies and the Attorney General, charging the State with illegal extraction for misuse of public funds to license companies.¹⁷ The complaint was dismissed by the trial court and is on appeal to the Arkansas Supreme Court.

Payday Lenders Try to Weaken Current Laws

The industry is trying to expand its privileges under existing state payday loan laws. Washington completed a major revision of its payday loan law in 2003, expanding the size of loans to \$700 with the finance charge for loan amounts over \$500 set at \$10 per \$100 and expanding the maximum term for loans from 31 to 45 days. Payday lenders, having won legal status in Indiana with a 2002 bill negotiated between lenders and the Department of Financial Institutions, got amendments in 2004 to increase loan size limits, finance charges and repeat borrowing. Colorado lenders pushed a bill to drastically undercut state policy on unconscionable lending standards which was narrowed due to opposition from state regulators and consumers.

Public interest groups' campaigns to improve consumer protections in existing payday loan laws have had mixed results so far in 2004. Bills to prevent repeat borrowing in Arizona

¹⁵ Joseph N. DiStefano, "Pa's pact with a check-casher," *Philadelphia Inquirer*, February 6, 2004.

¹⁶ Statement in Opposition to House 663, An Act Relative to Cashing Checks for Deferred Deposit and House 664, An Act to Permit Consumers to Cash Checks for Deferred Deposit, MA Division of Banking, June 11, 2003.

¹⁷ *Sharon McGhee, et al. v. Arkansas State Board of Collection Agencies, et al.*, Circuit Court of Pulaski County, Arkansas, filed April 23, 2003.

and Utah were defeated, while a Virginia bill requested by the military to limit loans to one at a time enforced by a statewide database was carried over for further study. An Oklahoma bill amending the law that took effect September 2003 would cut the number of loans to one at a time with a cooling off period between loans. SB 1565 is pending in the House.

State Payday Loan Laws Protect Lenders, not Borrowers

The central feature of state payday loan laws is authorization for loans based on the borrower writing a check (or authorizing electronic access) which the lender holds until the loan due date. Lenders require personal checks written for the amount of the loan plus the finance charge although the “cold” checks are not payable on demand and take the checks knowing funds are not on deposit to cover the checks at the time. Some states also specifically authorize loans based on electronic access to the borrower’s bank account, although Virginia regulations prohibit loans made electronically without the paper check.

Payday loan laws enacted in states that also have small loan rate caps and/or usury laws exempt payday loans from application of those laws, granting lenders safe harbor from usury. In Texas, payday loans are authorized under the rate cap for signature loans. States that place no limit on the cost of check-based loans include Delaware, Idaho, Illinois, Nevada, New Hampshire, New Mexico, Oregon, South Dakota, Utah, and Wisconsin. In states with fee caps, the permitted rates range from \$10 per \$100 loaned plus up to \$5 per loan in Florida to \$75 per \$100 loaned in Missouri. The annual percentage rates for a \$100 loan due in two weeks under current state payday loan laws range from 309% in Texas to almost 2,000% in Missouri (current law allows a finance charge of \$75 per \$100 for one loan plus up to six renewals.) Montana allows \$25 per \$100 loan rates and Wyoming caps rates at \$30 or 20% of the amount loaned, producing a 780% annual interest rate for a \$100 loan. (See Appendix B.)

Payday lenders use a variety of ruses, loopholes, and tactics to get around state usury and small loan laws in states where safe harbor legislation has not passed and to go beyond the loan term limits and restrictions even in states where check-based lending is sanctioned. This report describes some of those practices.

Loopholes in State Laws and Regulations

Illinois is the worst case of lenders easily evading state-imposed limits on payday loans by exploiting loopholes. Rules adopted by the Department of Financial Institutions in 2001 did not cap fees or interest rates in this no-usury cap state. However, Illinois regulations set a \$400 ceiling on loans and required that loans be paid down by 20% each time a loan was refinanced. Illinois rules also set a 15-day waiting period between paying off one loan (plus two renewals) and getting another loan. The Department of Financial Institutions rules defined covered payday loans as having terms of 30 days.¹⁸ A preliminary 2002 inspection by the Department found that lenders escape the rules by making loans for 31 day terms at double their old 14-day loan fees,

¹⁸ Illinois Subpart B. Short Term Lending, 110.370

with less than 3% of the surveyed loans made according to the regulations.¹⁹ For example, payday loans marketed by Check Into Cash, one of the large national chains, have terms of 31 days in Illinois, while loans marketed by Check Into Cash in other states are for 14-day terms.²⁰

Payday Lenders Use Ruses to Evade State Protections

Early payday lenders used inventive schemes to hide the true nature of their loans. Lenders claimed to be “leasing” cash, or making “sale-leaseback” transactions. In the latter case, the lender claims to “buy” something the consumer owns and “lease” it back for a “rental payment” due in two weeks. Other lenders claimed to be selling catalog coupons to obscure a small loan transaction. The borrower always got cash that had to be repaid on the next payday, paid a steep fee and left behind a personal check.²¹

A booming market in thinly-veiled transactions continues to mask usurious small loans in states that outlaw payday lending outright and in states with more restrictive state payday loan laws. Advertisements in trade magazines blatantly tout ways to side-step state loan limits.

Usury Meets the Digital Divide

A full page ad for Cyber Center Solutions in a 2002 issue of *Cheklis*t, the trade magazine for check cashers and payday lenders, was headlined:

KISS REGULATORS GOODBYE: THE INTERNET ADVANTAGE

Are your state laws too restrictive?

Can't make money doing payday loans?

Sell Internet service instead! Make more money.

Low start up costs.

One contract per year (per customer).

No regulations Reg. Z, TILA, APR.

No sales tax (On Internet orders). No inventory to track.

Hugh profit potential. Best prices in the industry.

*You can be just like AOL, MSN, and all the other large Internet service providers that offer rebates to increase sales of internet service on term contracts. Dozens of payday loan companies have successfully marketed to their current payday loan customers in over a dozen states. Let Cyber Center Solutions, LLC Show You How to Make More Money.*²²

Cyber Services Technology also advertises in trade publications as “The Internet Solution” for payday lenders restrained by state laws. Ads promise “No Checks (Electronic

¹⁹ Steve Daniels, “Lenders skirt new rules on payday loans,” *Crain's Chicago Business*, June 2, 2003, p. 4.

²⁰ www.checkintocash.com/illinois.htm, visited March 5, 2004.

²¹ The Cost of Credit: Regulation and Legal Challenges, National Consumer Law Center, 2003 Cumulative Supplement, p. 71. See also, *Safe Harbor for Usury*, Jean Ann Fox, 1999 at www.consumerfed.org/safeharbor.pdf

²² Advertisement, *Cheklis*t, Spring 2002, p.19.

Transactions); No Forms to Fill Out (One contract per customer per year); No Regulations (No Reg Z, No APR, No Federal Truth in Lending); No Waiting (or “Cooling Off” Period); No Price Control (You set your own fees and payment plans).” The ad listed twelve states where the service is sold and claimed “Hundreds of PayDay Loan Companies were able to successfully market to their existing Customer base...resulting in greater profits.”²³

The Indiana Attorney General and Department of Financial Institutions filed charges in 2003 against nine companies advertising “internet access with cash rebates,” characterized by Indiana officials as “loans.” Companies charged included American Cash.Net LLC, CashConnects.com, Cash Links Service, FastCashConnects, MegaNet Services, Planet Cash, Quick Net Peru, Quick Net Kokomo, and Short on Cash.Net of New Castle. The companies operated from retail outlets in Indiana and claimed to sell Internet access from their store locations. The state countered that these companies use the sale of Internet membership services to disguise operation as small loan businesses without lending licenses or compliance with loan caps. Quicknet agreed to close its business following the complaints.²⁴ The Monroe Circuit court ordered Cash-Connects.com to stop its rebate offers and freeze funds.²⁵

In announcing the nine complaints, DFI Director Charles Phillips stated: “We have several companies trying to skirt the law by using the Internet to provide a service and by not obtaining proper operating licenses in Indiana...there is no reason, other than greed, that these particular companies should not be able to comply as well.”

Regulators alleged that one company used the sale of Internet membership to disguise its payday loan operation.²⁶ Consumers who became members of Quick Net’s Internet service selected a level of membership for a \$200 rebate and paid a periodic fee following receipt of the cash rebate. “Members” were entitled to access the Internet for limited time during business hours in the lobby of Quick Net’s store or on the consumer’s home computer. Cost for a \$200 rebate was \$1,460 in a year. A \$300 rebate cost \$2,190. The lowest price service cost 730% annual interest rate. Almost none of the customers used the Internet service. If the “membership” was cancelled, the consumer had to repay the rebate. By comparison, Indiana’s payday loan law capped finance charges at \$35 for loans up to \$400, with only an additional late charge of \$5 permitted.

North Carolina Attorney General Cooper filed charges against similar ruses in 2002. NCCS Loans Inc. and JAGJRTX, LLC doing business as Advance Internet and Advance Til Payday were accused of continuing as payday lenders following expiration of North Carolina’s payday loan law. Instead of making small loans at 36% annual interest under North Carolina’s Consumer Finance Act, NCCS Loans transferred ownership to JAGJRTX and started a “cash rebate” program tied to an Internet access contract. A borrower got an instant cash “rebate” from \$100 to \$600 if he signed a one-year Internet access agreement at a price of \$20 for every \$100

²³ Advertisement “the Internet Solution,” *Cheklis*, Spring 2002, p. 59

²⁴ “Payday Lender Closes Shop Following Lawsuit,” *TheIndyChannel.com*, Kokomo, Ind. Nov. 14, 2003.

²⁵ Press Release, “State Seeks Court Order to Close Payday Loan Companies Operating Without Licenses,” Indianapolis, IN, October 31, 2003. AP, “State Says Internet Service was Loan Scheme,” Mar. 19, 2004.

²⁶ *Department of Financial Institutions and Attorney General of Indiana v. Quick Net Kokomo*, Complaint for Preliminary and Permanent Injunction, October 30, 2003.

advanced every two weeks for a year or paid a cancellation fee equal to the cash rebate plus fees. The contract gave the consumer four Internet access hours every two weeks at computer terminals in the lender's store. The North Carolina complaint example was for a \$200 cash advance that cost \$1,040 (\$40 each two weeks for 26 payments) for an effective interest rate of over 500%. Regulators charged that Internet access was a device used to disguise unlawful payday lending to consumers who did not want or use the hours provided.²⁷

North Carolina also filed a complaint against Speed Net outlets for switching its payday loan business to a new program of offering and making payday loans under the pretext of cash "rebates" with the sale of Internet access contracts. Consumers paid \$20 every two weeks for a year or a \$120 cancellation fee to repay a \$100 cash advance for an Internet "account." Instead of requiring the borrower to renew the loan every two weeks, this vendor automatically withdrew the finance charge from the borrower's bank account. A \$300 advance cost \$1,560 over a year or over 500% annual interest. Speed Net sold Internet access for home use by consumers who did not own computers. North Carolina's Attorney General charged the company with offering internet services solely as a vehicle through which to disguise an unlawful payday lending business.²⁸

A class action lawsuit was filed in Circuit Court of Tuscaloosa County, Alabama against several Internet rebate lenders, alleging civil conspiracy, usurious interest rates in violation of the Alabama Small Loan Act, usurious rates in violation of the Alabama Mini-Code, unjust enrichment, and unconscionability.²⁹

The state attorney's office in Pensacola, Florida filed a lawsuit against Florida Internet, citing violations of Florida's Racketeer Influence and Corrupt Organization Act, and noted that criminal charges of fraud and usury could be filed. Florida Internet does business in seven Florida cities, making short-term loans based on 12-month contracts for Internet service. Borrowers who receive an upfront "rebate" are required to make biweekly payments equal to 20 percent of the money loaned. The example cited was a Pensacola woman who borrowed \$400 and repaid \$1,102 over a 10-month period. Florida Internet advertised "up to \$500 Instant Cash Rebate" and "No Credit Check; No Hassle; Savings or Checking Account Approved."³⁰

Payday Lenders Dial for Dollars with Phone Cards with "Rebates"

Another thinly-veiled payday loan is the sale of long distance phone cards with a cash rebate. A Georgia consumer earning less than \$10,000 a year got a \$300 loan from Cash In Advance which came with a contract to pay \$1,755 over the next year, or \$67.50 every two weeks, to buy telephone calling cards that she didn't need and that often didn't work. The

²⁷ *State of North Carolina v. NCCS Loans Inc. and JAGJRTX. LLC*, Complaint, General Court of Justice Superior Court Division, Feb. 2002

²⁸ *State of North Carolina v. Highlands Venture Financial, L.L.C., Speed Net of Asheville, L.L.C. et al*, Complaint, General Court of Justice Superior Court Division, Feb. 2002.

²⁹ *Yvonne Morton and Sherry Higginbotham v. Cyber Services Technology, Cash4U.Net, L.L.C., Cash Mart, Inc., Championcomm.net of Tuscaloosa, Inc., et al*, Class Action Complaint, Circuit Court of Tuscaloosa County, Alabama, May 16, 2002.

³⁰ Ad, *Shorelines*, May 29, 2002.

storefront where she got the loan had a sign in the window: “Up to \$500 Instant Cash.” The store’s Yellow Pages ad included the term “cash advance” several times.³¹

A few companies that market phone cards and software packages to check cashers, payday lenders, and pawn shops run ads in trade magazines touting these “cash back prepaid programs” as “redefining the future of cash advance.”³² Another ad offers “Serious Money! Our Clients have been making Serious Money for over 4 years. The Best Alternative to Pay Day Advances. PhoneCashUSA.”

PhoneCashUSA was formed by a group of check cashers following “circumstances affecting the payday advance industry” to “see what could be done to satisfy the needs of their customers and maintain profitability without extending credit or offering loans.” The company’s web site last year urged check cashers to “Get with the Program!,” claiming that “the PhoneCashUSA program assists you in maintaining your business income by retaining your customer base lost or reduced in size due to circumstances affecting the cash advance industry.”³³

The Georgia Industrial Loan Commissioner found that the phone card rebate program constituted illegal payday lending and issued a cease and desist order against Cash in Advance, Inc. for using PhoneCashUSA’s phone card sales to disguise usurious loans. The owner had already been convicted in Georgia for making illegal loans and was a principal in Cashback Catalog Sales, Inc. which had paid \$2.35 million to settle a lawsuit alleging that the sale of bogus “catalog coupons” was used to disguise illegal interest on payday loans. The company had previously made payday loans through an out of state bank arrangement.³⁴

The phone cards cost Cash in Advance \$2.50 for 100 minutes when the cards were activated, but the borrower was charged \$22.50 each. Instead of asking for the borrower’s check, Cash in Advance required the borrower to sign a contract authorizing an electronic debit directly from the borrower’s checking account. For a \$500 cash advance, a consumer had to sign a contract to buy five 100-minute phone cards for a total price of \$112.50 every two weeks for 52 weeks. The contract could be terminated with payment of a fee totaling \$650 which, according to the contract, “does not include the Cash Back Bonus paid to Member by Cash in Advance.”³⁵

Consumers who testified at a Georgia hearing illustrated the high cost of payday loans disguised as the sale of phone cards. One retiree borrowed \$300 and had to pay \$135 a month for a year until she could pay off her loan with \$390 in cash. Another borrower got \$750 under the “phone card program” and had his account debited for a total of \$675 but still owed the full

³¹ Don Schanche, “Quick Loan Teaches Borrower Lasting Lesson,” *Macon Telegraph*, June 22, 2003

³² USA Communications, Inc. ad in *Cheklis*, Winter 2003, page 19.

³³ www.phonecashusa.com/intro1.html, visited 5/23/03

³⁴ Defendant’s Reply Brief Opposing Motion for Stay, *Cash In Advance, Inc., v. John W. Oxendine, Industrial Loan Commissioner*, In the Superior Court of Turner County, Civil Action No. 2002cv0178, Nov. 21, 2002.

³⁵ Contract, Cash In Advance, dated July 25, 2002. Hearing transcript, Sept. 27, 2002, Georgia Industrial Loan Commissioner with Cash In Advance owner. On file with author.

\$750 plus another \$225 in interest to “buy out” the contract.³⁶ Georgia officials concluded that the cash advance was the product being sold, with the phone cards as a side inducement. The case against Cash In Advance is pending final court decision.

Rent-a-Bank Payday Lending

Payday Lenders “Rent” Bank Charters to Evade State Usury Laws

Payday lenders, not content to comply with state small loan and usury laws, also continue to pursue their “national bank model” to conduct business in states with hostile small loan legal requirements.³⁷ State-chartered, FDIC-regulated banks are the only banks currently partnering with payday lenders. Lenders claim to be merely “brokering” loans for banks and claim that states cannot enforce their laws against out-of-state banks.

The Depository Institutions Deregulation and Monetary Control Act of 1980 is claimed to extend most favored lender treatment of federally chartered banks to any federally insured commercial bank, savings and loan, or credit union. Under this federal law, state-chartered, federally insured banks claim the right to export home state interest rates and to preempt some state consumer protections to be on an equal regulatory footing with federally chartered banks and thrifts.³⁸ This belief is challenged by a recent decision from the U. S. District Court in Oklahoma. In a case involving EZ Pawn and County Bank of Rehoboth Beach, DE, the court remanded the case back to state court, finding that DIDA does not preempt state usury law and does not create federal question jurisdiction on the face of the complaint.³⁹

Payday Lenders Hide Behind Bank Charters

As described in cases filed by state regulators, Attorneys General, and consumer lawyers, a handful of banks are alleged to be “renting their charters” to payday lenders to front for loans that would be in violation of state law if made directly by the payday lender. These check cashers, pawn shops, or payday lenders are alleged to be the actual lenders or retain a predominant economic interest in the loans. In a typical payday lender-bank arrangement, the payday lender markets loans, solicits borrowers, accepts applications, disburses loan proceeds, services and collects the loan. The decision to make loans is typically handled by a third-party risk assessment company, such as TeleTrack, which is used by the payday lender regardless of

³⁶ Defendant’s Brief Opposing Petition for Judicial Review, *Cash In Advance, Inc. v. Oxendine*, March 2003, p. 122-13.

³⁷ “Agent Assisted Bank Payday Lending Examination Prep Module,” CFSA, August 17, 2003, p. 4: “...some payday lending institutions have contracted with banks to service markets that otherwise would be closed to them.”

³⁸ National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges, Second Edition, p. 94

³⁹ Order, *Flowers v. EZPAWN Oklahoma*, U. S. District Court for the Northern District of Oklahoma, Case No. 03-CV-359-K©, Feb. 3. 2004.

whether a bank is involved in the loan. Loans are usually sold back to the payday lender within a day, with the bank retaining five to fifteen percent of the face value of the transaction.

A complaint filed September 23, 2003 against Pennsylvania payday loan servicing companies Cashnet and Telecash and County Bank of Rehoboth Beach, DE by New York Attorney General Eliot Spitzer describes the rent-a-bank arrangement used in New York.

“County Bank, however, is the payday lender in name only. Cashnet and Telecash provide the capital for, market, advertise, originate, service and collect the payday loans. Cashnet and Telecash pay County Bank an annual fee to use County Bank’s name and charter to make loans, pay County Bank a small percentage of the finance charge received on each loan, and agree to indemnify County Bank for losses and liabilities (other than credit losses) arising out of the loan operation. County Bank shares none of the risk of these loans because it receives all principal plus a substantial part of the finance charge from Cashnet and Telecash within twenty four hours of the loan’s origination and prior to the loan’s repayment.”⁴⁰

New York has a 16% civil usury cap and a 25% criminal usury cap while payday lenders charge up to 780% for two-week payday loans. The Attorney General’s complaint alleges repeated illegal, fraudulent, and deceptive business practices for payday loans made by unlicensed lenders in a scheme to get around New York’s usury statutes. In announcing the suit, Attorney General Spitzer stated, “The entities that are really extending the loans, Telecash and Cashnet, are not Delaware banks. They are renting from County Bank the right to make these loans. This is nothing more than loan sharking that has been legitimized by a loophole in a federal statute, but we’re here today to say it’s enough. We’re going to stop it.”⁴¹

Similar allegations are made in a class action lawsuit filed in Superior Court of New Jersey in Union County against County Bank of Rehoboth Beach, Delaware, Easycash, Telecash, and Main Street Service Corporation. Loans are electronically marketed in New Jersey that cost over 500%, far more than New Jersey’s 30% criminal usury cap. The plaintiff alleged that the bank “has participated in and profited by a ‘Rent-A-Charter’ scheme whereby it aids and abets the unlawful conduct of the other defendants, including assisting those Defendants’ collection of interest in excess of the criminal usury rate, by ‘renting’ its name and status as a state-chartered bank without actually funding or meaningfully participating in the loans.”⁴²

In Pennsylvania payday lenders register as credit services companies and partner with out of state banks to charge rates far in excess of the 23.75% annual interest rate cap for licensed small loan companies. A telephone survey of registered credit services companies conducted in mid-2003 by Consumer Federation of America found that about a dozen companies “brokered” payday loans in partnership with FDIC-regulated state banks including County Bank of

⁴⁰ *People of New York v. County Bank of Rehoboth Beach, Delaware, Cashnet, Inc., and TC Services Corporation, d/b/a Telecash*, complaint filed in the Supreme Court, County of Albany, September 23, 2003, at 4.

⁴¹ Louis, Errol, “Spitzer Says Out-of-State Companies Charge Illegally High Interest Rates Up to 780% a Year on Payday Loans,” *The New York Sun*, Sept. 25, 2003, p. 3.

⁴² Class Action Complaint, *Jaliyah Muhammad v. County Bank of Rehoboth Beach, Delaware, Easycash, Telecash and Main Street Service Corporation*, Superior Court of New Jersey Union County.

Rehoboth Beach, DE; Republic Bank & Trust; First South Bank; and BankWest. For example, Check 'n Go's Access TelAdvance loans made to Pennsylvania consumers through County Bank cost \$24 to borrow \$100 or 625.71% APR for a two-week loan.⁴³ The Pennsylvania Banking Department estimates that more than \$350 million in loans are outstanding at any one time.⁴⁴

Payday Lenders Partner with Banks to Evade State Payday Loan Limits

Payday lenders not only partner with banks to make loans in states where usury laws and other consumer protections prevent typical payday lending. The payday loan industry also uses banks to by-pass state regulations that authorize check-based small loans at a slightly lower rate than the industry prefers or that restrain repeat lending.

In Texas, payday loans can be made under regulations adopted by the Texas Finance Commission. Terms can be as short as seven days and lenders can charge \$10 per loan and 48% annual interest, but the \$10 fee can only be levied monthly. A \$100 loan for two weeks costs 309% annual interest or \$11.87 for \$100. Almost all payday loan outlets partner with out-of-state banks to make loans in Texas in order to charge even higher rates. Currently 1,185 outlets use exported rates while only half of 51 licensees indicate that they are actively making loans using Texas rates.⁴⁵ A survey of payday lenders advertising in Texas conducted by Consumers Union's Austin office in 2003 found that none of the companies came close to the 178.98% APR cap for a two-week \$200 loan. Lenders charged from 450 to 880% APR with rates ranging from \$35.28 to \$67.76 for a \$200 loan. Only four of the 31 companies were licensed as required in Texas. The survey also found some lenders using the Internet rebate program to make loans.⁴⁶

Florida's Office of Financial Regulation reported to the Florida legislature that several payday lenders partner with banks to escape state regulation, noting "The affiliation is typically made to assist non-bank companies in evading consumer protection laws, including usury laws and payday loan laws." The Office disagreed with the interpretation that state consumer protection laws are preempted by Federal law and report that it will pursue necessary remedies against national bank model companies when deemed appropriate.⁴⁷ No case has been filed.

Payday lending is legal in California, yet Dollar Financial Group partners with First Bank of Delaware to make Cash' Til Payday loans that exceed the loan size limits under state law. Under California law, the maximum check for a payday loan including interest is \$300, making most loans no more than \$255. In partnership with First Bank of Delaware, Dollar Financial Group makes loans up to \$500, almost twice the state limit.⁴⁸ Amendments to the California law that require licensees, including those with bank partners, to comply with all provisions of the Deferred Deposit law take effect December 31, 2004.

⁴³ "Rent-A-Bank Payday Lending in Pennsylvania," CFA Survey conducted in August, 2003.

⁴⁴ Carl Rotenberg, "High Price for Quick Cash," *Times Herald*, Norristown, PA. March 6, 2004.

⁴⁵ Electronic communication from Maureen Kelly, Office of Consumer Credit Commissioner, November 3, 2003.

⁴⁶ "Payday Lenders Burden Working Families and the U. S. Armed Forces," *Consumers Union*, July 2003, p. 2.

⁴⁷ Florida Office of Financial Regulation, Deferred Presentment Program, 2003 Annual Program Report to the Legislature, January 2004, p. 18.

⁴⁸ Cash' Til Payday brochure, on file with author.

Leaders of the Payday Loan Industry Rent Bank Charters

Partnering with banks to evade state loan and interest rate limits is not a tactic used only by companies on the margins of the industry. Eleven of the thirteen largest payday lenders (by number of outlets) partner with banks to make loans in some states, according to a September 2003 Stephens Inc. report to the Financial Service Centers of America convention. Advance America, with four bank partners, is the heaviest user of banks to make loans in states without industry-friendly laws. Five of the largest chains partner with County Bank of Rehoboth Beach, DE, raising questions about the capacity of the bank to safely manage its multiple partnerships.

The payday loan companies and their recent or current bank partners include:

Advance America:	BankWest, Republic Bank & Trust Co., Venture Bank, First Fidelity Bank ⁴⁹
ACE Cash Express:	Republic Bank & Trust Company (AR, PA, TX)
Check n' Go:	County Bank (NC), First Bank of Delaware (TX), Reliabank Dakota (PA) ⁵⁰
Check into Cash:	First Bank of Delaware (GA), American Bank & Trust (NC) ⁵¹
Dollar Financial Group:	County Bank, First Bank of Delaware (CA) ⁵²
Cash America International:	County Bank, Community State Bank
First American Holding:	Community State Bank
QC Financial Services, Inc. d/b/a Quik Cash:	Bank partner unknown
EZCORP, Inc.:	County Bank
First Cash Financial:	County Bank
FlexCheck Holdings:	County Bank, formerly First South Bank

Of the thirteen largest payday loan chains, only Venture Services and Express Check Advance make loans directly.⁵³

State Chartered FDIC Banks Make Payday Loans

The only banks now partnering with payday lenders are state chartered, FDIC regulated institutions. Based on a search of major payday lender web sites, reports from state regulators,

⁴⁹ www.advanceamerica.net/aa_info.php, visited March 5, 2004.

⁵⁰ www.checkngo.com/, visited March 5, 2004.

⁵¹ www.checkintocash.com/georgia.htm, www.checkintocash.com/north_carolina.htm, visited March 5, 2004

⁵² Dollar Financial Group Investor Conference Call Feb. 6, 2004

⁵³ Stephens Inc., "Update on the Payday Loan Industry: Observations on Recent Industry Developments," September 26, 2003, p. 15.

and other sources, following is a list of FDIC banks known to recently or currently be partnering with payday loan companies, pawn shops and check cashing outlets to make payday loans.⁵⁴

New York Regional FDIC Office:

- ? County Bank of Rehoboth Beach, DE, which has \$259 million in assets and 89 employees, is the most active state bank in the payday loan market with over twenty payday lenders. County Bank has or is now partnering with third-party storefronts, such as Check'n Go, Express Money Service, and Urgent Money Service in North Carolina; Currency One in Philadelphia;⁵⁵ EZPAWN, Cash 'n Go, First Cash Advance, Mister Money Financial Services, Inc., Extra Cash, Money Mart (Check Mart), and EZMoney Payday Loans in Texas; FlexCheck; and USA Payday in Georgia. County Bank also makes loans through third-party servicing agents such as Cashnet and Telecash that market loans via 800 numbers or through dozens of Internet web sites. County Bank partners with eight companies making payday loans in Pennsylvania. According to Dollar Financial Group SEC filings, it partnered with County Bank as well.
- ? First Bank of Delaware partners with Check Into Cash to make loans in Georgia, with Dollar Financial Group in California, and with Check'n Go and The Cash Store in Texas. Payday lending is very lucrative for First Bank, accounting for \$1.4 million of its parent bank's total net income of \$2.4 million for the first half of 2003.⁵⁶

Kansas City FDIC Regional Office:

- ? BankWest, Inc., Pierre, SD, partnered with Advance America to make payday loans in Georgia, and is listed currently by Advance America and National Cash Advance in Pennsylvania.
- ? First Fidelity Bank in Burke, South Dakota is used by Advance America to make payday loans in Michigan.
- ? Community State Bank, South Dakota, owned by the same holding company as First National Bank of Brookings, SD, now partners with Cash America in several states, with Longhorn Pawn & Gun, Inc. and Mr. Payroll Corp. in Texas, with Southern Cash Advance in North Carolina and with First American Cash in Arkansas and Florida. All of the bank's Texas partners are part of Cash America.
- ? American Bank & Trust, Wessington Springs, SD, partners with Check Into Cash at all North Carolina locations. Loans cost 469.29% APR for two-week terms or \$54 to borrow \$300,

⁵⁴ Fact Sheet on FDIC banks in payday lending, Community Reinvestment Association of North Carolina, February 2004, on file with author.

⁵⁵ Currency One recently settled with Pennsylvania Banking regulators to stop making payday loans from its Philadelphia offices. See Joseph N. DiStefano, "Pa's pact with a check-casher," *Philadelphia Inquirer*, 3/6/04.

⁵⁶ Rulison, Larry, "Bank Quits Fed over Loan Tactic," *Philadelphia Business Journal*, October 10, 2003, <http://philadelphia.bizjournals.com/philadelphia/stories/2003/10/20/story2.html>

compared to North Carolina's 36% small loan rate cap. American Bank & Trust is a South Dakota state-chartered six-office bank

- ? Bryant State Bank, Bryant, SD, makes loans for The Cash Store in Texas. Bryant had one office and only \$17 million in assets in 2003.
- ? Reliabank Dakota, Estelline, SD, makes loans for Check n' Go in Pennsylvania. Reliabank has five branches in South Dakota and has \$101 million in assets.

Chicago Regional FDIC Office:

- ? Republic Bank & Trust. This Kentucky bank partners with Advance America in North Carolina and Texas, with National Cash Advance in North Carolina, and with ACE Cash Express in Texas, Arkansas, and Pennsylvania. As of June 30, 2003, Republic Bank had \$20.6 million in outstanding payday loans. Republic Bank & Trust, through Advance America, is currently charging \$17.50 for each \$100 borrowed in North Carolina, which translates into an annual interest rate of 456% on the average 14-day loan in a state that caps small loan rates at 36%. A coalition of community and consumer groups filed comments with the FDIC for the Bank's 2003 safety and soundness exam, urging the FDIC to immediately halt the Republic Bank & Trust payday loan operation. The groups questioned the Bank's knowledge of and ability to oversee payday lending by Advance America and ACE Cash Express. Contrary to the Bank's claim of serving 70,000 customers with 600 stores, the groups estimated that Republic Bank has more than 400,000 payday loan customers and that its payday partners conduct around four million transactions annually.⁵⁷

San Francisco Regional FDIC Office:

- ? Venture Bank, formerly First Community Bank of Washington, partners with Advance America and National Cash Advance to make payday loans in Arkansas, a state with a constitutional usury cap. Before Alabama legalized payday lending, Venture Bank partnered with Advance America there as well. Groups filed comments with the FDIC regional office in San Francisco, urging the FDIC to fail Venture Bank in its CRA exam for unsafe and unsound payday lending in partnership with Advance America in Alabama and Arkansas.⁵⁸ Results of the first application of the FDIC guidelines have not been released.

Another state chartered bank recently withdrew from partnering with a payday lender. Until late in 2003, First South Bank in Spartanburg, SC made payday loans through FlexCheck, a chain of payday lenders operating in West Virginia, Pennsylvania and Georgia, states where payday lending is not authorized. FlexCheck failed to receive a license in Virginia and was

⁵⁷ CRA-NC, et al. letter to Mr. Scott Polakoff, FDIC Chicago Regional Office, November 13, 2003, on file with author.

⁵⁸ CFA et al comments to FDIC, Venture Bank CRA Exam, www.consumerfed.org/venturebankpr.pdf

ordered to stop brokering loans for First South Bank under a Virginia Bureau of Financial Institutions cease and desist order.⁵⁹

National Banks, Thrifts and Federal Reserve Member Banks Halt Payday Lending

As a result of enforcement actions, no federally-chartered bank or thrift rents its charter to payday lenders. The Office of the Comptroller of the Currency and the Office of Thrift Supervision found that payday lending exposes national banks and thrifts to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risks. In the last two years, the OCC signed Consent Orders halting all payday lending activity with third parties by federally-chartered banks.⁶⁰ In a speech given in early 2002, Comptroller of the Currency John Hawke said the following about rent-a-bank concerns:

“Let me raise one other caution about preemption. The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.

We have recently seen several instances in which nonbank lenders who would otherwise have been fully subject to various state regulatory laws have sought to rent out the preemption privileges of a national bank to evade such laws. Indeed, the payday lending industry has expressly promoted such a ‘national bank strategy’ as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempts to clothe itself with the status of an ‘agent’ of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank.

Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multi-state loan origination operation that is in reality the business of the payday lender. As you probably saw, we recently took supervisory action against a small national bank that dramatically demonstrated its inability to manage such a relationship in a safe and sound manner.”⁶¹

The banks and thrifts involved in OCC, OTS, FDIC, FRB and state enforcement actions include:

⁵⁹ Notice of Proposed Cease and Desist Order, Case No. BFI-2003-0043, FlexCheck of Virginia, Inc., July 23, 2003. Shannon Brennan, “FlexCheck operating without a license since October 2002,” *Lynchburg News and Advance*, August 1, 2003.

⁶⁰ OCC Annual Report, 2003, p. 17, “All national banks with known payday lending activities through third-party vendors were order in FY 2003 to exit the payday lending business. By undertaking enforcement actions against those banks, the OCC addressed safety and soundness concerns about the management of these payday loan programs, and ended significant consumer protection violations.”

⁶¹ OCC speech given February 12, 2002, available at www.occ.treas.gov/ftp/release/2002-10a.doc

Eagle National Bank: The Comptroller of the Currency cited Dollar Financial Group for actively promoting rollovers of the bank’s payday loans, without Eagle National Bank’s knowledge, by providing an incentive to Dollar’s employees, which resulted in a higher volume of rollovers than new loan originations and a misuse of the loan product for long-term credit. The Comptroller noted that Dollar failed to consistently follow the bank’s underwriting criteria, violated federal law relating to privacy notices and Truth in Lending disclosures, and opened stores in some states and began originating payday loans without the bank’s knowledge or approval. In announcing the Consent Order, Comptroller Hawke stated, “Eagle had effectively turned over the management of the bank’s main business to a third party, and then virtually ignored how that business was being conducted...The bank essentially rented out its national bank charter to a payday lender to facilitate that nonbank entity’s evasion of the requirements of state law that would otherwise be applicable to it.”⁶²

Goleta National Bank: Goleta National Bank made loans through ACE Cash Express outlets, a publicly-traded chain of check cashers. The OCC ordered Goleta National Bank in California, which was partnering with ACE Cash Express, to cease its payday lending activities. The order was issued after hundreds of customer loan files with sensitive customer financial data were found in a dumpster outside of an ACE facility. The OCC also found that the bank did not have the management needed to effectively oversee and monitor the third-party payday lending program.⁶³ Goleta was also involved in state litigation in Ohio, Colorado, North Carolina and in class action lawsuits filed in Florida, Texas, Maryland, and Indiana. When the OCC halted Goleta’s role in ACE’s payday loan business, the state and class action suits were settled and received final approval of the terms by the court.

Peoples National Bank of Paris, TX: The OCC ordered Peoples National Bank to terminate its payday loan arrangements with Advance America due to safety and soundness concerns. The OCC was prepared to allege that Peoples failed to ensure that its payday lender, which held itself out as agent for the bank, complied with federal consumer protection laws and regulations. Peoples Bank, through Advance America, routinely failed to make disclosures required under the Truth-in-Lending Act (TILA) by failing to verbally disclose the annual interest rate (APR), and repeatedly violated the disclosure and record-keeping requirements of the Equal Credit Opportunity Act (ECOA). The OCC also recognized that the bank allowed borrowers to roll over loans a number of times.⁶⁴ Among numerous safety and soundness risks, the OCC found that as of October 2001, 60 percent or more of the Bank’s classified assets were delinquent payday loans, yet the Bank failed to classify the loans as Substandard.⁶⁵

First National Bank in Brookings, SD: First National Bank in Brookings, SD made payday loans through Cash America pawn shops and First American Cash Advance payday loan outlets. The OCC Consent Order noted that the Comptroller intended to charge the Bank with violations of Truth in Lending and violations of safety and soundness guidelines for failure to identify the

⁶² Press Release, “OCC Orders Eagle to Cease Payday Lending Program,” January 3, 2002, NR 2002-01

⁶³ Press Release, “OCC Takes Action Against ACE Cash Express, Inc. and Goleta National Bank,” October 29, 2002, NR 2002-85.

⁶⁴ Press Release, “Peoples National Bank to Pay \$175,000 Civil Money Penalty and End Payday Lending Relationship with Advance America,” January 31, 2003, NR 2003-06.

⁶⁵ Office of Comptroller of the Currency, Notice of Charges for Issuance of an Order to Cease and Desist, In the Matter of Peoples National Bank, Paris, TX, AA-EC-02-03, May 17, 2002, p. 4.

source of repayment and to assess the borrower's ability to repay loans in connection with payday loans originated in the name of or on behalf of the Bank. The Order required the bank to withdraw from this line of business within 90 days. In announcing the order, the Comptroller Hawke stated "It is a matter of great concern to us when a national bank essentially rents out its charter to a third party vendor who originates loans in the bank's name and then relinquishes responsibility for how these loans are made....We are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws that would otherwise apply to it."⁶⁶

First Place Bank: The Office of Thrift Supervision directed First Place Bank in Warren, Ohio to terminate its payday loan arrangements in Texas with Check'n Go.⁶⁷ Earlier, the OTS downgraded the Community Reinvestment Act rating for Crusader Bank, a Philadelphia thrift that partnered with National Cash Advance in Pennsylvania and Delaware. To our knowledge, there are no federal thrifts renting their charters to payday lenders.

Brickyard Bank: In 2002, the Illinois banking regulator and the FDIC took action against Brickyard Bank, a state nonmember bank renting its charter to Check'n Go in Texas and North Carolina. Following a public campaign by community and consumer groups and higher capitalization requirements by regulators, the bank withdrew from the payday loan business.⁶⁸

Bank of Kenney: CNG Financial, parent company of Check'n Go, applied to the Federal Reserve, the FDIC, and Illinois bank regulators to acquire Bank of Kenney, one of the smallest state banks in Illinois, and create a bank holding company. CNG proposed to transform its Illinois payday loan outlets into bank branches. CFA and dozens of groups around the country filed protests at both the FRB and FDIC. CNG's BK Acquisition Bank (Interim Bank) of Kenney, Illinois withdrew its application in September, 2003.⁶⁹

First Bank of Delaware: The Federal Reserve Bank of Philadelphia raised regulatory requirements for the only Fed-member state bank involved in payday lending. First Bank of Delaware announced to the Securities and Exchange Commission that it would leave the payday loan business as of October 31, based on the Fed's requirements. (See below.)

FDIC Is Regulator of Choice for Payday Lenders

As federal bank regulators halted charter-renting for their banks, payday lenders turned to state-chartered FDIC insured banks. According to a Cash America press release, "Based on current attitudes of federal regulators toward short term cash advances, we believe state chartered banks provide our customers with the most reliable source of future cash advances..."⁷⁰ An

⁶⁶ Press Release, OCC, January 27, 2003, www.occ.treas.gov/newsrelease.asp?Doc=C4GDHG41.xml.

⁶⁷ "Texas Payday Lending to End. First Place lists earnings," *Tribune Chronicle*, Warren, Ohio, Jan. 30, 2003.

⁶⁸ Order to Cease and Desist, In the Matter of Brickyard Bank, FDIC and State of Illinois, Sept. 9, 2002.

⁶⁹ Letter from Scott M. Polakoff, Regional Director, FDIC, to Jean Ann Fox, September 30, 2003.

⁷⁰ Press release, Cash America, "Cash America Announces Intention to Change Cash Advance Provider and Confirms Earnings for the Fourth Quarter of 2002," January 21, 2003.

American Banker article noted that “Given the recent actions by the OCC and OTS, payday-lending companies say they will seek partnerships with state-chartered banks. They say the Federal Deposit Insurance Corp., which regulates state-chartered banks, is more permissive of the partnerships than other regulators.”⁷¹

Just before its payday loan guidelines were issued in 2003, FDIC deputy director for policy and examination George French forecast that institutions would not see them as encouragement to enter the business.⁷² On the contrary, three more state-chartered banks have joined the ranks of FDIC-supervised banks that apparently view the payday loan guidelines as a recipe for how to make triple-digit interest small loans through store-front operators. FDIC banks recently joining the ranks of payday lenders include Reliabank Dakota, American Bank & Trust, and Bryant State Bank, all based in South Dakota, a state with no usury cap.

FDIC Permits Payday Loan Bank To Switch Regulators

One bank switched regulators to benefit from the FDIC’s permissive view of payday lending. First Bank of Delaware, a wholly-owned subsidiary of Philadelphia’s Republic First Bancorp, Inc. and originally a Federal Reserve member Delaware-chartered bank, announced to the Securities and Exchange Commission June 27, 2003 that it would withdraw from the payday loan business by October 31 due to strict regulatory requirements from the Federal Reserve Bank of Philadelphia. The Bank’s SEC filing stated “The Board of the Bank made its determination based on materially increased regulatory requirements for participation in that line of business that the Bank does not believe it can satisfy. The Bank believes that these changes permit termination of contracts between the Bank and the companies which assist it in making such loans.”⁷³

Instead of terminating its payday loan business, however, First Bank of Delaware got permission from the FDIC to come under its regulation and continue federal insurance coverage after withdrawing from the Federal Reserve System. The Bank’s subsequent SEC filing explained:

“As part of the transition, the Delaware Bank entered into a Memorandum of Understanding with the FDIC and the Office of the State Bank Commissioner which Memorandum of Understanding requires, among other things, that in the event the FDIC and the Delaware Commissioner determine that the short-term loan (payday loans) program of the Delaware Bank is not operated in a safe and sound manner and request in writing that the Delaware Bank cease making such short-term loans, the Delaware Bank will provide a strategy for exiting the short-term loan program. After discussions with the FDIC and the Delaware Commissioner, the Board of Directors of the Delaware Bank determined to continue the short-term loan program in accordance with the provisions of

⁷¹ “OCC Payday Purge Done: Lenders Eye State Banks,” *American Banker*, February 3, 2003, p. 2.

⁷² Blackwell, Rob, “In Focus: FDIC Hints at a Crackdown on Payday Partnerships,” *American Banker*, June 30, 2003.

⁷³ Republic First Bancorp Inc., Form 8-K, Securities and Exchange Commission, June 27, 2003.

http://eol.finsys.com/edgar_conv_html/2003/06/27/0000950159-03-000559.html

the guidelines issued by the FDIC and the laws and regulations of the State of Delaware.”⁷⁴

This development suggests that the Federal Deposit Insurance Corporation is willing to accept banking practices that the Federal Reserve Bank of Philadelphia likely rejected. FDIC regulations require an applicant bank to include information about outstanding or proposed corrective programs or supervisory agreements with the Federal Reserve System and a statement that the bank’s Board of Directors is willing to enter into similar programs or agreements with the FDIC.⁷⁵ The Memorandum of Understanding between the FDIC and First Bank is not a public document,⁷⁶ but observers can only conclude that the “increased regulatory requirements” from the Federal Reserve reported by the bank to the SEC in June were not part of the FDIC agreement in October. Otherwise, First Bank of Delaware would still be unable to operate its payday loan business while satisfying those regulatory requirements.

CFA and national consumer groups wrote a letter of protest to FDIC Chairman Powell regarding permission for First Bank of Delaware to remain in the payday loan business.⁷⁷ The letter noted, “It is becoming painfully evident that the Federal Deposit Insurance Corporation is the regulator of choice for payday loan companies who wish to misuse bank charters to make loans that would be illegal if made directly by the store front payday lender...Clearly payday lending is so lucrative that a bank would rather switch regulators than give up the flow of funds from vulnerable consumers.”⁷⁸

FDIC Payday Loan Guidelines Fail to Protect Borrowers

The FDIC issued payday loan examination guidelines in mid 2003 which do not include a clear statement against rent-a-bank arrangements and do not appear to benefit from the OCC and OTS experience in implementing their earlier guidelines. The Office of Thrift Supervision and the Comptroller of the Currency Bank Advisories issued in 2000 to federally-chartered financial institutions engaged in or considering payday lending arrangement made a clear and important statement: “*Payday lenders entering into such arrangements with national banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them.*”⁷⁹ The FDIC guidelines have no such statement.

CFA and a broad coalition of national and state consumer and community organizations filed comments with the FDIC on its draft payday loan guidelines, strongly urging the Federal Deposit Insurance Corporation to amend its draft guidelines for payday lending to:

⁷⁴ Republic First Bancorp, Inc., Form 8-K, Securities and Exchange Commission, October 2, 2003. <http://www.sec.gov/Archives/edgar/data/834285/000095015903000803/0000950159-03-0>

⁷⁵ 12 C.F.R. § 303.25, (4)(I) and (ii).

⁷⁶ Letter from Michael J. Zamorski, Director, Div. Of Supervision and Consumer Protection, FDIC, to Jean Ann Fox, CFA, October 22, 2003. “Part 309 of the FDIC Rules and Regulations prohibits us from commenting on financial institution supervision matters, including discussing the status of supervisory arrangements, with respect to any specific institution.”

⁷⁷ CFA letter to FDIC Chairman Powell, October 8, 2003, www.consumerfed.org/fdicletter10-2003.pdf

⁷⁸ Id.

⁷⁹ OCC Advisory Letter AL 2000-10, p. 1.

- ? Definitively prohibit rent-a-bank payday lending by banks, particularly in situations where the third party originates the product and uses the bank as a delivery vehicle, and the third party retains the preponderant economic interest in the loans.
- ? Clearly state that third parties cannot “rent” bank powers to export interest rates or preempt state laws.
- ? Strengthen guidelines for direct bank “payday lending” to require any small loan product to be based on the borrower’s ability to repay and have adequate terms to repay without the necessity of loan flipping.
- ? Base bank Community Reinvestment Act evaluations on small loans made outside the bank’s assessment area as well as within it.
- ? Conduct compliance inspections at all nonmember banks that currently partner with third parties to make payday loans and vigorously enforce guidelines and laws.

The FDIC final guidelines issued in July strengthened some provisions, but failed to prohibit bank partnerships with store-front payday lenders. The guidance emphasized safety and soundness concerns, instructing examiners to apply the FDIC’s Subprime Lending Examination Procedures, look for risk management programs for third-party payday lending relationships, have bank Board approval for contracts with third-parties, and limit the volume of payday loans to less than 25% of the bank’s Tier 1 capital. While FDIC rules call for up to 100% capitalization of loans outstanding, banks that sell 85 to 95% of payday loans back to their partners have little to capitalize. Bank payday loan portfolios are to be classified Substandard, according to the FDIC.⁸⁰

FDIC Payday Loan Guidelines Do Not Replace State Regulation of Lenders

The Guidelines do not substitute for state consumer protections for the loans made to consumers by bank/payday loan partnerships. The FDIC guidance notes that payday loans are considered extensions of credit for purposes of federal consumer protection law and spells out how to examine for compliance with the Community Reinvestment Act, Truth in Lending, Equal Credit Opportunity Act, Fair Credit Reporting Act, Electronic Fund Transfer Act, Truth in Savings Act, Fair Debt Collection Practices Act, Federal Trade Commission Act, Privacy of Financial Information/Part 332, and the Interagency Guidelines on safeguarding customer information.⁸¹ All of these federal laws apply to payday lenders and to state small loan companies directly, regardless of whether a bank is involved in the transaction. No additional protection is conferred on payday loan customers by inclusion of this list of federal consumer protections in the FDIC Guidelines. And, these federal laws do not replace state small loan laws.

Unlike state usury, small loan, or, even payday loan laws, the Guidelines do not set specific limits for payday loans made by banks. Instead, examiners are instructed to look for third-party lender programs that:

⁸⁰ FDIC, Guidelines for Payday Lending, issued July 2003

⁸¹ FDIC Guidelines for Payday Lending, “Compliance Issues,” p. 5-8.

- ? Consider “the economic substance of consecutive advances without “cooling off” or waiting periods as continuous advances in classify the risk of loans.” Banks are to treat loans outstanding for 60 days or more as a loss.
- ? Set limits on the number and frequency of extensions, deferrals, renewals and rewrites; prohibit additional advances to finance unpaid interest and fees and simultaneous loans to the same customer; and require customers to show a renewed willingness or ability to repay the loan if an extension is requested.
- ? Establish “cooling off” or waiting periods between the time a loan is repaid and another application is made; set the maximum number of loans per customer allowed within one year; and allow no more than one payday loan to be outstanding with the bank at a time to any one borrower.

Boiled down to the actual protections for consumers, the FDIC Guidelines fall far short of the state laws or regulations evaded by payday lender-bank partnerships. The Guidelines set no cap on finance charges or interest rates for payday loans made through third-parties; do not require lenders to comply with the usury or interest rate laws of the states where consumers are located; do not require lenders to determine ability to repay when making the initial loan; set no limit on the size of loans, the minimum or maximum loan term, or the cost of additional fees. The Guidelines do not set specific limits on rollovers, renewals or multiple loans per customer or per household or set a minimum “cooling off” period that recognizes the “economic substance” of a roll over. The FDIC does not require payday lenders to be licensed or supervised by state officials or be subject to state payday loan reporting requirements.

The state laws that apply to the banks’ payday loan partners doing business in the fifteen states with usury laws or small loan rate caps, on the other hand, cap annual interest rates at 23.75% to 60%. Even in states that grant safe harbor to payday lenders, many state laws set maximum loan amounts, cap finance charges, provide limits on loan renewals or multiple loans, and specify collection methods and recourse for borrowers. The FDIC Guidelines do not replace any of these state usury, small loan or payday loan consumer protections, regulatory requirements, or disclosure requirements and do not “regulate” this market.

Industry Views FDIC Guidelines Favorably

The payday loan industry interprets the FDIC payday loan guidelines as recognizing a place for third-party relationships.⁸² The FDIC guidelines note that banks may have payday lending programs that they administer directly using their own employees or may enter into arrangements with third parties. With third parties, the bank funds loans originated through a third party and may involve selling loans or servicing rights to the loans to a third party. The third party may handle collections, advertising and soliciting applications. “The existence of third party arrangements may, when not properly managed, significantly increase institutions’ transactions, legal and reputation risks.”⁸³

⁸² Lee, Phillip, “FDIC Sets Examiners’ Guidelines for Payday Lending,” *Cheklis*, Fall, 2003, p. 16.

⁸³ FDIC Payday Loan Guidelines, Significant Risks section, p. 2.
www.fdic.gov/regulations/safety/payday/index.html.

Stephens Inc., a Little Rock investment bank, reported that “while the regulations are tough on banks, we believe that all banks that currently offer the product should be able to continue to offer the product absent any changes in their financial condition.”⁸⁴ The same view from the payday loan trade group was reported in a trade magazine. “The regulations have set some fairly high bars for safety and soundness purposes for banks engaged in payday lending, but I think most people I’ve talked to are satisfied that the banks they are working with can meet those standards, says Jim McIntyre, CFSA Washington regulatory counsel....McIntyre adds that it’s particularly important that the guidelines make it clear that payday lending is a permissible banking activity when performed in the specified manner.”⁸⁵

The payday loan trade group included a session at its 2004 convention on “Agent Assisted Lending and FDIC Audits,” presented by the First Bank of Delaware, a former Washington state regulator, and Advance America.⁸⁶ IntegraAdvisors, a consulting company whose CEO was Washington’s payday loan regulator, has also prepared an Agent Assisted Bank Payday Lending Examination Prep Module, sponsored by CFSA, to assist banks that partner with payday lenders survive regulatory scrutiny. The manual advises banks and payday lenders that their payday loan arrangements are less vulnerable to charges of “rent a charter” if the bank retains the preponderant economic interest in loans.⁸⁷

FDIC Is Slow to Apply Guidelines

The FDIC assured the payday loan trade group that the guidelines will be applied during banks’ regular examinations, with no special exams for payday lenders.⁸⁸ This means that some banks may not be examined for a year or longer. The FDIC also failed to provide guidance to regional offices that have to interpret the guidelines. While the guidelines permit examiners to conduct targeted examinations of the third party where appropriate, the FDIC has not scheduled examinations of payday lenders who partner with its banks.⁸⁹

Three FDIC-regulated banks were under review in 2003, following issuance of the guidelines. A coalition of consumer and community groups filed extensive comments with the San Francisco FDIC office in the CRA review of Venture Bank of Lacey, Washington, the first bank to be examined under the guidelines.⁹⁰ County Bank of Rehoboth Beach, DE, already under review by the New York FDIC regional office when the guidelines were issued, is currently awaiting its performance evaluation. Republic Bank & Trust is under safety and soundness review by the Chicago FDIC office. No decisions have been rendered in any of these cases.

⁸⁴ Stephens Inc., “Update of the Payday Loan Industry: Observations on Recent Industry Developments,” September 26, 2003, p. 4.

⁸⁵ Lee, Phillip, “FDIC Sets Examiners’ Guidelines For Payday Lending,” *Cheklis*, Fall, 2003, p. 16.

⁸⁶ CFSA Convention Schedule, *Cheklis*, Official Program Guide to the 2004 CFSA Annual Meeting.

⁸⁷ IntegraAdvisors “Agent Assisted Bank Payday Lending Examination Prep Module,” August 17, 2003, Version 1.2. p. 34.

⁸⁸ Lee, Phillip, “FDIC Sets Examiners’ Guidelines for Payday Lending,” *Cheklis*, Fall, 2003, p. 16.

⁸⁹ *Ibid.*

⁹⁰ CFA et al comments, FDIC CRA Examination of Venture Bank, www.consumerfed.org/venturebankpr.pdf

States Fight Back Against Rent-a-Bank Payday Lending

States have fought back against rent-a-bank payday lending that undermines state authority to regulate their small loan market. The approaches differ, depending on the legal status of payday lenders. Massachusetts' small loan act applies to both lenders and brokers and has been enforced by state officials to stop County Bank of Rehoboth Beach, DE from making payday loans through a Mail Boxes Etc. store in Boston. Maryland and Oklahoma amended their credit services acts to prohibit local companies from brokering or arranging loans that they could not legally make on their own. Virginia's payday loan law flatly prohibits brokering or arranging of payday loans. The anti-brokering provisions adopted by California take effect at the end of 2004. Georgia's bill pending the Governor's signature also prohibits bank involvement if the payday lender holds the predominant economic interest in the loan. Other states require all lenders to comply with their state payday loan laws, even when banks are part of the transaction, including Colorado, Indiana, Louisiana and Montana.⁹¹

Following enforcement of the OCC's order against Goleta National Bank and ACE Cash Express, the check cashing chain sought state lending licenses in some states where formerly the company made loans through Goleta National Bank. As of March 31, 2003, ACE was offering a state-regulated loan product or service in 862, or about 89%, of its owned stores. ACE reported to the SEC that it was not marketing loans in any of its stores in Alabama, Georgia, Maryland, and North Carolina, states where payday loans were not authorized at that time.⁹²

In 2002 Colorado Attorney General Ken Salazar settled a case against ACE Cash Express for \$1.3 million in restitution to consumers and an agreement to comply with Colorado's payday lending laws. Salazar had sued ACE in 2001 alleging unlicensed lending in violation of payday loan limits. In announcing the settlement, Mr. Salazar stated, "This is a landmark settlement, because it signals that all payday lenders in Colorado must comply with Colorado law. If they do not, they will suffer the consequences. The resolution of this lawsuit affirms our position that payday lenders are subject to state consumer credit laws even though they may align themselves with national banks." In addition to paying restitution to repeat borrowers, ACE agreed to become licensed and comply with Colorado's consumer credit and payday lending laws, and to terminate its relationship with Goleta National Bank.⁹³

Lawsuits by Attorneys General in three states were settled following the OCC actions terminating Goleta National Bank's arrangements with ACE Cash Express. North Carolina Attorney General Roy Cooper and then-Commissioner of Banking Lingerfelt had sued ACE for

⁹¹ Virginia 6.1-445. License Requirement; Maryland Commercial Law Section 14-1902; Oklahoma 24 O.S. 2001, Section 141; California effective December 31, 2004. Civil Code Division 10. California Deferred Deposit Transaction Law, section 23037; Colorado CO Revised Statutes 5-3.1-102 Definitions (5) (a); Indiana IC 24-4.5-7-102. Montana 31-1-704, MCA (1); Louisiana regulations *Title 10, Financial Institutions, Consumer Credit, Investment Securities, and UCC, Part XV.*

⁹² 10-Q filing, ACE Cash Express, Securities and Exchange Commission, Quarter ended March 31, 2003, p. 29.

⁹³ Press Release, Colorado Office of Attorney General, "ACE Cash Express to Pay \$1.3 Million in Restitution to Consumers," May 6, 2002.

charging illegally high rates. ACE agreed to stop making loans in North Carolina for one year and to get a state license and comply with state laws that regulate loan offers and terms. ACE dropped its claims that its affiliation with a nationally chartered bank made it immune to state regulation.⁹⁴

In settling a case brought by the Florida Attorney General, ACE agreed to pay \$250,000 to Florida Department of Banking and Finance and \$250,000 to the University of Florida law school. Florida agreed to withdraw its suit against ACE in exchange for ACE getting a state license to make loans. In Ohio, ACE sent out \$250,000 in coupons for discounts toward loans, and agreed to pay \$16,000 in licensing fees to the state to operate under the Ohio Small Loan Act.⁹⁵ ACE experienced a 3.5% decline in loan fees and interest in the second quarter of fiscal 2004 as a result of eliminating its payday loan products in Georgia, Alabama and North Carolina as well as changing its Florida loan design.⁹⁶

State regulators and attorneys representing consumers filed complaints or took regulatory action to stop payday lenders from using FDIC bank partners to evade state consumer protections, as well. In April 2003, Pennsylvania Banking Secretary William Schenck sent a letter to 155 state-chartered banks and thrifts warning that his staff would be as aggressive as the federal banking regulators in addressing the safety and soundness issues associated with payday lending. The Banking Secretary required banks proposing to enter the payday lending business to provide written notification to the Department, including an analysis of the risks associated with the proposal.⁹⁷

In Virginia, the Bureau of Financial Institutions used a strengthened anti-broker provision in the state's payday loan law against an unlicensed lender. FlexCheck from South Carolina applied for and was denied a payday lending license in Virginia, but opened outlets around the state, claiming to broker loans for First South Bank. The Virginia Bureau of Financial Institutions issued a cease and desist order against FlexCheck for violating the Virginia law prohibiting brokering of payday loans. FlexCheck's 35 outlets were sold to a licensed company and Virginia's anti-broker law was not challenged in court.⁹⁸

The Oklahoma Consumer Credit Commissioner issued a cease and desist order against Loan Mart, a licensed supervised lender owned by Dollar Financial Group, for making small loans in Oklahoma that violated limits on interest rates and loan repayment terms. Loan Mart was making loans via County Bank of Rehoboth Beach, DE. Oklahoma regulators also filed a federal action in the Western District of Oklahoma, asking for a permanent injunction against EZ Pawn and Cash America who were acting as "servicers" for County Bank. The complaint alleged violation of Oklahoma's Credit Services Organization Act and violations of the UCCC for requiring repayment in fewer installments. These cases were settled in November 2003 with lenders getting state licenses as deferred deposit lenders and giving up their bank partners.

⁹⁴ Press Release, "Payday Lender Barred From Making Loans, AG Cooper Announces," Raleigh, NC, Dec. 13, 2002

⁹⁵ Anu Raghunathan, "ACE to settle with 2 States," *Dallas Morning News*, January 2, 2003.

⁹⁶ Press Release, ACE Cash Express Reports Fiscal 2004 Second Quarter Net Income Increases 54 percent," www.acecashexpress.com/investor/press/2004/FY04Q2%20Earnings.html, 3/5/04

⁹⁷ Letter to: Pennsylvania state-chartered banks, bank and trust companies, savings banks, and savings and loan associations, from A. William Schenck III, Acting Banking Secretary, April 1, 2003.

⁹⁸ Sommers, Novelda, "Payday Lender Closes Va. Stores," *Daily Press*, August 22, 2003.

The Georgia Attorney General issued an opinion in 2002 that payday lending violates the Georgia Industrial Loan Act small loan rate cap.⁹⁹ When Industrial Loan Commissioner John Oxendine opened an investigation of Advance America's payday loans, BankWest and Advance America brought legal action to prevent the state from investigating its payday lending in Georgia. The Superior Court of Fulton County issued a final order granting state regulators summary judgment and denying BankWest and Advance America's motion to quash subpoenas.¹⁰⁰ The Court found that the record showed a genuine issue of material fact on whether Advance America is the de facto lender in the loans made from its Georgia offices. Advance America holds the preponderant economic interest in those loans and pays the majority of the operating costs. The Court noted that Advance America uses "Tele-Track" to make underwriting decisions in whether or not the bank is involved. The Court found that "Advance America has offered no reason why it would involve a bank in its Georgia transactions when it does not do so in states where payday lending is legal. These facts would be sufficient to authorize a jury to draw the inference that BankWest, Inc. is not the true lender."¹⁰¹ The Georgia Court of Appeals affirmed the lower court decision.¹⁰²

Conclusion and Recommendations:

Consumer protections in the small loan market are undermined by safe harbor payday loan laws that condone check-writing without money in the bank to cover checks as the basis for borrowing money. None of the state payday loan laws protect borrowers from usurious interest rates, curtail perpetual debt, or adequately shield borrowers from the consequences of checks/debits as security for loans. As long as the FDIC fails to take action to stop rent-a-bank payday lending, major lenders will find state-chartered banks willing to help them evade state usury and small loan laws to the detriment of financially fragile families. State legislators will find the industry unwilling to come to the bargaining table over terms of state credit laws as long as bank partners are available. As long as there is money to be extracted from cash-strapped consumers, some payday lenders will continue their historic use of ruses and shams to evade legal limits on loans. Tough enforcement tools and penalties are necessary to take the profit out of pushing the legal envelope on small loans.

State Legislatures and Officials should:

- ? Preserve and strengthen state usury laws and/or small loan rate caps; or rewrite payday loan authorizing laws to protect borrowers from usurious rates, perpetual debt and coercion. Prohibit the use of checks or debits as the basis for small loans.
- ? Close the loopholes exploited by lenders to exceed state small loan limits and protections, including prohibiting:
 - Retail outlets from brokering or arranging loans they couldn't legally make.

⁹⁹ Official Opinion 2002-3, Thurbert E. Baker, Attorney General, Georgia, www.ganet.org/ago/read.cgi?searchval=payday%20loans&openval=02-3

¹⁰⁰ Final Order and Judgment, *BankWest, Inc. and Advance America Cash Advance Centers of Georgia, Inc., v. John W. Oxendine, Commissioner of Insurance of the State of Georgia*, Civil Action File No. 2002CV56563, Feb. 17, 2003.

¹⁰¹ Id..

¹⁰² Court of Appeals of Georgia, *BankWest, Inc. et al. v. Oxendine*, March 22, 2004.

Choice of law or forum clauses that deprive consumers of home-state protections

- ? Apply state small loan laws to loans made via the Internet, by mail or phone.
- ? Define coverage broadly to prohibit use of subterfuges and thinly-veiled loan transactions

FDIC should:

- ? Promptly inspect all state chartered, FDIC-supervised banks and their payday loan partners to vigorously apply payday loan guidelines. Enforce the Federal Trade Commission Act ban on unfair and deceptive practices for deceptive brokering claims

FRB should:

- ? Declare that taking a check or debit as security for a loan is an unfair trade practice under authority from the Federal Trade Commission Act

Congress should:

- ? Prohibit the use of checks or debits drawn on federally insured banks as the basis for a payday loan
- ? Halt the misuse of bank charters by third party lenders to make loans prohibited in states.

Appendix A: Status of State Payday Loan Laws/Regulations

States that prohibit payday loans due to small loan interest rate caps, usury laws, and/or specific prohibitions for check cashers¹⁰³

Alaska	(Arkansas ¹⁰⁴)	Connecticut	Georgia
Maine ¹⁰⁵	Maryland	Massachusetts	Michigan ¹⁰⁶
New Jersey	New York ¹⁰⁷	North Carolina ¹⁰⁸	Pennsylvania
Rhode Island	Vermont	West Virginia	Puerto Rico
Virgin Islands			

¹⁰³ Alaska (Alaska Stat. § 45.45.010), Connecticut (Conn. Gen. Stat. § 36a-555 to 573, Small Loan Law), Georgia (Ga. Code Ann. §§ 7-3-1 to 7-3-29 Industrial Loan Act), Maine (Me. Rev. Stat. Ann. Tit.9-A §§ 2-101 to 2-601 §2-301, Maine UCCC), Maryland (Md. Code Ann. Com. Law II § 12-301 to 12-317 § 12-306), Massachusetts (Mass. Gen. Law Ann. Ch. 140 §§ 90 and 96), Michigan (Mich. Comp. Laws § 493.1 to 493.25), North Carolina (N. C. Gen. Stat. §§53-164 to 53-191, Consumer Finance Act), New Jersey (N. J. Rev. Stat.. § 2C: 21-19), New York (N.Y. Penal Code §§ 190.40, 190.42), North Carolina (N.C. Gen. Stat. § 53-164 to 53-191 Consumer Finance Act); Pennsylvania (Pa. Stat. Ann. Tit. 7, §§ 6201 to 6219, Consumer Discount Company Act), Puerto Rico (P.R. Laws Ann. tit. 10, §§ 941 to 959. Small Personal Loan Act), Rhode Island (R. I. Gen. Laws §§ 19-14.2-1 to 19-14.2-16, Small Loan Lenders Act), Vermont (Vt. Stat. Ann. tit. 8, §§ 2200 to 2239, Licensed Lenders), Virgin Islands (V.I. Code Ann. tit. 9, §§ 181 to 204, Small Loan Act), and West Virginia (W. VA. Code §§ 46A-1-101 to 46A-8-102, Consumer Credit & Protection Act.)

¹⁰⁴ Arkansas (Ark. Stat. Ann. § 23-52-101 *et seq.*, fee section is invalid attempt to evade the usury provisions of Arkansas Constitution, 3/22/01 Arkansas Supreme Court) (maximum interest rate set by state constitution in Ark. Const. art. 19 § 13).Luebbers v. Money Store, Inc., et al, ___Ark.___2001.)

¹⁰⁵ Limited payday lending under small loan law.

¹⁰⁶ Michigan Financial Institutions Bureau declaratory ruling April 25, 1995 re: Oak Brook/Cash Now Partners d/b/a Cash Connection held 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.*)

¹⁰⁷ 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.)

¹⁰⁸ North Carolina payday loan law expired August 31, 2001 when legislature did not reauthorize payday loan law. Small loan cap is 36% APR.

States with no interest cap or usury law for licensed lenders¹⁰⁹

New Mexico Wisconsin

States with laws or regulations that authorize payday loans¹¹⁰

Alabama	Arizona	California	Colorado
Delaware	Florida	Hawaii	Idaho
Illinois	Indiana	Iowa	Kansas
Kentucky	Louisiana	Minnesota	Mississippi
Missouri	Montana	Nebraska	Nevada
New Hampshire	North Dakota	Ohio	Oklahoma
Oregon	South Carolina	South Dakota	Tennessee
Texas	Utah	Virginia	Washington
Wyoming			
District of Columbia			

Source: Consumer Federation of America and National Consumer Law Center Summary of State Payday Loan Laws

Updated: March, 2004

¹⁰⁹ N. M. Stat. Ann. § 58-15-1 to 58-15-31, Small Loan Act.; Wis. Stat. § 138.09. Payday loans not subject to substantive consumer protections specific to payday lending.

¹¹⁰ Alabama (Act No. 2003-359); Arizona (Ariz. Rev. Stat. § 6-1251 *et seq.*); California (Cal. Fin. Code § 23000 to 23106); Colorado (Colo. Rev. Stat. § 5-3.1-101 *et seq.*); Delaware (Del. Code Ann. Tit. 5. § 961, 976, 2227, 2235A); the District of Columbia (D.C. Code § 26-301 *et seq.*); Florida (§560.401, *et seq.*); Hawaii (Haw. Rev. Stat. § 480F-1 *et seq.*); Idaho (Chapter 46, Title 28, Idaho Code, 28-46-401 *et seq.*); Illinois (Ill. Admin. Code tit. 38, § 110.300 *et seq.*); Indiana (IC 24-4.5-7-101 *et seq.*); Iowa (Iowa Code § 13-533D.1 *et seq.*); Kansas (Kan. Stat. Ann. § 16a-2-404); Kentucky (Ky. Rev. Stat. Ann. § 368.010 *et seq.*); Louisiana (La. Rev. Stat. Ann. § 9:3578.1 *et seq.*); Minnesota (Minn. Stat. § 47.60); Mississippi (Miss. Code Ann. § 75-67-501 *et seq.*); Missouri (Mo. Rev. Stat. § 408.500 to 408.506; Mo. Code Regs. Tit. 4, §§ 140-11.030, 140-11.040); Montana (Mont. Code Ann. § 31-1-701 *et seq.*); Nebraska (Neb. Stat. Ann. § 45-901 *et seq.*); Nevada (Nev. Rev. Stat. § 604.010 *et seq.*); New Hampshire (N. H. Rev. Stat. Ann. § 399-A *et seq.*); North Dakota (N. D. Cent. Code § 13-08-01 *et seq.*); Ohio (Ohio Rev. Code Ann. § 1315.35 *et seq.*); Oklahoma (Title 59 Oklahoma Statutes § 3101 *et seq.*); Oregon (O.R.S. § 725.600 and 725.610); South Carolina (S.C. Code Ann. § 34-39 *et seq.*); South Dakota (S. D. Codified Laws Ann. § 54-4-65, 54-4-66); Tennessee (Tenn. Code Ann. § 45-17-101 *et seq.*); Texas (7 Tex. Admin. Code § 1.605 *et seq.*); Utah (Utah Code Ann. § 7-23-101 *et seq.*); Virginia (Va. Code Ann. §§ 6.1-444 to 6.1-471; 10 Va. Admin. Code §§ 5-200-10 to 5-200-80); Washington (Wash. Rev. Code Ann. § 31.45.010 *et seq.*); Wyoming (Wyo. Stat. § 40-14-362 *et seq.*).

Appendix B: Terms of State Payday and Small Loan Laws for Check-Based Loans

States with Safe Harbor Payday Loan Law or No Usury Laws

State	Min./Max Term	Min/Max Loan	Maximum Fee %/\$	Cost/ \$100	Effective APR ¹¹¹ 14 day
Alabama Act No. 2003-359	10/31 days	-\$500	17.5% of loan	\$17.50	455%
Arizona Ariz. Rev. Stat. § 6-1251 <i>et seq.</i> 2000	NA	\$50-\$500	15% of ck	\$17.65	459%
(Arkansas) Ark. Stat. Ann. § 23-52-101 <i>et seq.</i> 1999. Arkansas Supreme Court ruled that fee section is invalid attempt to evade the usury provisions of Arkansas Constitution. (Luebbers v. Money Store, Inc., et al, ___ Ark. ___ 2001)	6/31 days	- /\$400 ck	10% + \$10	\$22.22	579%
CA Cal. Fin. Code § 23000 to 23106	-/30 days	- /\$300 ck	15% of ck	\$17.65	459%
CO ¹¹² Colo. Rev. Stat. § 5-3.1-101 <i>et seq.</i> 2000	-/40 days	-\$500	20% 1 st \$300 7.5% > \$30	\$20	520%
DE Del. Code Ann. Tit. 5, §961, 976, 2227, 2235A	-60 days	-\$500	No Limit	No Limit	No Limit
FL §560.401. <i>et seq.</i>	7/31 days	-\$500	10% + \$5 fee	\$15	390%
HI Haw. Rev. Stat. § 480F-1 <i>et seq.</i>	-/31 days	- /\$300 ck	15% of ck	\$17.65	459%
ID Chapter 46, Title 28, Idaho Code, 28-46-401 <i>et seq.</i>	NA	-\$1,000	No Limit	No Limit	No Limit
IL Ill. Admin. Code tit. 38, § 110.300 <i>et seq.</i>	-/30 days	-\$400 or 50% gross income term of loan	No Limit	No Limit	No Limit
IN IC 24-4.5-7-101 <i>et seq.</i>	14 days/ ¹¹³	\$50/\$500	15% of 1st \$250 13% of >/\$250 to \$399 10% of \$400 to \$500	\$15	390%

¹¹¹ Approximate APR without compounding

¹¹² Colorado Deferred Deposit Loan Act enacted in 2000 replaced regulations under the UCCC. Applies to agents.

¹¹³ After six small loans, a seven day waiting period must be given or a 36% APR simple interest loan payable in installments must be initiated.

State	Min./Max Term	Min/Max Loan	Maximum Fee %/\$	Cost/\$100	Effective APR ¹¹⁴ 14 day
IA Iowa Code § 13-533D.1 <i>et seq.</i>	-/31 days	-\$500 ck	\$5+10% ck \$10/\$100	\$100 \$16.67	435%
KS Kan. Stat. Ann. § 16a-2-404	-/30 days	-\$860 2 loans/lender	Scale of fees ¹¹⁵	\$15	390%
KY Ky. Rev. Stat. Ann. § 368.010 <i>et seq.</i>	14/60 days	-\$500 ck	\$15/\$100 ck For 14 days	\$17.65	459%
LA La. Rev. Stat. Ann. § 9:3578.1 <i>et seq.</i>	-/60 days	-\$350 loan	16.75% ck	\$20	520%
MN Minn. Stat. Ann. § 47.60	-/30 days	-\$350 loan	Scale of fees ¹¹⁶	\$15	390%
MS Miss. Code Ann. § 75-67-501 <i>et seq.</i>	-/30 days	-\$400 ck	18% ck	\$22	572%
MO Mo. Rev. Stat. § 408.500 to 408.506; Mo. Code Regs. tit. 4, § 140-11.030, 140-11.040	14 /31 days.	-\$500 loan	75% loan ¹¹⁷	\$75	1,980%
MT Mont. Code Ann. § 31-1-701 <i>et seq.</i>	-/31 days	\$50/\$300 loan	25% of loan	\$25	650%
NE Neb. Stat Ann.. § 45-901 <i>et seq.</i>	-/31 days	-\$500 ck	15% per \$100 ck pro rata	\$17.65	459%
NV Nev. Rev. Stat. § 604.010 <i>et seq.</i>	NA	% income ¹¹⁸	No Limit	No Limit	No Limit
NH N. H. Rev. Stat. § 399-A <i>et seq.</i>	7/30 days	-\$500	No Limit	No Limit	No Limit
NM <i>N. M Stat. Ann. §58-15-Ito 58-15-31.</i>	NA	NA	No Limit	No Limit	No Limit
ND N D Cent. Code § 13-08-01 <i>et seq.</i>	-/45 days	/\$500	20% of loan	\$20	520%
OH Ohio Rev. Code Ann. § 1315.35 <i>et seq.</i>	-/6 mon.	-\$500 loan	5% + \$5/\$50	\$15	390%

¹¹⁴ Approximate APR without compounding

¹¹⁵ Kansas fees: \$5.50 for loans \$0 to \$50, 10% of loans + \$5 for \$50 to \$100, 7% + \$5 for \$100 to \$250, 6% + \$5 for \$250 - \$300

¹¹⁶ Minnesota fees: \$5.50 for loans \$0 to \$50, 10% + \$5 for loans \$50 - \$100, 7% + \$5 loans \$100 - \$250, 6% + \$5 for loans \$250 - \$350

¹¹⁷ Total accumulated interest capped at 75% of initial loan amount for entire term of loan and up to 6 renewals.

¹¹⁸ Nevada: 1999 amendments prohibit loans that exceed one-third of the borrower's expected net monthly income

State	Min./Max Term	Min/Max Loan	Maximum Fee %/\$	Cost/ \$100	Effective APR ¹¹⁹ 14 day
OK Okla. Stat. Tit. 59 §3101 <i>et seq.</i> , effective 9/1/03	13/45 days	-\$500	15% up to \$300 10% \$300 to \$500	\$15	390%
OR ORS 725.600 and 725.610	-/60 days	-	No Limit	No Limit	No Limit
SC S.C. Code Ann. § 34-39 <i>et seq.</i>	-/31 days	-\$300 loan	15% ck	\$17.65	459%
SD S.D. Codified Laws Ann. § 54-4-65, 54-4-66	NA	-\$500	No Limit	No Limit	No Limit
TN Tenn. Code Ann. § 45-17-101 <i>et seq.</i>	-/31 days	-\$500 ck	15% ck	\$17.65	459%
TX ¹²⁰ 7 Tex. Admin. Code § 1.605 <i>et seq.</i>	7 days/31 days	\$100-\$350	48% APR + \$10 Monthly fee	\$11.87	309%
Utah Utah Code Ann. § 7-23-101 <i>et seq.</i>	NA	-/12 weeks	No Limit	No Limit	No Limit
VA Va. Code Ann. §§ 6.1-444 to 6.1-471.	7days/-	-\$500	15% of loan	\$15	390%
WA Wash. Rev. Code Ann. § 31.45.010 <i>et seq.</i>	-/45 days	-\$700	15% up to \$500 10% \$500 - \$700	\$15	390%
WI Wis. Stat. §138.09	NA	NA	No Limit	No Limit	No Limit
WY Wyo. Stat. § 40-14-362 <i>et seq.</i>	-/30 days	NA	\$30 or 20%	\$30	780%
DC D.C. Code § 26-301 <i>et seq.</i>	-/31 days	\$50/\$1,000	10% + fee ¹²¹	\$16.10	419%

Updated March 2004

¹¹⁹ Approximate APR without compounding

¹²⁰ Texas Finance Commission adopted regulations effective July 9, 2000 to permit payday loans under the Texas Finance Code § 11.304

¹²¹ DC: If included in contract, administrative fee of \$5 on checks up to \$250, \$10 on checks \$250.01 - \$500, \$15 for checks \$500.01 - \$750, \$20 on checks \$750.01 - \$1,000