The Truth About Payday Loans:

How Hardworking Coloradans Take the Bait and Get Caught in a Cycle of Debt

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Executive Summary

While the recent meltdown of sub-prime mortgages has captured the attention of the media, other forms of predatory lending have also expanded rapidly, taking advantage of the growing debt and financial insecurity facing millions of middle-class Americans. In the face of a weakening economy and the rising cost of living, working families across the nation have increasingly been turning to accessible, yet costly, short-term loans to survive financial shortfalls.

This report focuses on one type of consumer lending product — payday loans. Also known as deferred deposit loans, these are short-term loans of relatively small amounts that are secured with a post-dated check signed by the borrower. Under a 2000 Colorado law that opened the door for payday lending in the state, payday loans cannot exceed $500. Finance fees average about $60 and the repayment period is typically two weeks.

Data from the Colorado Attorney General's office, which licenses and regulates the payday lending industry, demonstrate that instead of one-time emergency loans, payday loans cause a downward spiral of long-term debt that borrowers cannot easily escape. Specifically, in 2006:

- Borrowers took out an average of 9 loans
- The average payday loan annual interest rate (APR) was 353 percent
- The average borrower paid $544 to borrow $343
- Almost 2 out of 3 payday loans were either refinanced loans or loans given to a borrower the same day as the previous loan was paid off ("rollover loans"), and
- During 2000-2006, 70 percent of all loans went to borrowers who had 11 or more loans in the past 12 months

The Payday Loan Industry

Recent years have seen substantial growth in "alternative financial services" and other forms of sub-prime lending. These services include pawnshops and title lending, sub-prime mortgage lending, check-cashing businesses, rent-to-own stores, and payday lenders. Sub-prime mortgage loans accounted for 8 percent of all mortgage originations in 2003, and grew to be 28 percent of all mortgage originations in 2006.[1]

One of the most thriving sectors of the sub-prime market, payday lending, has become a booming business across the United States. The research group Stephens Inc. estimated that in 2005 the entire payday lending industry was worth $40 billion, and the industry has only grown since then.[2]

The financial burden of payday loans has become prevalent for borrowers all over the country. In a recent report from the Center for Responsible Lending, researchers found that Americans spend $4.2 billion in excessive finance fees per year. It was also found that over 9 out of 10 payday loans go to borrowers who make five or more transactions a year.[3] ■

The impact on Colorado borrowers is clear: payday loans entrap working Coloradans in an unanticipated and costly cycle of long-term debt.

In 2007, the U.S. Department of Defense determined that payday loans were a harmful product and mandated a 36 percent rate cap on payday loans for military personnel and their dependents. Based on our analysis of payday lending data in Colorado and our review of federal and state policies implemented to address the growing problem of payday loans, we recommend that Colorado follow suit and take immediate action. Not only do payday loans harm our soldiers and their families, but they have also proven to be an abusive product for the vast majority of Coloradans who use them. For Colorado to effectively protect consumers, it must join the Department of Defense and the growing number of states setting fair rules and promoting responsible lending.

In 2007, the U.S. Department of Defense determined that payday loans were a harmful product and mandated a 36 percent rate cap on payday loans for military personnel and their dependents.

We recommend setting a 36 percent interest rate cap on all payday loans. If lenders cannot make a profit from a 36 percent APR, there is something fundamentally wrong with their business model.

The predatory aspect of payday lending is that it is designed to encourage continuous borrowing. Unable to pay back in full the original loan within just two weeks, borrowers extend it for months by "rolling" it over and paying the same fee over and over again. The only way to fix the problem is to end the privilege given to payday lenders that allows them to charge such exorbitant fees and to level the playing field by setting a lower interest rate cap.

We urge Colorado policy makers to protect consumers by fixing a harmful product that impacts thousands of working Coloradans. ■

Introduction

Payday loans, also called deferred-deposit loans, are cash advances on a borrower's upcoming paycheck. They are intended to provide short-term credit to assist borrowers with immediate, one-time needs. But the evidence shows that, in Colorado and throughout the country, the structure of these loans makes it particularly difficult for borrowers to pay them off. As a result, low-income workers across the nation have found themselves dependent on a product that leads to long-term debt that is difficult to escape.

Payday lending is just one part of a larger problem of abusive lending practices in the United States. This report focuses solely on payday lending because changes in state policy can curb its harmful effects. In recent years, several states have successfully regulated payday lending, and Colorado needs to follow suit.

This report analyzes payday lending in Colorado by using data collected by the Attorney General's staff. These data clearly show that payday loans are a financially destructive product for consumers. In addition, the report examines the industry's business model and the legal framework in which it operates.

Payday lenders in Colorado are exempted from the state's usury laws. This legal privilege allows them to charge triple-digit interest rates, as measured on an annual basis, and facilitates the industry's rapid growth. Other states have addressed this problem by enacting legislation to tighten the regulation of payday loans, effectively putting money back into the hands of working families.

Federal policy, experiences in other states and data collected in Colorado all show that the most useful way to help Coloradans stay out of payday lending debt is to enforce a low interest rate cap as measured by the Annual Percentage Rate, or APR. This would bring payday lenders more in line with the conditions imposed on other lenders. In 2005, Colorado residents paid an estimated $84 million in total fees for payday loans. If state policy makers rein in the payday lending industry, they could save working Coloradans up to $76 million by eliminating unnecessary interest and fees.[4] ■

Annual Percentage Rate (APR)

Annual Percentage Rate is a method of incorporating all the costs of a loan over time into one percentage rate. The APR is used to compare loans with different rates and terms, giving borrowers a simple way of comparing the long-term loan costs without getting confused by complicated loan details. To compute the APR for payday loans, the loan amount, fees on the loan and the loan term (usually one pay period) are combined into one interest rate that shows how much a borrower would pay if the loan were continued for a full year.

Many argue that because payday loans are for much shorter terms, using APR is not a valid comparison. However, because these loans are, on average, long-term commitments for borrowers, the APR is a legitimate tool to use. In Colorado, the Uniform Consumer Credit Code requires licensed payday lenders to state the APR on the loan agreement. A common method to evaluate the total cost of loans gives borrowers a way to compare payday loans to other forms of small-dollar loans. ■

Payday Lending in Colorado

A Typical Payday Loan—How One Can Lead to Many

> "These advances are not intended to be a long-term financial solution, but for immediate cash needs."
>
> —*Ace Cash Express*[5]
>
> "And the theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is."
>
> —*Dan Feehan, CEO of Cash America*[6]
>
> "I took out a loan because my car broke down, and it was OK for a while, then … it became a snowball. It was a continuous thing — I never got ahead on it. It's been almost two years now, and I still have a couple loans to pay off. I will never ever do it again."
>
> —*Colorado payday loan borrower*[7]

Borrowers must meet only minimal requirements to receive a payday loan. Along with identification, borrowers need only to have a checking account and proof of a steady income, such as a paycheck stub. Colorado law limits payday loans to $500 or no more than 25 percent of the borrower's gross monthly income, whichever is smaller. A borrower who makes $2,000 per month ($24,000 annual income) is eligible for the maximum payday loan. The borrower is required to write a check, post-dated to his or her next payday, for the amount borrowed plus the cost of the finance fee. Or alternatively, the borrower may allow the lender direct access to his or her bank account. This check or account information is then held as security on the loan.

Because it is relatively easy to obtain a payday loan, borrowers often become trapped in debt. The payday lending industry insists that its products are meant for short-term use; however, the industry's business practices, as allowed by state law, make it difficult for borrowers to use payday loan services this way. The common provisions in these loans, such as a two-week loan term, denial of partial payments and high finance fees, create a situation that makes it almost impossible for borrowers to pay back their loans. Furthermore, loan "rollovers" and loan "flipping," or permitting borrowers to take out loans right after they have paid off the previous loan, allow lenders to minimize the amount of money they loan out while maximizing the number of times they charge finance fees.

In Colorado, the highest allowable finance fee on a $300 loan is $60. Since it is typical for payday lenders to charge the maximum amount of finance charges, the scenario below is a good example of how one payday loan can quickly become a continual debt cycle for borrowers:

- A borrower takes out a loan for $300 and pays a $60 finance fee, writing a post-dated check for $360.

- Two weeks later when the loan has matured and the borrower cannot pay back the loan in full, he or she pays another $60 to "roll over" the loan. At this point, the lender has collected $120 on a $300 loan.

- Under Colorado law, a payday loan cannot be "rolled over" more than once. So, after another two weeks, when the "rolled over" loan has matured, the borrower must pay back the loan in full. However, there is nothing to prevent another loan from being issued to the same borrower on the same day. The borrower pays another $60 finance fee for the second loan. **In one month, the lender has now made $180 on the original $300 loan.**

- According to the Colorado Attorney General's office, the average payday borrower in Colorado either rolls over the loan or takes out "same as refinance-type loans" six times before paying off the original loan. Data show that the average Coloradan who borrows from a payday lender pays a total of $887, including $544 in finance fees, for a period of less than five and a half months on an average loan of $343.[8]

Attorney General Data Shows Repeat Borrowing

A breakdown of data collected by the Attorney General's office shows that payday lending has pushed many Colorado borrowers into long-term debt. In 2000, Colorado exempted payday lenders from state interest-rate caps, and since then the number of payday lending locations has grown three-fold, to 677.

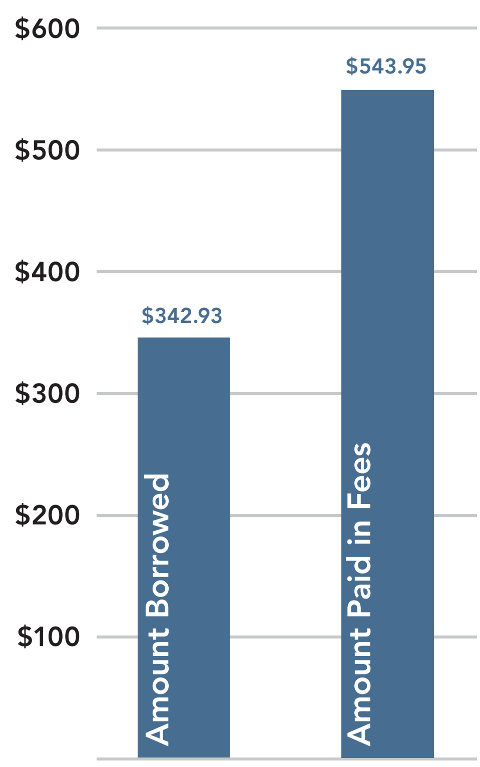
The truth about payday lending in Colorado lies in the data. Information gathered from payday lenders over the past six years shows that very few borrowers take out only one loan. In fact, most end up taking out multiple payday loans in a year, and since the data collected by the Attorney General comes from individual payday lending locations only, it is likely that many of these borrowers are indebted on the same scale to more than one payday lender at a time. Specifically:

- In 2006, the average borrower took out nine loans.[9] From 2000 to 2006, the average number of loans per borrower per year was between 9 and 10. This strongly suggests these loans are being used as long-term credit, rather than as a source of one-time emergency cash.

- In 2006, 65 percent of all payday loans written were "refinance-type" loans.[10] "Same-day-as-payoff" loans (or "flipped" loans) and refinanced loans are both considered to be "refinance-type" loans. These loans are defined by the office of the Uniform Consumer Credit Code (UCCC) as "transactions

Figure 1

Average Amount Borrowed and Average Amount Paid in Fees for Payday Loans in 2006



Source: Colorado Attorney General data from mandatory examinations by UCCC staff.

where the consumers remained indebted to the lender."[11] This means that most payday loans are issued consecutively as a way to further extend borrowers' debt, rather than as one-time emergency loans.

• The average APR paid by borrowers was 353 percent.[12] The average amount borrowed in 2006 was $343 and the average amount paid in finance fees on this amount was $544 (see Figure 1). The $544 includes finance fees paid on the initial loan as well as fees paid to refinance loans and to take out other "refinance-type" loans. In other words, in Colorado the average borrower pays $544 in fees to borrow $343.[13]

• Based on data collected from 2000 to 2006, 70 percent of all loans went to borrowers who had received 11 or more loans in the previous 12 months (see Figure 2).[14]

• Based on data published in March 2007, more than one-third of payday borrowers (37 percent) took out 70 percent of all loans in the previous 12 months (see Figure 3). Just over 1,200 borrowers, or 3 percent of the total number of borrowers, took out 26 or more loans in the past 12 months. This means that more than 1,200 people in Colorado potentially had a payday loan outstanding every week of the year.

• According to the Attorney General's database, the highest number of total payday loans taken out by one borrower from a single lender in a year ranged from a high of 74 in 2005 to a low of 50 in 2000.[15]

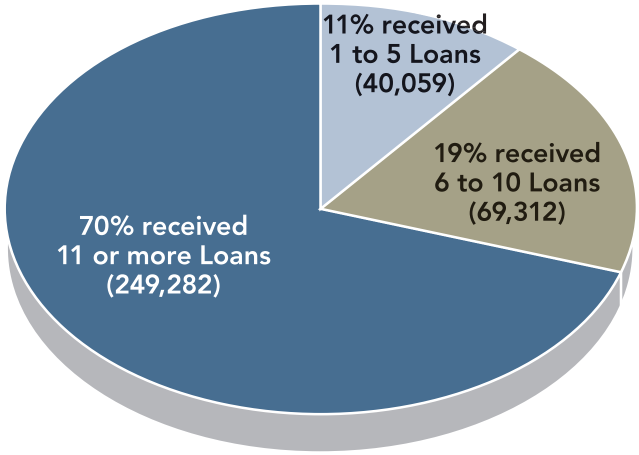
• In 2006, 14 percent, or about one of every seven, of all payday loan borrowers had a loan out with the same lender for the six months prior to the UCCC examination.[16]

• The average payday loan borrower is a 36-year-old woman. 61 percent of payday loan borrowers are 20 to 36 years old, and 14 percent are 50 or older.[17]

• The majority of payday loan borrowers have lower to middle level incomes. The average gross monthly income for all borrowers is $2,396 (or $28,752 annually) and the median monthly income is $2,167 ($26,604 annually).[18] In comparison, the 2006 median annual earnings for full-time workers in Colorado is $41,156.[19] The largest percentage of borrowers by occupation was laborer, accounting for about one-third of all borrowers.[20]

Figure 2

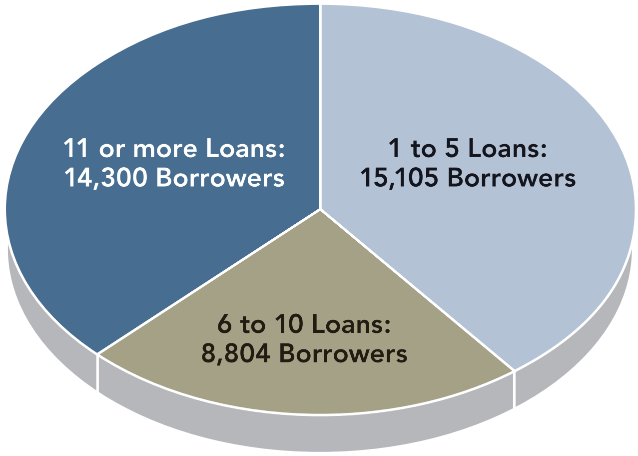
Frequency of Loans to Individuals Over the Previous 12 Months



Source: Colorado Attorney General data from mandatory examinations by UCCC staff.

Figure 3

Number of Borrowers by Number of Loans Received in the Previous 12 Months



Source: Colorado Attorney General data from mandatory examinations by UCCC staff.

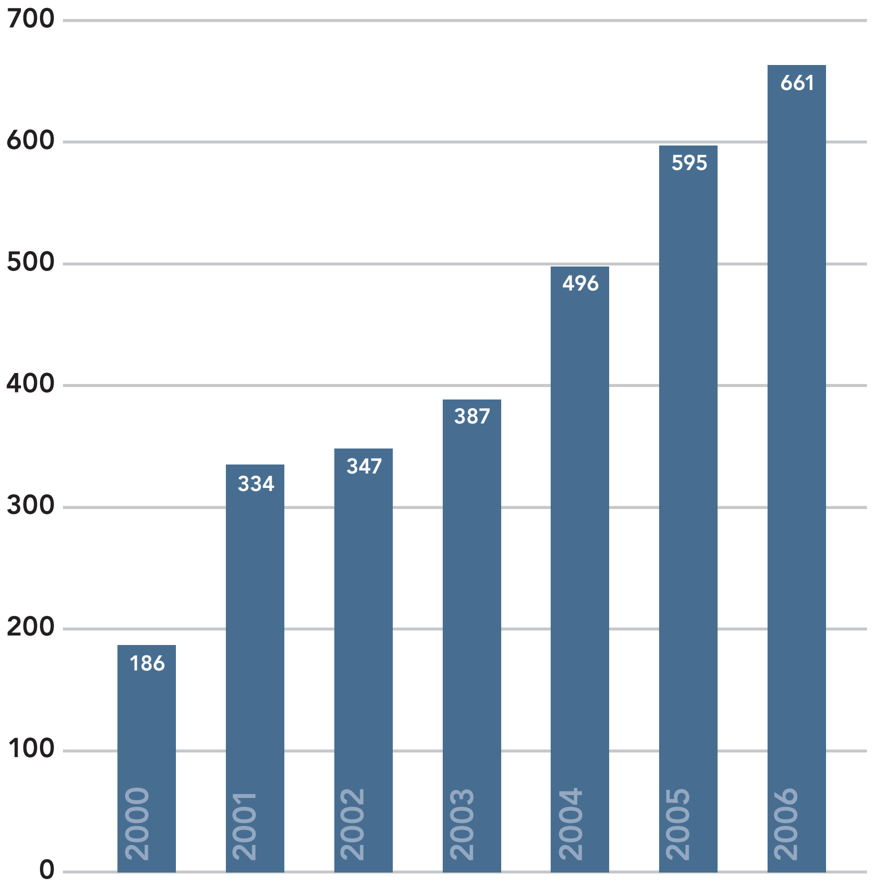
How Colorado Regulates Payday Lending

In 2000, the legislature authorized the payday lending industry to operate in Colorado and exempted it from the state usury cap of 45 percent APR. This law, the Deferred Deposit Loan Act (DDLA), gave the payday lending industry legislative clearance to charge fees that amount to an APR of over 350 percent. Provisions of the DDLA include:[21]

- Loans cannot exceed $500
- Lenders can charge a finance fee on loans
- Finance fees are assessed through a step-rating system. Payday lenders can charge a fee of no more than 20 percent on the first $300 of a loan, and then an additional 7.5 percent fee on any amount that exceeds $300. For a $300 loan, the maximum finance charge is $60, and for a $500 loan the maximum finance charge is $75
- The loan term cannot exceed 40 days
- Loans can only be renewed once, and renewals are subject to the same limits on finance fees as original loans
- All loans require an agreement signed by both the lender and the borrower
- Borrowers can cancel a payday loan by 5 p.m. on the following business day after the loan is made

Figure 4

Number of Licensed Deferred Deposit Lenders Reporting Annually to the UCCC, 2000-2006



Source: UCCC Deferred Deposit Lenders Annual Reports.[26]

The DDLA was amended in 2007 (HB 07-1261) to require that payday lenders offer a payment plan to borrowers when they take out their fourth consecutive loan. However, experiences in other states show that borrowers are unlikely to take advantage of such plans. In Washington, payment plans are used for only 0.8 percent of all loans and in Oklahoma payment plans are used on 0.4 percent of all loans.[22] In Florida, lenders are required to offer a 60-day grace period to give borrowers time to pay back the loan. The grace period has been used on 0.5 percent of all loans.[23] Furthermore, the payment plan aims to help the borrower pay back the loan only after they are already in long-term debt, rather than aiming to prevent the borrower from entering into long-term debt in the first place.

Payday lenders assert they must charge high fees because payday loan borrowers are "riskier and are more likely to default." However, reported charge-off rates for Colorado payday lenders show that these borrowers are not much more of a risk than borrowers at banks. In 2006, Colorado payday lenders reported a 14.2 percent rate of default on the total loan volume. However, the total loan volume that was charged off (in which the lender never received the principal loan amount and had to absorb the costs) in 2006 was only 4.2 percent.[24] The rest of the defaulted loan volume was recovered, and the lenders received the principal loan amount. In the same year, the Federal Reserve Board reported an average charge-off rate of 2.1 percent for all consumer loans. For credit cards, the rate was 3.5 percent.[25] Ultimately, payday lenders do not lose a significantly greater amount of their total loan volume than commercial banks.

How Colorado Law Enabled the Growth of Payday Lending

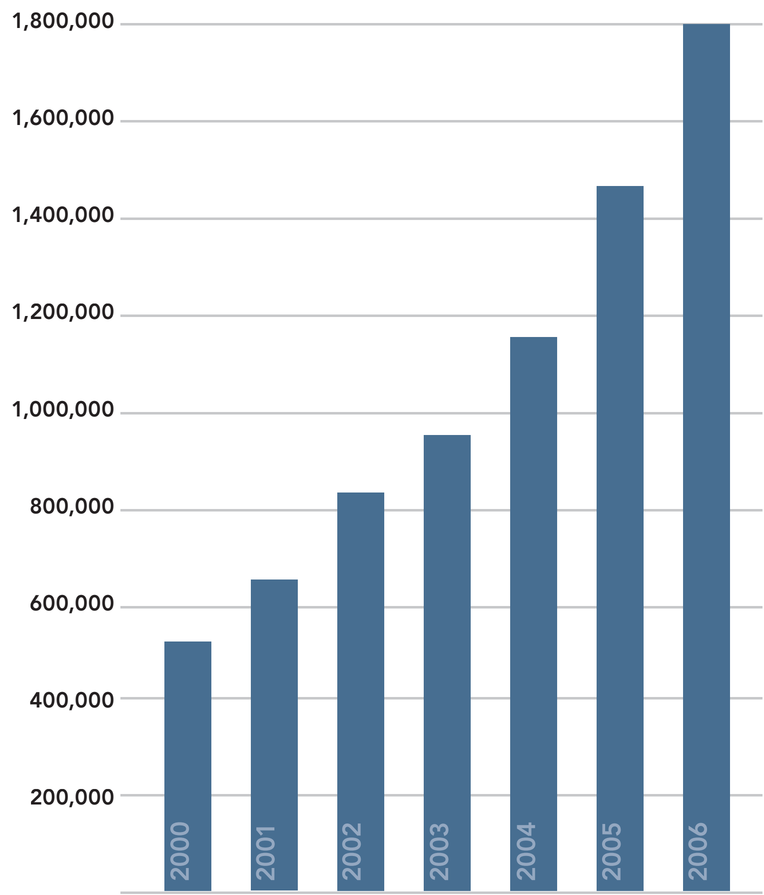
The DDLA facilitated the growth of the payday lending industry in Colorado. Once enacted, both the number of loans made per year and the number of licensed payday lenders increased dramatically.

In 2000, the number of DDLA licensed lenders reporting to the Attorney General's Uniform Consumer Credit Code administrator was 186; the number grew to 661 by 2006. (See Figure 4). However, not all licensed payday lending locations report to the UCCC before the annual report is released. The UCCC has reported that the actual total of all DDLA licensed lending locations in Colorado was about 220 in the year 2000 and 677 in 2006.[27] The number of licensed payday lending locations that are reporting to the UCCC administrator has increased by 255 percent between 2000 and 2006 (the increase in the actual number of licensed payday lenders in the same time frame is 200 percent). To put this in perspective, there are three payday lenders for every one McDonald's in Colorado, or 13 payday lenders per 100,000 Coloradans—the 15th highest ratio in the country.[28] In a different context, Colorado's population grew by 11 percent between 2000 and 2006.[29] The number of payday lenders grew 18 times faster than the state's population. Even with the extreme growth of the payday lending in Colorado, only a few companies account for most of the industry. The 10 largest companies make up 56 percent of all licensed payday lenders.

Total loan volume also demonstrates the dramatic growth of the payday lending industry. As Figure 5 shows, in 2006 the loan volume was three times the volume in 2000. This is a 236 percent increase in total loans made from 2000 to 2006.[30] ■

Figure 5

Total Payday Loans by Year, 2000-2006



Source: UCCC Administrator Annual Reports 2000-2006.

Moving Forward in Colorado

A close look at the Colorado payday lending data shows a serious problem in how the payday lending business system functions. Our current laws facilitate a cycle of debt in which borrowers take out payday loans for emergency uses and are then trapped by multiple loans. In this process, the average Colorado borrower takes out a loan and refinances it or extends it six times and ultimately pays $544 in finance fees for a $343 loan. In order for this problem to be solved, legislative action is needed.

Many other state legislatures, the FDIC (Federal Deposit Insurance Corporation) and experts on this topic all agree that a double-digit interest rate, such as 36 percent, is a fair APR cap. Analysis of other state approaches shows that this is the most effective and the least costly approach to regulating payday lending (see *How Other States Regulate Payday Lending,* page 15). For example, the U.S. Congress set a 36 percent APR cap on payday loans for members of the military and their families. Oregon's new payday lending law mandates a 36 percent APR, not including a supplemental origination fee. We believe the military APR cap should be applied across the board to all payday loan borrowers, using a legal framework similar to the Oregon model.

A recent study published by the Center for Responsible Lending shows that states that enforce an APR of 36 percent are the only states that keep borrowers out of long-term payday loan debt. This study also outlines a variety of ineffective legislative measures:[31]

- Renewal bans/cooling-off periods
- Limits on number of loans outstanding at any one time
- Re-payment plans
- Loan amount caps based on a borrower's income

The report shows that most of the legislation aimed at providing a compromise between consumer advocates and the payday lending industry has not been helpful to borrowers. As long as the payday lending industry is allowed to charge a triple-digit APR, borrowers will struggle to pay back their loans.

Those who take out payday loans typically have access to other resources to help them get through financial hardships. Payday loans are simply one of the most convenient and widely advertised options. If the payday lending industry is more stringently regulated, Colorado borrowers are likely to use other resources (see *Alternatives to Payday Lending* on page 14). ■

Conclusion

A loan with an average 353 percent APR is simply not a product that should be allowed in the Colorado market. Like any other product, such as a car with faulty brakes, it should be recalled or fixed as soon as the problem is identified. If lenders cannot make a profit with an interest cap of 36 percent, then there is something wrong with their business model.

Using data from the Attorney General, this report identifies the problem with payday loans; now state decision-makers need to address it. Our task in Colorado is simple: We enabled this industry to thrive, but it has proven to be a costly trap for borrowers and now we must pull it back. If lawmakers truly want to help hard-working Coloradans build assets, borrowers need to be given a way out of the long-term debt trap caused by payday lending and introduced to fair and responsible credit options. Colorado must take decisive action on this important issue. ■

Organizations in Colorado that Promote Access to Financial Services

Although banks and credit unions are available to most people who use payday loans, gaining access to these resources is not always as easy as it seems. These three organizations are offering financial education and counseling to Colorado borrowers on how to enter the mainstream banking system:

• **Consumer Credit Counseling Services (CCCS)** is a non-profit division of Money Management International. Its mission is "helping people improve their financial well-being through counseling, community outreach and financial education." In Colorado, the organization serves 600 to 700 families per month, offering free advice to organize and understand household budgets, so families can match their spending to their income.[32] CCCS has five locations in the Denver metro area, as well as locations in Grand Junction and Fort Collins.

• **America's Family** is a non-profit organization that aims to give Colorado's struggling populations access to financial sustainability. Based in Colorado Springs, it provides access to a membership with a local credit union and financial literacy classes. America's Family also encourages clients to become more active and involved members of their communities.

• **Renewal Financial Services** is an organization based in Denver. It serves those who are "on the fringe of financial services," helping them attain the knowledge and financial status necessary to gain access to mainstream banking and credit. RFS offers advice on how to gain access to banking, credit, and insurance. The organization focuses on minority groups and the under-banked population at large. ■

Alternatives to Payday Lending

> "Many borrowers who use payday loans have a checking account and a steady paycheck, so why aren't they borrowing from their bankers?"
>
> —*Sheila C. Bair, FDIC chairwoman*[33]

If Colorado tightens its regulation of the payday loan industry, where will borrowers turn for credit? Payday loans are often the most accessible option for people in a financial bind, but are rarely the only option. In states that do not allow storefront payday lending, borrowers are still able to get through financial shortfalls. A 2007 study of borrowers by the Center for Community Capital at the University of North Carolina found that they use several options, including:

- Borrowing from family and friends
- Using money from a savings account
- Using a cash advance from a credit card
- Negotiating bill payments
- Using overdrafts and paying the related fee
- Receiving money from a charity or church
- Borrowing from a finance company

It should also be noted that the reported demand for payday loans is inflated by the cycle of refinancing. For example, Colorado borrowers take out an average of nine loans per year. But it is unlikely that borrowers have nine separate emergencies for which they take out nine separate loans. Instead, borrowers take out one loan, cannot pay it back, and take out an average of six subsequent loans in an effort to repay the original loan. The "demand" is largely created by the first loan, and then set in place by abusive conditions that prevent borrowers from paying it back. ■

In states that do not allow storefront payday lending, borrowers are still able to get through financial shortfalls.

How Other States Regulate Payday Lending

> "The other thirty-nine states have legalized payday lending using provisions such as mandatory databases, cooling-off periods, attempts to stop rollovers and back-to-back transactions, and attempts to stop borrowing from multiple lenders. However, even with the addition of all these 'consumer bells and whistles,' these laws do not stop the debt trap."
>
> *—2006 Department of Defense report on predatory lending practices directed at members of the armed forces and their dependents*[34]

Usury, or setting a maximum interest rate on loans, falls under the authority of state law. Limits on usury vary from 17 percent in Arkansas to 60 percent in Georgia, while some states set no limit on interest charged by licensed lenders. State governments also cap rates for specific forms of lending, such as payday lending, small consumer loans and pawn transactions. States have taken a variety of approaches in managing payday lending, ranging from criminalizing it to leaving it virtually unregulated. Several states enacted legislation to authorize payday loans, while others prohibit lending by check cashers or effectively prohibit triple-digit-rate loans by applying state usury or small loan laws. The following section describes the spectrum of legislative approaches states have taken to address payday lending.

Unregulated Payday Lending

There are eight states that leave payday lending virtually unregulated. Seven of these states have authorized payday lending but have left it unregulated. Wisconsin does not authorize the payday lending industry but also does not have a state usury cap for licensed lenders, so they are free to charge any interest and fees they choose. South Dakota and Utah are two states that legally authorize but do not regulate the payday lending industry. Utah's only limit is that the loan term may not exceed 12 weeks.[35] South Dakota limits payday lenders to a maximum loan amount of $500 and a three-day cooling off period between loans from the same lender.[36] Neither of these states have a usury cap, nor do their regulators require a specific cap for payday loans.

Capping the Interest Rate and Prohibiting Payday Lending

Some states have taken measures to effectively prohibit the payday lending industry as it functions now. Some simply do not allow triple-digit APR loans and apply criminal usury caps. Other states prohibit check cashers from transacting loans, which consequently bans payday lending. Statutes vary greatly, but all states that take this approach have eradicated single-payment small loans with triple-digit APRs, and foster other kinds of small-dollar lending instead. Among the states that use these approaches are Connecticut, District of Columbia, Georgia, Maine, New

York, North Carolina, Pennsylvania and West Virginia (See Appendix 1 for a listing of all states with similar small loan laws). Of all the states that ban payday lending, Georgia has taken the most aggressive approach by explicitly adding payday lending to its criminal code.

Georgia

Payday lending was never legal in Georgia, but weak enforcement of state loan caps resulted in rampant payday lending. Georgia put an abrupt stop to payday lending by redefining it as a crime and closing all the loopholes lenders exploited to evade small-loan interest caps. The Georgia Payday Loan Act of 2004 added a new chapter to the state's criminal code that defines payday lending as "a misdemeanor of a high and aggravated nature."[37] The code defines an illegal "payday loan" as any loan of less than $3,000 with an interest rate higher than 16 percent.[38] The code makes no reference to any of the unique characteristics of payday loans, such as holding a post-dated check as collateral, to ensure that all forms of payday lending are included. Because this would prohibit other legitimate forms of lending, such as credit cards and small consumer loans, these forms of lending are separated from the "payday loan" criteria with specific exemptions to the act.

Georgia also set strict penalties for transacting a payday loan, including up to one year in jail and a $5,000 fine for the first three offenses. If convicted of four or more offenses, the lender is charged with a felony and can face up to five years in jail and a $10,000 fine. Borrowers are entitled to sue for three times the amount of finance charges and interest fees, along with attorney fees and courts costs. The state can also bring a civil action seeking three times the loan and interest charges. Along with all these sanctions, the state can also collect a tax from the lender on 50 percent of all revenue made on the payday loan.[39]

Georgia was also the first state to ban "rent-a-charter" tactics by banks. This prohibits payday lenders from using a charter from an out-of-state bank to run a business in Georgia and charge higher interest rates than what the state law allows (see *Charter Renting,* page 18).

Authorized and Regulated Payday Lending

Between effectively banning payday lending and allowing it to go unrestricted, many states (such as Colorado) have authorized it, but with restrictions. Some states, such as New Mexico, provide the industry with its own legislative framework. Others, such as Oregon, impose a specific interest cap.

New Mexico

Prior to New Mexico's 2007 legislation, payday lending was legal but unregulated. There is no state usury cap or regulation on small consumer loans. This new legislation, which became effective Nov. 1, 2007, authorizes the payday lending industry in the state and sets up a complex regulatory framework.[40] Until this bill was passed, payday lenders were charging as much as 560 percent APR. The new payday lending guidelines result in an APR between 300 percent and 400 percent. In this context, the new regulations are an improvement, but they still allow triple-digit interest rates.

In order to ensure that borrowers are not taking out more than one loan at a time, New Mexico state government is setting up a database to track borrower loan activity. It is one of eight states that limit borrowers to one loan at a time, using databases to enforce this provision.[41] While there is minimal data that show the effectiveness of these databases, it is a necessary provision to make sure borrowers are following the one-loan maximum, since borrower activity would otherwise be left unmonitored. Veritec Solutions of Belmont, California, has set up the databases in all eight states requiring their use, and specializes in working with states to track payday lending activity.[42]

A concern for New Mexico consumer advocates is that payday lenders will simply switch their business to become small-installment consumer lenders. These lenders remain unregulated and can charge interest rates even higher than payday loans. Payday lenders in Illinois and Nevada switched to installment loan licenses to evade payday loan law changes, so this concern seems well grounded.

Oregon

Oregon has instituted a simple, cost-efficient, and effective means of regulating the payday loan industry.

2006 Oregon legislation authorizes payday lending and sets a specific interest cap. Before this legislation was passed, Oregon did not regulate payday lending, nor was there a state usury cap. Payday loans are now capped at 36 percent annual interest, and lenders are limited to an origination fee of no more than $10 for every $100 of the loan for the first loan. The loan can be renewed twice. Upon renewal, the lender cannot charge another origination fee, but can charge up to the maximum interest rate.[43]

The Oregon law extends the loan term to a minimum of 31 days and ultimately lowers the APR by a substantial amount. Under the new guidelines, the APR on a $300 loan in Oregon would be about 160 percent.[44] ■

Charter Renting

Charter renting occurs when a payday lender uses the charter from an out-of-state bank to issue high-interest loans that circumvent the state's interest rate cap. The payday lender will often pay the bank a fee in exchange for the bank's authority to loan out-of-state.[45]

For example, if a payday lender wants to open a storefront in Oregon, where the interest cap is 36 percent, it could contract with a bank chartered in South Dakota (where payday lending is unregulated) and use that bank's charter to lend in Oregon. Given that no other legislation or code would stop this practice, the lender is then free to charge interest rates that are much higher than what Oregon would allow. State regulators have had difficulty imposing state laws on charter-renting payday lenders, since it is often unclear when state and federal laws conflict on this issue.

In 2005, the FDIC issued revised guidelines for payday lending for banks. The guidelines tighten the standards for FDIC-regulated banks and their non-bank partners by ensuring that they do not make loans to borrowers already stuck in debt. Banks are also required to find other long-term credit options for these borrowers. These guidelines do not prevent banks from "renting" their charters but try to ensure that these payday loans do not abuse payday loan borrowers. ■

State regulators have had difficulty imposing state laws on charter-renting payday lenders, since it is often unclear when state and federal laws conflict on this issue.

Federal Payday Lending Legislation and Policy

> "The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending …"[46]

The federal government imposes minimal regulations on the payday lending industry, but the industry's high interest rates and loan fees are gaining more attention from policy makers. Recent federal legislation regarding payday loans for the military and guidelines issued by the Federal Deposit Insurance Corporation (FDIC) show that payday lending has become a concern for national regulators and politicians.

In 2007, the Department of Defense deemed payday lending to be a product that "contributes to a cycle-of-debt."[47] An amendment to the 2007 Defense Authorization bill caps the APR of payday loans to members of the military at 36 percent.[48] A report by the Department of Defense argues that payday lending fits all four criteria of what it considers to be predatory lending practices: Lending without regard to the borrower's ability to repay, charging excessive fees and interest, an unrealistic repayment schedule, and encouraging repeated loan refinances.[49] This legislation was passed to protect U.S. troops and their families from falling into long-term debt from payday lending. Proponents of the legislation argued that payday lending is a growing problem for soldiers, whose families are often in unstable financial situations.

In June 2007, the FDIC issued guidelines for small loans that recommend setting an APR below 36 percent along with other measures that reflect fair lending practices. The FDIC recommends that repayment periods be longer than one pay period (or 14 days), that lenders not offer loans to borrowers who had loans outstanding at any lender for a total of three months during the previous 12 months, and that lenders establish an appropriate cooling-off period between loans. This last provision addresses the issue of chronic or long-term borrowing that typifies payday loans. By seeking to prohibit banks from giving loans to frequent borrowers, the FDIC is recognizing that payday lending is a long-term problem for borrowers. ■

Examples of Affordable Products

In the face of the payday lending boom, banks and credit unions are making strong efforts to offer short-term loans as a fair and affordable alternative to payday loans.

Credit unions throughout Colorado are beginning to offer small loans as alternatives to payday loans. Denver Community Credit Union has recently begun a three-step process of offering short-term loans to newer members as a gateway into long-term credit. The ultimate goal is to help borrowers reach a point at which they have a credit card and are more financially competent.[50]

- The first small loan of up to $300 carries an interest rate of 18 percent and a $25 origination fee. The loan term is one pay period, or two weeks. If the borrower is late in repayment, he or she must pay a one-time fee of $10 and attend a mandatory financial counseling session with a credit union financial counselor. Minimum credit union membership for six months is required to start this step.

- Successful repayment of the first loan or completion of the counseling session allows the borrower to take out a loan of up to $500. It has the same $25 origination fee and late fee, but the interest rate falls to 15 percent.

- If the first and second loans are successfully repaid, the borrower then qualifies for a revolving line of credit, with a maximum limit of $500. The interest rate is the prime rate plus 3.99 percent and the minimum monthly payment is $25.

The FDIC has recently launched a two-year pilot program that will "review affordable and responsible small-dollar loan programs."[51] In 2008, researchers will begin collecting information to identify legitimate and responsible small-loan programs offered by banks. Researchers will seek small-dollar loans that have an APR of less than 36 percent, a repayment time longer than the usual 14-day pay period, charge finance fees that are limited to the actual costs of the lender, and have an automatic savings component.[52] The FDIC is searching for a responsible and fair product that is not being provided by payday lenders. ■

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[6] King, Uriah, Leslie Parrish. 2007. *Springing the Debt Trap - Rate caps are only proven payday lending reform.* Remarks made at the Jefferies Financial Services Conference. June 20, 2007. Quote from http://www.responsiblelending.org/issues/payday/reports/springingthe-debt-trap.html
Transcript of Cash America's presentation at the Jefferies Financial Services Conference is on file with above authors.

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[8] *Payday Lending Demographic and Statistical Information: July 2000-December 2006.* Data prepared by the staff of the Administrator of the Uniform Consumer Credit Code under the Colorado Attorney General. March 8, 2007. Online at: http://www.ago.state.co.us/UCCC/PDF/ddlasummary2006.pdf

[9] *Ibid.*

[10] *Ibid.*

[11] *Ibid.*

[12] *Ibid.*

[13] *Ibid.*

[14] *Ibid.*

[15] This data is from a database of information gathered from the statutorily mandated field examinations of all Colorado DDLA licensed lenders by Uniform Consumer Credit Code examiners. The examiners looked at the 30 most recent loans given by the lender. Data available upon request to the office of the Administrator of the Colorado UCCC. Contact information can be found online at: http://www.ago.state.co.us/UCCC/UCCCmain.cfm

[16] *See,* footnote 8.

[17] *Ibid.*

[18] The gross annual incomes are calculated by multiplying the gross monthly incomes by 12.

[19] U.S. Census Bureau, 2006 American Community Survey, Class of worker by median earnings in the past 12 months (in 2006 inflation adjusted dollars) for the full-time, year round civilian employed population16 years and over. http://factfinder.census.gov/servlet/DatasetMainPageServlet?_program=ACS&_submenuId=factsheet_1&_lang=en&_ts

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[25] *Charge-offs and Delinquency Rates on Loans and Leases at Commercial Banks.* Federal Reserve Statistical Release, Federal Reserve Board website: http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm

[26] The annual reports are of compiled information that is submitted by DDLA licensed lenders. The numbers in the chart are the total number of lenders that submitted data to the UCCC office before the annual report was published. It does not reflect the total number of DDLA licensed lenders. These reports are available to the public at http://www.ago.state.co.us/UCCC/UCCCmain.cfm

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[28] *McDonald's vs. Payday Lenders.* California State University at Northridge, Department of Geography Social Justice Research. http://www.csun.edu/~sg4002/research/mcdonalds_by_state.htm

[29] 2000 and 2006 Colorado Fact Sheets. U.S. Census Bureau American Factfinder. http://factfinder.census.gov/servlet/ACSSAFFFacts?_event=&geo_id=04000US08&_geoContext=01000US%7C04000US08&_street=&_county=&_cityTown=&_state=04000US08&_zip=&_lang=en&_sse=on&ActiveGeoDiv=&_useEV=&pctxt=fph&pgsl=040&_submenuId=factsheet_1&ds_name=DEC_2000_SAFF&_ci_nbr=null&qr_name=null&reg=null%3Anull&_keyword=&_industry=

[30] This data comes from annual reports submitted to the UCCC by DDLA licensed lenders. It is the total number of loans made, according to the lenders. All annual reports are available to the public at http://www.ago.state.co.us/UCCC/UCCCmain.cfm

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[33] *When You Need Money Fast: Sources of Affordable Cash.* FDIC Consumer News, Summer 2007- Special Edition: 51 Ways to Save Hundreds on Loans and Credit Cards. http://www.fdic.gov/consumers/consumer/news/cnsum07/sources.html

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[37] Summary of SB157: "Payday Lending." The Center for Responsible Lending. March 18, 2004. http://www.responsiblelending.org/pdfs/GA_bill_summary.PDF

[38] *Ibid.*

[39] Georgia O.C.G.A. §§ 7-3-29, 16-14-3, and 16-17-1 to-10, established by Senate Bill 157 in 2004.

[40] The legislative framework includes a $15.50 finance charge for every $100 of a loan, a prohibition on loan renewals or rollovers, a mandatory 130 day repayment plan if the borrower cannot pay the loan back, a 35 day minimum loan term, a 10 day "cooling off" period between loans, a limit of one payday loan at a time, and a maximum 50 cent fee for the database. New Mexico House Bill 92. Passed in the 48th Legislative Session, 2007.
http://legis.state.nm.us/lcs/_session.asp?chamber=H&type=++&number=92&Submit=Search&year=07

[41] The seven other states that have set up databases are Alabama, Florida, Illinois, Indiana, Michigan, North Dakota and Oklahoma.

[42] Veritec Solutions works with states to set up lending databases, and claims that it does so at no cost to the state. This is made possible with a mandated fee, from $0.43 to $0.55, which is collected from the finance fees on every payday loan made. This fee is then used to cover the cost of the database.

[43] Oregon Revised Statutes 725.340 and 725.622.

[44] This is an estimate of the APR calculated with a loan amount of $300, a loan term of one month, an interest rate of 37% (30% interest plus an estimate of the prime interest rate), and an origination fee of $30.

[45] The FDIC defines "charter renting" as when "a bank allows non-bank lenders in other states to use the bank's authority to circumvent state caps on interest rates in exchange for a fee. This process allows payday lenders to use the banks' licenses to loan out of state, as a satellite lender of that bank." FDIC Chairman Tanque Denounces "Charter Renting" as a Means of Funding Predatory Payday Lenders. FDIC Press Release PR 41-2000. June 14, 2000. http://www.fdic.gov/news/news/press/2000/pr0041.html

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Appendix A

Comparison of States that have Prohibited Payday Lending*

	Connecticut	Georgia	Maine	Maryland
Legal Status	Prohibited	Prohibited	Prohibited (permitted for supervised lenders)	Prohibited
Citation	Usury act applies or small-loan act applies. Conn. General Stat. § 36a-563	Industrial loan act applies. Ga. Code Ann. §7-3-14. Ga. Comp. R & Regs. r. 80 § 3-1.02(7)	Maine's UCCC applies. 9A Me. Rev. Stat. Ann. 2-401. Supervised Lenders are exempt from 32 M.R.S.A 6138(4)(D), which prohibits a check casher from cashing or advancing any money on a post-dated check.	Consumer loan act applies. Md. Code Ann. Com. Law II §12-301 et seq.
Small Consumer Loans	No one other than a bank, credit union, or pawnbroker can issue a loan, and these loans are limited to $15,000 at a rate no higher than 12 percent a year, unless the lender becomes registered with the state as a "small loan lender." Small-loan lenders may charge up to 19.8 percent on open-ended loans.	All loans will be considered "industrial loans" and cannot exceed 5 percent interest per month.	Small-loan rate caps apply to all licensed lenders. Lenders must be registered with the state and only include banks, credit unions, and pawnbrokers.	Consumer loan caps apply to banks for all small consumer loans granted by licensed financial institutions.
Small Loan Rate Cap	30.03 percent APR or $17 per $100 up to $600; $11 per $100 up to $1,800; add-on interest.	16 percent per year (10 percent per year discounted plus fees); 60 percent per year criminal usury cap.	30 percent per year on amounts up to $2,000, or a fee of $5 for amounts financed up to $75; $15 for amounts financed $75.01-$249; or $25 for amounts financed of $250 or more.	2.75 percent per month; 33 percent per year
Regulator	Connecticut Banking Commissioner	Georgia Insurance Commissioner	Office of Consumer Credit Regulation	Maryland Commissioner of Financial Regulation
Punishment for Violation	Suspend, revoke, non-renewal of a license. Violations are considered to be unfair or deceptive trade practices.	Anyone who violates these laws can be charged with a misdemeanor and up to a $5,000 fine. On the fourth offense, the crime is considered to be a felony. Allows borrowers to sue for three times the amount of all interest and charges for payday loan, plus attorneys' fees and court costs. Authorizes class-action suits against lenders who violate the law. Lenders that loan to military families are not allowed to try to collect funds from a service member in active service overseas, or to contact the borrower's commanding officer in an effort to collect the loans.	Criminal (class E crime) and civil penalty (awards can be no more than $5,000 or the amount of actual damages, whichever is greater)	Civil penalty (up to $1,00 for the first offense and $5,000 for each additional offense) and misdemeanor (punishable by a fine of no more than $5,000 and/or imprisonment for up to three years)

*The above states have either prohibited payday lending in their states by enforcing the state criminal usury cap or by prohibiting the business in their law, such as prohibiting check cashers from making loans.

Source: Payday Loan Consumer Information, State Information. Consumer Federation of America. <http://www.paydayloaninfo.org>

Appendix A (continued)

Comparison of States that have Prohibited Payday Lending*

	Massachusetts	New Jersey	New York	North Carolina
Legal Status	Prohibited	Prohibited	Prohibited	Prohibited (North Carolina General Assembly Stat. § 53-281 authorizing payday loans allowed to sunset in 2001)
Citation	Small loan act applies. Mass Gen. Laws Ann. Ch. 140 §96 et seq.; 209 Mass. Code Regs. § 26.01. Check cashers are specifically prohibited from making loans unless licensed under the small-loan act. 209 Mass. Code Regs. §45:14(8)	Consumer loan act applies, but rates as agreed to by contract N.J. Stat. Ann. Tit. 17 § 1 et seq. N.J. Stat. Ann. § 2C 21-19. N.J. Stat. Ann. §17:15A-47.	Licensed lender law applies but interest rate is agreed to by contract. N.Y. Banking Law § 340 et. Seq. A check casher licensee cannot make loans or cash or advance any moneys on a postdated check, except for payroll checks. N.Y Banking Law § 373. Criminal law sets the usury cap at 25 percent. N.Y. Penal Code § 190.40.	The Consumer Finance Act applies. N.C. Gen. Stat. § 53-173
Small Consumer Loans	Massachusetts small loan law states that any loan issued under $6,000 with an average interest rate not exceeding 12 percent can only be issued by a state chartered bank, thrift or credit union.	Granted only by banks, credit unions or other licensed financial institutions.	Granted only by banks and entities licensed by the Superintendent of Banks.	Granted only by licensed financial institutions.
Small Loan Rate Cap	23 percent plus $20 administrative fee upon granting of the loan.	Criminal law sets the usury cap at 30 percent. Check cashing licensees cannot cash or advance money on a postdated check.	25 percent per year	36 percent per year
Regulator	Massachusetts Division of Banks	Commissioner of Banking and Insurance	Superintendent of Banks	State Banking Commissioner
Punishment for Violation	Civil penalty for up to $500 and/or imprisonment for no more than six months	Not listed	Misdemeanor, with a penalty of up to one-year imprisonment, up to $500 fine, or both	Civil penalties (not exceeding $1,000 per violation), restitution and Criminal Class 1 felony

*The above states have either prohibited payday lending in their states by enforcing the state criminal usury cap or by prohibiting the business in their law, such as prohibiting check cashers from making loans.

Source: Payday Loan Consumer Information, State Information. Consumer Federation of America. <http://www.paydayloaninfo.org>

Appendix A (continued)

Comparison of States that have Prohibited Payday Lending*

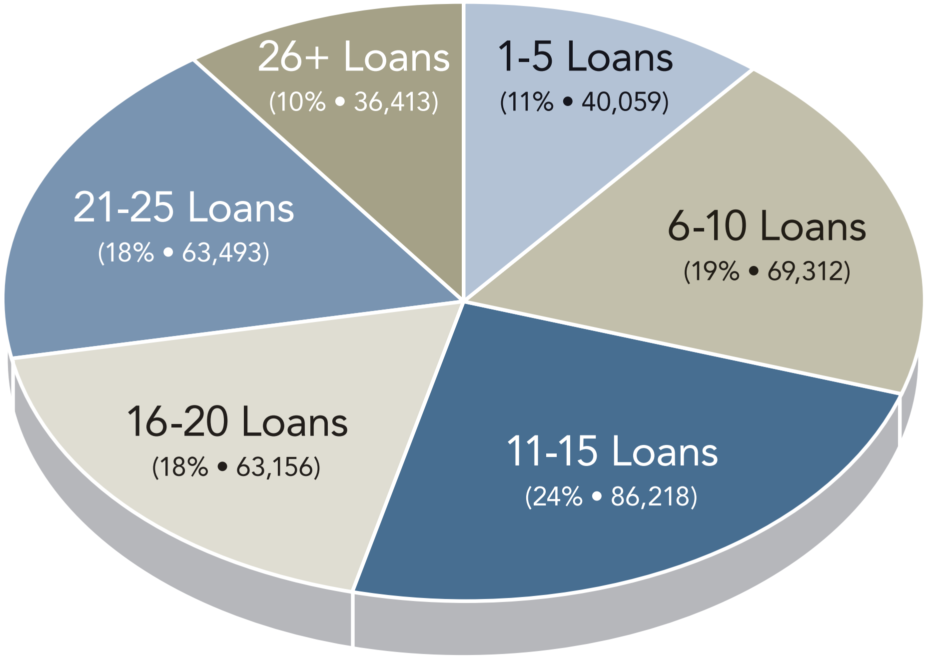
	Pennsylvania	Vermont	West Virginia
Legal Status	Prohibited	Prohibited	Prohibited
Citation	Check cashers are specifically prohibited from making payday loans under Check Cashing Licensing Act of 1998, § 505(a). Otherwise, Consumer Discount Company Act applies, 7 Pa. Cons. Stat. Ann. § 6201 et seq.	Small loan act applies. Vt. Stat. Ann. tit. 9 § 41(a)	Small loan act applies. W.Va. Code §46A-4-107 and §32A-3-1 et. seq
Small Consumer Loans	Granted only by licensed financial institutions.	Granted only by licensed financial institutions.	Federally insured depository institutions, foreign bank agencies, and governmental entities exempt from licensure as money transmitters under Chapter 32A
Small Loan Rate Cap	$9.50 per $100 per year discount or 24 percent per year.	18 percent per year	31 percent per year on a loan of $2,000 or less.
Regulator	The Department of Banking	Banking Commissioner	Commissioner of Banking
Punishment for Violation	Civil penalty up to $2,000 per violation; 3rd degree misdemeanor if unlicensed.	Administrative (not to exceed $1,000 per day) and criminal (not exceeding $10,000 and/or three years imprisonment).	Civil (twice the damages or all the damages of the injured party recovered depending on the type of violation)

*The above states have either prohibited payday lending in their states by enforcing the state criminal usury cap or by prohibiting the business in their law, such as prohibiting check cashers from making loans.

Source: Payday Loan Consumer Information, State Information. Consumer Federation of America. <http://www.paydayloaninfo.org>

Appendix B

Percentage of Total Payday Loans in Colorado by Number of Loans Held per Borrower Over the Previous 12 Months



Source: Payday Lending Demographic and Statistical Information: July 2000- December 2006. Data prepared by the staff of the Administrator of the Uniform Consumer Credit Code under the Attorney General. March 8, 2007. This data is open to the public and can be found at: <http://www.ago.state.co.us/UCCC/PDF/ddlasummary2006.pdf>

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