Arkansans Against Abusive Payday Lending

www.StopPaydayPredators.org

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Payday Lender Schemes and Shams

Payday lending (while legal in many states) is seeing the pendulum turn as a number of states outlaw or attempt to seriously regulate traditional payday lending. When state reforms are enacted, payday lenders often try to re-invent their product to evade state law and continue their lucrative lending practices instead of complying with the new reform. This tactic has been seen in the states of North Carolina, Georgia, West Virginia, Illinois, Oregon, Nevada, Texas, Pennsylvania and Arkansas. It is being used today in Ohio and Arizona and may be tried in Colorado and Montana.

Some of the schemes and sham transactions used in the past are as follows:

Rent-A-Bank Payday Loans – In this scheme the payday lender partners with a bank so that it can use the national banking laws to override individual state usury laws. One by one the national banking regulators have clamped down on the banking industry with the FDIC closing the final loophole in the spring of 2007. ACE Cash Express operating 19 stores in Arkansas was the last payday lender to lose their bank partner in April 16, 2007. This scheme has been shut down as far as banks and payday lenders are concerned nationwide. This scheme is still used for Income Tax Refund Anticipation Loans, by some major banks for their own Cash Advance Loan product and by some Credit Unions for direct Payday Lending or Payday Lending Alternatives.

Rent-A-Payday Lender Payday Loans – In Arkansas, 5 small local operators obtained payday lender licenses from the neighboring state of Missouri. They set up a physical location (in one case a closet to store records) in Missouri to electronically process the loans originated in their Arkansas payday loan stores. They failed to obtain Arkansas licenses for their 29 Arkansas stores claiming the loans were made in Missouri (choice of law). The Arkansas regulator with the help of the Missouri regulator put an end to this scheme in June, 2006.

Rent-A-Finance Company Payday Loans – In Arkansas, 3 local operators obtained Small Loan licenses from South Dakota. They set up a physical location in South Dakota to electronically process the loans originated in their 59 Arkansas payday loan stores. They also had an Arkansas license for their Check Cashing activities. They claimed 'choice of law' contracts. The South Dakota Department of Banking would not intervene, saying that loans made in Arkansas are an Arkansas problem, not a South Dakota issue. This scheme was shut down in Arkansas in February, 2009.

Open End Payday Loans – In some states open-end lending (like credit cards) are exempt from the state's usury law. Payday lenders have been known to take advantage of this perceived loophole. In Pennsylvania Advance America developed an open-end line of credit product with an interest rate of 6% APR and a $149.95 monthly participation fee. They also claimed 'choice of law' as the loans while made in Pennsylvania used Delaware law in their contract. The Pennsylvania Banking Department closed down this perceived loophole in June, 2008 and decision was upheld by state courts.

Credit Services Organization (CSO) Payday Loans – In some states lenders use an existing CSO law designed to assist borrowers resolve their credit problems. The "lender" charges a reasonable interest rate below the usury rate in the state. The payday lender "arranges" the loan and charges a very high fee in addition to the lender's interest. The entire transaction then works like the traditional triple digit payday loan. This is how payday loans are made in Texas. Florida and Michigan regulators have put a stop to CSO payday lending. A Texas payday lender with stores in Arkansas began exporting this payday loan scheme into Arkansas using a 'choice of law' provision in the contract. This scheme was shut down in Arkansas in October, 2008.

Money Order (or Check) Payday Loans –In Arkansas two large national payday lenders (Advance America and First American Cash Advance) and a number of small local payday lenders believed they had found a way around the Arkansas usury law. They made payday loans using a low interest rate (4.00% - 16.97% A.P.R.) and then issued the loan in the form of a money order or corporate check. They then charged a Check Cashing fee of 10% to cash the money order or corporate check. The check cashing fee was not disclosed as interest. Advance America closed up their 30 stores and left Arkansas as of October 31, 2008. First American Cash Advance continued to make these loans from 27 Arkansas stores using this scheme until shut down by the Attorney General on July 31, 2009.

Promissory Note Payday Loans – Using a takeoff on the Money Order Payday Loan one small local operator with 6 stores in Arkansas claimed they were not making payday loans at all, because they did not take a check or ACH authorization as collateral for the loan. They had a promissory note signed (like all traditional payday lenders do). They charged a very low interest rate 7.5% APR and then issue a corporate check for the loan. They also charged an additional 10% fee to cash the corporate check. The check cashing fee was not disclosed as interest. This scheme was shut down in Arkansas in August, 2008.

Summary - These schemes are nothing but sham transactions meant to disguise the traditional payday loan as a different type of loan product. Sometimes these schemes are used as a way to justify collecting more interest than allowed by state law. Other times these schemes are used as a way to continue to operate when the state does not have a payday loan law, revises or discontinues their payday loan law.

By being aware of these schemes and sham transactions you may be better equipped to deal with similar situations should you spot them in your state.