



Consumer Federation of America

Safe Harbor for Usury: Recent Developments in Payday Lending

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Consumer Federation of America issued a report¹ in 1998 that described the growth of payday lending, the legal status of these small loans, and the lack of effective consumer protections against exorbitant interest rates, perpetual debt and coercive collection practices. This report updates developments in state legislation, court decisions, and enforcement activity.

Twenty-three states and the District of Columbia have granted payday lenders a safe harbor from state small loan interest caps or usury laws, while another seven states have no usury laws to restrain rates. Payday loans are permitted in one state under a temporary court injunction and in another state through a minimum finance charge loophole. Six states rejected legislation in 1999 to legalize this type of high rate lending.

As the majority of state legislatures grappled with legislation impacting the fast-growing payday loan industry in 1999, legislation to establish minimum standards for state laws was introduced in Congress. In 1999 Attorneys General in Texas and Pennsylvania filed cases to enforce interest caps. The use of national banks to extend payday loans is being challenged.

Payday Loan Developments

Payday Loans Described: Cold Cash For "Hot" Checks

Payday loans are single-payment short-term small loans based on personal checks that go by a variety of names, including "deferred presentment," "deferred deposits," "cash advance," or "check loans." In a typical loan the consumer writes a personal check drawn on his bank account for the amount borrowed plus the fee. The fee, stated as a percentage of the check or of the loan, translates into triple digit annual interest rates. The lender agrees not to deposit the check until

¹ "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry," Consumer Federation of America, November 1998. Available online at www.stateandlocal.org/loanshar.html

the consumer's next payday, or up to 14 days. When the loan is due, the borrower can redeem the check for cash, allow the check to clear through the bank, or pay another fee to extend the loan for another two-week period. A typical loan costs \$17.65 to borrow \$100 for two weeks, or 459% Annual Percentage Rate (APR). Payday loans are made by check cashing outlets, stand-alone payday lenders, and by a few banks in partnership with check cashing outlets.

Variations on Payday Lending

In some states, payday lenders hide behind subterfuges such as "sale-leaseback" transactions, catalog sales or personal advertising schemes. The Texas office of Consumers Union issued a report in February, documenting a variety of guises used to hide usurious lending. While the report noted several variations, the companies surveyed in Texas all advance money for an initial period of less than a month, taking a personal check as collateral. Consumers Union surveyed "sales-leaseback" companies that claim to buy home appliances from their customers and then lease them back for a "rental fee," fast cash advertisement companies, and catalog sales companies that "sell" catalog certificates to customers who need quick cash. Some lenders simply advertised "cash back on your check."²

Another variation on the theme is "cash leasing" at 780% APR where companies claim they are "leasing," not loaning, funds.³ Under this scenario, money is leased at the cost of 30% of the amount loaned per 15 days. Clients must have an active checking account and verify ownership of at least three electronic items, such as stereo, computer or television, in order to borrow up to \$300, according to a Washington, D. C. area survey conducted by a Georgetown University professor.

Check cashers, especially those located in states with usury or small loan caps, seek to disguise the true nature of the payday loan transaction by claiming that it is a "deferred presentment" of a check for deposit. The aim is to avoid enforcement of laws that limit interest charged for loans, require comparable cost disclosures, and provide consumer protections.

Courts Uniformly Find That Payday Loans are Credit Transactions

State and federal court decisions have consistently unmasked these transactions and revealed them for what they are -- loans subject to state usury and small loan laws, and to federal credit laws, such as the Truth in Lending Act. In the first recorded case, a federal court in Kentucky rejected the payday lender's argument that the 10% per week charge imposed for deferring presentment of a personal check was a service charge, not interest. The court refused to dismiss claims brought under Kentucky's Consumer Loan Act, RICO, the Truth in Lending Act, and fraud, deceit, and misrepresentation.⁴

² Consumers Union, "Wolf in Sheep's Clothing: Payday Loans Disguise Illegal Lending," Austin, Texas, February 1999.

³ Manning, Robert, "Poverty, Race, and the Two-Tiered Financial Services System," *Poverty & Race*, July/August 1999.

⁴ Hamilton v. HLT Check Exchange, LLP, 987 F. Supp. 953 (E.D. Ky. 1997).

The Kentucky Supreme Court recently ruled that all payday loans made in Kentucky prior to 1998 are illegal as disguised loans.⁵ The Court answered this question of law:

“When a check cashing company licensed under KRS 368 *et seq.* accepts and defers deposit on a check pursuant to an agreement with the maker of the check, is the service fee charged by the check cashing company a “service fee” and not “interest” under KRS 368.100(2), or is the fee “interest” which is subject to the usury laws and disclosure provisions in KRS 360?”

The Kentucky Supreme Court, which refused to rehear the case, concluded that a deferred deposit business was not “check cashing” and was not exempt from usury laws and credit disclosure provisions in Kentucky law.

The U.S. District Court in Middle Tennessee handed down an order in early 1999 that also rejected the claim by E-Z Check Cashing of Cookeville, TN, Inc. that it was merely cashing checks and not making small loans.⁶ The Court concluded:

“The Court finds that the undisputed facts of this case prove that Defendant’s deferred check-cashing transactions with the Plaintiff are essentially consumer loans which violate the Truth in Lending Act, Regulation Z, and the Tennessee Consumer Protection Act.”

Several rulings quote a provision in a 1926 Kentucky case:

“With regard to lending transactions, courts are required ‘to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance which must be considered. No case is to be judged by what the parties appear to be or represent themselves to be doing, but by the transaction as disclosed from the whole evidence; and, if from that it is in substance a receiving or contracting for the receiving of usurious interest for a loan or forbearance of money the parties are subject to the statutory consequences, no matter what device they may have employed to conceal the true character of their dealings.’”⁷

Payday Lending Produces High Returns

The Tennessee Department of Financial Institutions reported to the General Assembly that licensees in the first nine months under Tennessee’s Deferred Presentment Act earned spectacular profits. Not counting the two major lenders with sizeable losses due to large class action lawsuit settlements, payday lenders in Tennessee had a return on assets of 22.72% and a return on equity of 30.37%.⁸ Stephens Inc., a Little Rock investment firm, estimates that a

⁵ White v. Check Holders, Inc., 1999 WL 401919 (Ky., June 17, 1999).

⁶ Turner v. E-Z Check Cashing of Cookeville, TN, Inc. 35 F. Supp.2d 1042 (M.D. Tenn. 1999).

⁷ Hurt v. Crystal Ice & Cold Storage Co., 286 S.W. 1055, 1056-57 (Ky. 1926)

⁸ Report to the 101st General Assembly on the Deferred Presentment Services Act T.C.A. § 45-17-101, *et seq.*, Tennessee Department of Financial Institutions, 1999, p. 9.

typical payday advance store generates a 48% unleveraged return on investment, assuming a 40% tax rate.⁹

Since many payday loan companies are privately held, industry profit figures are not widely available. Ace Cash Express, a publicly-traded check cashing chain which also makes payday loans, reported record revenue and a 29% increase in net income for the fiscal year ended June 30, 1999. ACE reported that 11.7% of its revenue came from payday loans, up from 10.1% in fiscal year 1998.¹⁰

Explosive Growth of Payday Lending

Some states that license payday lenders report industry size and volume of business data. Colorado reports a 16% increase in licensed lenders in 1998 (218 licensees) and a 40% increase in the number of loans and 56% increase in the dollar amount of loans for the year.¹¹ Colorado consumers borrowed almost \$67 million in 1998 and paid an average 486% annual interest rate. Registered payday lenders in Indiana increased from 15 in 1994 to 115 with 454 outlets in 1998 with loan volume of almost \$300 million. Mississippi has issued approximately 625 payday loan licenses since 1998 but does not report financial information on licensees. Ohio had 450 licensed check lenders as of early 1999. In Wisconsin, licensed payday loan institutions went from 17 in 1995 to 183 in early 1999. About 1600 payday lenders have opened in California in the two years since the California legislature made the business legal. News reports indicate that the payday loan industry in California serves 750,000 customers monthly with annual business of \$114 million.¹²

Stephens Inc. reports 6,000 storefronts making payday loans in 1999 with a potential mature market with 24,000 stores generating \$6 billion in fees annually. The Little Rock company reports about 15 operators with more than 50 stores and 4 companies with more than 400 stores each.¹³ One trade association forecasts that revenue from payday lending in 1999 will total \$1.4 billion and will exceed \$2 billion in 2000.¹⁴

ACE Cash Express reported payday loan volume in fiscal 1999 of \$105,765,000, compared to \$69,182,000 in 1998. Total number of loans was 460,000 in 1999 and 338,000 in 1998. Net charge-offs were 2.6% of loan volume in both years.¹⁵

State of the States

Four States Authorize Payday Loans in 1999

⁹ Stephens Inc., "The Emerging Business of Deferred Presentment," Little Rock, Ark., 1999, p. 5.

¹⁰ PR Newswire, "ACE Cash Express Increases Earnings Per Share 28 Percent During Fiscal 1999," August 18, 1999.

¹¹ State of Colorado Department of Law, "1998 Post-Dated Check Cashers Supervised Lenders' Annual Report."

¹² Tracey Correa, "Payday Lenders Come Under Fire; Lawmakers Propose Limits on the Popular, Profitable Companies," The Fresno Bee, April 18, 1999.

¹³ Stephens Inc., "The Emerging Business of Deferred Presentment," April 1, 1999.

¹⁴ Van Voris, Bob, "'Payday' Loans Under Scrutiny," The National Law Journal, May 17, 1999, B1, 4.

¹⁵ PR Newswire, *ibid*.

Two state legislatures have granted payday lenders safe harbor from usury laws since CFA's 1998 report. Legislation enacted in 1999 authorizes payday loans in Arkansas and Hawaii, states where small loan interest rate caps had prevented these loans. Also, Montana and Utah, states with no usury caps, carved out payday loans from other small loans in new legislation. While the Montana legislature set the highest fee cap in any state payday loan law, it did include significant other consumer protections based on the CFA/NCLC model deferred deposit loan act.

In addition, Mississippi, Nevada, and Louisiana amended existing payday loan laws in 1999 to either tighten consumer protections or slightly reduce maximum fees. Bills based on the model payday loan law offered by consumer groups were introduced but not enacted in Louisiana, California and Kansas. The payday loan industry failed to win legislation in Florida to permit payday lending as carried out in other states. A Wyoming bill to authorize a 100% bad check penalty was defeated.¹⁶

Despite a Department of Financial Institutions report that over half of newly licensed payday lenders violated the law, the Tennessee legislature made its experimental deferred presentment law permanent in 1999. The DFI report filed with the General Assembly noted that refunds were ordered for 6,036 customers totaling \$212,657 but no licensees were fined. Violations included failure to deliver written loan cost disclosures, failure to accurately quote the Annual Percentage Rate, charging for bad check fees and other collections costs not permitted by Tennessee's law, loan roll-overs and loan-splitting to collect higher fees than the \$30 limit per loan.¹⁷

Twenty-four states with specific payday loan laws or regulations that permit payday loans (see Appendix A) include:

Arkansas	California	Colorado	Florida ¹⁸
Hawaii	Iowa	Kansas	Kentucky
Louisiana	Minnesota	Mississippi	Missouri
Montana	Nebraska	Nevada	North Carolina
Ohio	Oklahoma ¹⁹	South Carolina	Tennessee
Utah	Washington	Wyoming	District of Columbia

¹⁶ Wyoming SF0062 to make debtors whose checks bounce liable for the amount of the check and court costs and, if the contract provides, liable for an additional amount equal to the amount of the check as liquidated damages.

¹⁷ Report to the 101st General Assembly on the Deferred Presentment Services Act T.C.A. § 45-17-101, *et seq.*, Tennessee Department of Financial Institutions, 1999.

¹⁸ Florida money transmitter regulations permit cashing post-dated checks at the same fee as cashing personal checks for one-time only. Roll-overs or extensions of loans violate Florida usury and/or consumer finance act.

¹⁹ Oklahoma permits loans of under \$101.97 as single-pay one-month loans. Any loans for \$102 or more have a minimum term of 60 days.

States Prevent Payday Loans Through Small Loan and Usury Laws

Nineteen states and two territories currently have laws that limit interest rates for small loans. New Hampshire will move out of this category when a repeal of small loan interest rate caps takes effect January 1, 2000. States that prohibit payday loans due to small loan interest rate caps, usury law, and/or specific prohibitions for check cashers include:

Alabama ²⁰	Alaska	Arizona	Connecticut	Georgia
Maine	Maryland	Massachusetts	Michigan ²¹	New Hampshire
New Jersey	New York	North Dakota	Pennsylvania	Puerto Rico
Rhode Island	Texas	Vermont	Virginia	Virgin Islands
West Virginia				

Payday lenders are currently operating in Alabama under the terms of a court injunction pending the outcome of litigation between the Alabama Banking Department, which issued over 150 cease and desist orders against payday loan companies in 1998, and the Alabama Check Cashers Association which filed suit. Judge Eugene Reese signed an interim injunction on October 9, 1998 that allowed Plaintiff check cashers to continue offering payday loans until the lawsuit is decided in a case tried in 1999. Alabama lenders may charge 16.67% of the face amount of the check, or \$20, to borrow \$100 or 520% APR. In March individual consumers were granted the right to intervene in the Alabama Banking Department's case.²² The Alabama legislature adjourned without enacting a bill to legalize payday loans.

Industry-backed legislation to make payday loans legal failed to become law in 1999 in Arizona, Texas, Alabama, Georgia, and Virginia, all of which currently prohibit payday loans through small loan and/or usury laws and/or check casher registration laws.

New York's Banking Department issued a letter June 29, 1999 stating that loans advanced resulting in an annual interest rate in excess of 25% violates New York's State Penal Code § 190.40. The New York Banking Department also takes the position that any and all charges to the borrower to obtain a loan are interest and are subject to the 25% usury limitation. New Jersey's criminal usury limit of 30% applies to small loans.²³ Both New York and New Jersey laws prohibit check cashers from making loans of any kind.

(See Appendix B for terms of state small loan rate caps in these states.)

²⁰ Payday loans currently permitted under terms of court injunction in litigation pending between Alabama Banking Department and check casher trade group. Legislation to authorize payday lending failed at the 1999 session of the Alabama legislature.

²¹ Michigan Financial Institutions Bureau has stated that companies are not required to be licensed under the Regulatory Loan Act if they charge no more than 5% per annum interest plus the check casher's fee for cashing personal checks. Check cashing rates are not regulated in Michigan.

²² Order, In the Circuit Court of Montgomery County, Al. Check Cashers Association v. State Banking Department, March 1, 1999

²³ New Jersey: Criminal usury cap NJS 2-C:21-19

States Enforce Small Loan Laws

Two more states brought cases in 1999 to enforce small loan laws against payday lenders.²⁴ Pennsylvania Attorney General Mike Fisher settled three cases involving payday lending. JB's Cash Advance in Franklin and Arctic Cash Advance in Grove City were charged with violating the Pennsylvania Unfair Trade Practices and Consumer Protection law, the Consumer Discount Company Act, federal Truth in Lending Act and Reg. Z. Both companies agreed to cease offering "deferred presentment check cashing" and agreed not to collect fees. The Attorney General charged that JB's characterization of the transaction as check cashing constituted an unfair or deceptive act or practice.

Pennsylvania's Attorney General also signed an Assurance of Voluntary Compliance with McKenzie Check Advance of Pennsylvania, LLC which operates nationally as National Cash Advance, resolving claims that it operated an unlicensed money-lending business that charged consumers annual interest rates as high as 574 percent. Investigators alleged that National Cash Advance and United Cash Advance illegally offered loans to consumers under the guise of a check cashing service.

Texas Attorney General John Cornyn filed against three payday lenders in 1999, including Quick Cash, EZ Cash, and Cash Today. Texas alleged that these payday lenders were making usurious loans and violating the Deceptive Trade Practices Act, the Texas Debt Collection Act, and the Texas Credit Title. Cases filed at the request of Consumer Credit Commissioner Leslie L. Pettijohn noted that these companies had tried several creative but still illegal ways to make payday loans, including selling "ads" in a publication available only in the Cash Today offices.²⁵

Deregulated States Consider Impact of Payday Lending

Seven states currently permit payday lending because those states have no small loan rate caps or usury limits. As long as lenders comply with state lender licensing provisions, they are able to charge triple-digit interest rates typical of payday loans. Those states include: Delaware, Idaho, Illinois, New Mexico, Oregon, South Dakota, and Wisconsin. Indiana's Uniform Consumer Credit Code caps interest rates at 36% but permits a minimum \$33 finance charge. New Hampshire recently amended its small loan law.²⁶ Effective January 1, 2000, licensed lenders can charge any rate agreed to by customers, making payday lending possible.

Legislation impacting payday loans was introduced this year in Indiana, Illinois, New Mexico, Oregon and Wisconsin. Competing bills backed by the payday loan industry or by state regulators in Indiana failed to pass, leaving Indiana's \$33 minimum finance charge in place. A New Mexico bill to impose a civil usury limit of 45% plus a \$10 processing fee on all forms of consumer lending failed to pass. Instead, the New Mexico legislature adopted House Memorial 36 to establish a Consumer Lending Study Committee under the Director of the New Mexico Financial Institutions Division to examine small loan rates and practices.

²⁴ See "The Growth of Legal Loansharking," CFA, November 1998 for description of earlier enforcement cases.

²⁵ Press Release, Attorney General John Cornyn, Texas, May 12, 1999.

²⁶ "Small Loan Interest Charges Consolidated," Consumer Credit Guide No. 818, CCH Incorporated, 1999, p. 5.

An Illinois House bill initially set out to impose an interest rate cap on loans, was amended to authorize payday lending, and was finally gutted to be a “place-holder” for future legislation.²⁷ The Illinois Senate adopted a resolution directing a study by the Department of Financial Institutions and the Illinois House set up a study committee.²⁸ The House resolution created a Payday Loan Review Commission made up of legislators and directed the Commission to study the size and structure of the payday loan industry, the cost of loans and a profile of borrowers. The Commission is to report September 15. Legislation in Oregon to strictly regulate payday loans failed to advance while a bill to impose a 24% small loan rate cap in Wisconsin is pending.

Maximum Payday Loan Fees Set by States

The maximum legal cost of payday loans in states where these loans are authorized by state law range from \$15 to \$33.50 to borrow \$100 for 14 days. Five states (MN, MO, KS, OH, and WA) cap fees at \$15 per \$100 borrowed or 390% APR. The District of Columbia caps fees at \$16.10 (419% APR), while eight states permit lenders to charge \$17.65 per \$100 (459% APR) loaned (TN, NC, SC, CA, HI, IO, KY, NE). The highest maximum fees allowed are in Louisiana²⁹ (\$20/\$100 or 520% APR), Arkansas (\$21/\$100 or 546% APR), Mississippi (\$22/\$100 or 572% APR), Colorado (\$25/\$100 or 650% APR), Wyoming (\$30/\$100 780% APR), and Montana (\$33.50/\$100 or 871% APR). Utah and Nevada permit payday loans with no limit on fees.

Some states set fees based on a maximum percentage of the face value of the total check, including cash advanced and the fee, while thirteen states impose the percentage fee on the proceeds of the loan. A maximum 15% fee costs customers in the “total check” states \$17.65 per \$100 while in the “amount loaned” states the 15% fee is \$15 per \$100 borrowed. A \$100 payday loan costs \$22 in Mississippi, a state that caps fees at 18% of the face value of the check. (18% of \$122=\$21.96 fee per \$100 principal.) A few states set a sliding scale of fees, depending on the size of the loan.

Although fees have a variety of names, under the federal Truth in Lending Act, all costs of extending credit must be disclosed as a dollar finance charge and as an annual percentage rate. The annual percentage rate is the cost of credit at a yearly rate which permits consumers to compare the cost of borrowing money from a variety of sources such as small loans, pawns, payday loans, or credit card cash advances. As permitted by state laws, the maximum effective annual percentage rate for a \$100 payday loan for the typical term of 14 days ranges from 390% to 871%. The same \$100 loan payable in 7 days has double the APR of the 14-day example.

(See Appendix A for a chart of fees permitted by state payday loan laws.)

²⁷ Illinois HB 2704.

²⁸ Illinois: Senate Resolution 42, House Resolution 164

²⁹ Louisiana amendments effective 1/1/2000. Current cost is \$25 per \$100 borrowed, with a maximum fee of \$40.

Role of National Banks and Thrifts

Payday Lenders Partner with Banks to Evade State Laws

Partnerships between banks and companies in the fringe banking market are a growing trend in the payday loan field. As an investment advisor newsletter to the industry notes, “we see a trend afoot to utilize some sort of national bank charter lending program to permit the product in states that are unwilling to act on legislation to allow the product.”³⁰ One such partnership between a national bank in Pennsylvania and the nation’s second largest chain of check cashers is being challenged in a national RICO class action suit filed in federal court in Los Angeles. The *Phanco* case alleges that Eagle National Bank has “rented” its national bank charter to allow Dollar Financial Group’s check cashing outlets to circumvent otherwise applicable state law restrictions.³¹ Eagle is making payday loans in at least three states, Arizona, Texas and Virginia, where these loans are illegal for state-licensed lenders. The *Phanco* case also alleges that Eagle makes loans that do not comply with state payday loan laws, such as California’s.

The legal theory underlying the use of national banks to make payday loans is “exportation.” As currently interpreted, a 1978 Supreme Court decision is being used to argue that banks with certain kinds of privileged charters are able to ignore the usury laws in the borrower’s home state. By chartering the bank in a deregulated state, the bank claims the right to export its home state’s lack of regulation all across the country irrespective of whether their practices would be illegal for payday lenders in the borrower’s home state.

In a recent letter to the Comptroller of the Currency, CFA and other consumer organizations noted that Eagle’s activities appear to violate the intent of the Riegle-Neal Act. A central premise behind interstate banking as allowed by Riegle-Neal was that national banks would comply with state laws. The Conference Report³² noted “utmost concern” for the ability of states to protect its citizens. The letter charged that Eagle’s use of its bank charter to export its activities without regard for state law ignores Riegle-Neal.³³

The Pennsylvania Attorney General condoned the use of national bank charters to circumvent Pennsylvania’s Consumer Discount Company Act in settling a case involving McKenzie Cash Advance, the Cleveland, Tennessee-based company which operates two payday lending chains in that state. Instead of agreeing to cease making loans in violation of

³⁰ Stephens, Inc. “The Emerging Business of Deferred Presentment,” April 1, 1999, p. 6.

³¹ *Phanco v. Dollar Financial Group*. Case No. CV99-1281 DDP (C.D. Cal., filed Feb. 8, 1999).

³² Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, H.R. Conf. Rep. No. 651, 103rd Cong., 2d Sess., at 53 (1994)

³³ California Reinvestment Committee, Consumer Federation of America, Consumers Union, Greenlining Institute, National Community Reinvestment Coalition, National Consumer Law Center, U. S. Public Interest Research Group, Woodstock Institute, Letter Re: Eagle National Bank and “Payday Loans,” Addressed to The Honorable John D. Hawke, Jr., Comptroller of the Currency, July 27, 1999.

Pennsylvania's small loan act as other payday lenders have done, National Cash Advance agreed to affiliate itself with a federally insured financial institution and to register as a Pennsylvania loan broker.³⁴ National Cash Advance uses Crusader Savings Bank, a federally chartered thrift in Philadelphia, to make loans that would otherwise be illegal under Pennsylvania's small loan act.³⁵ Pennsylvania banks are exempt from small loan laws and there is no limit on fees that Pennsylvania banks may charge for loans.

Comments filed with Treasury by Consumer Federation of America and the National Consumer Law Center in an Advance Notice of Proposed Rulemaking proceeding indicated that banks are partnering with check cashers, pawn shops, and other fringe bankers to provide "voluntary" EFT'99 accounts through which the federal government can electronically distribute federal benefits to recipients. An informal survey of accounts across the country noted that these entities were expecting to make payday loans to federal recipients, secured by anticipated deposit of social security checks and other benefits.³⁶

A start-up bank has applied for a Delaware bank charter to provide nationwide electronic banking, including payday loans. Axxess Bank plans to "only" charge 200% interest for advances secured by anticipated deposits of social security benefits as one of several account options for unbanked or underbanked consumers³⁷. The Delaware Community Reinvestment Action Council expressed concerns about Axxess Bank's planned high-cost payday loans at a public hearing before the Delaware Bank Commissioner although the bank organizers offered some concessions in the design of the overdraft loans.³⁸

CFA Recommendations

Congress Should Close the National Bank Exportation Loophole and Protect Consumers

Federal legislation is needed to prevent the use of national bank and thrift charters to evade state small loan rate caps and usury laws. One approach would be to simply prohibit loans based on personal checks made by banks. As CFA told the Subcommittee on Financial Institutions and Consumer Credit, banks should not be in the business of profiteering from desperate borrowers by enticing consumers to write bad checks to borrow money at exorbitant rates. Legislation that prohibits banks from making loans based on personal checks or electronic withdrawals from accounts would close the national bank loophole.³⁹

Another approach is to set limits on bank payday loan rates and require banks to comply with the laws of the state where the consumer receives the proceeds of the loan. Representative Bobby Rush (D, IL) introduced H. R. 1684, the "Payday Borrower Protection Act of 1999" in

³⁴ Press Release, Attorney General Mike Fisher, Pennsylvania, April 22, 1999.

³⁵ www.nationalcashadvance.com

³⁶ Comments to the Treasury on ANPRM 31 C.F.R. Chapter II RIN 15055—AA74, National Consumer Law Center, Consumer Federation of America, et.al. April 1999.

³⁷ Epstein, Jonathan, "Banks for non-bank account working people," Wilmington News-Journal, June 24, 1999.

³⁸ Epstein, Jonathan, "Axxess Bank gains support for plans," Wilmington News-Journal, July 7, 1999.

³⁹ Testimony of Jean Ann Fox, Before the Subcommittee on Financial Institutions and Consumer Credit, H. R. 1584 "Depository Institution Regulatory Streamlining Act of 1999," May 12, 1999.

May to provide minimum standards for state payday loan laws and to close the federal bank charter loophole. Under the terms of the bill, states would retain the right to enforce small loan rate caps and usury laws that prohibit payday lending. The Federal Reserve would be required to certify that state payday loan laws meet the minimum consumer protection standards contained in the legislation. Banks would be limited to 36% interest rates on payday loans and be required to comply with the payday loan law of the state in which the borrower is located, not the state where the bank is domiciled. (See Appendix C: H. R. 1684 Summary).

States Should Maintain and Enforce Interest Rate Caps for Small Loans

CFA recommends that states with no usury or interest rate caps enact legislation to put limits on the cost of payday loans. Consumers who are desperate enough for credit to pay triple digit interest rates for two-week loans have little market power to bring rates down. The real cost of payday loans made in small sums for very short periods of time may not be clear to unsophisticated consumers. When lenders deny that their cash advances are “loans” and fail to comply with Truth in Lending Act disclosures of Annual Percentage Rates, consumers do not have the key price tag needed to comparison shop for credit. If, as the industry claims, payday loan customers have no where else to go for small loans, rate regulation is necessary to prevent abuse of a captive market.

States that have not granted payday lenders safe harbor from interest rate caps or usury laws should resist industry pressure to legalize payday lending. States should enforce small loan laws against payday lenders and companies that use “sale-leaseback,” “catalog sales,” and other schemes in an effort to obscure usurious loan transactions.

States Should Strengthen Existing State Payday Loan Laws

Last year the National Consumer Law Center and CFA provided a model state bill to state regulators and interested groups and legislators for use in states where payday lending is already permitted. Some of the model act provisions were enacted in Montana, Nevada, Louisiana, Hawaii and Arkansas in 1999 and bills based on the model are pending in Kansas and California. At a minimum, CFA continues to urge state lawmakers to reform existing payday loan laws with the lower maximum rates and comprehensive consumer protections in the CFA/NCLC model bill.⁴⁰ Fees should be based on the proceeds of the loan, not the face value of the check. In addition to lowering rates, state payday loan laws should better address loan roll-over and “hot-check” prosecution abuses, the subject of a future CFA report.

⁴⁰ CFA/NCLC Model State Deferred Deposit Loan Act available from CFA, 1424 16th Street NW Suite 604, Washington, DC 20036.

Appendix A

Maximum Cost and Terms in States That Authorize Payday Loans

State	Min./Max Term	Min/Max Loan	Maximum Fee %/\$	Cost/ \$100	Effective APR ⁴¹ 14 day	Max \$
AR Check Cashers Act of 1999 (not yet codified)	6/31 days	-\$400 ck	10% + \$10	\$21	546%	\$54
CA Cal. Civ. Code § 1789.30 <i>et seq.</i>	-/30 days	-\$300 ck	15% of ck	\$17.65	459%	\$52.95
CO Colo. Rev. Stat. § 5-3-501 <i>et seq.</i> And 4 Colo. Code Regs. § 902-1 (Rule 7)	NA	-\$500 ck	\$25	\$25	650%	\$25
FL ⁴² Fla. Stat. Ann. § 560.201 <i>et seq.</i> ; Fla. Admin. Code Ann. R. 3C-560.101 <i>et. seq.</i>	NA	NA	10% + \$5	\$16.10	419%	NA
HI Check Casher Act, H. B. 460 (not yet codified)	-/31 days	-\$300 ck	15% of ck	\$17.65	459%	\$52.95
IO Iowa Code § 13-533D	-/31 days	-\$500 ck	\$15 1 st \$100 \$10/\$100 additional	\$17.65	459%	\$73.15
KS Kan. Stat. Ann. § 16a-2-404	-/30 days	-\$860	Scale of fees ⁴³	\$15	390%	\$56.60
KY Ky. Rev. Stat. Ann. § 368.010 <i>et seq.</i>	14/60 days	-\$500 ck	\$15/\$100 ck	\$17.65	459%	\$75
LA La. Rev. Stat. Ann. § 9:3577.1 <i>et seq.</i> as amended 1999. Amendments effective 1/1/2000. ⁴⁴	-/30 days	-\$350 loan	16.75% ck	\$20	520%	\$45
MN Minn. Stat. Ann. § 47.60 <i>et seq.</i>	-/30 days	-\$350 loan	Scale of fees ⁴⁵	\$15	390%	\$26
MS Miss. Code Ann. § 75-67-501 <i>et seq. as amended 1999</i>	-/30 days	-\$400 ck	18% ck	\$22	572%	\$88

⁴¹ Approximate APR without compounding

⁴² Florida money transmitter regulations permit cashing post-dated checks at same fee as cashing personal checks. Roll-overs or extensions of loans violate Florida usury and/or consumer finance act.

⁴³ 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

⁴⁴ Louisiana: Current cost is \$25 per \$100 borrowed, with a maximum fee of \$40. A \$100 14-day loan costs 650% APR.

⁴⁵ 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

State	Min./Max Term	Min/Max Loan	Maximum Fee %/\$	Cost/ \$100	Effective APR ⁴⁶ 14 day	Max \$
MO	14 days/10 mon.	-\$500 loan	\$15 per \$100	\$15	390%	\$45
Mo. Rev. Stat. § 408.500; 4 Mo. Code Reg. 140-11.010 <i>et seq.</i>						
MT	-/31 days	\$50/\$300 loan	25% ck	\$33.50	871%	\$117.25
Deferred Deposit Loan Act enacted 1999 (Not yet codified)						
NE	-/31 days	-\$500 ck	\$15 per \$100 Face amt. Ck	\$17.65	459%	\$88.25
Neb. Rev. St. § 45-901 <i>et seq.</i>						
NV	NA	% income ⁴⁷	NA			No limit
Nev. Rev. Stat. § 604.010 <i>et seq.</i> as amended 1999						
NC	-/31 days	-\$300 ck	15% ck	\$17.65	459%	\$52.95
N. C. Gen. Stat. § 53-275						
OH	-/6 mon.	-\$500 loan	5% + \$5/\$50	\$15	390%	\$75
Ohio Rev. Code Ann. § 1315.35 <i>et seq.</i>						
OK ⁴⁸	30 days/NA	-\$101.97	Scale of fees ⁴⁹	\$14	364%	\$14
Okla. Stat. Tit.14A, § 3-508B						
SC	-/31 days	-\$300 loan	15% ck	\$17.65	459%	\$52.95
S.C. Code Ann. § 34-39-110 <i>et seq.</i>						
TN	-/31 days	-\$500 ck	15% ck	\$17.65	459%	\$30
Tenn. Code Ann. § 45-17-101 <i>et seq.</i> Amended 1999						
Utah	NA	NA	No Limits			
Check Cashing Registration Act, S. B. 57 to be codified as Utah Code Ann. § 7-23-101 <i>et seq.</i>						
WA	-/31 days	-\$500	15% loan	\$15	390%	\$75
Wash Rev. Code § 31.45.010 <i>et seq.</i>						
WY	-/30 days	NA	\$30 or 20%	\$30	780%	\$30
Wyo. Stat. Ann. § 40-14-362 <i>et seq.</i>						
DC	-/31 days	\$50/\$1,000	10% + fee ⁵⁰	\$16.10	419%	\$131
D. C. Code Ann. § 28-4701 <i>et seq.</i> (1998 Supp.) (“Check Cashers Act of 1998)						

⁴⁶ Approximate APR without compounding

⁴⁷ Nevada: 1999 amendments prohibit loans that exceed one-third of the borrower’s expected net monthly income

⁴⁸ Oklahoma permits loans of under \$101.97 as single-pay one-month loans. Any loans for \$102 or more have a minimum term of 60 days.

⁴⁹ Oklahoma: 20% of loans up to \$29.99, 10% + \$3 for \$29.99 - \$35, 10% + \$3.50 for loans \$35-\$70, 10% + \$4 for \$70 - \$101.97

⁵⁰ 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

Appendix B

Terms of State Small Loan/Usury Law/Check Cashier Law

State	Maximum Interest Rate	Check Cashier Law Bans Loans
Alabama ⁵¹	36%	
Alaska	36%	
Arizona	36%	
Connecticut	28.52%	Yes
Georgia	57.68%	Yes
Maine	30% ⁵²	Yes
Maryland	33%	
Massachusetts	39.86%	Yes
Michigan ⁵³	25%	
New Hampshire	24%	
New Jersey	30%	Yes
New York	25%	Yes
North Dakota	30%	
Pennsylvania	23.75%	Yes
Puerto Rico	25%	
Rhode Island	36%	
Texas	31.65%	
Vermont	24%	
Virginia	36%	Yes
Virgin Islands	26%	
West Virginia	31%	Yes

⁵¹ Payday loans currently permitted under terms of court injunction in litigation pending between Alabama Banking Department and check cashier trade group. Legislation to authorize payday lending failed at the 1999 session of the Alabama legislature.

⁵² Maine Supervised Loan Act sets a minimum finance charge for loans under \$75 at \$5, loans from \$75 to \$250 at \$7.50, and loans over \$250 at \$25. A \$100 two-week payday loan would cost 195%.

⁵³ Michigan Financial Institutions Bureau has stated that companies are not required to be licensed under the Regulatory Loan Act if they charge no more than 5% per annum interest plus the check cashier's fee for cashing personal checks. Check cashing rates are not regulated in Michigan.

Appendix C

H. R. 1684 "Payday Borrower Protection Act of 1999"

Sponsor: Representative Bobby Rush (D, IL) Subcommittee on Financial Institutions and Consumer Credit

- Prohibits payday loans unless authorized by state law that meets minimum standards of Act as certified by the Federal Reserve Board and the state enforces the law.
- Defines "payday loan" as a credit transaction based on a check or electronic fund transfer.
- Loan is considered made in the State in which the borrower receives the proceeds of the loan.
- Requires banks, whether loans are made directly or through agents, to comply with the law of the state in which the borrower receives the proceeds of the loan.
- Caps interest rates for banks making payday loans at 36% APR.
- Banks are prohibited from making loans to payday lenders unless banks make sure lenders comply with Truth in Lending Act, Electronic Fund Transfer Act, and state payday loan law.
- Minimum Requirements for payday loans:
 - Licensing of lenders (non-banks) with standards to be met and surety bond
 - Public hearing on applicants for license
 - Reporting to state regulator including copy of all loan documents and fee schedule
 - Prohibits use of criminal complaints or threat of criminal complaints to collect payday loans, any practice prohibited under the Fair Debt Collection Practices Act, unconscionable loan terms, unfair or deceptive practices, roll-overs or loan extensions, charging for credit insurance.
 - Requirements for loan terms include at least two weeks per \$50 loaned, loan cap at \$300, interest cap at 36% plus \$5 administrative fee per loan
 - Checks used to make loans stamped on back as loan instrument and with holder in due course protection
 - Unearned interest must be rebated to consumers who pay early.
 - NSF charge limited to lesser of \$15 or actual charge from bank.
 - Disclosures in writing to borrowers and posted on premises include complete description of terms of loan, rights of borrower under state law, Truth In Lending Act, Fair Debt Collection Practices Act, Electronic Fund Transfer Act, etc. and a clear and conspicuous statement that the borrower may not be subject to any criminal action or any threat of criminal action for making a check or authorizing an electronic fund transfer on an account with insufficient funds.
 - Civil enforcement: Minimum civil money penalty \$1,000 per day per violation; private right of action for actual, consequential, or liquidated damages suffered by a borrower or class of borrowers.
 - Criminal penalties: Anyone making payday loan without state license or knowingly violating any provision of statute or regulations.