America's working families pay billions of dollars in excessive fees every year, as payday lenders across the nation routinely flip small cash advances into long-term, high-cost loans with annual interest rates in the range of 400 percent.

Despite attempts to reform payday lending, now an industry exceeding $28 billion a year, lenders still collect 90 percent of their revenue from borrowers who cannot pay off their loans when due, rather than from one-time users dealing with short-term financial emergencies.

Based on data collected by state regulators, financial records released by payday lenders, and assessments by third-party analysts, CRL has updated our 2003 quantification of the cost of predatory payday lending to American families.

New information from data provided by state regulators, payday lenders' public filings, and assessments of third-party industry analysts confirms that the payday lending industry's continued reliance on loan flipping.

	Loans to borrowers with 5 or more transactions per year	**Loans to borrowers with 12 or more transactions per year**
CRL 2003 findings	**91%**	**62%**
Washington State	90%	58%
Florida	89%	57%
Oklahoma	91%	66%
Colorado	Not Available	65%
2005 Average	**90%**	**62%**

The typical payday borrower pays back $793 for a $325 loan.

Taking the interest on the average payday loan principal as reported by state regulators, and multiplying it by the average number of loan flips per year, we find that the typical borrower ends up paying back $793 for a $325 loan.

Average principal (from state regulator data):	$325
Typical fee for $325 loan:	$52
Average Transactions per year:	$9
Total Interest for original loan + 8 flips	$468
Total principal plus interest paid:	**$793**

Predatory payday lending now costs American families $4.2 billion per year in excessive fees.

Counting the fees paid by borrowers who have five or more payday loans per year, which indicates

they are caught in a cycle of debt, we calculate the 2005 costs of predatory payday lending in each state, for a national total of $4.2 billion per year.

State	2005 Cost of Predatory Payday Lending	State Predatory	2005 Cost of Payday Lending
Alabama	$225 million	Nebraska	$20 million
Alaska	$4 million	Nevada	$108 million
Arizona	$139 million	New Hampshire	$5 million
Arkansas	$25 million	New Mexico	$27 million
California	$365 million	North Carolina	$74 million
Colorado	$76 million	North Dakota	$6 million
DC	$3 million	Ohio	$209 million
Delaware	$23 million	Oklahoma	$38 million
Florida	$156 million	Oregon	$51 million
Hawaii	$ 3 million	Pennsylvania	$29 million
Idaho	$26 million	Rhode Island	$3 million
Illinois	$219 million	South Carolina	$186 million
Indiana	$219 million	South Dakota	$87 million
Iowa	$40 million	Tennessee	$133 million
Kansas	$30 million	Texas	$259 million
Kentucky	$131 million	Utah	$69 million
Louisiana	$311 million	Virginia	$160 million
Michigan	$120 million	Washington	$155 million
Minnesota	$4 million	Wisconsin	$124 million
Mississippi	$135 million	Wyoming	$10 million
Missouri	$317 million		
Montana	$8 million	**Total**	**$4.2 billion**

Questions to ask the industry about operating within the current CSO loophole:

1) It's my understanding that most of the major payday and car title lending companies did not begin operating as CSOs until July 2005 or thereabouts. Given that the CSO act has existed since 1987, what was so magic about that date?
2) Who owns the CSO?
3) Who is the third-party lender in these transactions? Why do you need a third-party lender?
4) What kind of underwriting does the CSO do?
5) Do your customers ever graduate to a cheaper form of credit or do your rates always stay the same no matter how many times a customer repays the loan?

Questions to ask the industry when they claim that payday loans are better than overdraft fees and bounced checks:

1) What happens to the borrowers check when they eventually default?
2) Do CSOs or the third-party lenders collect insufficient fund (NSF) fees? Are these separate from the overdraft fees charged by the bank?
3) How much is the NSF fee collected by the CSO or the third-party lender? I've heard it's about 30 dollars? How is that any better than a $35 overdraft fee?
4) Can the CSO collect the NSF and the lender collect its own NSF fee on a single cash advance? Who does the NSF fee go to- the lender or the CSO?
5) Is there any limit to the amount of times you can draw on a person's bank account? Who actually draws on the account, the CSO or the lender?
6) It's my understanding that you also can charge a late fee. Is that true? Who charges the late fee- the CSO or the lender? Who does the money go to- the CSO or the lender? How much is that late fee?
7) Are these late fees and NSF fees in addition to the fees already owed by the borrower?

Questions to ask industry when they raise the argument that closing the loophole will kill jobs:

1) It's my understanding that annual turnover rates ranged from 60 to 80% for staff at your storefronts. Why do you think turnover is so high?
2) If you say that doing business at 135% APR which is what would be allowed for payday loans under existing Texas Finance Code would cause a loss in jobs, at what rate would you say you need to avoid job loss?
3) If you don't operate as CSOs in other states, why would no longer operating as a CSO in Texas put you or your parent company out of business?
4) It's my understanding that some of the largest companies in Texas, like Ace Cash Express for example, charge nearly 700% interest rates to obtain a loan through their CSO business in Texas. Is that how much they charge in other states? Can they only operate at 700% APR?

Texas Payday Lending Facts & Fiction

Myth #1: *"Payday loans provide needed credit to consumers for emergency needs"*

In reality: Getting a payday loan usually causes MORE financial problems for a consumer, not fewer.

While fast cash and no credit checks makes it easy for a consumer to get a payday loan, it usually only postpones the financial crisis for two weeks until the loan comes due. Because payday loans are targeted to people in financial trouble, there are few borrowers who can pay off their loan at that point. 91% of all payday loans are made to borrowers caught in a cycle of repeat borrowing with five or more payday loans per year.

Borrowers, on average, receive 8 to 13 payday loans per year from a single payday shop. Typically these are loan flips - rollover extensions or back to back transactions loans where the borrower is basically paying a fee for no new money, never paying down the principal owed. The typical borrower's situation is even worse since borrowers often go to more than one shop (1.7 shops on average), therefore taking out 14 to 22 loans per year. In fact, **only one percent (1%) of all payday loans go to one-time emergency borrowers** who pay their loan within two weeks and don't borrow again within a year.

With such a high payback on their loans, payday lenders are willing to lend to virtually anyone with a checking account and some kind of regular income. This "open door" policy is described by the industry as "serving people who have been denied access to credit by traditional lenders." But payday lenders are actually providing access to debt, not credit. And as bankruptcy and credit card industry statistics confirm, American consumers are awash in more debt than they can handle. For people living paycheck to paycheck, a 400% payday loan is not the answer.

"I felt like I was in a stranglehold each payday. After awhile I thought, "I'm never going to get off this merry-go-round". During this time, I got a promotion and a raise, but I never saw any of that money. It all went to pay the fees on my loan."
Anita Monti, NC payday borrower. Anita had to turn to her church for help paying her rent after falling behind with payday fees.

Myth #2: *"Payday lenders serve working middle class families."*

In reality: Industry business plans describe targeting customers who are disproportionately minority or low-income.

The payday industry claim to middle class "roots" is based on a study by the Georgetown Credit Research Center (CRC) that was funded by and produced in

collaboration with the payday industry trade group. This study, which not surprisingly attempts to put the best face on the abusive practices of payday lenders, is based on proprietary industry data that cannot be reviewed by independent observers. Read our critique of the Georgetown CRC study.

The CRC study conclusion that 50% of payday borrowers are middle income is based on interviews with only 427 of 5,400 payday borrowers. Further, researchers down played the fact that almost twice as many borrowers (726) denied they even had a payday loan, and two-thirds of borrowers refused to be interviewed.

In contrast, actual business plans by payday lenders suggest a different targeted customer base:

"There are 40 million American households with incomes of $25,000 or less that need convenient check cashing [and] quick availability of micro loans between $50 and $300...Moreover, this market is expected to grow over the next decade; especially those households that are leaving the rolls of welfare for employment."
Payday business plan

"Time of year is important...Tax season and Xmas offer [more payday loan] activity; summers can be slower but could be greater if your community grows with migrant workers."
Payday business plan

Myth #3: *"Customers understand the cost of this service"*

In reality: Payday lenders misrepresent the true cost of borrowing to their customers.

Even the industry-funded CRC study found that over 40% of borrowers believed their payday loan rates were less than 30% APR, not much more than a credit card rate. In fact, payday loan rates are on average **thirteen times higher, or roughly 400%**. The following excerpt from a payday lending business plan may explain one cause for this confusion:

"Annual percentage rate [on the customer disclosure form]:...Do not enter a % sign in this box! Simply enter a number. For example...enter the number 805 in box 1. Should you enter 805%, your client may become uncomfortable. Remember, in your response to clients' questions regarding your fees, [say] "We charge $15 per $100 advanced." Sounds like 15%, but in reality since it is an 8 day loan, the true annual percentage rate is 805%!"
Payday business plan

Myth #4: *"Payday loans are cheaper than bounced check charges and other alternatives"*

In reality: The typical payday loan is more than twice as expensive as a credit card late fee, and much more costly than paying bills late. Payday lenders routinely collect bounced checked fees and late fees as well.

In theory, a payday loan could make economic sense, IF you were in immediate and temporary financial crisis without any other possible source of funds and IF your income was such that you could readily cover a postdated check. In reality, anyone who meets these criteria probably also has access to some form of more affordable credit than a payday loan.

But for the vast majority of payday borrowers -- the borrowers who take out five or more payday loans per year and account for 91% of all payday loans -- payday lending functions as chronic debt, instead of helpful credit. This is because payday renewal fees are charged repeatedly, while late fees and bounced check charges are one-time fees and do not vary by loan amount.

Here's a comparison on various late fees compared to the average payday loan made in 2000 in North Carolina ($255 in cash for two weeks):

Transaction	Fees/ Month	APR
$255 payday loan	$90*	391%
$255 bounced check	$43	202%
Late fee on $255 credit card bill	$30	141%
Late fee on $800 mortgage (homeowner)	$32	48%
Late fee on $600 rent payment (renter)	$30	60%
Late fee on $300 car payment	$15	60%

* The vast majority of borrowers paid this fee over and over again for no "new money," because they were caught in the debt trap.

The comparison with small consumer loans is even more telling: **a person can borrow $1,000 from a finance company for a year, and pay less than a $300 payday loan over the same period!**

Also, while many states have criminal bad check laws, these do not apply to a check accepted by the creditor with full knowledge that it was not "good" when written. This fact does not stop payday lenders from threatening or often filing criminal cases. Other lenders simply deposit the checks after the consumers fail to repay and then proceed under insufficient-funds laws to collect the principal and interest, the regular bounced check fees, triple the check amount as a penalty, and attorney's fees. For example, the Indiana Department of Financial Institutions found that at least three lenders filed 700 such lawsuits in two years.

"The threat of a $200 advance eventually costing them in excess of $1,000 and destroying their credit will yield a compliant customer...This [agreement] allows you to collect a multitude of late fees and NSF charges."
Payday business plan

"Late fees are a very lucrative profit center. You do not need to actually present a client's check(s) to the bank to have them stamp NSF. Purchase your own stamp! You simply say "My bank verifies funds before accepting my deposit...When I presented your check it wasn't good. The fee is $15 per check." If you broke their payday advance into two or three [smaller] checks, you can let them slide on one[late fee] if you like."
Payday business plan

Myth #5: *"Fees need to be high because these loans are risky."*

In reality: Payday lenders have low losses and high profits (34%+ return on investment).

A payday lender would have to work hard to lose money, even though borrowers are generally low-income and have weak credit histories. Holding a "live" check as security gives a lender strong collateral and leverage over a borrower who, when faced with the threat of criminal prosecution and penalty fees, will keep paying renewal fees every two weeks when they cannot afford to repay the loan in full and walk away. With these renewals (or loan flips), they are never paying down the principal owed. In North Carolina in 2000, for example, only 6% of payday checks were returned for insufficient funds (NSF) and lenders recovered about 69% of the value on these. They also collected $2 million in NSF fees.

In comparison, the credit card default rate, like the payday default rate, is also approximately 6% -- but the interest rate on a credit card rarely exceeds 29% (as opposed to payday loans that routinely charge 400% APR or more). Personal loans and car loans have default rates of around 2%, with APRs

between 5 and 15%. Compared to other forms of credit, the exorbitantly high APR charged on payday loans is drastically out of proportion with the relatively normal risk involved in making those loans.

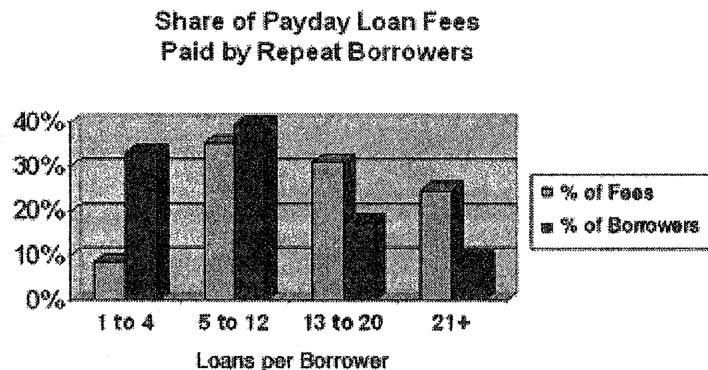
Moreover, if a borrower defaults after repeatedly renewing a payday loan, a lender can actually make money, because **accumulating fees quickly surpass the amount lent**. In most states, a payday lender loses only 10-12¢ for every dollar loaned out in the few cases when a loan goes unpaid.

"[Payday lenders] understate profits and overstate default rates to dissuade potential new competitors from entering the industry."
Payday business plan

Myth #6: *"Most consumers use payday loans responsibly"*

In reality: Payday lenders thrive by getting borrowers trapped on a debt treadmill.

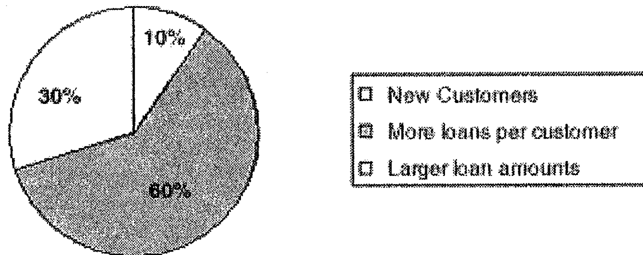
People with legitimate, short-term needs who will pay off their loan within two weeks aren't that attractive to payday lenders. Instead, payday lenders make most of their profits from borrowers who cannot pay off their loans, and instead renew them repeatedly, quickly paying more in fees than they originally borrowed. Borrowers who get five or more loans account for 91% of payday lender revenues.



This customer "churning" -- not additional consumer demand -- is fueling the growth of the payday industry. For example, while payday revenues in North Carolina grew 27% from 1999 to 2000, the vast majority of this increase came from lenders getting their customers to take out more and larger payday loans.

"[Lenders] may say they are providing a service to people who just need some money once in awhile until payday. But we were trained to encourage customers the day they paid a loan off to make another loan as early as the next day...We tried to get customers to keep getting loans and borrow up to

their maximum approval amount whether they wanted it or not."
Ex-employee of payday lender in West Virginia



Myth #7: *"Consumers appreciate this service and oppose any limits on payday lending"*

In reality: Consumers want (and deserve) non-predatory small consumer loans, not "business as usual."

According to the industry-funded Georgetown Credit Research Center (CRC) study, 75% of borrowers interviewed believe the government should limit the fees charged by payday advance companies, and 72% believe the government should limit the interest rates that lenders can charge, even if it meant that fewer consumers would be able to get credit.

Further, the following quotes from a payday business plan provide a glimpse of the real "service" borrowers are getting along with their high-cost payday loans. No wonder 80% of borrowers contacted by the CRC refused to be interviewed or denied they even had a payday loan!

"These clients are very malleable. They will do as you wish -- they need the money."
Payday business plan

"Tell [your clients] if their funds are not good on the day they promised, you must forward their check(s) to your [mythical] "bonding company" so their legal team can pursue the matter."
Payday business plan

"Help them visualize a uniformed, gun toting US Marshall arriving at their place of employment. Emphasize to them that this US Marshall will first ask for [their] immediate supervisor!"
Payday business plan

"An arbitration clause in all your contracts is good advice; [it] has a chilling effect on class action lawyers."
Payday business plan

Myth #8: *"The payday industry is already highly regulated."*

In reality: State payday laws almost always favor lenders, not consumers. In states with laws with real consumer protections, payday lenders ignore unfavorable state provisions, claiming federal preemption.

Payday loan legislation passed in 34 states and the District of Columbia does not "regulate" the industry. For the most part, these statutes were drafted by the industry and are intended to permit this type of lending rather than restrict it. These statutes contain few restrictions that actually protect consumers. Another two states have no usury limits and do not otherwise regulate payday loan terms. Only fourteen states, plus Puerto Rico and the Virgin Islands, currently retain their small loan laws and usury limits.

"The payday advance industry is following the same strategy as the rent-to-own industry and bank/credit card industry. That is, hiring the very best legal minds to enable legislation to allow our industry to grow...The BEST action is a for a state to implement laws enabling our industry!"
Payday business plan

In the states with strong consumer protections, payday lenders are using brokering arrangements with banks, known as rent a charter arrangements, to circumvent state bans and usury limits. These lenders claim they are exempt from state law because they have partnered with banks outside the state.

The Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve Board have taken significant action to prevent the institutions they regulate from partnering with payday lenders. However, the Federal Deposit Insurance Corporation (FDIC) still tolerates this subterfuge by its member institutions. These small FDIC-regulated banks -- about a dozen -- enable payday loans to be made in fifteen states where such loans are illegal. Several states, such as Georgia and Maryland, have successfully taken action to close the rent a charter loophole.

"We have been greatly concerned with [payday lending] arrangements in which national banks essentially rent out their charters to third parties who want to evade state and local consumer protection laws."
Comptroller of the Currency John Hawke Jr.

Texas Constitution

Article 16. General Provisions

§11. USURY; RATE OF INTEREST IN ABSENCE OF LEGISLATION. The Legislature shall have authority to define interest and fix maximum rates of interest; provided, however, in the absence of legislation fixing maximum rates of interest all contracts for a greater rate of interest than ten per centum (10%) per annum shall be deemed usurious; provided, further, that in contracts where no rate of interest is agreed upon, the rate shall not exceed six per centum (6%) per annum. (Amended Aug. 11, 1891, Nov. 8, 1960, and Nov. 6, 2001.)

TEXAS
BUSINESS REVIEW
Bureau of Business Research • IC² Institute • The University of Texas at Austin
APRIL 2008

The Hidden Costs of Payday Lending

by
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Payday lending, *sometimes known as a* cash advance, *is a small, short-term, high interest loan that is intended to bridge the borrower's cash flow gap between pay periods. Payday loans are secured by access to the individual's checking account, typically through a postdated check or an automated clearinghouse (ACH) authorization. Available at storefronts and via the Internet, these loans are generally due in about two weeks or on the borrower's next payday.*

This article examines the nearly $3 billion payday industry in Texas and offers an overview of its practices and impact on Texas communities while raising questions about the need for more state oversight and safeguards.

As the subprime mortgage market implodes, the payday lending industry thrives unfettered in Texas, with more storefronts than McDonald's® and Whataburger® combined. This proliferation is possible because Texas payday lenders largely operate outside any state regulatory system, whereas the products and activities of banks and other financial institutions must meet public standards and safeguards.

This lack of oversight for the payday industry has led to the nation's highest interest rates, and spiraling consumer debt. Because the Texas Legislature has not monitored these institutions more closely or established reasonable rules, municipalities are beginning to take steps to rein in payday lending and protect their residents from financial abuse.

The Advent of Payday Lending

While short-term lending has existed for decades in the U.S., the modern version of payday lending initially appeared in the late 1980s and eventually morphed into a sizable industry during the 1990s. Several states, including Texas, have usury laws that typically limit interest rates to no more than 20% annually. Over time, states developed rules and strategies to regulate short-term loan operations, while lenders tested the limits of these state usury or check-cashing laws.

Until 2005, the most common business model to facilitate payday lending in Texas, and other states, was the so-called "rent-a-bank." Under this arrangement, payday firms partnered with out-of-state banks to "import" higher lending rates. These out-of-state banks – located in states without usury limits, such as Delaware or South Dakota – would provide the capital, while the payday lender assumed a "broker" role.

As the FDIC began to limit and eventually ban this practice, payday lenders actively pursued more industry-friendly legislation or forged alternative operating models.

How States Approach Payday Lending

States approach payday lending in one of three ways. Some allow payday lenders to operate with virtually no legal restrictions (e.g., Texas). Others enforce an interest rate cap at or around 36 percent on all small loans, which effectively eliminates traditional payday lenders. Meanwhile, a third group attempts to regulate payday lenders charging triple-digit interest rates with certain statutory limitations that seek to prevent lending abuse.

Interest rates and loan fees vary among states, and lenders usually charge the maximum allowed by state law. While the national average hovers around $16 per $100 borrowed, fees and interest charges on Texas payday loans range from $20-$25 per $100 borrowed. For a 10-day/$400 loan, a Texan could expect to pay about $100 in interest and fees, equating to a 925% APR.[1]

Despite these regulations – which include limits on loan fees and number of renewals – payday loans still create chronic and paralyzing debt and leave customers in a worse financial condition than prior to the original payday loan.

For states with a regulated model, many have also authorized data collection systems that both collect loan data and enforce the state's lending restrictions. Despite these regulations – which include limits on loan fees and the number of renewals – payday loans still create chronic and paralyzing debt and leave customers in a worse financial condition than prior to the original payday loan. Among the findings:

- 70 percent of all loans went to borrowers who had 11 or more loans in the past 12 months (Colorado);[2]
- The average payday loan customer took out 8 loans in a 12-month period (Florida);[3]
- The typical payday borrower repays $793 on a $325 loan (U.S.); and
- Only 1 in 100 payday borrowers pays the entire balance by the original due date.[4]

Largely because of these trends, along with countless anecdotal stories of spiraling consumer debt, federal and state action against payday lending practices has accelerated over the past few years. In addition to the FDIC ban outlawing the "rent-a-bank" model in 2005, the U.S. Congress enacted the Military Lending Act in 2006 to protect active duty military personnel from high-cost loans, especially payday lending.[5] The 36% rate cap – effective October 2007 – was promoted by the Department of Defense to improve troop morale and enhance national security, as military bases and families had been targeted by the industry for over a decade.[6] Since 2004, five states (plus Washington, D.C.) have enacted interest-rate caps that effectively remove payday loans from the financial marketplace. Table 1, below, highlights recent state initiatives, including annual interest rate caps and year of enactment.

Consumers in these states have not exactly petitioned for a return of payday loans. In a recent study, prepared for the North Carolina Commissioner of Banks after payday lenders exited the Tar Heel state, Carolina consumers reported that the absence of payday lending had a positive household effect, while they preferred other options to bridge financial shortfalls.[7]

Currently, payday lending occurs in 35 states, but several states, including Iowa and Arkansas, are taking dramatic steps to enforce their small loan laws and regulate payday lending.

Is Payday Lending Legal in Texas?

Beginning in July 2005, all major Texas-based payday lenders registered as Credit Service Organizations (CSOs). Before this shift, virtually all Texas payday lenders operated under the aforementioned "rent-a-bank" model. Under this now-defunct model, payday lenders claimed they were loan brokers or arrangers, thereby evading Texas usury laws and the short-term interest rates established by the Texas Finance Commission under Section 342 of the Texas Finance Code.[8] Table 2 (page 3) shows the rates established by the Texas Finance Commission – pursuant to state law – along with fees charged under the CSO model.

As defined under the Texas Credit Services Organization Act, a CSO is any entity or person that provides one of the following services:

- Improving a consumer's credit history or rating;
- Obtaining an extension of consumer credit for a consumer; or
- Providing advice or assistance to a consumer with regard to the previous two services.[9]

This broad criteria enables lending without standards, in which aspiring CSOs need only

Table 1
Recent Actions to Restrict Payday Lending, 2004 - 2008

State/Jurisdiction	Interest Rate Cap	Year of Enactment
Georgia	60%	2004
North Carolina	36%	2006
Oregon	36%	2007
Washington, D.C.	24%	2007
New Hampshire	36%	2008*

* At press time, the New Hampshire Governor had yet to sign the bill passed by the Legislature in February 2008.

Source: Center for Public Policy Priorities, 2008

Table 2

Comparison of Texas Office of Consumer Credit Commissioner (OCCC) Rates and Credit Service Organization (CSO) Fees for a 14-day Loan

Amount Borrowed	OCCC Finance Charges/APR	CSO Estmated Charges/APR
$300	$15.60/135.6%	$76.44/664.3%
$500	$19.33/100.8%	$127.40/664.3%
$700	$23.07/133.7%	$178.36/664.3%
$1,000	$28.67/199.3%	$254.29/664.3%

Source: Texas Finance Commission, CPPP Analysis, http://www.occc.state.tx.us/pages/int_rates/deferred%20presentment%20transaction%20rate%20charts%20.XLS.

Texas remains the only state in which such a permissive use of the CSO statute is the predominant model for payday loan transactions....

The result is that Texas payday loans remain the most expensive in the U.S.

complete a minimal application and remit a $100 annual fee. Although CSOs are required to register with the Secretary of State, they are not licensed by the Texas Office of Consumer Credit Commissioner (OCCC). Their fees and activities are unregulated by the state of Texas. Unlike other states with payday lending, the Texas CSO model has no maximum loan amount, although many lenders do not exceed $1,500 in loan value.

In substance, little has changed under the new model: payday lenders still offer the exorbitant loans they did under the rent-a-bank model. Only now, they do so in partnership with an unregulated third-party lender instead of an out-of-state bank.

Larger questions continue to surface about the overall legality of the CSO model given the original intent of the CSO Act. Texas law appears to preclude any and all attempts to dodge the intent of regulating payday loans, also known as "deferred presentment transactions." The Texas Finance Code makes it clear that the Finance Commission shall regulate these transactions, and that "[a] person who is a party to a deferred presentment transaction may not evade the application of this subtitle or a rule adopted under this subchapter by use of any device, subterfuge, or pretense. Characterization of a required fee as a purchase of a good or service in connection with a deferred presentment transaction is a device, subterfuge, or pretense."[10]

A Closer Look at the Texas Industry

The Texas payday lending industry is dominated by large companies. Of the approximately 2,000 payday-CSO storefronts across Texas, 92% are owned and operated by a half-dozen firms, many with headquarters in Texas: Ace Cash Express (Irving); Advance America (South Carolina); Cash America (Fort Worth); The Cash Store (Irving); First Cash/Cash & Go (Arlington); Check 'N Go (Ohio); EZMoney (Austin). The remaining payday lenders are independent, regional firms scattered across the state.[11]

Texas remains the only state in which such a permissive use of the CSO statute is the predominant model for payday loan transactions. Under this model, the payday-CSO storefront arranges a credit extension for a customer who pays a CSO fee for every $100 borrowed ($20-$25), while the CSO issues a letter of credit in conjunction with an affiliated third-party lender at 10% annual interest. Additional fees may be added. The result is that Texas payday loans remain the most expensive in the U.S.

From 2004-2007, OCCC fielded hundreds of complaints from consumers regarding payday lending. Neither the Attorney General nor OCCC resolved these complaints, primarily because state entities lack jurisdiction. In general, the Texas Attorney General has assumed a passive role in investigating customer abuse and confronting CSO statute manipulation. Complaints typically fall into three categories:[12]

Snowballing Debt

- (June 2006, Arlington): "She took out a payday loan Dec. 2005 for $500.00. She pays $170.00 in interest every two weeks since Jan. 2006, she got behind on her interest payments and... the Manager offered her [another] payday loan."
- (June 2007, Floresville): Customer "is in her 80's and has taken a payday loan. She has been renewing for a year. Each time she goes in to make payment, they offer her a [$50] premium to renew. The $100 loan has now increased to a $600 debt. [She] wants to put a stop to the renewals."

These accounts represent a slice of the personal and economic consequences wrought by a harmful combination of high-cost loans coupled with little state oversight and few consumer protections.

Harassment

• (January 2007, Irving): "She is getting harassing collections calls at work. She has asked them to stop and they continue to call her and have made her ill, she has been told that they are telling her boss about the problem and [are] going to make [her] lose her job."

• (September 2006, Dallas): "My Cash Time continues to contact her at work and harass her. [She] alleges that they call several times per day at work, calling her a 'liar and a thief.'"

• (August 2007, Arlington): "[She] alleges that they are making calls to her place of employment and going directly to her employer/supervisor... [and] have threatened to have [a] constable come to her place of employment and have her arrested."

Lender Misconduct

• (August 2006, Austin): [She] went in to make payments and she had to give two personal checks, when she went to fill them out she was asked by the employee to leave them blank and just sign them... After the check went through her bank she noticed that the checks were made out to the employee's name and not the company."

• (July 2006, Round Rock): "He had taken out a loan on 5/28/06, his payment was due in June, they were to take out only $125.00 for one month and instead they took out for the whole loan. He called the company and was told that they took out the full amount because they felt he was not going to pay the loan."

These accounts represent a slice of the personal and economic consequences wrought by a harmful combination of high-cost loans coupled with little state oversight and few consumer protections.

Calculating the Toll of Payday Lending

Despite the lack of a centralized data collection system to capture payday loan volume, total fees, and other indicators, the economic toll of payday lending is substantial, as product use continues to rise. Annually, Texans take out an estimated $2.5 billion in principal loan amounts per year and pay an additional $500-$600 million in annual interest and fees, not to mention the overdraft (NSF) fees that often accompany these payment arrangements.

Accordingly, a recent Brookings Institution study quantifies the costs of payday lending in Texas' largest cities. As shown below in Table 3, many communities (most often lower income neighborhoods) are saturated with alternative financial service providers such as payday lenders. Additionally, these costs represent a snapshot of the economic toll on Texas cities and neighborhoods.

With the lowest average credit scores in the U.S., ballooning mortgage payments, and relatively low wages, Texas households face numerous challenges in achieving and maintaining financial stability. According to estimates from the Center for Public Policy Priorities, the average Texas family cannot afford the short-term interest on a $300 payday

Table 3
The Impact of Payday Lending on Texas' Largest Cities, 2006

City	# of Payday Lenders	Payday Loan Value in Millions ($)	Payday Loan Fees in Millions ($)	Share of Alternative Financial Service Providers (%) in Lower Income Neighborhoods *
Austin	52	$90.8	$14.8	66.5%
Dallas	98	$171.2	$27.8	71.7%
El Paso	59	$103.1	$16.8	79.2%
Fort Worth	68	$118.8	$19.3	83.1%
Houston	237	$414.1	$67.3	76.2%
San Antonio	136	$237.6	$38.6	83.3%

* Alternative Financial Service Providers include check cashers, pawn shops, and payday lenders. The Brookings study divides neighborhoods into four income groups: low income, lower middle income, higher middle income, and high income. This figure includes the first two groups.

Source: Brookings Institution, 2008.

loan while maintaining essential household necessities (see Table 4, page 6). Many Texas communities, concerned with these trends, are taking steps to limit this damage to their economy and quality of life.

Cities Take Charge

In January 2008, Richardson became the first Texas city to adopt a municipal ordinance restricting the operations of so-called fringe financial services, including payday lenders, check cashers, and car-title lenders. City officials were concerned about the clustering of these businesses, along with their negative effects on property values and public safety. In February, the City of Mesquite followed suit by adopting an ordinance to restrict the existence and concentration of alternative financial establishments (AFE). Following a national trend – over 75 municipalities in 17 states have adopted similar ordinances – city leaders have concluded that such businesses harm citizens and local economic development efforts.[13]

Conclusion

The municipal movement reveals local discomfort with payday lenders in the face of state inaction. Will the state of Texas continue to leave communities and consumers to their own devices? Or will the Lone Star State remain true to its heritage as a staunch opponent of usury, as reflected in the state Constitution? To address this growing problem, the Legislature should consider tightening the CSO statute by establishing meaningful consumer safeguards and implementing a reporting requirement for payday lenders. As lessons from the mortgage crisis unfold, it is clear that standards and safeguards are critical to protect borrowers and promote economic growth.

In a recent interview with the *Dallas Morning News* about the anti-payday lending ordinance, Mesquite Mayor John Monaco noted, "If your business depends on people who are desperate, that speaks for itself. I don't look forward to seeing one more in Mesquite... They just don't do your community any good."[14]

References

1. Many supporters of payday lending contend that evaluating these products by the annual percentage rate is misguided. However, the main problem with payday loans is the short repayment period, reflected in the APR. As such, repaying a $400 loan in 10 days causes more financial disruption than repaying this loan over several months. APR is a function of principal, interest/fees, and time (or number of days).

2. Bell Policy Center, *The Truth About Payday Loans: How Hardworking Coloradans Take the Bait and Get Caught in a Cycle of Debt,* Feb. 2008.

3. Veritecs, *Florida Trends in Deferred Presentment,* August 2007. http://www.veritecs.com/FL_trends_aug_2007.pdf.

4. Center for Responsible Lending, *Financial Quicksand,* Nov. 2006. http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

5. The MLA, as it has become to become called, was part of the FY 2007 John Warner Defense Authorization Act of 2007.

6. For more information on how payday lending has affected the armed services community, see Steven Graves & Christopher Peterson, *Predatory Lending and the Military,* March 2005, http://www.law.ufl.edu/faculty/publications/pdf/peterson_military.pdf. Also see U.S. Department of Defense, *Report on Predatory Lending Directed at Members of the Armed Forces and Their Dependents,* Aug. 9, 2006, http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf.

7. Center for Community Capital, *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options,* Nov. 2007. http://www.ccc.unc.edu/documents/NC_After_Payday.pdf.

8. Although the CSO's broker fee is included for purposes of Truth in Lending disclosures, CSOs argue that for purposes of Texas law, the broker fee cannot be treated as interest, since the Texas Credit Services Organization Act (CSOA) has no explicit regulation of fees. This theory arises from a U.S. Fifth Circuit Court of Appeals opinion, in *Lovick vs. Rite Money,* which held that payments to a registered CSO loan broker could not be treated as interest. This ruling came despite repeated rulings by Texas courts prior to the passage of the CSOA that broker fees could be considered interest.

9. See Chapter 393, Texas Finance Code.

10. Texas Finance Code 342.008, Added by Acts 2001, 77th Leg., ch. 1235, § 13, eff. Sept. 1, 2001.

11. Texas Secretary of State, Credit Services Organization Database, Aug. 2007.

12. These complaint records were made available through the Center for Public Policy Priorities' Open Records Request to the OCCC, Sept. 2007.

13. Griffith, Kelly et. al., "Controlling the Growth of Payday Lending Through Local Ordinances and Resolutions," Washington: CFA, Nov. 2007. http://www.consumerfed.org/pdfs/PDL%20Local%20Ordinance%20Handbook%2012%2007%20Final.pdf.

14. Frank Trejo, "Mesquite Limits Payday Lenders," *Dallas Morning News,* Mar. 2, 2008. http://www.dallasnews.com/sharedcontent/dws/news/city/mesquite/stories/DN-payday_02eas.ART0.North.Edition1.466b224.html.

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Texas Business Review is published six times a year (February, April, June, August, October, and December) by the Bureau of Business Research, IC² Institute, The University of Texas at Austin. Subscriptions are available free upon request. Views expressed in this newsletter are those of the authors and do not necessarily reflect the position of the Bureau of Business Research.

Research and service activities of the Bureau of Business Research focus on strategies to make Texas industries more nationally and globally competitive. The Bureau is policy oriented and dedicated to public service. Offices are located at 2815 San Gabriel, Austin, Texas 78705.

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Table 4

Why Payday Loans are Unaffordable for Texas Families

Basic Necessities for a Single-Parent/One-Child Family (San Antonio)

Income per two-week period	$1,160
Essential Household Expenditures per two-week period	
Food	**-$124**
Housing	**-$358**
Child Care	**-$259**
Medical/Health Care	**-$87**
Transportation	**-$168**
Taxes[1]	**-$47**
Other Necessities	**-$115**
Total (Essential) Expenditures	-$1,158
Amount Remaining	$2
Amount Due to Repay $300 Loan w/ typical fees	**-$365**
Pay Period Deficit	<$363 >

[1]Taxes include all federal taxes, along with yearly eligible tax credits such as the Earned Income Tax Credit and others.

Source: Center for Public Policy Priorities, Family Budget Estimator 2007

Announcement

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