

Basic Needs: Payday Lending Industry Reform

Position Statement approved by One Voice: February 13, 2009

Issue/Concern: Texans pay an effective interest rate of between 400-1,000% for payday loans. As a result, hundreds of millions of dollars are drained from moderate-income Texas families every year. Without real reform, hard-working Texans remain vulnerable to lending abuses in the marketplace.

Specific Policy Recommendation(s):

- ★ Expand and market competitive services through formal financial institutions (i.e. banks, credit unions, etc.). Provide incentives to financial institutions to encourage creation of products designed to provide access to short-term financing along with installment repayments.
- ★ Enact legislation, as 15 other states have, that caps interest rates at two-digits, limits rollovers, and restricts the size of payday loans.
- ★ Tighten statute to establish meaningful consumer safeguards and implement a reporting requirement for payday lenders. Clarify Credit Service Organization (CSO) provisions to exclude payday lenders from getting around usury laws by claiming to be CSO's.

How does this issue/recommendation relate to prevention and early intervention or maximizing federal funds for health and human services? Families without bank accounts or access to affordable credit are less likely than other Americans to have a cushion for emergencies, to save for a home or higher education, or to build retirement security.

Supporting Facts/Research/Resources: As banks stepped away from small-dollar loans in favor of credit cards and overdraft-type services, alternative providers arose to meet the demand. Approximately, 40% of payday loan recipients have bank accounts, suggesting that the payday lender provides a service that is not available from the bank. Many patrons cite an easier process, convenient hours and locations as a reason for their patronage. Also, past unpaid debts or overdrafts will prevent some low-income persons from qualifying for banking accounts or for bank loans.

But payday loans are a vicious cycle. Terms require full repayment almost immediately, which generally triggers repeat borrowing. The average borrower is caught in the system for nine cycles, or about four to five months and some customers pay on the interest for years before completely paying off the debt. The annual interest rate charged by payday lenders is about 400 percent or \$50 every two weeks for a \$300 loan, amounting to almost \$450 in interest. U.S. payday lenders argue that charging 400 percent annual interest is the only way their business model can be profitable due to high risk. 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.

Payday lenders are able to evade the Texas usury law established by the Texas Finance Code by claiming that they are loan brokers or arrangers not direct lenders. FDIC regulations, instituted March 3, 2005 call upon payday lenders to limit the number of outstanding loans, the number of rollovers, and the maximum size of their loans. Lenders are also required to provide a waiting period between the repayment of one loan and the issuance of another. However, Texan payday lenders have not fully adhered to these restrictions, again claiming that they are brokers. Payday lenders bear claim to the Credit Service Organization Act, which sets no limits on what brokers, called Credit Service Organizations (CSO), can charge in fees. As a result, payday lenders have no fee caps. This is despite the fact that the lenders are not doing what CSO's were originally commissioned to do, repair consumers' credit and find sources of credit that the consumer would not be able to access on his/her own.

Specific recommendations and reference information was provided in cooperation with Raise Texas (formerly Texas Asset Building Coalition) at www.raisetexas.org and from the following sources:

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One Voice: A Collaborative for Health and Human Services is a network of diverse community organizations that advocates for public policy to meet the health and human service needs in Texas.