CONSUMER CONCERNS
Information for Advocates Representing Older Adults
National Consumer Law Center®

High Cost of Payday Loans

Many older Americans have difficulty meeting their monthly expenses. A fixed income can't always cover a senior's needs, particularly unexpected ones. Medical problems, home and car repairs, or even an old appliance breaking are just a few of the events that can trigger financial strain. Desperate for help, many seniors end up with very high cost small loans, including payday loans. Payday loans may appear to offer a solution to seniors' problems but, in fact, they only create more trouble because they trap seniors in debt they cannot afford to repay.

What is a Payday Loan?

Payday loans go by a variety of names, including "deferred presentments," "cash advances," "deferred deposits," or "check loans," but they all work in basically the same way.

The customer writes a check to the lender. The amount on the check equals the amount borrowed plus a fee that is either a percentage of the full amount of the check or a flat dollar amount. Some payday lenders will offer an alternative "automatic debit" agreement. Customers who sign this agreement give the lender permission to automatically debit the customer's account at a future date. These automatic debit arrangements, in particular, are often marketed to public assistance recipients and Social Security recipients.[1]

The check (or debit agreement) is then held for one to four weeks, usually until the customer's next payday or until receipt of a government check.

The payday loan is for an amount of cash that is less than the amount written on the check or set forth in the automatic debit agreement. At the end of the agreed time period, the customer must pay back the full amount of the check or debit agreement (more than

[1] Government benefits are often protected by state and/or federal law from being taken by private creditors to repay debts. For instance, Social Security is thus protected by federal law. 42 U.S.C. § 407(a). Seniors with payday debt who get Social Security or other benefits should be advised on how legal protections can be used to keep their benefits safe.

the amount of the loan), allow the check to be cashed or the debit to go through, or pay another fee to extend the loan.

Why Are Payday Loans Expensive?

The difference between the amount of the check or debit agreement and the amount of cash the customer gets in return is interest or a loan fee that the lender is charging. These types of short-term loans are always very expensive because the customer is paying a lot to borrow for a short period of time.

The High Cost of Payday Loans

You write a check dated in two weeks for..........................$256
You get back today.. $200
Interest and charges...$ 56
The cost of a loan for two weeks is...................... 730% annual percentage rate ("APR").

Triple digit APRs are the norm for payday loans. This is exponentially higher than the cost to borrow from more traditional lenders. For instance, compare this 730% APR to the cost of a short term small dollar loan from a federal credit union. The maximum the credit union may charge is 28% interest and a $20 application fee, which translates to 28% APR. (If the application fee is charged to all applicants, regardless of whether credit is extended, then it may be excluded from the APR, although the true cost is higher due to the fee.)

Abuses in Payday Lending

Abuses in making and collecting payday loans occur in a variety of ways. Cash-strapped customers are rarely able to repay the entire loan when payday or the next benefits payment arrives because they need the new funds for current living expenses. Lenders encourage these customers to rollover or refinance one payday loan with another; those who do so pay yet another round of charges and fees and obtain no additional cash in return. If the check is returned for insufficient funds or the loan otherwise goes unpaid, the lender may threaten to involve the criminal justice system, a tactic that is possible only because a check, rather than a mere promissory note, is involved.

A growing area of abuse is payday lending done over the internet. Online payday lenders typically don't make their physical place of business known–if they even have one. Customers are thus particularly vulnerable to being harassed for repayment because the lender has their contact information but they might not be able to track down the lender. Indeed, lenders are moving toward operating online to avoid being found, especially by government overseers.

Summary of Legal Claims

There are numerous legal claims that can be used against payday lenders. These are summarized briefly below. More information on these claims can be found in the National Consumer Law Center's manual, The Cost of Credit (4th ed. 2009) and NCLC's handbook, Stop Predatory Lending: A Guide for Legal Advocates (2d ed. 2007). For information on ordering NCLC publications, call (617) 542-9595 or visit NCLC's web site, www.consumerlaw.org.

Possible Legal Claims Include:

• Truth in Lending Violations[2]

Payday lenders often fail to comply with Truth-in-Lending disclosure requirements, making it nearly impossible to understand the true cost of these loans. Payday lenders often try to get around the law by claiming that they are not making loans. They come up with schemes such as catalog sales, phone card clubs, or internet service that attempt to characterize the loan as something else. These disguises may be challenged, and courts will often rule that the transaction is really a loan.

• State Payday Lending Law Violations

About two-thirds of the states have passed industry-backed laws specifically authorizing payday lending. These laws generally require either licensing or registration. Some specify maximum loan terms and/or amounts, as well as fix the interest rate or fees to be charged.[3]

• Military Lending Act[4]

Payday lending to active duty members of the armed forces and their dependents (including spouses) has effectively been banned by this law.

• Usury

Most states have several different usury statutes, including "special usury laws", such as small loan acts. Small loan laws are usually structured as exceptions to a general usury ceiling. In roughly one-quarter of states and the District of Columbia, payday lenders must comply with state small loan and/or criminal usury laws. Since the caps imposed by these laws are substantially below payday industry charges (with limits up to about 36%, including fees), lenders in these locations often simply ignore the usury cap or try to disguise the loan.[5] A very small number of places permit payday lenders to operate and to charge any interest rate or fees the borrower agrees to pay but require them to comply with other small loan act provisions.

[2] 15 U.S.C. §§1601 *et seq*. See generally National Consumer Law Center (NCLC), Truth in Lending (6th ed. 2007 and Supp. 2008), and The Cost of Credit § 7.5.5.4 (4th ed. 2009).

[3] The list of states with payday loan laws continues to grow and change. To keep up to date, see NCLC's manual The Cost of Credit § 7.5.5.5 (4th ed. 2009) and/or the payday loan section of NCLC's web site, www.consumerlaw.org.

[4] 10 U.S.C. § 987. See NCLC, The Cost of Credit § 2.3.3.12 (4th ed. 2009).

[5] In some cases, state usury limits may be preempted by federal law. Up until 2006, many payday lenders attempted to avoid state law by partnering with state banks from other states. In 2006 the FDIC imposed restrictions that effectively stopped this "rent-a-bank" lending. For a detailed explanation of preemption, see NCLC, The Cost of Credit ch. 3 (4th ed. 2009).

Racketeer Influenced and Corrupt Organizations Act ("RICO")

The federal RICO law[6], 18 U.S.C. §§1961-1968 as well as state RICO laws may also be considered as providing possible causes of action in some situations, such as when payday lenders attempt to collect debts arising from usurious transactions.

State Unfair and Deceptive Acts and Practices ("UDAP") Claims

Overreaching consumer credit transactions can often be challenged under state UDAP laws. For example, when payday lenders try to disguise their products as something other than loans, UDAP claims should be pursued.[7]

Fair Debt Collection Laws

Illegal or deceptive debt collection threats, such as threats to arrest borrowers, may violate federal or state fair debt laws.[8]

Common Law Claims

Claims such as breach of fiduciary duty, fraud, or negligence should also be considered.

Licensing Violations

Licensing laws and penalties exist in many states.[9]

Possible Alternative Sources of Credit[10]

Many seniors understand the high cost of payday loans, but do not know where else to turn. Creating affordable lending alternatives should be a top advocacy priority so that consumers can say "no" to the payday lenders and still find reasonably priced loan products. In addition, advocates should learn about the affordable sources of credit currently available in their communities and direct clients to these resources.

Here are some places to look for good alternatives to payday lending available in your community:

- Credit unions, including many community development institutions, often offer small loans at reasonable rates. More information about community development credit unions is available from the Coalition of Community Development Financial Institutions, (202) 393-5225, http://www.cdfi.org and the National Federation of Community Development Credit Unions, 212-809-1850, http://www.natfed.org.

[6] 18 U.S.C. §§1961-1968. See NCLC, Unfair and Deceptive Acts and Practices §§ 14.2-14.3 (7th ed. 2008); NCLC, The Cost of Credit §§ 10.8.5.3 &12.6 (4th ed. 2009).
[7] See generally NCLC, Unfair and Deceptive Acts and Practices ch. 6 (7th ed. 2008).
[8] See NCLC, Fair Debt Collection § 5.5.7 (6th ed. 2008 and Supp. 2009).
[9] For discussion of licensing laws, see NCLC, The Cost of Credit § 7.5.5.5 (4th ed. 2009).
[10] These organizations are listed as a starting place for research. NCLC is not endorsing any credit union, bank, or other financial institution, or any of the products they offer. Advocates should familiarize themselves with the details of the specific products being offered by the institutions in their communities to ensure they are affordable before recommending them to seniors. Not all of the products offered by the institutions identified by these organizations are necessarily affordable.

- Some credit unions are focusing on developing alternatives to payday loans. A list of these credit unions can be found through the National Credit Union Foundation's REAL ("Relevant, Effective, Asset-building, Loyalty-producing") Solutions program, http://www.ncuf.coop/home/programs/realsolutions/realsolutions.aspx. Any alternative products should be carefully scrutinized, as not all of them are safe for consumers. For more information about determining whether an alternative is safe, see NCLC's report, "Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't," http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf
- The FDIC recently completed a pilot program of banks willing to offer affordable small loans aimed at providing customers with an option other than payday borrowing. Information on participating banks can be found at http://www.fdic.gov/SmallDollarLoans/.

For More Information

The National Consumer Law Center publishes a manual The Cost of Credit (4th ed. 2009), a handbook, Stop Predatory Lending: A Guide for Legal Advocates (2d ed. 2007), as well as various reports. For more information, contact NCLC Publications at (617) 542-9595 or check out NCLC's web site, www.consumerlaw.org.

Useful Publications About Payday Lending

Reports from Center for Responsible Lending, available at http://www.responsiblelending.org/payday-lending/research-analysis/, including:

- Uriah King and Leslie Parrish, "Springing The Debt Trap: Rate Caps Are Only Proven Payday Lending Reform," Center for Responsible Lending (December 2007).

Reports from Consumer Federation of America, available at http://consumerfed.org/about/studies.asp and http://www.paydayloaninfo.org/, including:

- Jean Ann Fox and Anna Petrini, "Internet Payday Lending: How High-Priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections," Consumer Federation of America (November 2004).
- "Small Dollar Loan Products Scorecard," Consumer Federation of America, Consumers Union, and National Consumer Law Center (August 2008).

Reports from the Woodstock Institute, available at http://www.woodstockinst.org/publications/research-reports/, including:

- Geoff Smith, Sarah Duda, and Kathryn Biggins, "Improving Economic Security Later in Life: Meeting the Credit and Financial Services Needs of Older Persons," Woodstock Institute (October 2009).

Advocacy Organizations

AARP
601 E Street, NW
Washington, D.C. 20049
(888) OUR-AARP
www.aarp.org

Consumer Federation of America
1620 I Street, NW
Suite 200
Washington, D.C. 20006
(202) 387-6121
www.consumerfed.org

Consumers Union
Washington D.C. Office:
1101 17th Street, NW
Suite 500
Washington, D.C. 20036
(202) 462-6262

- West Coast Office:
  1535 Mission St.
  San Francisco, CA 94103
  (415) 431-6747
  www.consumersunion.org

NATIONAL CONSUMER LAW CENTER®
7 Winthrop Square, 4th Floor
Boston, MA 02110-1245

Phone: 617-542-8010
Fax: 617-542-8028
E-mail: consumerlaw@nclc.org
www.nclc.org

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