

Consumer Concerns for Older Americans

The 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 needs associated with medical problems, home and car repairs, or even an old refrigerator that doesn't work anymore. Unfortunately, there are few resources to help vulnerable seniors get through these hard times. Affordable small loans are hard to come by. As a result, many seniors end up with very high cost small loans, including payday loans.

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 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.

The check (or debit agreement) is then held for up to a month, 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. At the end of the agreed time period, the customer must either pay back the full amount of the check (more than the amount of the loan), allow the check to be cashed, or pay another fee to extend the loan.

Why are Payday Loans Expensive?

The difference between the amount of the check 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.

For example:

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You write a check dated in two weeks for.....	\$256
You get back today.....	\$200
Interest and charges.....	\$ 56
The interest rate for a loan of two weeks is..... 730% on an annual basis.	
Compare this 730% interest rate loan to annual interest rates as low as 10-15% that bank, credit unions, and finance companies charge.	

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 arrives, because they need the new paycheck 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.

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* (3rd ed. 2005) and NCLC's handbook, *Stop Predatory Lending: A Guide for Legal Advocates* (2002). For information on ordering NCLC publications, call (617) 542-9595 or find out more on NCLC's web site, www.consumerlaw.org.

Possible Legal Claims Include:

- **Truth in Lending violations.**¹ 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 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 and the District of Columbia 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.²
- **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 some states of the states, payday lenders must comply with state small loan and criminal usury laws. Since these caps are substantially below payday industry charges (the small loan limits are up to about 36%), lenders in these states often simply ignore the small loan law or try to disguise the loan.³ Some states 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. The federal **Racketeer Influenced and Corrupt Organizations Act (RICO)** RICO law, 18 U.S.C. §§1961-1968 as well as state RICO laws may also be considered as possible claims.⁴
- **State Unfair and Deceptive Acts and Practices (UDAP) claims.** Overreaching consumer credit transactions can often be challenged under state UDAP laws. For example, disguising a small loan as check cashing constitutes a UDAP violation.⁵
- **Fair Debt Collection Laws.** Illegal or deceptive debt collection threats, such as threats to arrest borrowers, may violate federal or state fair debt laws.⁶
- **Common Law Claims** including breach of fiduciary duty, fraud, or negligence should also be considered.
- **Licensing Violations.** Licensing laws and penalties exist in many states. The laws are discussed in NCLC's manual, *The Cost of Credit* (3rd ed. 2005).

Alternative Sources of Credit

Many seniors understand the high cost of payday loans, but may not know where else to turn. Creating affordable lending alternatives should be a top advocacy priority so that these consumers can say no to the payday lenders and still find reasonably priced loan products.

Consumer education is important, but unlikely to be effective when there are few (or no) alternatives available. For this reason, it is critical for advocates to learn more about affordable sources of credit in their communities and to help direct clients to these resources. 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, 215-923-5363, <http://www.cdfi.org> and the National Federation of Community Development Credit Unions, 212-809-1850, <http://www.natfed.org>.

For More Information

The National Consumer Law Center publishes a manual *The Cost of Credit* (3rd ed. 2005), as well as a handbook, *Stop Predatory Lending: A Guide for Legal Advocates* (2002). 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

Jean Ann Fox and Edmund Mierzwinski, "Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections", *Consumer Federation of America and U.S. PIRG* (November 2001). Available at www.consumerfed.org.

Elizabeth Renuart and Jean Ann Fox, "Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities", *34 Clearinghouse Review* 589 (Jan./Feb. 2001)

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). Available at www.consumerfed.org.

Marva Williams and Kathryn Smolik, "Affordable Alternatives to Payday Loans", *Woodstock Institute Reinvestment Alert No. 16* (March 2001). Available at www.woodstockinst.org.

Advocacy Organizations

AARP

601 E St., NW
Washington, D.C. 20049
1-800-424-3410
www.aarp.org

Consumer Federation of America

1424 16th St., NW
Suite 604
Washington, D.C. 20036
(202) 387-6121

Consumers Union

Washington D.C. Office:
1666 Connecticut Ave., NW
Suite 310

Washington, D.C. 20009
(202) 462-6262

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

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1 15 U.S.C. §§1601 et seq. See generally National Consumer Law Center, Truth in Lending (5th ed. 2003 and Supp.).

2 The list of states with payday loan laws continues to grow. To keep up to date, see NCLC's manual The Cost of Credit (3rd ed. 2005) and/or the payday loan section of NCLC's web site, www.consumerlaw.org.

3 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 National Consumer Law Center, The Cost of Credit (3rd ed. 2005).

4 See generally National Consumer Law Center, Unfair and Deceptive Acts and Practices §9.3 (6th ed. 2004 and Supp.); National Consumer Law Center: The Cost of Credit §12.6 (3rd ed. 2005).

5 See generally National Consumer Law Center, Unfair and Deceptive Acts and Practices (6th ed. 2004 and Supp.).

6 See generally National Consumer Law Center, Fair Debt Collection (5th ed. 2004).