The Existence, Perpetuity, And Proliferation Of Payday Loans: Impact On Vulnerable Populations And The Regulatory Policy Process In Texas

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THE EXISTENCE, PERPETUITY, AND PROLIFERATION OF PAYDAY LOANS: IMPACT ON VULNERABLE POPULATIONS AND THE REGULATORY POLICY PROCESS IN TEXAS

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Dedication

This thesis is dedicated to the little person that sacrificed the most from my hard work on it – my little Maya Cosette who has not only filled my life with immeasurable happiness but has also given me the strength to finish.

To you Cosette – know that you can do anything you want to do no matter how difficult it may seem at times. I love you and thank you for your understanding at your young age of four. 

_Te amo, mi Princesa._
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by

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THESIS

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Chapter 1: Introduction, Literature Review and Methodology

If you have ever driven by a street, typically not in a very wealthy neighborhood, where a store front displayed signs with words like “Instant cash!,” “No Credit Check,” “First loan free,” then you likely witnessed the marketing of a product called a payday loan. Payday loans are a form of a short-term loan product that is usually grouped with other loan products within the subprime lending industry, alternative financial resources, or fringe economy markets. This loan product has been the focus of a number of controversial debates among consumer protection groups, financial institutions, state regulatory entities, and legislators, regarding the payday lending industry’s practices.

Its documented interest rates in excess of 500% annual percentage rates (APR) as well as the known fact that the majority of payday loan borrowers are typically minorities and low-income individuals, has led to a synonymous use of payday lending with predatory lending (Karger 5). Predatory lending practices are illegal within the financial services industry, yet the legality of payday lending within the majority of the states where regulation exists for the industry remains. One may pause and ask what the real story may be, especially when it is learned that payday lenders often operate outside their respective state regulatory parameters.

To first illustrate the payday loan product and its use, I offer the following story of ‘Lisa’ which is based on actual scenarios and stories of consumers who have utilized payday loans; the associated financial data with this story is also based on average loan terms and interest rates.
1.1 Story of Lisa

Lisa is a single-mother of two in her mid 30’s. She makes about $30,000 a year and lives paycheck to paycheck. She drives a five year-old Honda, almost paid for, but in December, she realizes her tires are low, goes to the mechanic and finds out she needs new tires. She needs to pay $400 for new tires, has no savings, has two credit cards but they are both already maxed out. She can’t go to her bank and ask for a loan because they only give loans for homes, for cars, or loans that are at least $2500. Even if she wanted to get the $2,500 she would not be approved because she does not have good credit. Her checking account balance is low, as it is the end of the month, and she doesn’t get paid for another week and a half, but she needs her car to go to work, and to take her kids to school.

She has seen those signs before – “Need cash now?”, “No credit check!”, “Instant cash!”, “Loans up to $1000 in minutes!” The loan installations look informal, not like a bank, and they are nearby in her neighborhood. She needs the money now, so she proceeds to get a loan. Lisa fills out an application for $350, with her name, social security, driver’s license, phone number, date of birth, and home address. She is asked to provide a post-dated check, 2 weeks out, in the amount of the loan plus a $60 fee and $2.83 charged in interest.

Two weeks pass by, and as much as Lisa really thought that she would be able to figure out a way to pay back the loan amount, she now realizes that she was not able to save up enough to pay the loan amount. She does not want to default on her loan because the lender will just deposit her post-dated check into her account that will not be able to cover the amount of the check. If the lender deposits the check, she will now owe the bank a
nonsufficient fund fee in the amount of $25 in addition to the bounced check fee with the lender which will have her incur another $25, this all on top of what she owes for the loan.

She learns from the lender that she can renew, or roll-over her loan, giving her two more weeks to pay off the loan. All she needs to do is pay another loan fee and an additional interest rate fee. In weighing her options she determines that she would rather pay $62.83 (the new fee and interest fee) instead of defaulting on the loan.

Another two weeks pass, at which point Lisa was successful in saving enough to give a $150 payment, not the full $350, but she quickly learns that the lender does not accept ‘partial payments.’ She wishes she could at least bring down her balance to $200 but instead is offered to pay another fee and interest, that will not go towards her balance, but will at least buy her another two weeks to come up with the total loan amount. Of her saved $150, she now has a little less than $90 towards the next installment, and realizes she will have to work much harder to save money to pay down the loan. At this point, she renews her loan once again.

She continues in this pattern until she is finally able to save up the money to pay for the $350 she borrowed. After renewing the loan 5 times, she ends up paying a total of $703.47 ($353.47 in interest and fees) for an original loan of $350. The interest rate for this entire transaction is equal to 439% APR. If Lisa had continued on this pattern, like is common, had she renewed 19 times, she would have paid $1,520 for a $350 loan in a period of 38 weeks.

Lisa understands how difficult it was to pay that loan back and hopes to never have to get another loan like that, but as she stops to think about it, realizes that she really needed those tires and that she really had no other choice but to obtain that payday loan.
The story of ‘Lisa’ is not uncommon and is based on the fact that most consumers roll-over their loans at least five times because they are unable to pay their loans back as first agreed on (Skiba and Tobacman, Payday Loans, Uncertainty, and Discounting 6). With very few alternatives for similar loan products, consumers considered to be in lower-income brackets turn to nontraditional funding sources to meet their financial needs. The problem with this is that while this method of borrowing is accessible, it is also very expensive, costing the consumer more that what he or she initially borrowed.

1.2 BACKGROUND ON HIGH-COST LENDING AND IMPACT ON THE POOR

Access to financial products is almost a necessity in today’s world and in the United States. The financial services industry has been part of the U.S. way of life for the majority of its existence as a country. Consumer needs as well as the formality of the banking system have evolved over time to meet the needs of consumers who need financial services to purchase homes, finance their cars, and have open lines of credit for every day needs.

Access to capital and economic resources is also not equally available to all consumers. It has been a constant struggle to adequately demand a supply of financial resources to the more economically challenged populations in this country, and notably to populations of racial minorities (Retsinas and Belsky 4). For example, low to moderate income households do not have the type of incentives that higher income level households have from institutions to save and accumulate capital; financial institutions will not encourage savings plans when weighing the costs of serving those that may accumulate very little money in savings, that is, when they cannot profit as much from servicing these customers (Sherraden and Barr 302). This uneven access to economic resources has essentially led to a financial system that has a prime and a
subprime level of financing that has opened the doors to the exploitation of those vulnerable populations with little access to loan products.

The subprime lending industry has emerged to serve those that are less than credit worthy, where the cost of financing is more expensive as higher interest rates are charged to offset the loan defaulting risks posed by less than credit worthy customers. There is no clear distinction between what is a reasonable higher interest rate to adequately offset loan default risks and what is otherwise usurious; but the rise and profitability of the subprime lending sector of the financial industry has clearly opened the door for predatory lending (Squires 2). As Gregory Squires states “not all subprime lenders are predatory but virtually all predatory loans are subprime” (2).

The distribution of wealth is also a problem in this country. The amount of wealth attributed to the top 5% of the U.S. population continues to grow as the concentration of the poor has increased (Squires 5). Fifty percent of Americans live paycheck to paycheck making it difficult for families to save for emergencies let alone accumulate wealth (Karger 18). Additionally, a larger number of low-income households are considered underbanked, meaning they do not have access to the right set of loan products and often end up being served by the subprime lending market even when they might qualify for better priced loans (Belsky and Calder 24).

Payday loans fall within the subprime lending market and also considered an alternative financial resource. Though the payday lending industry claims it is a resource for one time emergencies, the truth is that borrowers end up trapped in a cycle of debt difficult to get out of. Payday loans are hurting families and it has now been documented that payday loans can
lead to bankruptcy (Skiba and Tobacman, Do payday loans lead to bankruptcy?). The government supplies low-income families with $125 million in public assistance programs yet over $78 million is gained by alternative financial service provides from precisely those low-income individuals in need of financial resources (Karger 6).

Given the lack of economic resources available to low-income and vulnerable populations, like reasonably priced loan products, consumer protection groups and community based organizations (CBOs) have led the charge to bring light to the lending practices of this industry. They publicly make the claim that payday loans are predatory and should be more strictly regulated if not banned.

Consumer protection groups, typically non-partisan and grassroots driven organizations, have been the leaders in calling the attention of consumers and regulators to unfair practices of lenders (Apgar and Fishbein 117). It was people and organized groups that also made action possible to try and eliminate discrimination and predatory lending practices in the more traditional and larger banking institutions during the civil rights era (Squires 13).

Though banks and financial institutions are both regulated at the state and federal levels, banks and financial institutions are expected to comply with noteworthy federal acts like the Community Reinvestment Act (CRA), Home Mortgage and Disclosure Act (HDMAs), and the Truth in Lending Act (TLA). These acts, enacted first in the 1970’s, have paved the way for the successful passage of federal legislation meant to address issues of disparity among racial and economic groups, and the elimination of discriminatory lending practices; ones that give consumers reason to believe that the financial industry is to be regulated in a manner that protects the consumer.
The HDMA helped in requiring banks to disclose home lending numbers with respect to geographic distributions, and was eventually amended to include reporting requirements on government monitoring information (race, national origin, and gender) of borrower (Apgar and Fishbein 117). The CRA helped by requiring that banking institutions seek to help meet the credit needs of the community they serve with the intent to better serve low to moderate-income populations (Robles 284). These acts have contributed to the evolution of credit markets and their ability or responsibility to serve diverse populations.

In spite of federal regulations in existence meant to protect consumers, consumer protection groups have now once again brought to light that practices by alternative financial lenders, namely payday lenders, do not operate in a responsible manner that would be considered in adherence to the intent of these acts. Today this awareness has been ongoing, but as CBOs faced challenges with the passage of mortgage related policy, they continue to face the challenges posed by the complexity of the financial services industry, in that it is not only important to ensure that underrepresented groups have access to financial products but that those that they have access to are provided with fairness and with reasonable rates and terms (Apgar and Fishbein 123-124).

An example of a CBO that effectively combated predatory lending is the Association of Community Organizations for Reform Now (ACORN), and from the organization participants’ experience, they attribute successful impact on regulation to their strategies entailing the building and engaging a base, building a case, and taking direct action through the utilization of the media. They also developed shareholders strategies that included legal action against
predatory lenders, impacting Wall Street, and putting pressure on legislators and regulatory agencies to take action (Hurd, Donner and Phillips 134-151).

While grassroots organizations play a critical role in motivating change within the financial services industry, the payday lending industry has yet to be successfully regulated. It continues to expand and profit from the most economically strained populations. Its practices are difficult to monitor given the industry’s ability to operate under the radar, given that it is one component of the financial industry system, and with fairly recent, yet expedient, evolution.

As researchers Belsky and Retsinas state, ‘regulation matters’ and if consumers will be adequately protected from exploitation or from potentially predatory practices of lenders, then regulation must be explored, understood, addressed and impacted to do so (6).

1.3 PURPOSE OF THIS STUDY

If the consumer is to be protected through the adequate provision of necessary financial products and services from the financial service industry, then the same should be expected of the payday lending industry as a subset of the financial services industry. The purpose of this descriptive and exploratory study is to mainly document the industry’s practice, the impact on consumer populations with regard to consumer behavior, the industry’s operations in relation to the existence and absence of regulation, and the state of Texas’s trajectory towards reforming or developing regulatory policies for the industry as a case study.

The goals of this study are to:

1. Document and understand how payday loans work and how lenders operate within states - Existence and Perpetuity
2. Analyze its practices in connection to existing (though not universal) predatory lending definitions - Impact on vulnerable populations

3. Analyze how the industry is regulated to understand its challenges and the legality of payday lending operating outside the parameters of state charters - Proliferation and the regulatory process

1.4 Significance of Study

The significance of this study is that it contributes to an emerging body of knowledge on the topic of payday lending. Because payday lending is just one aspect of the large scale financial services arena, it is typically grouped in research studies that study the fringe economy, alternative financial services, and subprime lending.

Payday lending specific research to date has been mostly descriptive with regard to its characteristics as well as to the identification of its consumer base. New research beyond the parameters of the study is just now beginning to document, evaluate and quantify the impact of the industry on consumers and legislation passed, but is still new and now included in this thesis.

The knowledge base gained so far, however, is incredibly important given that just ten years ago very little was known about the industry. With regard to regulation, more research in this area is necessary given that current research typically addresses regulation challenges either as a characteristic of the industry (with little background on how and why) or as solely a legislative problem. Last, research on specific legislation and the manner in which payday lending has evaded usury laws is already outdated given the ongoing operational changes of this rapidly growing industry.
Through this study I offer the following outcomes:

1. Empirical research on the distribution of traditional versus nontraditional lending sources in El Paso, Texas as well as the need and availability of loan products for people in the border community;

2. A first step in taking a state (Texas) and tracking its performance or experience with the regulatory challenges of the industry to open the door to further analyze potential explanatory theories;

3. A compilation of knowledge produced from years 2000 to 2010 that is applicable to payday lending specifically as an individualized area of the financial services arena that faces regulatory challenges;

4. An analysis of how different regulatory and policy-making bodies (federal legislation, federal and state administrative offices, and state and federal courts) simultaneously and collectively have contributed to the regulatory landscape challenges of the payday lending industry at a state level; and

5. A critical analysis of how the complexity of the financial services industry itself poses a regulatory challenge that should be studied apart from policy-explanatory theories

1.5 Methodology

The methodology I employ in this study is one of mixed methods using a combination of qualitative and quantitative methods. I conduct empirical research on alternative financial institution and loan products at a micro level, and I also conduct exploratory and descriptive research, and analyze the state of Texas as a case study for state-specific regulation.

My stated purpose is to document the practices and impact of the payday lending industry on vulnerable populations to determine whether consumer protection is being
addressed in relation to existing or nonexistent regulation. I utilize the historical precedent of action taken at state and federal levels to ensure that the financial services industry (state and nationally chartered banks), operate in a manner in which consumers are protected. From this precedent, I argue that the same should apply to the payday lending industry, and as I describe and analyze the industry practices and its impact on the populations of focus, I will make the determination, comparatively, of whether this is the case or not.

1.5.1 Case Selection and Data Collection

To analyze the existence, perpetuity, and proliferation of the payday lending industry, I use both national and state data. National data help to track the overall trend of the industry, while state data provide an example and baseline for state-specific numbers and regulations. When utilizing state data, I use Texas as a case study. I have selected Texas for a number of reasons:

1. **Relevance**: Texas was one of the first states to legalize and recognize payday lending within its finance code.

2. **Applicability**: Texas has attempted to regulate the payday lending but has been impacted by regulatory challenges in line with the evolutionary trend of the payday lending industry.

3. **Applicability to other states**: Texas is a state that falls within the middle category of states in a spectrum of regulation – on one end, those that do not regulate the industry and the other end those that ban the use and operations of payday lending.

4. **Data availability**: Texas produced a study to document payday lending practices in the early 2000s that serves as a baseline for tracking the evolution and growth of the payday lending industry within the state.
5. **Connectivity**: the origins of this study for me began in the City of El Paso in Texas that is a prime community for the operation of payday lenders.

The data used in this study are both quantitative and qualitative and are predominantly government documents and secondary data. Data in this study are comprised of:

A) industry reports, most in electronic format available via the world wide web, produced by:

1) Consumer protection groups and public policy think tanks like the Center for Responsible Lending, Center for Public Policy Priorities, Consumer Federation of America, and the National Conference of State Legislatures;

2) Both federal and state administrative and regulatory entities like the Texas Finance Commission and the Office of Consumer Credit Commission, Federal Deposit Insurance Corporation, and the Office of the Comptroller of Currency.

3) Participants within the private industry like PersonalMoneyStore.com

B) Book publications including research produced by academics in the fields of law, economics, sociology, and social policy

C) One U.S. congressional hearing

D) Texas state legislation search engine

E) Court decision texts

F) Phone and in-person interviews, focus groups, and business reference databases

1.6 **PARAMETERS AND LIMITATIONS**

1.6.1 **Legislation and Timeline**

Given the fact that payday lending is regulated and/or chartered at the state level, I only utilize the Texas example to illustrate how payday lenders are regulated at the state level. To
address the trajectory of the industry, I utilize data for the years 2000 through 2009 with the following emphasis:

- Texas administrative data from 2000-2003 for industry baseline
- Texas legislation analysis from 2000-2009
- Financial industry regulation and evolution leading up to 2005 and 2006

1.6.2 Definition of Predatory Lending

There is no legal definition of what would constitute ‘predatory lending,’ and not enough research has been conducted in the application of existing ‘predatory lending’ definitions to the payday lending industry specifically. In the absence of such validation, I utilized a generally accepted definition of the practice based on the problems commonly identified with the practices of the industry. This is not a universal definition but it does provide a base by which the practices can be analyzed in relation to the consumer base. This definition helps make a determination of how payday lending practices, based on researched and documented facts, can be adequately described as predatory lending behavior.

1.6.3 Uniformity of Data

In the absence of uniform national data for all payday lending operations, descriptive statistical data for payday loans are presented in this thesis as an accumulation of research conducted over the course of 10 years by different, but few researchers. Specific numbers in terms of average number of loans, average interest rates, average fees, and other similar information may slightly vary depending on the study that produced the findings, but still
produced comparable results. Note: the very nature of the industry and its regulatory challenges has made the availability of data a challenge as well.

1.6.4 Limit in Scope

Besides the geographic and timeline parameters of this study, I would like to acknowledge that there are a variety of factors that may impact the existence, perpetuity, and proliferation of the industry. This study does not attempt to explain the existence, perpetuity, and proliferation of the industry in relation to consumer education and financial literacy, nor on the impact of specific political actors like interest groups or elected officials. Some descriptive data are offered with regard to the population that is impacted, but that is not meant to suggest causal relationships.

1.7 UNDERSTANDING REGULATION AND POLICY-MAKING

Given the focus of this thesis on the regulatory process of the payday lending industry, it is important to provide an overview of what it is that is meant by regulation and the policy-making process that it takes to achieve regulation. This overview is not exhaustive, but does feature the main aspects of regulation and policy-making that I utilize in this study.

There are three branches of government in the U.S.: the Executive, the Legislative and the Judicial Branches. Though each branch has an ability to make policy, I mainly focus on the legislative branches at the federal level and the state level, specifically Texas. In the regulatory challenges faced with regard to the payday lending industry, I did find later in my study the policy-making ability of the judicial branch came to impact the legislative policy-making process.
The legislative branch has the ability to formulate laws to address issues of public good concerns. There are a variety of policies including substantive, procedural, distributive, symbolic, and regulatory policies. Regulatory policies are those that are meant to impose limitations, mandates or restraints on business, persons or groups, that inhibit their ability to act on their own as they see fit (Anderson 318). In this study, I analyze the laws and polices presumably meant to regulate the payday lending industry with respect to its practices affecting vulnerable populations.

The policy-making process is very complex made up of different actors and institutions all with different interests, values, and powers. There are generally five stages to the policy making process that include setting the policy agenda, developing policies, adopting those policies, implementing them, and then evaluating them (Anderson 4). Though this process appears simple, linear, and logical, there are many challenges within each of the stages, and even more so in moving from one stage to the next one.

What moves legislation through this process is attributed to many factors including the political actors involved. These actors are the actual elected officials in office expected to author, co-sponsor, and vote on the bills proposed. Other actors identified, implied, or participants of this process are lobbyists, interest groups, research organizations, and communications media, and individual citizens; I would also add to this administrative offices. The payday lending industry has a number of lobbyists whose job is to represent their client’s values and interests when legislation is proposed and formulated to that could impact them, such as regulatory legislation.
Interest groups and research organizations also participate in the different stages of the policy-making process from business and industry groups, to professional and labor, to governmental and public interest groups (Kingdon 47). Research ‘think tanks’ can also serve the process by producing important evidence and documentation of problems and can better inform legislators about potential alternatives and solutions (Anderson 62). Much of the information available on payday lenders was produced by such groups because they considered the issue and impact on vulnerable populations important enough to document what was happening.

For instance, and in the case of payday lending, examples of public interest groups and some research organizations are Consumer Federation of America, National Consumer Law Center, Center for Responsible Lending, and Neighborhood Works America, and ACORN at the National level and at the Center for Public Policy Priorities, Texas Industrial Areas Foundation, Texas Freedom Network and even faith-based organizations such as the Texas Faith for Fair Lending at the state level in Texas, all of which organized to speak out against payday lending.

Individual citizens as actors also have the ability to impact the policy-making process through citizenship. There are two models to describe this citizenship, one as the rights-bearing model and the community loyalists. The first of the two addresses citizenship in an individualistic fashion in which the individual has rights and has the responsibility to follow the law, but the second, and the one I want to highlight, is the one that takes into account the participation of individuals in organized groups, as public servants, and members of a team working together towards a collective good. Building coalitions to deal with societal problems is
a perfect example of this citizenship and participation in the policy-making process, though it is admittedly challenging and often difficult to powerfully impact the process.

The regulatory and legislative challenges for the payday lending industry, among other notable ones, consisted of the unsuccessful passing of legislation to correct identified challenges with regulating payday lenders. To explain the policy-making process, political scientists have developed approaches to studying and understanding the dynamics that take place in this process - Political Systems, Rational Choice, Institutionalism, Group, and Elite theory.

Political system theory explains that institutions, in this case the legislation, take demands and inputs from society to formulate legislation meant to address those inputs. Outputs are then produced in the form of legislation, and once the outcomes of the legislation are evaluated, new inputs are channeled back into the process (Anderson 18-20).

Rational choice theory explains that the actors within the political system will act in a ‘rational’ and self-interested manner. This theory was drawn from economists and from a model that claims that individuals will identify the problem, evaluate the alternatives, and choose the alternative that produces the best outcome given a cost-benefit analysis (Budd, Charlesworth, Paton 11).

Institutionalism refers to the focus of policy making in reference to the institutions involved in the process that further emphasizes that each institution has its own set of rules, practices and powers that influence the way policy is made. This theory also takes into account the complexity of institutions (be it the legislature, the courts, etc.) and how each relate to one another (Kraft and Furlong 68).
Group theory refers to the belief that policy is formed as a result of the constant struggle among groups of interest that battle it out for the adoption of policies that meet their interests. This theory assumes that policies are made in a pluralist fashion and not just as part of the decision-making ability, or rather power holding ability, of the elites (Kraft and Furlong 66-68).

Elite theory is a competing theory to group theory in that it explains that policy is influenced most by those with power and means rather than those powerless and underrepresented minorities. Those with access to policy makers (be it through campaign contributions or even personal connections) have a stronger ability to dictate the direction policy making goes (Genieys and Smyrl).

Each of these theories can help explain aspects of the policy-making process that has taken place throughout the study’s timeline. However, what I found as I documented the practices of the payday lending industry was that there were challenges with getting the issue of payday lending to be set in the policy agenda. As John Kingdon argues, in order to set policy issues on the agenda problems must be well defined, viable solutions must be developed, and political will must be present. On top of the three, a window of opportunity must present itself in order to push this further into the agenda as a priority (196-205). I would add to this that the push from advocacy networks and groups have the power to contribute (and have contributed) in defining the problem, but as we find in the end, more and better solutions are needed, and political will needs the most the most work. Each of these components contributed to the ultimate challenges with regulation, but I leave the recommendations and reflections for the end of the study.
Last, I would like to highlight the importance of administrative agencies in the policy implementation process. This payday lending industry study revealed the major role that administrative agencies play in the process. Administrative agencies at the state level were the actors that produced reports as mandated by legislation, but also the tool by which payday lenders were able to evade state usury laws. Administrative agencies at the federal level were also most impactful on the regulation of the financial services industry in a manner that passed regulation to payday lenders as subsidiaries, and this power, was more impactful when legislation was absent.
Chapter 2: Genesis of Research – Short-term lending a problem in El Paso, Texas

In 2002, I interned with the El Paso Collaborative for Community and Economic Development, an El Paso nonprofit that focuses on family asset development, and at that time, on housing. During my internship, I assisted with a study to determine what low-income families’ banking behavior was like. This study was important to establish the need to create alternative loan products for families trying to build a home, start a business, or pay for education. The El Paso Collaborative (shortened name) understood what researchers have established, that families, mainly in the colonias of El Paso, or unplanned land settlements, had nontraditional ways of saving their money, paying bills, and investing in their homes as assets (Belsky, Calder 21). This effort was consistent with alternative ways of assisting low income families with the development of Community Development Financial Institution (CDFI) loans and Individual Development Asset (IDA) loans (Robles 257).

In this chapter, I establish the significance of the study through analyzing the results of a series of interviews, focus groups, and data gathering from the varying industries within traditional and non-traditional banking institutions. The analysis will show (1) how short-term lending in low-income communities was prominent over traditional banking institutions, (2) the distinction among loan products pointing to the needs met by nontraditional lending sources versus traditional, (3) the basis for scrutinizing the short-term lending industry given product disclosure practices and documented high interest rates associated with short-term loans, and (4) how the groundwork was laid for the emergence of payday loans, corresponding studies of the industry, and activism by consumer protection groups that documented impact of payday lending on vulnerable communities.
The study was conducted in the County of El Paso located in the westernmost tip of Texas, located right across the border from Mexico. The City of El Paso is the heart of the county with various small incorporated cities and colonias connecting tightly to the outskirts of the city. The county’s population was close to 680,000 in 2002 (over 800,000 today) with a median household income of $31,051 compared to the U.S. median income of nearly $41,994 (these numbers are now estimated to be $35,249 and $51,425 respectively, according to the U.S. Census Bureau). El Paso is also predominantly Hispanic, with over 75% of the population comprising this demographic (2009 American Community Survey).

Having conducted the study in the community of El Paso, Texas, a community with high poverty rates and families within low-income brackets, and a community in the U.S.-Mexico borderlands, I believe this study illustrates a micro-level glimpse at the larger problems described and documented in this study (Coronado 293).

2.1 Setting the Stage for the Study

I assisted in conducting surveys and focus groups in the City of Socorro, in the unplanned settlements known as colonias: Agua Dulce, Montana Vista, and San Elizario. What I learned through this study was that many families did not have established credit, had very low credit scores, and/or conducted their daily financial activities in ways that mathematically were more costly for long-term financial stability and health. An example of this is that many families did not have checking accounts, and thus no checks, so they would constantly pay fees to purchase money orders. They also paid for bills in person as opposed to mailing in their payment, which also meant accruing a service fee cost at the paying outlets plus time and gasoline. These residents did not have established ‘relationships’ with banks, so when the need
for a loan would arise, they turned to ‘nontraditional’ outlets for these small loans. These outlets were typically small financing establishments like pawnshops, signature loan companies, and payday lending agencies or ‘financieras’ informal Spanish term for financial entities (Nuñez 154).

As part of this study, and consistent research showing disparities with regard to accessibility to loan products for minorities, it became evident that understanding what the real options in terms of financing were available for low-income families (Taylor, Silver and Berenbaum, 35). The need for comparing services, products, and accessibility became part of the study. The questions were laid out: (1) how many financing establishments existed in the county and of what kind; (2) in what areas of the city were financing establishments located and how were they distributed by type of establishment; and (3) what products did each financing establishment provide and what were their characteristics and requirements for accessing those loans.

2.2 THE PRELIMINARY STUDY - METHODOLOGY

To learn more about financial institutions and other lending agencies, I was directed to create a database of those that existed in the El Paso County in Texas. To do this, I learned to search for any kind of business by the categories set through the Standard Industrial Classification System or SIC Codes. Businesses, agencies, and organizations can be classified by this system based on their line of business and primary service. I selected SIC Codes that were under Financial Services associated with loans. The following is a table of the SIC Codes used.

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1 This coding system has now been replaced by the North American Industry Classification System or NAICS.
The SIC Codes were utilized as the search criteria in a search engine or database called Reference U.S.A. By searching by SIC codes, I was able to gather profile information for each business under each SIC Code that was located in El Paso. I then created my own database of the identified businesses that included the business name, address, zip code, phone number, and estimated yearly sales for companies for which this data was available. In my database I classified each business as being ‘traditional’ or ‘nontraditional’ as shown in Table 2.1. Commercial and Credit Unions were listed under traditional and the rest as nontraditional. It is important to note that the use of the term ‘nontraditional’ derived from the fact that it was the official term used in this classification system for agencies which primary service was check cashing, money orders, and other forms of personal credit financing like signature loans.

After looking closely at the database that essentially contained 426 businesses, or records, I along with the El Paso Collaborative, decided to exclude the businesses that fell under the 6141 SIC Code that solely offered mortgage loans. Since the primary purpose of the study

<table>
<thead>
<tr>
<th>Code*</th>
<th>Line of Business*</th>
<th>Services (can have more than one)*</th>
<th>Type of service**</th>
</tr>
</thead>
<tbody>
<tr>
<td>5932</td>
<td>Pawnshops/Personal Credit</td>
<td>Pawnbroker, loans</td>
<td>Nontraditional</td>
</tr>
<tr>
<td>6021</td>
<td>National Bank</td>
<td>Traditional banking services</td>
<td>Traditional</td>
</tr>
<tr>
<td>6061</td>
<td>Federal Credit Union</td>
<td>Traditional Credit Union services</td>
<td>Traditional</td>
</tr>
<tr>
<td>6099</td>
<td>Nontraditional</td>
<td>Check cashing, loans, money orders, financing, bill paying</td>
<td>Nontraditional</td>
</tr>
<tr>
<td>6141</td>
<td>Personal Credit</td>
<td>Financing, mortgage loans</td>
<td>Nontraditional</td>
</tr>
</tbody>
</table>

* As stated in classification system / **As categorized in study
was to assess the need for alternative financial products, the products we really wanted to learn about were small loans to be utilized for other things that did not include real estate mortgages.

Once the database was set up, I began to conduct telephone and in-person interviews to learn about the products offered by the banks and credit unions, as well as the nontraditional lending agencies. I was given a list of things to inquire about such as loan product size, terms, and use of credit scores for determining a customer’s ability to access the loan. I created an entry form in a Microsoft Access Database to capture my telephone interviews and a similar instrument for in-person interviews. I first began with telephone interviews with banks, but as I noticed that a certain distrust or apprehension to provide me with information over the phone, I began to conduct interviews in person. I met only with the banks that would give me an interview. As to the short-term lending agencies, I also inquired about loan products, terms, payments and interest rates over the phone. I tried to call as many agencies as possible and included only those responses that I was successful in obtaining over the phone.

In the end, over a period of about a month, I interviewed a total of 5 different commercial banks, 6 different credit unions, and 17 different signature loan companies. Each bank, credit union, and signature-loan company represented multiple establishments in the El Paso area; the 17 signature loan companies that I was able to get information from represented a total of 125 actual establishments.
2.3 Preliminary Findings

2.3.1 Numbers and Distributions

After dividing up the 426 businesses of financial institutions by whether they were considered traditional or nontraditional (as determined by the SIC system), I found that 256 were nontraditional financing establishments and 88 were traditional ones. I then further divided each of the two categories by whether they were a commercial bank, credit union, pawnshop, or personal credit or check cashing agencies to make up the four categories by which the data was classified. The chart below shows the percentage distribution by category of the total financial entities, again excluding primary mortgage lenders.

![Figure 2.1 Percentage Distribution of Financing Institutions](image)

Source: El Paso County, 2002

To illustrate the numeric distribution of establishments in the different areas of the county, I quantified the number of establishments within each category and per area of town.
The area of town was determined by zip codes. The following table shows the distribution and percentage make up of each type of establishment per area of town (For a listing of the zip codes under each area of town see Table A in the Appendix Section).

<table>
<thead>
<tr>
<th>Geographic Area</th>
<th>Pawnshops</th>
<th>Personal Credit/check cashing</th>
<th>Commercial Banks</th>
<th>Credit Unions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Far West (79821, 79835)</strong></td>
<td>1</td>
<td>3%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td><strong>West (79912, 79922, 79932)</strong></td>
<td>1</td>
<td>3%</td>
<td>19</td>
<td>8%</td>
</tr>
<tr>
<td><strong>Northeast (79904, 79924, 79934)</strong></td>
<td>5</td>
<td>16%</td>
<td>6</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Fort Bliss (79906, 79908, 79916, 79918)</strong></td>
<td>0</td>
<td>0%</td>
<td>1</td>
<td>2%</td>
</tr>
<tr>
<td><strong>Central/downtown (79901, 79902, 79903, 79905, 79930)</strong></td>
<td>11</td>
<td>35%</td>
<td>97</td>
<td>43%</td>
</tr>
<tr>
<td><strong>Lower Valley (79907, 79915)</strong></td>
<td>7</td>
<td>23%</td>
<td>4</td>
<td>7%</td>
</tr>
<tr>
<td><strong>East (79925, 79935, 79936)</strong></td>
<td>5</td>
<td>16%</td>
<td>19</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Far East (79836, 79838, 79849, 79927, 79938)</strong></td>
<td>1</td>
<td>3%</td>
<td>4</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>31</td>
<td>100%</td>
<td>225</td>
<td>100%</td>
</tr>
</tbody>
</table>

After looking at the distribution of these establishments, the highest concentration of nontraditional establishments appeared to be in the Downtown Area, in zip codes 79901 and 79902. At the same time however, 30% or 21 of the traditional establishments were also located in this area. The Lower Valley (southeastern side of the county) had the greatest difference in traditional versus nontraditional establishments with 41 or 16% of all
nontraditional establishments and only 8 or 9% of the traditional establishments of which 4 were credit unions.

2.3.2 Products

After conducting interviews over the phone and in-person, I learned that banks and credit unions had very similar products. They also relied either entirely or predominantly on credit score ratings for the provision of loans, though one of the banks claimed to take collateral as an alternative to the credit score. They also typically required, on the low end, 6 months of job stability and on the high end, 3 years. They all required at least a year’s worth of established credit with utility payments counting as a way to establish some of this credit. As to loan sizes, personal loans were typically not smaller than $2,500 for the minimum, and home equity loans were all set at a minimum of $10,000. Interest rates for personal loans ranged from 7.25% to 18% depending on credit scores, and home equity loans were on average 10%.

Signature loans on the other end ranged from $50 dollars to $100 as the minimum amount and from $100 to $500 as the maximum loan size. Interest rates for the smaller loans ranged from 103% to 201%, and from 59% to 109% for the bigger loans. Most companies did not require a credit check to obtain these loans and were all based on the applicant’s ‘signature’ for the loan, meaning there was no need for collateral. I should add that when I called and asked for this information, I was given the loan terms but not the corresponding interest rate. I was given the loan amount, the term or number of payments, and the payment amount. With this information, I was able to compute and calculate the interest rate in annual interest rate format to accurately compare products and gather means and medians for this set of data. Since I called a number of signature loans, I confirmed that it was common practice not
to disclose the APR even when I specifically asked for the interest rate; the common response was that they could not provide me with that information, only the loan terms.

2.4 Preliminary Use of Data

After gathering this information, with the El Paso Collaborative, I prepared a statement to present in the form of public testimony for the May of 2002 Texas Senate Business and Commerce Committee, Subcommittee on Interim Charge #4 Lending Practices and Access to Capital held in El Paso, Texas between legislative sessions.² Via this public testimony, we explained that there was some evidence that there were higher concentrations of the nontraditional financing establishments in the lower-income areas than in more affluent zip codes. We pointed to the geographic distribution of alternative non-traditional financial resources as an indicator of predatory lending, and as the source of for banking needs for low-income workers.

Last, we also included testimony related to learning that we gained through a relevant yet different data gathering effort, one through which we conducted surveys and focus groups in colonias to help determine people’s understanding of financial loan terms, desired rates, and need for loan products. In the testimony, we explained that families were in need of some form of financing to continue or complete their education, to finish building their homes, or start their own businesses.

Though I gave the testimony orally, I also submitted it in writing. I add as an observation that no questions were asked but I was pleased that our testimony was consistent with similar issues presented to the committee by the then Mayor of El Paso, Ray Caballero.

²The testimony and hearing agenda are included in the Appendix section.
2.5 The Next Steps

Since then, I developed an interest for the subject matter. I was astonished that the signature loan companies were charging an incredible amount of interest on such small loans. I was also particularly intrigued by the way I was denied specific loan information when I called saying I was a student, yet when I called as a potential consumer, I was still not given interest information, but was supplied the loan terms.

I was also impacted by the families I was able to meet through the surveying and focus group process. I remember one woman in particular in the San Elizario Colonia who was truly distraught. She had been invited to participate in the focus group session by a local community organization, and somewhere in the communication, she misunderstood that the meeting was about getting access to a loan. She soon realized that we were only having a conversation and asking them questions, as opposed to giving them the information about how to access the loan. She then blurted out how upset she was and walked out of the room.

I went after her bewildered as to why she was so upset and soon enough I learned that her world turned upside down the moment she realized that she had given up an afternoon of work and wages to sit in a room to be asked questions. I saw her anguish and her clear panic, and while at that moment I did not fully understand, I now know that she was in dire need for a loan. She needed one so much that she gave up a day’s worth of income that obviously negatively affected her.

Since 2002, when I participated in the study, I have kept up with some of the media coverage that has been devoted to payday loans. Throughout the years, signature loans have dissipated, and payday loans have emerged. Consistent with the trend, locally, in El Paso where
I began the study, I started noticing the previous establishments that offered signature loans, began to switch their storefront advertisements to appear to be offering payday loans instead of the previous signature loans; the amounts of the loans also apparently increased from $500 to well over $1000.

Because of my experience with the subject and because these nontraditional lending agencies continue to evolve and prosper, I decided to dedicate my thesis work to further understand the dynamics within the small lending industry, namely payday loans. In an effort to remain objective, I decided that I needed to accurately understand and describe the industry to track its trends, its practices, perhaps also understand the reason for which some establishments would not offer interest rate information over the phone. To understand how they truly operate and what these entities are supposed to function like, I went straight to the source of how they are regulated. The following chapter describes the industry as I learned about it, including accurate descriptions and distinctions between loan products I first learned about through this study (signature loans, pawnshop loans, payday loans). I mainly gathered information from the Texas Finance Commission website and resources available within it in conjunction with studies that emerged in the early 2000s that were already documenting and following the payday lending industry.
Chapter 3 – Administrative Regulation of Small Loans in Texas

The payday lending industry in the United States is prosperous. It is estimated that in 2006, profits ranged around $42 billion with over 15 million customers (Samolyk 176). It is also estimated that there are over 24,000 payday lending agencies in the U.S. which compared to McDonalds and Starbucks, amount to the combined number of the two franchises in the United States. Their geographic accessibility is real as is their growth in numbers. According to the Center for Responsible Lending, a nonpartisan nonprofit agency focused on ‘protecting homeownership and family wealth’, the payday lending industry quadrupled in size over the course of three years based on their sales volume which increased from $10 billion in 2000 to the $40 billion mark in 2003.

In this chapter, I first define what payday loans are and how they may be obtained by a consumer. Since payday loans have been in existence, mostly since the early 2000, I describe some of the basic knowledge gained in recent years about the industry and the loan terms. I also describe where payday lending fits within the finance code in Texas to provide an understanding of how the industry is regulated at the state level (payday loans are regulated by states and not a federal entities). I also illustrate how payday loans, along with its close family of products like signature loans, have grown in numbers and how they operate legally within the state.

Though the major focus of this study is on payday loans, explaining similar products gives relative points of comparison when looking at industry growth, interest rates, and loan terms. Also, much of the existing research about the payday lending industry is very much
associated with subprime lending, alternative financial resources, and the fringe economy, all of which are further defined in this and later chapters.

Last, I make use the term ‘legally’ to begin to illustrate the way the industry operates according to state regulations, out-of-state regulations, as will be noted within this chapter, and yet in a manner considered legal by finance code definitions. In later chapters, I will refer back to practices and information within this chapter to illustrate how the legality of such products may be questioned when analyzed through different definitions, namely predatory lending definitions. The following can be considered the known facts of the industry within the state of Texas as they were documented in 2003.

3.1 What are Payday Loans?

Payday loans are deferred presentment transactions, or postdated checks, for a determined loan amount. The date of the postdated check is meant to be that of the consumer’s next pay day. The check is made out in the amount of the loan plus whatever applicable fee accompanies the loan. This fee is often referred to as the interest rate, and when calculated as an Annual Percentage Rate, the rate may turn out to be well over the thousand percentage points.

Payday loans are quick and accessible. To acquire a payday loan, one only typically needs to show a form of personal identification, proof of employment, and a valid checking account. Usually to attain the loan, a credit check is not required and the cash may be handed to the customer on the spot. Payday loans are meant, as indicated by industry proponents, for emergency situations when cash is not available between pay checks. What ends up happening

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3 APR stands for Annual Percentage Rate and is further defined in the ‘Loan Terminology’ portion of this chapter.
many times, however, is an unintended, from the consumer’s perspective, dependency on such loans and repetitive transactions in this type of lending.

According to the previously cited Center for Responsible Lending (CRL), 90% of payday loan users or consumers are repeat users, that is, they rarely stop at one loan for their immediate emergency. They instead make the use of payday loans either a necessity or a difficult debt from which to escape. In a study produced by the CRL in 2006, it was reported that consumers on average pay back $793 for a $325 loan. For example, if an individual is unable to pay back the first loan in part or in its entirety as intended on the ‘pay day’, the customer may choose to reactivate the loan, or to roll it over into a new loan. The new loan is treated as such and is assessed a new loan fee. The customer at this point may have paid two loan fees, but not paid down the balance. If this pattern repeats itself, the borrower may continue to pay fees but not make enough payments to reduce the initial loan amount.

Customers are motivated to renew the loan because the alternative consequence for not paying the loan back on time may be more costly. If the loan is not paid in full by the pay date, then the lender may deposit the check left with the lender to secure the loan. If the customer does not have the funds in the bank to pay for the check, this person may be assessed ‘insufficient fund fees’ by the banks in addition to a ‘returned check’ fee assessed by the lender. These two fees are more expensive than the new fee acquired to renew the loan, or to roll it over into a new one.

Payday loans are part of a family of products within the subprime lending industry that provide cash alternatives in unconventional banking practices. These loan products are expensive in the long run, yet millions of consumers continue to utilize these and similar
products. Payday loans are within this family of subprime loans that possess similar characteristics like high interest rates.

3.2 Subprime Lending Industry

Subprime refers to the term used for less than prime loan products available to consumers that do not meet high standards of credit worthiness. Creditworthiness refers to the borrower’s ability to repay a loan. Most companies use a form of credit score card that takes into account the consumer’s financial health which may entail their assets, borrowing and employment history. Also, many consumers carry a form of credit rating from nationally known and utilized companies like Equifax and TransUnion. If a consumer has a low credit score, or scores below the desired level for a particular lender, the consumer may be considered to be a high-risk borrower and may be either be denied for a prime loan (usually with market rate interest rates) and thus may need to turn to a subprime lender that will offer a similar loan product but with a much higher interest rate.

Most of the loan products that are available within the prime lending industry are also available within subprime lending; however, additional small loans are available within the subprime lending industry to meet the needs of the consumer group that typically does not have access to traditional loans or that may choose to not bank in traditional forms (further covered in Chapter 4). Although products within the subprime lending industry are more expensive, as this form of lending is often referred to as ‘high-cost lending’, there is a definite demand for these products as lending within this industry continues to grow. In a Housing and Urban Development (HUD) report, the subprime lending industry increased from $20 billion in subprime loans to $150 billion from 1993 to 1998, which is over 700% growth in five years.
Prior to 2004, in the United States, 10,000 payday loan companies produced between $8 billion and $14 billion dollars in loans within a year’s time, and pawnshop agencies increased from 5,000 outlets to close to 14,000 within a little over 15 years (Temkin and Sawyer 5-6). What this indicates is the great need for consumer credit that is not available through the prime market and thus is produced through subprime financial services.

The subprime lending industry serves a wide population in the real-estate and non-real estate markets; mortgage, home equity, and land acquisition loans fall within the real-estate category, while other shorter-term loans like consumer installment loans fall within the non-real estate category. Payday loans fall within the non-real estate category which is also categorized as loan products that are shorter in terms as are Signature loans and pawnshop loans.

3.3 NON-REAL ESTATE, SHORT-TERM LENDING IN TEXAS

Most usury laws are determined and regulated at the state level. Usury refers to the “act of lending money at an unreasonably high interest rate.” Since usury laws are set at the state level, these rates differ widely from state to state along with loan products and services. As indicated in Usurylaw.com, the term usury has emerged more so in legislative conversations in recent years given the rise of the subprime lending industry and specifically payday loans.

In the State of Texas, the policy making body for the depository and lending institutions is the Texas Finance Commission which oversees the Department of Savings and Mortgage Lending, the Texas Department of Banking, and the Office of the Consumer Credit Commissioner (OCCC). Payday lending is overseen by the latter.
The mission of the OCCC is “to regulate the credit industry and educate consumers and creditors, thereby producing a fair, lawful, and healthy credit environment for social and economic prosperity in Texas.” The OCCC regulates home equity loans, secondary mortgages, home improvement loans, motor vehicle sales financing, pawnshop transactions, signature loans, payday loans, consumer installment loans, and retail credit accounts.

In 2005, Texas Legislative Council produced an exploratory report of the non-real estate consumer lending agencies regulated by its office as a result of two legislative actions that called for a study of the high-cost lending industry within Texas, SB 272, 77th Regular Session and House Bill 1, 78th Regular Legislative Session. This report focused primarily on consumer installment, signature, payday (with both exported and state rates), and pawnshop lenders, or as referenced by the report as OCCC-licensed lenders, OLLs.

To better understand payday lending as an industry and the market that it shares within the overall lending industry, it is important to differentiate it from other loan products to have different points of reference when it comes to interest rates, lending practices, populations served, and overall industry growth. The following was obtained from this report:

- **Consumer installment loans** are medium-sized consumer loans typically used for the purchase of a car, furniture, or for home refurbishing, and/or education purposes. Amounts vary but are typically greater than $500 (average loan size is $5,352). Payment installments for these loans may range from 1 to 5 years, and are typically secured with collateral. Annual percentage rates (APRs) may range from 18% to 32% in Texas.
• **Signature loans** are loan products ranging from $50 to $1080 with payment installments of 2 to 12 months. They are typically unsecured and may range in APRs of 72% to 240% with state rates but may have a higher APR rates if an out-of-state rates are used.\(^4\)

• **Payday loans** range from $1 to $500 if following state limitations, or from $1 to whatever the exported state permitted amount is (this to be further discussed later in the chapter). They are typically secured with a post-dated check, in addition to the interest rate and fees, to be paid back in one installment after two or three weeks from the time the loan was made. The annual percentage rate for this kind of loan may range from 153% to 570% if state rates are used, and up to a recorded 1000% APR with out-of-state rates.

• **Pawnshop loans** may range in amounts but may not exceed $12,500. These loans are secured with personal property and interest rates may range between 12% to 240% and the repayment terms are usually a month.

Due to the use of a number of finance terms, I offer the following definitions to understand the characteristics and differences of each loan.

### 3.4 Loan Terminology

The Annual Percentage Rate, or APR, is a standard calculation used to express the true cost of a loan. This standard is utilized to compare loan products that would otherwise be

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\(^4\) In state and out of state rates were recognized in the state of Texas as documented in the OCCC report. The manner in which this was and is possible is further illustrated in the description of the business models used to operate in section 3.7 and 3.8.
difficult to do so because of the different terms of each loan. The APR usually includes all fees associated with borrowing that loan and is calculated based on the loan amount sometimes referred to as the principal. The loan term refers to the number of payments (or installments) that it will take to pay off the loan, which is the principal plus associated fees and APR. The payment amount is usually determined by the total loan amount divided by the loan term.

A loan is either secured or unsecured depending on whether the consumer, or borrower, secured the loan with some form of collateral or asset that the lender may take or gain in the event that the borrower defaults on the loan. Securing a loan oftentimes offsets some of the risk the lender takes on by lending to a less-than-credit-worthy individual when loans are not secured, that is when lenders justify their high interest rates to offset the lending risks associated with this form of transaction. A common type of collateral for non-real estate loans is the title of a car or an asset worth a similar amount to the loan.

Out-of-state rates versus in-state rates refers to whether lending agencies apply the interest rate to the loans as permitted by the state or whether they use state rates that are associated with other states. The use of out-of-state rates will be further described later in this chapter.

### 3.5 Numbers and Growth of OCCC-Licensed Lenders in Texas

According to the numbers produced by the Texas Legislative Council report cited earlier, the short-term lending industry grew significantly within 15 years. In 1987, before the introduction of payday loans, and before pawnshops were required by law to report on loan products, signature loans accounted for 4 million of the subprime, short-term loans in Texas. In 2000, once payday loans were recognized and legalized in Texas, and pawnshop lenders were
required to report on loan product numbers, pawnshop, payday and signature loan companies produced over 13 million loans to Texas residents – a growth of 9 million within 13 years. By 2003, this number increased to 15.35 million. The total dollar equivalent of these 15.35 million loans was $4.8 billion.5

Payday loans increased more rapidly between 2000 (first year reported) and 2003, than consumer installment loans, signature loans, and pawnshop loans (See table 3.1). Within this period of time, signature loans and pawnshop loans, with regard to total amount loaned, had a net increase of 9% and 7% respectively while payday loans increased by 381% (with state rates) and by 443% (with exported/out of state rates). In 2000, out of the total amount financed via all OLLs, payday loans with exported rates only made up 3%, or $112.6 million.6 By 2003, this number grew to $611.76 million making up 12.6% of the total loan amounts (Texas Legislative Council 15). This number is significant considering that the total amount financed through OLLs ($4.8 billion referenced earlier) includes consumer installment loans which averaged over $5,000 per loan and made up 41.8% of the total, whereas payday loans with exported rates averaged $338, which is 6% of the consumer installment amount. Another way to look at it is that a loan product (payday loan) with 1/15 the size of the other, cumulatively lends over 1/3 the amount of the other (consumer installment).

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5 This number includes consumer installment loans which make up 1% of the total loans produced per year.  
6 Calculated from figures provided by the Office of Consumer Credit Commission report of 2005
Table 3.1: Loan Amount Totals in U.S. Dollars (Millions) and Percentage Increase/Decrease between 2000 and 2003 by Loan Product

<table>
<thead>
<tr>
<th>Type</th>
<th>Consumer Installment</th>
<th>%</th>
<th>Signature Loans</th>
<th>%</th>
<th>Payday Exported</th>
<th>%</th>
<th>Payday State Rate</th>
<th>%</th>
<th>Pawnshop</th>
<th>%</th>
<th>Total (overall)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$1,791.370</td>
<td></td>
<td>$1,396.431</td>
<td></td>
<td>$112,639</td>
<td></td>
<td>$2.934</td>
<td></td>
<td>$625.215</td>
<td></td>
<td>3,928.591</td>
</tr>
<tr>
<td>2001</td>
<td>$1,530.193</td>
<td>(14.58)</td>
<td>$1,432.783</td>
<td>2.60</td>
<td>$127.477</td>
<td>13.17</td>
<td>$8.246</td>
<td>181.01</td>
<td>$763.679</td>
<td>22.15</td>
<td>3,862.380</td>
</tr>
<tr>
<td>2002</td>
<td>$1,913.097</td>
<td>25.02</td>
<td>$1,492.612</td>
<td>4.18</td>
<td>$391.779</td>
<td>207.33</td>
<td>$12.567</td>
<td>52.39</td>
<td>$793.978</td>
<td>3.97</td>
<td>4,604.034</td>
</tr>
<tr>
<td>2003</td>
<td>$2,023.506</td>
<td>5.77</td>
<td>$1,524.234</td>
<td>2.12</td>
<td>$611.761</td>
<td>56.15</td>
<td>$14.119</td>
<td>12.34</td>
<td>$668.784</td>
<td>(15.77)</td>
<td>4,842.406</td>
</tr>
<tr>
<td>Net % Increase</td>
<td>12.96</td>
<td></td>
<td>9.15</td>
<td></td>
<td>443.12</td>
<td></td>
<td>381.11</td>
<td></td>
<td>6.97</td>
<td></td>
<td>23.26</td>
</tr>
</tbody>
</table>

Source: Texas Legislative Council report, 15.7

Similar to the growth in loan amounts financed, the number of loans financed also increased among OLLs between 2000 and 2003 (See Table 3.2). Signature loans had a net increase of 1.5% (remaining above 4 million loans), and pawnshop loans had a net increase of 4.2% (nearing 9 million loans). Payday loans with state rates increased by 611%, going from a little over 13,000 loans to nearing 100,000 loans, but more significantly, payday loans with exported rates went from almost 354,000 loans in their introductory year to nearing 2 million loans within 2 years.

7 Loan amount totals provided by Texas Legislative Council report. Rates of increase and decrease or overall net increases were not supplied by the report; however, I was able to make calculations based on total amounts supplied.
Table 3.2: Number of Loans and Percentage Increase/Decrease between 2000 and 2003 by Loan Product

<table>
<thead>
<tr>
<th>Type</th>
<th>Consumer Installment %</th>
<th>Signature Loans %</th>
<th>Payday Exported %</th>
<th>Payday State Rate %</th>
<th>Pawnshop %</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>366,564 27.88</td>
<td>4,223,122 (1.28)</td>
<td>1,125,807</td>
<td>80,122</td>
<td>156.71</td>
<td>8,689,385</td>
</tr>
<tr>
<td>2003</td>
<td>387,579 5.73</td>
<td>4,160,306 (1.49)</td>
<td>1,810,789</td>
<td>96,687</td>
<td>20.67</td>
<td>8,889,734</td>
</tr>
</tbody>
</table>

Net % Increase

| Type               | (0.33) | (1.54) | 411.66 | 633.70 | 4.22 | 13.58 |

Source: Texas Legislative Council report, 35. 8

Based on this report, which was the first of its kind ever produced in Texas, there is enough evidence that the payday lending industry, as prosperous as it is nationwide, also had a rapid growth in Texas from its inception to the year 2003 (year up to which findings were produced for the report to be released in 2005). This report, though it revealed similar growth rates for payday loans with instate as well as those utilizing exported rates, also noted that only 2% of all payday-licensed entities used the state mandated APR rates (153% to 570%).

The Texas Legislative Council report produced other findings with respect to populations served and geographic location of the OLLS in reference to more traditional financial institutions, topics which will be further covered and analyzed in Chapter 4. However, for

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8 Loan number totals provided by Texas Legislative Council report. Rates of increase and decrease or overall net increases were not supplied by the report; however, I was able to make calculations based on total amounts supplied.
further understanding of the payday lending industry within Texas, the following section provides a summary of how payday loans are regulated, how they are licensed and how they may operate within Texas.

3.6 History of Payday Loans in Texas

Before payday loans were recognized in Texas, they were first recognized in the mid 1990’s in California. Currently, payday loans are legal and regulated in just about all states and in six states, Georgia, Oregon, Pennsylvania, Maryland, Massachusetts, and West Virginia, legislation is so restrictive that they are banned de facto (Payday Loan Industry Report 2010). In Texas, payday loans were made legal in the year 2000 and are recognized under the Texas Finance Code Subchapter F, Chapter 342. Under Texas law, each payday lending company is to apply for a state license for each establishment that handles loans.

To attain a payday lending license, the company must apply for it under the OCCC that regulates it. As mentioned earlier, the OCCC is overseen by the Texas Finance Commission which is essentially a board of private citizens appointed by the Texas Governor and approved by the state Senate. The board is made up of 9 members representing various yet specific areas (as of 2001) within the banking and lending industry – one must be a state banker, one a state savings and loan executive, one mortgage broker, and five public members one of whom must be a CPA (certified public accountant).

There are two types of legal payday loans that are recognized under the Texas Finance Code, the state-rate and out-of-state rate. The difference between the two is essentially what the labels imply; some payday lenders use the state-mandated rates and others have the option of using out of state rates.
3.7 Bank Model

The ‘bank-model,’ also referred to as the rent-a-bank model or rent-a-bank charter model, was introduced in Texas in 2000 and was a prominent way of operating up until 2005 and 2006. This model, under which many payday lending agencies operated, is one in which lending agencies claimed to serve as intermediaries between out-of-state banks and the consumer, or borrower. The payday lending agency facilitated the loan process for the bank, and because the bank would reside outside the state, usury laws and regulations would thus pertain to the loan product administered by the bank. This model of operating was referred to as renting a bank’s charter because once the loan was processed, the loan would be sold back to the payday lending agency to collect on the note. Even if the payday lender was licensed in the state of Texas under the OCCC, it was not required to utilize state rates and regulations because it would claim federal preemption.

When payday lending agencies partnered with out-of-state banks, the banks they partnered with were those from states where there are either higher interest rate caps or no usury caps at all. One of the most notorious states that does not have usury caps is the state of South Dakota. Several banks in South Dakota rented their charter in Texas such as the Community State Bank which partners with Cash America, Longhorn Pawn&Gun, Inc. and Mr. Payroll Corp, and the Bryant State Bank which partnered with The Cash Store (Unsafe and Unsound 14).
The Texas Legislative Council report also concluded that there is reason to believe that there are payday lenders that are operating in Texas that do not hold an OCCC license to do so. Even though the Texas Legislative Council attempted to collect data from 187 potential agencies of this kind, the response rate for the study was too minimal to include in the report (Texas Legislative Council, viii). Though the report does not state this, it is also widely known that payday lenders, across various states including Texas, have chosen to operate under a different model called the Credit Service Organization (CSO) Model. In fact, this was the model of choice as after the Bank Model was no longer the model of choice in 2005 and 2006 (see Chapter 5). According to the Texas Secretary of State, credit service organizations are governed by Chapter 393 of the Finance Code which states that a CSO is:

“A person who provides, or represents that the person can or will provide, for the payment of valuable consideration any of the following services with respect to the extension of consumer credit by others:

A. improving a consumer's credit history or rating;
B. obtaining an extension of consumer credit for a consumer; or
C. providing advice or assistance to a consumer with regard to Paragraph (A) or (B).

Tex. Fin. Code § 393.001(3)”

In other words, agencies may register as CSOs as long as they provide services to improve consumers’ credit history or rating, provide an extension of credit for a consumer, or provide assistance or advice for improving credit history or rating and for the extension of consumer credit (Unregistered and Unregulated 2). Many payday lenders have chosen to either register as CSO from the beginning of their operations, or have chosen to cancel their license
with the OCCC to register as CSO’s in order to continue to operate providing payday loans with fewer regulations.

From January 2003 to December of 2005, the OCCC received cancellation notices for 47 licenses from entities that noted that their cancellation was due to their claim that federal preemption applied to them as subsidiaries of national banks and thus did not require to operate under the State license (Finance Commission of Texas 27). Under the CSO model, payday lenders are not tied to any state regulation with regard to state usury laws pertaining to small loans regulated by the Consumer Credit Commissioner and thus may charge various fees, interest rates, may roll-over loans without limit, among other regulations that would otherwise apply to them (http://www.sos.state.tx.us/statdoc/faqs2800.shtml).9

3.9 CONCLUSION

The payday lending industry has quickly grown in Texas and the U.S. consistent with the growth of the subprime lending industry. Payday loans have grown more exponentially than similar products within the small lending industry that have been presented as loan products that carry high interest rates for borrowers that otherwise do not have access to prime loans. They have been operational within the state of Texas for over 10 years with licensing requirements, yet operating mainly outside of state regulations via the use of business models like the Bank Model and Credit Service Organizations model.

9 Information available via the Texas Secretary of State Frequently Asked Questions for Credit Services Organizations. According to the Fifth Circuit Court of Appeals decision in Lovick v. Ritemoney Ltd, No. 03-20917 (5th Cir. July 14, 2004), CSO’s providing payday loans to consumers do not have to abide by the small lending regulations as regulated by the OCCC.
The payday lending practices have been have raised concerns because of their high interest rates and their apparent evasion of state usury laws. The subprime lending industry alone has raised questions regarding the actual justification for charging such high interest rates to adequately offset default risks of consumers (Karger 5). With documented faulty practices of the subprime lending industry, the payday lending industry has appeared to operate with a similar rationale for charging usurious interest rates. What has caused more alarm, or has raised more questions, is the consumer base that predominantly uses the product. With the documented concentration of payday lenders and similar lending entities around communities with lower incomes, especially border communities, studies have focused on documenting further who makes use of the payday loan and why.

In the following Chapter, I compile this body of knowledge and analyze the payday lending industry’s practices in connection to predatory lending practice definitions. I document who the average consumer is, how payday lenders prosper, and how vulnerable populations are being impacted by such practices.
Chapter 4 – Payday Loan Practices and Impact on Vulnerable Populations

The payday lending industry has been prosperous and growing at a more rapid rate than most other non-traditional lending sources. As fast as it has grown and as relatively new as it is in Texas and other states, it has also quickly developed a large number of proponents and opponents. In the previous chapter, I described the industry, mainly as it pertained in Texas, noting and illustrating the characteristics of the loan products as well as the recorded annual percentage interest rates associated with some of the loan products. I did not comment, however, on the perhaps obvious observation that an Annual Percentage Rate (APR) in the hundreds may just be usurious.

When one compares APRs to those of car purchase loans, normally in the single digits for prime loans, and double digits (under 20%) for subprime loans, or even to home purchase loans below 10% interest rates again depending on whether the rate is a prime rate, any loan product with an interest rate above any of these interest rates will seem almost inconceivable.

In this chapter, I will illustrate the debate that payday lending has sprung among proponents and opponents: those who consider the industry predatory versus others who justify it as a needed alternative financial product and service. I will analyze the claimed predatory nature of the industry by contrasting and documenting its practices against an existing predatory lending definition meant to be applicable to payday lending. I utilize research produced by academics as well as reports produced by nonpartisan consumer protection groups like the Center for Public Policy Priorities and the Center for Responsible Lending. Through this analysis I illustrate the population that comprises the majority of payday loan users, or targets, and how the industry practices impact them.
4.1 Payday Lending Predatory?

Payday lending has been claimed to be a form of predatory lending by industry researchers and opponents. Several consumer protection groups, researchers, and policy think tanks have published policy notices, books, and studies on the practices within the industry, as well as on the legislature that impacts and authorizes their standing operations. Typically proponents of the industry are those that operate in it, that is, the actual industry operators, financiers, and business owners; most opponents are made up of nonprofits, consumer protection groups, and policy making think-tank independent groups. Policy makers and federal and state agencies fall in both categories depending on the issue on the table and the state in which they are located. Consumers of the product, for the most part, are proponents of the industry because they make use of it, though many times this may be because they have no other viable alternatives.

There is no single definition for predatory lending. The term became more popular when finance and mortgage lending schemes became prominent in the late eighties and early nineties (Bradley and Skillerm). Most definitions or descriptions, however, generally encompass all or most of the following as provided by Gregory D. Squires:

“A loan with the following features may be considered a predatory loan:

(1) “One that charges more interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections;

(2) One that contains abusive terms and conditions that trap borrowers and lead to increased indebtedness;

(3) One that does not take into account the borrower’s ability to repay the loan;
(4) One that often violates fair lending laws by targeting women, minorities and communities of color” (4).

Taking this definition into account, I will now provide a description of the payday lending industry citing reports and studies that have documented evidence of some of the practices within the industry that may fall within each of these criteria. In each of the four predatory lending criteria, I offer and note some of the views presented in each matter by both proponents and opponents.

**4.1.1 More Interest and Fees than Required to Offset Default Risk**

As described in previous chapters, interest rates associated with payday loans are extremely high when calculated in APR terms. There is no known mathematical computation of formula that can specifically determine what the accurate interest rate is to offset borrower default risk. Lenders may have access to highly sophisticated programs to help determine risks; however, given the wide range of interest rates tagged to payday loans across the nation, it cannot be said with certainty what the exact threshold between reasonable and abusive interest rates is.

Payday loans may have over 1000% APR associated with their loans. Both proponents and opponents seemingly agree that payday loans serve as an alternative lending source for groups of individuals that may have no other means of financing (whether considered healthy or not); however, opponents say that payday lenders cannot justify the high cost of the loans based on the consumer’s ability, or lack of ability, to pay. Proponents, typically those operating within the industry, say that without the interest charged for the loans and related fees, the industry would not be sustainable and thus would not be able to offer this loan product to
those that need and demand it. One then may ask whether these interest rates are more likely determined to sustain the industry (though it is debatable, that is really a question of sustainability versus higher profitability), than in relation to the particular consumer whose interest rate would be determined based on the represented risk of defaulting on the loan.

In 2003, only 2% of the registered payday lenders used the then state-authorized interest rate of up to 570% APR (depending on the size of the loan) when financing a payday loan (Texas Legislative Council 5). This means that 98% of all payday lenders utilized out-of-state rates which are typically higher than the state rates. The Texas state rate is already considerably high; however, while viewed as permissible rate by the state, it is evidently still not accepted or utilized by the majority of licensed lenders in Texas. Lenders were obviously not seeking just to offset borrower default risk, as predetermined by the state, but rather a higher profit for the same service and product.

It is estimated that on average, a borrower pays $793 for a $325 loan (King, Parrish and Tanik 2). Customers are in essence repaying their loan, and in the latter example, double that amount, though it may not be explained in such a manner given that to eventually repay their loan the customer likely paid multiple fees along the way. The majority of payday loan borrowers end up rolling their loans over at least 5 times, though typically 7 or more times, with very small number of borrowers actually making no payments at all (see Table 4.1).
Table 4.1 Payday Loan Example A - 5x Renewal Scenario

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Days</th>
<th>Transaction</th>
<th>Advance</th>
<th>Payments</th>
<th>Fee portion of payment</th>
<th>APR</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/23/10</td>
<td>Lisa obtains loan for Payday Loan from CashNet USA for Christmas</td>
<td></td>
<td>Payday Advance</td>
<td>350.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/6/11</td>
<td>Loan is due on January 6, but she pays fee of $62.83 for 1st renewal to January 20.</td>
<td>14</td>
<td>Renewal Fee</td>
<td>62.83</td>
<td>62.83</td>
<td>62.83</td>
<td>468%</td>
</tr>
<tr>
<td>1/20/11</td>
<td>Loan is due on January 20, but she pays fee of $62.83 for 2nd renewal to February 3.</td>
<td>14</td>
<td>Renewal Fee</td>
<td>62.83</td>
<td>62.83</td>
<td>62.83</td>
<td>468%</td>
</tr>
<tr>
<td>2/3/11</td>
<td>Loan is due on February 3, but she pays fee of $62.83 for 3rd renewal to February 17.</td>
<td>14</td>
<td>Renewal Fee</td>
<td>62.83</td>
<td>62.83</td>
<td>62.83</td>
<td>468%</td>
</tr>
<tr>
<td>2/17/11</td>
<td>Loan is due on February 17, but she pays fee of $62.83 for 4th renewal to March 3.</td>
<td>14</td>
<td>Renewal Fee</td>
<td>62.83</td>
<td>62.83</td>
<td>62.83</td>
<td>468%</td>
</tr>
<tr>
<td>3/3/11</td>
<td>Loan is due on March 3, but she pays fee of $62.83 for 5th renewal to March 17.</td>
<td>14</td>
<td>Renewal Fee</td>
<td>62.83</td>
<td>62.83</td>
<td>62.83</td>
<td>468%</td>
</tr>
<tr>
<td>3/17/11</td>
<td>Lisa finally makes payment with fee on March 17.</td>
<td>14</td>
<td>Final Payment</td>
<td>(350.00)</td>
<td>389.32</td>
<td>39.32</td>
<td>293%</td>
</tr>
<tr>
<td>3/17/11</td>
<td>For a $350 loan for 89 days, Lisa pays a total of $704.13, which results in interest of $354.13 for an APR of 439%</td>
<td>84</td>
<td>Total</td>
<td>-</td>
<td>703.47</td>
<td>353.47</td>
<td>439%</td>
</tr>
</tbody>
</table>

Payday Loan Example A - 19x Renewals Scenario

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Days</th>
<th>Transaction</th>
<th>Advance</th>
<th>Payments</th>
<th>Fee portion of payment</th>
<th>APR</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/15/11</td>
<td>For a $350 loan for 266 days, after 19 renewals, Lisa pays a total of $1,520.26 by 9/15/2011, which results in interest of $1,170.26 for an APR of 459%</td>
<td>266</td>
<td>Total</td>
<td>-</td>
<td>1,520.26</td>
<td>1,170.26</td>
<td>459%</td>
</tr>
</tbody>
</table>

Source: Table based on information attained from an actual CashNet customer. Information and scenario put together with the assistance of Liliana Miranda, CPA in 2011.

According to the Center for Responsible Lending, payday lenders report losses of 10 to 12 cents on the dollar (Karger 73). In this same study, it was reported that in Virginia there was only a 3-4% loss reported, while this number was 6% in North Carolina (Karger 77). These losses are realized losses only if the payday lender is unable to cash the post-dated check left as collateral because of insufficient fees.

The fact is that though payday loans are considered to be unsecured loans, they are being secured with the continual renewal or rolling-over of loans. Additionally, they are in
essence secured from the moment the loan is acquired given that to receive cash from the lender, the borrower must leave a personal post-dated check left as collateral; if the borrower defaults on the loan, the lender can simply cash the check. It should be added, that if this is the scenario, and the borrower has insufficient funds in his or her account, the lender not only has legal recourse to go after the borrower for the loan but also for returned check fees. In this scenario, the borrower also incurs NSF fees (nonsufficient fund fees) from the bank as well. This scenario is not a desirable one, and thus, the borrower is more likely to pay an additional fee (as illustrated in Table 4.1) to roll the loan over.

As a result, the default risk, or the risk of borrowers not repaying their loan, is difficult to justify, 1) because the average borrower pays more than the initial amount borrowed and 2) because very few borrowers completely default on the loan given the option to renew the loan (which has become documented that the majority of customers make use of this option).

4.1.2 Abusive Terms and Conditions that Trap Borrowers into Indebtedness

Payday lenders and industry proponents claim that the payday loan is meant to be a quick access loan meant to alleviate an extraordinary emergency or to fill a cash flow need between paychecks. According to the Center for Responsible Lending, only 1% of payday loans are utilized in this fashion (Karger 77). Additionally, in study after study, it has been documented that payday borrowers usually enter into seven or more loan transactions over the course of a year. In fact, one study in particular documented that of those borrowers considered to be “long term borrowers” (borrowers with more than 5 loans within the prior 10 months), 44% had more than 20 transactions (Caskey 21). The median number of transactions or renewals within this group was actually 19. In the same study, of the quantified transactions
processed by the lenders within the study, 53% of all transactions were rollovers (term for renewing the previous loan into a new one with an additional fee), and an additional 26% of transactions were made only within 13 days of the termination or completion of the previous loan, not more than two weeks later or likely by the next pay date (Caskey 22).

Whether the industry claim is that the product is meant to be a source of a short-term financial relief, the reality and fact is that only 1% of customers actually use it for the one-time or occasional need (Baylor, “As Payday Lending Spreads Across Texas” 2). The overwhelming majority of borrowers end up continuing to renew their loans to an extent that makes their initial loan acquisition a very costly transaction in the long run. This documented cycle of loan renewals points to the claim of indebtedness as well as the potential ‘trap’ for borrowers to continue in this cycle. In fact, the prosperity of the industry relies on such borrowing behavior to make its profits. If customers did not roll their loans over in the manner in which they do, the industry would likely neither thrive nor perpetuate itself over the years in the manner in which it has.

Some states, over the past few years, have begun to set caps on the number of renewals that such lending agencies may make, some requiring that agencies take into account the number of outstanding loans or number of loans taken out by the individual within a certain period of time. Administrative federal agency, the Federal Deposit Insurance Corporation (FDIC) (which will be further discussed in the next chapter) has also influenced and condoned the monitoring of the number of loan renewals. In the meantime, however, with the ability of many payday lending agencies to operate outside the regulation of states, through Credit Service
Organization (CSO) model, this aspect of the business also often goes unregulated along with the interest rates.

Last, with regards to the terms and conditions of the loan, Howard Karger, professor of social policy at University of Houston, explains that the terms of the payday loan with regard to the repayment timeline is not realistic if they are meant to be utilized for a one-time emergency. If an individual indeed seeks out this loan for such an emergency, it is unlikely that the customer may recover from such an emergency (at least financially wise) within the typical 14-18 days within which he or she is to repay the loan. In Karger’s suggestions to reform the payday lending industry, he suggests that the terms for these short-term transactions should be no less than 90 days (85).

In sum, the loan terms of payday loans are designed in a way that does not provide relief for the borrower, but rather encourages a continual need for renewing the loan in order to pay it off. When customers do not use these loans for a short-period of time, the industry benefits greatly from this behavior, in fact, encourages it, and the end result is that the repayment of the loan ends up equaling double the amount of the original loan given the ‘trap’ of indebtedness the loan terms perpetuate.

### 4.1.3 Does not take Borrower’s Ability to Repay the Loan

To acquire a loan, customers typically need a photo ID, a bank account statement, proof of income in some cases, and a completed personal check to ‘secure’ the loan. There is no credit check performed to determine whether a loan is approved or not. Very few agencies may run a Teletrack check – which is similar to a credit check only that it checks for nontraditional credit data (data pertaining to credit acquired through nontraditional sources as those
described in the last chapters), and in Texas, 50% of licensed lenders in 2003 utilizing exported rates asked for a rent or bill statement with the loan application as an additional way to determine the ‘credit worthiness’ of the borrower’s application.

In 2008, it was documented that typical checking account balances at the time of loan application were very low – with a mean balance of $283 and a $100 as the median (Skiba and Tobacman, Payday Loans, Uncertainty, and Discounting 5). In a Texas specific study, in the years between 2000 and 2004 (similar time frame studied by the Texas Legislative Council), the checking account median balance was $66 yet the application approval rate by licensed lenders was 92% (Huffman; Texas Legislative Council 24). This high approval rate may raise a few questions as to whether the applicants proved that they could repay the loan, or simply met the application requirements. Given that the majority of borrowers renew their loan, and the low checking account balances, one would lean towards the claim that lenders may follow a few guidelines with regards to meeting certain standards to approve the loan, but do not necessarily take into account the borrower’s ability to repay. To further make this point, according to data gathered by the Texas Legislative Council, all borrowers that obtained a payday loan were given exact same rates regardless of their ‘qualifications’ to repay the loan (Texas Legislative Council 22).

I did not find any data indicating what percentage of payday lenders nationally use Teletrack versus those that do not. However, to make matters more ‘questionable,’ I found a number of online payday loan companies advertising ‘no Teletrack check.’ It is not uncommon to find payday lenders that advertise that they do not perform credit checks; in fact, this is one of the features of payday loans that customers find attractive, but now lenders also offer less
verification of the borrower’s ability to repay the loan, likely because the documented trend is that borrowers will simply continue to roll the loan over (Caskey 20).

With lenders asking for very little information from the borrower, other than what would seem pertinent for the payday lender to attain its way of collecting on the loan, that is the post-dated check, there is no real way for lenders to determine the customer’s ability to pay the loan back within the specified amount of time. Moreover, there is a documented intentional geographic distribution of where these lenders open their storefronts (to be further discussed in the next section), which are typically in neighborhoods where consumers have great need for the loans but less ability to repay them; one study documented 12% default rate for first-time loan users (Skiba and Tobacman, Payday Loans, Uncertainty, and Discounting 6).

Payday lenders seek to lend to those lower-income families that typically do not have access to credit, for many reason among which is that they may already have high debt ratios, or may be strapped for cash because families in these neighborhoods have little solvency and live paycheck to paycheck. Lenders seek those who need the cash, but not necessarily those that are capable of terminating the loan on the basis of the original terms – for one time use, within the specified repayment time period, and with only one fee associated with the original loan. As noted in the previous section, it is the minority of borrowers that actually end up paying the loan as originally accorded.

4.1.4 Evasion of Fair Lending Laws by Targeting Minorities and Other Vulnerable Populations

Besides the exorbitant interest rates charged for payday loans and similar products, the obvious concentration of payday lenders in lower income communities became a prominent red flag that led to the closer studying of the short-term lenders across the nation. When the
Texas Legislature first studied this sector of its financial market, it called for the study of high-cost lenders and their ‘availability’ to the consumers. Availability in this study\textsuperscript{10} was not based on a comparison of available products but rather geographic availability of loans.

The Office of Consumer Credit in Texas found that in 2004, Texas counties with higher percentages of minorities also had higher distribution of short-term lenders (those licensed by the OCCC) in comparison to traditional banks. There was an even higher disproportion of the nontraditional lenders to traditional ones in border counties, with a greater concentration of licensed lenders that utilized exported rates specifically. In another study produced by the Center for Public Policy Priorities, fact sheets were developed for the larger cities in Texas, each of which demonstrated a disproportionate amount of payday lenders to traditional banks in communities with lower to middle income people, especially in border communities (Texas Legislative Council \textsuperscript{10}).

According Katherine Samolyk, Senior Economist with the Federal Deposit Insurance Corporation (FDIC), most payday loan users are women between the ages of 30 and 40, there is an over representation of African Americans and Latinos within payday loan users, borrowers are more likely to rent than own a home, and household incomes are typically between $25,000 to $50,000. Almost a third of borrowers had a higher monthly debt to income ratios than the general population, and only one in four of borrowers pay their bank credit card (if any) balances in full, which when compared to the general population is one in two (86).

As mentioned previously, payday lenders geographically place themselves in communities where families fall within the lower income brackets. Karger argues, however,
that the categorization of individuals that fall within the ‘financially strained’ population may be 
broadened beyond the classified ‘low-income’ or within the U.S. definition of poverty rates 
(22). Many employees in the U.S. have full-time jobs but are either underpaid or have no 
health benefits and so may be categorized as the “working poor.” As with the earlier “Lisa” 
example provided, a person making a living above $30,000 may not be considered low-income 
per se, yet the individual’s inability to save because he or she lives paycheck to paycheck, only 
needs one unplanned financially draining incident, like a need to replace car tires, to cause a 
financial crisis. Similarly, if individuals do not have health insurance, they will likely find 
themselves in a financial dilemma with a single medical emergency.

It should be further noted that a parallel connection may be made between the growth 
in the fringe economy, the economy of alternative financial sources for the underbanked or 
people otherwise not utilizing prime and traditional lending sources, and the economic 
development in the U.S. (Karger 21). As costs of living have increased, and the value or ability of 
the dollar earned lessened, more and more people are falling out of the middle class and into 
the struggling ‘poor’ (Karger 21; Committee 11).

In addition to targeting the poor, and in a broadened sense, the working poor, there 
have also been claims made and evidence produced that payday lenders not only target 
women, minorities, and the working poor, but also college students, the military, and the 
elderly and disabled. Soldiers are ‘ideal’ targets because they have steady incomes and may be 
usually in need of ‘fast cash’ given their relocation nature and their low compensatory salaries 
(“Soldiers at Risk”). Also, military families are considered easy targets because they are typically 
young and inexperienced with regard to finances and have no established relationships with
banks (Tanik). They also happen to be good loan prospects because the United States Government does not permit delinquency in debt of any military personnel.

It has also been documented that an elderly population is a prime target for payday lenders with the increased clustering of storefronts around government-subsidized housing for seniors and the disabled (Lewis). Payday lenders have partnerships with banks to facilitate the payment of loans via this population’s social security checks (Lewis). This population is targeted because of this generation also makes less use of traditional credit or banking institutions. Their steady social security paycheck every 30 days from the Government, though, makes them a desirable customer (Lewis).

In spite of the documented geographic positioning of payday lending storefronts around populations that may be deemed vulnerable and those that are likely to be caught in the payday loan trap, the payday lending industry proponents negate this as being a ‘predatory lending’ practice. They claim that the ‘apparent’ targeting of consumers is justified because they have a right to locate and market themselves among the population of customers that would be most in demand of the product. This claim is illustrated by a comparison made to other businesses that locate their businesses where consumers will use their product, for example, those businesses that want to market and sell parkas will locate themselves where the temperature calls for the use of the product and not in areas like Phoenix where consumers would have no use for the product. The claim is made that targeting those that need or want the product is not predatory (PersonalMoneyStore.com).

The justification made by the industry does not address that this is a financial product that is being marketed that impacts the wealth and survivability of its consumers. The financial
industry is to be held responsible for providing necessary products to consumers but with regard to responsible lending that is safe and sound. Payday loans cannot be treated as a product that does not possess the qualities and characteristics of other financial products that are more heavily regulated, and this is a central argument for this thesis.

4.2 SUMMARY

The payday lending industry practices can be documented and fit within the different components of Gregory Squire’s definition of predatory lending. Payday loans pose an economic burden and challenge on a large number of customers because they are costly, lenders do not take into account the borrower’s ability to pay the loan back, the industry perpetuates a practice that promotes the continuous use, or otherwise referred to as the ‘debt trap’, of the payday loan product, and it is made highly accessible among the most vulnerable of communities whether it is called targeting or marketing.

Those who make use of payday loans are those that fit a broader definition of the poor as more and more Americans struggle to make ends meet and find themselves in situations where payday loans become their product of choice to relief a financial crisis brought on at a moment in time, not foreseeing, the end result of how much the initial crisis will cost them in the end.

The industry practices are predatory, though not legally defined this way at the moment, but an equally significant problem is the rapid growth and emergence of the payday lending industry over the years, a trend that can be traced from the early 2000s and that corresponds to the growth of the fringe economy.
4.3 Proliferation of Payday Loans: Part of a Fringe Economy

As Karger states, “there’s considerable money to be made from the financial misery of the poor and credit-challenged” (9). There is an estimated 19 million payday loan users in the United States costing over $4.2 billion in fees, and most attributed to the 62% of that population that finds themselves acquiring five or more payday loan transactions a year.

In the previous chapter, I discussed where payday lending fits within the subprime lending industry; however, payday lending has also been categorized as being part of an industry referred to as Alternative Financial Resources (AFR) or the fringe economy (Samolyk 176). Alternative financial resources refers to a set of businesses and agencies that offer products to consumers that either prefer to use their services or may only have those services available to them as an alternative to less desirable or less available traditional banking sources.

Services and products within this realm of financing are rent-to-own furniture services, check-cashing, car-title loans, signature loans, pawnshops and their loans, rapid refund loans, and of course, payday loans. What is common among these products and services is that they are mostly used by populations of individuals that do not use the more traditional banking institutions like state and national banks or credit unions, and in the case of furniture financing, traditional consumer installment loan companies like Wells Fargo Financial, Beneficial, etc., for their banking and financing needs (Samolyk 177). Another common factor among all these services is that many of these types of lending services offer a form of payday loans in addition to their established line of business. It is not uncommon for check cashing agencies, rent-to-own, and pawnshops to also offer payday loans.
Check cashing agencies were most prominent before payday lending surfaced (Caskey 34). Check-cashing agencies typically charge a service fee, usually a percentage of the check amount that is to be cashed for the customer. Individuals seeking this service are normally those that do not either have a bank account to deposit the check into or a banking institution to cash it, or people that may seek additional services typically provided by these agencies like bill payment services that traditional banking institutions do not offer. Banking institutions may offer bill payment services via online banking services, yet individuals who typically use bill payment services at check cashing institutions are not typically known to have the online banking practice.

It is also known, that payday lending emerged from check-cashing agencies where loans began to be offered through these establishments before becoming more widely known as payday loans or as monolithically operating financial entities (Samolyk 178-179). Many AFR entities may be licensed or registered under a certain type of business while conducting another, like a payday loan, which would normally be regulated under a different regulatory body. However, the entity is accountable to the entity that governs or oversees the reported primary business of the entity; monolithic entities refer to entities that only have one product or service as opposed to the latter combination of services or products.

Rent-to-own furniture stores finance individuals with non- or poor credit to lease furniture until they may own the furniture. Customers basically make monthly payments to own the furniture by the end of their payment agreement, while the amount paid includes a finance charge. The furniture is not owned until the last payment is made otherwise the furniture or equipment is considered rented property. Rapid Refund Loans are cash
advancements for expected tax returns. These are made by tax preparing agencies, though some pawnshop lenders and rent-a-centers offer tax preparation service and in the process anticipate the refund for a fee, also in line with the fees that turn out to be a high cost for a loan.

Pawnshop, signature, and payday loans were described in previous chapters, and they share the characteristics of financing small loans to customers that typically would not access similar products from traditional lending sources, but at very high cost rates. This industry provides services to a stressed population of individuals with credit challenges, or lack of accessibility to other products. It is known that over 53% of Americans live paycheck to paycheck, meaning that very few Americans are able to save for situations when cash is tight (Karger 18). However, when situations arise for the need for immediate cash, consumers turn to these services to alleviate their needs before they turn to traditional banking institutions.

4.4 FILLING A FINANCIAL NEED GAP

Though the debate for whether the industry is predatory and unfair as a lending industry will likely be ongoing, the reality is that consumers continue to flock to the establishments for financial products. States regulating the industry have taken into account the discussion about whether these loan products, putting aside that they are expensive, are indeed filling a service gap between traditional banking services and other alternative financial resources.

The Alternative Services Industry, and thus payday loans, exists because it fills a few voids among the needs of consumers with a lack or perceived lack of alternatives. According to John Caskey, what makes payday loans attractive is that there is no credit check, the loan cash
is acquired immediately (within minutes), consumers like the apparent close-endedness of the loan in that it is a short-term loan and not a long-term debt, that it is perceived to be more respectable than a pawnshop loan, and that no collateral is needed (as with car title loans and pawnshop loans (20). Some of payday loan users also show a preference for payday lenders because they appear to be less intimidating than traditional banks, and are more accessible geographically (as mentioned in previous sections that nontraditional financial institution are disproportionately available when compared to traditional banking institutions (Karger 18).

Banks and credit unions do not offer comparable payday loan in a loan’s traditional form. Loans offered by banks require credit checks, are larger in loan amounts, are longer term, and are rarely unsecured. Some consumers, typically those in border communities made up of immigrant populations, do not find banks to be accessible in that their service or products if they are not explained in their spoken language or if the U.S. banking system is not as easily understood (Robles 207; Karger 19). Many immigrants are part of a blue-collar low-skilled workforce whose skills may not “translate into the American workplace” and may simply lack the necessary basic knowledge to properly understand the difference in consumer products, especially the fringe products, because these may not be available in their home country (Karger 25).

Accessibility to banks is a problem that contributes to the use of payday loans as well as families’ debt behavior. As noted earlier, the debt ratio of those that use payday loans is higher than the general population as well as their ability to pay off bank card balances in full. An increasing number of families live paycheck to paycheck and their ability to save is minimal. There is also a perception that utilizing banks is more expensive than the storefronts offering
check cashing services and payday loans, in addition to the number of people that auto-
categorize themselves as subprime loan borrowers.

As inaccessible as banks may appear to be, or in actuality be, to consumers of payday
lenders, there is a layer to be added to the existence and proliferation of the payday lending
industry. It can be said that banks have too jumped on the bandwagon of the payday lending
industry. Many claim that banks have had their form of a high cost short-term loan with their
overdraft and nonsufficient fund fees (NSF) for years, even before the payday lending industry
emerged and exploded. Depending on the amount of a consumer’s bounced check via an NSF
transaction, the interest rates associated with these fees can oftentimes exceed the
documented payday loan rates. In fact, industry proponents make it a point to advertise and
defend the industry by stating that they are indeed providing a service that is not effectively
being offered by banks, and that were it not for their payday loan products, their customers
would inquire significantly higher expenses with charged bank insufficient fees on top of the
fees imposed by vendors who also charge a returned check fee.

In more recent years, banks have begun to engage in developing and marketing their
own form of payday loans to counter and modify their NSF route of charging for bounced
checks. Banks now advertise their trademarked services to compete with payday loans called
“bounce protection programs,” “overdraft privilege,” and “courtesy pay” (Caskey 25). All these
programs offer services to allow customers to overdraft on their account by a certain amount
through a certain period of time for a fee. This is meant to be offered as a way to alleviate
immediate cash-flow needs that may lead to higher costs with multiple check bouncing fees
that is typically cited as a reason for the use of payday loans.
Before one may assume that banks are helping fill the financial need gap, Karger warns against this potentially optimistic perception stating that banks are behind the scenes in the provision of AFS. National Banks like Wells Fargo and Bank of America finance third parties that support and fund AFS because it is more profitable to finance these entities than to provide the direct services themselves in the actual neighborhoods where they are needed (Karger 14-15).

4.5 Why is Payday Lending a Problem?

Payday lending is “hurting families,” according to the Center for Public Policy Priorities and other industry opponents. More than 60% of what the government spends on public assistance programs for low-income families is gained from low-income families by fringe lenders. It is estimated that rent-to-own, pawnshops, check-cashers, and payday lenders generated about $78 billion in 2001 (this number is higher in recent years) while public assistance programs cost $125 billion (Karger 6).

Families are further getting into debt and payday lending is contributing to the number of families that end up filing for bankruptcy. In a study comparing payday lenders who were approved versus denied by lenders in Texas, first-time borrowers were two-times more likely to file for bankruptcy within two years of the loan that those borrowers that were denied the first time (Skiba and Tobacman, Do Payday Loans Cause Bankruptcy 20). According to this study, payday loans do lead to bankruptcy because those that access payday loans are already financially strained individuals, they make repeated use of payday loans, and in the at the time of bankruptcy, these loan debts end up amounting to 11% of the liquid debt interest burden (Skiba and Tobacman, Do Payday Loans Cause Bankruptcy 1).
In addition to hurting families, namely those within minority populations and women head of households in their mid 30’s, the elderly and other vulnerable populations, the military are also hurting in more ways than one. Not only are they part of the statistic of people that are paying high amounts in fees and finance charges, but they are also hurting at work. In the military, those that default on their loans run the risk of losing security clearances necessary to perform their duties, and as a report produced by the U.S. Department of Defense states, the high debt and stress related to payday loans posed a threat to morality of military personnel when performing security tasks (“Report on Predatory Lending Practices”).

4.6 CONCLUSION AND SOLVING THE PROBLEM

The payday lending industry has had an ability to charge increasingly higher interest rates to vulnerable communities, while it continues to evolve and prosper. For years it has undermined the economic welfare of its consumer base, financially hurting families, yet claiming to offer a financial product that is filling a financial gap left unserved by traditional banking institutions.

For years industry opponents and critics have called on legislators to solve the problems posed by payday lenders on such vulnerable populations. Regulating the industry has been a challenge from the early 2000s when very little was known about the industry, to the current day that we now know more about its practices and its ability to prosper and operate outside state usury laws. Calls to action are constantly put out by consumer protection groups like the Center for Responsible Lending, Consumer Federation of America, Center for Public Policy Priorities, and Association of Community Organizations for Reform Now (ACORN) among others, asking the public to encourage their legislators to pass laws that will effectively help
regulate the industry. Yet to date, the payday lending industry has continued to grow and proliferate.

In the next chapter, I illustrate the challenge that regulating the industry has become from its ability to evade state usury laws, to the utilization of the different business models that limit governmental oversight over its operations. I specifically look at the challenges presented by the very complexity of the financial industry system, as well as the competing state and federal regulations that have left loopholes by which payday lenders can benefit. Last, I will specifically look at the State of Texas ability or inability to regulate the industry to further illustrate the challenge posed at the state level.
Chapter 5: The Payday Lending Industry Regulatory and Legislative Challenge

5.1 INTRODUCTION

To analyze the regulatory challenge of the industry, stemming from legislation at national and state levels, in this chapter, I illustrate a general overview of the legislative trends that have existed across the country within the financial services system that has impacted payday lending since the early 2000s up until 2009. In this illustration, I further elaborate on the business models, introduced in earlier chapters, which permit payday lenders to evade state usury laws. This illustration will provide for further understanding on the legislative and regulatory challenge within the industry utilizing terms like ‘federal preemption’ and by elaborating on the debate between states and the federal government when laws applicable to common industries conflict.

Through this analysis, I provide a chronological overview of legislative and judicial action that has led to the current model of operation used by payday lenders, as well as an analysis of how states have been able, or unable to effectively regulate the payday lending industry using mainly Texas as a case study.

5.2 REGULATORY CHALLENGE

Payday lending is legal or recognized in 33 states via laws and regulations (as well as in the District of Columbia), in 15 states payday lending is prohibited, banned, or very strictly regulated making the industry not viable in those states, and in two states there are no usury limits for small loans by licensed lenders (Fox 1).
Table 5.1 Payday Lending Regulation in the U.S.

<table>
<thead>
<tr>
<th>Regulated</th>
<th>Prohibited/banned/strictly regulated</th>
<th>No usury limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>Nebraska</td>
<td>Arizona</td>
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<tr>
<td>Alaska</td>
<td>Nevada</td>
<td>Arkansas</td>
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<tr>
<td>California</td>
<td>New Mexico</td>
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<td>Colorado</td>
<td>North Dakota</td>
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<td>Hawaii</td>
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<td>Idaho</td>
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<td>Maryland</td>
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<td>Illinois</td>
<td>Rhode Island</td>
<td>Massachusetts*</td>
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<td>Indiana</td>
<td>South Carolina</td>
<td>New Hampshire</td>
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<td>Iowa</td>
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<tr>
<td>Kansas</td>
<td>Texas</td>
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<td>Kentucky</td>
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<td>North Carolina</td>
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<td>Louisiana</td>
<td>Vermont</td>
<td>Pennsylvania</td>
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<td>Michigan</td>
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<td>Minnesota</td>
<td>Washington</td>
<td>West Virginia</td>
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<tr>
<td>Mississippi</td>
<td>Wisconsin</td>
<td>District of Columbia</td>
</tr>
<tr>
<td>Missouri</td>
<td>Wyoming</td>
<td>South Dakota</td>
</tr>
<tr>
<td>Montana</td>
<td></td>
<td>Delaware</td>
</tr>
</tbody>
</table>

As in the case of Texas, payday lending is recognized in the state’s finance code where the loan terms, licensing, interest rates, and reporting requirements are addressed for regulation. Very few payday lenders licensed by the state of Texas actually utilize the Texas interest rate cap on payday loans; in fact, less than 1% utilizes the state-determined cap. Meanwhile, payday loans carrying rates with imported interest rates from other states with less strict usury laws are recognized, and considered legal, because of the partnerships that have existed with out-of-state banks (Texas Legislative Council viii). In these partnerships, out-of-state banks essentially rented their charter to import their respective state-permitted interest rates to those payday lenders even if they were chartered in states with specific caps on interest rates, usually lower than the imported rates (more on this in the following section).
The prominent challenge with effectively regulating the payday lending industry has the last decade been because of the industry’s ability to evade state usury laws and regulations. Even when payday loans have legislation specifically meant to regulate their practices, the payday lending industry has identified ways in which it can utilize practices and interest rates that produce higher profits than what they would produce if they abided by state laws.

There are two most notable ways payday lenders have managed to do the latter – through the rent-a-bank model that was the business model of choice for payday lenders up until 2005 and 2006, and then followed by the Credit Service Organizations model that continues to be the mode of operation today.

The following section describes the first of the two business models and addresses a major component that has contributed to the major challenges with effectively regulating the industry, federal preemption. Federal preemption was the main reason for the payday lenders to import interest rates and even some regulations that applied to their bank partner and not necessarily them specific. Though I will explain later how the rent-a-bank model was eventually shut down, federal preemption issues continue to linger today that no longer impact store front payday lenders, but may impact Internet payday lending (issue that should be further studied though not within the parameters of this study).

To better understand federal preemption, I also describe the debate around the issue with respect to the rights of states versus the powers of the federal government. As with any conflict among states and the federal government, the judicial system and its courts have had a
say on the matter. \textsuperscript{11} Since legislative action or the court-decision-making process is rarely linear, that is that rarely will one take place in an orderly fashion once the other is resolved, I offer the following table to help illustrate when in the 2000 to 2009 timeline certain cited cases and events take place within it.

\textsuperscript{11} The issue of federal preemption is not only applicable to payday lending but also other financial services, like mortgaging, in partnership with out of state banks where state laws and federal laws conflict. However, payday lenders have been able to attach themselves to this preemption by calling themselves subsidiaries.
Table 5.2: Impactful Legislative and Regulatory Action on Payday Lending between 2000-2009

<table>
<thead>
<tr>
<th>Year</th>
<th>Payday lenders (TX)</th>
<th>State legislations</th>
<th>Federal Government</th>
<th>Courts (state / fed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>Regulations permitting payday loans (FC 11.304)</td>
<td>Growth of payday lenders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>Rent-a-bank partnerships model of operation (national banks out of payday lending business with charter renting- only state chartered)</td>
<td>Study of short-term lenders and discovery of out of state rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td>Subsidiary in Michigan relinquishes license (mortgage company)</td>
<td>Federally chartered institutions to cease payday lending</td>
<td></td>
</tr>
</tbody>
</table>
| 2004 | 2003-2005 Relinquishing of state licenses | | | 2005 - U.S. 11th Court of Appeals upheld law and rejected Federal Preemption for interest (Georgia)  
OCC V. Spitzer (response to preemption rules)  
Sixth Circuit decision in favor of Wachovia in Wachovia V. Watters |
| 2006 | Exiting of rent-bank with state chartered banks Rise of internet payday lending (TX and country) 2005 -2009 Shift to CSO Model | Study on Preemption challenge | | 2006 Military Lending Act (36% cap) |
| 2007 | | | | Supreme Court upholds Wachovia V. Watters decision in favor of Wachovia (OCC authority) |
| 2008 | | | | |
| 2009 | | | | |

This table is set up as a timeline of a few actions and events that took place within the payday lending industry, Texas legislation (the main case study), other noteworthy action and legislation that took place in other states, and action that took place at the federal level within its two main federal regulation administrative offices, the Federal Deposit Insurance...
Corporation (FDIC) and the Office of the Comptroller of Currency (OCC). Last, in the last column, noteworthy court cases that addressed the federal preemption debate as well as class action suits that also helped lead to the end of payday lender and bank partnerships are noted. All these actions and events illustrate what brewed to impact the way the payday lending industry operated and currently operates.

I should further note that with regard to the table, it is not meant to be a comprehensive encapsulation of all legal and legislative activity that impacted payday lending activities and further legislation. Instead, this table is meant to serve as a reference for some of the sections in this chapter where 1) I refer back to some of the incidents captured in this table, and 2) when the timelines and chain of events may be forgotten or may appear confusing. Last, this table should help with visualizing the number of events that led to the shift from the rent-a-bank model to the CSO, and leading up to the new challenges faced with regulating the industry today.

5.2.1 Rent-a-bank Model

The ‘rent-a-bank’ model, also known as the ‘bank model or the ‘rent-a-charter’ model, is a business model of operating that was used by payday lenders before they were recognized as payday lenders in Texas (law in effect in 2000) and up until 2005 and part of 2006. This rent-a-bank model was a way for payday lenders to get around utilizing state usury rates and other regulatory requirements like number of permitted loan renewals and loan terms with regards to payment periods. The way the business model worked was that payday lenders would enter into partnerships with out-of-state banks through which partnership payday lenders would advertise the loan, service the loan to the consumer at the store front, and collected on the
loan. Banks, on the other hand, would be considered to be the lending entity and the payday lender the subsidiary or broker of such a loan.

Under the auspices of this model, the rates and regulations applied to the transaction would be those that would apply to the bank and not the payday lender within the state. It is in this manner that interest rates would be imported from other states where the banks were chartered. These interest rates would likely be illegal if they were directly offered by the payday lender as a registered entity within a state, but because of the nature of the partnership model, ‘federal preemption’ was claimed. Before defining what this entailed, it is important to note that lending transactions handled through this partnership would typically yield a fee to the bank partner while the loan was sold back to the payday lender within a day of the transaction (Samolyk 179).12

5.2.2 Federal Preemption

Federal Preemption is perhaps the most challenging aspect of regulation when concerning financial institutions within states, national banks, and conflicting state and federal laws. Federal preemption was claimed as the authority by which payday lenders could utilize imported rates from other states; it was also claimed when the financial service organizations began a trend in which they would cancel their state licenses that corresponded with certain regulations and instead opted to register under different types of organizations with differing administrative offices that would permit for more lax regulation while still performing the same functions. (see Table 5.2. years 2003-2005 under payday lenders and other states).

12 This specific detail became the issue of importance in the 2005 Court decision in Georgia cited on the Table 5.2.
To elaborate on details of this section, I will refer to a very detailed study produced by the Texas Finance Commission and the Texas Credit Union Commission in 2006. This report was prepared in response to another Texas legislative mandate, this one by the 79th legislative session, via House Bill 955. This report was precisely requested to study the laws that governed financial institutions when state and federal laws were in conflict. This study became crucial to help identify the power the state of Texas had over financial institutions within it, and consequently the power other states could similarly exercise when in conflict with federal regulations.

This report goes into great depth as to the whole background behind the need for national banks, state banks, and the ability of banks to be governed and regulated in such a way that they, state and federal banks alike, could compete with one another, providing crucial financial services to consumers, while operating within a common states and across state lines. It is explained that in order to expand financial institution products in a competitive market across states, it was important to achieve ‘parity,’ or a certain level of equality and comparableness, with regard to usury, trust powers, and intra-state branching (Texas Finance Commission 12-13).

The payday lending industry is chartered by states and not by any national or federal regulatory body; each state determines the industry’s legality, usury limits, and licensing requirements (among other transactional specific requirements and limitations). National banks, state banks, credit unions, and other finance-related entities, on the other hand, are governed by differing state and federal entities and regulatory bodies, sometimes by more than one regulatory body at the same time.
National banks are regulated by two federal administrative offices - the Office of the Comptroller of the Currency (OCC) under the U.S. Department of Treasury, and the Federal Deposit Insurance Corporation (FDIC). State chartered banks are regulated by their respective state offices but may also be members of the FDIC. State banks may be subject to abide by some state regulations while also abiding by federal regulations, and in other cases, may be required to abide by one or the other depending on the regulation in question.

The purpose of the OCC is to “charter, regulate, and supervise all national banks,” and its stated goal is to “ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products.” The FDIC was created by Congress to help with consumer confidence in the banking industry, and it is meant to insure deposits and examine and supervise its member financial institutions for “safety and soundness, and consumer protection” (FDIC.gov).

These two federal offices have exercised their regulatory power, according to the Texas Finance Commission report (2006), to allow national and federally regulated banks to model their business in manners which permit them to avoid certain state laws that would otherwise hinder their business, as may be the case with some of their state competitors. This power, consequently, extended to the operations of federally regulated banks’ subsidiaries and other state chartered financial services institutions. With state and federal regulations in potential conflict, the determination of the rightful use of federal preemption became the question for debate among banking intuitions. However, while this debate took in effect, under the rent-a-

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13 The ‘safe and sound’ language is utilized in various reports and articles when claiming that payday lenders, when operating as bank subsidiaries, are not practicing ‘safe and sound’ practices. This claim led to the OCC requiring all national banks to desist from entering in partnerships with payday lenders as the practice was risky and unfavorable.
bank model, payday lenders claimed to serve banks in a subsidiary capacity and thus observed loan operation parameters permissible under the regulations that applied to their partner banks.

5.2.3 The Debate

**Federal Preemption vs. States’ Rights**

As issues of parity or disparity have came to light among state and federal regulatory bodies, states fought and continue to federal preemption – the ability for federally regulated entities to preempt state laws with federal laws in their financial business practices. In some cases, federal preemption overrides state laws that may be considered too lenient and not too restrictive, while in other states this preemption may limit the extent to which state regulations may further regulate and restrict their financial institutions. Depending on the state is whether federal preemption limits their ability to operate more freely or limits their ability to further regulate the industry.

According to the report, the OCC has called on federal preemption claimed to derive from the U.S. Constitution’s “Supremacy Clause” which declares federal law the “Supreme Law of the Land” to preempt state laws with regard to the way federally regulated depository institutions operate (Texas Finance Commission 5). Subsequently, states have also called on the ‘States Rights’ principle from the U.S. Constitution to preserve the states’ rights to exercise their governing powers otherwise not prohibited by the U.S. constitution or other states to compete with the federal preemption claim where the financial institutions are concerned (Texas Finance Commission 5).
The debate is very complex because it takes into account historical intent behind what national banks versus what state banks were supposed to do in response to acts passed since the 1860’s (Watters v. Wachovia Bank, N.A 9). One example of this is that the expectation that then state chartered banks would become part of the national banking system but have instead led to the creation of a ‘dual-banking system’ that exists today (Texas Finance Commission 12). This dual-banking system has led to a number of regulatory entities that oftentimes conflict with one another as they try to regulate their respective member or chartered institutions.

The debate also takes into account a need to determine what has been congressionally expressed or implied to be the powers delegated to the regulatory body of federal administrative office, like in the case of the OCC. The U.S. Congress is the body that can determine legislatively what federal law is, and in the absence of federal law, states may develop their own laws. Through legal suits brought to court, it has been questioned whether the delegation of authority to the OCC can be considered expressed or implied with regard to its authority to grant or award preemption to national banks over state statues.

States utilizing federal preemption to import their regulations and interest rates to other states that would otherwise not permit them sparked the debate with respect to which entity superseded the other with regard to effectively governing the financial institutions. States claimed to have the right to govern their state-created and authorized entities, like payday lenders, while federal regulatory bodies claimed states could not infringe on the operations of their federally regulated entities.

The latter came to question more recently in the Supreme Court Case, Watters v. Wachovia, where the court ruled in 2007 in affirmation of previous rulings that basically held
that federally chartered banks and their subsidiaries (though in this particular case the subsidiary was a mortgage lender) may “seek declaratory and injunctive relief from state registration and inspection requirements based on preemption of the National Bank Act” (Watters v. Wachovia Bank, N.A 1). This ruling basically held that the Office of the Comptroller of the Currency (OCC) as the oversight regulatory body of national banks also has oversight over the subsidiary entities with regard to lending requirements that conflicted with state requirements (this ruling could thus be transferred to other federal entities regulating subsidiaries chartered within states).

States and opponents of the exercised power of the OCC in this question of preemption, continue to disagree with this decision as well as with other prior court decisions that held similar conclusions. It is argued that the power it exercises has not been fully expressed by Congress, or implied, yet the Supreme Court held that “pre-emption is the necessary consequence of various congressional statutes” (Watters v. Wachovia Bank, N.A 14)

The debate continues at all levels of the financial industry as it applies to conflicting state laws and OCC regulations (this debate continues beyond the impact it has had on the payday lending industry). With regard to payday lenders, this argument was debated not only on the basis of whether a federal regulatory administrative body (whether it would be the OCC or the FDIC) had the right to preempt state laws (as it may appear to be the ultimate case with its authority to govern banking institutions within states and determine which laws apply to them and which do not) but also whether payday lenders could effectively call themselves subsidiaries of federally regulated financial institutions, and thus, apply those federally
preempted laws to their operations (Subsidiaries are those that engage solely in the activities that national banks are permitted to engage in directly).

As Law Professor Arthur E. Wilmarth, Jr. from George Washington University Law School stated:

“operating subsidiaries are chartered separate and distinct corporate entities under the authority of state law. Because they are creatures of state law, operating subsidiaries must comply with all applicable state requirements. The OCC rules effectively ‘federalize’ state-chartered subsidiaries by placing them under the exclusive supervisory control of the OCC.”

(Texas Finance Commission 32)

5.3 Administrative Regulation

Besides the debate over federal preemption with regard to the state laws versus federal laws, the complexity of regulation extends to the regulatory bodies that oversee the financial entities. The financial services industry can be broken down and categorized in a number of ways beyond how I described in Chapter 3, in which I mainly drew a distinction between financial institutions within a single state that fell within the non-real estate short-term lending industry and concurrently within the subprime lending industry. The financial services arena goes beyond distinctions between real estate and non-real estate, short-term and long term services, subprime or prime lending; it too encompasses a number of services and functions ranging from loans (personal, business, capital), investments, depository transactions, trades, and credit cards, among many other services and functions. It is important to know that all these functions exist (along with many more) because each function within each financial type of institution is recognized differently in different areas of finance codes, whether these are federal or state codes, with specific regulatory specifications (Kennedy 267).
Much of the complexity of the industry lies in that the financial entities (not just the financial service functions) are chartered differently and regulated differently as well. As is the case with Texas, banks and other credit entities are regulated by the Texas Finance Commission but by three different departments – Texas Department of Banking (TDB), Department of Savings and Mortgage Lending (DSML), and the Office of the Consumer Credit Commissioner (OCCC). As one may recall, payday loans fall within the OCCC.

The finance code within a single state will dictate very distinctly what its financial service entities may do with its industry specific regulations; yet because of the complexity of the financial services arena and the crossover of financial services and related language, regulations that may be applicable to more than one financial serving institution, also described and delineated in other parts of the finance code, may allow for unintended regulatory consequences.

To give an example, payday loans were first mainly referred to as deferred presentment transactions; this term can also apply to transactions that other financial service entities may practice like in the case of auto-title lenders; regulation labeled to apply to a ‘deferred presentment transaction’ initially meant that to regulate a auto-title loan could consequently impact (be it negatively or positively) a payday loan transaction without intention. As with transferable language within a finance code, a similar situation occurs with part of the preemption debate. Regulations meant to apply to one entity may thus be transferable to unintended parties because of language. What may have originally meant to help state and national banks operate with parity for the purpose of fair lending has unintentionally extended to payday lending subsidiaries.
Payday lenders have benefitted from the complexity of the industry and the vagueness of some regulatory laws. The payday lending industry is small compared to the size and complexity of banks and credit union operations, and given the great number of rules and areas of regulation that govern national banks, payday lenders have made it a choice to tag on to any number of these rules while claiming preemption whenever possible (as with the example of relinquishing state licenses and opting to operate outside of the Texas OCCC claiming they did not need to register with the state).

Generally, payday lenders regulated by states may be required to comply with interest rate caps, loan amount maximum and minimums, credit checking procedures, disclosure of information, reporting on clientele and products, licensing processes, and fee caps, among other features. However, when they attach themselves to their bank partner, they opt to avoid compliance with some or none of the requirements because of the federal preemption claim.

In sum, payday lenders were able to pick and choose which laws applied to them, depending on which state they operated in when in partnership with out-of-state banks. Once the rent-a-bank model was defeated, payday lenders had to move to a different mode of operating that still permitted them to evade state laws.

### 5.4 From Rent-a-bank to CSO Model

The regulatory and legislative challenge with payday lending has stemmed from its ability to grow, prosper, and proliferate; adapting and changing into different business models, citing case law; and seemingly staying one step ahead of state legislatures and regulatory bodies. In the previous section I described the manner in which payday lenders were able to partner with state and national banks to evade state regulations and usury laws while
removing in legal operation; payday lenders attached themselves to federal preemption while it was debated and was the major subject of interest to financial institutions beyond payday lenders. However, as federal regulation began to address the rent-a-bank model, the industry had to shift from the rent-a-bank model to the CSO model.

5.4.1 OCC and the FDIC end Rent-a-Bank Model

Though from the previous section it may appear that the OCC was a protector of payday lenders, it was not necessarily the case. The OCC as an oversight of national banks maintained its position of being the superseding regulatory body for national banks and thus its ability to preempt state laws that conflicted with the regulations that national banks had to observe. In the process of the OCC making this argument and protecting its powers in court, payday lenders simply attached themselves to this rule from the beginnings of this preemption debate when early court rulings favored in this view.

In 2002 and 2003, roughly around the time that Texas acknowledged through its non-real estate lending report from the Office of the Consumer Credit Commissioner (one that reported that only 1% of registered payday lenders utilized state rates), the OCC in conjunction with the Office of the Thrift Supervision (OTS) decided that “risks” associated with bank-payday lender partnerships were unacceptable and called on federally chartered institutions to end the practice (though it was not explicitly made illegal to operate in this matter). All national banks ceased to partner with payday lenders by renting their charter because otherwise they would run the risk of non-compliance with the OCC and OTS, on “safety and soundness risks; consumer and compliance risks; and legal and reputational risks” (Samolyk 181).
Though this eliminated a number of banks that were in partnership with payday lenders, it did not eliminate the rent-a-bank model altogether. As explained earlier, there are nationally chartered banks as well as state chartered banks; those that were state chartered could still export their rates in partnership with payday lenders because they did not answer to the OCC, but rather to the FDIC. According to the Consumer Federation of America (one of the leading consumer protection groups against payday lending in the U.S.), eleven out of the thirteen largest payday loan chains did not make payday loans directly but partnered with banks to finance payday loans (Fox 14). Five of the eleven leading payday lenders had operations in Texas (Advance America, ACE Cash Express, Check n’ Go, Check into Cash, Cash America) and the banks that they partnered with were mainly from Delaware and South Dakota, states known for having lax financial regulations or no cap on interest rates (Fox 15-16).

In 2005, two years after the OCC determined the bank partnerships to be questionable, the FDIC issued revised guidelines for state chartered FDIC members that eventually led to the exiting of banks out of the rent-a-bank model altogether. In the revised guidelines, the FDIC did not prohibit or ask banks to refrain from payday lending or from partnering with third parties to administer these loans; instead, it set regulations with respect to the number of renewals that could be permitted of a single customer within a calendar year, taking into account loans from other lenders, and whether there were outstanding payday loans within three months in the prior 12 months that the borrower had had an outstanding loan. The FDIC issued its guidelines to provide for more safe and sound practices that lowered the risk involved in banks entering in these partnerships (similarly to what was determined by the OCC and the OTS a couple of years prior). Consequently, given the industry’s dependence on the borrowers’ repeated renewal and
use of the product, this FDIC revision led to the exiting of banks from the rent-a-bank model (Samolyk 196).

5.4.2 CSO Model Emerges

With the end of the rent-a-bank model, payday lenders were not left without alternative avenues of operating. Payday lenders in different states were already shifting to operating without state licenses, where no regulatory body could govern them and ask for data, while others were already shifting to the Credit Service Organization (CSO) model (See Table 5.2 Timeline). Since 2003, when national banks were out of the rent-a-bank partnership, and the federal preemption debate was ongoing, but still being applied, payday lenders had begun to relinquish their state licenses and further removed themselves from state regulation by claiming that state licensing was also not required of subsidiaries of federally regulated entities (Texas Finance Commission 27). In the State of Texas, between 2003 and the end of 2005, 47 payday lending entities had already cancelled their licenses specifically stating the latter for their cancellation (Texas Finance Commission 27).

By 2005, the payday lenders were mainly registering as Credit Service Organizations. As with other financial service providers, these two are recognized and chartered at the state level, and thus regulations that apply to them vary from state to state. As described in Chapter 3, in Texas, Credit Service Organizations are recognized by the Texas Finance Code Chapter 393 meant to:
A. “Improv[e] a consumer’s credit history or rating;
B. obtain an extension of consumer credit for a consumer; or
C. provid[e] advice or assistance to a consumer with regard to Paragraph (A) or (B)”.

(Tex. Fin. Code § 393.001(3).

According to the Secretary of State’s website (entity with which CSOs are to register), CSO's are not subject to small-loan laws that the Texas Finance Commission's OCCC oversees because they are not necessarily, at least not up to 2009, a lending entity. It is recognized by a different section of the finance code from the one that recognizes payday loans and similar products. When it was learned that CSOs were offering payday loans (or rather, payday lenders were continuing their practices as CSOs), legislators in favor of further regulating payday loans and the interest rates used opted for having fees associated with CSO services to be equated with interest rates. This was negated though; according to a 5th Circuit court decision in 2004 (Lovick v. Ritemoney Ltd) fees administered by CSO through payday loans could not be considered interest.

So what does this mean? Payday lenders under the CSO model could and can continue to operate in the manner that they did before, yet this time however, with less regulation and less oversight. Payday lenders still partner with third-party lenders that do not need to be registered or regulated like banks are, and can now offer loans with higher costs to the borrower.14 According to the Center for Public Policy Priorities (CPPP), CSO loans are even more expensive, providing the following table:

14 Not enough is known about these new third party lenders. In some cases these third-party lenders may not even be disclosed given the lack of states’ authority to request reporting information from CSOs.
## Table 5.3 CSO Model Fees

<table>
<thead>
<tr>
<th>Loan Principal</th>
<th>CSO Fee</th>
<th>Interest</th>
<th>APR</th>
</tr>
</thead>
<tbody>
<tr>
<td>$300</td>
<td>$60</td>
<td>$1.13</td>
<td>531%</td>
</tr>
<tr>
<td>$500</td>
<td>$100</td>
<td>$1.89</td>
<td>531%</td>
</tr>
</tbody>
</table>

Source: Baylor, “As Payday Lending Spreads Across Texas Can it be Reformed or Regulated” (1).

While growth in payday lender licenses reached a halt or a plateau in 2005 compared to the boom in prior years, the number of registered CSO almost tripled in four years in Texas increasing from 1,279 to 3,594 (Texas Faith for Fair Lending). As the CPPP put it regarding the emergence of Credit Service Organization, it is simply a “new name for an old game.”

Below is a comparative table of the fee and interest rates administered by CSOs compared to legal rates regulated by the OCCC.

## Table 5.4 Fees and Interest Rates (APR) on a $300 Payday Loan

<table>
<thead>
<tr>
<th></th>
<th>Current Law-</th>
<th>OCCC rates</th>
<th>CSO</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>8-day loan</td>
<td>189%</td>
<td>$12.80</td>
<td>1153%</td>
<td>$75.82</td>
</tr>
<tr>
<td>10-day loan</td>
<td>161%</td>
<td>$14.00</td>
<td>925%</td>
<td>$76.03</td>
</tr>
<tr>
<td>15-day loan</td>
<td>124%</td>
<td>$15.60</td>
<td>621%</td>
<td>$76.54</td>
</tr>
</tbody>
</table>

Source: Shapleigh

### 5.5 Continued Regulatory Challenge

To this point, I have described the challenge regulating payday lending as an operating subsidiary of national and state charter banks where federal preemption was applied. I have described how the issue of federal preemption has been ruled in favor of federal administrative
offices (something which may come in ‘play’ again with the creation of the Federal Consumer Protection Agency in 2010). I have also described how the payday lending industry shifted models of operation to continue to operate outside of the states’ regulations pertaining to interest rates, loan terms and conditions, relationships with third-party lenders, licensing, reporting requirements, and number of times a consumer may be granted loans within a calendar year (to name a few).

With the end of the rent-a-bank model, the federal preemption debate continued in its own path as it pertains to other operating subsidiaries of financial institutions, and now, the challenge with regulating payday lending has shifted back to the respective states and the federal government separately. The federal administrative offices -- OCC, OTS, and the FDIC -- played a crucial role in aiding in some aspect of regulating the industry by putting a stop to banks renting their charters to evade state usury laws, and now, states have been able to focus on legislation that is more specific to their state chartered entities.

Before I describe what some of the states have moved towards in an effort to regulate the industry, there is one piece of federal legislation that has been passed and can be considered progress towards effectively regulating the industry. In 2007 the Military Lending Act went into effect which essentially capped the payday loan interest rate at 36% for military personnel and their spouses. This federally mandated cap on the interest rate associated with a payday loan was the first legislative act of its kind. Even though this law only protected one of the identified vulnerable or targeted groups by payday lenders, it has been considered model legislation for states to follow, and initial progress towards effective legislation by the Center
for Responsible Lending, Consumer Federation of America, and the National Consumer Law Center (“Military Lending Act”).

5.6 REGULATING THE INDUSTRY AT THE STATE LEVEL – POST RENT-A-BANK MODEL INTO CSO ERA

With the existence of only one federal law with respect to payday lending and only in the protection of one group of interest, the military, the states have had to develop their own ways of dealing with the regulatory challenge posed by the payday lending industry. As mentioned in previous sections, there are various areas of the industry to regulate. The interest rate continues to be one of the primary focus areas given that in spite of the end of the rent-a-bank model, the new CSO model presents an even bigger challenge with the continuation of these loan products being supplied at a high cost.

The payday lending industry claims that in order for the industry to sustain itself, the interest rates and fees that it charges are fair and necessary. Additionally, it claims that payday loans do provide an alternative to more expensive options for bridging cash flow emergencies like credit cards that accumulate interest in perpetuity, insufficient fund fees that banks charge for bounced checks and over-drafting checking accounts, and even bank offered overdraft protection fees (PersonalMoneyStore.com 28).

As more studies continue to be produced and published, not one study has been able to conclusively state that banning payday lending is the best solution. Conflicting claims have been made by consumer protection groups like the Center for Responsible Lending that states that have banned payday lending have had no negative impact, while industry proponents claim that banning payday lending has deprived the low-income and less than credit worthy from a financial alternative (PersonalMoneyStore.com). I do not offer more details on this debate as
there will be more to come in the subject area in the future years and there is no current data can effectively predict this (this is an area for further study as well).

The state regulatory landscape can be summarized as reported by PersonalMoney.com, which is an advertising website that helps generate applications for online payday lenders. Though it is not a direct payday lender, it has financial interest from the gain of the payday lending industry. Payday lending industry participants like lenders, affiliates, third-party lenders, however, are very knowledgeable in state laws as they provide guidance to payday lending agencies on how to operate within each state or in connection to another state.

- Fifteen states ban payday lending or have usury ceilings that makes the payday lending business unsustainable; Three states only cap the loan amount (three different amounts); six states do not cap interest rates, have no restrictions on the length of number of repayment periods, or the loan amount and;

- Thirty-three states in addition to the District of Columbia have a variety of regulations from loan amounts, to length of repayment, to interest rate (among other regulations).

- Each of these 33 states may have a combination of one more of the regulations.

Texas falls within the last group and has interest rate caps on payday loans among other restrictions but has no expressed limitations on payday loans supplied by CSOs. It should be further noted that state regulations change on a yearly basis so these numbers may be off by one or two states depending on those changes. In similar studies, these categories and number within each category are not that different.
The Texas legislature meets every two years. Payday loans were recognized and in effect by the Finance Code in 2000 (from legislative action taken in 1999). With the rapid growth of small-loans and the nontraditional lending industry (which I have also referenced as the alternative financial services industry, the fringe banking industry and part of the subprime lending industry) and the exponential growth of the payday lending industry, the state legislature (2001 and 2003) called for two reports to inform decision making at the legislative level. Both of these reports were produced by the Texas Finance Commission (both of which I have cited extensively in this thesis) and both were mandated through legislative action.

The first of the two was produced as a result of Senate Bill 272 of the 77th Regular Legislative Session in 2001 and House Bill 1 out of the 78th Regular Legislative Session in 2003. This report was produced and released in 2005 titled: “Legislative Report: The Non-Real Estate Consumer Lending Study.” The second of the two was mandated by House Bill 955 of the 79th Regular Session in 2005 and was released in 2006 titled: “Legislative Report: Preemption of Financial Services Study.”

The first of the two revealed, among other things, that the majority of payday lenders were supplying loans with out of state rates; the second report provided information on how certain financial related laws were preempted by out of state entities like the OCC. The importance of bringing up these two studies again is that besides being a great source of information regarding regulation that had been in effect for payday lending since 2000, it also gives indication of the type of action the State of Texas took towards further regulating the industry; that is, the state first sought to gather information on the financial products
supervised under the OCCC, whether they were effectively or ineffectively regulated, and how laws that were meant to regulate them were being preempted. Additionally, these two studies, pretty much sum up the legislative landscape of the payday lending industry before the FDIC finally put an end to the rent-a-bank model through which payday lenders mainly operated.

To further illustrate on Texas’s trajectory towards the regulation of payday lending, I now offer a general analysis of legislative efforts that took place between 2001 and 2009. I gathered bill information was from the Texas Legislature Online “Bill Search” tool. I searched for bills passed in each legislative session (all bills found took place during the regular session each year) and utilized the following keywords: “deferred presentment transaction,” “payday loans,” and “credit service organizations.” I complemented and cross-referenced this list with a number of bills that were supplied by the National Conference of State Legislatures on Payday lending legislation for years 2007 and 2009 as similar data was not available for previous years.15

The following table is meant to illustrate the amount of activity on the subject matter in each legislative session from 2001 to 2009 and the level of success reached towards the enactment of the proposed bills. Though the two legislatively mandated reports produced by the Texas Legislative Council and the Texas Finance Commission aided in contributing to the knowledge needed for future drafting of legislation, they are not included in this table because they were mandated as part of action associated with other financial products and matters like the overall Office of Consumer Credit Commissioner licensees or the overall Texas Financial entities.

15 It is possible that sometimes legislation may not come out in a search using the keywords search criteria if it was introduced in conjunction with other legislation for other financial products.
Within each legislative session included in the table, I make a distinction between the number of bills introduced each year in the House and Senate to identify whether a difference could be noted. I further break down the number of bills that pertained to each of the searched keywords (it is possible that some bills can be double listed, but the total number of bills is most accurate) to give indication on the familiarity or understanding of the payday lending industry language, and perhaps its scattered approach to attempt to regulate the industry. The bill general descriptions column should give indication of the change in trends towards regulating the industry by the focus area of regulation (be it the language, the components of the legislation, the subject matter of the legislation, etc).
Table 5.5 Chronology of Texas House and Senate Bills

<table>
<thead>
<tr>
<th>Legislative Session</th>
<th>Year</th>
<th>Number of Bills</th>
<th>Subjects</th>
<th>Bills General Descriptions</th>
<th>Summary of Action (see Stages Diagram below)</th>
</tr>
</thead>
<tbody>
<tr>
<td>77th R</td>
<td>2001</td>
<td>3</td>
<td>HB 2</td>
<td>3 SB 1</td>
<td>Bills concerning the practices of payday lenders with regard to licenses, renewals disclosures, and ability to cash checks as collateral. 2 of the 3 bills did not make it past Stage 1. SB 471 Bill concerning the renewal of loans prior to payment of first loan and disclosure of practices (and not other provisions like the other two bills) made it to Stage 3.</td>
</tr>
<tr>
<td>78th R</td>
<td>2003</td>
<td>1</td>
<td>SB 1</td>
<td></td>
<td>Though the search turned up 4 deferred transaction bills, and CSO, only one DPT was concerning payday loans. The rest of the bills were regarding regulating the subprime lending, and some predatory lending, in mortgaging, and auto loan financing. 1 payday loan specific bill did not make it past Stage 1.</td>
</tr>
<tr>
<td>79th R</td>
<td>2005</td>
<td>5</td>
<td>3 HB 2</td>
<td>2 SB</td>
<td>Bills were presented in both senate and house to add language to the Finance Code 342 to address deferred presentment transactions. One of the bills began to address military personnel. Both of the payday loans were within the deferred presentment transaction bills. None of the bills made it past Stage 1.</td>
</tr>
<tr>
<td>80th Regular Session</td>
<td>2007</td>
<td>14</td>
<td>7 HB 7</td>
<td></td>
<td>Legislation introduced pertaining to the regulation of people offering deferred presentment transactions, reporting requirements of CSOs, credit to military personnel, and one of interest and fees. 11 of the 14 bills did not make it past Stage 1 HB 285 pertaining to debt of military in active duty made it to Stage 2. SB 753 concerning reporting of CSO information made it to Stage 3 SB 855 concerning credit and members of the armed forces made it to Stage 4</td>
</tr>
<tr>
<td>81st Regular Session</td>
<td>2009</td>
<td>15</td>
<td>8 HB 7</td>
<td></td>
<td>Legislation introduced regarding consumer education, military and national guard personnel protections, and several for the regulation of CSOs each with similar and different provisions. 14 out of the 15 did not make it past Stage 1. SB 189 concerning the extension of credit to Texas National Guard and U.S. Armed forces providing penalty made it to Stage 4</td>
</tr>
</tbody>
</table>

Screen capture of a successful law passed in the State of Texas. Each stage delineates progress on a particular bill. Source: Texas Legislature Online, Bill Search
Prior to 2005 when not enough was known about the payday lending industry, only three payday lending specific bills were introduced in 2001 and only one in 2003. In 2005, two payday lending specific bills were introduced, and five ‘deferred presentment transaction’ bills were introduced all with more specific language a specific changes to the finance code recognizing payday loans. Prior to 2005, good language was presented via a few of the bills that were payday lending specific; however, those bills that were presented that offered a virtual rewriting of the entire sections of the code that would impact payday lending did not make it past Stage 1 of the legislative process. The only bill prior to 2005 that made it as far as Stage 3 contained only a few revisions, identifying only certain aspects of the lending practices for payday lenders.

Before 2005, there was also little acknowledgement of legislative action with regard to Credit Service Organizations; the two bills that did get introduced in 2003 were irrelevant to payday lending and instead had more to do with auto title-loan financing (auto loan-title financing has also evaded state regulations by registering as CSOs). In 2005, however, seven bills were introduced with more specific language trying to regulate the payday lending industry through the deferred presentment transaction language and the payday lending language. Also, it is in 2005 that the emergence of military personnel specific legislation emerged, consistent with the national trends that were brewing up to the Military Lending Act that went into effect in 2007.

What should be noted and highlighted from this is that none of the bills attempting to regulate payday lending made it past Stage 1, perhaps giving indication of unsuccessful
regulation of the industry. One of these bills can still be considered a success, however, in spite of its unsuccessful passage — the successful passage HB 846, which as opposed to helping regulate the industry for the protection of consumers, would have tripled the interest rate cap on payday loans (Baylor, “Unregistered and Unregulated” 1).

By 2007, an influx of activity occurred at the legislative level with regard to payday loans, deferred presentment transaction, and the first CSO specific pieces of legislation. In the 80th Regular Legislative Session, fourteen bills were introduced, half in the House and half in the Senate; five were for payday lending, seven for deferred presentment transaction, and two pertaining to credit service organizations. Of the fourteen bills, eleven did not make it past the first legislative state; however HB 285 pertaining to the military in active duty made it to Stage 2, SB 743 pertaining to CSOs reporting on some of their acuities reached Stage 3, and SB 855 also concerning members of the armed forces made it to Stage 4.

In 2009, a similar trend as 2007 took place with respect to the majority of bills not making it past Stage 1 occurred and the one bill that reached the highest level, or further in the legislative process (Stage 4), was the one bill, SB 189, which was about loans concerning members of the Texas Guard and the U.S. Armed Forces. What differed most in 2009 from prior years, however, is that bills were not introduced within the following distribution of area of focus or subject matter – nine in payday loans, six in deferred presentment transactions, and seven in the Credit Service Organization subject matter.

5.9 What Does this All Mean?

Texas has addressed payday lending in the legislature but has seemingly been unwilling to make changes to regulations pertaining to payday loans. Texas has produced good
information regarding the industry in conjunction with other financial services data, but has shown little progress towards effectively regulating the industry. Texas is part of the majority of states that has continued to regulate the industry at the state level with the introduction of bills that attempt to address components of the payday lending practices. However, it has failed to pass legislation that effectively regulates the industry.

As the trend may indicate, federal legislation and regulation has come to impact the regulatory challenges of the industry much before Texas has either been able to or been willing to. As with the case of the armed forces group of interest, Texas did make some progress in efforts to regulate the industry to protect military personnel and Texas Guard. However, with the passage of the Military Lending Act that went into effect in 2007, the latter was basically taken care of outside of the state’s ability or willingness to effectively regulate the industry since federal regulation preempts state law.

The defeat or lack of action with HB846 may show some consistency with the states’ lack of action in regulating the industry. There appears to be no interest or political will to address the industry through legislative action. It could be assumed that this inaction is of no consequences when such payday lending caps would have had little impact given the shift that took place around the same time to the CSO model. Interest rate increases to the payday loan caps would have had little impact if the majority of payday lenders were relinquishing their licenses and opting to operate as registered credit service organizations.

There is some speculation, as noted by some industry critics, that lack of movement ineffectively regulating the industry comes from Governor’s Rick Perry’s apparent ties to payday lenders as well as potential influence the industry may have on elected officials. It was
reported by Senator Eliot Shapleigh in 2009, former Senator from El Paso, Texas and author of over 10 bills to address predatory lending within the payday lending industry, that Governor Rick Perry and other members of the Texas Senate and House received over $400,000 in contributions in 2008 from payday lending entities. He further reported that Cash America, one of the top payday lending companies in the state, spent more than $700,000 in political campaign contributions in Texas alone between the years 2000 and 2006. Last, he also noted the fact that in 2009, Governor Perry appointed Chair of the Texas Finance Commission, William J White, Vice President of Cash America International.\footnote{White’s appointment ended in 2010.}

5.10 Conclusion

The regulatory challenge with the payday lending industry continues, and with the end of the rent-a-bank, the challenge to effectively regulate the industry is back within the jurisdiction of states to effectively do so within their legislative bodies. Though some states have come to ban the use of payday lenders in their states, it is still unclear if this is the most effective way to regulate the industry given the lack of alternatives that borrowers may have, and yet another area of the issue to keep researching. However, the federal government has had a role in serving as a model on potential ways in which the industry can be regulated with its 36% interest cap for military personnel, and may prove to help lead the way in further regulating the industry.

With the many aspects of lending features and aspects associated with payday loans, it is important to identify legislation that effectively deals with the problem, be it by regulating the interest rate, the number of renewals, the lenders practices with regard to taking the
payers’ ability to repay the loans into account, or be it the length of the loan terms. Whichever the area or areas of the payday lending practices that need to be regulated are in order to effectively protect consumers, it is of most importance to recognize the need to do so; the high cost associated with payday loans, and its negative impact on the most vulnerable of consumer populations, is undeniable and must be properly addressed be it at the state or federal levels.
Chapter 6: Conclusion and Recommendations

The payday lending industry has grown exponentially compared to other lending markets within the short-term subprime and alternative financial resources industries. Its existence and prosperity are perpetuated by its use of business models that encourage borrowers to become repeated users. The consumer base for the industry continues to expand given the apparent need for the product in the absence of other alternatives that meet the borrower’s needs. Very few (if any) product alternatives exist for the majority of the consumer base for this product that possess comparable loan terms or that are as accessible with regard to credit-worthiness, loan disbursement, geographic proximity, and with cultural appeal.

The major problems identified to this point are not just that payday loans exist, though some states have outright banned them, but that the lending practices of the payday lending industry can be documented and categorized within the description of predatory lending. Not only are its practices predatory in nature, but there is a very obvious use of the regulatory challenges to their advantage, as the industry continues to operate successfully through the evasion of state usury laws meant to further regulate them to protect consumers.

The payday lending industry represents a problem and causes significant hardship to vulnerable populations because it is costly and because its practices are predatory: (1) high interest rates assessed for payday loans that cannot be fully justified based on lender risk, (2) the loan product and design encourage repeated use of the loan or an intended ‘trap’ for indebtedness, (3) the ability of the borrowers to pay back the loans is not fully taken into account when approving the loan, and (4) they target minorities and other vulnerable populations.
The industry continues to charge high interest for payday loans above 500% APR, borrowers on average renew the loan more than 5 times while it has also been documented in cited studies that some borrowers renew and rollover their loans more than 20 times a year. Borrowers usually fall within the lower income brackets of society. With the economic recession and rise in unemployment, many people that would have been considered middle income are now falling into a broader definition of the poor or the working poor. Last, the populations that are targeted for these loans are also the most vulnerable to fall within these low-income brackets consisting of women, the elderly, college students, the military, and high volumes of African Americans and Latinos.

The larger problem, however, is that despite the evidence of the industry’s questionable practices, what officially constitutes predatory practices applicable to the payday lending industry are yet to be effectively defined and articulated. Problems and solutions must be adequately identified and conceived in order to formulate the right policy meant for passage (Kingdon 110). States that wish to effectively regulate the industry remain at a standstill, like Texas, in the absence of well defined legislation. Additionally, it poses a bigger challenge to regulate the industry when payday lenders appear to be a step ahead of any legislative efforts by operating under the radar with regard to payday lending specific language, yet benefiting from those laws that they claim protect their practices.

Though the rent-a-bank model was ultimately defeated and eliminated through administrative regulation, it did not eliminate the ways in which payday lenders may continue to operate with little regulation or oversight. The emergence of Credit Service Organizations as
payday lenders proved that the industry can identify ways to continue to operate despite legislative and administrative attempts to effectively regulate the industry.

Through this study, the elite policy-making process--involving the industry to be regulated, the regulatory bodies, and politicians whose self-interest in campaign contributions stymied action--was shown to be ineffective in regulating the industry with the exception of the one federal law protecting the military. This can be argued that it was bound to happen because the impact on the military was of higher consequence to the United States Government than the impact the same loans are having on the historically disadvantaged populations, such as low-income people, women heads of household, Latino and border populations.

Besides being economically disadvantaged, the targeted populations have had to struggle to make their voices heard as with the example of the 1970’s efforts to pass consumer protection laws (CRA and HDMA): the same struggle continues and repeats itself with the need for consumer protection from payday lenders. They continue to be relatively powerless politically and unable to provide large campaign donations to representatives to curry their favor, which competes with the group theory belief that groups will struggle to achieve their interests as though these were competing in the same playing field.

Additionally, in the policy-making process in the attempt to regulate the industry (if the introduction of bills may be labeled as such in Texas), it was demonstrated that it is neither an easy process nor a linear one. Instead, it showed how the impact of other regulatory bodies, and even policy-making bodies like the courts, had an impact in the overall regulatory challenge. The effective passage of laws at one point would have been preempted anyway
when the courts upheld that subsidiaries of banking institutions did not have to comply with state regulations.

Last, what was also learned was that administrative regulation had the most impact on addressing the regulatory challenges, when the OTC, the OCC, and the FDIC ultimately put a stop to the rent-a-bank model. These regulatory bodies were informed, with pressure exerted by consumer protection groups and nonpartisan research organizations, which is consistent with the successful passage of any legislative action meant to protect consumers (Hurd, Donner, and Phillips 151).

6.1 Limitations and Areas for Further Study

There are many aspects of the payday lending industry and its regulatory challenges that can and should be further studied. At the outset of this study, I identified the problem of predatory lending through empirical research among low-income border people and payday lenders. Through the remainder of this study, I analyzed the complex regulatory environment of the payday lending industry, narrowing my focus to the industry’s users, the industry’s growth, the apparent predatory lending practices of the industry, and its regulatory challenges, primarily in the State of Texas. I also focused on regulatory challenges posed by the industry’s agility in taking advantage of existing regulatory loopholes in their ability to operate with different business models, as well as the consequential action federal regulatory offices took to impact the industry.

In offering alternative policy solutions, I uncovered the difficulty of navigating reform through the Texas legislature without ‘champions’ or strong, civil society activism that can counter the well organized and well-financed payday industry. I first attributed Texas’s inability
to effectively regulate the industry to the challenges faced by most states with the federal preemption debate. Yet, the fact that some states were successful in either banning the industry, reveals Texas’s inability or unwillingness to regulate the industry. Future analysis should examine those states where legislatures have effectively regulated or banned predatory lending in order to determine what constellation of voices, arguments, and approaches operated in the policy-making process.

There are two major areas that I believe would be of continued importance to study moving forward that I did not cover in this study. One is the study of the payday lending industry that operates mainly via the Internet. This is an evolving and growing subset of the industry that I suspect, given the historical precedent, that it has its own set of corresponding challenges and practices that differ from storefront payday lenders. The way Internet payday lending industry operates, functions, profits, and is regulated is a whole other area to examine. If regulations are successful in states and at the federal level that address store-front payday lenders and not internet based payday lenders, then the regulatory challenges saga will continue. If much effort and resources are being dedicated to control the negative impacts of the industry, then the internet-based payday lending industry must be addressed in those efforts.

The second area for further study that I also consider to be important is the determination of the actual need for the payday lending industry. In the absence of comprehensive legislative efforts to help the traditionally underserved, and the struggling middle class, to come out of financial strain (efforts that would help with healthcare challenges, employment, and overall distribution of wealth in this country) payday loans will
continue to be utilized whether the use of these loans is deemed rational or not. If the loan product is necessary because it is more accessible, less intimidating than traditional products, more culturally appropriate, and available to those with less than worthy credit, then the product should be redesigned to meet the needs of consumers while not exploiting them.

There is more to learn about product alternatives, about the overall availability of credit for the increasing number of people that have fallen into debt traps and considered ‘non credit worthy,’ and there is more to learn about the role banks have played in the perpetuity of the industry. Banks might be contributing factors to the problems as financiers and participants within the industry, but might also be contributors to potential future solutions with the provision of financial services that meet consumer needs.

6.2 RECOMMENDATIONS

The following are recommendations for consideration, consistent with some recommendations made by those who wish to further regulate the industry, protect consumers and limit the negative financial impact payday lenders have on its consumers:

- In agreement with many consumer protection groups, the CSO loophole should be eliminated so that proper regulation can be developed and applied to the payday lending industry. There is no sense in continuing to pass laws to address payday lenders if they will continue to evade such regulations under other forms of operation.
- The Internet based payday lending industry should be thoroughly examined to understand the applicability of existing laws, and where those applicable laws are being violated, and action against violators should be taken.
• Legislation should be formulated in partnership with industry associations as well as consumer protection groups that know the consumer base best and can facilitate their input in the process. Together with legislators, they may develop and propose solutions that will successful pass legislation (i.e. that won’t be blocked by well financed lobbyists) and that will in essences protect consumers.

• More studies on the industry should be conducted as not enough is known about this portion of the financial services. These studies should indicate whether having separate regulation for small-lending agencies at the federal level, for instance, might be more appropriate than at the state level - just because the banking industry has been effectively operating as a dual-banking-system, it does not necessarily mean that this is appropriate for ALL types of financial service entities.

• While avenues to regulate the industry are being studied, federal legislation should be focused on predominantly. With the standing ruling of the authority of federal agencies having the power to preempt state laws when federally regulating state chartered financial institutions, it should be used to preempt state laws that are not effectively regulating the industry, which to date, is the majority of the states. It should be noted that effective in 2011 is the creation of the federal Consumer Financial Protection Agency enacted by Congress in 2010. This federal regulatory agency may be the body that may be able to address some of these recommendations. Too little is known about this agency to intelligently speculate, but it is definitely an agency to study and learn about.
• The ‘successful’ passage of regulations for payday lenders in the states that have banned the industry or strictly regulated it, should be evaluated for impact to develop best practice legislation or to avoid potential unforeseen negative impacts of such legislation.

• The power of grassroots and community-based organizations should be further strengthened and supported as it is these entities and groups that have achieved the necessary pressure on legislators to pass consumer protective regulations. It is the activists that produce evidence of the problem the fastest, can come up with realistic solutions, and can best represent the traditionally underserved and underrepresented minorities.

• Last, nonprofit economic development strategies should be funded like Individual Asset Development Account (IDA) programs that can be utilized for emergencies typically met through payday loans (IDA accounts are saving accounts with match dollars typically used to fund education, business, or home down payment needs).

After years since I first interned with the El Paso Collaborative, it has been exhilarating to see how an issue of concern for me in the early 2000’s became such a widely understood problem and that efforts to address it have been made. The number of studies and articles that came out regarding the industry truly emerged in the last decade. There is much more work to be done in this arena, and I have come to appreciate the importance of deeply analyzing a social problem to come up with potential public-policy oriented solutions to address them. It is uncertain what the future of the payday lending industry will look like in the next decade, but if
it is anything like the last decade in the speed by which the growth of knowledge was produced,

I suspect proper and fair regulation will be accomplished by the end of it.
Works Cited


## Appendix A

### Distribution of Banking Agencies in El Paso County by Zip Code

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<th>Pawnshops</th>
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<th>Commercial Banks</th>
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Appendix B

SENATE BUSINESS AND COMMERCE COMMITTEE
SUBCOMMITTEE ON INTERIM CHARGE #4
LENDING PRACTICES AND ACCESS TO CAPITAL

TUESDAY, MAY 21, 2002, 10:00 A.M.
ONE STOP CAPITAL SHOP
1359 LOMALAND DRIVE
EL PASO, TEXAS

AGENDA

I. ROLL CALL

II. INVITED TESTIMONY

Border Community Perspective on Lending and Access to Capital
Mayor Ray Caballero
Arthur Piscenzi, County Attorney’s Office

Trends and Patterns: State Leading Environment
Bank Fees and Federal Preemption Issues—Steve Martin, Texas Department of Banking
Maximum Interest Rates and Preemption—Leslie Pettijohn, Consumer Credit Commissioner

Access to Credit and Capital Issues
Kathy Cor, El Paso Hispanic Chamber of Commerce
Fermin Acosta, OECU
John Field, Greater El Paso Chamber of Commerce

Mortgage-Secured, Business and Personal Lending
Abel Pichardo, Mortgage Fund America
John Henneberger, Texas Low Income Housing Information Service
DaCosta Mason, AARP

Business Lending
Betty Navares, ACCION
Jerome Green, Community Scholars

Panel: Financial Literacy and Strategies for Moving Underserved Markets into Mainstream Lending
David Lovell, Chairman and CEO, Aquisa Bancorporation Inc.
Neale Godfrey

III. PUBLIC TESTIMONY

IV. RECESS
Appendix C

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Good afternoon, my name is Azuri Gonzalez. I am a senior undergraduate student majoring in Political Science at the University of Texas at El Paso. I am an intern with the El Paso Collaborative for Community and Economic Development, where I have been assigned to conduct research related to access to capital and predatory lending, with a focus on colonia residents. I will be presenting testimony today on behalf of our organization.

Testimony presented to the State Senate Committee on Business and Commerce
El Paso, TX May 21, 2002

Background

Established in 1997, the El Paso Collaborative for Community and Economic Development is a federally certified, tax-exempt nonprofit organization. Its mission is to facilitate affordable housing, homeownership, and economic development in the region that includes El Paso County, Texas and Dona Ana, New Mexico.

Through its work in supporting and helping to build the capacity of local nonprofit organizations over the years, the Collaborative came to see that providing affordable housing was not enough to address the needs of the most isolated and underserved sector of our community. To break the cycle of poverty and move families beyond subsistence level, residents needed mechanisms to increase their personal savings rate and access to alternative financing. They also needed financial literacy services to show them how to save and invest their meager incomes, rather than squander what little they have on interest, fees and refinancing schemes perpetrated on them by predatory lenders.

In response to a lack of access to capital for residents of the Empowerment Zone and the colonias, in 2001 the Collaborative was certified as a Community Development Financial Institution (CDFI) and is currently the only such entity operating in El Paso County. Our Goal is to help low-income residents build assets and wealth, by establishing a foundation of saving and investment linked to their most basic asset- a home. Despite the technical and financial obstacles faced by colonia residents, these families are invested in their community, determined to own land and build their own home, and struggling to do so with virtually no access to education or capital. A door-to-door survey found that nearly 70% of these residents own or are buying their homes, affirming their ownership and borrowing potential and the permanency of their communities.

Few, if any, colonia residents have a checking or savings account and a majority must rely on fringe financial services to meet their credit needs. Most pay cash for purchases and any financing they are able to obtain generally comes from developers, pawn shops, or finance companies at significantly higher rates and fees than traditional financial institutions. In addition
to financing, residents need cultural and language-appropriate financial literacy education and housing counseling to help them understand and utilize legitimate financial services.

Our efforts to establish a successful revolving loan fund for housing and economic development are financially supported by the US Dept of HUD, Housing Assistance Council, Wells Fargo Bank, Chase Bank, and the US Department of Treasury CDFI Fund. With a technical assistance grant from the Fund, we are undertaking extensive research to compile data and test our assumptions about the access to capital needs of low-income residents. This research is being conducted largely by college-level interns under the supervision and guidance of expert practitioners and qualified consultants and consists of a variety of surveys, focus groups, information on “best practices” and the combined 30 years experience in our staff.

We want to highlight some preliminary findings of our local market research that point to disturbing trends in predatory lending in our border community:

1) Non-traditional lenders in El Paso County outnumber traditional lending institutions by a ratio of nearly 3 to 1. The research, based on SIC Codes, identified a total of 256 non-traditional lenders operating throughout El Paso County vs. only 88 traditional financing institutions. This number includes all branches of a bank or credit union, so the unduplicated number is presumed much smaller.

2) In a review of data obtained on 131 signature loan companies, 76 or 58% generate annual sales revenue of $1 million to $2.5 million, while another 22% generate half a million to $1 million in annual sales. An additional 5% generate annual sales in excess of $2.5 million.

3) Based on information obtained from 29 companies surveyed thus far, loans range from $50 to $500, with interest rates ranging from 80% to 200% and a median term of 12 months.

4) The three zip code areas with the lowest median household incomes in the county which are located downtown (79901), central (79902), and south central El Paso (79905) had a disproportionately high prevalence of “fringe” financial services, such as pawnshops, check cashing establishments, and finance companies. Based on 1990 census data, median household incomes for these areas ranges from a low of $6,743 to $16,460 for a family of four.

5) 58% of the 256 non-traditional lenders in El Paso County are located in seven zip codes (79901, 79902, 79903, 79905, 79907, 79915, and 79930) that comprise the downtown, Central and Lower Valley areas of the city. By contrast, only 33% of the 88 traditional financing institutions (banks and credit unions) operating in El Paso are located in these areas.

6) Of eight (8) distinct geographical areas of the county, Downtown had the largest number (72) of non-traditional financing companies, followed by Eastside (50), Lower Valley (42), Central (35), Northeast (22), and Westside (20), Far East and Far West areas outside the city limits (in predominantly colonia areas) had a total of (13).

7) Colonias areas in Far West and Far East El Paso had a total of 13 non-traditional financing institutions vs. only 4 commercial banks and credit unions.

(This data will be correlated with population to determine the number of these types of businesses per capita as a more accurate measure of their prevalence within the community.)
In Summary, we leave you with excerpts from an article published by the Progressive Policy Institute in August 2001, which indicates that:

1) Unbanked households are predominantly poor, minority, young and less educated than the general population.

2) Low-income workers are increasingly turning to “non-traditional” lenders such as pawnshops and check-cashing establishments for their banking and credit needs. An estimated 11,000 check-cashing stores are in business today or double the number five years ago.

3) “Payday lending” which was in its infancy just a decade ago, is perhaps the fastest growing fringe service available today.

4) Mainstream banks can and should compete effectively in low-income markets, but doing so will require a radical re-thinking of how they do business with low-income consumers. Bringing banks to the unbanked will also require the full cooperation of government and community-based organizations.

5) Traditional banks can adapt to a nontraditional market either by offering nontraditional services themselves or partnering with institutions that do. Community-based organizations can help educate consumers and the relative costs of financial services and the benefits of saving.
Curriculum Vita

Azuri Lizeth Gonzalez was born in Ciudad Juarez, Chihuahua Mexico and has lived in the El Paso-Cd. Juarez region all her life. She earned her Bachelor of Arts degree from the University of Texas at El Paso (UTEP) majoring in Political Science with a minor in General Business in 2002. After earning her degree, she has worked professionally at the University in various capacities at the Center for Civic Engagement (CCE). She is currently the Director of the where she develops service-learning and academic engagement teaching and learning opportunities for students and faculty. In her role as Director, she has also co–taught a University 1301 course with Dr. Kathleen Staudt in 2005 and a Women’s Studies Course on Social Entrepreneurship with Deanna Varela in 2009.

Gonzalez has ample experience with working with nonprofit organizations as a technical assistance provider and capacity-building facilitator. She has also served on a number of nonprofit boards including the Nonprofit Enterprise Center, the Women’s Fund of El Paso, the YWCA Paso del Norte and the YWCA USA.

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