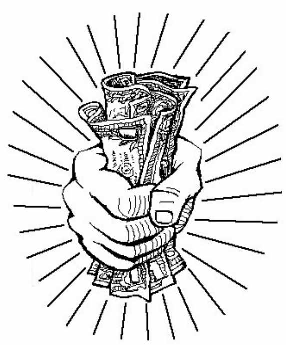
Don’t Fix What Ain’t Broke:

The Payday Lending Ban in Georgia Works



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DON'T FIX WHAT AIN'T BROKE: GEORGIA'S PAYDAY LOAN BAN WORKS

EXECUTIVE SUMMARY

Payday lending is a national problem. Payday lending is not a Georgia problem.

In dozens of other states, where payday lending is legal, powerful payday lobbyists have convinced lawmakers to exempt their industry from existing state usury limits. Payday lenders in these states charge over ten times the interest that most banks and credit card companies are permitted to charge and they repeatedly roll-over loans, generating new fee income without extending new credit.

The fee income payday lenders make from rolling-over loans is the lifeblood of their industry. Loan fees cost borrowers in *other* states $4.2 billion annually. But not in Georgia.

For two years, Georgia consumers have been spared the crippling cost of paying triple-digit interest on payday loans. Georgia has saved its families over $350 million in hard-earned income since banning payday lenders in 2004. Most of that money would have otherwise gone into the pockets of out-of-state companies. Instead, working families have used it to pay for groceries, school supplies and heating costs.

Payday lenders prey on our neediest citizens. While payday loans are marketed for meeting emergency needs, only 1 in 100 loans are made to borrowers who use the product once in a year. Ninety percent of loans go to borrowers who have five or more payday loans per year, and nearly two-thirds of total payday revenues are extracted from borrowers who take out 12 loans or more per year.

These types of numbers led researchers at the University of North Carolina to conclude that "the financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers."

In this report we find that:

- Georgia families save $147 million a year because the state's usury rate cap prevents predatory payday lending.
- The existing small loan market in Georgia thrives—with consumer finance companies making $473 million in small loans each year.
- Allowing payday lending at triple-digit interest rates will only cause families to become trapped in a cycle of debt.

Policy Recommendation

- Georgia should continue to successfully protect its families by upholding its 60 percent usury cap for small loans.

INTRODUCTION

Payday loans are short-term cash advances on a borrower's next paycheck, secured by access to the borrower's bank account. To qualify for a payday loan, borrowers need only have a checking account and a steady income. The borrower gives the payday lender a personal check and receives cash, minus the lender's fee, which is generally $15 for every $100 borrowed—the equivalent of about 400 percent APR. While an occasional payday loan used for a financial emergency may seem reasonable, over 90 percent of loans go to repeat borrowers caught in a cycle of debt. Rather than helping people bridge a financial gap, these loans lead to financial ruin.

Borrowers most likely to use a payday loan are those living paycheck-to-paycheck and without any significant savings. Not surprisingly, the vast majority of borrowers, after accepting a payday loan, cannot pay back the loan and their other bills. To avoid default, they must renew the loan and pay another high fee. Pressures to renew the loan include the specter of multiple bounced check fees from the bank (as the payday lender can repeatedly pass the check through the borrower's account). Borrowers consequently find themselves trapped in an endless loop of loan flipping, as payday lenders repeatedly refinance these high-cost loans.

In the 39 states that currently do not apply a sensible usury rate cap to payday lenders, borrowers pay a total of $4.2 billion in predatory fees every year.[i] Georgia is a different story—because the state has refused to carve-out an exemption for predatory payday lenders, these defective loans are not made, saving consumers an estimated $147 million every year. Payday lenders, however, are trying to work their way back in, asking state policymakers for an exemption to the usury cap, which would allow them to make loans at a cost to consumers in excess of 390 percent APR.

A RADICAL DEPARTURE FROM OUR CIVILIZATION'S VALUES

Civilizations throughout history have banned or limited the charging of interest upon a loan of money, starting with the Old Testament (Ezekiel 18:19-13) and the Code of Hammurabi. The Greeks and Romans restricted interest rates. So did Elizabethan England. The original thirteen American states adopted usury caps, most of them set at 6 percent. In 1916, a uniform small loan law allowed specially licensed lenders to charge up to 36 percent in return for adhering to strict lending standards. All states adopted special lending laws, including versions of the uniform small loan law, from 1945 to 1979, permitting higher rates but continuing the tradition of capping interest.[ii]

Payday lending laws, including House Bill 163, are an **exemption** from the long-standing traditions of our civilization and not "regulation" as the industry often characterizes them. The United States enacted usury laws for very important reasons - almost two hundred years ago, a Virginia court stated:

> *These statutes were made to protect needy and necessitous persons from the oppression of usurers and monied men, who are eager to take advantage of the distress of others; while they, on the other hand, from the pressure of their distress,*

are ready to come to any terms; and with their eyes open, not only break the law, but complete their ruin. Whitworth v. Adams, 5 Rand. 333, 335, 1827 WL 1200 (Va. 1827) (quoting Brown v. Morris, Cowp. Rep. 792).

Payday Lending's History in Georgia

Although Georgia has never legalized payday lending, some form of payday lending went on for over a century. In the late nineteenth and early twentieth centuries, lenders calling themselves "wagebuyers" evaded Georgia's usury laws by giving credit to borrowers in return for an assignment of future wages. Because borrowers could not afford to pay these loans back when due, they often rolled-over debts.

Georgia policymakers attempted to respond by outlawing roll-overs and outlawing assignments of future wages as security. Determined to keep operating in the state, payday lenders then sought to get around these new laws by purchasing future wages rather than having borrowers explicitly assign these wages to them, and continued to find ways to roll-over loans.

By the 1950s, it was apparent that regulations seeking to curb high-interest rates would not deter payday lenders. So, lawmakers established an interest rate cap for small loans, along with the Office of the Industrial Loan Commissioner, which was charged with monitoring the small loan industry.

But the payday lenders weren't deterred. They evolved their business model again in the 1990s to circumvent state law by securitizing the loan with a borrower's personal check rather than wages. They also began operating storefronts using the "bank agency" (sometimes called "rent-a-bank" or "rent-a-charter") model, in which a payday lender partners with a federally-insured bank in order to export favorable lending laws from the bank's home state to consumers in states like Georgia where lending regulations are more restrictive. Because of this partnership, payday lenders in Georgia were able to charge triple-digit interest rates on payday loans – well in excess of the state's 60 percent usury cap. Other lenders made payday loans through such thinly-veiled subterfuges as selling long distance phone cards with a cash rebate, catalog coupons, and other schemes to hide high interest rates charged to borrowers. For example, in one case, a borrower received a cash rebate of $300 and a long distance phone card, and was then required to pay $67.50 every two weeks for an entire year.[iii]

After seeing many families become trapped in yet another iteration of payday lending, the Georgia legislature passed the first state law to prohibit payday lenders' usage of this "bank agency" model to evade the state's usury cap. The law also created new criminal and civil penalties, making it a felony offense for lenders to charge rates in excess of the usury cap. The legislation received bi-partisan support, and was signed into law by Governor Sonny Perdue in April 2004. Though the payday lenders' trade association challenged the law, costing the state millions of dollars in legal fees, Georgia won every decision until finally, the FDIC issued regulations to end the bank agency model in every state, rendering the court challenge moot.

Today, payday lenders are again attempting to re-start their operations in Georgia. They are throwing their support behind a bill that would carve out an exemption in the usury cap for payday lenders. House Bill 163 would allow payday lenders to charge up to 13 times more than all other lenders can charge. Supporters of the bill argue that APR is not an appropriate way to assess the costs of a payday loan. This reasoning is in direct conflict with the Federal Reserve's position that payday loans are, in fact, loans and that the interest charged on payday loans should be expressed in terms of APR, according to the federal Truth-in-Lending Act.[iv] The annual percentage rate is important because it allows consumers to compare the cost of credit across products of varying terms and other features. For example, it can help borrowers determine whether a credit card advance is a better option than the typical payday loan for a short-term cash need.

PAYDAY LENDING HURTS REAL PEOPLE

In March 2003, Paula Shamburger's husband was out of work, the family's savings were exhausted, and she needed money to pay her car insurance. Rather than let her car insurance lapse and risk driving uninsured, she went to a payday lender in Jonesboro and took out a $500 loan.

Shamburger, an insurance investigator in the consumer services division of the Georgia Department of Insurance, quickly regretted her decision.

"I have a college degree, Shamburger said. "Should I have known better? Yes, I probably should have. But desperate times call for desperate measures."

Shamburger says she made interest payments on her loan every month for five months. But not long after she got the payday loan, the state passed a law making these loans illegal – at which point the lender called her and told her she needed to restructure her loan.

The payday lenders canceled Shamburger's payday loan and entered her into a "leasing program." The lender asked Shamburger to bring in the serial numbers belonging to two household appliances. Shamburger sold the lenders her used electric can opener and coffee maker, and they leased them back to her – for $250 each, plus interest.

In July 2003, Shamburger paid back her loans, along with the interest owed on them. In all, she paid over $1,000 on a $500 loan.

"Would I do it again? Absolutely not. But you never know what you're going to do until you're in dire straights," she says.

HB 163'S "PROTECTIONS" – DEFUSING A BOMB AFTER IT HAS EXPLODED

In addition to allowing payday lenders to charge triple-digit interest rates, House Bill 163 contains a few "best practice" provisions that may appear at first glance to protect borrowers from the predatory aspects of payday lending – but do not. The simple truth is, for families that genuinely need small cash loans (typically those without savings and who live paycheck-to-paycheck), the two-week loan is not the answer. These families just won't have enough to pay both the loan and the 390 percent interest, in addition to household costs such as utilities, food and other essentials. Therefore, any so-called "protection" that is imposed after the fact, after making the payday loan, is very likely to fail.

Renewal Prohibitions

Other states, Oklahoma for example, have enacted similar legislation prohibiting renewals, and the resulting data found no reduction in the amount of payday lending debt trap activity. A "renewal" is a loan that is extended (or rolled-over) with a new fee for an additional term (usually two weeks). A "back to back" loan is where the borrower pays off the initial loan, but immediately takes out a new loan with a new fee. From the consumer's perspective, a "back to back" loan serves the same purpose, but is designed to ensure that it does not meet the definition of a renewal and so is excluded from "protections" under a payday authorization statute.[v] Even when the borrower must wait a short period of time between the transactions (i.e. the so-called "cool-off period"), the borrower is still trapped, because he or she still needs to re-borrow the money before the next payday.

Limits on number of loans outstanding

Several states restrict the number of loans a payday borrower can have outstanding at any given time. However, even with this measure in place, a borrower can continue in the debt trap indefinitely, repeatedly renewing the same $300 loan for months or years on end, and paying $1,200 in interest every year. If a typical borrower is paid twice a month, they could still take out 24 loans per year in a state with even the strictest restrictions of this kind.

Payment plans

Other states have attempted to address the predatory payday lending debt trap by adopting payment plans. Evidence from these states suggests that there are problems with the model used for these payment plans. Often the installments remain too large to be viable within a family's budget. For example, a borrower with a $500 outstanding loan may have a choice of doing a "back to back" loan for $75, or making the first installment of a payment plan for $125. In order to pay housing, food and utilities, families that are living paycheck-to-paycheck may in effect have no choice but to repeatedly pay the $75.

Many states have already tried these provisions, and they have proven ineffective at stopping borrowers from sinking into a payday loan debt trap. Examples of these states—and their results—are outlined in the Table 1.

TABLE 1

	Regulations	Results
Florida[vi]	• No more than one outstanding loan at a time • Cooling off period • Payment plan option • 60 day grace period available, upon declaration of inability to repay • Roll-overs prohibited • Database	• 89% of loans go to borrowers with five or more transactions per year • 57% of loans go to borrowers with 12 or more transactions per year • Average of 8 loans per borrower • Less than one percent of transactions take advantage of the 60 day grace period
Oklahoma[vii]	• No more than two outstanding loans at a time • Cooling off period • Payment plan • Roll-overs prohibited • Database	• 91% of loans go to borrowers with five or more transactions per year • 66% of loans go to borrowers with 12 or more transactions per year • Average of 9 loans per borrower • Less than 0.5% of transactions employ payment plan
Washington[viii]	• Cannot borrow more than $700 from a single lender at one time • Payment plan • Roll-overs prohibited	• 90% of loans go to borrowers with five or more transactions per year • 58% of loans go to borrowers with 12 or more transactions per year • Average of 8 loans per borrower • Less than 0.8% of transactions employ the payment plan option

Thus, states with varying combinations of these regulations still have an overwhelming percentage of borrowers who take out loan after loan, unable to break the payday lending debt cycle. There is no evidence that any payday authorization law with these types of protections will be able to help a borrower stop a cycle of payday loan debt. Put simply, attempts to legalize payday lending and protect borrowers from the debt trap have failed.

Moreover, the data reveals an important fact: the payday lending business model is dependent upon very high usage per borrower. Indeed, roughly *two-thirds* of this business's revenues comes from borrowers taking out twelve or more loans a year – loans hyper-marketed for emergency and short-term use.

Because the payday lending business model is dependent on revenues from the trapped borrower, policymakers should expect circumvention of regulations and empty concessions from the industry in the negotiation of payday lending laws. The payday industry has the strongest of incentives – any concession that eliminates the cycle of debt means a drastic, if not fatal, reduction in revenues.

EXISTING LAWS SAVE GEORGIANS $147 MILLION EACH YEAR

Based on Morgan Stanley estimates that an average payday loan store supports 3,500 households, Georgia would likely have 859 stores if payday lending were to return, with an annual loan volume topping $1 billion. More importantly, $147 million in predatory fees would be drained from Georgia's families each year.

TABLE 2

# of Households[ix]	Projected Payday Stores[x]	Projected Loan Volume[xi]	Predatory Payday Loan Fees[xii]
3,006,369	859	$1,020,898,490	$147,009,383

Instead, Georgia's usury cap saves families $147 million annually in predatory payday fees alone—money that families can use for housing, food, utilities, and other necessities.

WHY GEORGIA DOESN'T NEED PAYDAY LENDERS

Despite industry rhetoric,[xiii] the debt trap drives the "demand" for payday loans. In fact, an analysis of North Carolina's defunct payday lending industry found that over 90 percent of loan volume was not actual "new" credit, but merely new and larger loans used to pay off old loans.[xiv] This strongly suggests that "volume" isn't credit at all but rather paper shuffling between the trapped borrower and the predatory payday lender – each time extracting a fee without providing any real service.

A vibrant consumer loan market already exists in Georgia, where banks, credit unions, consumer finance companies and other financial institutions offer responsible credit. These nearly 1,000 storefronts are located throughout almost every Georgia county, and a majority are locally owned. This is in stark contrast to the typical state's payday loan market, which is dominated by a handful of out-of-state companies.[xv]

Consumer finance companies are a significant and growing source of small-dollar loans, with $932 million in loan volume in 2005. Over half of these loans (56 percent) are for $600 or less.

TABLE 3

	Loans of $600 or less	$600-1000 Loans	Total Loans of $1000 or less
Number	657,422	279,382	936,804
Volume	$247,046,988	$225,938,650	$472,985,638

The consumer finance loan market has experienced steady growth in Georgia, with loans up to $1,000 growing by 15 percent since 2003.

TABLE 4

	Loan Volume (loans $600 or less)	Loan Volume (loans $600-1000)	Total Loan Volume (loans $1000 or less)
2003	$222,836,799	$187,292,960	$410,129,759
2005	$247,046,988	$255,938,650	$472,985,638
% Change	11%	21%	15%

Nationally, there is momentum to develop similarly responsible loan products, with the FDIC's issuance of small loan guidance signaling its intention to encourage financial institutions to develop and actively market responsible credit products by offering Community Reinvestment Act (CRA) credit.

STAY THE COURSE – CONTINUE TO ENFORCE GEORGIA'S RATE CAP

While the payday lenders lobbying for a return to Georgia promise to abide by many "best practices," borrowers in states where regulations are already in place remain trapped in payday loan debt. Borrowers in these states take out an average of nine loans a year and pay $4.2 billion in predatory fees.

Meanwhile, Georgia's approach to offering small loans has resulted in a thriving small loan market, and a savings of $147 million for families every year. Now, the state must decide if it will continue down the path of responsible lending, or open itself up to predatory payday lending.

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[i] The total payday fees paid in 2005 are estimated at $4,628,929,156 (see *Financial Quicksand*, by the Center for Responsible Lending for calculations, available at www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf). Predatory payday fees are defined as those charged on loans going to borrowers with five or more loans per year, as these borrowers are trapped in a cycle of debt. Because 90 percent of loans go to these trapped borrowers, we determine that 90 percent of total payday fees are predatory (90%*$4,628,929,156=$4,164,694169—which rounds to $4.2 billion)

[ii] See generally James M. Ackerman, *Interest Rates and the Laws: A History of Usury*, 27 Ariz. St. L. J. 61 (1981).

[iii] For more information, see *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury*, by Jean Ann Fox, pg 9-11. Available at http://www.consumerfed.org/pdfs/pdlrentabankreport.pdf.

[iv] Truth in Lending, 65 FR 17129, 17130 (March 31, 2000).

[v] See Michael A. Stegman and Robert Faris, Payday Lending: A Business Model that Encourages Chronic Borrowing, *Economic Development Quarterly*, February 2003. Available at http://www.kenan-flagler.unc.edu/assets/documents/CC_Payday_lending.pdf.

[vi] Florida's payday lending regulations can be found through the Florida Office of Financial Regulation at http://www.flofr.com/licensing/DeferredPresent.htm. The results mentioned in this report are calculated from the September 2005-August 2006 report, *Florida Trends in Deferred Presentment*, generated from the state's database provider, Veritec Solutions LLC and available at http://www.veritecs.com/FL_trends_aug_2006.pdf.
[vii] Oklahoma's payday lending regulations can be found through the Oklahoma Department of Consumer Credit at http://www.okdocc.state.ok.us/mainDDL.php. The results mentioned in this report are calculated from the September 2005-August 2006 report, *Oklahoma Trends in Deferred Deposit Lending*, generated from the state's database provider, Veritec Solutions LLC and available at http://www.veritecs.com/OK_Trends_Aug_2006.pdf.
[viii] Washington's payday lending regulations and data used to calculate the result mentioned in this report are from the Department of Financial Institutions' *2005 Payday Lending Report*, available at http://www.dfi.wa.gov/cs/pdf/2005_payday_report.pdf.
[ix] The American Community Survey 2003
[x] This is calculated by dividing the number of households by 3,500, since Morgan Stanley projects that each payday store supports 3,500 households (3,006,369/3500=859).
[xi] To estimate the loan volume, we multiplied the number of payday stores by the national median loan size ($325) and the national average loans per store (3,657).
[xii] To calculate the predatory cost of payday fees, we took the total loan volume and multiplied it by 16%, which is the average fee Advance America charges for a payday loan. This results in the total payday fees projected in Georgia, $163,343,758. Because predatory payday loans are defined as those 90% that go to borrowers with five or more loans per year, the total predatory payday fees are $147,009,383 (90% of the total payday fees).

[xiv] See Keith Ernst, John Farris, and Uriah Kind, *Quantifying the Economic Cost of Payday Lending*, December 2003. Available at http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf.
[xv] For example, in Virginia, about 90 percent of payday stores are operated by out-of-state corporations. See *Protecting Working Families from Abusive Payday Loans: Lessons from Other States*, by the Virginia Partnership to Encourage Responsible Lending for more details.