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Wolf in Sheep's Clothing: Payday Loans Disguise Illegal Lending

In Brief

Although Texas' constitution and state law limits interest rates on small loans, some Texas companies ignore the state usury laws and charge interest far above the statutory caps. These companies say that they "do not make loans," and therefore the usury laws do not apply to them. But they advance money for a fee, and they advertise in the phone book in the "loan" section next to traditional small loan and pawn companies. Some, like FastFunding First in Austin, even use the word loan in their advertisement, while others refer to their fees as "interest."

While there are several variations, these companies all advance money for an initial period of less than a month, taking a personal check as collateral. They typically charge \$33 per \$100 borrowed every 14 days, and borrowers may renew this "advance" over and over again, quickly repaying the lender in fees far more than was borrowed. This fee is the equivalent of nearly 800 APR interest.

To ensure repayment, lenders threaten to cash the personal check. Without sufficient funds to cover it, the borrowers risk jail (on a "theft by check" or "issuance of a bad check" charge) if they cannot keep up with the steep "renewal" payments. Unlike other private creditors, these lenders use the local criminal court system as a collection agency. But, Texas's constitution bans imprisonment for debt. Justices of the Peace, seeking to limit the use of criminal laws to real criminal acts, are now among the officials calling for reform.

Consumers Union Study

To better understand the payday loan market, Consumers Union conducted a survey of twenty-seven local cash advance lenders in Austin, Dallas, Killeen, and Waco. Over a two-week period in January, CU surveyed companies advertising certain types of loans in local phone books and in the *Greensheet*. We surveyed companies that advertise loans of more than the \$460 maximum loan amount allowed under the credit code for signature loans, and advertise that they require only a valid checking account. CU called companies as any normal consumer would and asked questions that any normal consumer would ask, including loan limits and terms, cost of loans (fees), underwriting criteria, collateral, and the consequences of default.

Consumers Union also reviewed consumer complaints filed against these companies with the Office of Consumer Credit Commissioner (OCCC). Many of the complaints that were filed included copies of "lease" agreements or other loan contract information for the cash advance companies. Consumers Union reviewed these lease agreements closely and examined trends and language used. We also spoke with Justice of the Peace Offices in Dallas and Travis Counties as well as the Travis County Hot Check Division of the District Attorney's Office.

Overall Findings

The majority of the companies surveyed (12 companies) were "sales-leaseback" compa-

**Consumers
Union**

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Rob Schneider

CASH ONE
 111 W. Anderson Ln
 Austin, Tx
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 \$100 = \$1000
 Cash Now
\$100 - \$1000
 We will hold your check
 until your next pay day!
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 \$\$\$\$\$\$ TODAY "IN TEXAS" \$\$\$\$\$\$

Survey of Payday Lenders in Austin, Dallas, Killeen and Waco
 Conducted January and February, 1999

Date	Company	Market	Loan Type	Max Loan Amount*	Term (in days)	Fee (per \$100 borrowed)	Renewals
1/20/99	FastFunding First	Austin	P	\$200	earliest of 14 or payday	\$30	none permitted
1/20/99	Cash Now, Today in Texas	Texas	A	\$270	14	\$33	up to 6
1/20/99	Cash One (Cash Now Affiliate)	Austin	A	\$270	14	\$33	up to 6
1/21/99	Instant Cash- North Lamar and Airport	Austin	S	\$225	earliest of 14 or payday	\$33	unlimited
1/21/99	The Exchange	Cedar Park	S	\$200-250	15 days	\$2/day	daily rate
1/21/99	Cash Plus (Airport Blvd.)	Austin	S	\$270	15 days	\$33	unlimited
1/21/99	Advance Cash-1700 C Montopolis	Austin	P	\$300-400	14 days	\$33	unlimited
1/21/99	Cash Today- South Congress	Austin	A	\$300	14 days	\$33	6 times
1/21/99	Cash Today- 6217 N. Lamar.	Austin	A	\$300-\$500	14 days	\$33	6 times
1/21/99	Cash Today- Round Rock (1001 Maiz)	Round Rock	A	no phone quotes	14 days	\$33	6 times then payout
1/21/99	Cash Today- Burnet Road/Koenig	Austin	A	\$300-400	14 days	\$33	5 times
1/22/99	Cash Today- New Braunfels	New Br	P	\$300-400	14 days	\$33	5 times
1/15/99	Fast Cash Ads	Austin	A	\$270	14 days	\$33	4 times
1/21/99	Ready Leasing	Austin	S	\$205	14 days	\$33	unlimited
1/28/99	Emergency Rental	Dallas	S	\$200	15 days	\$32.5	11 times
1/28/99	EZ Cash	WACO	S	\$180	next payday	\$34	depends
1/28/99	Instant Cash	Dallas	S	\$200-350	15 days or next payday	\$33	unlimited
1/28/99	De-Metro	Dallas	S	\$300	14 days	\$30	3 times
1/28/99	Urban Rentals	Dallas	S	100-200	15 days then daily	\$4/day	unlimited
1/28/99	Personal Rental	Dallas	S	no phone quotes	14 days	\$30	unlimited
1/28/99	Public Leasing	Dallas	S	\$55-205	14 days	\$40	unlimited
1/28/99	Cash Today	Dallas	P	\$300-400	14 days	\$33	unlimited
1/28/99	Cash Time Leasing	Dallas	S	\$200	14 days	\$32.48	unlimited
2/22/99	Instant Cash Catalog Sales	Temple	C	\$150	14 days	\$25	none permitted
2/22/99	Downtown Discount Catalog Sales	Killeen	C	\$100	14 days	\$20	none permitted
2/22/99	Texas Catalog Sales	Killeen	C	\$250	14 days	\$30	none permitted
2/22/99	Instant Cash Catalog Sales	Killeen	C	\$260-365	14 days	\$30	none permitted

Loan Types:

- P=payday
- A=advertisement
- S= sale leaseback
- C= catalog sales

*Loan amounts based on a new customer with a monthly income of \$1,800.

Where renewals note "none permitted," some companies said that they would renew for return customers under some circumstances.

nies that claim to buy home appliances from their customers and lease them back for a "rental fee." Fast cash advertisement companies that sell advertisements to customers who need cash (rather than to those who need ads) were also popular (8 companies) in these markets. Other companies we spoke with offered "cash back on your check" (3 companies), or Catalog Sales (4 companies) that sell catalog certificates to customers who need quick cash.

Payday Loans

Payday loan companies offer "cash back on your check." Customers write a personal check payable to the lender for the amount of cash they need plus a fee. The company holds the check for 14 days. When the term is up customers can pay the full amount owed in cash (the company will rip up the original check in this case), tell the company to cash the check, or pay an additional fee (in cash) to postpone the due date for another 14 days. If the customer pays the fee to renew the loan, the company may ask the customer to re-write a check for the amount due (with a new date) or may simply hold onto the original check for another term.

Sale-Leaseback

Sale-leasebacks appear to be a more common type of cash advance loan in Texas. Under a sale-leaseback arrangement, a lender "buys" an item from the borrower, such as an appliance, and "leases" it back for a "rental payment," rather than offering a direct loan with repayment of interest and principal. While most of these companies offer two-week "rental" periods, some assess "rental fees" daily.

These companies require customers to bring in the serial numbers, make, and model of various appliances they own that are equal to, or greater than, the value of the

cash they borrow. Sales-leaseback companies do not ask to see the appliance being purchased and leased--the item itself never leaves the borrower's home. Nor do the companies appear to require proof that these

"I lost my job and called and spoke to [the manager] to see if there was any other way to work this out, and she basically told me tough luck. Because of the \$330 I have to pay each month I have constantly stayed behind on my other financial obligations. It basically is a vicious circle. So instead of being able to pay the loan off after 12 paydays (6 mo) I have had to continue to increase it."

Cash Today customer

items have not been "sold" to someone else.

Most of the companies we spoke with described the appliances as "collateral" but said they rarely repossess items. Instead they also keep a signed check that they can cash if the borrower doesn't make the "lease" payment. Many of these lease agreements have an "automatic renewal option" built into them that allows customers to renew the lease at the end of the 14 day period for an additional fee.

One desperate person wrote to the OCCC after becoming indebted to several

sale-leaseback companies. According to his letter, he "sold" his TV and VCR to more than one lender, making payments on at least eight loans (total value of \$1853) for five months. He ultimately paid more than \$3797 to lease the two appliances back over this period.

Some companies allow customers to turn over the title to their car as collateral to get a large amount of cash quick. The lease process is similar to an ordinary leaseback, but the lease payments are very large and sometimes difficult to pay back in a short period.

Another borrower who complained to the OCCC turned over her car title to The Check Place in order to qualify for a loan of \$2,500. According to the borrower, this sale-leaseback lender charged \$33 per hundred every week, with higher daily payments thereafter. After quickly getting in too deep, she wrote to the Consumer Credit Commissioner.

"I borrowed \$2,500 and was told to write a check for \$3,325 to be paid in cash less than a week later. When I was unable to pick up the check, I was told that I would have to pay an additional \$300 per day until it was paid or the check would go to the District Attorney."

Cash Back Ad Sales

Cash-back ads are a newer variation on the cash advance loan theme. Customers who need cash must purchase an advertisement (1 line per \$100 loaned) and pay an ad fee of \$33 per hundred.

Companies claim that the customer is purchasing a service and they are charging a fee for that service. Even if a customer has nothing to advertise the company will still insist upon an ad purchase, and place the ad in some type of publication. The terms of the loan are similar to other cash advance

The Treadmill

A Houston woman wrote to the Office of Consumer Credit Commissioner when she couldn't pay down her debt to Emergency Services, no matter how many payments she made. According to her letter, she answered an ad in the paper offering \$200 loans in five minutes with proof of a checking account. After approving her loan by phone, Emergency Services said she would have to put up two appliances. She brought in the model numbers for a microwave and a T.V. and began to write checks, leaving the "pay to"

line and the date blank.

Emergency Services said she would have to pay \$264.95 in two weeks or \$64.95 every two weeks. "We had to keep paying \$64.95 every two weeks and if we were late it was \$4.95 a day late charges."

This borrower, who lived on an income of only \$586 per month Social Security Disability, got behind in her payments.

"On May 3rd I would have sent another \$195, but my daughter's alternator went out and it was \$265 and we couldn't send it and she

started running checks through--that we had already paid her. She had us write checks and leave the name and dates blank. We have our receipts. When I asked her for the checks...she said when we paid off the loan we would get the checks."

The company pressured the borrower to pay in cash rather than with money orders, and once the manager asked them to meet her at a local mall and bring cash. The desperate family finally called the state for help. "My daughter agreed the \$200 loan for me. They call it a lease agreement," she wrote.

loan terms (typically 14 days) and the company holds the customer's check as a "security deposit" then "rebates" it to the customer when they repay the loan. Each time a customer wants to renew the loan the company charges an additional ad fee and places another ad in the publication.

Customers of Cash Today, for example, buy an advertisement in *Today in Texas News*, a free publication distributed to Cash Today customers, and pay an ad fee of \$33 per \$100 loaned in order to get cash. Most customers do not actually try and sell anything for their ad payment. Ads typically contain personal greetings, are sometimes nonsensical and often unsigned. *Today in Texas News* is not listed alongside the *Greensheet* in the *Yellow Pages* under advertising directories or newspapers—the place most people might look if they actually wanted to buy or sell personal goods via a real advertisement. It is, however, listed under "loans."

Catalog Sales

Like the cash-back ad sales, catalog companies require a borrower to purchase an item (a certificate) and they charge a fee for that item. Customers who need cash purchase catalog certificates (\$20-\$30 certificate per \$100 loaned) for merchandise that is sold in the company catalog. Customers write a check for the amount of the loan plus the catalog certificate cost (loan fee). Two weeks later the company cashes the check and gives the customer the certificate, at which time they can use the certificates to purchase merchandise from the catalog. The terms of the loans are similar to the other cash advance loan terms, however the catalog sales companies we spoke with did not allow extensions for new customers and did not take applications over the phone.

Consumers Union found four compa-

nies of the 27 total surveyed that sell catalog certificates. All of these companies are located in the Killeen/Fort Hood region. The companies were identified through OCCC customer complaints. Catalog certificates cost on average \$26 per \$100 loaned, a slightly lower fee than other payday lenders charge.

".....they charge on top of the renewal fee, extra late fees and in some cases other types of fees. So you end up owing every 14 days and it is like a form of slavery because you can never get to the point of paying them off....This loan/lease has been paid at least two times or more of what was borrowed. I had been a faithful customer but my health is now affected by this and it is now a long nightmare."

Skyline Leasing customer

Old Dog, New Tricks

Since the founding of the Republic, Texas has prohibited usury. Texas' constitution bans the practice and establishes the ability of the Legislature to regulate loan rates. The state's Credit Code clearly outlines the terms and conditions of a legal small loan, and these terms are quite generous.

"Signature" lenders may charge more

than 90% APR interest, including an up-front \$10 fee to cover processing costs, and \$4 per month per hundred borrowed. Like payday loans, signature loans are generally small, averaging \$255 in 1995. And the market is booming. According to the Office of Consumer Credit Commissioner, signature lenders in Texas make more than 3.5 million loans totaling \$1 billion annually. Lenders who loan more than \$460 can charge \$25 up-front and 18 percent "add-on" interest, or about 30 percent APR.



"Cash advance" companies insist they are different because their process is simple, short-term and merely amounts to "cash back" on your check. Or because they actually purchase the borrower's goods. Or because they sell a service (advertising) or merchandise (catalog certificates). But after looking at the facts it becomes clear that there is no substantive difference between a signature loan and a payday loan, except that payday lenders charge substantially more, use a personal check as collateral, and try to disguise their practice.

A "cash advance" loan is certainly simple. Cash-advance loan companies do not check customer's credit records. Instead, customers apply by phone and are approved based on specific criteria including full time job and monthly income (usually a minimum of \$800 with two pay stubs in support), residency, and the existence of a checking account.

The monthly income requirement is not absolute. For example, at least two of the companies surveyed allow customers to use household or other income if they don't meet the minimum requirements. A customer of Emergency Services in Houston told the OCCC that she got a loan although her income totaled only \$586 per month. Emergency Services allowed her to give them her daughter's income.

But signature loans are also simple. Like payday loans, a consumer can walk into a signature loan office and walk out with a small loan after minimal underwriting (the process for determining credit-worthiness). Like payday lenders, signature loan companies frequently take applications by phone and approve the loan while the customer waits.

Signature lenders believe they are in the same business as the usurious payday lenders and regularly write into the OCCC to complain. For example one finance company had this to say: "I am sure you are aware of the flourishing non-licensed 'lenders' all

 <p>HAPPY BIRTHDAY and Valentines Day to Michael & Scott 2-14</p> <p>HAPPY VALENTINE'S Day To Vickie Love</p> <p>HAPPY VALENTINES Day To Cyndi and Michael</p> <p>HAPPY</p>	<p>HAPPY VALENTINES Day Kim - From your Friends at Cash Now!</p> <p>MY VALENTINE Steph</p> <p>HAPPY VALENTINE'S Bev</p> <p>HAPPY VALENTINE'S Day To Walter From Mary</p> <p>JESUS LOVES YOU</p> <p>HAPPY VALENTINES to everyone at Cash Now in Arlington/PG</p> <p>HAPPY VALENTINE'S</p> <p>Day To Donna</p>	<p>HAPPY VALENTINE'S Day To: Cecilia-Allyssa-Avery and Cozelle Love you all!!!</p> <p>GOD BLESS our BUSINESS.</p> <p>HAPPY VALENTINES and Birthday to Lynda S.</p> <p>I AM READY FOR SUN.</p> <p>GOD BLESS Cash Now!</p> <p>HAPPY VALENTINE'S Day To Lorraine R.</p> <p>HAPPY VALENTINE'S DH</p>	<p>I HATE car repairs.</p> <p>HAPPY VALENTINES/ BK</p> <p>HAPPY VALENTINES BEV</p> <p>GOD LOVES YOU</p> <p>I LOVE you Tracy/Dan</p> <p>TRISTAN MAKAEI</p> <p>born Dec. 24, 1997.</p> <p>THANKS FOR your support Cash Now/ID</p>	<p>Cooking Corner</p> <p>Bacteria Can Spoil Outdoor Grilling</p> <p>GRAPS: This barbecue season, help keep your family and friends healthy. Be careful to clean and disinfect surfaces when handling raw meat and poultry. Surfaces that appear clean may still harbor invisible bacteria such as Salmonella and E. coli which can cause foodborne illness. An estimated 81 million Americans a year suffer from foodborne illness, more commonly known as food poisoning.</p>  <p>Foodborne illness can cause serious medical complications.</p>
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Ads from Today N' Texas News

"I started a cash lease on April 2 of 1997 with Cash for Lease. My account became delinquent and I was staying in contact with the manager, Leslie. On June 5 1997 I received a fax from 'Cash for Lease' of my contract at my office. Later on in the day Leslie called the office and asked to speak to my manager. I explained she was out for the day and could I help her. She replied 'You're in trouble!'...As I found out later, not only was my contract faxed to my office but also to offices in Texarkana and Orange. Not only was the faxes sent but my account was discussed with the assistant manager in the Texarkana office by the owner of Cash for Lease. He also contacted my supervisor and discussed my business with him, also. The managers and assistants of both offices seen my contract. ... I feel like this was a direct violation of my rights as a consumer and feel embarrassed that so many of my fellow employees now know so much about my personal business."

Cash for Lease customer

over the state. I know you are as concerned as we licensed lenders are about, not only the 'black-eye' our industry is receiving, but also the energy that is being sapped from it."

At most payday lenders, "renewal" is the only option if the consumer cannot pay the full amount owed in 14 days. But signature lenders also encourage customers to regularly refinance their loans. World Acceptance "actively markets the opportunity to refinance existing loans prior to maturity, thereby increasing the amount borrowed and increasing the fees and other income realized," according to its 1997 Form 10-K report to the Securities and Exchange Commission.

The up-front fee is non-refundable and can be charged again upon refinancing, and interest is refunded using a formula favorable to the lender.

Twenty-two payday loan companies surveyed allow customers to renew lease agreements by paying another fee. Only five companies in our survey limited their "service" to a one-time 14-day term. And of these, repeat customers may be able to renew if they have a strong payment history. Renewal policy varies. Two companies allow up to 5 renewals, and another 17 allow six or more. At most of these payday lenders, a customer who renews the agreement 3 or more times pays more in fees than the original amount of their loan.

For example, one customer borrowed

\$200 from Instant Rental, a sale-leaseback company in Houston. The customer wrote an initial check for \$200 plus a \$68 lease fee that the company held for the 14-day lease term. The customer was unable to pay back the \$268 when the term expired and extended the lease 14 more days for an additional fee of \$68. He continued to do this every two

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5 MINUTE APPROVAL
 NOT A LOAN - SALES/LEASEBACK
\$100 - \$750
NO CREDIT CHECK
NO HASSLE
 Checking Account & Source of Income Required
512-447-CASH
 (2274)
 Se Habla Español

weeks because he couldn't pay the \$268. Every period his receipt showed a "declining balance" of \$268 (similar to a loan receipt, except the "declining balance" did not decline). He ended up extending the lease 9 times—costing him \$612 in total fees. At the end of the 9 periods (just a few months) he still had a "declining balance" of \$268 to pay off, but had paid over three times the amount of the original loan (\$200) in fees.

Although they walk and talk like small lenders, payday loan companies claim that they are not loaning money and holding checks, but providing services. The primary service, however, is a quick cash loan under usurious terms. Of 27 companies surveyed in the three markets, 19 charge at least \$33 in "fees" for every \$100 cash advanced per

loan period. Six companies charge \$30 in "fees" for every \$100 cash advanced, and two companies charge under \$30 per \$100 loaned. Twenty-five companies advanced the money over a 14-day or 15-day period, which translates to approximately 792% APR. The remainder (2 companies) advance the cash on a daily basis, charging customers a daily fee for cash borrowed.

The Consumer Credit Commissioner and the Attorney General are responsible for enforcing the state's usury laws. Neither agency has pursued many cases in this area. One case filed by the Attorney General several years ago resulted in a District Court decision that a sale-leaseback was not a loan. However, this case was never taken up on appeal, so the case set no precedent.

Using the Criminal Justice System as a Collection Agency

The one thing that clearly differentiates "cash advance" lenders is their use of local law enforcement to collect unpaid loans. When companies ask customers to write a personal check for the amount they borrow plus a fee, they are likely aware that the customer does not have the funds in their account to make good on the check. That's why they need a loan.

The Travis County District Attorney's office will not accept a check for prosecution as theft by check if they know that it was taken with the knowledge that it would not be cashed, or would be held for any length of time. But the District Attorney, handling thousands of bounced checks each year, may not be able to differentiate one from another. Justices of the Peace, who

prosecute people for Issuance of a Bad Check (IBC), also a misdemeanor charge, do not require proof that the check was not held. Therefore Justices of the Peace sometimes act as the collection agent for these lenders.

Cash advance companies are frank about what happens when a customer defaults. Public Leasing of Dallas told our surveyor, "If you don't repay us we will cash your check. If your check bounces then we will file for a hot check."

Companies may also require that customers sign an "Assignment of Salary and Wages" that authorizes the company to go directly to a borrower's employer. The cash advance company uses the employer as a collection agent, asking him or her to deduct the full amount owed from the employee's check and pay it directly to the

lender.

As frightening as it is to face "hot check" prosecution by county law enforcement, or your employer for wage garnishment, the mere threat of these collection practices is a powerful incentive for borrowers to repay or continue to refinance loans.

Recommendations

Enforce existing Texas usury laws

Despite the fact that some lenders attempt to hide the nature of their transactions, Texas usury laws prohibit the excessive interest rates charged in these transactions. The problem of high cost "payday" loans has mushroomed in Texas in the last year. The Office of the Attorney General and the Office of the Consumer Credit Commissioner must step up enforcement against companies

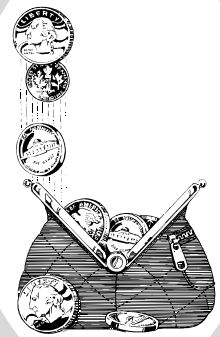
making these kinds of loans. Usury is already illegal in Texas, but without enforcement these practices will proliferate.

Make it illegal to use or threaten hot check collection for payday loans

Payday loan lenders use the state's criminal justice system as a collection agency when borrowers cannot repay these high cost loans. Lenders take a personal check from a borrower as collateral on the loans. The mere threat that a lender will pursue criminal hot check collection is enough to make borrowers find some way to repay or renew loans. The Legislature should make it illegal for lenders to pursue or threaten to pursue hot check collection against borrowers on these kinds of loans.

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