Rich Huddleston, Executive Director
Kathryn Hazelett, Research and Fiscal Policy Director
H. C. "Hank" Klein, founder of Arkansans Against Abusive Payday Lending

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Payday Lenders in Arkansas:

Renting Out-of-State Bank Charters Help Evade State Law

by H.C. "Hank" Klein

Payday lenders are a major source of instant cash for Arkansas' low-income working families and consumers with heavy debt burdens and poor credit histories. Instead of benefiting borrowers, payday loans trap them in high-cost debt. To qualify for a payday loan, borrowers only need a bank account and a steady income. They write a post-dated personal check in exchange for cash from the lender who then holds the check for the loan term, typically one to four weeks or until the borrower's next payday.

Payday loan borrowers become trapped in this cycle of debt, forced to pay interest every pay period often for months or years.

Because the entire loan is due to be paid in full on payday and is not repaid in smaller installments like most auto loans, home mortgage loans, and loans for furniture, most borrowers are unable to pay back the loan within the term. In order to avoid default, customers renew the loan and pay the interest fee for another pay period. Payday loan borrowers become trapped in this cycle of debt, forced to pay interest every pay period often for months or years.

According to the non-profit Center for Responsible Lending, the average borrower ends up paying $800 to borrow a $325 payday loan. In a typical example, the borrower writes a check for $377 for a payday loan of $325, plus $52 in interest. The money is typically due two weeks later at an annual percentage rate of more than 400 percent.[1]

If the borrower does not have the $377 to pay back the loan when it is due, he/she can pay another $52 fee. This does not pay down the principal; it is simply the interest to keep the loan afloat until the consumer's next payday and then the next, and the next, etc. - this is the "Debt Trap" of payday lending. More than 90 percent of payday loan recipients receive more than four loans every year, and 99 percent of loans go to repeat borrowers.[2]

In a first ever Arkansas study of all the payday lenders operating stores in the state, Arkansans Against Abusive Payday Lending (AAAPL) documented that 281 payday lenders are operating in Arkansas. The majority (76.51%) are unlicensed and unregulated by the state agency that oversees check cashers/payday lenders – the Arkansas State Board of Collection Agencies, Division of Check Cashers (ASBCA). Of the 281 payday lenders, 80 (or 28.47%) are using what is commonly referred to as the "Rent-A-Bank" model.[3] These lenders seek to evade the Arkansas state usury law by partnering with out-of-state banks that are permitted by bank regulations to "export" the interest rate of their home state into Arkansas.

The position taken by FDIC Chairman Powell and the 37 state Attorneys General disagrees with the current stance taken by the Arkansas State Board of Collection Agencies, Division of Check Cashers that these lenders are exempt from state regulation.

There are nine state-chartered banks partnering with payday lenders. These banks are insured and regulated by the Federal Deposit Insurance Corporation (FDIC) and are primarily located in states without any usury rate ceiling. Of the nine banks that operate in the nation, three Rent-A-Bank/payday lending chains are known to be currently operating in Arkansas:

- ACE - America's Cash Express partners with Republic Bank & Trust of Louisville, KY operating 20 Arkansas stores. This payday lender operates a multi-line business. In addition to offering payday loans, it also cashes checks in each of its offices and is licensed and regulated by ASBCA, but only for the check cashing portion of its business. The payday lending transactions are not reviewed or regulated by the ASBCA.

- First American Cash Advance partners with Community State Bank of Milbank, SD and has 30 stores in Arkansas. This payday lender operates a mono-line business and only makes payday loans. Each of its 30 offices is unlicensed and unregulated in Arkansas because the ASBCA has chosen to consider their loans to Arkansas consumers as exempt from the Arkansas Check Cashers Act of 1999 and the agency's regulations.

Rent-A-Bank/Payday Lending Chains Operating in Arkansas

Rent-A-Bank	Republic Bank & Trust Company, KY	Community State Bank, SD	First Fidelity Bank, SD
Local Business	ACE - America's Cash Express	First American Cash Advance	Advance America
Number of Locations	20	30	30
Number of Cities	13	28	26
Licensed by ASBCA	20*	0	0

Note: * Licensed only for check cashing activities, not for payday lending

Source: Study by Arkansans Against Abusive Payday Lending (AAAPL)

- Advance America had partnered with Venture Bank of Lacey, WA until June 30, 2005. On that date, Advance America lost their relationship with Venture Bank and began partnering with First Fidelity Bank of Burke, SD for the 30 stores they operate in Arkansas. This payday lender also operates a mono-line business and only makes payday loans in Arkansas. Each of its 30 offices is unlicensed and unregulated in Arkansas because the ASBCA has chosen to consider their loans to Arkansas consumers as exempt from the Arkansas Check Cashers Act of 1999 and the agency's regulations.

Rent-a-Bank/payday lenders partnerships were developed by payday lenders in order to protect their ability to make loans at usurious rates and to evade local laws and regulations.

The Arkansas law regulating payday lenders is the Arkansas Check Cashers Act of 1999. It requires payday lenders to:

1. Obtain and maintain a bond of $50,000 to protect consumers.
2. Maintain $20,000 in operating capital.
3. Limit the maximum loan to no more than $400.
4. Require no more then one check per customer be held at a time.
5. Require that checks be dated on the day of the loan and not postdated.

Rent-A-Bank payday lenders do not obtain bonds to protect consumers, often take more than one check as collateral and accept postdated checks. Additionally, while the maximum loan limit in Arkansas is $400 and the maximum fee for a Payday Loan is $10 per hundred borrowed plus $10, Rent-A-Bank payday lenders make larger loans and charge more than Arkansas allows as follows:

- ACE – America's Cash Express grants loans up to $425 and charges $17.64 per hundred borrowed.
- First American Cash Advance grants loans up to $750 and charges $20 per hundred borrowed.
- Advance America grants loans up to $750 and charges $20 per hundred borrowed.

Rent-A-Bank payday lenders do not obtain bonds to protect consumers, often take more than one check as collateral and accept postdated checks.

States have long recognized that out-of-state banks that partner with payday lenders are allowed to export the interest rate from the state of the bank's home office. States, however, also believe that the other laws of their state should be followed by Rent-A-Bank/Payday Lenders operating in their state. On May 10, 2005 the National Associations of Attorneys General wrote a letter to FDIC Chairman Donald E. Powell. The letter was signed by 37 state Attorney Generals, including Arkansas Attorney General Mike Bebee, and urged the FDIC to protect consumers from payday lenders who are "charter renting" and causing consumers to get on a "debt treadmill."

Chairman Powell replied to all 37 state Attorneys General on May 27, 2005. He clarified the FDIC's position that "federal law authorizes federal and state-chartered insured depository institutions making loans to borrowers to "export" interest rates in accordance with the laws of the state where the bank is located." The letter continued, "However, this statute does not exempt state-chartered banks partnering with payday lenders from consumer protection and lending laws of the borrower's state, other than interest-rate related limitations."

The position taken by FDIC Chairman Powell and the 37 state Attorneys General disagrees with the current stance taken by the Arkansas State Board of Collection Agencies, Division of Check Cashers that these lenders are exempt from state regulation. State regulations place a limit on the amount loaned, the maximum term of the loan, and prohibit rollovers (the ability of the borrower to pay an additional "fee" on the due date to continue the loan for another two weeks). Each lender that makes payday loans in Arkansas should abide by the Arkansas state law and the agency's regulations.

Nine Signs of a Predatory Payday Loan

1. Triple digit interest rate
Payday loans carry very low risk of loss, but lenders typically charge fees equal to 400% APR and higher.
2. Short minimum loan term
75% of payday customers are unable to repay their loan within two weeks and are forced to get a loan "rollover" or back-to-back transaction at additional cost.
3. Single balloon payment
Unlike most consumer debt, payday loans do not allow for partial installment payments to be made during the loan term. A borrower must pay the entire loan back at the end of two weeks.
4. Loan flipping (extensions, rollovers or back to back transactions)
Payday lenders earn most of their profits by making multiple loans to cash-strapped borrowers. 90% of the payday loan industry's revenue growth comes from making more and larger loans to the same customers.
5. Simultaneous borrowing from multiple lenders
Trapped on the "debt treadmill", many consumers get a loan from one payday lender to repay another. The result: no additional cash, just more renewal fees.
6. No consideration of borrower's ability to repay
Payday lenders encourage consumers to borrow the maximum allowed, regardless of their credit history. If the borrower can't repay the loan, the lender collects multiple renewal fees.
7. Deferred check mechanism
Consumers who cannot make good on a deferred (post-dated) check covering a payday loan may be assessed multiple late fees and NSF check charges or fear criminal prosecution for writing a "bad check."
8. Mandatory arbitration clause
By eliminating a borrower's right to sue for abusive lending practices, these clauses work to the benefit of payday lenders over consumers.
9. No restrictions on out-of-state banks violating local state laws
Federal banking laws were not enacted to enable payday lenders to circumvent state laws.

Source: Center for Responsible Lending

(Endnotes)
[1] http://www.responsiblelending.org/pdfs/2b002-payday2005.pdf
[2] Ernst, K., Farris, J., & King, U. "Quantifying the Economic Cost of Predatory Payday Lending." Center for Responsible Lending February 2, 2004 http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf
[3] Klien, H. C. "Payday Lenders in Arkansas: The Regulated and the Unregulated" Arkansans Against Abusive Payday Lending. AARP/Arkansas
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The State Fiscal Analysis Initiative (SFAI) Project

The mission of Arkansas Advocates is to ensure that all children and families have the resources and opportunities to lead healthy and productive lives and to realize their full potential. The goal of our SFAI project is to improve the economic well-being of the state's families with children by providing timely and credible analysis to policymakers, the media, and the public and promoting a more informed public debate about state tax and budget issues. The views of this report are those of the author and does not reflect that of the funders.

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For More Information:
H.C. "Hank" Klein
klein@aristotle.net

www.aradvocates.org

Arkansas Advocates for Children & Families
Union Station, Suite 306
1400 West Markham
Little Rock, AR 72201
(501) 371-9678