

Payday Lending Stores in Alabama: Facts and Issues

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INTRODUCTION

This study was prepared by members of the League of Women Voters of Alabama, a nonpartisan, political organization. It seeks to present a balanced view of the arguments for and against further regulation of payday loans based on previous studies. The League of Women Voters never supports or opposes political candidates or parties. It takes positions on issues after study, discussion and consensus.

In Alabama, one of 32 states that allow three-digit interest rates on payday loans, several attempts have been made to legislate interest-rate caps and other regulations regarding payday loans in the past several years. Last year a bill requiring significant changes to the way the industry operates in Alabama passed the state senate, but it did not pass the Alabama House of Representatives. It is expected to be introduced again during the 2017 legislative session.

A number of groups in Alabama are working toward payday lending reform: Alabama Arise, Alliance for Responsible Lending in Alabama (ARLA), Southern Poverty Law Center, American Association of Retired Persons (AARP), Tuscaloosa Citizens Against Predatory Practices (T-CAPP), Alabama Appleseed and others. LWVAL aims to use this study as the starting point to discussion about whether it also believes that Alabama should reduce allowable interest rates charged on payday loans and whether the state should enact other regulations or limitations on the industry.

This report, the effort of LWVAL members around the state,¹ attempts to provide the reader perspective from the major stake-holder groups involved in payday loans, including regulators, the payday loan industry and consumer protection organizations. It also looks at Alabama's and other states' experiences with payday loan regulation. It does not include online or car-title lending.

Many agencies and organizations have been studying payday lending for years, and it is hoped that the following information gathered from these studies will enable the reader to be better informed about payday lending. Because most of the research has been conducted by opposing interests, readers will find inconsistent findings (Huckstep 2007).

As interest in the issue has grown in both the state and the nation, in June of this year, Alabama Governor Robert Bentley appointed a 33-member task force to study the need for industry regulation.

The Consumer Financial Protection Bureau, a federal agency tasked with some oversight of the industry, has proposed new restrictions to the way the industry does business across the country, but it cannot change allowable interest rates. Only states may change these rates.

DEFINITION

A payday loan is a small, short-term, unsecured loan that the borrower agrees to repay on his or her next payday.

HOW PAYDAY LENDING WORKS IN ALABAMA

For loans under \$500, lenders can charge a 456% annual percentage rate (APR) under the Deferred Presentment Services Act (Act 2003-359) passed in 2003. A borrower can only have a total of \$500 in loans from payday lenders. There are no credit checks or underwriting requirements, but the borrower must be able to show a paycheck stub or a bank account. A lender accepts a postdated check from a borrower written for the amount of the loan plus a finance charge that comes to \$17.50 per \$100 loaned.

Assume a customer borrows \$500 from a payday lender. In two weeks, typically, the loan must be repaid in full. If the borrower cannot pay the entire loan in the specified time, he or she can “roll over” the transaction for another period by paying the finance charge. In two weeks the borrower again owes \$587.50. If he cannot pay, he pays the finance charge of \$87.50, and thus it continues. In three months he has paid a \$525 finance charge, but has not paid anything against the \$500 principal. This is called “churning” (Parrish & King 2009).

If the borrower cannot pay the finance fee to continue the loan, the lender can cash the postdated check. Because of the Deferred Presentment Law, this postdated check on the borrower’s bank account has priority over any other transactions. If insufficient monies are in the bank account, overdraft and other charges from the bank may result yet the loan principal is still unpaid.

HISTORY OF ALABAMA'S PAYDAY LENDING LAW

The Deferred Presentment Law came into being as the result of an Alabama Attorney General’s opinion issued in 1994 stating that payday loans were covered by the Alabama Small Loan Act, the Mini-Code, and subject to Truth-in-Lending Disclosure requirements (<http://www.ago.state.al.us/opinions/pdf/9400210.pdf>). Based on that opinion, in 1998, the Alabama State Banking Department issued 150 cease and desist orders to lenders violating the interest rate cap (Fox 1998). Lobbying efforts by lenders in 2002 resulted in the modification of the Alabama Small Loan Act that provided an alternative rate schedule increasing allowable loans to approximately 190% APR (Act 1959-374 Sect. 5-8-15, Alternative rate schedule, subsection (m)). In 2003, the Legislature passed the Deferred Presentment Act, carving out additional exceptions for small loans and setting the current APR at 456% (Act 2003-359).

PROFILE OF PAYDAY LOAN CLIENTS

A 2012 Pew Charitable Trust report states that nationally 12 million people, or 5.5% of adults, use payday loans annually. On average, these borrowers take out eight loans of \$375 and spend \$520 on interest and indebtedness every year.

“Most borrowers are white, female, and between the ages of 25-44. However, after controlling for other characteristics, there are five groups that have greater odds of having used a payday

loan: renters, African Americans, those earning below \$40,000 annually, those separated or divorced, and those without a college degree” (Pew 2012).

The Pew telephone survey of more than 1,000 borrowers across the country revealed that 69% of respondents secured a loan to cover recurring expenses, such as rent and utilities rather than to pay for a one-time emergency (Pew 2012). The average borrower could only afford a \$50 payment when the loan came due. Forty-one percent of borrowers needed a cash infusion from family, church, etc. to close out the payday loan debt, and many said they were so desperate that they would take out a loan under any circumstances (Carrns 2013).

A 2016 study by the Global Financial Excellence Center at George Washington University revealed that 42% of Millennials (those reaching young adulthood in the year 2000) had used payday loan or pawn shop services at least once. This increasing trend by Millennials crosses socio-economic boundaries and encompasses the college-educated. Reasons for this increase include lack of financial literacy, desperation due to lack of savings, student loan debt, ease and immediacy of procuring cash and lack of a credit history (Doerer 2016).

A 2016 study using information obtained from states' regulatory agencies reports that with 900 payday loan storefronts, Alabama has the third highest concentration of such businesses nationwide, with more than one per every 10,000 people. This finding is positively associated with the percentage of African Americans, unemployment and the poverty rate (Barth, Hilliard, Tahra & Sun 2016).

PAYDAY LOAN CRITICS

For many, payday lending is a moral issue. For these people, the treatment of one's fellow man is important, and payday lending is usury. Usury has been looked upon with disfavor across societies, centuries, cultures, and religions. “Governments have had laws against lending at high interest rates, or ‘usury,’ since the Code of Hammurabi” was developed around 1754 B.C. “At America's founding, all 13 original states had them” (Kim 2016).

The Consumer Financial Protection Bureau (CFPB), a federal agency, was created under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act signed into law in July 2010 (Pubic Law 111-203). CFPB's mission is to implement and enforce consumer financial laws. In performance of their duties, CFPB officials study, research and seek public input before issuing regulations.

The CFPB performed an in-depth study of payday loans, starting with a field hearing in Birmingham Alabama in 2012. The purpose of the study was to determine how to protect consumers while also ensuring that they were able to obtain small loans. Because on the surface using these products seems very simple, it was unclear whether consumers had a full understanding of the costs, benefits and risks involved in their use. There was concern that they might not foresee the possibility of long-term indebtedness nor its high cost (Consumer Financial Protection Bureau 2013).

The study found that two-thirds of payday borrowers had seven or more loans in a year with most of these loans taken within two weeks of the borrower having paid off a previous loan,

often on the same day. It indicated that many consumers could not pay their loan in full and still meet their other expenses.

Building on prior studies' loan churn findings that 75 to 80 percent of payday loans were taken out two to four weeks after paying off a payday loan -- racking up at least \$2.6 billion a year just in loan fees to the payday loan industry -- the Center for Responsible Lending (CRL) researchers examined other indicators of borrower distress. Montezemolo and Wolff (2015) analyzed loan defaults in the form of insufficient funds from customers' checking accounts in three scenarios: (1) bounced payday loan payments, referred to as "visible defaults" because they clearly reflected the borrower's inability to pay back the loan, resulting in NSF fees to banks and payday lenders; (2) "invisible defaults" that occurred when the bank covered the payment to the payday lender, even though the customer did not have enough money in the account, resulting in an NSF fee to the bank only; and (3) the rate of overdrafts occurring at other times in payday loan customers' banking cycles.

Because payday loans are designed to be first in line for payment on payday, they should be least likely to bounce. But the CRL's Montezemolo and Wolff found instead that payment default was high, as were the less obvious "invisible" signs of financial distress.

Concluding that "there is ample evidence that payday loans create great financial distress for borrowers," the CRL study found that:

- "Nearly half of all payday borrowers defaulted within two years of their first loan.
- Of borrowers who defaulted, nearly half did so within the first two payday loans.
- Default does not necessarily signal the end of payday borrowing, with many defaulters going on to repay their loan and even borrow (and possibly default) again at a later date.
- Nearly one in five borrowers had a loan charged off by the lender.
- One-third of payday borrowers experienced at least one invisible default in which their account was overdrawn on the same day that they made a payment to a payday lender.
- For payday borrowers, overdrafts and bounced transactions frequently occurred close in time to the use of payday loans. Nearly half of payday borrowers incurred an NSF fee in the two weeks following a payday loan transaction, and 64% paid NSF fees at some point" (Montezemolo & Wolff, 2015).

According to critics, payday loans keep borrowers in a cycle of debt. Debt-trap products often cause bankruptcy, overdrafts carrying bank charges, and other financial harms (Davis & Lupton, 2016).

EFFECTS OF PAYDAY LENDING ON COMMUNITIES AND STATES

The fact that payday lending not only affects borrowers, but states and communities as well is detailed in a 2013 study by Lohrentz for the Insight Center for Community Economic Development (CCED). Results of the study showed "that the payday loan industry had a negative impact of \$774 million in 2011, resulting in the estimated loss of more than 14,000 jobs. U.S. households lost an additional \$169 million as a result of an increase in Chapter 13

bankruptcies linked to payday lending usage, bringing the total loss to nearly \$1 billion” (Lohrentz 2013). The study further concluded that for every dollar paid in interest to payday lenders, \$1.94 leaves the community.

This CCED study was a response to a 2009 report written by the international finance data consultant firm IHS Global Insight (GI). The GI study was payday-industry sponsored and only considered gains to the economy made from the interest paid to payday lenders. Loss to the economy and community due to reduced household spending was not considered. The CCED study analyzed both sides of the equation and found that payday lending drains money from the economy (Lohrentz 2013).

Information from a May 2016 report shows that “payday loans drain over \$4.1 billion in fees a year from people in the 36 states that allow triple-digit interest rate payday loans” (Standaert & Davis, 2016). Together with title loans, these lending products drain \$8 billion in fees a year from the American borrower.

Since 2013, payday loan regulations have remained fairly static, but there have been changes in the market. Between 2013 and April 2016, no state that did not previously allow payday and car-title loans has legalized them. Where they are allowed to operate, payday lenders have been able to block many efforts to protect consumers from debt traps.

WHAT CONSUMER ADVOCATES RECOMMEND

Several organizations and government agencies that have studied payday lending over the years have made recommendations based on their findings. The recommendations tend to be very similar to each other. The following policy recommendations have been proposed by the National Consumer Law Center (NCLC), the Center for Responsible Lending (CRL) and the Pew Charitable Trusts (Pew). They maintain that to avoid long-term debt and make payday loans affordable, policies must:

- Set a maximum APR of 36% (NCLC, CRL). Pew notes that states that allow maximum APRs higher than Colorado's 45% have seen payday loan storefronts proliferate with no apparent benefit to the consumer.
- Require minimum repayment terms of 90 days or one month per \$100 borrowed (NCLC).
- Limit the amount of time per year that consumers can be kept in debt to payday lenders. CRL recommends that states follow the FDIC's 2005 payday loan guidelines which limit payday loan indebtedness to a maximum of 90 days over a twelve-month period, the equivalent of six two-week loans or three 30-day loans.
- Require multiple payments (NCLC) or payments that are evenly spread out (Pew) instead of one balloon payment at the end of the loan period.
- Prohibit the requirement that borrowers provide post-dated checks or electronic access to their bank accounts (NCLC, CRL).
- Require payday lenders to determine borrowers' ability to pay back the loan yet afford their regular expenses without taking out another payday loan (CRL) and limit payments

according to customers' income (Pew). Pew maintains that monthly payments higher than 5% of a borrower's gross monthly income are not affordable.

- Require full disclosure on all costs associated with payday loans.
- Guard against aggressive collections practices or other harmful repayment tactics.

There is much discussion surrounding acceptable payday interest rate caps, but a rate of 36% seems to permeate the literature. According to the NCLC, the 36% rate has gained wide acceptance for a number of reasons. It has a long history in America dating back 100 years. It has been reaffirmed repeatedly at state and federal levels in recent years. Congress and three federal agencies have endorsed the rate, and 15 states and the District of Columbia have capped APRs on small loans at 36% or less.

Advocates believe that the 36% rate results in payments that consumers have a decent chance of being able to pay and gives lenders an incentive to offer longer term loans with a more affordable structure while avoiding making loans that borrowers cannot afford to repay (Saunders 2013).

It was hoped that a 36% interest rate cap would encourage legitimate lenders to enter the small-dollar loan market by allowing them to make a profit on reasonably priced loans.

Even the U.S. military recommends a 36% rate cap for its members. The Department of Defense issued a report in August 2006 concerning the problems of military readiness that service members were experiencing because of payday loans. "Immediately in response, Congress voted to impose a 36% rate cap, including fees, on loans offered to active duty members of the military and their dependents. As DOD made clear in its implementing regulations that covered payday, car title, and refund anticipation loans, the 36% rate was adopted 'to balance protections with access to credit'" (Saunders 2013).

Even after Congress limited the APR that could be charged to military families, a South Carolina lender charged a service member \$15,613 in interest on a \$1,615 title loan. No federal law was violated. (*New York Times* Editorial, October 18, 2014).

CRITICS: PAYDAY LENDERS BREAK, IGNORE AND INFLUENCE THE LAW

Some payday lenders choose not to follow the law. Some claim affiliations with Native Americans to avoid regulation; some operate online, even when it is outlawed; some use improper methods of collection, etc. (Standaert & Coleman, 2015). ACE Cash Express, for example, one of the nation's largest payday loan companies, had to pay \$10 million in fines for using illegal collection practices. ACE had a manual that instructed its in-house collectors to "create a sense of urgency" in borrowers who could not repay their loans. Employees pressured borrowers who said they could not afford to repay into taking on more debt. Of course new fees were incurred. According to the *New York Times*, "ACE practices appear to be typical in the industry" (*New York Times* Editorial, July 14, 2014).

According to King and Parrish, payday lenders publicly say that their product is a short-term solution to an immediate problem, and that frequent use can create serious financial hardship. In private, they say something remarkably different, critics say.

"The theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is," Dan Feehan, CEO of Cash America, is quoted as saying at the 2007 Jefferies Financial Services Conference (King & Parrish, 2007).

A number of companies across jurisdictions have been scrutinized. J. Paul Reddam and his affiliated companies, Cashcall Inc. and WS Funding LLC, along with Martin Webb and his Western Sky Financial have been subject to enforcement actions in more than a dozen states (Standaert & Coleman, 2015).

State regulators continue to combat unlawful activity in their states by online and out-of-state lenders, successfully arguing that the nexus of the payday transaction is the state in which the consumer is located, and therefore, the laws of that state apply, including rate and fee restrictions (Standaert & Coleman, 2015).

The payday loan industry has worked hard and donated heavily to prevent meaningful reform and regulation. In Alabama during the last election cycle, the industry gave state legislators at least \$475,000, which doesn't include donations made after the election or made indirectly through lobbyists in Montgomery (Whitmire 2016). Of the \$475,000, \$116,000 went to members of the Senate Banking Committee and \$59,000 to the Alabama House Financial Services Committee (Whitmire 2016). The Senate Banking Committee controls what legislation reaches the Senate floor for a vote, and the House Financial Services Committee controls which legislation reaches the floor of the House.

PAYDAY LOANS PROVIDE FOR SHORT-TERM NEEDS UNAVAILABLE FROM BANKS

The Community Financial Association of America (CFSA) is a membership trade association representing more than half of all traditional payday loan storefronts in the country. CFSA's stated purpose is "to promote laws and regulation that balance stronger consumer protections while preserving access to short term credit." It believes "consumers deserve choices with simple, understandable loan terms and to be treated fairly throughout the loan process" (<http://cfsa.com>).

Proponents of payday lending claim that they are there to help the consumer who has an immediate need, and the loans are not intended for long-term use. They freely acknowledge that long-term use can be detrimental to the consumer.

In April 2015, CFSA Director Dennis Shaul testified before a subcommittee of the United States House Financial Services Committee, arguing that payday loans should remain an option and that consumers understand the conditions of the loan. Limiting payday loan store access, he said, would lead borrowers to "unlicensed, unregulated, and off-shore" sources of assistance (<http://financialservices.house.gov/uploadedfiles/hrg-114-ba15-wstate-dshaul-20150415.pdf>).

The Council of Fair Lending of Alabama, also called "Borrow Smart," is a payday loan association headed by Max Wood. It was established in 2007 by lenders who "recognized a need for accountability within the industry." All members agree to a Code of Ethics that, among other things, states lenders should "be especially careful in assisting customers that are on fixed

incomes by offering reasonably affordable loans (<http://www.borrowsmartalabama.com>). Member stores have “*Borrow Smart*” window stickers.

Payday loan stores evolved as a result of banking deregulations in the 1980s, which led to the closing of many small community banks. Small loans are not profitable for large banks, so they do not issue them. Payday loan spokespersons say that this situation makes a payday loan the only option for many borrowers who have below prime credit scores and cannot solicit help from family or other support systems. Borrowers often prefer the convenience of obtaining a payday loan: fast cash, no credit check, no cumbersome paperwork, the informal atmosphere, and often, a store close to home. They sometimes find it preferable to exhausting the credit limit on their credit card (if they have one) or to the fees or the threat of a closed account associated with bounced checks. According to Jeffrey Joseph, a professor at George Washington University, "Even low-income individuals with access to a bank are not necessarily being financially irresponsible to use a payday loan. Consider service charges, minimum balance, and punitive fees for bounced checks or overdrafts" (Andersen 2015).

Industry-backed research indicates that borrowers understand the costs associated with loans and that a significant portion of them are able to accurately assess the length of time it will take for them to pay the loans back (Elliehausen & Lawrence 2001). In direct contrast to consumer advocate findings, the industry claims that most customers do not "rollover" their loans for more than a few weeks (Mann 2013). These borrowers are not subject to the high interest rate cited by critics of the payday loan industry, industry advocates claim.

The payday loan industry argues that the fees and interest rates associated with payday lending are justified by fixed operating costs for payday loan stores and high loan loss rates. “To a great extent the high APRs implied by payday loan fees can be justified by the fixed costs of keeping stores open and the relatively high default losses suffered on these loans. The industry’s profitability is extremely sensitive to the volume of advances outstanding at any one time, but not specifically to the proportion of those advances that are rollovers” (Flannery & Samolyk 2005).

Consistent with industry explanations, Huckstep’s study of the payday loan companies’ profitability outlines lenders’ high operating expenses, including wages, occupancy costs, and loan losses. These expenses are incurred to promote customer convenience by offering longer business hours and a higher density of stores than traditional lenders. Offering this convenience lowers profitability (Huckstep 2007).

The payday loan industry compares its profit margins with that of Apple, stating that the average profit of 7.44% of the four largest payday loan companies paled in comparison to the computer giant's 2012 net profit of 26.65% (FinancialUproar.com 2013).

Critics point out that payday lenders deliberately locate in areas with low-income and/or large minority populations, which leads to exploitation of the poor. The industry responds, however, that decisions about where storefronts are located are determined by market demand for service (Prager 2009).

Proponents of payday lending asked IHS Global Insight (GI) to study the impact of payday lending. GI wrote: “The payday loan industry had a presence in 39 states and the District of Columbia in 2007 . . .” And it “supports more than 155,000 jobs nationally and contributed more than \$10 billion to national GDP in 2007 . . .” (IHS Global Insight 2009).

In August 2015, the Alabama Banking Department instituted a database for the regulation of payday lending. Before the database became available, borrowers were able to go from one payday loan storefront to another, borrowing more than the \$500 allowed by Alabama law.

Max Wood, President of Alabama's Borrow Smart, is an important spokesperson for the industry in the state. He fought the database requirements claiming that the new state database would cost closures and job loss. “We project that because of negative impact of this database, about half of the state’s 1,000 storefronts will close, which will result in the loss of thousands of jobs,” he said (Wood 2015).

Wood also fears interest caps and proposed regulations from the Consumer Financial Protection Bureau would make the situation even worse, perhaps even leading to the end of payday loan storefronts in Alabama. “The bottom line is that if the rules go into effect as proposed, 70 to 80% of the industry will no longer exist There is a large demand for this service, and we don’t want to see it go away for the sake of the consumer” (Wood 2016). Indeed, in states that have implemented a 36% interest cap, the payday loan storefront industry has virtually disappeared.

The short-term loan industry argues that Georgians and North Carolinians do not seem better off since their states outlawed payday credit: they have bounced more checks, complained more about lenders and debt collectors, and have filed for Chapter 7 (“no asset”) bankruptcy at a higher rate. The increase in bounced checks represents a potentially huge transfer from depositors to banks and credit unions. Banning payday loans did not save Georgian households \$154 million per year, as the CRL projected, it cost them millions per year in returned check fees (Capital Research Center 2010).

HOW OTHER STATES APPROACH PAYDAY LENDING REGULATIONS

North Carolina

Before 1996, North Carolina operated under the Consumer's Financial Act which limited APR to 36% (Ludwig, et al., 2013). In 1996, under check-cashing laws, North Carolina bypassed this act, authorizing the use of payday lending. The new ruling had a sunset provision set for five years, at which time North Carolina would decide whether or not to reauthorize payday lending (Desai & Elliehausen 2014). When the existing law was allowed to sunset in 2001, and interest rates returned to 36%, some lenders closed their doors. National chains affiliated with out-of-state banks were not required to comply with the 36% cap (Desai & Elliehausen 2014). The bank-lender partnership ended in 2005 when the FDIC changed leadership. Over time, the demand for such loans dissipated.

In 2006, the remainder of lenders working in North Carolina left the state under consent decrees (Manturuk 2008). North Carolina was the first state in the country to prohibit companies from charging more than 36% APR on payday loans (North Carolina Department of State Treasurer 2012). Increased regulatory practices have not been associated with a lack of access to credit

availability in North Carolina (Peterson 2013) and consumers generally welcome increased regulations of lending services.

In 2008, the state of North Carolina evaluated the impact of de-authorization of payday lending to citizens. Results indicated that payday loans and other high interest credit options were the least used and that citizens overwhelmingly reported that payday lending services were bad (Manturuk & Ratcliffe 2007).

Other research that included focus group interviews with individuals who had used payday lending services revealed that payday loan cycles were difficult to escape once started. Most participants were glad that lending services were no longer available in North Carolina, citing high interest rates and loan roll-overs as contributors to a cycle of debt. Further, most customers also agreed that the loan did not relieve their financial stress, and in the long-run, loans often caused greater financial difficulties. However, all but two agreed that individuals should have the right to take out a payday loan if needed (Manturuk & Ratcliffe 2007).

Georgia

Usury caps on small-dollar loans were first implemented in Georgia in the 1950s (http://www.georgiawatch.org/wp-content/uploads/2016/04/Letter-to-CFPB-Director-Cordray_Georgia-Organizations.pdf). New regulations imposed in 2004 effectively banned payday lending services in the state. Annual interest rates were capped at 60 percent, and non-banks and out-of-state banks were barred from working with Georgia banks to circumvent the maximum allowable APR. Georgia also imposed stiff criminal and civil penalties for violations.

Desai and Elliehausen (2014) examined the impact of payday loan bans in Georgia, North Carolina, and Oregon on serious delinquencies, borrowers whose payments were at least 60 days overdue, and less serious delinquencies, consumers late in payments by 30 to 59 days, of three types of consumer credit: retail, revolving, and installment accounts. They compared counties in these states to counties in contiguous states that do allow payday lending. Results indicated that the effect of payday lending bans on subsequent consumer delinquencies were generally small and positive, yet statistically non-significant.

Colorado

To address failed regulations that were implemented in 2007, Colorado eliminated the two-week, single-payment lending model in 2010 and adopted a high-cost installment plan (Montezemolo 2013). The 2010 regulations require that borrowers be granted a six-month installment plan to repay the loan, with no penalties if paid early (Urahn, Plunkett, Bourke, Horowitz, Lake, & Roche 2013). Colorado places an APR cap at 45% (Peterson 2013; Urahn et al. 2013), and borrowers are charged an origination fee and a monthly maintenance fee that is initially applied at the end of the second month of the loan. Borrowers are provided an opportunity to earn a portion of the origination fee back, as it is refundable “on a pro-rata basis” if loans are paid early. Lenders do, however, earn the full origination fee if a loan is not paid off within six months.

Although borrowers are paying, on average, 42 to 44% less on payday loan fees than they were before the 2010 regulations took effect, the associated costs of the loan remain high (Pew 2014b). Despite the greater flexibility to repay loans over time, Colorado borrowers continue to

face exorbitant fees, and the complex fee structure makes it difficult for consumers to research the products and compare rates to other lenders. Some critics suggest that it might have served consumers better if Colorado completely eliminating high-cost, short-term lending (Urahn et al. 2013).

Despite the shortcomings that remain, regulatory changes have resulted in increased loan affordability. For example, the 2010 Colorado regulations have been associated with fewer loan defaults, fewer bounced check fees charged by lenders, and fewer loan renewals (Pew 2014b). Although half of payday lenders closed following the 2010 regulations, those that remained open now serve more customers.

To examine the impact of the 2010 payday loan regulations implemented in Colorado, researchers conducted interviews with borrowers and with individuals who influenced these changes and/or had first-hand experience with lending services. Payday loan data published by the state attorney general's office was analyzed to examine use before and after regulations were implemented. Individuals who utilized loans before the regulations described their cycles of borrowing and a reliance on income tax refunds to finally break the cycle.

Pew researchers also conducted 14 focus groups in seven locations across the U.S., and borrowers overwhelmingly supported increased regulations of lending services (Urahn et al. 2013). In sum, payday lending was described by its users as a predatory practice that negatively impacts consumers and contributes to income inequality.

ALTERNATIVES TO PAYDAY LENDING AND PAYDAY LENDING STOREFRONTS

Besides asking family, friend or church for financial help, payday loan users already have other options that consumer advocates say are safer and cheaper: pay advances from employers, subprime credit cards, rent installment agreements, or a utility payment plan. Some traditional consumer finance companies or credit unions offer small, short-term loans. Even pawn shops are a better deal for the borrower than a payday loan that cannot be paid back in full in a short amount of time. Educating those living paycheck to paycheck about these options would be beneficial.

But what about people who need quick cash who cannot or choose not to use these options? There are customers who take out a payday loan and can pay it back without falling into the debt trap. So, if regulation and/or interest caps do lead to the closing of many storefronts, is there anything to take their place?

In the May 2016 issue of *The Atlantic*, in a piece titled "Payday Lending: Will Anything Better Replace it?" author Bethany McLean noted that Richard Cordray, director of the Consumer Financial Protection Bureau, is pushing for credit unions and banks to offer small-dollar, payday-like loans. By using their preexisting branches and therefore eliminating the overhead costs of payday stores, banks and credit unions could engage in short-term lending at a much lower rate (McLean 2016).

Banks have not warmed to this idea because of the time and costs required from staff to underwrite the loans and because regulators have been insisting since the financial bank crisis

that banks take fewer risks, not more. Cynics point out that banks make a lot of money on the fees from bounced checks.

A few credit unions have had success offering small, short-term loans, but “many struggle with regulators, with reputational risk, and with the cost of making such loans.” (McLean 2016). Also, the credit union industry is small, smaller than many of the large banks alone.

Senator Elizabeth Warren has suggested that the United States Postal Service partner with banks to offer short-term loans. However, even opponents of the current payday lending situation point out that the money-strapped postal service would require an entirely new infrastructure and extensive training for employees in order to offer this additional service.

McLean (2016) predicted the increased use of on-line lenders by the middle class. Although they do not have the overhead of storefront lenders, they do experience difficulty managing consumer fraud and are difficult to police. However, because they can avoid state interest caps where they exist, on-line lenders often charge higher interest than storefronts.

Suggestions for reform of the payday loan storefront industry as it exists in many states without caps or regulation, like Alabama, can be found above in the section entitled What Consumer Advocates Recommend.

PROPOSED REGULATIONS BY THE CONSUMER FINANCIAL PROTECTION BUREAU

The Consumer Financial Protection Bureau, or CFPB, is a federal agency charged with enforcing federal consumer financial laws and protecting consumers in the financial marketplace. It issued a set of proposed regulations for the payday lending industry on June 2, 2016, based on authority granted to it in the Dodd-Frank Act. Although this bureau can set regulations, it cannot set interest rates. That is up to the states.

There was a 90-day comment period from June 2, during which interested parties could make comments and suggestions on the CFPB proposed regulations.

“The proposal would generally cover two categories of loans. First, the proposal generally would cover loans with a term of 45 days or less. Second, the proposal generally would cover loans with a term greater than 45 days, provided that they (1) had an all-in annual percentage rate greater than 36 percent; and (2) either were repaid directly from the consumer’s account or income (payday loan) or were secured by the consumer’s vehicle.”

“For both categories of covered loans, the proposal would:

- identify it as an abusive and unfair practice for a lender to make a covered loan without reasonably determining that the consumer has the ability to repay the loan;
- require that, before making a covered loan, a lender must reasonably determine that the consumer has the ability to repay the loan;
- impose certain restrictions on making covered loans when a consumer has or recently had certain outstanding loans;

- provide lenders with options to make covered loans without satisfying the ability-to-repay requirements, if those loans meet certain conditions; [explained below]
- identify it as an unfair and abusive practice to attempt to withdraw payment from a consumer’s account for a covered loan after two consecutive payment attempts have failed, unless the lender obtains the consumer’s new and specific authorization to make further withdrawals from the account;
- require lenders to provide certain notices to the consumer before attempting to withdraw payment for a covered loan from the consumer’s account;
- and prescribe processes and criteria for registration of information systems, and requirements for furnishing loan information to and obtaining consumer reports from those registered information systems” (Consumer Financial Protection Bureau 2016).

The CFPB rules offer two proposed ability-to-repay protection options payday lenders would be required to use:

- A full-payment test to determine a borrower’s ability to repay the loan and also be able to pay for basic necessities. This requirement is aimed at preventing a debt trap.
- A principal payoff option applies to only certain short-term loans and does not apply the full-payment test. The loan would be repaid with a single payment or with two extensions with the money applied toward the principal (Southern Poverty Law Center 2016).

Many believe that the CFPB’s proposed regulations do not go far enough. Nick Bourke, of The Pew Charitable Trusts complains, “Pew’s research shows that borrowers want three things: lower prices, manageable installment payments, and quick loan approval. The CFPB proposal goes zero for three.” (O’Connell 2016).

“As currently written, the rule contains significant loopholes that leave borrowers at risk, including exceptions for certain loans from the ability-to-repay requirement, and inadequate protections against ‘loan-flipping’ – putting borrowers into one unaffordable loan after another,” states CRL President Mike Calhoun (O’Connell 2016).

CURRENT STATUS OF PAYDAY LENDING IN ALABAMA

In Alabama, James Harrison, Superintendent of Banking, released the first results from the new state database, which became operative in August 2015. By the 25th week, 1.13 million loans totaling \$349 million had been issued. That averages \$14.9 million a week. Harrison said that the 5.52 loans taken out by the average customer during this time is concerning since one of the criticisms of payday lending is that it leads to a cycle of poverty (Sheets 2016).

Kyle Whitmire reported on al.com that within the first ten weeks of the reporting period, there were 462,209 loans with the average amount of the loan being \$317. Total loans plus fees were \$172.1 million, and approximate gross profit was \$25.4 million (Whitmire 2015).

According to a personal communication from Mr. Harrison, as of May 22, 2016, there were:

- 1,072,086 payday loan transactions which were fee-only renewals or new loans on the same day representing 172,520 payday loan borrowers (“Fee-only renewal” and “new loan on the same day” mean the same thing)
- 1,655,917 opened transactions with 223,810 borrowers for that period (“open transaction” means that it is outstanding debt that has not been charged off or deemed uncollectible)

As of May 17, 2016, licensees indicated 65,532 loans listed as bad debts or 60 days or more past due (Personal communication, Harrison 2016).

A full report from the database is not expected until later (Personal communication, Corscadden 2016).

There are many groups in Alabama working toward payday lending reform: Alabama Arise, Alliance for Responsible Lending in Alabama (ARLA), Southern Poverty Law Center, American Association of Retired Persons (AARP), Tuscaloosa Citizens Against Predatory Practices (T-CAPP), Alabama Appleseed and others. The reform effort is bi-partisan aimed at helping the poorer consumer.

Owners of payday lending stores and their employees have worked to block many elements of the reform efforts. Joined in their efforts by representatives of industry trade groups and state based groups such as the Council of Fair Lending (Borrow Smart), they argue some reforms, especially a 36% cap on loan interest rates would have negative impacts such as job losses and the potential closing of many, if not all, store front lending facilities. They argue the poorer consumer would be hurt, not helped.

The subject of payday-lending reform has come before the Alabama Legislature for several years, and for the first time, in the 2016 session of the Legislature, the Senate voted 28-1 to approve a bill comparable to Colorado’s payday-lending law. The bill failed to pass the House. Similar legislation will be introduced in the 2017 session.

On June 14, 2016, Governor Robert Bentley issued Executive Order Number 21, creating the Alabama Consumer Task Force. “The Task Force shall study and identify areas for specific revision regarding Alabama consumer credit laws and shall report its findings and recommendations to the Governor by January 30, 2017. Recommendations may take the form of regulatory or statutory changes” (Bentley 2016).

The Alliance for Responsible Lending in Alabama (ARLA) has sent a letter to Governor Robert Bentley asking that he expand the task force to include more citizens representing the effort to cap payday lending interest rates. As it now stands, of the 33-member task force, only four are consumer advocates: Alabama Appleseed, SPLC, AARP and Alabama Arise. Industry supporters believe they are underrepresented. Elsewhere, ARLA pointed out that Mike Hill, the new state banking superintendent, is the original author and sponsor of the 2003 legislation on payday lending (See Whitmire 2015). Mr. Hill has appointed two people to the task force; one represents ENOVA, a national online payday lender, and another is counsel for the Alabama Lenders Association.

Alabama associations representing a wide variety of credit granting organizations are on the task force due to the varied nature of credit instruments the task force has the authority to consider, not just payday loans.

END NOTES

¹Those participating in the study are local League members from throughout the state: Annette Dudgeon (Chair), Brenda Boman, Gina Finnegan, Laura Hill, Shannon McDaniel, Beebe McKinley, Katie Terrell, Ida Tyree-Hyche and Betsy Wooten.

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