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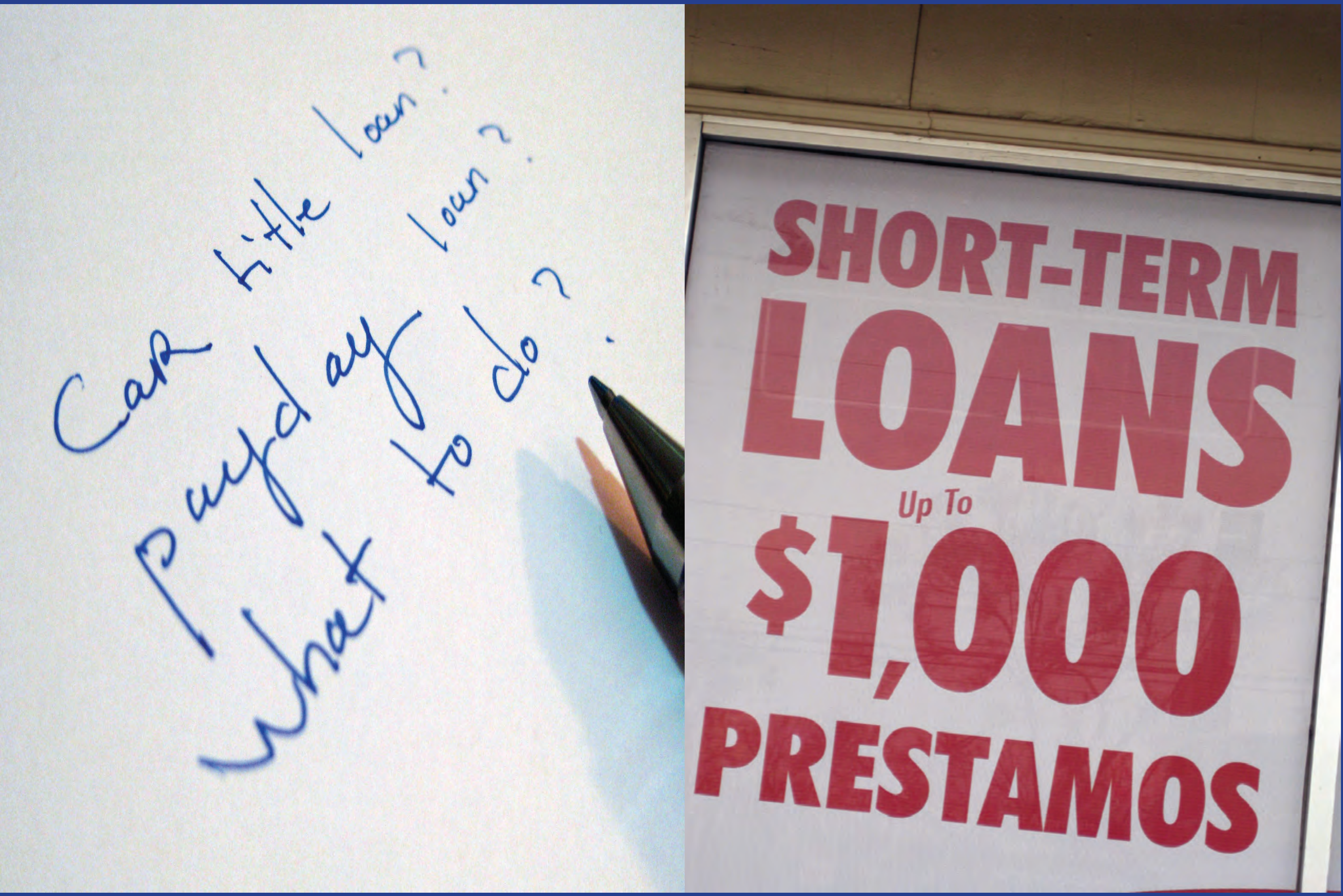
The Impact of Unregulated Lending in Texas



A Survey of Payday Borrowers

Texas
APPLESEED

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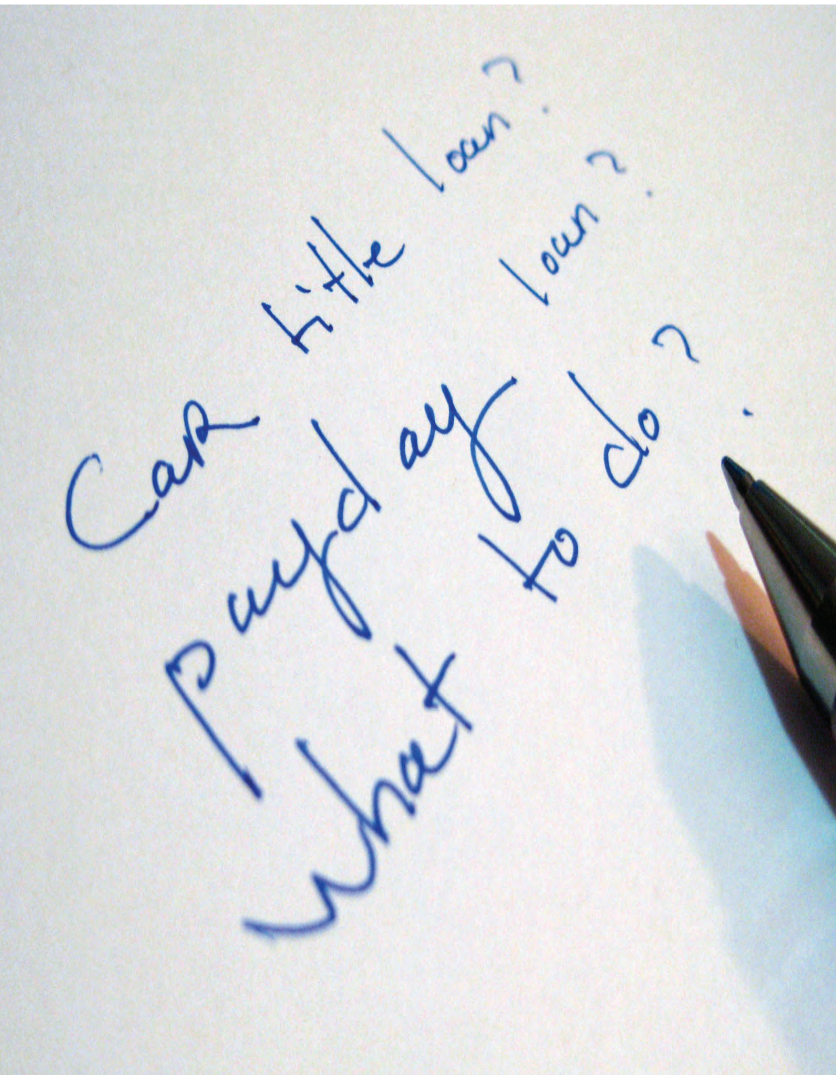

A Survey of Payday Borrowers

April 2009

Texas Appleseed

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Texas Appleseed Mission

Texas Appleseed's mission is to promote justice for all Texans by using the volunteer skills of lawyers and other professionals to find practical solutions to broad-based problems. Our prior work in fair financial services has focused on bringing low-income and immigrant consumers into the financial mainstream through greater financial education and through working with Texas banks and credit unions to encourage development of new financial products and services to better serve this market. This project focuses on the need for fair regulation of credit services organizations in Texas and expanding consumer choices for fair and reasonably priced small-dollar loans.

Visit our website for more information about this and other Texas Appleseed projects:
www.texasappleseed.net

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Finally, we would like to thank the **Texas Alliance for Economic Inclusion**, which partnered with Texas Appleseed to design and implement the survey, and the national **Appleseed** organization for their support.

*The opinions expressed in this report are those of Texas Appleseed and do not necessarily reflect the opinions of funders or the partner organizations.

Executive Summary

High-cost, small-dollar payday loans have attracted the attention of state legislatures around the country. There is a growing concern that these small dollar loans, the majority averaging $500 or less, are trapping consumers who can afford it least in a destructive cycle of debt.

Texas stands out among states in this national policy debate. Payday and other small dollar lenders operate a multi-billion dollar lending market in this state, yet they are not licensed or regulated—and no meaningful consumer protections are attached to these loans. In Texas, the vast majority of payday lenders are taking advantage of a loophole in state law allowing them to operate as "credit services organizations" (CSOs). Other types of high-cost, small dollar lenders (auto title and rent-to-own) also are taking advantage of this loophole to operate CSO lending storefronts across Texas. In Texas, a credit services organization is only required to pay a $100 annual registration fee to the Secretary of State—and in return, CSOs avoid the regulatory oversight, licensing and consumer protections required of other Texas lenders. As a result, Texas payday loans are among the most expensive in the country.

CSOs' lack of accountability translates into a lack of data upon which to base policy and market reform. To help fill this void, Texas Appleseed partnered in 2008 with the Texas Alliance for Economic Inclusion (TAEI)[1] to survey more than 5,000 low- and moderate-income Texans on their need for small dollar credit and their use of payday lenders, who make up the largest segment of the unregulated CSOs.

Survey results described in this report shed new light on the demand for payday loans and the demographics of payday borrowers in Texas. The majority of the survey respondents who needed short-term credit used it to pay for recurring basic expenses such as utilities, food and housing. In addition:

- Thirteen percent of those surveyed use payday loans for short-term credit needs.[2]
- Nearly one in 10 payday borrowers use payday loans monthly.
- Over half of the payday borrowers roll over or extend their loans at least once before they can pay them off—and nearly one in four payday borrowers surveyed roll over loans multiple times. As a result, the cost to borrow money frequently exceeds the original loan principal.
- A majority of payday borrowers are in their 20s and 30s. Fifty-nine percent of borrowers are women, many of them single women and single mothers.

[1] The Texas Alliance on Economic Inclusions (TAEI) is a coalition of financial service providers, regulators and community organizations working together to promote improved financial service options and financial education for underserved communities. The TAEI coalition, coordinated by the FDIC, does not take policy positions; recommendations in this report are solely those of Texas Appleseed.
[2] Texas Appleseed and TAEI conducted two surveys, a large 4,481person sample in Austin and a survey with 521 respondents in a tri-city area (San Antonio, Dallas and Houston). The tri-city survey showed a higher percentage (23 percent) using payday loans.

- Although payday borrowers include all major ethnic groups, a disproportionately high percentage is African American.

- Though not disproportionately represented among payday borrowers, the largest number of payday borrowers is Hispanic.

- Payday loan use declines with age, with two exceptions. Payday loan use increases both for single women and for Caucasians in their 50s.

Forty percent of the payday borrowers surveyed said they had approached mainstream lenders, but could not get the loans they needed. Some Texas financial institutions are offering affordable small-dollar loan products, however more Texas mainstream lenders should follow their lead. These types of competitively priced small-dollar loan products are regulated, encourage savings, and are an attractive alternative to high-cost unregulated payday and auto title loans.

The national subprime lending crisis provides an important lesson: consumer protections and regulation are essential for the proper functioning of financial markets and for preserving overall economic health. Though defaults on small-dollar loans do not have the same immediate impact as a home mortgage default, a 2008 study found that Texas payday borrowers were much more likely to file for Chapter 13 bankruptcy, because the loans often create a deeper financial crisis for borrowers already in desperate straits.[3]

Based on our market research, Texas Appleseed offers the following policy recommendations:

Urgent Policy Recommendations

1. Prohibit CSOs from arranging loans unless there is appropriate regulation, including licensing, oversight and consumer protection.
2. Collect loan data from CSOs, including type of loan, rates and fees, number of repeat customers, and their loan rollover history.

Long-term Positive Policy Changes

3. Develop policies and initiatives to encourage financial institutions to offer their customers alternatives to high-cost, short-term loans.
4. Consider an annual percentage rate cap on all small dollar loans.

Market Recommendations

5. Financial institutions and other loan providers should explore ways to meet short-term consumer credit needs without excessive fees or the risk of a cycle of debt.
6. Provide incentives to build savings.

Texas has an opportunity to make the necessary changes in state law to protect consumers against abusive high-cost loans. Holding CSOs accountable to the same licensing and regulatory standards required of other Texas lenders is essential to avoid predatory market practices and make fairly priced loans available to Texas families.

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[3] Paige Marta Skiba, Vanderbilt University Law School, and Jeremy Tobacman, The Wharton School, University of Pennsylvania, *Do Payday Loans Cause Bankruptcy?* (October 10, 2008).

Introduction

Lenders offering high-cost, short-term payday and auto title loans are proliferating in Texas. Low- and moderate-income families, along with single women, are the primary users of payday loans, according to this survey. Payday and short-term auto title lenders provide immediate access to cash, but at a very high price: often $20 or more per $100 borrowed for a two-week period.

Our Texas data shows that 58 percent of payday loan borrowers had to roll over or extend loans at least once before paying them off. The rollover percentage is even higher (72 percent) in a 2007 national survey.[4]

What are payday and auto title loans?

Payday and auto title loans are **non-amortizing loans**: borrowers generally cannot make installment payments to reduce loan principal. The loan must be repaid in full by the end of the loan period, usually within two weeks for payday loans and within one month for an auto title loan.

There is **minimal underwriting**—usually a job and a bank account are the core requirements for a payday loan. To get a loan, the consumer must give a post-dated check or electronic account access equal to the total loan amount plus fees for one loan period. An auto title loan is similar, but uses an automobile title as collateral. Loan fees are the equivalent of 300 to 500 percent APR (annual percentage rate). If the borrower cannot repay the loan in full by the end of the loan period, then he or she must pay this fee every time the loan is renewed for another two to four weeks. At charges upwards of $20 per $100 borrowed, the high rate of rollovers could mean **paying fees equal to or in excess of the original loan amount** as the "cost to borrow money."

In Texas, these loans are made through credit services organizations (CSOs). The CSO initiates, services and guarantees the loan but contracts with a third party lender to provide the actual loan. In the case of payday loan default, BOTH the CSO and the third party lender **can charge multiple bounced check fees**. n the case of default on an auto title loan, the automobile may be repossessed.

Payday lenders themselves acknowledge that their product can be detrimental for consumers, noting in a consumer brochure created by the industry trade association, "Repeated or frequent use of payday advances can cause serious financial hardships."[5]

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[4] Gregory Elliehausen, GEORGE WASHINGTON UNIVERSITY SCHOOL OF BUSINESS, *An Analysis of Consumers' Use of Payday Loans,* Financial Services Research Monologue No.41 (January 2009). Forty-two percent of payday borrowers participating in this national study took five to over 14 cycles to pay off their loans.

[5] COMMUNITY FINANCIAL SERVICES ORGANIZATION OF AMERICA, "*Your Guide to Responsible Use of Payday Advances*," *available at* http://www.cfsa.net/downloads/Your_Guide_to_Responsible_Use_of_Payday_Advances_English.pdf

Payday and auto title loans are now available in more than 2,800 locations in large cities and small towns across Texas.[6] Six of the 10 payday lenders operating the largest number of loan storefronts in Texas—nearly 1,700 locations—are based in Texas.[7] Payday borrowing in Texas is estimated at $3 billion annually.[8] Earlier this year, a major Texas-based small dollar lender reported record annual earnings.[9]

Currently, a large majority of high-cost, short-term payday and auto title lenders are taking advantage of a loophole in state law that allows them to operate as unregulated "credit services organizations," or CSOs.

Why would a payday lender choose to operate as a CSO?

The Credit Services Organizations Act was originally passed by the Texas Legislature in 1987, to reign in for-profit credit repair services. A growing number of high-cost lenders are taking advantage of a loophole in state law that allows CSOs to obtain "an extension of consumer credit for a consumer." [Texas Finance Code § 393.001 (3) (b)]

To become a CSO in Texas, a business must only register with the Secretary of State and pay a $100 annual registration fee.

CSOs cannot lend money directly, so they partner with a "third-party lender" that loans money to the CSOs' clients at 10 percent interest, in compliance with the state usury cap. The CSO then charges service fees, often $20 or more for every $100 borrowed for a two-week loan, to arrange the loan and guarantee the loan repayment.

The CSO takes on virtually all of the loan risk, engages in all consumer interactions and loan payment collection efforts, and **reaps the bulk of the profit** from the transaction.

There are **no restrictions on the terms of loans** that CSOs arrange and **no limits on the fees** CSOs can charge. Available complaint records indicate that CSOs use **aggressive payment collection tactics.**

In short, CSOs are able to **sidestep licensing and enforcement by the Texas Office of Consumer Credit Commissioner**, which holds all other consumer lenders accountable.

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[6] TEXAS SECRETARY OF STATE, LIST OF REGISTERED CREDIT SERVICE ORGANIZATIONS, Texas Secretary of State (November 2008).
[7] *Id.* These lenders include Ace Credit Services LLC, Cash America Financial Services Inc., First Cash Credit Ltd., Texas EZPAWN LP, Texas EZ MONEY LP, and Rent-A-Center East Inc.
[8] Commissioner Leslie Pettijohn, TEXAS OFFICE OF THE CONSUMER CREDIT COMMISSIONER, *testimony* before the Texas House Committee on Pensions, Investments and Financial Services (March 4, 2009).
[9] Aili McConnon, *"For Pawnshops, the Recession Is a Golden Egg; Cash America is boosting the loans it offers online, and is expanding a payday cash-advance feature,"* BUSINESS WEEK (February 4, 2009)

Unlike Texas, most other states limit maximum fee and rate charges for payday and auto title loans and place limits on loan terms, the size of the loan, the number of outstanding loans, and the number of loan renewals or rollovers per customer.[10]

Fifteen states have opted to ban high-cost payday and auto title loans by setting a 36 percent maximum annual percentage rate limit (cost of credit).[11] This is the same rate cap that Congress implemented in 2007 to apply to military personnel. ***In Texas, CSOs routinely offer loans at 500 percent APR and above.***

In order to better inform the debate on how the State of Texas should address this important consumer lending issue, Texas Appleseed and the Texas Alliance on Economic Inclusion (TAEI) undertook this survey to gather much needed data on payday lending in Texas.[12]

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[10] Don Baylor, Center for Public Policy Priorities, TEXAS BUSINESS REVIEW, *The Hidden Costs of Payday Lending* (April 2008). A rollover entails paying the loan interest and fees more than once in order to extend repayment of the principal, usually two weeks for each additional term.

[11] These states include Arkansas, Connecticut, Georgia, New Hampshire, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, West Virginia, as well as the District of Columbia.

[12] The Texas Alliance on Economic Inclusion, *supra* note 1.

A Survey of Small Dollar Lending in Texas

The lack of regulatory oversight in Texas means that the state has little to no data on loan volumes or lending practices of credit services organizations (CSOs).

To fill this information gap on the impact of payday lending on Texas consumers, Texas Appleseed partnered with the Texas Alliance for Economic Inclusion to survey low-and moderate-income consumers on their short-term borrowing practices.[13] Two separate surveys were conducted between January and April of 2008. The larger survey of 4,481 Austin respondents found that 13 percent used payday loans; in addition, this survey included demographic information—making it possible to identify payday borrowers by age, gender, income, ethnicity, and marital and housing status.[14] Another survey, with 521 respondents, was administered to clients seeking services through four non-profit organizations in Dallas, Houston, and San Antonio. It only addressed demand for and use of small dollar loans. Twenty-three percent of respondents in this smaller survey indicated that they use payday loans. Survey respondents generally had incomes of $50,000 or below.[15]

Both surveys focused on payday borrowing, since payday lenders comprise the majority of the state's unregulated high-cost lenders.[16] It is important to note that the survey was conducted before the impact of the current national economic crisis was widely felt.

The goal of this survey is to provide information to enable Texas policymakers and market players to address short-term consumer credit needs fairly and responsibly.

Survey Overview of Payday Borrowing: Dallas, Houston & San Antonio

In order to understand the market for short-term credit and the appropriate policy response, it is important to know why people need short-term credit. Just over half of all 521 respondents to the tri-city (Dallas-Houston-San Antonio) survey reported needing short-term credit to cover basic expenses.

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[13] *Id.*

[14] The Austin survey included 8,187 respondents, with 54 percent (4,481) choosing to answer questions about payday loan usage. See *Appendix A* for the data analysis methodology. See *Appendix B* for survey questions.

[15] Income information was not collected for survey respondents from Dallas, Houston and San Antonio. $50,000 reflects the general income cut-off point to receive services from these non-profit organizations.

[16] In 2008, 75 percent of the 400 registered Credit Services Organizations in Texas were payday lenders. Don Baylor, CENTER FOR PUBLIC POLICY PRIORITIES, *Payday Lending in Texas: Bucking the Trend,* presented at Federal Reserve Bank of Dallas & IC2 Institute Payday Lending Conference, The University of Texas Etter-Harbin Alumni Center (Nov. 14, 2008) *available at* http://dallasfed.org/news/ca/2008/08payday_baylor.pdf.

Short-term Credit Needs

	Total Sample	Payday Borrowers
Pay electric/telephone/cell phone bills	50%	55%
Buy groceries or gas	46%	49%
Rent payment	35%	39%
An emergency	34%	38%
A medical need	24%	25%
Car payment	23%	26%
Home mortgage payment	23%	30%
Help a friend or family member	17%	18%
Holiday or special occasion	13%	17%
Other	3%	2%

Percentages do not add up to 100 because respondents could choose multiple answers.

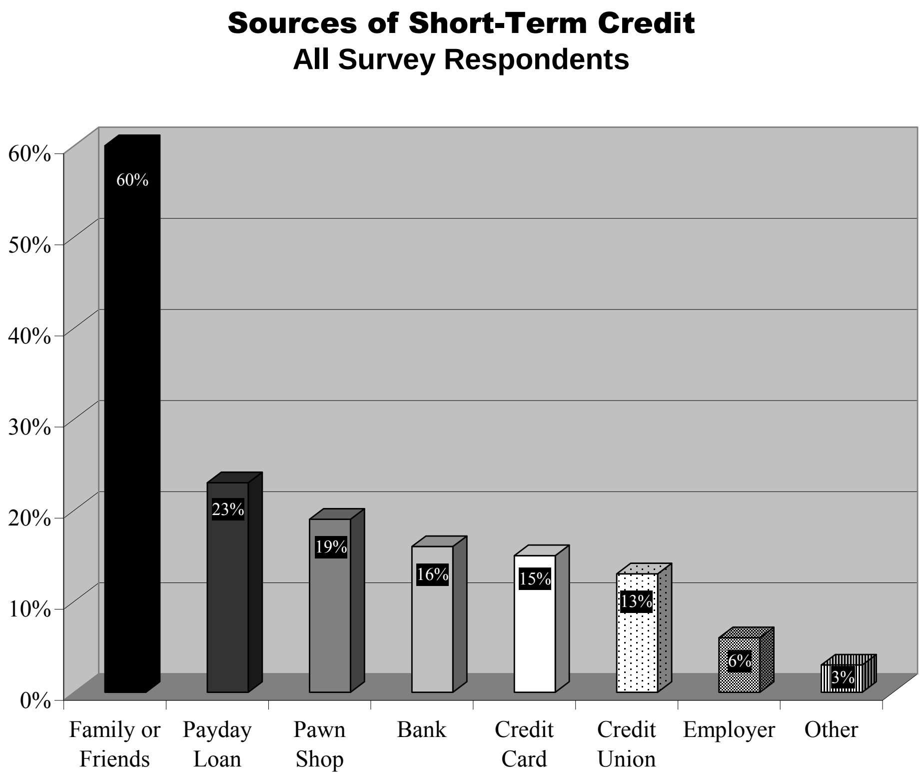
The majority of respondents needed short-term credit to cover recurring expenses like rent, food or bills; a third of them needed short-term credit for an emergency. This breakdown held true for the subgroup of respondents who use payday loans to meet short-term credit needs—however, payday loan users were more likely to use these loans to cover home mortgage payments.

Where do consumers go for short-term credit?

The most common source of quick cash among all respondents surveyed is "family and friends." About 20 percent of the survey respondents also indicated that they use "payday loans" or "pawn shops" as sources of ready cash. Banks and credit unions were used by 15 and 13 percent respectively for short-term credit, and 15 percent use credit cards. A much smaller percentage relied on "other" sources of quick cash included 401K, IRA or other retirement accounts; churches; social service agencies; small financial institutions; other loan companies; and a loan from a private source.

Among payday borrowers, 45 percent also used family and friends as a source of short-term credit, compared to 60 percent of all survey respondents.

Thirty-three percent of payday loan users also frequented pawn shops to secure quick cash, compared to 19 percent of all survey respondents. Payday loan users also borrowed from banks and credit unions and borrowed against their credit cards at comparable rates to non-payday users participating in the survey.



A Closer Look at Payday Borrowers

Twenty-three percent of total respondents to the tri-city survey use payday loans. This percentage is high compared to a national estimate that 19 million adults, or eight percent of the total American adult population, use payday loans.[17] The respondents are concentrated in the income range (earning less than $50,000 per year) that is more likely to use payday loans.[18]

Among those using payday loans, 55 percent use them once or twice a year. A third of the borrowers use payday loans a few times per year, four percent use them every few months, and nine percent use the loans once or more per month. ***Fifty-eight percent of payday loan borrowers had to roll over or extend the loan at least once.*** Nearly one in four payday borrowers reported having to extend their loans multiple times before being able to pay them back in full.

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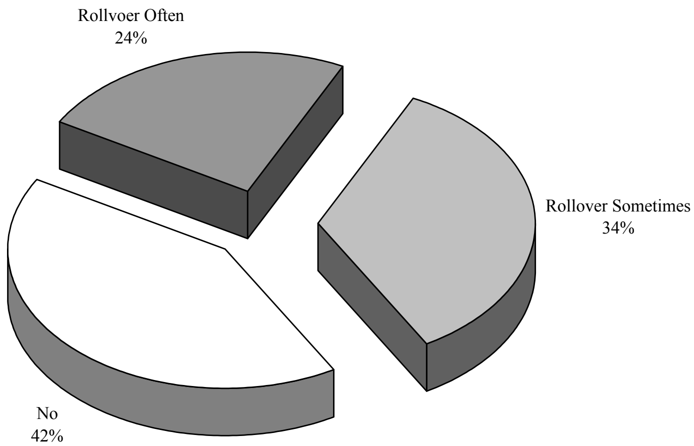
[17] CENTER FOR RESPONSIBLE LENDING, *A 36% Rate Cap on High-Cost Loans Promotes Financial Recovery* (January 2009) and *the 2007 American Community Survey*.
[18] Skiba et al, *supra* note 3.

Loan Rollovers Among Payday Borrowers



To better understand consumer choices, respondents were asked why they choose to use a payday loan. The most prevalent reason for using a payday lender is that it is quick and easy. Forty percent of the respondents indicated that they had tried to use their bank or credit union, but could not get the money they needed. Payday borrowers also noted the lack of a traditional credit check as an important reason for choosing a payday lender.

Reasons for Choosing a Payday Lender

It's quick and easy.	58%
I have tried to use my bank or credit union, but couldn't get the money I needed.	40%
No credit check.	35%
It's private - no questions asked.	27%
The store I go to is friendly and helpful.	23%
My credit cards are maxed out.	18%
No hassle – less identification required.	11%
Other	1%

Percentages do not add up to 100 because respondents could choose multiple answers.

Survey respondents who used payday loans were asked about the loan cost. The highest number of borrowers, 38 percent, thought that they paid $10 for every $100 borrowed from a payday lender. Twenty-eight percent thought they paid $20 for every $100 borrowed, and 18 percent reported that they did not know the cost of borrowing this money.

Borrower Perceptions of Payday Loan Cost

$10 for every $100 borrowed	38%
$15 for every $100 borrowed	13%
$20 for every $100 borrowed	28%
I don't know	18%
Other	9%

In Texas, a common market price for a payday loan is $20 per $100 borrowed. It is interesting that many borrowers underestimated their loan cost by half. It could mean that payday lenders are lending at these lower rates, or that there is a lack of understanding about the cost of loans.

Finally, it is important to note that ***the Texas Office of Consumer Credit Commissioner does not have any regulatory power over CSOs, and there is no agency both to take consumer complaints and to serve as an intermediary to help resolve disputes.***

The survey found that 13 percent of the payday borrowers had a complaint against a payday lender. Fifty percent complained about being harassed to make their loan payment, and 58 percent of those with a complaint had to close their bank account to resolve the problem.

SUMMARY:

The survey of payday loan usage among low- and moderate-income families and individuals highlights important points that can inform both policy and market reforms:

- Just over half of the survey respondents expressed a need for short-term credit.
- The majority of respondents need credit to cover basic recurring expenses, such as bills, food and rent, or mortgage payments.
- Friends and family are a major source of short-term funds, but a significant percentage resort to the high-cost credit options of payday loans and pawnshops.
- Just under half of payday borrowers surveyed indicated that they need payday loans more than once per year, and nearly one in 10 uses them monthly.
- Over half of the payday borrowers roll over or extend their loans at least once before they can pay them off—and nearly one in four roll over their loans multiple times and incur high fees that can exceed the amount of the original loan principal.
- Forty percent of the survey respondents who use payday loans approached a bank or credit union first, indicating that there is a lost opportunity for financial institutions to serve these consumers. Surveyed payday borrowers particularly appreciated the speed and convenience of obtaining a small-dollar loan.
- Complaints about payday lenders from survey respondents point to possible problems with the industry's collections practices.

Demographic Characteristics of Payday Borrowers

To supplement the data on payday loan usage, demographic information was collected for survey respondents in Austin. This section provides in-depth information on those who use and are most impacted by these high-cost products.

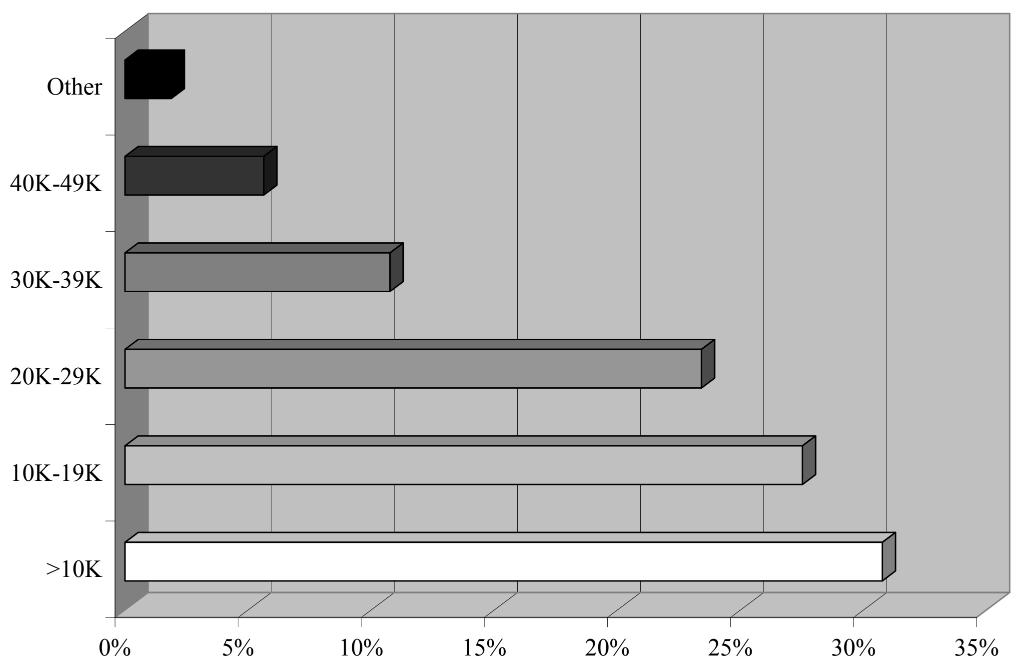
Nearly 4,500 respondents in the Austin survey answered questions about payday loan usage. Among the survey respondents, 13 percent were payday loan borrowers. The survey findings are presented below, focusing on income level, the age of borrowers, gender, marital and housing status, and ethnicity.

For purposes of further validating our survey results, this report compares our findings to those in the 2008 Skiba-Tobacman study. That study's findings are based on a review of loan records for 145,00 Texas payday borrowers over a four-year period (2000-2004).[19]

Income Level of Payday Borrowers

In this survey, the median income of those who used payday loans was $19,000, somewhat higher than the $16,000 median income for all survey respondents in Austin.[20]

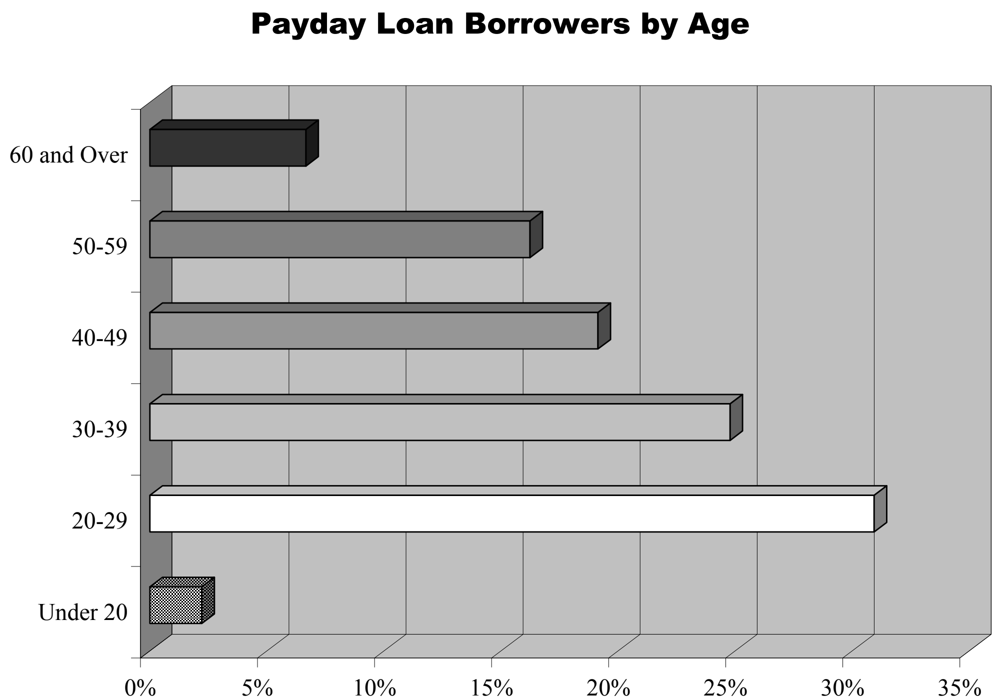
Payday Borrowers by Income



[19] Skiba et al, *supra* note 3.
[20] *Id.* This compares to the $18,540 median income for payday borrowers included in the Skiba-Tobacman study.

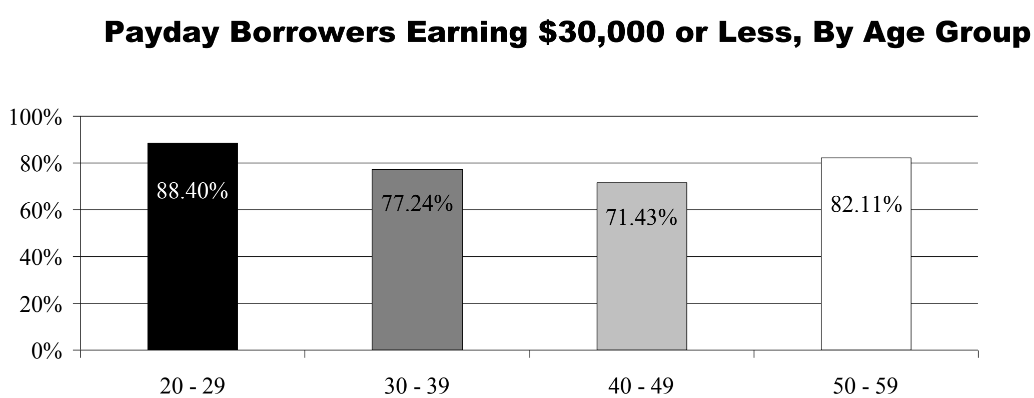
Demand for Payday Loans, by Age Group

The largest number of payday borrowers was in the 20-29 age range, followed by the 30-39 age range. (The median age of payday borrowers in this survey was 36.)[21]



The data reflect a ***general trend*** of decreasing payday loan usage as people age.

Across all age groups, the majority of payday borrowers have incomes of $30,000 or less. More than 80 percent of the payday borrowers, in both the 20-29 and the 50-59 age groups, earned less than $30,000 a year, as did more than 70 percent of payday borrowers in other age groups.



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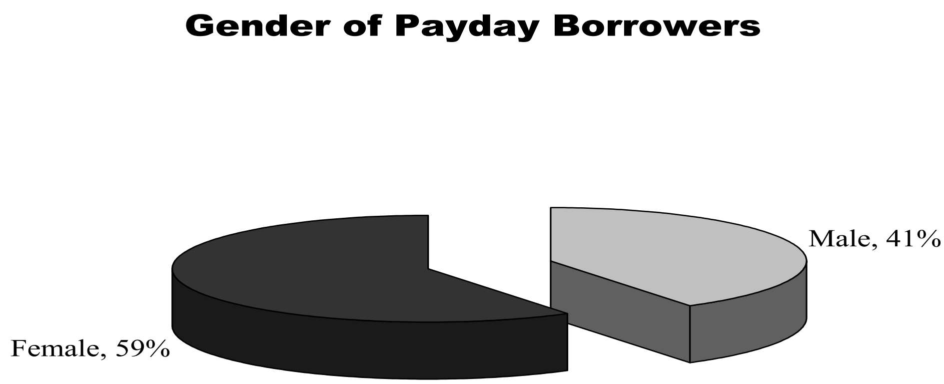
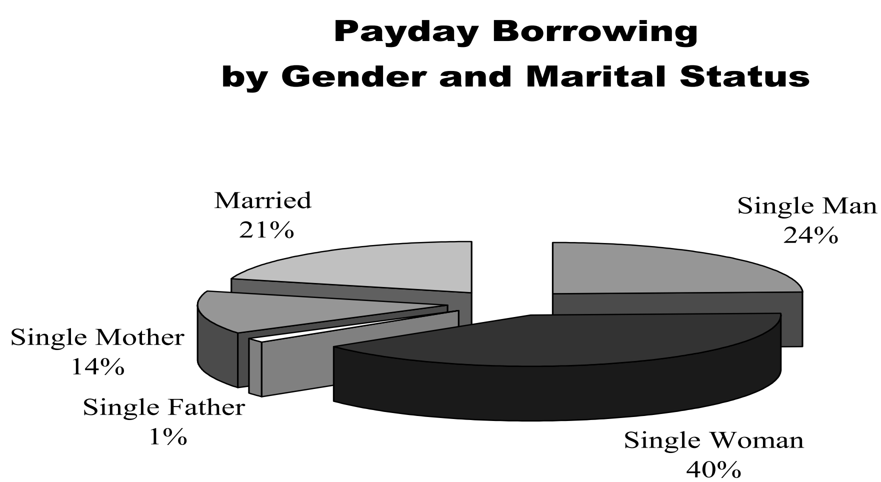
[21] *Id.* This data is consistent with the 2008 Skiba-Tobacman study of Texas payday borrowers, where the median age was 35.

Marital Status and Gender of Payday Borrowers

Women comprised the majority (59 percent) of payday borrowers in this survey.[22] Single women accounted for the largest segment of payday borrowers.



Single women and single mothers are more likely to use payday loans than other (gender/marital status) groups. The Federal Reserve's 2007 Survey of Consumer Finances showed a similar trend nationally, with single women making up 42 percent of payday borrowers (the largest share of borrowers based on marital status).[23]



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[22] *Id.* This finding is consistent with the previously cited Skiba-Tobacman study, which found that women made up 62 percent of a sample of 145,000 payday borrowers in Texas

[23] Amanda Logan and Christian E. Weller, CENTER FOR AMERICAN PROGRESS, *Who Borrows from Payday Lenders? An Analysis of Newly Available Data* (March 2009)

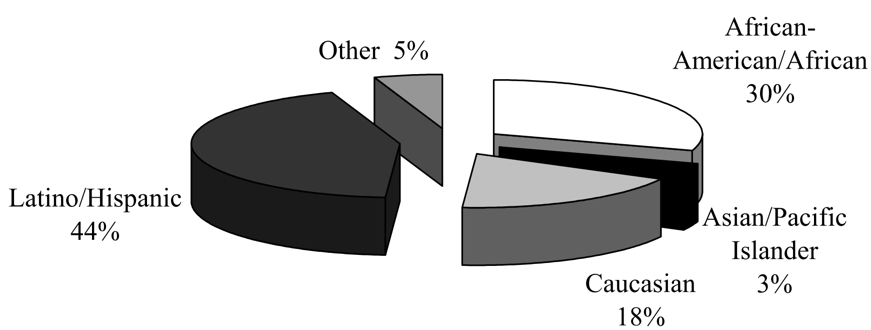
Reliance on payday loans decreases with age across most groups. ***Single women are an exception. Their use of payday loans increases from their 30s through their 50s.***

Payday Loan Borrowers, by Ethnicity

Hispanics make up the largest number of payday loan borrowers in the survey, but also outnumber all other ethnic groups in the total survey population.[24] African Americans are the second largest ethnic group using payday loans. These percentages differ from the 2008 Skiba-Tobacman payday loan study.[25] Austin's ethnic makeup, compared to that of Texas communities included in the Skiba-Tobacman study, could account for this difference.

In both studies, ***African Americans are the most likely to use payday loans.*** While they account for 20 percent of this survey sample, they comprise 30 percent of those using payday loans.

Payday Borrowing by Ethnicity



Women borrow in greater numbers than men across ethnicities. Respondents identified as African-American/African and Latino/Hispanic tend to reduce their payday loan usage as they age. In contrast, ***respondents identified as Caucasian use payday loans most heavily in these age groups: 20-29 and 50-59.***

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[24] Hispanics comprise 54 percent of the total survey population and 44 percent of surveyed payday borrowers.

[25] Skiba et al, *supra* note 3. In the Texas-based Skiba-Tobacman study, 34 percent of payday loan borrowers were Hispanic and 43 percent were African American.

Payday Borrowing, by Home Ownership/Rental Status

Homeowners represent about 20 percent of the Austin residents surveyed, compared to the 54 percent who rent their homes. The remaining respondents have alternative housing arrangements.[26] Among the subset of this group who use payday loans, there are fewer homeowners (15 percent) and more renters (60 percent).

Because this survey included a high number of low- and very low-income families and because Austin's housing market is more expensive than many other parts of Texas, it may not be possible to draw conclusions about the relationship between home ownership and use of payday lending from this survey. One major payday lender estimates that as many as 49 percent of all customers are homeowners.[27] The Skiba-Tobacman study found that 34 percent of payday loan borrowers owned their homes.[28]

SUMMARY:

Based on the demographic analysis of surveyed Austin payday borrowers, it appears that many fit the profile of those traditionally lacking access to mainstream credit. These are the same communities that are most often funneled into subprime credit irrespective of whether they have credit problems: women, minorities and low-income families. This survey indicates that:

- Low- and very-low income individuals make up an important segment of payday borrowers across all age groups, as do younger people in their 20s and 30s.
- Most borrowers are women—and single women and single mothers disproportionately use payday loans.
- A disproportionately high percentage of payday borrowers are African American.
- Though not disproportionately represented among payday borrowers, the largest number of payday borrowers are Hispanic.
- In most demographic groups, reliance on payday loans decreases as people age—with two important exceptions. Single women and Caucasians, who use payday loans, tend to increase their use of these loans in their 50s.

[26] Alternative living arrangements include living with a friend or family and living in temporary housing.
[27] UNITED STATES SECURITIES AND EXCHANGE COMMISSION, *10K Form for Advance America* (2007).
[28] Skiba et al, *supra* note 3.

Policy and Market Recommendations

The demographic analysis of surveyed payday borrowers underscores that these are working low- and moderate-income individuals trying to make ends meet. In the midst of an unstable economy, these families are the first to feel the pinch of tough times and are most in need of financial service options that offer them a reasonably-priced way to meet short-term financial challenges and build savings.

Our survey findings highlight the need for responsible regulation of small dollar lenders and increased market options for Texans who periodically need short-term loans to meet basic expenses.

Urgent Policy Recommendations

1. **Prohibit CSOs from arranging loans unless there is appropriate regulation, including licensing, oversight and consumer protection.**

CSOs must be regulated responsibly. The original CSO Act, passed in 1987, was designed to address problems with credit repair businesses. It was not designed as a mechanism to allow unregulated lending operations.

Texas should not allow this multi-billion dollar lending industry to operate without licensing or accountability. There are two viable choices for reining in CSOs:

- Prohibit them from arranging loans, therefore requiring CSOs that wish to engage in lending to be licensed under existing consumer credit laws; or
- Create a new licensing requirement for CSOs that arrange loans.

A new licensing requirement must include a cap on CSO loan fees, limits on the terms of the loans, and clear consumer protections regarding loan payment collection practices.

Currently, these businesses collectively pay $40,000 to $50,000 in annual registration fees. ***Per Texas licensing standards, an industry of this size and loan volume should be paying $2.5 to $6 million dollars for licensing and oversight.***[29] This estimate of licensing fees is based on the standard fees currently charged by the Office of Consumer Credit Commissioner per lending location. The current situation is clearly a boon for CSO lenders at great expense to Texas taxpayers.

[29] Don Baylor, CENTER FOR PUBLIC POLICY PRIORITIES, *testimony* before the Texas Senate Committee on Finance (February 20, 2009).

2. **Collect loan data from CSOs, including type of loan, rates and fees, number of repeat customers and their loan rollover history.**

Loan data is needed to better understand industry trends in Texas and enforce any new state regulations of CSOs. Without data, it is impossible to fully understand the scope and impact of any lending sector. In the context of CSO lending, data collection is particularly important, as CSOs offer an expanding array of loan products. Payday lenders, who began registering as CSOs in large numbers in 2005, now are offering a suite of high-cost loan products, including auto title loans and term loans. Data collection is necessary to keep on top of market trends to ensure that regulations appropriately address the products being offered. It is also essential to ensure compliance with existing regulations and standards.

Long-term Positive Policy Changes

3. **Develop policies to encourage financial institutions to offer consumers alternatives to high-cost, short-term loans.**

The FDIC has been the most proactive of financial institution regulators in encouraging market innovation to meet short-term credit needs at a low cost. In 2007, the FDIC launched a small-dollar loan pilot to test low-cost small-dollar lending approaches through banks. Three Texas banks are currently participating in the pilot—Amarillo National Bank, Main Street Bank in Kingwood, and Liberty National Bank in Paris.[30] Loan guidelines include a maximum 36 percent annual percentage rate, permissible loan fees that do not exceed the actual loan administration costs, principal reduction with each payment, and a feature that builds borrower savings.[31] As of the second quarter of 2008, pilot banks made over 3,900 loans under $1,000, for a total of $2.5 million in loans.[32] The average term of the loans was nine months, with an average 16 percent APR.[33] Most Texas payday loans are $500 or less, at 500 percent or more APR per two-week loan period.

Texas banking and credit union regulators have an opportunity to promote reasonable and responsible alternatives to high-cost short-term credit. Simple activities, such as promoting successful Texas models of short-term loans as part of outreach to state financial institutions, could serve as a catalyst for further expansion of small loan options in the marketplace.

[30] *Available at* http://www.fdic.gov/SmallDollarLoans/participants.html
[31] *Available at* http://www.fdic.gov/SmallDollarLoans/
[32] Andrew Stirling, FEDERAL DEPOSIT INSURANCE CORPORATION , *Small Dollar Loan Pilot,* presented at Federal Reserve Bank of Dallas & IC2 Institute Payday Lending Conference, University of Texas Etter-Harbin Alumni Center (November 14, 2008). Available at http://www.dallasfed.org/news/ca/2008/08payday_stirling.pdf
[33] *Id.*

4. **Consider an annual percentage rate cap on small dollar loans.**

The national policy trend is moving towards an annual percentage rate cap for small, short-term loans. Fifteen states have implemented a rate cap of 36 percent or lower over the past few years, including most recently Ohio, Arizona and Arkansas. In 2007, Congress implemented an annual percentage rate cap of 36 percent for all short-term loans to the military and dependents. Independent assessments of these initiatives from state regulators and the U.S. Department of Defense indicate that the rate cap is an effective strategy for consumers, without negative repercussions.

In particular, in July 2008, the U.S. Department of Defense assessed the impact of the short-term loan rate cap on the military. The Department found that fewer servicemen and women are being caught up in high-cost short-term debt associated with payday and auto title loans, and that they have access to alternative loans from banks, credit unions, and aid societies catering to the different branches of the military.[34] The report found some instances of lenders changing their products in order to get around the 36 percent APR military rate cap, and asserted the need for better cooperation with state consumer credit oversight agencies to help enforce the law. **Texas would better serve its military communities by enabling the Office of Consumer Credit Commissioner to enforce this rate cap.**

North Carolina provides another interesting case study. Payday lending storefronts closed in that state in 2006. In 2007, the North Carolina Commissioner of Banks commissioned a study to assess how the closure of payday outlets had impacted consumers in the state. The study, through a random cluster sample survey of low-income state residents, found that over three-quarters of those surveyed felt no negative impacts from the absence of payday loans. Ninety percent of those surveyed said that payday loans were a “bad thing,” including individuals going through a financial hardship at the time of the survey.[35]

These two studies provide evidence that, under an annual percentage rate cap, consumers continue to have access to short-term credit.

Market Recommendations

5. **Financial institutions and other financial service providers in Texas should explore viable ways to meet short-term consumer credit needs without excessive fees or the risk of a cycle of debt.**

Borrowers who use payday loans and other high-cost loan options are almost always customers of financial institutions, presenting an opportunity for banks and credit unions to offer fairly priced small dollar loan products. There are many interesting models from around the United States that do not exclude people from short-term loans based on credit scores.

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[34] U.S. Department of Defense, *Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents* (July 22, 2008).
[35] University of North Carolina Center for Community Capital, *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options* (November 2007). Prepared for the North Carolina Commissioner of Banks

Examples include offering short-term loans in partnership with employers, advances on direct deposits, and loans secured by automobile titles, at lower annual percentage rates and with reasonable repayment terms.

6. Provide incentives to build savings.

Given that the average payday loan is $300, saving $500 or less could help families weather short-term financial challenges that are now being met through high-cost borrowing.[36] Many of the new and innovative small-dollar loan programs being piloted in Texas include a component to build savings. The current economic crisis has led to an upward trend in personal savings—a jump from less than one percent in the first quarter of 2008 to five percent in January 2009.[37] Implementing incentives to save can build on the current trend to reinforce the financial stability of Texas families.

Conclusion

Every day a growing number of Texans are directly impacted by the national economic crisis. As more individuals and families struggle to make ends meet, it is critical to ensure that small-dollar lenders are appropriately licensed and regulated. This survey documents how these loans are used by some of the most financially vulnerable—including families, single women, and minority groups with low to moderate incomes.

Best practices for offering fair and affordable small-dollar loans should be shared and adopted by more mainstream lenders in Texas. At the same time, credit services organizations should be properly regulated by the state. ***Without accountability and consumer protections, there is greater risk of a market dominated by over-priced products that buoy families in the immediate short term, only to pull them deeper into debt over the longer term.***

Currently, credit services organizations offer high-cost loans, including small-dollar payday and auto title loans, with no oversight, no fee caps, and no place for consumers to go for complaint resolution.

If ever there was a time that small loans in Texas needed to be regulated, now is that time. Failure to do so breaks faith with Texas consumers and taxpayers who expect across-the-board fairness in lending.

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[36] Steve Broebeck, CONSUMER FEDERATION OF AMERICA, *Understanding the Emergency Savings Needs of Low-and Moderate-Income Households: A Survey-Based Analysis of Impacts, Causes, and Remedies* (November 2008).
[37] BUREAU OF ECONOMIC ANALYSIS, *Personal Income and Outlays* (March 2, 2009) *available at* http://www.bea.gov/newsreleases/national/pi/2009/pi0109.htm

Appendix A: Data Analysis Procedures

Data Collection

Survey data was collected over a three-month period, from January to March of 2008, in partnership with five nonprofit organizations in Austin, Dallas, Houston and San Antonio. In all cases, clients were given the option to complete the survey when accessing services from these nonprofits. In the case of the Austin survey, a volunteer helped willing clients complete the survey. In the other cities, clients completed the survey without assistance. The survey was available in both English and Spanish.

Texas Appleseed engaged the pro bono assistance of Huron Consulting Group to tabulate and analyze the data and ensure its statistical validity.

Statistical Validation

Statistical validation of the data analyses was based on a 95 percent confidence interval, assuming the standard normal distribution.

Data Analysis

Huron performed quality assurance procedures at all levels of the data analysis. Huron deleted surveys that contained inconsistent answers. Data was imported into an Access database. The database facilitated the use of queries to tabulate the survey data. Two kinds of queries were used, simple queries and cross tabulation queries. The simple queries reported the number of respondents who answered a given question. The cross tabulation queries compared respondents' answers between two or three given questions and/or data items. Once the simple queries were completed, various cross tabulation queries were used for further analysis.

In the Austin demographic survey, data, age and income data were stratified into ranges through the use of expressions in Access. The age stratifications are "<19," "20 to 29," "30 to 39," "40 to 49," "50 to 59," and "60+." The income stratifications were based on adjusted gross incomes provided by the tax centers. The income stratifications are "$0 to $9,999," "$10,000 to $19,999," "$20,000 to $29,999," "$30,000 to $39,999," "$40,000 to $49,999," "$50,000 to $59,999," and "$60,000+."

In the analyses, "payday loan users" are based on the total number of respondents that answered positively to the question, "Have you ever used a payday lender, like Ace Cash Express, Cash America, or others?" For all subsequent questions in each analysis, the total number of respondents is based on the population of "payday loan users" and the number of respondents that answered the given question.

Appendix B: Survey Form

Short-term Lending Survey[38]

1. Have you ever needed quick cash or a small loan to cover expenses?

☐ Yes ☐ No

If "Yes", what kinds of expenses? (please check all that apply)

☐ Rent payment ☐ Home mortgage payment ☐ Car payment

☐ Buy groceries or gas ☐ Holiday or special occasion ☐ An emergency

☐ A medical need ☐ Pay electric/telephone/cell phone bills ☐ Help a friend or family member

☐ Other (please specify) ____________________

2. Check all the places you go to get quick cash or a small loan when you need it.

☐ Family or friends ☐ Payday loan ☐ Pawn shop

☐ Bank ☐ Credit union ☐ Credit card

☐ Other (please specify)____________________ ☐ Employer

3. Have you ever used a payday lender, like Ace Cash Express, Cash America, or others?

☐ Once or twice ☐ A few times a year ☐ Every few months

☐ Once or more a month ☐ No

Please list your preferred payday lender if you have one:____________________

<u>If you have never used a payday lender, you can skip the remaining questions.</u>

4. Why do you use a payday lender?
(choose the top three reasons)

☐ It is quick and easy ☐ No hassle—don't need many IDs

☐ No credit check ☐ It's private—no questions are asked

☐ The store I go to is friendly and helpful ☐ I have tried to use my bank or credit union, but couldn't get the money I needed

☐ My credit cards are maxed out ☐ Other (please describe)____________

5. Do you ever have to take out a new payday loan or extend your loan because you don't have the money to pay back a payday loan?

☐ Yes, often ☐ Yes, sometimes ☐ No

6. How much do you pay to borrow money from a payday lender?

☐ $10 for every $100 borrowed ☐ $15 for every $100 borrowed ☐ $20 for every $100 borrowed

☐ Other(please specify)____________________ ☐ I don't know

7. Have you ever had a problem with a payday lender?
(please select all that apply)

☐ No ☐ Yes, they harassed me while trying to collect the money

☐ Yes, they kept making withdrawals from my bank account after I paid off the loan ☐ Yes, I had to close my bank account to stop them

☐ Yes, Other (please specify)____________________

THANK YOU FOR PARTICIPATING

[38] The Austin survey utilized these questions in conjunction with a client survey including demographic characteristics implemented by the nonprofit partner.

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