

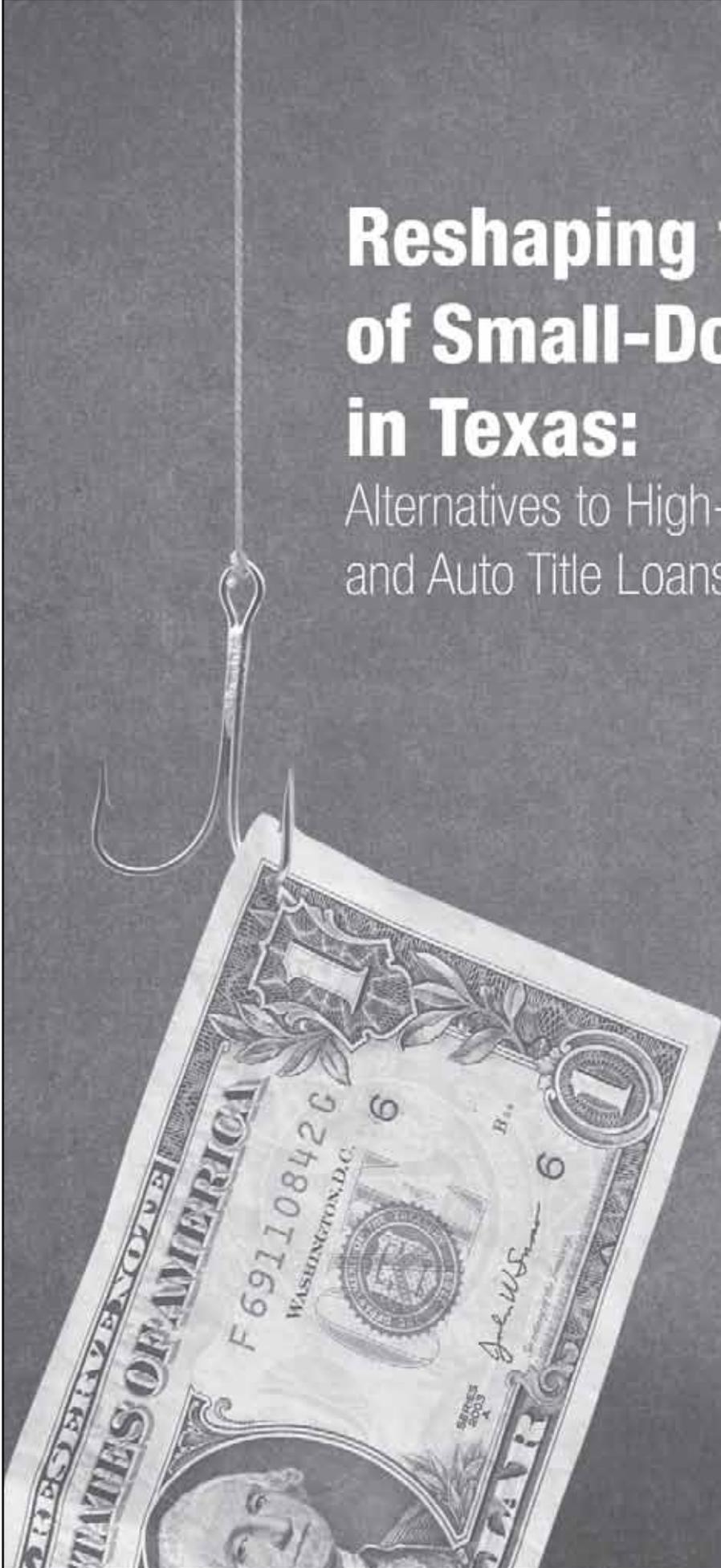
# Reshaping the Future of Small-Dollar Lending in Texas:

Alternatives to High-Cost Payday  
and Auto Title Loans



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and Auto Title Loans



January 2012

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## **Texas Appleseed Mission**

Texas Appleseed's mission is to promote social and economic justice for all Texans by using the volunteer skills of lawyers and other professionals to find practical solutions to broad-based problems. This report examines low-cost, small-dollar loan alternatives to high-cost payday and auto title loans. Financial service providers, including banks and credit unions, can use these models to structure their own alternative loan products to meet the needs of low-income consumers for affordable, short-term access to capital. Without affordable alternatives, consumers will continue to turn to payday and auto title loans, which can trap them in a cycle of debt and undermine their financial security.

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## Acknowledgements

This report would not have been possible without the generous support of **Houston Endowment, Harold Simmons Foundation, and Citibank**. Texas Appleseed is deeply grateful to the following banking and consumer credit experts for their guidance and insights in the development of this report: Emerson Hall, Community Affairs Specialist, FDIC; Roy Lopez, Community Development Specialist, Federal Reserve Bank of Dallas; Debbie Taylor, Southwest Regional Director and Texas State Director, Citi Community Development; and Woody Widrow, Executive Director, RAISE Texas. We are also grateful for the participation of the Texas businesses and organizations profiled in this study—for their time and willingness to share information about their small-dollar loan products.

We would also like to thank our pro bono partners—Will Dibrell and Cliff Ernst with Graves Dougherty Hearon & Moody and the following team of attorneys and law clerks from Akin Gump Strauss Hauer & Feld LLP led by Phyllis Young:

Chris Centrich	Eric Munoz
James R. England	Cynthia Perez
Jordan Jacobson	Rebecca Tyler
Parker Lee	

Finally, we are grateful for the support of our Board small-dollar loan committee—Jim George, Sean Gorman, and Michael Rodriguez—in guiding our work to improve credit options for Texas families.

The opinions contained in this report are those of Texas Appleseed alone.



# Reshaping the Future of Small-Dollar Lending in Texas

## Affordable Alternatives to High-cost Payday and Auto Title Loans

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# Reshaping the Future of Small-Dollar Lending in Texas

## Affordable Alternatives to High-Cost Payday and Auto Title Loans

### EXECUTIVE SUMMARY

The phenomenal growth of the payday and auto title lending industry in Texas—with over 2,000 new storefronts opening in the last six years alone—is the product of a market that, in recent years, has appeared more “free-wheeling” than “free market.” Unlike many other states that have basic standards for affordable consumer credit, in Texas, payday and auto title loan businesses operate outside of the standards set by state consumer finance laws. As a result, there is very little protection for consumers beyond some recently-passed loan disclosure requirements and a basic licensing structure. There is no state regulatory cap on fees charged for payday and auto title loans, no limit on the number of back-to-back loans, and no requirement that the loans be tailored to borrowers’ capacity to repay on time. Payday and auto title businesses remain fiercely protective of Texas’ “free-wheeling” market that is responsible for more than 60% of this industry’s annual profits nationwide.

Among the Texans who use these loans, many become trapped in a cycle of debt created by the short loan term and the recurring high fees. When these high-cost loans compound borrowers’ economic distress, whole communities are impacted—and local social service providers and faith-based institutions report being hard pressed to meet the growing requests for financial help from desperate families struggling to get out from under payday and auto title loan debt. It is a loan model that works against financial stability, against building savings, and discourages needed economic reinvestment in low- and moderate-income neighborhoods, which are frequent targets for predatory lenders. As a result, cities are increasingly moving to the front lines in the pushback against this type of lending. In 2011, the cities of Dallas and Austin passed ordinances to limit where new payday and auto title outlets can open and to extend some basic consumer protections designed to limit the cycle of debt brought on by these loan products.

Ultimately, a robust small-dollar loan market depends upon viable market alternatives. The payday and auto title industry has argued that—without charging in excess of 500% APR and recurring high fees—they would “go out of business” and Texas families with no credit, poor credit, or thin credit files would have no access to small loans to cover rent, utility bills, or a car payment.

However, the small-dollar loan market in Texas is undergoing an important shift in response to the recent proliferation of abusive products. This report *profiles six market newcomers offering affordable alternatives to high-cost payday and auto title loans in Texas*. Greater change is possible as more mainstream lenders recognize the market potential for offering easily accessible, affordable, small-dollar loans as was done in the early days of community banking. It is critical to enforce basic standards for affordable credit for all providers of small-dollar consumer loans. This report seeks to encourage this market shift by:

- **Profiling Texas payday and auto title loan borrowers.** Research shows that the majority of payday loan borrowers are female, and the most common age and income ranges are 25 to 34 years of age, and earnings between \$15,000 and \$35,000 a year. The same age profile holds true for Texas auto title loan borrowers, although males comprise the largest share of borrowers.
- **Underscoring the characteristics of an “affordable loan.”** These are loans that are 1) reasonably and fairly priced based on national standards, 2) structured on the borrower’s ability to repay on time, and 3) transparent in their advertising, disclosures, and contract—and often include 4) a loan repayment term of three months or more, 5) credit building for borrowers, and 6) pathways to build savings and connect borrowers to financial education.
- **Highlighting national trends in small-dollar lending.** This report focuses on two successful national small-dollar lending programs offered by traditional financial institutions—the FDIC Small-Dollar Loan Pilot Program (with details on the Amarillo National Bank program) and the National Credit Union Foundation’s REAL Solutions program (with Fort Worth City Credit Union cited as an example of participating Texas credit unions).
- **Focusing on an alternative loan product structure that can meet a borrower’s needs and reduce lender risk.** Options include lending institution partnerships with employers (where affordable small-dollar loans and financial management and credit building opportunities are offered through the workplace), nonprofits (which are usually the point of customer contact for the loan, with the nonprofit also providing loan-loss reserve funds and some loan loss guarantees), and cities (in “Bank On” small-dollar lending partnerships with local banks and credit unions). Affordable alternatives also exist in the non-bank market—including the regulated consumer finance model employed in Texas by Progreso Financiero and the Community Loan Center in Brownsville to make affordable, small-dollar loans with relatively low default rates. New Internet-based lending platforms, credit builder loans, and emergency savings initiatives can also offer affordable options to meet an emergency need for credit.
- **Profiling six Texas loan products that are making a difference in Texas’ small-dollar lending landscape.** These include Progreso Financiero, Community Loan Center, First Convenience Bank, Promise Credit Union, Generations Federal Credit Union-Goodwill Partnership, and Family Services of Greater Houston. A product snapshot is provided, along with a more detailed analysis of their lending model, the contact point for the loan,

the loan structure, and their progress and potential for reaching scale in the Texas financial market.

Texas lawmakers voted in 2011 to require state licensing of payday and auto title lenders and more transparent reporting of their loan practices to the Office of Consumer Credit Commissioner (OCCC) and loan disclosure to prospective borrowers; however no headway was made in protecting Texas consumers from high annual percentage rates and fees charged on these loans. The Appendix of this report includes an overview of the regulatory issues surrounding small-dollar lending in Texas—as well as a graphic comparing payday loan regulations in Texas with those in more than 30 other states.

## **Major Recommendations**

The following recommendations are aimed at providing affordable, easy-to-access small-dollar loans in Texas:

- 1. Texas needs basic standards for affordable credit to support fair competition in the small-dollar lending market. State regulations for providers of consumer loans [Texas Finance Code, Ch.342 (E) and (F)] should be applied market-wide—to include high-cost payday and auto title loan businesses.**

Texas has a long tradition of established protections against usurious lending. The state constitution includes a 10% cap on interest rates and specifies that the legislature must adopt laws to enable lending above the 10% cap. Adam Smith, the father of the free market, said fair market standards are needed “to prevent the extortion of usury.”

Chapter 342 (E) and (F) of the Texas Finance Code was adopted by the Texas Legislature to govern consumer lending within this state. They include rate and fee caps and protections for borrowers to ensure a fair market for both businesses and borrowers. Currently, there are over 1,700 lending locations licensed under this chapter of the Texas Finance Code, including two of the lending models profiled in this report. It is a lending model that is profitable and has been successful in Texas for decades.

Instead of rewarding businesses that pursue strategies to evade state usury laws through the credit services organization (CSO) model or other schemes, the state should stand behind its usury laws.

- 2. Texas banks and credit unions should consider investing in positive lending models to promote the availability of affordable small-dollar loans in Texas.**

Access to lending capital is an essential component of any affordable small-dollar loan program. Banks may obtain Community Reinvestment Act (CRA) credit for investing in Community Development Financial Institutions (CDFIs) that offer affordable small-dollar loans.

**3. Explore affordable small-dollar loan products offered by or in partnership with nonprofits as a strategy to serve consumers who, otherwise, may fall through the cracks.**

Nonprofits in Texas and other states have been exploring scalable models to meet the needs of their clients for small-dollar loans. These include nonprofit loan pools that nonprofits can access to provide credit to their clients; lending initiatives tied to employers; and partnerships with financial institutions where nonprofits provide loan guarantees to support lending to their clients. Developing and expanding initiatives such as these would meet an important market need in Texas for affordable loans and allow families to build a credit history to support future financial stability.

Foundations could invest in affordable loan programs as part of their program-related investment (PRI) strategies. Expanding access to capital will support growth of positive and successful market options.

**4. Texas would benefit from enhanced outreach and education about affordable small-dollar lending that targets both financial institutions and consumers.**

The FDIC, Texas Credit Union League, and others have engaged in education about successful models and strategies for offering affordable small-dollar loans, but there is a need for more alternatives. City and state governments should consider outreach to local financial institutions to explore successful models to provide affordable small-dollar loans to public and private sector employees.

Consumers could also benefit from education about affordable options and the dangers of high-cost, short-term loans. As a result of the high market saturation of storefront and online payday and auto title lenders, and their plentiful advertising, consumers often do not consider other credit options when a need arises. One study also indicates that consumers do not accurately compare the cost of payday and auto title loans to other credit options, including credit cards. It is important to inform consumers about affordable credit options and the predatory features of payday and auto title loans that often lead to a cycle of debt.

Implementing these recommendations will lead to greater financial stability for Texas communities, improved savings and credit-building options, more affordable small-dollar loans (as price-based competition expands), and greater potential for economic development and community reinvestment.

## Summary of Profiled Texas Small-Dollar Loan Programs

Small-Dollar Lender	Year of Inception; Number of Loans	Target Market	Loan Size	Loan Term	Loan APR	Loan Requirements	Loan Performance	Financial Education
Progreso Financiero	2006 in CA, 2010 in TX; 195,000 loans across all markets	Unbanked and under-banked Hispanics	\$500 - \$2,500	7 - 18 months	36%	At least \$1,000 in monthly income; 4 references	Single digit defaults	Part of loan process
Community Loan Center	October 2011; 258 loans in first three months.	Employees at partner businesses	\$300 - \$1,000	1 - 12 months	18% plus \$20 fee	3 months employment; checking account; loan maximum —50% of monthly income, \$900 minimum monthly income	No defaults	Offered
First Convenience Bank	November 2010; no loan volume information	Customers at retail locations	\$200 - \$1,000	10 - 15 months	14%-23%	Account with bank; 6 months employment and verified income	No information	Required
Promise Credit Union	2009; over 400 loans	Gulfton-Sharps-town residents; NCI employees	Up to \$3,000	7 - 12 months	24%-34%	6 months to 2 years of employment; \$200 monthly direct deposit; clear title for auto title loan	Under 5% delinquency	Part of loan process
Generations FCU-Goodwill Partnership	2008; hundreds of loans, usually 50 outstanding at any one time	Unbanked and under-served	\$200 - \$1,000	3 - 12 months	18%	Minimum 45-day credit union relationship	Few defaults	Offered
Family Services of Greater Houston	March 2010; 100 loans	Harris County residents under 80% of area median income	\$300, \$500, or \$800	3 months	8%	6 months employment and verified income	Under 12% default	Required



# Reshaping the Future of Small-Dollar Lending in Texas

## Affordable Alternatives to High-Cost Payday and Auto Title Loans

### INTRODUCTION

Texas is experiencing a crisis in consumer lending. High-cost payday and auto title loan products have expanded rapidly over the last decade in an environment lacking meaningful statutory oversight and consumer protections. As a result payday and auto title storefronts are clustered along almost every major thoroughfare in cities and towns across the state—advertising fast cash and easy loans. The offers sound too good to be true, and for many borrowers they are. The loans are fast and easy on the front end, but often create a deeper financial crisis on the back end.

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*“It started out to help me over a temporary cash flow shortage and has turned into a five-year nightmare.”*

—Nancy Oliver, Denton, Texas<sup>1</sup>  
Texas Payday Loan Borrower

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The high recurring fee payments and principal balances that never seem to decrease, payment after payment, are a debt trap for too many Texans. How did we get here, and what can we do to reshape small-dollar lending in Texas?

#### **The Texas Payday and Auto Title Loan Market**

The growth in payday and auto title lending in Texas is astronomical—with the number of locations more than doubling across the state in a few short years. Payday lending locations expanded from approximately 1,300 outlets in 2004 to more than 2,700 storefronts in 2010.<sup>2</sup> Auto title lending was a fledgling industry in Texas in 2004. Today, there are nearly 1,800 store locations in Texas that offer auto title loans.<sup>3</sup> The number only continues to grow, as more payday loan stores are getting into the auto title loan business and new auto title lenders enter the Texas market.

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## Payday and Auto Title Loans

Payday and auto title loans are sold as short-term loans, usually due in full in two weeks to one month. A payday loan is secured by a post-dated check, and an auto title loan is secured by a car title. Average loan amounts range from \$300 to \$700; fees alone are 20% to 30% of the principal and are due every two- to four-week loan term that the original loan amount is not repaid in full. Fees plus interest amount to over 500% APR.

Recurring fee payments to extend the loan do not reduce the amount owed, often leading to what is termed a “cycle of debt,” where the borrower pays high fees over and over again without making any progress in repaying the loan. A 2011 study found that payday borrowers are in debt to the payday lender an average of 212 days for the first year that they use a payday loan, the equivalent of rolling over a two-week loan more than 15 times.<sup>4</sup> According to data from the Tennessee Department of Financial Institutions, one of the few state agencies that collects data on rollovers of auto title loans, three quarters of auto title borrowers roll over their loans at least one time and half roll over the loans four times or more. Twelve percent of auto title borrowers roll over their loans every month for a one-year period and close to 10% lose their vehicles to repossession, often after paying fees for many months.<sup>5</sup>

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As the number of payday and auto title store locations has grown, so has the debt burden on Texas families. In 2010, looking only at storefront locations, these businesses drained an estimated \$800 million to \$1.1 billion in excess charges from Texas consumers—loan charges above the maximum permitted under Texas lending laws.<sup>6</sup>

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*“This is a trend that has increased dramatically over the last few years, both in terms of the percentage of clients that have used payday loans, and also the number of payday loans clients have taken out...There are not many options for clients that need quick cash, but products should also be affordable, and lending should be responsible, to the mutual benefit of the lender and clients.”*

—Nyla K. Woods, President and CEO  
Family Services of Greater Houston<sup>7</sup>

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Not surprisingly, the financial drain on Texas families from payday and auto title loan debt is reflected in the expanding pressure on Texas churches and nonprofits to fill the breach and provide stopgap funding to help families meet basic needs. A statewide survey by Catholic Charities, in the third quarter of 2010, found that nearly 20% of clients requesting cash assistance were trapped in payday or auto title loan debt.<sup>8</sup> The annual assessment of the United Way of Greater Houston’s tax center and financial coaching initiative found the average family served received a \$1,600 Earned Income Tax Credit refund and spent \$1,300 on fees for high-cost financial services, including payday and auto title loans.<sup>9</sup>

A RAISE Texas survey of member nonprofits, conducted in the summer of 2010, produced similar findings. Out of 50 nonprofits surveyed, 63% reported that one-third or more of their clients use high-cost payday or auto title loan products. Just over 10% indicated that the majority of clients use payday or auto title loans. Unfortunately, churches and nonprofits are seeing more and more desperate families who, having paid their original payday or auto title loan amount many times over in recurring high fee charges, find they still owe nearly as much as they originally borrowed. Their desperation is fueled by an inability to pay rent or utilities and by the threat of having their car repossessed—leading many to appeal to churches and nonprofits for financial help.

## Consumer Credit Oversight in Texas

Looking at the letter of the law in Texas, it appears that the state has reasonable consumer loan standards that offer consumer protection and market latitude to accommodate the cost of serving subprime borrowers. Article 16, Section 11 of the Texas Constitution states: “...in the absence of legislation fixing maximum rates of interest, all contracts for a greater rate of interest than ten per centum (10%) per annum shall be deemed usurious.” The legislature is authorized to set higher rates and, under Chapter 342 of the Texas Finance Code, permits rates that should more than accommodate for the additional risk of subprime consumer lending. The highest rates permitted under Chapter 342 allow for a \$10 acquisition fee and a fee of \$4 per \$100 borrowed per month. The annual percentage rate (APR) under this regulatory scheme varies based on the loan amount and loan term, but generally falls in the 60% to 100% APR range.<sup>10</sup>

However, payday and auto title lenders have found a way to get around state usury laws. A loophole in Texas law is used by credit services organizations (CSOs) to broker consumer loans with unlimited fees.<sup>11</sup> The CSO law was designed to regulate credit repair businesses, but high-cost payday and auto title lenders saw an opportunity to exploit a provision that allows a CSO to arrange consumer loans. Because CSOs facilitate and manage loans between the borrower and a third-party lender but do not technically extend credit, their fees are not considered interest and are not subject to the limits otherwise applicable to short-term lenders. The result has been the proliferation of high-cost, often predatory small-dollar loan options in Texas with no cap on the loan charges.<sup>12</sup>

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*“The biggest roadblock that we come up against with our clients is our clients are stuck in payday loans. There’s nothing that we can do. There’s nothing that we can offer. What we really need is an alternative small-dollar payday loan that can help our clients get out of the predatory loans that they are currently in. If we had an alternative, we would be able then to help them get back on track.”*

—*Building a Savings Culture in Texas*  
Karen Lyons Serna  
Director of Asset Building Programs  
Foundation Communities

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Over the past two years, federal and state legislation has been enacted to help curb some of the abusive payday and auto title lending practices. The Dodd-Frank Wall Street Reform and Protection Act was passed by Congress and signed into law by President Obama in 2010. In 2011, the Texas Legislature passed two bills that began to address problems in the payday and auto title lending market in Texas. The two bills do not address the high fees or damaging cycle of debt, however.

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## **Recent Legislative Action**

### *Federal Action:*

The Dodd-Frank Act provides consumers with better protection against abusive lending practices. Title X of the Dodd-Frank Act establishes the Bureau of Consumer Financial Protection (CFPB), which has authority over payday lenders. Title XII of the Dodd-Frank Act, the “Improving Access to Mainstream Financial Institutions Act of 2010,” aims to move low-income people into mainstream banking through the use of grants, financial education, and micro-loans. The CFPB has not yet begun to regulate payday lending. It does not have the authority to cap rates, but could address other consumer protection issues, such as loan rollovers, the loan term, and pricing transparency.

### *State Action:*

Two new Texas laws require CSOs offering payday or auto title loans to be licensed, report data on lending practices, and provide detailed pricing disclosures.

The new licensing establishes a basic framework for accountability, but with no product standards. Whereas previously there was a simple registration process with the Texas Secretary of State, as of January 2012, payday and auto title loan businesses operating as CSOs will have to apply for a license from the Texas Office of Consumer Credit Commissioner that includes disclosure of officers, products, and third-party lender partners, in addition to other information. This will be the first time in many years that there will be official documentation of how many of these businesses are operating in Texas.

The new disclosure requirement includes information on the cost of loan rollovers and on the amount of time it takes most borrowers to repay the loans in full.

Neither of the new laws addresses the core problems with payday and auto title loans in Texas: uncapped fees and a loan structure that makes it virtually impossible for borrowers to repay what they owe in the two-week to one-month loan term.

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## **Texans Needs Better Choices**

A small, but growing number of Texas businesses and nonprofits are taking up the responsible lending challenge to meet consumers' need for affordable small-dollar credit. This report includes information about payday and auto title lending markets, product innovations, and regulation to facilitate the creation and expansion of fair loan options in the Texas market.

Specifically:

- The first section profiles Texas payday and auto title loan borrowers based on recent state and national surveys.
- The second section reviews efforts around the country to meet short-term, small-dollar credit needs through loan products that build financial stability.
- The final section profiles efforts by Texas nonprofits and businesses to create fair, low-cost lending opportunities for borrowers who feel they have few choices.
- Appendix A offers a regulatory overview for small-dollar lending, and Appendix B compares Texas payday and auto title loans to those offered in other states.

Expanding affordable small-dollar loan products in the market is a powerful complement to regulatory reform. This study is one step in an effort to expand affordable small-dollar loan options in Texas.



## TEXAS BORROWER PROFILES

### Who Uses Payday and Auto Title Loans and Why?

Texas is a big market for payday and auto title lending nationally. Texas is the source of 60% of the annual profits reported nationwide by the four largest publicly traded companies offering payday loans.<sup>13</sup> The profile of the typical payday borrower appears to have shifted over the last decade, from lower-income to more middle-income consumers. The economic downturn of the last several years likely has played a role in this trend.<sup>14</sup> One major payday loan company notes:

*The median annual household income of [our] customer[s] has increased to about \$50,000, and nearly 20 percent of our customers earn more than \$75,000 annually. Our data also shows that the average customer is now 48 years old and has achieved a higher level of education than in previous years, with 91 percent holding a high school diploma and nearly 60 percent having some college education.*<sup>15</sup>

The market described above does not present a full picture of Texas borrowers, but it raises a significant point—that market segmentation is important in creating reasonable alternatives to payday and auto title loans. An individual who earns \$75,000 per year and is recovering from a period of unemployment may have different financial product needs than a single mother of two who earns \$25,000 per year or a senior living on a fixed income.

### **Texas Borrowers: A Look at Demographics, Income, and Credit Profiles**

According to the U.S. Financial Capability Study (2009), a significant share of the nation's population uses high-cost, small-dollar loan products. The national survey found that 9% of all adult Americans used a payday loan and 6% used an auto title loan at least once between 2004 and 2009, and 24% used one or more non-bank credit products.<sup>16</sup> The reported percentages were higher for Texas borrowers: 12% of Texans used a payday loans at least once in the previous five years, 8% used an auto title loan, and 32% used one or more non-bank credit options, including pawn loans, payday loans, and other products.<sup>17</sup> Texans use non-bank or

alternative financial services at rates higher than the national average, but at rates similar to other states in this region.<sup>18</sup> In order to better understand the market for these products and the opportunity for alternatives, it is helpful to take a closer look at who uses these loans. Because there is not a lot of borrower data for auto title loans, the following discussion focuses primarily on payday loan borrowers, with auto title data included where available.

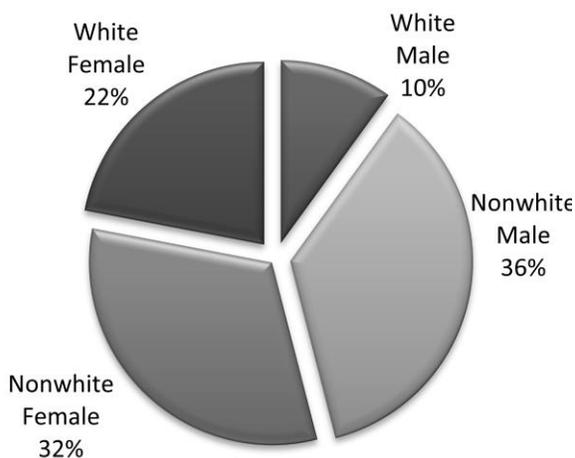
**Gender and Ethnicity**

Women make up the majority of Texas payday loan borrowers. A 2008 survey of clients served by participating nonprofits found that 59% of those who used payday loans were women.<sup>19</sup> Single women and single mothers were disproportionately represented among payday loan borrowers.<sup>20</sup>

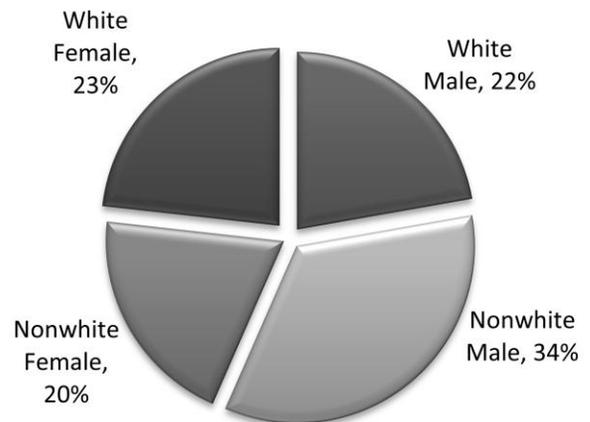
The U.S. Financial Capacity Survey produced similar findings, with women comprising 54% of payday loan borrowers in the Texas sample.<sup>21</sup> Though women comprised the majority of payday borrowers, the largest single group of borrowers was nonwhite males,<sup>22</sup> followed by nonwhite females. Nonwhite survey respondents made up 68% of payday borrowers.

This survey also found that auto title borrowers in Texas are more likely to be male. Nonwhite males made up the largest group of borrowers (34%), followed by white females (23%), white males (22%), and nonwhite females (20%).<sup>23</sup>

**2009 Texas Survey:  
Payday Loan Borrowers  
by Gender & Ethnicity**



**2009 Texas Survey:  
Auto Title Loan Borrowers  
by Gender and Ethnicity**



Source: Texas Appleseed Analysis of 2009 FINRA Financial Capacity Survey

## Age and Income

Borrowers ages 25 to 34 account for over a third of all payday and auto title loans in Texas.<sup>24</sup> Though the largest percentage of borrowers is young and in the early stages of family and professional life, there is also a sizeable group of individuals age 35 and older who use payday and auto title loans.

### 2009 Texas Survey: Age Profile of Payday and Auto Title Borrowers

Age	Percent of Payday Borrowers	Percent of Auto Title Borrowers
18-24 years	12%	5%
25-34 years	35%	34%
35-44 years	23%	20%
45-54 years	16%	26%
55+	14%	16%

Source: Texas Appleseed Analysis of 2009 FINRA Financial Capacity Survey

Note: Totals may not equal 100% due to rounding.

A national AARP study of unbanked and underbanked persons identified a similar trend, with 25% of survey participants ages 44 to 64 and 22% of those age 65 and older using auto title loans.<sup>25</sup>

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*“I became aware of [auto title loans] through...Mrs. K., a 73-year-old raising her granddaughter and great-granddaughter...She was financially struggling to get by on a fixed income...She borrowed \$500 with 317% APR. She was supposed to pay \$150 per month and she had difficulty with that...She...took out an extension on the loan, borrowing \$150 to pay what was due at that time...She was not able to get any of the principal paid off...If there hadn't been funds [from a nonprofit] to get out from this loan, she would still be struggling and she would have lost her car.”*

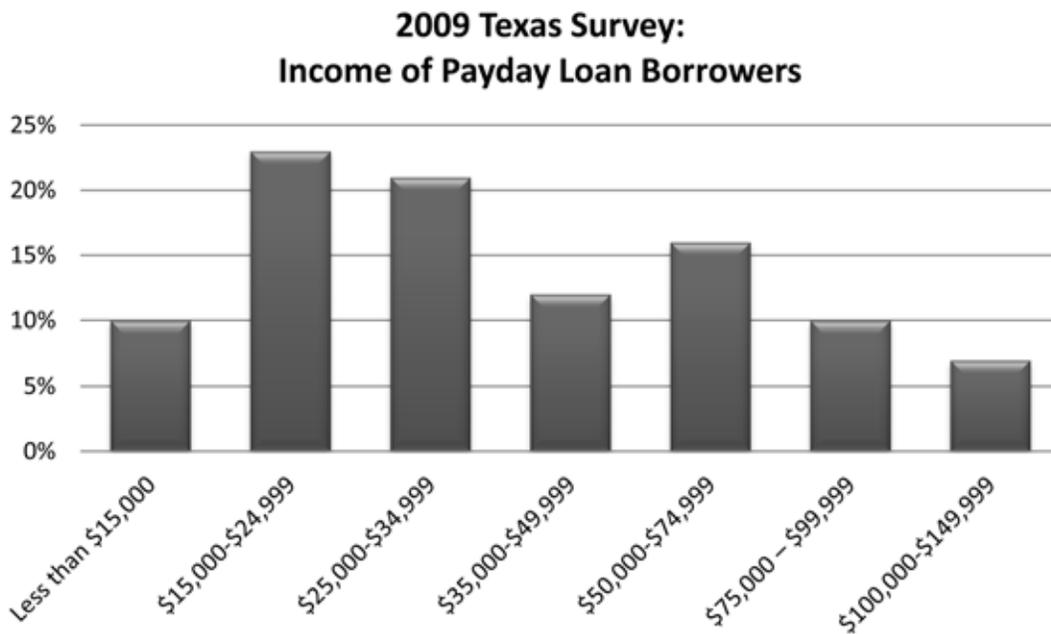
—Jackie Kudlaty  
Jewish Family Service, Houston<sup>26</sup>

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Major payday lenders, like the one cited at the beginning of this section,<sup>27</sup> claim that their borrowers are primarily moderate- to upper-income; however non-industry surveys, including the U.S. Financial Capacity Survey data applicable to Texas, documents a concentration of borrowing among lower-income families.

A 2009 survey and analysis of payday loan borrowing conducted by the George Washington University Financial Service Research Program found that 16% of payday loan customers earned below \$15,000 a year, an income group overrepresented compared to their representation among all wage earners (12%).<sup>28</sup> Similarly, the study found that more than half of all payday borrowers earn between \$15,000 and \$49,999; each category within this range is disproportionately represented as compared to the general population.<sup>29</sup>

For Texas, the U.S. Financial Capacity Survey data shows a similar breakdown: 66% of borrowers reported household earnings of less than \$50,000 a year, and 33% of borrowers earning less than \$25,000 a year.<sup>30</sup> What is perhaps the single most telling data point about payday lending in Texas is that 41% of all payday borrowers are nonwhite with a household income of less than \$35,000 a year.<sup>31</sup> Half are nonwhite earning below \$50,000.



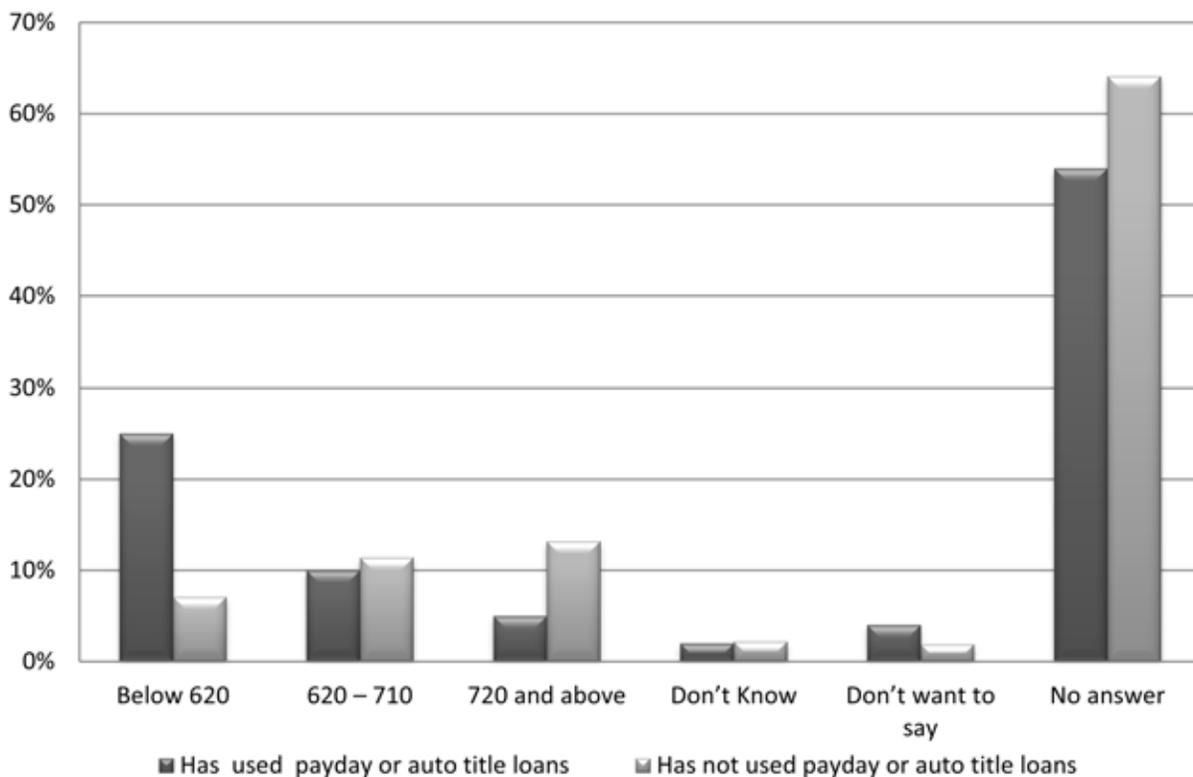
Source: *Texas Appleseed Analysis of 2009 FINRA Financial Capacity Survey*

### **Credit Scores, Credit Cards, and Savings**

Payday and auto title loan stores aggressively market to customers with credit problems, routinely advertising “We say YES!” and “Bad Credit OK.” But what is the credit score profile of the typical payday and auto title borrower? Subprime credit scores generally fall below 620.<sup>32</sup> More than half of the U.S. Financial Capability Study (2009) survey respondents chose

not to answer the question about credit scores. Nearly 25% of the responding payday and auto title borrowers had a credit score below 620, as did 7% of those who had not used payday or auto title loans. Ten percent of payday and auto title borrowers reported a credit score between 620 and 710, as did 11% of those who had not used a payday or auto title loan. Though this data suggests that payday and auto title loan customers are more likely than the general population to have subprime credit scores, it also indicates that an important segment of the market does not have bad credit.

**2009 Survey of Texas Division\***  
**Credit Scores of Payday and Auto Title Borrowers vs. Non-borrowers**



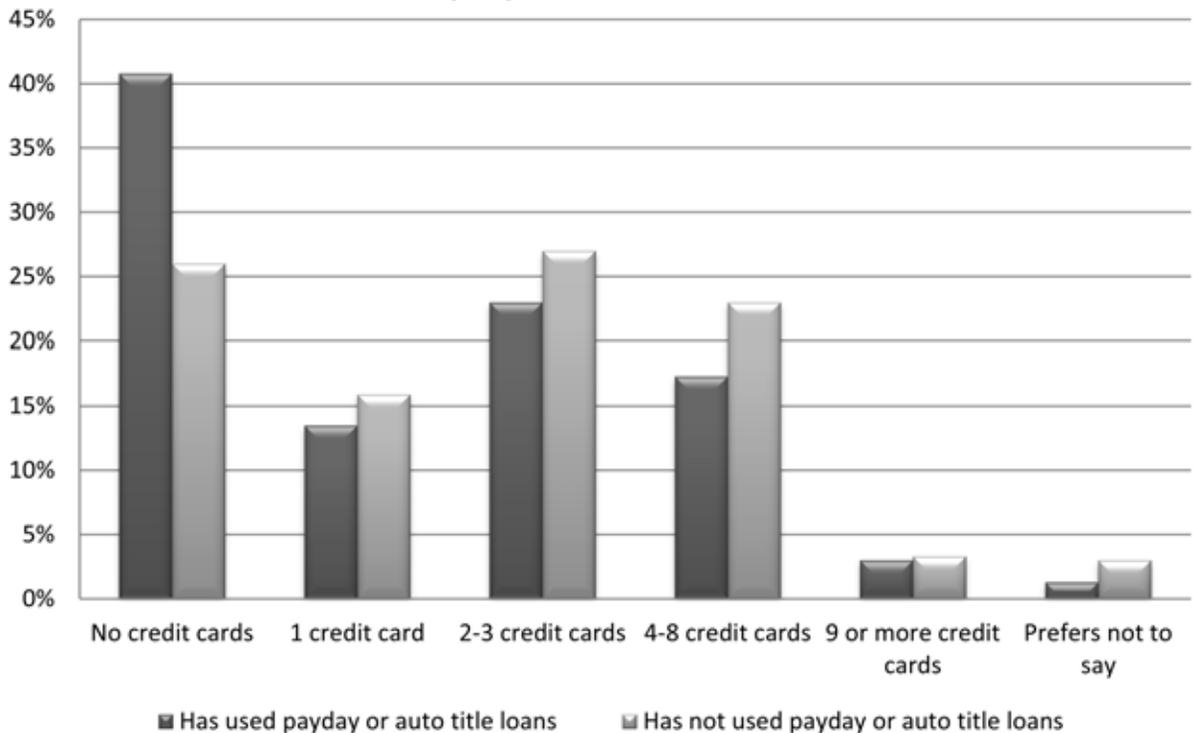
Source: Texas Appleseed Analysis of 2009 FINRA Financial Capacity Survey

\*Texas is part of the West South Central Census Division. This data includes all states in that division, including Texas, Oklahoma, Louisiana, and Arkansas. Division data was used due to the high number of no answers.

Credit cards are another widely available product that, like payday loans, offers quick access to cash. Though credit cards come with pitfalls of their own, it is useful to understand what percentage of payday and auto title borrowers have access to this alternative form of credit. According to the U.S. Financial Capability Study (2009), just over 40% of payday and auto title borrowers in the Census Division that includes Texas have no credit cards.<sup>33</sup> However, over 40% of borrowers have two or more credit cards—with 17% of payday and auto title borrowers having between four and eight credit cards.<sup>34</sup> Payday and auto title borrowers represent a disproportionate number of consumers without credit cards, but a majority of borrowers have access to at least one.

## 2009 Survey of Texas Division\*

### Credit Card Possession of Payday and Auto Title Borrowers vs. Non-borrowers



Source: Texas Appleseed Analysis of 2009 FINRA Financial Capacity Survey.

\*Texas is part of the West South Central Census Division, including Texas, Oklahoma, Arkansas and Louisiana.

It is optimal to use savings to address a financial emergency, and some products developed as alternatives to payday loans include a savings component. Though not specific to Texas, the 2009 George Washington University Financial Service Research Program study provides some interesting insights into the savings practices of payday borrowers. The study found that 45% of payday borrowers had some savings, and 29% regularly put money aside for savings.<sup>35</sup> Eighty-three percent of those with savings found it “somewhat difficult” to “very difficult” to rebuild savings after using the money.<sup>36</sup> Thirty-six percent of the surveyed payday loan customers spent all of their monthly income.<sup>37</sup>

Taking the credit and savings data together, some interesting insights emerge. Because many payday loan borrowers prioritize savings, it makes sense to offer loan products that include a savings component. There is an opportunity to encourage borrowers to rebuild depleted savings by allowing them to leverage their savings as collateral to obtain lower cost credit. The previously cited credit score data underscores the need for credit building—and it is clear that borrowers need a pathway out of the subprime market.

## **Borrower Choices: Why Payday and Auto Title Loans?**

Given the high interest rates and high risk involved with taking out a payday loan, what makes these loans so appealing to so many? The answer may have more to do with aggressive advertising and plentiful payday and auto title loan store locations and less to do with the capacity of a payday or auto title loan to meet borrower needs.

Surveys that examine borrower choices often focus on these three primary questions: Why do borrowers need the money? What are borrowers' perceived loan options? Why do they choose a payday or auto title loan?

The available data focuses on payday loan borrowers. There is little information about attitudes and choices of auto title loan borrowers. Anecdotally there is at least some crossover between the two products, with payday loans being used to retire or make monthly fee payments for auto title loans, for example. In Texas, payday and auto title loans are often available at the same store locations and target similar borrower profiles.

### **Borrower Needs**

The Federal Deposit Insurance Corporation (FDIC) conducted a survey of unbanked and underbanked households in early 2009 to assess borrowers' need for small-dollar loans—and included a series of questions on why borrowers turn to payday loans. According to the survey, 38% of underbanked households turn to alternative financial services—including payday lenders, pawn shops, rent-to-own, and refund anticipation loans—for basic living expenses.<sup>38</sup> By adding in the 15.4% of borrowers who use these loan products to make up for lost income and the 1.6% who use the funds for school or childcare, one arrives at a striking 55% of borrowers who use high-cost credit products to meet a sustained, recurring financial need.<sup>39</sup>

A 2008 Texas survey of nonprofit clients found a similarly high percentage of payday loans being used to pay for basic recurring expenditures. Over half of the respondents used the funds for rent, groceries, gas, or utility bills, which were the top reasons for needing short-term credit.<sup>40</sup> Paying utility bills, including phone, electricity, and cell phones, was the most common reason cited for needing short-term credit.<sup>41</sup> An emergency ranked below basic expenditures as a reason for needing credit.<sup>42</sup>

These survey results support the need for loan products that are structured to take into account the borrower's ability to repay. In some cases, a loan may not be what the customer needs; referrals to utility or other local assistance programs may be more appropriate.

### **Market Options**

The 2008 Texas survey of nonprofit clients asked all survey participants, both those who used payday loans and those who did not, to list all of their sources for short-term credit. "Family and friends" was by far the most common source, selected by 60% of those surveyed.<sup>43</sup> Payday

lenders and pawn shops were the second and third most common responses, at 23% and 19%. Banks, credit cards, and credit unions followed at 16%, 15%, and 13% respectively.<sup>44</sup>

The 2009 report released by George Washington University Financial Services Research Program directed similar questions to payday loan borrowers. Asked where they could borrow money, 50.6% of borrowers said they believed payday loans were their only option, while 17.5% indicated they could use funds in a checking or savings account. Slightly more than 45% reported that they did not have a bank credit card to access funds. Of those who did consider a lending source other than payday loans, 49% considered friends and family, and 23.3% considered banks. The report also indicated that the majority of borrowers, who believed payday loans were their only option, did not consider other sources.<sup>45</sup>

These two surveys present complementary results. In the first survey, the majority of surveyed consumers felt they had some choices for short-term loans; but given that payday and pawn loans were most commonly cited, after “family and friends,” as a source of short-term, small-dollar loans, it is clear that there is a critical need for more and better loan options. The second survey underscores the importance of consumer education. When borrowers do not believe other choices exist, there is often little impetus to seek them out.

### **Why Choose a Payday Loan?**

Convenience and ease of the transaction are often cited as the appeal of payday loans. Forty-three percent of respondents to an FDIC survey of underbanked and unbanked households said they use payday loans primarily because they are “easier to get than a bank loan.”<sup>46</sup> Twenty-six percent of households identified “convenient location” as their top reason for choosing payday loans.<sup>47</sup> Sixteen percent of households chose a payday loan because they could not qualify for a bank loan.<sup>48</sup>

In the George Washington University Financial Service Research Program survey, 28% cited “speed and ease of obtaining a payday loan” and 12.4% cited “convenient location” as the primary attraction of borrowing from a payday lender.<sup>49</sup> Responding to questions about post-loan satisfaction, surveyed borrowers ranked convenience and ease as the primary reasons they chose a payday loan. More specifically, convenient process (41.3%), speed of getting the money (36.5%), and courteous staff (23.9%) were the most commonly cited reasons for satisfaction.<sup>50</sup> High cost was the most common reason for dissatisfaction (69%).<sup>51</sup>

These findings are largely consistent with a 2008 Texas survey of payday borrowers: 58% of respondents said they chose a payday loan because it is “quick and easy.”<sup>52</sup> Other reasons most frequently cited were rejection by a bank or credit union (40%) and no required credit check for a payday loan (35%).

**2008 Texas Nonprofit Client Survey  
Reasons for Choosing a Payday Lender**

Reason	Percent
It's quick and easy.	58%
I have tried to use my bank and credit union, but couldn't get the money I needed.	40%
No credit check.	35%
It's private—no questions asked.	23%
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%

*Source: Short-term Credit Long-term Debt, Texas Appleseed (2009) at 11.*

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

The Texas survey documented a notably higher rate of bank rejections among respondents than in the national FDIC study, but all surveys consistently identified convenience and ease as the primary attraction of a payday loan. Ease appears closely tied to the borrower's virtually guaranteed success in obtaining a loan. Success on the front end is important—particularly for borrowers who, based on their demographic, income data, and credit score profile, may expect to be turned down for mainstream credit.

### **A Snapshot of Nonprofit Client Needs and the Impact of High-Cost Loans**

Of course, success on the front end of the transaction is only half of the story. The reason high-cost credit has received so much scrutiny is that borrowers frequently fail, on the back end of the transaction, to repay the loans in the designated loan term. The back end failures have become particularly relevant for nonprofit organizations in Texas.

A statewide survey of Catholic Charities' clients seeking cash assistance, conducted in the last quarter of 2010, found that nearly 20% were trapped in payday or auto title loan debt.<sup>53</sup> The majority (77%) of those who had used payday or auto title loans believed that the terms of these loans made it hard to cover other bills. Seventy percent had to extend or get new loans because they could not pay the full loan amount, and 73% were also receiving public benefits.<sup>54</sup> This survey presents compelling evidence that payday and auto title loans increase financial stress for borrowers and drain limited charitable assistance available to low-income families. A better loan option on the front end would not only help borrowers, but also reduce the amount of charitable resources used to repay or help mitigate the impact of these high-cost loans.

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*“We are concerned that our charitable dollars are in fact funding the profits of payday lenders rather than helping the poor achieve self-sufficiency. The extreme interest rates charged by payday lenders create a painful cycle of dependence that traps financially vulnerable families across our state”*

—Bishop Joseph S. Vásquez  
Catholic Diocese of Austin  
Testimony before the Texas Senate Committee on  
Business and Commerce, February 22, 2011

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A 2010 RAISE Texas survey of member nonprofits also addressed clients’ need for credit. The survey measured how the nonprofit organizations perceived the needs of their client base. Sixty-four percent of the organizations reported that their clients earn on average less than \$20,000, with the majority of clients employed. Eighty-four percent reported that clients needed loans of \$1,000 or less to meet short-term emergencies.

### **2010 RAISE Texas Member Survey Nonprofits Assess Client Loan Needs for Emergencies**



*Source: RAISE Texas 2010 Nonprofit Survey*

Over 80% of organizations participating in the survey said many of their clients need money to refinance high-interest payday, auto title, and auto loan debt; and 89% reported that their clients needed a credit building product.<sup>55</sup> It is clear that use of payday and auto title loans is relatively high among very low-income nonprofit clients, as is the demand for alternatives. Alternatives to high-cost payday, auto title, and other consumer loans can meet a variety of borrower needs—building credit, refinancing high-cost debt, and addressing short-term emergencies.

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*“In the City of Corpus Christi and surrounding areas, the large number of Payday Loans and Title Loans, especially in neighborhoods where low and moderate income families and individuals live, work, and conduct day to day operations continue to increase...Payday lenders continue to be a problem for LMI [low to moderate income] groups. The loophole they utilize needs to be closed.”*

—Community Outlook Survey  
(Survey of nonprofits discussing client needs)  
Federal Reserve Bank of Dallas, 4<sup>th</sup> Quarter, 2010

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## **Meeting the Need for Affordable Small-Dollar Loans in Texas**

The consumer surveys summarized here have a common theme: there is no “one size fits all” approach to addressing the credit needs of Texas payday and auto title loan borrowers. Though the majority of borrowers are low- to moderate-income and in their 20s and 30s, this picture does not tell the full story. We do know:

- It is essential to provide better choices targeting the small-dollar loan needs of the majority of the market. It is also important to meet the needs of seniors living on fixed incomes; low-income nonprofit clients; communities with unique profiles within the majority demographic, such as immigrant communities; and higher income borrowers.
- The prevalence of low credit scores or lack of credit among borrowers is not surprising. It is important to provide borrowers with a chance to turn their financial lives around and begin to build a positive loan repayment history to improve credit.
- Finally, the insights into savings—that a significant percentage of borrowers do save, but find it hard to replace savings once used—highlights the opportunity to encourage savings and create avenues to leverage savings as security for lower-cost credit.

The information about borrowers demonstrates a clear need for better products and better borrower awareness of the risks associated with high-cost loans. While financial education can help consumers make better informed choices and understand the high cost of payday and auto title loans, financial education alone will not reduce the number of consumers taking out these high-cost loans and falling into a cycle of debt. Combining better market options for small-dollar loans with financial education will better serve the needs of consumers in Texas.



## CREATING A BETTER MARKETPLACE

### National Trends: Alternatives to High-Cost Payday and Auto Title Loans

Efforts to create better products to compete with payday and auto title loans began on a small scale in the late 1990s, when payday lending first started to have a major market presence. In the last five years, national pilot projects and other initiatives have built on those early efforts and more mainstream lenders have become interested in offering alternative products to expensive payday and auto title loans.<sup>56</sup>

It is challenging, however, to compete with an industry with limited regulatory constraints, an extensive network of loan storefronts that saturate the market, and one that has mastered the art of “quick and easy” lending. However, it is important to note that payday loans have only dominated the small consumer loan market in the last 20 years. Traditional finance companies have long played a role in serving credit needs of underbanked borrowers, and banks once made small loans to their customers.<sup>57</sup> The expansion of credit cards is often cited as a transition point, where many banks pulled back on small loans in favor of marketing the cards.<sup>58</sup>

At the core of this discussion is the basic question: What is an affordable alternative to a payday or auto title loan product? Financial institutions already offer the following products that could be structured as alternatives to payday and auto title loans:

- Secured and unsecured personal loans;
- Overdraft lines of credit or other lines of credit associated with a checking account; and
- Credit cards.

Existing non-bank products could serve the same niche market. Some examples include:

- Traditional installment loans offered by state-licensed finance companies;
- Pawn loans; and
- Targeted advances such as bill payment loans.

Savings is another important alternative that should not be overlooked. In addition, pay advances from employers, charitable assistance, and loans from family and friends are also available to at least some who are in need of small-dollar credit.

Some alternative products have attracted scrutiny due to their high charges and short repayment terms:

- **Advances on direct deposit payments.** The Office of Comptroller for the Currency recently proposed general guidance on safe and sound direct deposit-related consumer credit products.<sup>59</sup> Core concerns include the high cost of these products, no clear assessment of the consumer’s ability to repay the loan within a short period of time,<sup>60</sup> and the high incidence of loan rollovers.
- **Advances on direct deposits onto a pre-paid debit card.** A bank loading cash advances onto a pre-paid credit card tied to account-based direct deposits was forced by the Office of Thrift Supervision to end its lending program due to “unfair and deceptive practices.”<sup>61</sup> The bank was recently ordered to pay \$4 million in restitution to borrowers.<sup>62</sup>
- **Over-priced Credit Union Loans.** A small number of credit unions has been criticized for offering payday loan alternatives that are priced and structured similarly to a payday loan. To avoid the predatory pricing and regressive loan structure common to payday loans, both the Texas Credit Union Commission and the National Credit Union Administration have issued rules that establish fair standards for small-dollar, short-term consumer credit.<sup>63</sup>
- **Pawn loans.** Though they do not generally entrap borrowers in a cycle of debt—since borrowers can decide to give up the loan collateral—they are expensive and must be repaid within a short period of time (usually one month).<sup>64</sup>

Some of these alternatives may cost less than payday and auto title loans in Texas, but they still can contribute to financial distress for borrowers.

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### **Annual Percentage Rate (APR) vs. Fee**

Many in the short-term loan industry argue that APR is not a fair measure of the cost of payday and auto title loans and that their charges are “fees” for a service rather than interest. APR reflects an annualized cost and, they argue, it is not an appropriate measure for a two-week or one-month advance. If payday and auto title loans were consistently repaid in two weeks or a month—without re-borrowing—the “fee” argument could have merit; however, as data from numerous states indicate, the vast majority of payday and auto title loans extend far beyond the original loan period, with borrowers in debt for an average of five months or longer. Therefore, in the case of payday and auto title loans, APR is a valid measure of the loan cost and should be used as a standard to allow apples-to-apples cost comparisons and to assess reasonable charges.

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What follows is an assessment of affordability standards for alternative small-dollar loans, examples of affordable bank and non-bank alternative loan products from around the country, and a look at savings initiatives that address short-term, small-dollar consumer loan needs.<sup>65</sup>

## **What Makes a Small-Dollar Loan Affordable?**

Multiple perspectives exist on what makes for a positive, affordable small-dollar consumer loan product.

In its report, *Stopping the Payday Loan Trap: Alternatives That Work and Ones that Don't* (June 2010), the National Consumer Law Center (NCLC) established these parameters for a sound alternative to a payday loan:

- 36% APR or less;
- A term of at least 90 days, or one month per \$100 borrowed;
- Installment payments with loan amortization;
- No paper or electronic check holding;
- Effective assessment of the borrower's ability to repay the loan; and
- A component that promotes savings.<sup>66</sup>

The Center for Financial Services Innovation (CFSI), in recent testimony on consumer credit before the U.S. House Subcommittee on Financial Institutions and Consumer Credit, laid out an overlapping, but somewhat different, set of standards for fair consumer loans:

- Transparent marketing and disclosures;
- Fair pricing;
- Affordable to the borrower;
- Effective assessment of borrower ability to repay;
- Structured so as not to create a cycle of repeat borrowing, with appropriate "cooling off" periods;
- Reports positive repayment to major credit bureaus to build credit; and
- Incorporates "financial capability" tools.<sup>67</sup>

An important difference between the two is that NCLC defines fair pricing and affordability by assigning a specific maximum rate and loan structure. CFSI includes additional standards related to building long-term borrower financial stability, emphasizing building positive credit and financial education.

The Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), and the Texas Credit Union Commission (TCUC) have adopted specific product standards for small-dollar, short-term consumer loans. While the FDIC standards are recommendations, the NCUA and TCUC standards are implemented through agency regulations. Another important difference is that the FDIC standards were designed to

encourage positive product offerings, while the NCUA and TCUC standards were adopted in part to address concerns posed by loan products already being marketed.

Standards adopted by financial institution regulators (*see chart below*) have significant overlap with the NCLC and CFSI standards. They are closer to the NCLC model—outlining specific rates, fees, and loan terms. These standards emphasize fair pricing and the importance of assessing borrower ability to repay the loan. All view loan rollovers as problematic, and most encourage credit products that include a savings feature. The CFSI testimony highlights the importance of the loans serving as a tool to build credit. The borrower profile information supports the need for borrowers to build a positive credit history.

### Standards for Financial Institution Small-Dollar Loans

<b>Standard</b>	<b>FDIC<sup>68</sup></b>	<b>NCUA<sup>69</sup></b>	<b>TCUC<sup>70</sup></b>
Interest and Fees	36% APR; fees should not cause APR to exceed 36%	28% plus \$20 fee—charged once per 6 months	18% plus \$20 fee—charged once every 180 days
Loan Term	90 days or more	1 to 6 months; amortizing loan with payment schedule based on borrower’s ability to repay	6 months or less; amortizing loan with principal reduction with every payment
Loan Amount	\$2,500 or less	\$200 - \$1,000	\$1,100 or less
Loan Requirements	Streamlined method to collect identity, address, and proof of income; credit report to assess loan amount and ability to repay—decision within 24 hours	Minimum 1-month credit union membership requirement; other requirements at discretion of FCU	Underwriting focus on member's history with the credit union and ability to repay a loan within an acceptable timeframe; allows for streamlined underwriting process
Repeat Loans	Payments should be structured to reduce principal owed so as to not necessitate re-borrowing	No additional fee, only interest for a rollover; if term extended, no increase in loan; 3 loans per 6 months	Excessive renewals or prolonged periods with no reduction in principal indicate unsound lending
Additional Features	Savings and financial education component	Outstanding small-dollar loans limited to 20% of credit union net worth	Outstanding small-dollar loans limited to 20% of credit union net worth; permits loans secured by savings

The Small-Dollar Lending Group of RAISE Texas, a statewide asset building organization, has also developed its own standards for affordable small-dollar loans. The group includes financial institutions, consumer advocates, nonprofits that provide asset building services, and community development corporations with expertise in lending.<sup>71</sup>

The RAISE Texas standards are very much in line with the others highlighted previously. They include:

- Reasonable loan fees and interest rates designed to enable borrowers to pay back the entire loan in the designated loan period without loan renewals or back-to-back loans;
- An amortization period that is longer than a single pay cycle—ideally three to six months, contingent on the size of the loan and the borrower's ability to repay;
- Sound underwriting criteria built on the customer's ability to repay the loan on time;
- Limit on the total amount of outstanding loan balances, in addition to other short-term or revolving debt, to 25% of the borrower's monthly income;
- Plain language contracts;
- Customer remedy and recourse options;
- No prepayment penalties;
- Reasonable timeframe to cure default; and
- Negotiate with HUD-approved nonprofit consumer credit counseling services in the event that the customer is struggling to repay debt and has sought their services.

The RAISE Texas standards were developed as a direct response to the problems created by high-cost, largely unregulated payday and auto title loans in Texas. All of the standards provide helpful templates for an affordable loan. Taken together, they provide guidelines for protecting consumers against high-priced loan products.

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### **Characteristics of an Affordable Loan**

1. Reasonably and fairly priced;
2. Based on borrower ability to repay the loan and structured so that the borrower can repay without needing to re-borrow;
3. Loan term of three months or more is recommended;
4. Credit building for borrowers;
5. Transparent in advertising, disclosures, and contracts; and
6. Includes vehicles to build savings and/or connects borrowers to appropriate financial education.

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Most of the alternative loans products profiled in this report embody the desired characteristics outlined above. All of the products offer reasonable pricing and focus on the borrower's ability to repay the loan.

## **Affordable Small-Dollar Loans: Financial Institution Loans**

Banks and credit unions, with their expansive footprints and established lending infrastructure, have the systems in place to meet small-dollar loan needs. While financial institutions have been slow to meet this need with affordable products that support long-term financial stability for borrowers, interest is growing.

In recent testimony before a Congressional subcommittee, Robert Mooney, FDIC Deputy Director for Consumer Protection and Community Affairs, cited these FDIC study findings from two years ago: 73% of surveyed banks considered the unbanked and underbanked market “important,” but only 18% prioritized it. Since that study, 50 banks have started to offer small-dollar loans or plan to do so in the near future.<sup>72</sup>

Credit unions have also increased their small-dollar lending. Since the NCUA adopted regulations governing short-term, small-dollar consumer loans a little over a year ago, many federal credit unions (FCUs) have either implemented or adapted programs to meet their members’ small-dollar loan needs. As of June 30, 2011, 343 FCUs reported originating more than 33,000 small loans year-to-date, with an aggregate balance of almost \$14 million.<sup>73</sup> The loans averaged \$413, with an average interest rate of 20.76%.<sup>74</sup> The loan totals equate to about 100 loans per credit union in a six-month period. Taken in the aggregate, the loans are providing a positive option for a meaningful number of borrowers.

What follows is a closer look at two national efforts to encourage banks and credit unions to offer affordable small-dollar loans. Also included is an overview of closed-end loan programs, lines of credit, and loan programs offered through employer and nonprofit partnerships.

### **FDIC Small-Dollar Loan Pilot Program and the REAL Solutions Credit Union Program**

The FDIC Small-Dollar Loan Pilot Program and the National Credit Union Foundation’s REAL Solutions program stand out among affordable small-dollar lending programs offered by traditional financial institutions.

#### FDIC Small-Dollar Loan Pilot Program

The FDIC launched the Small-Dollar Loan Pilot Program in 2008 “to illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products such as payday loans and fee-based overdraft protection.”<sup>75</sup> Twenty-eight FDIC member banks participated in the two-year pilot. In order to appeal to payday customers, the loan process was streamlined to provide a credit decision within 24 hours, although the application still required a credit check to determine the appropriate loan amount and capacity to repay. The participating banks offered loans up to \$2,500 and repayment periods of 90 days or more. Including origination and other upfront fees, the cost of the loans could not exceed 36% APR; in practice, the most common rate charged was 18%.<sup>76</sup>

During the two-year pilot period, the participating banks made 18,100 loans of under \$1,000 and 16,300 loans of \$1,000 to \$2,500, for a total of \$40.2 million in loans.<sup>77</sup> Delinquency rates for both the smaller and larger loans fluctuated from quarter to quarter, with more volatility in the larger loans. For the loans under \$1,000, delinquency rates varied between 9% and 11%. For the larger loans, they fluctuated from 6.4% to 10.9%.<sup>78</sup> These rates were higher than the rates generally reported by banks for unsecured “loans to individuals” over the same time-period— between 2.4% and 2.6%.<sup>79</sup>

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### **Amarillo National Bank Small-Dollar Loan<sup>80</sup>**

Amarillo National Bank is an example of a community bank that never stopped offering its customers small-dollar loans. The bank has been making loans as small as \$500 for more than 100 years. The loans are offered as a way to meet customer needs and build a long-term relationship. In 2008, the bank made just under 3,000 small loans, with 21 charge-offs and 155 loans that were 30 days or more delinquent at the end of the fourth quarter. The loans are offered at between 14% and 18% interest with a nine- to 12-month repayment period and are disbursed within 30 minutes to one hour of the application. The bank continues to offer and market small-dollar loans in the Amarillo community. Underwriting is delegated to the branch manager, emphasizing the relationship nature of the loan offering. Credit reports are pulled, but there is no specific credit score threshold.

According to the bank CRA officer, who administers the small-dollar loan program, “Amarillo National Bank has been making these loans for as long as I have been here [30 years], and I still see people with houses, successful businesses, and kids in college who tell me that the small-dollar loan I made to them was their first step in establishing a relationship with a bank.” The bank does not measure the short-term profitability of the program, but sees it as a long-term investment in the community that “pays off over the long term through goodwill and stronger customer relationships.” With less than 1% charge-offs, the program has performed better than average among the FDIC pilot participants.

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Though the delinquency ratios for the pilot loans were significantly higher than for the “loans to individuals” reported on the FDIC Call Reports, it is important to note that the final charge-off rates for the smaller loans are quite similar—ranging between 4.3% and 6.2% for the pilot loans under \$1,000 and between 4.9% and 5.4% for “loans to individuals” on the FDIC Call Reports.<sup>81</sup> Charge-off rates for the larger pilot loans were higher—at 8.8%, a rate slightly lower than the charge-off rates for credit cards.<sup>82</sup> Lower-income borrowers are more likely to experience fluctuations in income, leading to late payments. This pattern could explain the higher delinquency ratio, but is comparable to charge-offs on other unsecured loans.

Two Texas community banks participated in the pilot program: Amarillo National Bank, with nearly \$3 billion in assets, and Liberty Bank in Paris, Texas, with about \$250 million in assets. Twenty-six of the 28 pilot banks continue to offer their small-dollar loan program two years after the end of the pilot program.<sup>83</sup>

## National Credit Union Foundation's REAL Solutions Program

REAL (Relevant, Effective, Asset-building, Loyalty-producing) Solutions was launched in 2004 by the Filene Research Institute. REAL Solutions became a program of the National Credit Union Foundation (NCUF) in 2007—providing technical assistance to credit unions actively working to reach underserved and low-wealth families with a variety of products and services including affordable small-dollar loans. It operates through partnerships with state credit union leagues. At least 34 state credit union leagues participate in the program, including the Texas Credit Union League.<sup>84</sup> The program does not prescribe one solution, but rather presents successful programs from credit unions across the country and works with local groups to formulate a package of products and services that are responsive to the needs of participating credit unions and the local underserved population.

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### **Fort Worth City Credit Union**

Fort Worth City Credit Union (FWCCU) offers the Texas REAL Solutions small-dollar loan under the name *SMARTChoice*. This payday loan alternative requires proof of employment for the past six months and proof of income greater than \$1,000 a month.<sup>85</sup> The loan costs include a \$20 application fee and 18% interest.<sup>86</sup> *SMARTChoice* features loans from \$100 to \$1,000 with up to a 90-day repayment period. Borrowers must be members in good standing and must have a checking account with direct deposit or payroll deduction elected in order to receive a *SMARTChoice* loan.

*SMARTChoice* includes a mandatory 10% savings provision with each loan. Borrowers receive 90% of the loan upfront, but must place the remaining 10% in a savings account and cannot access it until the loan is paid in full. Like many credit unions, FWCCU also provides financial educational services to help their clients avoid a cycle of debt commonly experienced with payday and auto title loans. Since launching the loan program in October 2010, FWCCU has made at least 371 loans totaling \$300,000. Less than .5 % of the loans are 30 days or more past due.<sup>87</sup>

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The Texas Credit Union League became part of the REAL Solutions program in 2008 and launched the Texas REAL Solutions small-dollar loan program in March 2010.<sup>88</sup> The Texas REAL Solutions program currently has over 60 participating credit unions.<sup>89</sup> The small-dollar loan program is designed as a closed-end loan at 18% interest, with a repayment period of up to 90 days; 10% of the loan amount goes into a savings account for the borrower. In order to qualify for the loan, a borrower must be a member of the credit union for a designated period of time. The loan is an installment loan and allows borrowers to build a positive credit history if they repay the loan.<sup>90</sup>

### **Closed-End Loans vs. Lines of Credit**

The majority of affordable small-dollar loan programs are structured as closed-end loans. All participants in the FDIC pilot program offer closed-end loans, as does the Texas REAL

Solutions program. One of the advantages of a closed-end loan is it is usually repayable in installments, making it more affordable. The longer loan terms, generally extending beyond one pay cycle, make it easier for borrowers to improve their credit scores. A 12- to 18-month payment history is most beneficial for building credit.

Lines of credit offered as alternatives to payday loans tend to be single-payment loan products. If the borrower successfully repays the loan in full on the due date, a single-payment product is not as helpful as a longer term loan in building positive credit. It is also more likely that borrowers will need to immediately take out another loan to make up for the lost income from a single-payment loan. The greatest strength of a line of credit is that it has streamlined underwriting—once a borrower is approved for a loan, it is not necessary to re-approve the borrower every time a new advance is needed. The advantage to the borrower is that lines of credit are often faster to access than a closed-end loan product.

One of the oldest and most successful line-of-credit loans is offered by the North Carolina State Employees Credit Union. In 2000, the North Carolina State Employees Credit Union discovered that over 4,000 of its members were trapped in a cycle of debt trying to pay off high-cost payday loans.<sup>91</sup> As an alternative, the credit union developed a loan program which was a modified version of its existing line-of-credit program.<sup>92</sup>

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### **North Carolina State Employees Credit Union**

The North Carolina State Employees Credit Union (NCSECU) is a \$21.4 billion credit union with 1.6 million members and 233 branches.<sup>93</sup> In January 2001, NCSECU launched the Salary Advance Loan.<sup>94</sup> The credit union offers members a loan of up to \$500 to be repaid on their next payday—usually in one month—at 12% interest.<sup>95</sup> Borrowers are required to deposit 5% of the loan amount into a special savings account. Once they reach \$500 in savings, the terms of the product change. They are required to save 7% of the loan amount and pay a reduced interest rate of 5.5% for the loan.<sup>96</sup> In order to encourage the accumulation of savings, no loans can be made if the would-be borrower has withdrawn funds from his or her savings account within the previous six months.<sup>97</sup> Though not required, borrowers have access to free financial education through a partnership with Balance, a financial education and counseling service.<sup>98</sup>

The loan program requires a short application with name, address, social security number, and employer information. Borrowers must receive a regular paycheck with direct deposit at the credit union.<sup>99</sup> NCSECU uses credit reports to ensure that the borrower is not in bankruptcy. After repayment, consumers may take out a new loan the following month.

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The loan program has many positive characteristics. It offers loans at rates substantially below other similar products and reaches a borrower demographic difficult to serve with mainstream loan products. According to a 2009 overview, the average credit score of program borrowers was 537, with only 10% earning a score above 620.<sup>100</sup> Borrower income averaged about \$2,100 a month.<sup>101</sup> The savings component has a double benefit of helping borrowers build emergency funds and providing security for the loan. Annual charge-offs range from .19% to .27% of total loan volume.<sup>102</sup> In the 10 years that the loan has been offered, nearly 150,000 credit union

members have used it and have accumulated a combined \$20 million-plus in savings.<sup>103</sup> A 2005 study found that the program is profitable for the credit union.<sup>104</sup>

One downside to this loan program is that there has been a high incidence of back-to-back borrowing.<sup>105</sup> Creating an installment option would allow customers to pay the loan in full over time. Still, the low interest rate and the savings component are a dramatic improvement over payday and auto title loans—interest charges over a full year are less than the interest and fee charges of an average Texas payday lender for a two-week loan.

### **Affordable Small-Dollar Loan Programs Implemented Through Partnerships**

The structure of the loan product is important in meeting borrower needs and reducing lender risk. Partnerships provide another tool to reduce the risk of the transaction.

#### Employer Partnerships

In recent years, there has been growing interest in employer partnerships to offer general financial education and promote financial stability among employees. Offering affordable, small-dollar loans through employers is a natural extension of this strategy. Some employers have provided no-cost, small-dollar salary advances to employees for decades. Offering affordable small-dollar loans through the workplace formalizes that practice, while providing new credit building and financial management training opportunities.

Credit unions generally participate in more employer partnerships than banks because their membership groups provide them with a unique connection to the workplace. In Virginia, the Virginia Credit Union loan program for state employees provides an interesting example of the intersection of lending reform and development of improved market options.

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*“While we should regulate payday lending and other forms of predatory lending, there is a strong need for people to have small-dollar loans in the marketplace. That’s why Virginia pioneered a new strategy to offer more than 100,000 state employees a viable and cost-effective alternative to payday lending.”*

—Tim Kaine, Governor of Virginia  
*Wall Street Journal*, December 30, 2009<sup>106</sup>

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The loan program was announced in July 2009 by then Governor Tim Kaine to demonstrate that private businesses can offer better loan products than the high-interest loans offered by payday lenders.

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## Virginia Credit Union—Virginia State Employees Small Loan Program

In 2009, Virginia Credit Union partnered with the Virginia State Employee Assistance Fund (VSEA) to launch the Virginia State Employees Small Loan Program.<sup>107</sup> VSEA, part of the nonprofit Commonwealth of Virginia Campaign, had been collecting donations for emergency grants to state employees, but found that it was rejecting many people with serious financial needs due to limited funds. VSEA opted to leverage \$10,000 as a loan loss reserve for the loan program.<sup>108</sup> State employees can access two loans per year of up to \$500 at 24.99% interest for a six-month loan term. Borrowers must take a short online financial fitness course.<sup>109</sup>

To qualify for the loan, a borrower must be employed with the state for 12 months or more and be paid semi-monthly or monthly. The credit union attempts to approve loans on the same day, but first-time applications can take a few days to process.<sup>110</sup> The loan can be accessed online, and repaid through direct deposit.

Over 2,000 loans were made in the first three months of the program.<sup>111</sup> By February 2010, over \$1.7 million in loans had been made through the program.<sup>112</sup>

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Other examples include a city-bank partnership to offer loans to municipal employees, and a social enterprise partnership with banks and credit unions to offer employers a pre-packaged small-dollar loan program for their employees:

- **Lake Forest Bank**, in Lake Forest, Illinois, participated in the FDIC small-dollar loan pilot program. In the second year of the pilot program, the bank launched a partnership with a local government to offer loans to city employees. Loan applications can be faxed to the bank, and the loan closing is held at the bank. The bank offers small-dollar loans of \$250 to \$1,000, at an interest rate of approximately 8%.<sup>113</sup> Loans are repaid through voluntary automatic payroll deductions.
- **Emerge Workplace Solutions** is a project of New Foundry Ventures in San Francisco, California. New Foundry Ventures is an incubator for for-profit businesses with a social mission. Its projects have three major requirements: financial sustainability, social impact, and national scale.<sup>114</sup> Emerge provides an online platform to offer loans to employees of partner businesses. It currently collaborates with three credit unions and one bank to provide the loans: Express Credit Union, which serves residents of Washington State; Liberty Bank<sup>115</sup> in New Orleans, a national lender; Spectrum Federal Credit Union, which can provide loans in all states; and St. Louis Community Credit Union, which serves the greater St. Louis area.<sup>116</sup> Loans of \$300 to \$2,500 are offered at between 9.99% and 19.99% interest depending on the lender and the borrower credit profile. The loan term is between four and eight months. The Emerge website offers a useful dynamic tool for borrowers. It allows borrowers to enter a loan amount and repayment period and quickly calculate what their periodic payments will be and how the loan compares with payday and auto title loan options.<sup>117</sup> The program also includes

free one-on-one financial coaching and financial wellness assessments. Emerge has made 150 loans since its launch in July 2011.<sup>118</sup>

Two of the Texas programs profiled in the following section are also based on employer partnerships—one is a financial institution program. Promise Credit Union, a relatively new community development credit union in Houston, Texas, began offering loans to the employees of its sponsoring organization, Neighborhood Centers, Inc., in 2009. Now that the program is established, the credit union is looking to partner with other employers, including nonprofits in its service area. The second program, the Community Loan Center in Brownsville, Texas, launched in 2011, operates as a licensed consumer finance company and offers loans only through employer partnerships.

### Nonprofit Partnerships

Nonprofit partnerships provide another avenue to reduce lending risk for small-dollar loan programs. They generally offer loan-loss reserve funds, and some guarantee all loan losses. Usually, in such partnerships, the customer contact point is through the nonprofit partner rather than the financial institution that funds the loan.

The Loan Plus program, started in Wilmington, Delaware, is a good example of a bank-nonprofit partnership. The program was developed in 2007 as a partnership between Wilmington Trust and West End Neighborhood House. In 2005, the nonprofit began to notice that about one-third of its 2,500 client families were in financial crisis due to a payday loan. A typical family borrowed \$500 and, after paying \$1,500, still owed the full payday loan amount.<sup>119</sup>

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*“As a small nonprofit in Wilmington, we did not want to have cash in the building, or write checks to customers...It doesn’t make sense for us to be the lender for this program. We want good name brand credit.”*

—Barbara Reed  
Director of Housing and Financial Management  
West End Neighborhood House<sup>120</sup>

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The nonprofit worked with Wilmington Trust to establish a loan program that mimicked the speed of a payday loan, but without the oppressive terms.

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## West End Neighborhood House-Wilmington Trust “Loan Plus” Partnership

Loan Plus was initially offered through the West End Neighborhood House, a nonprofit organization in Wilmington, Delaware. Though Wilmington Trust issues the loan, the customer interaction is mainly with the nonprofit. The nonprofit screens borrowers and underwrites the loan.

Loans averaging between \$300 and \$500 are offered through the program at an interest rate between 12% and 15%.<sup>121</sup> No rollovers are permitted, and borrowers qualify for two loans per year.<sup>122</sup> Prospective borrowers must supply their name and address, official state identification or a passport, two most recent pay stubs, a checking account with no overdrafts or nonsufficient funds charges, and a utility bill in their name.<sup>123</sup> Potential customers can make an appointment or walk into the nonprofit location. In order to underwrite the loan, a staff member completes an “affordability budget worksheet” to assess income and expenditures. The maximum loan amount is 30% of the borrower’s net monthly income. Loans are approved only if the borrower’s budget worksheet shows sufficient surplus income to make the loan payments. Approximately 70% of the applicants are approved for a loan. The remaining 30% are in financial crisis and would not benefit from a loan; instead, they need other support services.<sup>124</sup> Staff is trained to connect applicants to utility assistance and other assistance as necessary.

Loans are approved and the funds are available in less than two hours. These loans are generally repaid in three monthly payments—borrowers write three checks for the payment amount, and the checks are cashed by the nonprofit on the due date. The program also features case management, financial education, and steps to establish credit.<sup>125</sup> These loan features are designed to help the customer break the cycle of debt.<sup>126</sup>

As part of the program, the nonprofit guarantees the loan and is responsible for any losses. It holds a 10% loan loss reserve fund and engages in collections for past-due loans. The program issued 400 loans in its first 18 months.<sup>127</sup> In July 2009, the program expanded statewide through partnerships with Catholic Charities and the YWCA.<sup>128</sup>

In 2011, M&T Bank purchased Wilmington Trust and the bank is continuing the program. The bank decided to lower the interest rate to 9.9%. As of November 2011, approximately 200 loans have been made since the start of the year—with a borrower approval rate of 81%. \$64,750 has been loaned with a 0% default rate. Over the life of the program, \$400,000 has been loaned, with an 11% default rate. West End plans to add 6 new lending locations in 2012 and to have a presence in all three Delaware counties. New locations include financial coaching support.<sup>129</sup>

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Family Services of Greater Houston, a Texas nonprofit with a loan program profiled in the following section, modeled its program on the Loan Plus program. Other similar programs include:

- **La Salle Bank and the Centers for Working Families** in Chicago. Partnered in 2005 to launch an affordable small-dollar loan program specifically for the clients of the Centers for Working Families.<sup>130</sup>
- **Central Bank of Kansas City and Fair Community Credit.** Recently announced a partnership to offer affordable small-dollar loans to borrowers referred from a church and two social services agencies. Fair Community Credit is raising funds for a loan collateral pool. Once the program develops a track record, there are plans to expand to include additional financial institutions and nonprofit agencies.<sup>131</sup>

### “Bank On” Partnerships

“Bank On,” a city-sponsored initiative to connect residents with safe and affordable financial services, was first launched in San Francisco in 2006. Two years later, the National League of Cities adopted the campaign and promoted it nationwide. Today, approximately 100 cities, counties, and states are working on a “Bank On” program.<sup>132</sup>

In addition to helping families access mainstream financial services, some “Bank On” campaigns have taken on the problem of high-cost payday lending and have pursued accessible alternatives. According to a recent study by the National League of Cities, “Bank On” campaigns in Savannah, Seattle, and San Francisco have established alternative small-dollar loan programs by partnering with banks and credit unions.<sup>133</sup>

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### **Bank On San Francisco Payday Plus SF Partnership**

To create alternatives to payday loans, five local credit unions in the San Francisco area jointly marketed a small-dollar loan program. Participating credit unions include: Mission SF Federal Credit Union, Northeast Community Federal Credit Union, Redwood Credit Union, San Francisco Federal Credit Union, and Spectrum Federal Credit Union.<sup>134</sup> The program, launched in December 2009, allows members to borrow up to \$500 at maximum interest rate of 18% APR.<sup>135</sup> San Francisco residents can call 2-1-1 to be connected with a participating credit union.

Payday Plus loans can be repaid in six to 12 months, which compares favorably to payday loans which entrap consumers in a cycle of debt by requiring the loan to be repaid in full in two to four weeks.<sup>136</sup> Payday Plus borrowers must be residents of San Francisco and provide proof of regular income and a checking account.<sup>137</sup> There is a limit of three loans per year, and a loan must be paid in full before another loan can be made.<sup>138</sup> Borrowers must take a financial education class before a second loan is approved.<sup>139</sup>

In 2010, the program made 320 loans and made a similar number of loan in 2011.<sup>140</sup> The goal is to create a scalable program over time.

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## **Affordable Alternatives in the Non-Bank Market**

New financial products, as well as established one, are emerging in the push for fair and affordable small-dollar lending alternatives. Though financial institutions are offering many more alternative loan programs than their counterparts, there is notable progress towards scale in the non-bank market. Areas of growth include nonprofit initiatives, a new take on the regulated consumer finance company model, and in new online lending opportunities to reach large numbers of potential borrowers.

### **Nonprofit Initiatives**

Many nonprofits across the country have struggled to find affordable and fair small-dollar loan options for their clients, who often have low incomes and poor or no credit. Clients mired in payday or auto title debt often need affordable options to refinance those loans before they can get back on their feet financially. Clients may need small emergency loans, but if no affordable programs exist in their communities, they may feel stuck with predatory options. Just as some U.S. nonprofits decided 30 years ago to address an unmet need by jumping in and offering small business micro-credit, so are some nonprofits deciding today to begin offering micro-consumer loans.

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### **Neighborhood Housing Services—Borrow and Save Loan**

In 2009, Neighborhood Housing Services of Baltimore partnered with a consortium of eight banks and credit unions to offer an affordable small-dollar loan to the residents of East Baltimore.<sup>141</sup> The consortium, brought together through the local FDIC-sponsored Baltimore Alliance for Economic Inclusion, provided \$70,000 in capital to fund a loan pool to support the program. The nonprofit offers loans of \$300 to \$1,000 at 7.99% interest, over a six- to 12-month term.<sup>142</sup> The program requires \$5 be deposited into savings every month, and the savings is matched, dollar for dollar, when the loan is paid off—hence, “borrow and save.” Borrowers must be employed, have direct deposit, and have income at or below 80% of the area median income. Financial education is required.<sup>143</sup>

In the first 18 months of the program, credit standards were more relaxed and financial education was required, but only after the loan had been funded. With 20% of the loans late 90 days or more, the program made some changes that cut the late payment rate in half. Borrowers must complete the financial education course before receiving the loan; and the program examines credit reports and will not lend to people with past due accounts, judgments against them, or those in bankruptcy.<sup>144</sup> In November 2010, Neighborhood Housing Services announced an expansion of the program to all residents of Baltimore who met the program’s qualifications.

As of April 2011, the program has made 107 loans, with a 10% default rate. Plans are in the works to expand the program to the county surrounding Baltimore.<sup>145</sup>

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## Consumer Finance Companies

Consumer finance companies have been around for decades, focused on lending to lower-income families and the subprime market. In a recent *Huffington Post* opinion piece, Bill Himpler, the executive vice-president of The American Financial Services Association, a national trade association for consumer finance companies, described his members' businesses as providing an important alternative to payday loans. "In fact, the consumer finance company micro lending model has been around and working quite successfully for more than 100 years. A staple of consumer credit, the personal installment loan is available in thousands of finance company branches across the country."<sup>146</sup>

An interesting feature of the Texas market is that many consumer finance companies continue to operate under the state consumer loan licensing structure (Chapter 342 of the Texas Finance Code), which includes rate and fee caps, despite the wholesale move of payday and auto title loan stores to the CSO model with unlimited fees. Three reasons likely contribute to their continued operation under a more regulated system: 1) The existing consumer lending licensing structure is not a source of constant controversy and has high regulatory certainty; 2) The fee and rate caps offer sufficient flexibility to operate a profitable business; and 3) consumer finance companies are direct lenders and would need to change their business model to become loan brokers and find third-party lenders who will offer credit to their customers.

Though they generally offer loans that are far less costly than a payday or auto title loan, not all consumer finance companies engage in positive lending practices. Some have encouraged borrowers to continually roll over installment loans and to borrow more to keep the cycle of debt going. In testimony before the Texas House Pensions, Investments, and Financial Institutions Committee in March 2011, a pastor produced a list of companies targeting clients of the Texas Department of Mental Health and Mental Retardation (MHMR) as potential borrowers and preying on adults with the mental capacity of children.<sup>147</sup> Every company on the list was a licensed consumer finance company in Texas.

However, these companies can offer a reasonable alternative for consumers. A survey by the Center for Community Capital, in North Carolina, found that consumers in that state gave the highest satisfaction ranking to finance company loans.<sup>148</sup> In Texas, consumer finance companies have rate and fee caps that average between 60% and 100% APR, with an obligation to "consider, in determining the size, duration, and schedule of installments of a loan, the financial ability of the borrower to repay the loan. The lender should evaluate whether the borrower should be reasonably able to repay the loan in cash in the time and means provided in the loan contract and repay all other known obligations concurrently."<sup>149</sup> This standard provides an opportunity to offer a better loan product.

In fact, some companies are using the consumer finance company model to offer low-cost small-dollar consumer loans:

- **Progreso Financiero** began lending in California in 2006 to provide access to credit and the opportunity to build a credit score for Latino immigrants. Progreso has an expanding presence in the Texas market and is profiled in detail in the following section.

Progreso has made over \$210 million in loans.

- **Community Loan Center**, a recently created consumer finance company in Brownsville, Texas, focuses on providing loans, through an Internet interface to employees of partner businesses. It is also profiled in the following section.

### **New Lending Approaches**

Online lending is not new. High-cost online payday lending is an expanding business. There are also many online resources to access home mortgage and home equity loans. Many of the more affordable online loan options are for higher dollar loans (\$1,500 and up) and require higher credit scores.<sup>150</sup> But, there are online options offering small loans at affordable rates. Two initiatives cited above, the Community Loan Center and Emerge Workplace Solutions, use the Internet to reach their customers. Another initiative, launched two years ago, is a company called BillFloat. BillFloat specializes in very small loans, of \$225 or less, and for a very specific purpose, paying bills—cable, insurance, utility, phone, and cell phone are among the options.

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#### **BillFloat**<sup>151</sup>

BillFloat has relationships with approximately 2,500 companies to provide their customers with bill payment services. Potential borrowers fill out an online questionnaire that includes name, address, phone number, birth date, social security number, and either a checking account or debit card account number. Based on this information, and information about the bill and amount to be advanced, BillFloat conducts an alternative credit assessment that looks at bill payment history, income, obligations, and expenses to determine if the borrower can afford the loan.<sup>152</sup> Borrowers have between 30 and 60 days to repay the loan. According to the company CEO, 97% of borrowers have repaid the loans and do not need to borrow again the following month.<sup>153</sup>

The loan is offered at a 36% interest rate, with bill payment fees ranging from \$4.99 to \$14.99. As an example, a \$94 telephone bill includes a \$2.35 interest charge and an \$11 bill payment fee. The total owed in 30 days is \$107.35. A payday loan in Texas for a similar amount would cost, on average, \$37.60 in fees for 28 days—more than twice as much. The small loan amounts and distinct nature of the service—limited to direct payment of bills coupled with low rates of re-borrowing—makes this product an interesting alternative to a high-cost payday or auto title loan.

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## Promoting Emergency Savings and Credit Builder Loans

Loans are not the only way to approach creating affordable alternatives to high-cost payday and auto title loans. Another approach is to look at the source of the demand—low savings and poor credit—and to address those underlying issues.

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*“It’s hard to get people to put something away for a rainy day when it’s always raining.”*

—Audrey Cerise, Former President  
ASI Credit Union, Louisiana<sup>154</sup>

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### Efforts to Build Emergency Savings

Building emergency savings is not easy, particularly for lower-income families who spend most of their resources on basic living expenses. Though the economic downturn has led to higher savings rates among Americans, many families do not have enough savings to weather an emergency or a short period of unemployment.

The Consumer Federation of America has found that “those with less than \$500 in emergency funds are often more than twice as likely to experience financial and psychological problems as are those with more than this amount.”<sup>155</sup> A 2010 report from the Urban Institute found that savings of up to \$1,999 had a significant impact on reducing the incidence of financial hardship on low-income families.<sup>156</sup> These studies underscore that savings of between \$500 and \$1,999 can significantly reduce the need of low-income families for small-dollar loans.

There are ongoing national campaigns to encourage savings, including the America Saves campaign launched in 2001 and its related state-based programs, such as Texas Saves.<sup>157</sup> Research is ongoing to identify successful strategies to encourage low-income families to save money, approaches ranging from prize-linked savings incentives, to matched savings, to an opt-out approach, where employers automatically deduct money for savings unless the employee opts out of the program.<sup>158</sup> Research and pilot projects are also targeting tax-time savings. Tax time is the one time every year when many lower-income families have a lump-sum infusion of cash through the Earned Income Tax Credit (EITC).

Opportunity Texas piloted a tax-time U.S. Savings Bond purchase program, with a \$50 match or a gift card. While only a small percentage took advantage of the program—on average 2.1% of the tax filers at participating free tax filing locations, it represents an improvement upon savings rates among filers in the previous tax year.<sup>159</sup> The program generated \$30,000 in new savings among the 265 participants.<sup>160</sup> The tax-time matched savings program, Save NYC, sponsored by the New York City Office of Economic Empowerment, employed different strategies to boost savings rates.

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## **Save NYC<sup>161</sup>**

Launched in 2008, the program offers to match—with a deposit of up to \$250—half of the tax-time savings for free tax center clients in New York City with family incomes of \$45,000 or less. To get the match the participant must maintain savings for a one-year period. In the first year of the program, 6% of eligible people used the program—with 177 participants and an average of \$387 in savings. For the second year of the program, marketing and training were improved, a goal-oriented savings focus was adopted, and the program expanded beyond just recipients of EITC. As a result, participation rates increased to 9%. Changes for the third year—increasing the maximum match amount to \$500 and minimum savings amount to \$200—led to a dramatic increase in total savings, from an average of \$381 the previous year to \$705 with nearly 1,400 participants. Save NYC accounts are opened at one of seven participating financial institutions. Most importantly, 80% of the participants have held their savings for at least a year and received a match.

The success of the program has led to the launch of SaveUSA—to expand the program to other cities. San Antonio participated in the program in the 2011 tax season, with 472 savings accounts opened, amounting to \$267,000 in initial savings deposits. Three-quarters of the participants have maintained their savings to qualify for the matching funds.

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## **Credit Builder Loans**

The 2010 RAISE Texas survey of nonprofit organizations found that 90% of the surveyed organizations identified significant demand for credit builder loans among their clients. Credit builder loans exist in many financial institutions—primarily in the form of secured loans and secured credit cards; however, often they are not marketed, making them more difficult to access. Funds to secure the loans are frequently deposited in a restricted account and can only be withdrawn once the loan is paid in full.

The Credit Builder's Alliance, formed in 2006, allows nonprofit lenders to report payment histories to the major credit bureaus, expanding options for nonprofit clients to build credit. Credit building is an important piece of the small-dollar loan puzzle. With better credit, borrowers will not have to turn to the most expensive loan options in the market.

One example of a credit builder loan offered to nonprofit clients is available through a partnership between the Local Initiatives Support Corporation (LISC) in Chicago and the North Side Community Federal Credit Union.<sup>162</sup> Clients in financial coaching take out a fully secured \$500 loan from the credit union. Their \$500 security is held in a locked savings account. The loan is offered at 16% interest, and the clients pay \$45 monthly in loan payments. For clients who successfully repay the loan, LISC matches every loan payment with a like deposit to the client's savings account. Successful clients see a significant increase in their savings over the loan period in addition to a positive payment history on the loan, which is reported to the credit bureaus by the credit union.

## **Transitioning from Initiatives to a Changed Market**

There are many ongoing efforts across the county to address the need for affordable small-dollar credit, from loan programs, to savings, to credit building. Few of these efforts have reached significant scale, largely due to the limited reach of the organizations that implement them. A credit union with a handful of locations can never reach scale. Large institutions, like the State Employees Credit Union of North Carolina, have reached scale—due to their large footprint and client base. Newer initiatives, like that of Progreso Financiero, are expanding their market reach, but will take time and investment to reach their full potential.

There is clearly no easy solution to reach scale with affordable, small-dollar loan initiatives. Bad products are currently more accessible to desperate consumers than good ones. Reshaping the national small-dollar loan market can seem like an overwhelming task. Starting with a focus on the Texas market could be a first step to reshaping consumer options. Strategic partnerships, market incentives, and investment can effectively promote affordable alternative small-dollar loan products and make them more accessible to consumers.

## PLANTING THE SEEDS FOR AN AFFORDABLE SMALL-DOLLAR LOAN MARKET IN TEXAS

### Profiles of Six Texas Loan Products That Are Making a Difference

In the last few years, businesses and organizations in Texas have started working actively to create affordable alternatives to high-cost payday and auto title loans. Each of the six Texas loan programs profiled here is relatively new to the market. Some are striving for greater scale, or have the potential to reach greater scale due to an already existing large footprint. Others are designed as smaller scale models, but if replicated by others, have potential to reach a broader borrower base, and one that the general market may not otherwise serve.

The six profiled Texas loan programs incorporate many of the different models highlighted in the previous section. They include employer-based models, nonprofit partnerships, financial institution models, and consumer finance companies. Most are “brick and mortar” based, but one program is looking to technology and the Internet as the access point for its product. They do not include discreet savings or credit building initiatives, but focus primarily on lending programs. Credit building is part of each of the small-dollar lending programs profiled, but is not a sole focus. Savings is included in one of the profiled programs, but again, as part of a broader loan program.

Though savings and credit building are important pieces, as described in the previous section, the focus here is on loan programs, as they are the most immediate way to meet short-term credit needs and provide an avenue to compete directly with high-cost payday and auto title loan companies. However, a broader affordable small-dollar lending strategy should incorporate savings and credit building.

The table below provides an overview of the six profiled programs, including the different models utilized and potential for scalability of the program.

## Characteristics of the Profiled Small Dollar Loan Programs

Business	Characteristics					
Progreso Financiero	Finance Company	CDFI	Brick and mortar	For-profit	Locations in large retail stores	Scalable—currently expanding in Texas
Community Loan Center	Finance Company	CDFI	Internet and brick and mortar	For-profit	Employer-based partnership	Scalable—starting in Brownsville, but open to growth in other communities
First Convenience Bank	Bank		Brick and mortar	For-profit	Locations in large retail stores	Scalable—has statewide footprint
Promise Credit Union	Credit Union	Community Development Credit Union	Brick and mortar	Nonprofit	Employer-based partnership	Limited scalability within 14-zip code area
Generations FCU-Goodwill Partnership	Credit Union		Brick and mortar	Nonprofit	Nonprofit partnership; locations in retail Goodwill stores	Scalable to other Goodwill stores, but currently not focused on scale
Family Services of Greater Houston	Nonprofit		Brick and mortar	Nonprofit	Partnership with nonprofit Ways to Work loan fund	Scalable through loan fund partnerships with other direct service nonprofits; requires loan-loss reserve grant funds

These programs and other similar lending initiatives have the potential to change the Texas market. To compete effectively with payday and auto title loans, positive lending programs must expand their reach.

## Progreso Financiero: Consumer Finance Company<sup>163</sup>

(17 Locations throughout Texas)

Progreso Financiero (Progreso), a Community Development Financial Institution (CDFI) and licensed consumer finance company, was established in California in 2005 and issued its first loan in 2006. James Gutiérrez, the founder of Progreso, developed the business concept while a student at Stanford Business School. As the son of immigrants from Mexico living in Southern California, he knew firsthand the financial challenges faced by immigrant communities. Progreso's mission is "to help ... customers build credit in the United States and gain access to better lives and mainstream financial services."<sup>164</sup> Progreso offers small-dollar loans between \$500 and \$2,500.

### Progreso Financiero Texas Loan Product Snapshot

Year of Inception and Number of Loans	First loan made in 2006 in California; opened in Texas in 2010; 195,000 loans across all markets
Target Customers	Underbanked and unbanked Hispanics
Loan Size	\$500 - \$2,500
Loan Term	7 - 18 months
Interest Rate and Fees	Averaging 36% APR; based on amount of loan and customer credit profile; \$10 acquisition fee
Loan Requirements	Borrower must have a valid ID, social security number or Individual Taxpayer Identification Number (ITIN), proof of income, proof of address, and four references that confirm questions asked by lending agent and minimum income of \$1,000 per month; credit score checked as part of underwriting process (no credit score is ok); ultimate credit evaluation is based on assessment of ability to repay and desire to establish credit
Loan Performance	Single digit delinquencies
Financial Education	Financial education is included as part of the loan process; financial counseling is provided at the borrower's initial meeting with the lender and as needed throughout loan repayment; borrowers can get pamphlets on financial education in Spanish or English

Since only 3% of its loan applicants have both sufficient credit history and a high credit score, Progreso designed an alternative credit scoring system that assesses over 1,400 attributes, mostly obtained from its application and non-credit bureau sources, to assess creditworthiness of clients who have thin credit, no credit, or poor credit scores.

Progreso's first Texas offices opened in Houston in 2010. In the past year the company has expanded to Dallas, San Antonio, McAllen, Alamo, Laredo, and Brownsville. Progreso expects to have 20 Texas locations by the end of 2011.

### Progreso Loan Product Details

Progreso provides small, unsecured loans and FDIC-insured accounts linked to a Visa debit card to help its clients establish and build credit at affordable terms. Its core loan product has the following characteristics:

- Fully-amortizing installment loans ranging from \$250 to \$2,500 (\$1,000 on average);
- Six- to 18-month term (11-month average);
- Fixed-rate;
- Bi-weekly or semi-monthly payments with no prepayment penalty;
- All payments reported to credit bureaus;
- Underwriting policies assess borrower's ability to repay the loan; and
- Credit education at the point of disbursement.

Initial customer loans usually range from \$500 to \$1,600. Once a loan is successfully repaid and a positive payment track record is established, the customer may qualify for a larger loan amount, up to \$2,500. The company is willing to work with customers who are late in their payments, including restructuring loans if necessary. Less than 10 percent of the loans go into default.

The loan paperwork clearly lays out repayment terms including how much of the loan principal is retired with each payment and when the loan will be paid in full. Collateral is never posted for a loan.

Progreso requires proof of income, proof of residence, and a valid photo ID. A Social Security number or Individual Taxpayer Identification Number (ITIN) is also required. Credit is checked as part of the loan underwriting, and borrowers must provide four references. Progreso contacts references to verify customer information and character. Currently, customers with no credit can qualify for loans, but generally not those with a substantial negative credit history. Approximately half of those who apply qualify for a loan.

The loan approval process usually takes 24 hours, although it often takes borrowers a few days to assemble all of the appropriate documents to complete the loan process. The funds are provided by check, or deposited on the Ventiva card, a Visa pre-paid card offered by Progreso. Customers who receive funds on the Ventiva card can withdraw money one time at an ATM machine for no charge. Subsequent withdrawals carry fees. Clients with bank accounts can authorize electronic loan repayment through their account. Though use of electronic payments is increasing, most borrowers continue to make in-person cash loan repayments.

Through multiple sales points located inside supermarkets and at stand-alone locations within predominantly Latino communities, Progreso is able to provide a culturally relevant experience.

The company currently operates 53 locations in California and 17 in Texas. Progreso has over 500 employees, many hired from low-income communities.

### Challenges and Successes

Progreso expects to reach profitability in the near future. Reaching scale for Progreso is about expanding its footprint and product offerings.

One challenge Progreso faces in Texas is the lack of a level regulatory playing field that holds all providers of small-dollar loans to the same standards. As long as some lenders operate outside of any meaningful regulation, including operating without interest rate caps, businesses like Progreso will remain at a competitive disadvantage. Enforcing basic standards for affordable credit will encourage more providers to invest in technology, become more efficient, and offer low-cost loan products.

Another key challenge for Progreso is the cost of capital to make loans. Since Progreso is a CDFI, with a mission of serving primarily low- and moderate- income consumers, banks may get Community Reinvestment Act (CRA) credit by lending to Progreso, allowing the company to grow faster with greater access to less expensive capital. Banks and credit unions that currently do not have small-dollar consumer loan products may be able to partner with an institution like Progreso to offer those services without direct exposure to market risk.

Progreso has disbursed more than \$210 million through 195,000 micro loans.

### **Community Loan Center: A Subsidiary of the Rio Grande Valley Multibank CDFI<sup>165</sup> (Brownsville, Texas)**

The Community Loan Center (CLC) is a subsidiary corporation of the Rio Grande Valley (RGV) Multibank Community Development Financial Institution. CLC incorporated on September 1, 2010, in response to the community's expressed need for affordable small-dollar consumer loans. Wendy Hanson, Community Impact Director at United Way of Southern Cameron County, talked to local leaders to better understand what factors were working against the financial health of Brownsville's citizens. She discovered that a large number of people taking advantage of the community's Consumer Credit Counseling Services were struggling to repay payday loan debt. "From there we started looking at the potential the Multibank had in the downturned housing market and how they might be able to diversify their products to help other people in the community."

The RGV Multibank is a for-profit Community Development Financial Institution (CDFI) made up of nine investor banks. It was launched in 1995 as a way to finance affordable housing in the Rio Grande Valley. J.P. Morgan Chase, Wells Fargo Bank, IBC Brownsville, Bank of America, BBVA Compass Bank, IBC McAllen, Frost National Bank, Lone Star National Bank, and the National Community Impact Corporation, Washington, D.C., began developing a small-dollar loan program as an alternative to the high-cost payday and auto title loan businesses

proliferating in South Texas. The United Way of Southern Cameron County and CDC Brownsville worked with the RGV Multibank to develop a model for a sustainable, for-profit business offering small-dollar loans at rates far below the 300% to 500% interest rate offered by payday and auto title lenders.

### **Community Loan Center Product Snapshot**

Year of Inception and Number of Loans	Began offering loans in October 2011; 258 loans in first three months of loan program
Target Customers	Employees of participating businesses
Loan Size	\$300 - \$1,000
Loan Term	1 - 12 months depending on loan amount and borrower preference
Interest Rate and Fees	\$20 administrative fee; 18% interest
Loan Requirements	Must be employed by a participating business for at least three months and have a checking account; loan cannot exceed 50% of monthly income; minimum monthly income of \$900
Loan Performance	New program; no lending record
Financial Education	None required, but financial education and financial counseling referrals offered in the workplace

It took one year to develop the business plan that resulted in the Community Loan Center (CLC). CLC partners with businesses to offer small consumer loans to their employees. Under this employer-based model, the participating business is not required to invest any funds in the loan program, but must be willing to offer the loan program in the workplace.

In 2009, the CDFI Fund awarded a grant to the RGV Multibank to support a loan loss reserve lending capital fund and hire staff to launch the program. After assessing the regulatory environment, RGV Multibank created CLC, a subsidiary, and obtained a Chapter 342 license to make consumer loans in Texas.<sup>166</sup> The license was obtained in July 2011, and CLC made its first loans in October 2011.

The target customer for CLC is an employee of a participating business. The intent of the program is to provide a new choice to people who believe that their only choice for short-term loans is to use a high-cost payday or auto title lender.

Local research found that many low-income families in Brownsville are banked, but do not use banking services beyond basic transaction accounts. Due to credit problems or other barriers, they often cannot access bank loans. An important goal of the CLC loan program is to enable borrowers to improve their credit and establish their eligibility to participate in a full range of mainstream banking services.

## Community Loan Center Product Details

CLC offers loans ranging from \$300 to \$1,000. The loan amount cannot exceed 50% of the borrower's monthly income. The loan term is based on the size of the loan: \$300 loans have a maximum term of three months; \$500 loans, a six-month maximum; \$900 loans, an eight-month maximum; and \$1,000 loans, a 12-month maximum. The loans are offered at 18% interest with a \$20 administrative fee and no pre-payment penalty. The fees and interest translate to a 58% APR for a \$300 loan; 31% APR for a \$500 loan; 24% APR for a \$900 loan; and 21% APR for a \$1,000 loan.

Borrowers must be employed at the participating location for at least three months, be age 18 or older, and have a minimum income of \$900 per month. Valid identification and a social security number are also required. Borrowers must have a checking account, and loan repayments are generally accepted via either ACH authorization or payroll deduction.

Once the loan is approved, the money is deposited in the borrower's account within 24 hours. The first payment is due one month after receiving the loan. A payment is due every time the borrower gets paid—weekly, bi-weekly, or monthly.

The loan is made through a web-based platform that borrowers can access either through their company's human resources department or by using other designated terminals in the workplace. Because of limitations in the web-based platform, it is not possible currently to conduct the entire loan process online. The platform does not accept electronic signatures on final loan documents, for example, but the goal is to eventually move the process completely online. As a licensed consumer lender, CLC must use a web platform approved by the Texas Office of Consumer Credit Commissioner. Currently, there is no approved platform that can accommodate a fully electronic loan process.

Participating employers must allow CLC staff to make loan program and financial education presentations to their employees. CDC Brownsville also offers free financial counseling for employees experiencing financial problems. CLC's Eva Woodfin said the intent is to create long-term relationships with borrowers to help the Center meet its long-range goal of reporting credit.

## Challenges and Successes

CLC faced major challenges in the launching process. "I never guessed how long it would take to make this happen," noted Hanson. After the time spent approving the concept, developing a business plan, and obtaining funding, an additional year was required for the licensing process, largely because of the unique nature of the CLC employer partnership model.

The first challenge was to find a vendor willing to provide the web-based platform for the lending program. Initially, there was no such regulator-approved vendor. Some months into the process, an approved vendor launched a web-based platform that CLC ultimately adopted. The second challenge was ensuring that borrowers had appropriate payment choices, in compliance

with the regulatory and legal standards. With these two issues resolved, CLC was able to complete the licensing process and begin operation.

Because the program is new, it is not possible to evaluate its potential success. Currently, there are five local employer partners. Once there is a positive track record for the program, CLC would like to expand to other businesses, including employers outside of Brownsville. It is a model that could expand to other parts of Texas. Using a web-based platform means that the lender does not need to be physically present in communities where the loans are offered. Once a strong lending track record is established, expansion would be limited only by organizational goals and capacity, employer interest, and capital.

**First Convenience Bank: Smart Cash Loan**

*(231 Texas Locations)*

First Convenience Bank, a division of First National Bank Texas, the oldest Bell County bank, dates back to February 27, 1901. The bank operates 231 banking centers and 360 ATMs across Texas. The bank’s target markets include military communities and customers of major retail locations, including Wal-Mart, Kroger’s, Fiesta, and HEB. First Convenience Bank offers products, hours, and locations tailored to meet the needs of the customers served in these retail centers. Banking centers are open seven days a week, with extended hours to 7 p.m. six days a week.

**Smart Cash Loan Product Snapshot**

Year of Inception and Number of Loans	November 2010; no information available
Target Customers	Customers at retail locations
Loan Size	\$200 to \$1,000
Loan Term	10 – 15 months depending on loan amount and borrower preference
Interest Rate and Fees	Between 14% and 23% APR, depending on term and loan amount; loans are offered at 12% simple interest; \$10-\$15 administrative fee, depending on loan term
Loan Requirements	Documentation of income; employment for the previous six-month period; identification information—name, address, social security number
Loan Performance	No information available
Financial Education	Borrowers are given a banking basics course, which is provided in hard copy and online; course covers a number of topics, including how to use and successfully manage a bank account

The Smart Cash Loan program was launched in November 2010. The bank developed the program as a way to better address existing customer needs and to strengthen customer retention. It is modeled after the FDIC small-dollar loan template, which allows for a maximum annual percentage rate of 36%. The Smart Cash Loan program charges a 12% interest rate plus a small administrative fee.

The program is marketed through in-branch countertop advertising; the bank website, where Smart Cash is listed under loan options; through the tellers; and by word of mouth. Other marketing avenues include community partnerships and community outreach initiatives. First Convenience Bank is a partner in the Bank On Dallas and Bank On Houston initiatives as well as other community outreach efforts across Texas.<sup>167</sup>

### Smart Cash Loan Product Details

The Smart Cash Loan provides access to loans of \$200 to \$1,000. Borrowers can choose a 10-month, 12-month, or 15-month repayment term. Payments for the Smart Cash Loan are due monthly, and borrowers can choose the payment due date.

The loan is fully amortizing and carries an interest rate of 12%. The loan interest does not change based on credit history. Everyone who qualifies for the loan receives the same interest rate. Loan fees are between \$10 and \$15 depending on the loan term—and the loan carries no prepayment penalty. Borrowers can repay the loan with an auto debit option or they can come into the branch and make payments.

Borrowers are required to have an account at the bank. Customers can apply for the loan either online or at a branch location.

Loan requirements include documentation of income, employment for the previous six-month period, and identification information (name, address, social security number). Most loans are processed and funded within 24 hours.

Loan applicants are provided with a banking basics financial education program, which is available in hard copy or online. The curriculum provides information on account basics, such as how to write a check and keep a balance register, information on Automated Clearing House (ACH) transactions, how to read bank statements, and tips to successfully manage an account and avoid unnecessary fee charges.

### Challenges and Successes

Customers may not always think to go to the bank when they need access to a small loan. Jessica Pelache, Director of Customer Experience, observed, “Banks haven’t been seen, historically, as that convenient alternative. Our opportunity is to recognize the need and proactively offer the product.”

The biggest challenge is figuring out how to help people with bad credit. The loan can be used to build credit, but it is not designed to be a credit re-builder.

For First Convenience Bank, the Smart Cash Loan is still relatively new—and the bank is monitoring the loan program to see how it performs and where it can be improved. There has been steady customer demand for the loan both among military customers and among customers at the bank’s retail store locations. The bank believes a small-dollar loan program is helping to better serve customer needs.

### **Promise Credit Union: PAL, PAL Plus, and Auto Title Loans<sup>168</sup>**

*(Houston, Texas)*

Promise Credit Union is a community development credit union (CDCU) sponsored by Neighborhood Centers Inc., a long-standing Houston nonprofit organization founded in 1907. Promise Credit Union was founded in late 2008 and opened officially in February 2009 to help individuals establish credit, build savings, access affordable loan products, and become financially independent. It was established in response to calls from community members for accessible and reasonably-priced financial services options. “There is a large underbanked and immigrant population in the Gulfton-Sharpstown area, largely Hispanic families. Our goal is to bring them into the financial mainstream so they don’t get taken advantage of,” said Promise Credit Union CEO Randy Martinez.

Promise Credit Union is housed in the Baker-Ripley Neighborhood Center, a large complex that includes a charter school, neighborhood tax center, and other community-based educational programs and activities.

To qualify for membership in the credit union, individuals must live, work, worship, or attend school in a 14-zip code area. Promise Credit Union offers its members free checking accounts with debit cards and savings accounts. It also provides check cashing services with no fees, car loans, citizenship loans, certificates of deposit, and payroll advance loans. Promise Credit Union has approximately 2,400 members, \$2 million in assets, and a \$1.5 million loan portfolio consisting primarily of used car loans.

Promise Credit Union began offering its Payroll Advance Loan (PAL) approximately four to six months after opening. In 2011, the credit union began offering a second payroll advance option with a savings component, the PAL Plus loan program. The feasibility study conducted prior to the opening of the credit union indicated that approximately 55% of the target population was unbanked. The study also found a large and growing number of payday lenders, pawnshops, and auto title loan storefronts in the target community.

Most borrowers using the credit union’s small-dollar loan program are Neighborhood Centers Inc. employees. The credit union sees partnerships with employers as a top strategy for expanding its PAL program to a broader customer base. Auto title loans are its latest loan product to compete with high-cost lenders in the community and are available to the broader credit union membership.

### PAL, PAL Plus and Auto Title Product Snapshot

Year of Inception and Number of Loans	PAL first launched in 2009; PAL Plus and Auto Title, in 2011; over 400 loans to date
Target Customers	Gulfton-Sharpstown neighborhood residents and Neighborhood Centers Inc. employees
Loan Size	<u>PAL</u> : up to \$1,000 <u>PAL Plus</u> : up to \$1,000 <u>Auto Title</u> : up to \$3,000
Loan Term	<u>PAL</u> : 10-month <u>PAL Plus</u> : 7-month <u>Auto Title</u> : 12-month
Interest Rate and Fees	<u>PAL</u> : 10% interest; \$75 fee; 27.69% APR <u>PAL Plus</u> : 10% interest; \$75 fee; 34.26% APR <u>Auto Title</u> : 18% interest; \$100 fee; 24% APR
Credit Evaluation	<u>PAL</u> : 2 years employment; monthly income of at least \$2,500 for \$1,000 loan, less for smaller amounts; minimum \$200 monthly direct deposit into account at Promise Credit Union <u>PAL Plus</u> : Six month employment; otherwise same as PAL <u>Auto Title</u> : Clear title; credit check and vehicle inspection loan for up to 70% of vehicle value
Loan Performance	Programs are still relatively new; less than 5% delinquency on loans to date
Financial Education	Financial education is not required; one-on-one financial education is often provided as part of the loan process

#### PAL, PAL Plus and Auto Title Loan Product Details

Promise Credit Union currently offers PAL and PAL Plus loans to employees of Neighborhood Centers Inc. and is exploring partnerships with other employers in its service area.

The credit union offers a simplified application process. Similar to a payday lender, Promise Credit Union does not ask its customers why they want to obtain the loans. The turnaround for all loans is one business day; loans are deposited directly into the member's account.

The PAL loan has a 10-month term and requires two years of employment. The PAL Plus loan currently has a 7-month term and requires six months of employment, but the credit union may extend the term in the future. Both loans are offered at 10% interest. The PAL Plus loan has an added savings feature that will create \$300 in savings for the borrower.

The annual percentage rates on the loans, including all fee charges, range from 20% to 47%, depending on the amount and term of the loan. Both loans require a minimum direct deposit of \$200 into an account at the credit union every month; the loan repayments are generally due twice per month, to coincide with borrower's payday. A member is allowed to have only one PAL or PAL Plus loan outstanding at any time.

The credit union does not use credit scores for the PAL loans. Debt-to-income ratios are used to ensure that the borrower can afford to make the loan payments. Though financial education is not required for the loans, the credit union provides one-on-one assistance as part of the loan process, answering questions and providing budgeting help and other relevant information.

The auto title loan is very new. It allows customers to borrow larger amounts of money, up to \$3,000 for a 12-month term. For this product, both a credit score and the borrower debt-to-income ratio are considered. The borrower is also required to have a clear title to the vehicle. The auto title loan is offered at annual percentage rates between 24% and 37% for loan amounts from \$1,000 to \$3,000. The rate includes an 18% interest rate and a \$100 loan fee.

Promise Credit Union relies primarily on direct email to market the loans to customers. The credit union also relies heavily on word-of-mouth advertising and makes community presentations to highlight its products and services. Using more traditional marketing strategies, such as door hangers, to advertise the credit union's loan products has not been successful.

### Challenges and Successes

The key challenge for the credit union is to expand the lending programs while minimizing losses. Because its small-dollar loan products are not yet self-sustaining, the credit union is limited in the amount of risk it is able to assume.

Marketing is another challenge. The credit union does not have a large marketing budget to reach the entire community and develop the same name recognition as the higher-cost lending options in the community. Promise Credit Union believes that it will need a solid marketing program to effectively reach the broader community.

Expanding Promise Credit Union's small-dollar loan products depends on its success in forging partnerships with other employers, including nonprofit organizations. At issue will be managing the credit union's loan loss reserve, perhaps by partnering with organizations that could invest loan loss reserve funds into the credit union.

The strength of Promise Credit Union's program is the products themselves. The credit union employees see firsthand the positive difference their affordable loan products are making for community members.

**Generations Federal Credit Union Partnership with Goodwill Industries:  
*MoneyExpress*<sup>169</sup> (San Antonio, Texas)**

Goodwill Industries and Generations Federal Credit Union (GFCU) are fixtures in the San Antonio community. GFCU was founded during the depression (1940) by city employees. GFCU has a long history of serving the San Antonio community and advocating for its citizens. “People helping people” is part of the credit union charter. Founded in 1945, Goodwill Industries currently has 16 retail stores and nine job help centers in San Antonio, with an operating budget of \$48 million, mostly generated through sales at the retail store locations.

Recognizing the detrimental impact of high-cost and predatory financial services on its clients and customers, Goodwill approached local banks and credit unions in 2006 about offering alternative loan products.

**MoneyExpress Product Snapshot**

Year of Inception and Number of Loans	Launched in 2008; consistent volume of approximately 50 outstanding loans at any given time; hundreds of loans over the life of the program
Target Customers	Unbanked and under-served customers, clients, and employees of Goodwill Industries
Loan Size	\$200 - \$1,000
Loan Term	Traditional loans average 3 to 12 months depending on loan amount and borrower preference
Interest Rate and Fees	18% interest; no application fees
Loan Requirements	Must have an account relationship with the credit union for at least 45 days
Loan Performance	Few defaults
Financial Education	Though not required, borrowers are encouraged to take a four-part financial education training offered at Goodwill locations; training includes setting financial goals, saving, credit repair, and responsible borrowing; free access to a phone-based financial counseling service for customers with specific credit or other financial issues

“We were looking for someone who would actually work with the unbanked and under-served individual. We wanted a bank that truly understood our mission and was willing to help people get out of a bind and rebuild their credit,” said Tammy Deininger, Director of People Services with Goodwill Industries in San Antonio. Only two financial institutions responded, and only Generations Federal Credit Union was willing to work with Goodwill to serve the distinct needs of their clients, customers, and staff, she said.

The *MoneyExpress* loan program grew out of that partnership. GFCU has branch locations in two Goodwill stores and has designed a relationship-based approach to meet the financial services needs of Goodwill customers.

“Our model is not to be another payday lending shop, but to be a credit union first,” said Bonnie Garcia, Director of Business Development for GFCU. “We want every person who comes in to see if they can qualify for a traditional loan product before we refer them to this alternative. We see *MoneyExpress* as an alternative to the regular loan.”

The product is designed to help people avoid expensive payday loan debt. A *MoneyExpress* loan can be used to either pay off outstanding payday loans or as a bridge loan to get through life’s emergencies. Borrowers must be members of the credit union for at least 45 days before they can qualify for a *MoneyExpress* loan. Only borrowers who cannot qualify for a traditional credit union loan product are offered the *MoneyExpress* loan. The loan can be used two times per year.

*MoneyExpress* is not actively marketed—rather, it is viewed as a tool the credit union can use to best meet customer needs. It is offered to individuals who come to GFCU looking for help with emergency or other short-term cash needs. GFCU staff members are briefed on the various assistance programs offered by Goodwill. If an applicant requests a loan to pay a large utility bill, it may be more appropriate for the credit union staff make a referral to the Goodwill utility assistance program.

More broadly, the Goodwill partnership with Generations Federal Credit Union is marketed through an ambassador’s program. Goodwill employees are trained to share information and explain the benefits of Generations membership to their clients and customers. The ambassador program has been successful in raising customer and employee awareness of the credit union’s products and services.

### *MoneyExpress* Loan Product Details

The *MoneyExpress* Loan ranges in size from \$200 to \$1,000. Depending on the amount of the loan and the borrower’s circumstances, the loan repayment term is from three to 12 months. Longer term loans are more beneficial to borrowers who are striving to improve credit scores.

The loan is offered at 18% interest with no fees. Borrowers must provide income, address, and identification as part of the loan application. In addition to a minimum 45-day history of active transactions with the credit union, borrowers must have some funds directly deposited into their account. The credit union also runs a credit report and takes the credit score into account in deciding whether to authorize a loan. Most loans are processed and funded within 24 hours.

The credit union encourages borrowers to deposit savings that they otherwise would have paid in high fees to payday lenders, into a savings account for future emergencies. The goal is to meet customers’ immediate loan needs, help them avoid the financial drain of payday and auto

title loan debt, and help them build credit and savings so that they can qualify for the credit union's conventional loan products in the future.

There is currently no financial education requirement to obtain a loan, but the credit union is considering one if completion can be verified easily. Generations offers four financial education classes at Goodwill locations. The topics covered include: financial goal setting, savings and budgeting, credit review and repair, and responsible borrowing. All credit union members and Goodwill customers and employees are encouraged to attend these financial education classes.

### Challenges and Successes

The *MoneyExpress* loan program's initial challenge was to develop appropriate loan underwriting processes. The credit union originally offered the loan more broadly at the Goodwill store locations. Program staff found that, without a relationship with the credit union, loan defaults increased. The credit union then required a 45-day banking relationship and the direct deposit of all or part of monthly income into the borrower's account. These two changes have led to a sustainable loan program with minimal defaults.

The program is not designed to be profitable as a stand-alone product. Instead, it is viewed as part of a broader relationship building process with the customer and as part of the mission of the credit union to meet the needs of under-served populations. Goodwill and Generations are working together to change people's lives through an integrated set of services, of which financial services is just one piece.

As Tammy Deininger described it, "We have a very large ex-offender's population—nonviolent felonies. Almost every one of them who went to Generations got an account opened. Now they are banked. They feel so proud because they are now beginning a new chapter in their life and now truly feel like the banks didn't just see them as a person with a felony conviction."

Goodwill and Generations have served more than 1,200 families through their partnership—integrating them into the financial mainstream. Though there are currently no plans to expand the *MoneyExpress* program, the Credit Union will continue to offer this small-dollar loan as an attractive alternative to incurring high cost payday and auto title loan debt and as a stepping stone to a stable financial future.

## Family Services of Greater Houston and Ways to Work Partnership

### Bridge Loan<sup>170</sup> (Houston, Texas)

Founded in 1904, Family Services of Greater Houston is a nonprofit organization that provides mental health counseling, case management, parent education, and financial education services to low-income Houston families. Today, Family Services has seven locations in Harris, Montgomery, Waller, and Fort Bend counties and provides services to more than 40 schools and 18 community locations in the greater Houston area.

#### Bridge Loan Product Snapshot

Year of Inception and Number of Loans	March 2010; approximately 100 loans
Target Customers	Harris County residents with at least 1 child and earning less than 80% of area median income
Loan Size	\$300, \$500, or \$800
Loan Term	3 months
Interest Rate and Fees	8%; no fees
Loan Requirements	Must be employed at least 6 months; have bank account with payment history; provide bank statements, utility bills, paycheck stubs, sources of government income and a budget; credit check and review of credit score also conducted; must demonstrate ability to repay the loan; must provide 3 postdated checks for payment to Family Services, which makes the loan payments monthly to Ways to Work
Loan Performance	Under 12% default rate
Financial Education	Must participate in the financial coaching program

In 2008, Family Services began providing financial coaching and education. Also in 2008, Family Services partnered with the national Ways to Work organization to offer clients low-cost auto purchase loans.<sup>171</sup> Ways to Work provides the loan capital and Family Services guarantees the loan with a loan loss reserve fund to repay Ways to Work if a borrower defaults. Richard Simonds, Program Manager of Financial Support Services for Family Services of Greater Houston, observed, “We were seeing that a lot of our clients coming in for both the car loans and financial coaching were running into a lot of issues with payday loans. The accessibility of small-dollar affordable credit was lacking.”

In March 2010, in response to unmet client needs, Family Services and Ways to Work launched the Bridge Loan, an affordable small-dollar consumer loan product. The Bridge Loan is a low-cost loan designed to meet a family’s short-term credit needs. Like the Ways to Work car loan, if the borrower defaults, Family Services is responsible for paying off the loan. Family Services maintains a loan loss reserve to guarantee its obligations.

Individuals earning less than 80% of the area median income for their particular geographic area make up the target population for the Bridge Loan. In Harris County, families with incomes of \$32,000 or less will qualify if they have at least one dependent.

### Bridge Loan Product Details

Family Services offers a standardized loan product through Ways to Work. The Bridge Loan is a simple interest, short duration loan with three loan amounts offered: \$300, \$500, and \$800. All options have the same 8% interest rate and the same terms and conditions, including a fixed repayment period of three months. The loan is serviced by Ways to Work, which provides and processes the required documentation.

In order to qualify for the loan program, individuals must be continuously employed for a six-month period, have a bank account in good standing, and a dependent child. Loans will only be extended to those whose cash flow can be clearly understood and who demonstrate the ability to repay the loan. Approximately half of the applicants are approved for loans.

### Challenges and Successes

The single greatest challenge to the program is funding. Family Services maintains a loan loss reserve of approximately 25% of the value of the outstanding loans. The loan fund currently has a default rate of less than 12%.

The loan loss reserve is funded exclusively through grants. Therefore, in order to expand the number of outstanding loans, a further infusion of capital is necessary to maintain the loan loss reserve ratio. Donors often are not interested in funding loan loss reserves.

Family Service's greatest success is its customer education programs. Customers that participate in the financial coaching sessions leave with a better understanding of their finances and how to maintain a balanced budget. Family Services also considers the Bridge Loan program a true community service, because it offers low-cost funding to help people weather difficult times in their lives.



## CONCLUSION:

### Reshaping the Future of Small-Dollar Lending in Texas

An important part of reshaping the future of small-dollar lending in Texas is supporting market incentives and enforcing fair standards for businesses offering responsible small-dollar loan products. The new licensing law for credit services organization, passed by the Texas Legislature in 2011, is a small step in the right direction, but does not address the core problems with the high cost and the structure of the loans.

For the past six years, Texas has effectively encouraged the expansion of high-cost payday and auto title lending across the state by allowing these companies to operate as unregulated “credit service organizations.” By operating outside of any meaningful state regulatory framework, these firms have saved millions in lower operating costs and charged fees that are *many times higher* than those allowable under the state’s consumer lending laws. This double standard undermines the free market and hurts low-income consumers.

### Recommendations to Support and Expand Affordable Small-Dollar Loan Choices

The following recommendations were developed through meetings and conversations with directors and key staff members of the small-dollar loan programs profiled in this report, and other businesses and organizations working on affordable small-dollar loan alternatives in Texas.<sup>172</sup>

- 1. Texas needs basic standards for affordable credit to support fair competition in the small-dollar lending market. State regulations for providers of consumer loans [Texas Finance Code, Ch.342 (E) and (F)] should be applied market-wide—to include high-cost payday and auto title loan businesses.**

Texas has a long tradition of established protections against usurious lending. The Texas Constitution includes a 10% cap on interest rates and specifies that the legislature must adopt laws to enable lending above the 10% cap. Adam Smith, the father of the free market, said fair market standards are needed “to prevent the extortion of usury.”

Chapter 342 (E) and (F) of the Texas Finance Code was adopted by the Texas Legislature to govern consumer lending within this state. They include rate and fee caps and protections for borrowers to ensure a fair market for both businesses and borrowers. Currently, there are over 1,700 lending locations licensed under this chapter of the Texas Finance Code, including two of the lending models profiled in this report. It is a lending model that is profitable and has been successful in Texas for decades.

Instead of rewarding businesses that pursue strategies to evade state usury laws, through the credit services organization (CSO) model or other schemes, the state should stand behind its usury laws.

**2. Texas banks and credit unions should consider investing in positive lending models to promote the availability of affordable small-dollar loans in Texas.**

Access to lending capital is an essential component of any affordable small-dollar loan program. Banks may obtain Community Reinvestment Act (CRA) credit for investing in Community Development Financial Institutions (CDFIs) that offer affordable small-dollar loans.

**3. Explore affordable small-dollar loan products offered by or in partnership with nonprofits as a strategy to serve consumers who, otherwise, may fall through the cracks.**

Nonprofits in Texas and other states have been exploring scalable models to meet the needs of their clients for small-dollar loans. These include nonprofit loan pools that nonprofits can access to provide credit to their clients; lending initiatives tied to employers; and partnerships with financial institutions where nonprofits provide loan guarantees to support lending to their clients. Developing and expanding initiatives such as these would meet an important market need in Texas for affordable loans and allow families to build a credit history to support future financial stability.

Foundations could invest in affordable loan programs as part of their program-related investment (PRI) strategies. Expanding access to capital will support growth of positive and successful market options.

**4. Texas would benefit from enhanced outreach and education about affordable small-dollar lending that targets both financial institutions and consumers.**

The FDIC, Texas Credit Union League, and others have engaged in education about successful models and strategies for offering affordable small-dollar loans, but there is a need for more alternatives. City and state governments should consider outreach to local financial institutions to explore successful models to provide affordable small-dollar loans to public and private sector employees.

Consumers could also benefit from education about affordable options and the dangers of high-cost, short-term loans. As a result of the high market saturation of storefront and

online payday and auto title lenders, and their plentiful advertising, consumers often do not consider other credit options when a need arises. One study also indicates that consumers do not accurately compare the cost of payday and auto title loans to other credit options, including credit cards. It is important to inform consumers about affordable credit options and the predatory features of payday and auto title loans that often lead to a cycle of debt.

Texas is at a crossroads in its regulatory approach to small-dollar lending. The prevalence of predatory payday and auto title loan products has drained wealth from our most vulnerable families. Texas can and must do better—by supporting policies and products that comply with usury laws and revive the standards of fair and affordable credit for all Texans.

## END NOTES

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<sup>1</sup>TEXAS FAITH FOR FAIR LENDING AND 500% INTEREST IS WRONG, *The Case for Payday and Auto Title Loan Reform*, (January 2011) at 16.

<sup>2</sup>Forrest Wilder, Texas Appleseed, and Workhorse Digital, “Mapping Payday Locations in Texas,” TEXAS OBSERVER (March 9, 2011), *available at*: <http://www.texasobserver.org/cover-story/taking-an-interest>.

<sup>3</sup>TEXAS APPLESEED AND LBJ SCHOOL OF PUBLIC AFFAIRS, analysis of April 2010 CSO registration data from the Texas Secretary of State.

<sup>4</sup>Uriah King and Leslie Parrish, *Payday Loan, Inc.: Short on Credit, Long on Debt*, CENTER FOR RESPONSIBLE LENDING, (March 31, 2011) at 1.

<sup>5</sup>TENNESSEE DEPARTMENT OF FINANCIAL INSTITUTIONS, *The 2010 Report on the Title Pledge Industry*, (March 2010) at 6-8.

<sup>6</sup>TEXAS FAITH FOR FAIR LENDING AND 500% INTEREST IS WRONG, *supra* note 1, at 1.

<sup>7</sup>*Id.* at 10.

<sup>8</sup>TEXAS CATHOLIC CONFERENCE AND THE CENTER FOR HEALTH AND SOCIAL POLICY, LBJ SCHOOL OF PUBLIC AFFAIRS, *2010 Catholic Charities Survey on Payday and Auto Title Loan Use*, (February 2011).

<sup>9</sup>WORKING PARTNER AND CLCG ENTERPRISE, *THRIVE: Year Three Evaluation Report*, (August 2011).

<sup>10</sup>See Appendix A for more detailed information regarding regulated lending in Texas.

<sup>11</sup>Ch 393.001, TEXAS FINANCE CODE.

<sup>12</sup>See Appendix B to learn how standards for payday and auto title loans in Texas compare to other states.

<sup>13</sup>Texas State Representative Tom Craddick, Statement before the Texas House Committee on Pensions and Investments, (March 22, 2011).

<sup>14</sup>Timothy Tutt, Senior Pastor at United Christian Church in Austin, Texas, testified before the Austin City Council on August 18, 2011 that a local Cash America store had distributed fliers advertising payday loans to every teacher’s mailbox in a Pflugerville school, even as Texas schools were announcing major teacher layoffs due to budget shortfalls.

<sup>15</sup>ADVANCE AMERICA, *Advance America 2009 Annual Report*, (March 2010) at 3.

<sup>16</sup>FINRA INVESTOR EDUCATION FOUNDATION, *U.S. Financial Capability Study*, (November 2010), *available at*: <http://www.usfinancialcapability.org/pdfs/Texas.pdf>. The Texas data in this survey is based on a 2009 survey of a sample of 500 Texans. The results are weighted based on Census data to reflect the population of Texas.

<sup>17</sup>*Id.*

<sup>18</sup>As defined in by the U.S. Census Bureau, Texas belongs to the West South Central region, which also includes Oklahoma, Arkansas, and Louisiana.

<sup>19</sup>TEXAS APPLESEED, *Short-term Credit, Long-Term Debt*, (2009) at 15.

<sup>20</sup>*Id.*

<sup>21</sup>Texas Appleseed analysis of 2009 survey data from *U.S. Financial Capability Study*. See FINRA INVESTOR EDUCATION FOUNDATION, *supra* note 16.

<sup>22</sup>The *U.S. Financial Capability Study* data breaks out ethnicity into white and non-white only.

<sup>23</sup>TEXAS APPLESEED analysis of *U.S. Financial Capability Study* data, *supra* note 21.

<sup>24</sup>*Id.*

<sup>25</sup>AARP PUBLIC POLICY INSTITUTE, *A Portrait of Older Underbanked and Unbanked Consumers: Findings from a National Survey*, (September 2010) at 57.

<sup>26</sup>TEXAS FAITH FOR FAIR LENDING AND 500% INTEREST IS WRONG, *supra* note 1, at 10.

<sup>27</sup>ADVANCE AMERICA, *supra* note 15.

<sup>28</sup>Gregory Elliehausen, *An Analysis of Consumer’ Use of Payday Loans*, GEORGE WASHINGTON UNIVERSITY FINANCIAL SERVICES RESEARCH PROGRAM MONOGRAPH, (January 2009) at 27.

<sup>29</sup>*Id.*

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<sup>30</sup> TEXAS APPLESEED analysis of *U.S. Financial Capability Study* data, *supra* note 21.

<sup>31</sup> *Id.*

<sup>32</sup> LENDING TREE, *How Bad Credit Affects You*, available at: <http://www.lendingtree.com/credit-resources/advice/understanding-credit/how-bad-credit-affects-you/> (last viewed August 20, 2011).

<sup>33</sup> TEXAS APPLESEED analysis of *U.S. Financial Capability Study* data, *supra* note 21. This finding is consistent with other national data available. See Elliehausen, *supra* note 28, at 39. The Texas Census Division includes Texas, Oklahoma, Arkansas, and Louisiana.

<sup>34</sup> *Id.*

<sup>35</sup> Elliehausen, *supra* note 28, at 29.

<sup>36</sup> *Id.* at 29-30.

<sup>37</sup> *Id.* at 3.

<sup>38</sup> FDIC, *FDIC National Survey of Unbanked and Underbanked Households*, (December 2009) at 42.

<sup>39</sup> *Id.* The total assumes that medical expenses, car repairs, and home repairs are “emergency” needs. We further assume that the household taking out the loan did so for the explicit purpose designated (i.e., for basic living expenses), and not for a monetary shortfall caused by some other expenditure (i.e., because the borrower paid for medical expenses, they didn’t have enough money to pay for their basic living expenses).

<sup>40</sup> TEXAS APPLESEED, *supra* note 19, at 9.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* The 2009 George Washington University Financial Service Research Program report had somewhat different findings. The survey found that 71% of payday borrowers agreed strongly with the statement that their most recent payday loan was taken out because they had “an unexpected expense that could not be delayed.” Though this finding would seem to emphasize that emergency was the strongest motivator, 47% agreed strongly with the statement that they “knew the expense was coming but did not have cash when the expense was due.” These responses reflect the pressure on financially pressed borrowers to decide which bill to pay *first*.

<sup>43</sup> TEXAS APPLESEED, *supra* note 19, at 10.

<sup>44</sup> *Id.*

<sup>45</sup> Elliehausen, *supra* note 28, at 39-40.

<sup>46</sup> FDIC, *supra* note 38, at 43.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> Elliehausen, *supra* note 28, at 39.

<sup>50</sup> *Id.* at 41.

<sup>51</sup> *Id.* at 42.

<sup>52</sup> TEXAS APPLESEED, *supra* note 19, at 11.

<sup>53</sup> TEXAS CATHOLIC CONFERENCE AND THE CENTER FOR HEALTH AND SOCIAL POLICY, LBJ SCHOOL OF PUBLIC AFFAIRS, *supra* note 8.

<sup>54</sup> *Id.*

<sup>55</sup> RAISE TEXAS, *RAISE Texas Survey* (2010), Unpublished.

<sup>56</sup> Sheila Bair, who recently stepped down as chairman of the FDIC, has been a national leader in promoting alternatives to high-cost payday and auto title loans. Before becoming chairman of the FDIC, she authored a report in 2005 that documents opportunities and barriers to bank and credit union payday loan alternatives. In 2008, she oversaw an important FDIC small-dollar loan pilot to demonstrate that banks of all sizes could offer small-dollar loans safely and at a profit. See: Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles*, ANNIE E. CASEY FOUNDATION (June, 2005), available at: <http://www.aecf.org/upload/publicationfiles/fes3622h334.pdf>; and *A Template for Success: The FDIC’s Small-Dollar Loan Pilot Program*, FDIC QUARTERLY vol 42 (2010), available at: [http://www.fdic.gov/bank/analytical/quarterly/2010\\_vol4\\_2/FDIC\\_Quarterly\\_Vol4No2\\_SmallDollar.pdf](http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf).

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<sup>57</sup> Robert Mooney, FDIC Deputy Director Consumer Protection and Community Affairs, noted in written testimony submitted on September 22, 2011, to the House Committee on Financial Services, “A generation or so ago, it was common for banks to make small, unsecured loans to individuals,” *available at*: <http://financialservices.house.gov/UploadedFiles/092211mooney.pdf>. Though also the subject of some controversy tied to high rates and loan rollovers, finance companies are required to comply with rate and fee caps that were established in Texas to accommodate the higher risk associated with the subprime market. Today, there are over 1,700 licensed consumer finance company locations in Texas, a sizable number, but many fewer than the nearly 3,000 payday and auto title locations across the state.

<sup>58</sup> Lauren K. Saunders, Leah A. Plunkett, and Carolyn Carter. *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't*, NATIONAL CONSUMER LAW CENTER (2010) at 10.

<sup>59</sup> FEDERAL REGISTER, Vol. 76, No.110, (June 8, 2011). As early as 1997, a bank suspended its direct deposit advance program due to regulatory scrutiny tied to a merger. It is interesting to note that the program charges at that time were half what is charged by most market participants today—\$5 per \$100, instead of the \$7.50 to \$10 per \$100 often charged today. The advance was also limited to \$200. At the time, the program was billed as one of the bank’s “most lucrative services.” The article concludes, “To comply with regulations, [the bank] has also started reporting the service fee in a new way. This month's bank statements show the cost of the service as an annual percentage rate: a whopping 60 percent.” *See*: <http://www.bizjournals.com/sanfrancisco/stories/1997/06/02/focus4.html?page=all>.

<sup>60</sup> These advances are required to be repaid within one month, generally by the next direct deposit into the account. Practically speaking, the loans generally range from one week to one month in duration and can be renewed multiple time at the discretion of the borrower. A Center for Responsible Lending study found that most direct deposit loans were paid back within 10 days, resulting in an APR of 365%. Some financial institutions that offer these loans have instituted limits on the number of back-to-back loan transactions, but the study found that those standards still resulted in an average period of indebtedness of 175 days among borrowers. *See*: <http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf>.

<sup>61</sup> METABANK FINANCIAL GROUP, INC., *Form 8K, MetaBank Financial Group, Inc., Securities and Exchange Commission*, (October 6, 2010), *available at*: [http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319\\_18k.htm](http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm). *See also*: [http://www.ots.treas.gov/\\_files/enforcement/97744.pdf](http://www.ots.treas.gov/_files/enforcement/97744.pdf).

<sup>62</sup> Andrew Johnson, *MetaBank to Repay Borrowers \$4.8 Million Under Regulatory Order*, AMERICAN BANKER (July 18, 2011), *available at*: [http://www.americanbanker.com/issues/176\\_137/metabank-repay-borrowers-under-order-1040198-1.html](http://www.americanbanker.com/issues/176_137/metabank-repay-borrowers-under-order-1040198-1.html).

<sup>63</sup> See 7 Tex. Admin. Code §91.720 and 12 CFR Part 701.

<sup>64</sup> Licensed pawnbrokers in Texas may charge up to 240% APR for loans up to \$189; 180% APR for \$189-\$1,260; 30% APR for loans between \$1,260 and \$1,890; and 12% APR for loans from \$1,890 to \$15,750. Texas pawnshop rate chart *available at*: [http://www.occc.state.tx.us/pages/int\\_rates/pRate12.pdf](http://www.occc.state.tx.us/pages/int_rates/pRate12.pdf).

<sup>65</sup> It is important to note that the review of national initiatives is not exhaustive. There are many payday loan alternative programs across the county. This section highlights typical product structures and presents examples that are either unique or particularly successful.

<sup>66</sup> Saunders, et al, *supra* note 58, at 8-18.

<sup>67</sup> Written Testimony of Melissa Koide, Vice President of Policy, Center for Financial Services Innovation, House Subcommittee on Financial Institutions and Consumer Credit. “An Examination of Credit Availability for Consumers,” (September 22, 2011), *available at*: <http://financialservices.house.gov/UploadedFiles/092211koide.pdf>.

<sup>68</sup> FDIC QUARTERLY, “A Template for Success: The FDIC’s Small-dollar Loan Pilot Program,” Vol. 4, No. 2 (2010), *available at*: [http://www.fdic.gov/bank/analytical/quarterly/2010\\_vol4\\_2/FDIC\\_Quarterly\\_Vol4No2\\_SmallDollar.pdf](http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf).

<sup>69</sup> NATIONAL CREDIT UNION ADMINISTRATION, *Final Rule, Short-Term, Small Amount Loans*, 12 CFR Part 701 (September 2010), *available at*: <http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf>.

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<sup>70</sup> 7 Tex. Admin. Code §91.720 Note: This is a safe harbor standard. A credit union may seek approval for additional charges from the Texas Credit Union Commission.

<sup>71</sup> These standards were developed in early 2010 in response to a request by a payday and auto title industry representative to provide them with suggestions for improving their loan product offerings. The standards were presented to the representative, but the industry association never formally responded.

<sup>72</sup> Robert Mooney, *supra* note 55.

<sup>73</sup> Statement of David M. Marquis, Executive Director, National Credit Union Administration, *An Examination of the Availability of Credit for Consumers*, Written testimony submitted to the U.S. House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit (September 22, 2011) at 9.

<sup>74</sup> *Id.*

<sup>75</sup> <http://www.fdic.gov/small-dollarloans/>

<sup>76</sup> *Id.*

<sup>77</sup> FDIC QUARTERLY, *supra* note 68, at 30.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.* at 31. The FDIC Call Reports are submitted quarterly by banks insured by the FDIC. The reports include financial information about federally insured banks.

<sup>80</sup> FDIC QUARTERLY, "FDIC's Small-Dollar Loan Pilot Program: A Case Study After One Year," *Vol. 3, No.2* (2009).

<sup>81</sup> FDIC QUARTERLY, *supra* note 68, at 30.

<sup>82</sup> *Id.* at 32.

<sup>83</sup> Mooney, *supra* note 57, at 7.

<sup>84</sup> *See*: [http://www.realsolutions.coop/assets/2009/7/23/REAL\\_Solutions\\_Overview\\_final\\_July\\_2009.pdf](http://www.realsolutions.coop/assets/2009/7/23/REAL_Solutions_Overview_final_July_2009.pdf).

<sup>85</sup> *See*: <https://fwccu.org/default.asp?page=4.4>.

<sup>86</sup> *Id.* It is unclear whether or not the \$20 application fee is included in this interest calculation.

<sup>87</sup> *REAL Solutions Payday Lending*, video posted by Texas Program Director Natasha McAdoo, citing David Clay, Vice President of Lending at Fort Worth City Employees Credit Union, (March 2011). *See*: <http://vimeo.com/15238674>.

<sup>88</sup> David Morrison, "Texas League to Launch Paydays," CREDIT UNION TIMES, (March 26, 2010), *available at*: <http://www.cutimes.com/2010/03/24/texas-league-to-launch-paydays>.

<sup>89</sup> *For a list of participating credit unions, see*: [https://www.tcul.coop/Participating\\_Credit\\_Unions2.html](https://www.tcul.coop/Participating_Credit_Unions2.html).

<sup>90</sup> *See*: [http://www.tcul.coop/uploads/real\\_solutions\\_cus\\_offer\\_alternative\\_to\\_payday\\_loans.pdf](http://www.tcul.coop/uploads/real_solutions_cus_offer_alternative_to_payday_loans.pdf).

<sup>91</sup> Phil Greer, *State Employees' Credit Union - Salary Advance Loans - An Overview*, STATE EMPLOYEES CREDIT UNION OF NORTH CAROLINA, (July 2009) at 1.

<sup>92</sup> *Id.* at 2.

<sup>93</sup> This information is as of 2010, *available at*: <https://www.ncsecu.org/AboutSECU/SECUHistory.html>.

<sup>94</sup> *Id.* at 2.

<sup>95</sup> STATE EMPLOYEES CREDIT UNION, <https://www.ncsecu.org/Loans/SalaryAdvance.html>.

<sup>96</sup> *Id.*

<sup>97</sup> Greer, *supra* note 92, at 5.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 4.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 8.

<sup>103</sup> David Morrison, "State Employees Proving Payday Alternative Will Save," CREDIT UNION TIMES, (March 2, 2011), *available at*: <http://www.cutimes.com/2011/03/02/state-employees-proving-payday-alternative-members>.

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- <sup>104</sup> Bair, *supra* note 56, at 22.
- <sup>105</sup> *Id.*
- <sup>106</sup> Tim Kaine, “How Virginia is Handling Payday Loans,” THE WALL STREET JOURNAL, (December 30, 2009), available at: <http://online.wsj.com/article/SB10001424052748703510304574626192168675928.html>.
- <sup>107</sup> FDIC QUARTERLY, *supra* note 68, at 36.
- <sup>108</sup> *Virginia State Employee Loan Program, Frequently Asked Questions*, available at: <http://www.dhrm.virginia.gov/vaemploan/faqs.html>.
- <sup>109</sup> FDIC QUARTERLY, *supra* note 68, at 36.
- <sup>110</sup> *Virginia State Employees Loan Program*, available at: <http://www.dhrm.virginia.gov/vaemploan/index.html>.
- <sup>111</sup> FDIC QUARTERLY, *supra* note 68, at 36.
- <sup>112</sup> Courtney Mailey, *Employer-sponsored Alternatives to Payday Loans in Virginia*, Market Wise Community, Federal Reserve Bank of Richmond, Vol. 1, Issue 1 (2010) at 3.
- <sup>113</sup> FDIC QUARTERLY, *supra* note 68, at 13.
- <sup>114</sup> *Emerge Workplace Solutions*, available at: <http://newfoundryventures.org/our-projects/emerge-loan-program/>.
- <sup>115</sup> Liberty Bank was also a partner in the FDIC small-dollar loan pilot program.
- <sup>116</sup> Company information, available at: <http://www.emergebenefit.com/AboutUs.aspx>.
- <sup>117</sup> See: <http://www.emergebenefit.com/>.
- <sup>118</sup> BLOOMBERG BUSINESSWEEK, “Cash from the Boss to Replace Payday Loans,” (October 20, 2011), available at: <http://www.businessweek.com/magazine/cash-from-the-boss-to-replace-payday-loans-10202011.html>.
- <sup>119</sup> Barbara Reed, Presentation to the RAISE Texas Small-dollar Lending Group, (November 2009).
- <sup>120</sup> *Id.*
- <sup>121</sup> *Loan Plus Program Information*, <http://www.westendnh.org/financial-management-services/>.
- <sup>122</sup> FDIC QUARTERLY, *supra* note 68, at 35.
- <sup>123</sup> *Loan Plus Program Information*, <http://www.westendnh.org/financial-management-services/>.
- <sup>124</sup> FDIC QUARTERLY, *supra* note 68, at 35.
- <sup>125</sup> West End Neighborhood House, <http://www.westendnh.org/financial-management-services/>.
- <sup>126</sup> *Id.*
- <sup>127</sup> WEST END NEIGHBORHOOD HOUSE, “West End Unveils Statewide Low-interest Loan Program,” Press Release, (July 16, 2009).
- <sup>128</sup> *Id.*
- <sup>129</sup> Interview by Phyllis Young and Parker Lee with Barbara Reed of West End Neighborhood House, (November 22, 2011).
- <sup>130</sup> LaSalle Bank no longer exists. It was purchased by Bank of America in 2007.
- <sup>131</sup> KANSAS CITY STAR, “Fair Community Credit is Better Bridge for the Poor,” (September 19, 2011), available at: <http://www.kansascity.com/2011/09/19/3153916/the-stars-editorial-fair-community.html>.
- <sup>132</sup> NATIONAL LEAGUE OF CITIES, *Bank On Cities: Connecting Residents to the Financial Mainstream*, (April, 2011) at 3.
- <sup>133</sup> *Id.* at 93.
- <sup>134</sup> BANK ON SAN FRANCISCO, *Payday Plus SF: Frequently Asked Questions*.
- <sup>135</sup> *Id.*
- <sup>136</sup> *Id.*
- <sup>137</sup> *Id.*
- <sup>138</sup> *Id.*
- <sup>139</sup> *Id.*
- <sup>140</sup> Interview by Woody Widrow, Executive Director, RAISE Texas, with Marco Chavarin, (June 2011).

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- <sup>141</sup> Consortium partners include: Baltimore FDIC; Bank of America; BB&T; Catholic Campaign for Human Development; 1st Mariner Bank; Hamilton Federal Bank; M&T Bank; Municipal Employees Credit Union of Baltimore, Inc. (MECU); SunTrust; Wachovia; and Neighborhood Housing Services of Baltimore, Inc.
- <sup>142</sup> BALTIMORE BUSINESS JOURNAL, “Borrow and Save Loan Program Unveiled for Low-Income Residents,” (September 24, 2009), *available at*: <http://www.bizjournals.com/baltimore/stories/2009/09/21/daily48.html>.
- <sup>143</sup> Borrow and Save Loan Program overview, *available at*: <http://www.nhsbaltimore.org/services/borrow-and-save.php>.
- <sup>144</sup> Eileen Ambrose, “Small-dollar Loan Expands City-Wide,” THE BALTIMORE SUN, (November 9, 2010), *available at*: [http://articles.baltimoresun.com/2010-11-09/business/bs-bz-ambrose-micro-lend-20101109\\_1\\_payday-loans-small-dollar-loan-credit-cards](http://articles.baltimoresun.com/2010-11-09/business/bs-bz-ambrose-micro-lend-20101109_1_payday-loans-small-dollar-loan-credit-cards).
- <sup>145</sup> Adam Doster, “In Baltimore, A Test for an Alternative to Payday Loans,” THE NATION, (April 7, 2011).
- <sup>146</sup> Bill Himpler, “Addressing the Credit Needs of the Unbanked,” THE HUFFINGTON POST (October 7, 2011), *available at*: [http://www.huffingtonpost.com/bill-himpler/affordable-credit-lending\\_b\\_998906.html](http://www.huffingtonpost.com/bill-himpler/affordable-credit-lending_b_998906.html).
- <sup>147</sup> Mr. Jeff Johnson, Pastor, First Baptist Church, Del Rio, Texas, *Testimony before the Texas House Committee on Pensions and Investments*, (March 22, 2011).
- <sup>148</sup> Dr. Kimberly R. Manturuk, Center for Community Capital, University of North Carolina at Chapel Hill, Written Testimony Submitted to the Subcommittee on Financial Institutions and Credit for Consumers, U.S. House Committee on Financial Services, (September 22, 2011) at 3. Finance companies in North Carolina have a rate cap of 30% interest for loans up to \$1,000 plus fees. The rate decreases for loans above \$1,000. *Available at*: <http://financialservices.house.gov/UploadedFiles/092211manturuk.pdf>.
- <sup>149</sup> 7 Tex. Admin. Code §83.852.
- <sup>150</sup> Prosper.com and Pawngo.com are two examples of companies serving the higher dollar market.
- <sup>151</sup> Detailed information *available at*: <https://www.billfloat.com/>.
- <sup>152</sup> Bryan Gilbert, CEO BillFloat, Inc., Hearing on “An Examination of the Availability of Consumer Credit” before the House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit (September 22, 2011) at 2, *available at*: <http://financialservices.house.gov/UploadedFiles/092211gilbert.pdf>.
- <sup>153</sup> *Id.*
- <sup>154</sup> Bair, *supra* note 55, at 24.
- <sup>155</sup> Stephen Broebek, *Understanding the Emergency Savings Needs of Low- and Moderate-Income Households: A Survey-Based Analysis of Impacts, Causes, and Remedies*, CONSUMER FEDERATION OF AMERICA, (November 2008) at 18.
- <sup>156</sup> George Mills and Joe Amick, *Can Savings Help Overcome Income Instability?*, THE URBAN INSTITUTE, Brief 18, (December 2010) at 9.
- <sup>157</sup> See: [www.americasaves.org](http://www.americasaves.org) and [www.texassaves.org](http://www.texassaves.org).
- <sup>158</sup> The D2D fund has been particularly active in piloting prize-based savings programs. For more information, see: [http://www.d2dfund.org/our\\_work/building\\_savings/prize\\_linked\\_savings](http://www.d2dfund.org/our_work/building_savings/prize_linked_savings). The New America Foundation is currently piloting an opt-out employer-based savings plan. For more information, see: [http://newamerica.net/publications/policy/autosave\\_0](http://newamerica.net/publications/policy/autosave_0).
- <sup>159</sup> OPPORTUNITY TEXAS, *Texas Saves at Tax Time 2011: Best Practices to Operating a Tax Time Savings Project*, (October 2011) at 3.
- <sup>160</sup> *Id.*
- <sup>161</sup> See: [http://cfed.org/programs/innovation/mhernandez/chronicles\\_of\\_the\\_ave\\_nyc\\_program/](http://cfed.org/programs/innovation/mhernandez/chronicles_of_the_ave_nyc_program/); [http://cfed.org/blog/inclusiveeconomy/savenyc\\_and\\_matched\\_savings/](http://cfed.org/blog/inclusiveeconomy/savenyc_and_matched_savings/); and <http://www.nyc.gov/html/ofe/html/poverty/save.shtml> for program information.
- <sup>162</sup> For information about this program, see: <http://www.creditbuildersalliance.org/toolkit-innovations/lisc.html>.
- <sup>163</sup> This profile is based on interviews with Josue Alballero, Houston District Sales Manager, on June 28, 2011, and with Sarah Livnat, Director Product & Consumer Experience, and Gustavo Lasala, Director of Retail Operations with Progreso Financiero, on July 7, 2011.
- <sup>164</sup> <http://www.progressfin.com/en/about/>.

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<sup>165</sup> This profile is based on an interview with Wendy Hanson, Community Impact Director, United Way Southern Cameron County, and Eva Woodfin, Community Loan Center. The interview was conducted on July 6, 2011.

<sup>166</sup> See Appendix A for details on Chapter 342 E licensing as well as other regulatory issues related to small-dollar consumer loans.

<sup>167</sup> “Bank On” campaigns are campaigns based in cities across the country. The campaigns focus on banking the unbanked, providing financial education, and promoting positive alternatives to high-priced check cashing and payday loan services.

<sup>168</sup> This profile is based on interviews with Randy Martinez, Promise Credit Union CEO, and Elizabeth Colvin, Director Economic Opportunity and Tax Services, Neighborhood Centers, Inc., June 28, 2011.

<sup>169</sup> This profile is based on three interviews: Ashley Harris, Director of Public Relations, Generations Federal Credit Union and Tammy Deininger, Director of People Services, Goodwill Industries of San Antonio, July 8, 2011; and Bonnie Garcia, Director of Business Development, Generations Federal Credit Union, August 29, 2011.

<sup>170</sup> This profile is based on an interview with Richard Simonds, Program Manager of Financial Support Services for Family Services of Greater Houston on June 28, 2011.

<sup>171</sup> The Ways to Work program began in 1984 as a project of the McKnight Foundation in Minnesota. It eventually expanded to a national loan fund to help low-income families meet credit needs primarily to purchase or repair an automobile. The program provides the loan capital and the local nonprofit partner guarantees the loan through a loan loss reserve fund.

<sup>172</sup> Texas Appleseed and RAISE Texas co-sponsored a convening, in November of 2011, of representatives of the programs profiled in the report and a sample of businesses and organizations with a strong role or interest in supporting or creating alternative small-dollar loan programs. Businesses and organizations represented at the convening included: ACCION Texas, Amarillo National Bank, Citibank, Community Loan Center, Foundation Communities, El Paso Affordable Housing Credit Union Service Organization, Family Services of Greater Houston, Federal Reserve Bank of Dallas, FDIC, First Convenience Bank, Progreso Financiero, Promise Credit Union, RAISE Texas, Texas Appleseed, Texas Association of Community Development Corporations, United Way of Cameron County, and United Way of Greater Houston. The recommendations represent Texas Appleseed’s analysis of the discussions and needs that were shared by convening participants and through the profile interviews that informed the section of this report profiling examples of affordable small-dollar loan programs in Texas.

# APPENDIX



# APPENDIX A

## Overview of Regulatory Issues

This section provides legal information but should not be interpreted as legal advice. Due diligence was paid to ensure the accuracy of this information, but you should consult your own attorney to receive the latest, most accurate information or legal advice regarding your own specific circumstances. Links to websites are provided for informational purposes only and do not imply an endorsement or recommendation of their contents.

Existing financial institutions and other entities in Texas that wish to offer alternatives to payday or auto title loans must take into account a number of state and federal regulatory issues. These include state licensing and regulation for consumer lending, state and federal rules for small-dollar loans, and regulations concerning electronic fund transfers and truth-in-lending disclosures.

### Chapter 342 Consumer Loans

Under Texas law, a “consumer loan” is one made primarily for personal, family, or household use, and that charges more than 10% interest per year.<sup>1</sup> Except by specific statutory authority to offer particular types of credit, a Texas lender cannot charge interest in excess of 10% per year, although state-regulated credit unions are permitted by statute to charge up to 18% per year.

Consumer loans are regulated under Chapter 342 of the Texas Finance Code. Chapter 342 allows a lender to charge higher and/or alternative interest rates, subject to regulation by the Texas Finance Commission and the Texas Office of Consumer Credit Commissioner (OCCC). Non-depository lenders must obtain a license from the OCCC to make consumer loans and are subject to OCCC examination. Each office of a non-depository lender—where consumer loans are made, negotiated, arranged, serviced, held, or collected—must be separately licensed.

State-chartered banks and credit unions (as separately regulated depository institutions) are exempt from the OCCC license requirement.<sup>2</sup> State banks are regulated and examined by the Texas Banking Commissioner, and state credit unions are regulated and examined by the Texas Credit Union Commissioner—but when making Chapter 342 consumer loans, banks and credit unions must comply with applicable statutes and regulations under the interpretive authority of the OCCC.

Federal laws governing national banks and federally-chartered credit unions generally preempt Texas consumer loan law. Federal banking law, however, does allow national banks to charge interest at any rate allowed by the laws of the state where the bank is located, subject only to the

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<sup>1</sup> “Consumer loans” also include certain secondary mortgage loans on dwellings.

<sup>2</sup> Tex. Fin. Code §§ 124.005, 342.051(c); 7 Tex. Admin. Code § 83.102(5).

provisions of state law that are material to the determination of the permitted interest rate.<sup>3</sup> There does not appear to be any comparable regulation for federally chartered credit unions, although a new federal credit union regulation does permit higher interest on small, short-term loans, which will be discussed below.

## License Application and Maintenance

Consumer loan licenses are obtained through the OCCC (<http://www.occc.state.tx.us>). License applications require detailed information about location, owners and principals, prior lending experience, business plan, financial condition, and organization structure of the entity.<sup>4</sup> Based on information provided in an application, the commissioner may require an applicant to file a bond, not to exceed \$50,000 for the first license, and \$10,000 for each additional license.<sup>5</sup> Applicants must pay a \$200 nonrefundable “investigation fee,” and a first annual \$600 “assessment fee,” which is refundable if an application is not approved.<sup>6</sup>

Applications are ordinarily approved or denied within 60 days after filing.<sup>7</sup> Approvals and denials are made based on the commissioner’s findings regarding the applicant’s financial responsibility, experience, character, and general fitness.<sup>8</sup> The applicant must also have net assets of at least \$25,000 available for operating the business.<sup>9</sup> If an application is denied, the applicant has 30 days to request a hearing before an administrative law judge, who will recommend a final decision to the commissioner.<sup>10</sup>

License holders must maintain the minimum \$25,000 in net assets to conduct business.<sup>11</sup> Annual renewal and assessment fees include a \$600 fixed fee plus an additional volume-based fee, capped at a maximum \$1,200 per licensed location.<sup>12</sup>

All authorized consumer lenders must undergo examination. OCCC examines its own licensees, and banks and credit unions are examined by their respective regulatory agencies. For consumer loan licensees, OCCC regulations impose extensive, detailed record-keeping requirements, including loan registers, borrowers’ account records, official fee records, daily transaction records, loan records and documents, and advertising records.<sup>13</sup>

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<sup>3</sup> 12 U.S.C. § 85.

<sup>4</sup> Tex. Fin. Code § 342.101; 7 Tex. Admin. Code § 83.302.

<sup>5</sup> Tex. Fin. Code § 342.102.

<sup>6</sup> Tex. Fin. Code § 342.101; 7 Tex. Admin. Code § 83.310.

<sup>7</sup> 7 Tex. Admin. Code § 83.307.

<sup>8</sup> Tex. Fin. Code § 342.104.

<sup>9</sup> *Id.*

<sup>10</sup> Tex. Fin. Code § 342.104; 7 Tex. Admin. Code § 83.307.

<sup>11</sup> Tex. Fin. Code § 342.153.

<sup>12</sup> 7 Tex. Admin. Code § 83.310.

<sup>13</sup> 7 Tex. Admin. Code § 83.828.

## Consumer Loan Interest Rates and Structures

Chapter 342 provides a variety of structures for making non-real property consumer loans. These structures involve the use of “brackets” or “ceilings,” which define the size of loan to which a certain interest rate or alternate charge can be applied. The OCCC annually computes brackets and ceilings for loan amounts based on statutory formulas. Revised brackets and ceilings are issued by the OCCC in March of each year, effective July 1 of that year through June 30 of the following year. ([http://www.occc.state.tx.us/pages/int\\_rates/Index.html](http://www.occc.state.tx.us/pages/int_rates/Index.html)) Two basis loan structures are authorized under Chapter 342: loans using conventional methods of interest calculation under Subchapter E, and loans permitting alternate interest charges under Subchapter F. “Payday loans” (deferred presentment transactions) and “auto title loans” can be made under Subchapter E or Subchapter F, depending on the amount of the loan, the loan term, and the desired interest and fee charges.

### Loans Using Conventional Methods of Interest Calculation

Chapter 342, Subchapter E provides for interest charges on consumer loans using the more conventional interest calculation methods of “add-on” interest and simple interest. Add-on interest is calculated at the front end on the full amount of a cash advance for the full term, as if the principal did not decline with each payment on the loan. For example, a \$1,000 loan payable in 12 monthly installments with 8% add-on interest would have a total interest charge of \$80, monthly payments of \$90, and an APR of 14.45%. Chapter 342 provides for two possible methods for computing simple interest, the “scheduled installment earnings method” and the “true daily earnings method.”<sup>14</sup>

A distinction is made between “regular” and “irregular” transaction loans. A “regular transaction” loan is one that is payable in consecutive, monthly, substantially equal installments, the first of which is due within one month and 15 days after the loan is made. An “irregular transaction” loan is one that is payable in installments that are not consecutive, monthly, and substantially equal, and the first of which is due later than one month and 15 days after the loan is made.<sup>15</sup>

### “Add-on” Interest Loans and Alternative Rate Ceiling Loans

For regular transaction loans under Subchapter E, an authorized consumer lender may charge “add-on interest” as follows:

- 18% per year on the cash advance amount not exceeding \$1,890 (annually revised loan amount bracket effective through June 30, 2012); and
- 8% per year on any additional cash advance amount exceeding \$1,890 but not exceeding \$15,750 (annually revised loan amount brackets effective through June 30, 2012).<sup>16</sup>

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<sup>14</sup> Tex. Fin. Code § 342.002.

<sup>15</sup> Tex. Fin. Code § 342.001.

<sup>16</sup> Tex. Fin. Code § 342.201(a); <http://www.occc.state.tx.us/pages/publications/ccl/2011/0315.pdf>.

An irregular transaction loan can charge interest (using any method or formula that does not exceed the effective return allowed above) if the loan is a regular transaction with installment payments beginning one month after the loan is made.<sup>17</sup>

A lender can also charge simple interest that does not exceed the alternative rate ceiling computed under Texas Finance Code Chapter 303, Subchapter A, which is currently capped at 18%.<sup>18</sup>

In any of these instances, the lender may charge an administrative fee of \$20 for a loan of \$1,000 or less, or \$25 for a loan of more than \$1,000, which fee cannot be charged in refinancing more than once in any 180-day period.<sup>19</sup>

### Simple Interest Loans at Higher Rates

For either regular or irregular transaction loans under Subchapter E, the lender may charge simple interest at higher rates as follows:

- 30% per year on the cash advance amount not exceeding \$3,150 (annually revised loan amount bracket effective through June 30, 2012);
- 24% per year on any additional cash advance amount exceeding \$3,150 but not exceeding \$6,615 (annually revised loan amount brackets effective through June 30, 2012); and
- 18% per year on any additional cash advance amount exceeding \$6,615 but not exceeding \$15,750 (annually revised loan amount brackets effective through June 30, 2012).<sup>20</sup>

For loans charging simple interest at these higher rates, lenders can charge an administrative fee of \$20 for a loan of \$1,000 or less, or \$25 for a loan of more than \$1,000, which fee cannot be charged in refinancing more than once in any 365-day period.<sup>21</sup>

### Additional Interest Charges; Interest Refunds

Certain additional interest charges are permitted for installment deferment or default, and pre-computed interest may be partially refunded if a loan is prepaid.<sup>22</sup>

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<sup>17</sup> Tex. Fin. Code § 342.201(c).

<sup>18</sup> Tex. Fin. Code § 342.201(d); Tex. Fin. Code § 303.009; [http://www.occc.state.tx.us/pages/int\\_rates/Index.html](http://www.occc.state.tx.us/pages/int_rates/Index.html).

<sup>19</sup> Tex. Fin. Code § 342.201(f); 7 Tex. Admin. Code § 83.503.

<sup>20</sup> Tex. Fin. Code § 342.201(e); <http://www.occc.state.tx.us/pages/publications/ccl/2011/0315.pdf>.

<sup>21</sup> Tex. Fin. Code § 342.201(f); 7 Tex. Admin. Code § 83.503.

<sup>22</sup> Tex. Fin. Code §§ 342.203-206, 352; 7 Tex. Admin. Code §§ 83.504-505, 753.

## Loan Term for Subchapter E Loans

The maximum loan term for an add-on or simple interest loan under Subchapter E depends on the size of loan, as follows: 37 months for a loan amount of \$1,500 or less; 49 months for a loan amount between \$1,500 and \$3,000; and 60 months for a loan amount greater than \$3,000.<sup>23</sup>

## Alternate Interest Charges on Small-Dollar Loans

Chapter 342, Subchapter F provides an alternate interest structure for certain small-dollar loans not exceeding an annually revised ceiling amount. For a cash advance loan of \$100 or more, but not exceeding \$1,260 (an annually revised loan amount ceiling effective through June 30, 2012), an authorized consumer lender can charge a \$10 non-refundable “acquisition fee,” plus an “installment account handling charge that is not more than the ratio of \$4 per month for each \$100 of cash advance.”<sup>24</sup> No other charges are allowed except in cases of deferment or default, where certain additional interest charges are permitted.<sup>25</sup> Slightly different interest charges and maximum loan terms are authorized for loans in amounts less than \$100.<sup>26</sup>

The maximum term for this type of loan is one month for each multiple of \$20 of the cash advance amount.<sup>27</sup> If a loan is prepaid, part of the installment account handling charge may be refundable.<sup>28</sup>

If a loan is payable with a single repayment, the interest charge cannot exceed the effective return allowed under Subchapter F for an installment account handling charge, determined as a “true daily earnings rate” (simple interest), considering the amount and term of the loan.<sup>29</sup> When a loan having an initial term greater than one month is fully repaid, the lender may earn a minimum of the acquisition charge and interest charge for one month.<sup>30</sup> When a loan having an initial term less than one month is fully repaid, the lender may earn a minimum of the acquisition charge and interest at the daily earnings rate for the time the loan is outstanding.<sup>31</sup> For a loan with a term of one month or less, a lender cannot receive from the borrower more than one acquisition charge per month for that loan, any refinancing of that loan, or any new loan made the same month.<sup>32</sup>

The “Interest Rate” page on OCCC’s website links to a detailed rate chart for Subchapter F loans with terms of one to 30 months, including prepayment refund calculations:

[http://www.occc.state.tx.us/pages/int\\_rates/Index.html](http://www.occc.state.tx.us/pages/int_rates/Index.html).

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<sup>23</sup> Tex. Fin. Code §§ 342.508.

<sup>24</sup> Tex. Fin. Code §§ 342.252(3); <http://www.occc.state.tx.us/pages/publications/ccl/2011/0315.pdf>.

<sup>25</sup> Tex. Fin. Code §§ 342.254, 257; 7 Tex. Admin. Code §§ 83.601-603.

<sup>26</sup> Tex. Fin. Code §§ 342.252(1)-(2).

<sup>27</sup> Tex. Fin. Code § 342.255.

<sup>28</sup> Tex. Fin. Code §§ 342.256, 351-352; 7 Tex. Admin. Code §§ 83.755-757.

<sup>29</sup> Tex. Fin. Code § 342.253.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> 7 Tex. Admin. Code § 83.605.

## Payday Loans and Deferred Presentment Transactions

OCCC regulations specifically address payday loans that can be made under Subchapter F of Chapter 342.<sup>33</sup> Under this rule, a “payday loan” is defined as a deferred presentment transaction, in which a cash advance is made in exchange for a postdated check or debit authorization for the amount of a cash advance plus a fee. The fee cannot exceed the alternate interest charge rates authorized under Subchapter F. The minimum term for a payday loan is seven days, and a check or debit authorization cannot be held by the lender for more than 31 days before depositing. Rule 83.604 includes an example table of authorized charges on different loan amounts for terms from seven to 30 days: <http://info.sos.state.tx.us/fids/200605712-1.pdf>.

Payday loans have additional requirements, including the following:

- The check or debit must be made payable to the authorized lender (OCCC licensee or regulated depository institution);<sup>34</sup>
- The transaction must be documented by a written, signed agreement that includes (1) the name of the lender, (2) the transaction date, (3) the amount of the check or debit, (4) the amount charged, both as a dollar amount and as an annual percentage rate, (5) the earliest date the check or debit may be deposited, and (6) required notices and OCCC contact information;<sup>35</sup>
- The borrower must have prepayment rights and be refunded any unearned finance charge;<sup>36</sup> and
- The lender must post a fee schedule notice for payday or deferred presentment loans.<sup>37</sup>

The rule also imposes a specific “fair lending” obligation to assess a borrower’s ability to repay a specific payday loan or deferred presentment transaction.<sup>38</sup>

Payday loans can be renewed in one of two ways: (1) by converting a single payment balloon note into a declining balance installment note, or (2) by renewing the loan an unlimited number of times as long as the total interest charge does not exceed that permitted under Subchapter F, “having due regard for the amount of the cash advance and the time the cash advance is outstanding.” If successive renewals of a loan are allowed in less than one month’s time, an acquisition charge can be earned only once a month. A lender and borrower may also agree to extend the maturity date of an existing payday loan.<sup>39</sup>

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<sup>33</sup> 7 Tex. Admin. Code § 83.604.

<sup>34</sup> 7 Tex. Admin. Code § 83.604(e)(1).

<sup>35</sup> 7 Tex. Admin. Code § 83.604(e)(2).

<sup>36</sup> 7 Tex. Admin. Code § 83.604(e)(4).

<sup>37</sup> 7 Tex. Admin. Code § 83.604(e)(6).

<sup>38</sup> 7 Tex. Admin. Code § 83.604(f)(3).

<sup>39</sup> 7 Tex. Admin. Code § 83.604(f)(1).

## Multiple Loans

For any type of loan under Chapter 342, a lender may make multiple loans to a single borrower or to a married couple at the same time, but the total finance charges on the multiple loans cannot exceed what could be charged for a single loan in the total aggregate loan amount.<sup>40</sup> A lender and borrower may also enter an agreement providing for multiple advances at a rate that does not exceed that permitted under Subchapter E for an equivalent amount loan.<sup>41</sup>

## Security for Loans

A lender cannot take any assignment of wages or any lien on real property as security for a Chapter 342 loan under Subchapter E or F.<sup>42</sup>

## Collection

All debt collectors, whether creditors themselves or third-party debt collectors, must comply with state and federal laws that prohibit certain debt collection practices, including threats, coercion, harassment, abuse, unfair or unconscionable means, and fraudulent, deceptive, or misleading representations—as well as restricting contact and communications for debt collection purposes.<sup>43</sup> Texas OCCC regulations impose supplemental rules for debt collection from consumer loan borrowers under Chapter 342.<sup>44</sup>

## Advertising

Texas statutes and regulations impose few restrictions on credit advertising that go beyond federal “truth in lending” regulations, which are discussed further below. Texas law requires credit advertising to contain basic information identifying the advertiser.<sup>45</sup> Texas law also prohibits false, misleading, or deceptive advertising about rates, terms, and conditions, and requires that any statement of a rate or charge be full and clear.<sup>46</sup> Otherwise Texas law actually prohibits the adoption of rules that restrict the form or manner of advertising except to prohibit false, misleading, or deceptive practices.<sup>47</sup> Accordingly, OCCC rules for advertising consumer loans simply prohibit various forms of misleading advertising (including misuse of certain phrases, conditional offers of credit, and resemblances of negotiable instruments),<sup>48</sup> and impose certain full disclosure requirements for any advertising of rates or charges.<sup>49</sup>

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<sup>40</sup> Tex. Fin. Code § 342.501; 7 Tex. Admin. Code §§ 83.851.

<sup>41</sup> Tex. Fin. Code § 342.455.

<sup>42</sup> Tex. Fin. Code § 342.503.

<sup>43</sup> Tex. Fin. Code §§ 392.301-305; 15 U.S.C. §§ 1692 *et seq.*

<sup>44</sup> 7 Tex. Admin. Code §§ 83.859-860.

<sup>45</sup> Tex. Fin. Code § 341.301.

<sup>46</sup> Tex. Fin. Code §§ 341.403(a) and (b).

<sup>47</sup> Tex. Fin. Code §§ 341.403(c) and (d).

<sup>48</sup> 7 Tex. Admin. Code §§ 83.853-855.

<sup>49</sup> 7 Tex. Admin. Code §§ 83.857-858.

## **Credit Union Regulations for Small-Dollar Loans**

Both the Texas Credit Union Commissioner and the National Credit Union Administration have promulgated new rules dealing with small-dollar loans.

### **Texas Credit Union Rules for Small-Dollar, Short-Term Credit**

The Credit Union Commissioner recently issued a new rule regarding “small-dollar, short-term credit.”<sup>50</sup> This rule defines a small-dollar, short-term loan as having a term of six months or less and a loan amount not exceeding \$1,100. The rule encourages “streamlined” underwriting that focuses on basic information, such as proof of recurring income.

Consistent with statutes authorizing credit union loans generally, the rule permits a credit union to charge reasonable expenses and fees incurred in connection with making or closing a loan. These authorized fees and expenses are not interest. While the rule does not set a maximum fee for small-dollar, short-term loans, it does state that expenses and fees are “presumed to be reasonable if the aggregate total is \$20 or less.” If refinancing a small-dollar, short-term loan, the credit union can only charge the expenses and fees once in a 180-day period. Credit unions can also charge a late fee penalty in accordance with its bylaws.

The small-dollar, short-term loan rule does not address interest rates, so unless the loan is made under Chapter 342 (and in compliance with all of its requirements), the maximum interest rate for a small-dollar, short-term loan is the standard 1½% per month (18% per year) generally permitted for loans by credit unions.<sup>51</sup>

The rule states that credit unions should structure payment programs in a way that reduces principal. Excessive renewals or prolonged failure to reduce an outstanding balance is considered an “unsound practice.”

### **Federal Credit Union Rules for Short-Term, Small Amount Loans (STS Loans)**

Federal credit unions regulated by the National Credit Union Administration (NCUA) are currently limited to a maximum interest charge of 18% per year for most loans. Under the NCUA regulation governing loan interest rates, the maximum rate is 15% per year, but the rule also provides that every 18 months the NCUA Board shall determine whether a higher rate is needed in order to protect the safety and soundness of individual federal credit unions.<sup>52</sup> The current 18% ceiling established by the NCUA is effective through September 10, 2012.<sup>53</sup>

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<sup>50</sup> 7 Tex. Admin. Code § 91.720.

<sup>51</sup> Tex. Fin. Code § 124.002.

<sup>52</sup> 12 CFR § 701.21(7)(i-ii).

<sup>53</sup> <http://www.ncua.gov/letters/2011/FCU/11-FCU-04.pdf>.

In 2010, the NCUA issued a final new rule on “short-term, small amount loans,” or “STS loans.”<sup>54</sup> STS loans are defined as closed-end loans having principal amounts of not less than \$200 or more than \$1,000, and maturity terms of one to six months. The allowable interest rate for STS loans is 1,000 basis points (10%) above the maximum interest rate established for other loans, therefore the current maximum interest rate for STS loans is 28%. A federal credit union can charge an application fee for a new STS loan that reflects the actual cost of processing the application, but the fee cannot exceed \$20.

A federal credit union can make only one STS loan at a time to a borrower, and cannot make more than three STS loans to any one borrower during any rolling six-month period. A federal credit union cannot roll over an STS loan, but can extend the maturity of a loan within the six-month maximum term as long as no additional fees are charged and no additional credit extended.

Other requirements of the STS loan rule include: 1) an STS loan be fully amortized (no balloon payments), 2) the credit union set a minimum membership term length of at least one month, and 3) the credit union implement appropriate underwriting guidelines for STS loans, “for example, requiring a borrower to verify employment by producing at least two recent pay stubs.” The rule also offers additional suggestions for developing an STS loan program for borrowers, including financial education, a savings component, credit reporting, and electronic loan transactions. Other suggestions include requiring members to participate in direct deposit and encouraging or incentivizing members to utilize payroll deduction (although noting that credit unions cannot require members to authorize a payroll deduction).

## **FDIC Guidelines for Small-Dollar Loans and Payday Loans**

In 2007, the FDIC issued guidelines to encourage affordable small-dollar credit products at reasonable interest rates, no or low fees, and payments that reduce principal balance—but that are still profitable for the financial institution. The guidelines recognize that small-dollar programs may be either broad-based or focused on particular markets, such as the military, employers, low-income borrowers, and borrowers with little or no banking experience or credit history. The FDIC states a primary objective of a small-dollar loan program be to provide borrowers with a meaningful opportunity to repay based on their circumstances. The guidelines are available on the FDIC’s website.<sup>55</sup> Some small-dollar loan program features encouraged by the FDIC include:

- Basing assessment of origination fees directly on actual origination costs;
- Eliminating or minimizing annual fees, membership fees, advance fees, and prepayment penalties;
- Reasonable annual interest rates no greater than 36%, with no or low fees;

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<sup>54</sup> 12 CFR § 701.21(7)(iii).

<sup>55</sup> <http://www.fdic.gov/news/news/financial/2007/fil07050a.html>.

- Loan structures that foster reduction of principal owed—affordable amortized payment for closed-end loans and minimum payments for open-end loans—avoiding excessive renewals;
- Accessibility and expediency for borrowers to obtain credit, with streamlined underwriting focused on a borrower’s history with the institution and/or proof of recurring income;
- Maximizing use of existing platforms and technologies to lower program cost, for example: 1) establishing a line of credit at the time a deposit account is opened, to be activated later once the account is maintained over a period of several months; 2) using existing automated telephone banking systems and/or online applications for quicker, less expensive service; and 3) offering (but not requiring) borrowers to use voluntary preauthorized transfers to help make regular loan payments;
- Including a savings component, such as having a portion of either the loan advance or the borrower’s monthly payments go into a savings account—possibly in combination with an Individual Development Account program;
- Collaboration with other financial institutions, non-profit organizations, social service agencies, and/or employers to develop and implement programs; and
- Monitoring borrowers’ use of credit and offering financial counseling and education when needed.

The FDIC guidelines note that some small-dollar loan programs may receive favorable consideration and help achieve higher ratings in Community Reinvestment Act (CRA) examinations, discussed further below.

The FDIC conducted a two-year Small-Dollar Loan Pilot Program, ending in 2009, and institutions wishing to design their own programs may want to review an analysis of that pilot. Features of the FDIC pilot included loan amounts of \$2,500 or less, loan terms of 90 days or less, annual interest rates of 36% or less, no or low fees, and streamlined underwriting. A report on the program is contained in the 2010 FDIC Quarterly, volume 4, no. 2.<sup>56</sup>

### **Guidelines for Payday Lending**

In 2005, the FDIC issued revised examination guidelines for payday lending to address problems and concerns raised by some FDIC-supervised banks. Some of the issues addressed by the examination guidelines include the use of third-parties in payday lending transactions, bank safety and soundness concerns, and loan renewals and rewrites. Among other items, the guidelines state that financial institutions with payday loan programs should:

- Limit the number and frequency of extensions, deferrals, renewals, and rewrites;
- Prohibit additional advances to finance unpaid interest and fees and simultaneous loans to the same customer;
- Establish appropriate “cooling off” or waiting periods between the time a payday loan is repaid and another application is made;

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<sup>56</sup> [http://www.fdic.gov/bank/analytical/quarterly/2010\\_vol42.html](http://www.fdic.gov/bank/analytical/quarterly/2010_vol42.html).

- Establish a maximum number of loans per customer allowed in a year;
- Provide that no more than one outstanding payday loan is allowed any one borrower; and
- Deny new payday loans for customers who have had prior payday loans outstanding at any lender for a total of three months during the previous 12 months.

The payday lending examination guidelines are available on the FDIC’s website.<sup>57</sup>

## **Fair Lending Laws; Community Reinvestment Act**

The federal Equal Credit Opportunity Act and Community Reinvestment Act were enacted in the 1970s to address discriminatory lending practices and unfair “redlining” of low-income and minority communities.

The Equal Credit Opportunity Act prohibits discrimination by any creditor against any loan applicant on the basis of race, color, religion, national origin, sex, marital status, age, or receipt of public assistance benefits, or because an applicant exercised rights under the statute.<sup>58</sup> Under the authority of this law, the Federal Reserve System has issued detailed rules that address both general and specific areas of potential discrimination, including requests by creditors for information from loan applicants, evaluation of loan applications, and extensions of credit.<sup>59</sup> Additional rules provide for exceptions, special cases, procedures, communication with applicants, and enforcement.<sup>60</sup>

The Community Reinvestment Act (“CRA”) requires federal regulators, when examining depository financial institutions, to:

- Assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and
- Take such record into account in its evaluation of an application for a deposit facility by such institution.<sup>61</sup>

Each financial regulatory agency has issued similar rules for conducting CRA examinations and assessing the institution’s performance in areas of lending, investment, service, and community development. Ratings are assigned based on performance assessments, which are taken into account when an institution seeks to establish or relocate a branch, merge with another institution, or change or apply for a charter.<sup>62</sup> CRA performance criteria for consumer and other types of loans include:

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<sup>57</sup> <http://www.fdic.gov/news/news/financial/2005/fil1405a.html>

<sup>58</sup> 15 U.S.C. § 1691.

<sup>59</sup> 12 CFR §§ 202.4 – 202.7.

<sup>60</sup> 12 CFR Part 202 generally.

<sup>61</sup> 12 U.S.C. § 2903; generally 12 U.S.C. §§ 2901 *et seq.*

<sup>62</sup> 12 CFR Part 25 (Comptroller of the Currency); 12 CFR Part 228 (Federal Reserve); 12 CFR Part 345 (FDIC); 12 CFR Part 563e (Office of Thrift Supervision).

- The number, amount, and geographic distribution of consumer loans;
- The distribution of consumer loans among low-, moderate-, middle-, and upper-income individuals; and
- Use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies.<sup>63</sup>

## Community Development Financial Institutions

Another federal program, the Community Development Financial Institutions Fund (“CDFI”), is designed to encourage and assist specialized financial institutions in providing financial services to underserved communities. The Community Development Banking and Financial Institutions Act, enacted in 1994, established a fund to award financial and technical assistance funding to qualified CDFIs.<sup>64</sup> The Department of Treasury has issued detailed regulations for the administration of the CDFI Fund and maintains a comprehensive website for the program.<sup>65</sup> To apply for funding, an entity must be certified as a CDFI, the criteria for which are generally described in the rule and specifically set forth in the application for certification.<sup>66</sup> To be certified as a CDFI, an applicant must:

- Be a legal entity;
- Have a primary mission of promoting community development;
- Be a financing entity—meaning that its predominant business activity is providing arms-length loans and equity investments, finance-related community development services such as financial or credit counseling or technical assistance to borrowers or investees, and/or “other similar financing” (regulated financial institutions are assumed to be “financing entities”);
- Primarily serve one or more eligible target markets such as an economically-distressed geographic “investment area,” or a low-income or otherwise economically-disadvantaged targeted population;
- Demonstrate accountability to its target market(s);
- Provide development services in the form of technical assistance or training activities to aid borrowers in utilizing the entity’s financial products and services; and
- Not be a government entity or under the control of a government entity.

Entities that have been certified as CDFIs and those that have submitted applications for CDFI certification can apply for a Financial Assistance award and/or a Technical Assistance award.<sup>67</sup> Financial Assistance awards directly fund lending, investing, and other forms of financing to

<sup>63</sup> See 12 CFR §§ 25.22(b), 228.22(b), 345.22(b), 563e.22(b).

<sup>64</sup> 12 U.S.C. §§ 4701 *et seq.*

<sup>65</sup> 12 CFR Part 1805; <http://www.cdfifund.gov/>.

<sup>66</sup> 12 CFR § 1805.201; <http://www.cdfifund.gov/docs/certification/CDFI/CDFIcertificationApplication.pdf>.

<sup>67</sup> 12 CFR § 1805.200(a).

eligible recipients such as consumer borrowers, businesses that benefit low-income persons, community facilities, and low-income housing.<sup>68</sup> Technical Assistance awards are intended to build an entity's capacity to serve its target market(s) by supporting such activities as management and personnel training, program or product development, and operational improvements.<sup>69</sup>

A depository institution or holding company that is insured by the FDIC, or its affiliate or subsidiary, may qualify as a CDFI only if all affiliates collectively meet the CDFI eligibility requirements.<sup>70</sup>

As discussed above regarding Chapter 342 Consumer Loans, a CDFI that is a licensed bank, savings bank, saving and loan association, or credit union does not need to obtain a separate Chapter 342 license in order to make consumer loans. Otherwise, a CDFI that wishes to make consumer loans at an interest rate in excess of 10% must obtain a consumer loan license from the Texas OCC under Chapter 342.

## **Regulation E – Electronic Transfers**

The United States Federal Reserve's current regulations on electronic fund transfers ("EFTs") have been in effect since 1996 and are called "Regulation E."<sup>71</sup>

Among other rules, Regulation E restricts creditors from requiring a borrower to make payments on a loan using preauthorized electronic transfers, such as automatic account debits. The rule reads as follows:

*No financial institution or other person may condition an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund transfers, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account.*<sup>72</sup>

In a supplement to the rules, the Federal Reserve has issued the following Official Staff Interpretation of Section 205.10(e):

*Creditors may not require repayment of loans by electronic means on a preauthorized, recurring basis. A creditor may offer a program with a reduced annual percentage rate or other cost-related incentive for an automatic repayment feature, provided the program with the automatic payment feature is not the only loan program offered by the creditor for the type of credit involved.*<sup>73</sup>

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<sup>68</sup> 12 CFR §§ 1805.300-301.

<sup>69</sup> 12 CFR § 1805.303.

<sup>70</sup> 12 CFR §§ 1805.200(b).

<sup>71</sup> 12 CFR Part 205.

<sup>72</sup> 12 CFR § 205.10(e).

<sup>73</sup> 12 CFR Part 205, Supp. I.

Since the federal “Check 21” law became effective in 2004, a paper check can be used as a source of information to create an EFT. Regulation E was amended to incorporate the new law in the definition of an EFT, which provides in part as follows:

*The person initiating an electronic fund transfer using the consumer's check as a source of information for the transfer must provide a notice that the transaction will or may be processed as an EFT, and obtain a consumer's authorization for each transfer.*<sup>74</sup>

It is possible that a “deferred presentment transaction” used for a typical “payday loan”—if it is a postdated check that will be used as a source of information for a future EFT—may be subject to the Regulation E restriction as a preauthorized EFT required for an extension of credit.

## **Regulation Z – Truth in Lending**

The Federal Reserve’s regulations for Truth in Lending Disclosures are found in Part 226 of Title 12 of the Code of Federal Regulations.

Truth in Lending disclosures are required when credit is offered or extended to a consumer:

- Primarily for personal, family, or household purposes;
- In an amount of \$25,000 or less (unless secured by real property or personal property used as a principal dwelling); and
- Is subject to a finance charge (cost of credit expressed as a dollar amount)  
OR is payable by written agreement in more than four installments.

Truth in Lending disclosure requirements cover various types of both open-end and closed-end credit. General disclosure rules for closed-end credit are the ones most likely to be applicable to small-dollar, short-term consumer loan programs. One rule provides form, format, and timing requirements for such disclosures.<sup>75</sup> Another rule describes basic requirements for what must be included in a closed-end credit transaction disclosure, including the following:

- Identity of the creditor;
- “Amount financed,” using that term and a brief description such as “the amount of credit provided to you;”
- “Finance charge,” using that term and a brief description such as “the dollar amount the credit will cost you;”
- “Annual percentage rate” (APR), using that term and a brief description such as “the cost of your credit at a yearly rate”—the detailed rules for APR calculations can be complex, but APR will usually be calculated by a software application);
- Payment schedule;

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<sup>74</sup> 12 CFR § 205.3(b)(2)(ii).

<sup>75</sup> 12 CFR § 226.17.

- “Total of payments,” using that term and a brief description such as “the amount you will have paid when you have made all scheduled payments;”
- Prepayment terms (penalty or rebate);
- Late payment charge; and
- A statement referring to a written contract document for information about nonpayment, default, right to accelerate, prepayment rebates, and penalties.<sup>76</sup>

These disclosures must be clear and conspicuous, grouped together and segregated from other information, provided in a form that the consumer may keep, and provided before the loan transaction is consummated.<sup>77</sup> Creditors are required to retain records of all truth in lending disclosures for two years.<sup>78</sup> Appendices to the Truth in Lending Regulations contain detailed models and forms for various types of disclosures, such as Appendix for closed-end credit transactions.<sup>79</sup>

Disclosures can be made in electronic form, with consumer consent, and based on an additional set of specific disclosures regarding electronic records.<sup>80</sup> Before consenting to receive truth in lending disclosures in electronic form, a consumer must be provided with these clear and conspicuous disclosures:

- The right or option to have truth in lending disclosures provided in paper form, the procedure for requesting a paper copy, and whether any fee will be charged for a paper copy;
- The right to withdraw consent to receiving disclosures in an electronic form, the procedures for doing so, and any consequences of such withdrawal;
- Whether the consent applies only to the particular transaction disclosures or to identified categories of additional records that may be provided during the course of the parties' relationship;
- The procedures for updating electronic contact information; and
- Hardware and software requirements for access to and retention of the electronic records.<sup>81</sup>

Truth in Lending regulations also address advertising. Similar to the disclosure requirements for an actual credit transaction, if the advertisement states a rate of finance charge, it must be stated clearly and conspicuously as an “annual percentage rate.” No other rates can be quoted except for a simple annual rate or periodic rate that is applied to an unpaid balance (and not so as to overpower disclosure of the annual percentage rate).<sup>82</sup> If the annual percentage rate is subject to increase, the advertisement must so state.<sup>83</sup> An advertisement can state only those terms that

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<sup>76</sup> 12 CFR § 226.18.

<sup>77</sup> 12 CFR § 226.17(a) and (b).

<sup>78</sup> 12 CFR § 226.25.

<sup>79</sup> 12 CFR Appendix H; [http://edocket.access.gpo.gov/cfr\\_2011/janqtr/pdf/12cfr226AppH.pdf](http://edocket.access.gpo.gov/cfr_2011/janqtr/pdf/12cfr226AppH.pdf).

<sup>80</sup> 12 CFR § 226.17(a)(1).

<sup>81</sup> 15 U.S.C. § 7001(c).

<sup>82</sup> 12 CFR § 226.24(b) and (c).

<sup>83</sup> 12 CFR § 226.24(c).

actually are or will be offered.<sup>84</sup> Using particular terms in an advertisement may trigger additional disclosure requirements.<sup>85</sup>

## **Internet Resources**

### **Agency Websites**

Texas Office of Consumer Credit Commissioner

<http://www.occc.state.tx.us/>

Texas Credit Union Department

<http://www.t cud.state.tx.us/>

National Credit Union Administration

<http://www.ncua.gov/>

Federal Reserve System

<http://www.federalreserve.gov/>

Federal Office of Comptroller of the Currency

<http://www.occ.treas.gov/>

Federal Deposit Insurance Corporation

<http://www.fdic.gov/>

Community Development Financial Institutions Fund

<http://www.cdfifund.gov/>

### **Other Resources**

Coalition of Community Development Financial Institutions

<http://www.cdfi.org/>

Browse or search the Texas Finance Code

<http://codes.lp.findlaw.com/txstatutes/FI>

Browse the Texas Administrative Code

<http://www.sos.state.tx.us/tac/>

Browse or search the United States Code (USC)

<http://www.gpoaccess.gov/uscode/>

Browse or search the Code of Federal Regulations (CFR)

<http://www.gpoaccess.gov/cfr/>

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<sup>84</sup> 12 CFR § 226.24(a).

<sup>85</sup> 12 CFR § 226.24(d).

# APPENDIX B

## State Payday Loan Regulations: How Does Texas Compare

Texas payday and auto title loan businesses operate without any rate or fee restrictions. Seven other states have no caps on payday loans.

The diagram on the following pages provides a “snapshot” of payday lending regulations in the United States. The diagram does not analyze the benefits or harm of the different approaches, but rather presents them for informational value, to show how Texas compares to other states. It includes three groupings of states: 1) States that have capped loan rates at 36% or lower, which is a common standard for affordable credit; 2) States that have capped loan rates at triple digit rates, ranging from 150% APR to over 400% APR; and 3) States with no rate caps. In many instances, negative impacts of the loans on borrowers in high rate cap states are comparable to those in states with no rate caps.

In addition to rate caps, some states have enacted other regulations, such as limits on the total number of payday loans a borrower can have during a one-year period, or a six-month loan term requirement, in an attempt to address the difficulty borrowers have in repaying loans within two weeks or one month. The diagram highlights some of those regulatory schemes.<sup>86</sup>

The diagram compares rates for a \$250, two-week loan.<sup>87</sup> The “typical interest rates” are taken directly from the websites of regional or national payday lenders.<sup>88</sup> Individual stores and different loan companies may have rates that differ – the rates are provided for illustrative purposes only.

Finally, not every state is included due to space considerations.

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<sup>86</sup> For a more technical, state-by-state breakdown, see the National Consumer Law Center’s *Small Dollar Loan Products Scorecard*, which gives a pass-fail grade to every state, available at: [http://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/payday\\_loans/cu-small-dollar-scorecard-2010.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/cu-small-dollar-scorecard-2010.pdf). See also Leah A. Plunkett & Ana Lucia Hurtado, *Small-Dollar Loans, Big Problems: How States Protect Consumers From Abuses And How The Federal Government Can Help*, 44 SUFFOLK U.L. REV. 31 (2011) and <http://paydayloaninfo.org/legal-status>.

<sup>87</sup> The state specific rate cap data has been taken from the National Consumer Law Center’s 2010 *Small Dollar Loan Products Scorecard*, and updated, where relevant, using the web reference site: <http://paydayloaninfo.org/legal-status> (Last viewed December 19, 2011). See note 86.

<sup>88</sup> For example, see: Advance America, *Fees and Terms*, <http://www.advanceamerica.net/apply-for-a-loan/fees/> (last viewed Oct. 20, 2011); Cash America, *Cash Advance Rates and Fees*, <http://www.cashamerica.com/LoanOptions/CashAdvances/RatesandFees.aspx> (last viewed Oct. 20, 2011); Cash Net USA, *Rates and Terms*, <http://www.cashnetusa.com/fee-schedule.html> (last viewed Oct. 20, 2011); Community Financial Services of America, *Know Your Fee*, <http://cfsaa.com/our-resources/customer-resources/know-your-fee.aspx> (last viewed Oct. 20, 2011); and EZ Payday Advance, *Fee Charts*, <http://www.ezmoneycashloansexpress.com/feecharts.php> (last viewed Oct. 20, 2011).

**TEXAS**

\$250 Payday Loan through a CSO:  
*No Rate Cap*

Typical Rate:  
*500-700% or more*

\$250 Loan through a licensed lender:  
*156% APR*

Cycle of Debt Protections:  
*None*

**NORTH DAKOTA**

\$250 Payday Loan:  
*521% APR Rate Cap*

Typical Rate:  
*521% APR*

Cycle of Debt Protections:  
*One renewal with additional fee; three day cool-off period between loans*

**OKLAHOMA**

\$250 Payday Loan:  
*396% Rate Cap*

Typical Rate:  
*396% APR*

Cycle of Debt Protections:  
*None; Auto-title loans prohibited*

**SOUTH DAKOTA**

\$250 Payday Loan:  
*No Rate Cap*

Typical Rate:  
*574% APR*

Cycle of Debt Protections:  
*None*

**LOUISIANA**

\$250 Payday Loan:  
*574% APR Rate Cap*

Typical Rate:  
*469% APR*

Cycle of Debt Protections:  
*None*

**No Rate Caps**

**High Rate Caps**

**IDAHO, MISSOURI, NEVADA, WISCONSIN**

\$250 Payday Loan:  
*MO – 75% of amount financed  
Others – No Rate Cap*

Typical Rate:  
*652% APR  
(a fee of \$25 per \$100 borrowed over two weeks)*

Cycle of Debt Protections:  
*None*

**DELAWARE**

\$250 Payday Loan:  
*No Rate Cap*

Typical Rate:  
*500-650% APR*

Cycle of Debt Protections:  
*None*

**ALASKA**

\$250 Payday Loan:  
*443% APR Rate Cap*

Typical Rate:  
*443% APR*

Cycle of Debt Protections:  
*None*

Eight states have no rate caps – or no meaningful rate cap – and charge whatever fees the market can bear.

These include:  
Delaware, Idaho, Missouri, Nevada, South Dakota, Texas, Utah, and Wisconsin.

**ALABAMA**

\$250 Payday Loan:  
*456% APR Rate Cap*

Typical Rate:  
*456% APR*

Cycle of Debt Protections:  
*None*

## WYOMING

\$250 Payday Loan:  
313% APR Rate Cap

Typical Rate:  
313% APR

Cycle of Debt Protections:  
Auto title loans prohibited; larger loans capped at 36% APR; \$100 loan rates upwards of 700%

## NEW YORK

\$250 Payday Loan:  
Prohibited

Typical Rate:  
Storefront payday lenders do not operate in this state

Consumer protections:  
Auto title lending prohibited; larger loan products capped at 25%

## COLORADO

\$250 Payday Loan:  
Varies based on the duration of the loan

Typical Rate:  
521% (if paid off after 14 days)

Cycle of Debt Protections:  
6-month minimum loan term with no penalties for prepayment

\* The loan is taken out at 45% interest, but lenders may charge a monthly maintenance fee up to \$30 and origination fees of 20% of the loan up to \$300, and 7.5% beyond \$300.

## MINNESOTA

\$250 Payday Loan:  
235% APR Rate Cap

Typical Rate:  
235% APR

Cycle of Debt Protections:  
Protections against out-of-state lenders; disclosure; max loan \$350

## ARKANSAS

\$250 Payday Loan:  
17% APR Constitutional Rate Cap (applies to all small dollar loan products)

Cycle of Debt Protections:  
Rate Cap

High Rate Caps

Rate Caps ≤ 36%

## RHODE ISLAND

\$250 Payday Loan:  
261% APR Rate Cap

Typical Rate:  
261% APR

Cycle of Debt Protections:  
Loan amount limited to 25% gross monthly income; limited to 1 renewal (monthly paychecks) or 3 renewals (weekly or bi-weekly paychecks)

## MONTANA

\$250 Payday Loan:  
36% APR Statutory Rate Cap (applies to all small dollar loan products)

Cycle of Debt Protections:  
Rate Cap

## FLORIDA

\$250 Payday Loan:  
313% APR Rate Cap

Typical Rate:  
313% APR

Cycle of Debt Protections:  
\$500 maximum loan

Sixteen states (and D.C.) explicitly prohibit or otherwise enforce restrictions that effectively halt payday lending.

These include:

Arizona, Arkansas, Connecticut, Georgia, Massachusetts, Maryland, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia.

## ARIZONA, GEORGIA, N. CAROLINA, W. VIRGINIA

\$250 Payday Loan:  
Not authorized / explicitly prohibited

Cycle of Debt Protections:  
Other predatory lending products are still permitted





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