



REFLECTIONS CONCERNING PAYDAY LENDING

*“Yet, as the unequivocal words of the Gospel remind us,
there is a special presence of Christ in the poor,
and this requires the Church to make a preferential option for them.”*

*—Pope John Paul II, 2001
“At the Beginning of the New Millennium”*

In 1999 Monsignor John Egan, a priest in the Archdiocese of Chicago, heard the story of a parishioner who was victimized by what is commonly known as the payday lending business. A prolific advocate of social justice and racial harmony, Msgr. Egan immediately became outraged by the parishioner’s tale and undertook a payday lending reform campaign as one of his last crusades in defense of the poor and vulnerable. Convening a broad-based coalition that included religious, community and political groups, Msgr. Egan labored intensively until the Illinois legislature passed measures ensuring that those in dire financial straits were no longer economically abused. The work of Msgr. Egan, who passed away in May 2001, has echoed vibrantly as some 37 states across the country now have laws that regulate the growing payday lending industry.

Following the tide created by Msgr. Egan in Chicago some 6 years ago, the Catholic Campaign for Human Development and other Catholic organizations, including the Michigan Catholic Conference, have focused its attention on states where payday loan regulations are new or have yet to occur. The intent of this *FOCUS* publication is to raise awareness of the payday lending industry, and to provide those in difficult situations with helpful information on how to avoid further financial burden.

According to the Center for Responsible Lending, the payday lending industry consisted of 7,000 to 10,000 loan offices in 2000, which accounted for 41 million transactions and \$1.4 billion in fees. By the end of 2003, there were approximately 22,000 payday offices generating \$6 billion in fees from around 100 million transactions. Total sales volume grew from \$10 billion in 2000 to \$40 billion in 2003. In other words, the payday lending industry quadrupled in size within three years.

UNDERSTANDING PAYDAY LENDING

Also known as “deferred presentment,” “cash advances,” or “check loans,” the payday lending industry provides customers with up-front cash to help the customer pay off debts or creditors. The transaction includes a customer writing a personal check to the business, or authorizing an automatic withdrawal from the customer’s bank account, equal to the amount borrowed plus a fee that is either a percentage of the full amount of the check or a flat dollar amount. For example, an individual needs to borrow \$200 and writes a check for that amount plus \$56 in fees and interest. The business will then hold the check or authorized automatic withdrawal for a short duration, usually for two weeks or until the borrower’s next payday. The customer then has the option of paying back the \$256 in return for the original check, depositing the check to the business, or renewing or rolling over the loan if it is unpayable.

Until laws were enacted across the country to regulate the payday lenders, a lack of accountability or oversight had enabled many businesses to exploit poor and elderly customers with excessive fees and/or interest. Even in states where the payday lending industry is now regulated, the borrower is typically of little financial means and is subject to interest rates that far exceed that of any bank or credit card company. In the example listed above, the customer is paying a compounded annual interest rate of 730 percent.¹ While a very small number of businesses operate in median-income neighborhoods, the majority are located in densely populated urban areas with a high concentration of poor and minority residents. Cash Now, Fast Cash, Instant Cash Advance, and Cash Connection typify a payday lending business name, indicating the ease of the transaction to the customer.

In 2003 the Woodstock Institute, a Chicago-based

organization that addresses economic development and reinvestment needs in minority communities, released an analysis that found payday lending businesses are twice as likely to establish themselves in predominantly African-American communities.² Similarly, a March 2005 study by the Center for Responsible Lending found that African-American neighborhoods in North Carolina have three times as many payday lenders per capita as white neighborhoods—even after controlling for variables associated with the industry’s assumed customer base such as income and home ownership. According to the president of the Center for Responsible Lending: “This study shows in the starkest terms that African-American neighborhoods bear the brunt of predatory payday loans.”³

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In an effort to address these practices, and to confront what it called “the high risk nature of payday lending and the substantial growth of this product,” the Federal Deposit Insurance Corporation (FDIC) released its *Guidelines for Payday Lending* report in July 2005. The guidelines were established following a letter composed by the attorneys general of 36 states, who wrote the FDIC chairman over concern that many payday lenders were using FDIC insured banks to undermine states’ law. Recommendations from the FDIC report included allowing a “cool off” period between loans, a prohibition on additional advances to finance unpaid interest and fees, establishing a maximum number of loans in a calendar year, and provide that only one loan be taken out at a time.⁴

MICHIGAN'S DEFERRED PRESENTMENT SERVICE TRANSACTIONS ACT

In 2005 the State of Michigan for the first time in its history enacted legislation that regulates the payday lending business. The legislation, sponsored by Representative Bill McConico (D-Detroit), is titled the “Deferred Presentment Service Transactions Act” and includes the following details:

A business engaging in the payday lending industry will need a license from the Commissioner of the state’s Office of Financial and Insurance Services (OFIS). A separate license will be required for each location where business is conducted. By July 1, 2006, the commissioner of OFIS will have to establish an application process and timeline for businesses to seek licensure, as well as establish an application fee. Licenses will have to be renewed annually.

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A licensee engaged in deferred presentment can enter into one transaction with a customer at a time for up to \$600, and may charge a service fee up to 15 percent of the transaction. A maturity date cannot exceed 31 days. A transaction will have to be documented with a written agreement signed by both the customer and the licensee. An agreement cannot be renewed, although it can be extended if no additional fee was charged and if the balance owed did not exceed the amount owed on the original agreement.

The commissioner of OFIS is required, by December 31,

2006, to develop, implement, and maintain a statewide common database with real-time access through an Internet connection that will be available to licensees and to the commissioner. The database will prohibit a licensee from entering into a transaction with a customer if the customer has an open transaction with the licensee or has an open transaction with any other licensee.

A licensee will be required to prominently post a notice containing certain specified statements about the nature of deferred presentment service in an area designed to be seen by the customer before entering into a deferred presentment service transaction, and will also be required to post prominently a schedule of all fees and charges.

A private right of action allows a customer to file a complaint against a licensee to the OFIS commissioner if the customer feels he or she has been wronged by the licensee. The commissioner of OFIS will have to investigate written complaints from customers and can investigate and conduct examinations on his or her own initiative as considered necessary. The commissioner is authorized to issue cease and desist orders; to suspend and revoke licenses; to investigate or conduct examinations and hold hearings to determine if the act had been violated, and can subpoena witnesses and evidence.

ALTERNATIVES TO PAYDAY LENDING

Borrowing money from a payday lender can turn into more of a problem than a convenience, especially for those who are on limited budgets and cannot afford incurred costs. In order to avoid compounded debt and further financial hardships, the following suggestions from the Federal Trade Commission and the Center for Responsible Lending may prove helpful:

- Seek the possibility of a payment plan with the creditor. Check with the company's customer relations department if it is possible to pay off debt through an agreed upon payment plan. Oftentimes it is easier to deal directly with the creditor rather than having to pay interest and fees on borrowed money.
- Those who need assistance working out a debt-repayment plan with creditors or developing a budget have the option of contacting a local credit counseling service. Such services are available at little or no cost and may be beneficial for alleviating debt. The United States Department of Justice provides a list of approved credit counseling agencies in Michigan, which may be found at http://www.usdoj.gov/ust/bapcpa/ccde/cc_approved.htm#MI
- If a consumer believes a lender has violated the Truth in Lending Act, he or she may file a complaint with the Federal Trade Commission (FTC). This governmental agency works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to prevent such practices. To accommodate complaints, the FTC provides a toll-free phone number at (877) FTC-HELP.

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¹ National Consumer Law Center, www.consumerlaw.org/initiatives/seniors_initiative/payday.shtml. Data Accessed November 2005.

² Woodstock Institute, "Payday Lending Gauging African-American Communities" www.woodstockinst.org March 2003.

³ Al Swanson, "Analysis: Unscrupulous Lending is Costly," *The Washington Times*, 30 March 2005.

⁴ Federal Deposit Insurance Corporation, "Guidelines for Payday Lending," July 2005.
