Financial Decisions, Spring 2015, Article 3

State Usury Laws versus Payday Lending

Richard Kish
Lehigh University

Abstract

This study outlines the friction that exists between usury laws and attempts to regulate payday lending. Abusive practices exist to maximize the return to the payday lender through high fees and lax policy enforcement on rollover of loans through same-day or "touch and go" rollovers. Interest costs are in the hundred on annual percentage terms and dollar interest amounts are typically greater than the initial amount of the loan when it is finally paid off. The case is made for Congress to extend the "Talent Amendment," which protects military personnel and their dependents against predatory lending to all consumers.

1. Introduction

Usury laws are utilized to place limits on the charging of excessive interest on borrowed money. In "The History of Usury," Ackerman (1981) outlines the progression of usury laws over time. The Code of Hammurabi, the first written code of law (1750 B.C.), regulated the interest that could be charged on a loan. For instance, a merchant was permitted to collect interest of 33⅓ percent on a loan of grain but only 20 percent on a loan of silver. This code or variations of it was the law of the land until the rise of the Roman Empire. Around 450 B.C., the Romans adopted their own code of law: The Twelve Tables. This code capped interest at 8⅓ percent, although there are many interpretations of an upper limit of 10 percent. In 88 B.C., the Romans transitioned to a legal limit of 12%, but it continued to fluctuate overtime. Although countries in modern times have set various limits on interest rates, the most common usury rate currently quoted in many jurisdictions is 36%.[1] Besides governmental authorities, many religions (Christian, Hindu, Islam, and Judaism) have banned or placed severe restrictions on any interest charged on the lending of money.[2] Unfortunately, with any set of rules there are always exceptions as seen within the payday lending industry.

The first payday loans are said to be credited to W. Allen Jones, a Cleveland, Tennessee businessman, in 1993.[3] The growth of the industry was helped by legislation passed in a number of States to supersede the interest rate limits applicable to other lending instruments. For instance, in 1995 the Ohio Legislature passed a bill exempting payday lenders from its usury laws. Most statues are built on legislation influenced by the Community Financial Services Association (CFSA), a leading payday lending trade group. Sample terms include: loans can only be made for $500 or less; loans can only be renewed one time; borrowers can rescind a loan within a day; lenders must obtain licenses to operate; lenders cannot use threats of criminal prosecution as a collection tool; and fees are capped at 20 percent of the first $300 lent and 7.5 percent on any funds over $300.[4]

CFSA has also tried to standardize the payday lending process among its members. To obtain an advance (i.e., a payday loan), a customer is required to meet 5 basic requirements: (1) Must have an active checking account; (2) Must provide proof of regular income; (3) Must present proper identification; (4) Upon completion of a simple application and approval, the borrower must read and sign an agreement containing disclosures required by the Truth in Lending Act (TILA); and (5) Must write a personal check for the amount of the cash advance plus the associated fee. After this process is completed, the lender immediately advances the customer funds, but holds the check until an agreed upon date (usually within two to four weeks) when the borrower receives his/her next paycheck. On the agreed upon date, either the check is deposited, the customer returns with cash to reclaim the check, or the loan is rolled-over with additional fees.[5] Another variant initiated by CFSA members to fend off continuing criticism of payday loans is an annual one time offer of an optional extended payment plan to borrowers who are unable to pay off their loans at maturity.

2. State Lending Laws: Legal, Usury, and Judgment Rates

Within the United States, no single rate limit applies across its 50 States or across the variety of lending contracts offered. Each State is permitted to incorporate its own legal limits on the

amount of interest that can be charged against loans within the broad field of usury laws. Current interest rate limits are summarized in Table 1. Unfortunately, these are not iron clad legal limits for there are often exceptions.

Table 1. Inter*est* Rate Limits by States

State	*Interest Rate Limits*
ALABAMA	The legal rate of interest is 6%; the general usury limit is 8%. The judgment rate is 12%.
ALASKA	The legal rate of interest is 10.5%; the general usury limit is more than 5% above the Federal Reserve interest rate on the day the loan was made.
ARIZONA	The legal rate of interest is 10%.
ARKANSAS	The legal rate of interest is 6%; for non-consumers the usury limit is 5% above the Federal Reserve's interest rate; for consumers the general usury limit is 17%. Judgments bear interest at the rate of 10% per annum, or the lawful agreed upon rate, whichever is greater.
CALIFORNIA	The legal rate of interest is 10% for consumers; the general usury limit for non-consumers is more than 5% greater than the Federal Reserve Bank of San Francisco's rate.
COLORADO	The legal rate of interest is 8%; the general usury limit is 45%. The maximum rates to consumers is 12% per annum.
CONNECTICUT	The legal rate of interest is 8%; the general usury rate is 12%. In civil suits where interest is allowed, it is allowed at 10%.
DELAWARE	The legal rate of interest is 5% over the Federal Reserve rate.
FLORIDA	The legal rate of interest is 12%; the general usury limit is 18%. On loans above \$ 500,000 the maximum rate is 25%.
GEORGIA	The legal rate of interest is 7%; On loans below \$ 3,000 the usury limit is 16%. On loans above \$ 3,000, the limit appears to be 5% per month. As to loans below \$ 250,000 the interest rate must be specified in simple interest and in writing.
HAWAII	The legal rate of interest is 10%. The usury limit for consumer transactions is 12%.
IDAHO	The legal rate of interest is 12%. Judgments bear interest at the rate of 5% above the U.S. Treasury Securities rate.
ILLINOIS	The legal rate of interest is 5%. The general usury limit is 9%. The judgment rate is 9%.
INDIANA	The legal rate of interest is 10%. Presently there is no usury limit; however, legislation is pending to establish limits. The judgment rate is also 10%.
IOWA	The legal rate of interest is 10%. In general consumer transactions are governed at a maximum rate of 12%.
KANSAS	The legal rate of interest is 10%; the general usury limit is 15%. Judgments bear interest at 4% above the federal discount rate. On consumer transactions, the maximum rate of interest for the first \$1,000 is 18%, above \$1,000, 14.45%.

KENTUCKY	The legal rate of interest is 8%; the general usury limit is more than 4% greater than the Federal Reserve rate or 19%, whichever is less. On loans above $ 15,000 there is no limit. Judgments bear interest at the rate of 12% compounded yearly, or at such rate as is set by the Court.
LOUISIANA	The legal rate of interest is one point over the average prime rate, not to exceed 14% nor be less than 7%. Usury limit for individuals is 12%, there is no limit for corporations. (As warned, you cannot evade the limit by forming a corporation when the loan is actually to an individual.)
MAINE	The legal rate of interest is 6%. Judgments below $ 30,000 bear 15%, otherwise they bear interest at the 52 week average discount rate for T-Bills, plus 4%.
MARYLAND	The legal rate of interest is 6%; the general usury limit is 24%. There are many nuances and exceptions to this law. Judgments bear interest at the rate of 10%.
MASSACHUSETTS	The legal rate of interest is 6%; the general usury rate is 20%. Judgments bear interest at either 12% or 18% depending on whether the court finds that a defense was frivolous.
MICHIGAN	The legal rate of interest is 5%; the general usury limit is 7%. Judgments bear interest at the rate of 1% above the five year T-note rate.
MINNESOTA	The legal rate of interest is 6%. The judgment rate is the "secondary market yield" for one year T-Bills. Usury limit is 8%.
MISSISSIPPI	The legal rate of interest is 9%; the general usury limit is more than 10%, or more than 5% above the federal reserve rate. There is no usury limit on commercial loans above $ 5,000. The judgment rate is 9% or a rate legally agreed upon in the underlying obligation.
MISSOURI	The legal and judgment rate of interest is 9%. Corporations do not have a usury defense. (Remember that a corporation set up for the purpose of loaning money to an individual will violate the usury laws.)
MONTANA	The legal rate of interest is 10%; the general usury limit is above 6% greater than New York City banks' prime rate. Judgments bear interest at the rate of 10% per annum.
NEBRASKA	The legal rate of interest is 6%; the general usury limit is 16%. Accounts bear interest at the rate of 12%. Judgments bear interest at the rate of 1% above a bond yield equivalent to T-bill auction price.
NEVADA	The legal rate of interest is 12%; there is no usury limit.
NEW HAMPSHIRE	The legal rate of interest is 10%; there is no general usury rate.
NEW JERSEY	The legal rate of interest is 6%; the general usury limit is 30% for individuals, 50% for corporations. There are a number of exceptions to this law.
NEW MEXICO	The legal rate of interest is 15%. Judgment rate is fixed by the Court.
NEW YORK	The legal rate of interest is 9%; the general usury limit is 16%.

NORTH CAROLINA	The legal interest rate and the general usury limit is 8%. However, there is a provision for a variable rate, which is 16% or the T-Bill rate for non-competitive T-Bills. Above $ 25,000 there is no express limit. However, the law providing for 8% is still on the books—be careful and see a lawyer!
NORTH DAKOTA	The legal rate of interest is 6%; the general usury limit is 5 1/2% above the six-month treasury bill interest rate. The judgment rate is the contract rate or 12%, whichever is less. A late payment charge of 1 3/4% per month may be charged to commercial accounts that are overdue provided that the charge is revealed prior to the account being opened and that the terms were less than thirty days, that is, that the account terms were net 30 or less.
OHIO	The legal limit on personal loans is 21%.
OKLAHOMA	The legal rate of interest is 6%. Consumer loans may not exceed 10% unless the person is licensed to make consumer loans. Maximum rate on non-consumer loans is 45%. The judgment rate is the T-Bill rate plus 4%.
OREGON	The legal rate is 9%, the judgment rate is 9% or the contract rate, if lawful whichever is higher. The general usury rate for loans below $ 50,000 is 12% or 5% above the discount rate for commercial paper.
PENNSYLVANIA	The legal rate of interest is 6%, and this is the general usury limit for loans below $ 50,000, except for: loans with a lien on non-residential real estate; loans to corporations; loans that have no collateral above $ 35,000. Judgments bear interest at the legal rate. It is criminal usury to charge more than 25%.
RHODE ISLAND	The legal rate of interest and judgment rate is 12%.The general usury limit is 21% or the interest rate charged for T-Bills plus 9%.
SOUTH CAROLINA	The legal rate of interest is 8.75%, and judgments bear interest at the rate of 14%. Subject to federal criminal laws against loan sharking there is no general usury limit for non-consumer transactions. The South Carolina Consumer Protection code provides regulations for maximum rates of interest for consumer transactions. Please consult with counsel for the latest rates.
SOUTH DAKOTA	The legal rate of interest is 15%, judgments bear interest at the rate of 12%. There is no other usury limit. There are certain limitations on consumer loans below $ 5,000.00.
TENNESSEE	The legal rate and judgment rate of interest is 10%. The general usury limit is 24%, or four points above the average prime loan rate, whichever is less.
TEXAS	The legal rate of interest is 6%. Interest does not begin until 30 days after an account was due. The judgment rate of interest is 18% or the rate in the contract, whichever is less. There are a number of specific ceilings for different types of loans, please see counsel for information.
UTAH	The legal rate of interest is 10%. Judgments bear interest at the rate of 12%, or a lawfully agreed upon rate. There are floating rates prescribed for consumer transactions. Please see counsel for information.

VERMONT	The legal rate of interest and judgment rate of interest is 12%. On retail installment contracts the maximum rate is 18% on the first $ 500, 15% above $ 500. The general usury limit is 12%.
VIRGINIA	The legal rate of interest is 8%. Judgments bear interest at the rate of 8%, or the lawful contract rate. Corporations and business loans do not have a usury limit, and loans over $ 5,000 for "business" or "investment" purposes are also exempt from usury laws. Consumer loans are regulated and have multiple rates.
WASHINGTON	The legal rate is 12%. The general usury limit is 12%, or four points above the average T-Bill rate for the past 26 weeks, whichever is greater. (The maximum rate is announced by the State Treasurer.) Judgments bear interest at the rate of 12% or the lawful contract rate, whichever is higher.
WEST VIRGINIA	The legal rate of interest is 6%. The maximum "contractual" rate is 8%; Commissioner of Banking issues rates for real estate loans, and, may establish maximum general usury limit based on market rates.
WISCONSIN	The legal rate of interest is 5%. There are a myriad of rates for different type of loans. There is no general usury limit for corporations. Note that a loan to an individual, even if a corporation is formed, will violate the law. The judgment rate of interest is 12%, except for mortgage foreclosures, where the rate will be the lawful contract rate.
WYOMING	The legal rate and judgment rate of interest is 10%. If a contract provides for a lesser rate, the judgment rate is the lesser of 10% and the contract rate.

Source: http://www.usurylaw.com/
Note: The legal rate is the highest rate of interest that can be legally charged based on the type of debt. The judgment rate is the rate of interest used in calculating the amount of post judgment interest which varies by court proceeding. The usury rate is supposed to be the upper lending rate allowed to restrict the lending at exorbitant interest rates.

In eight of the stricter States (Connecticut, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Vermont, and West Virginia), payday lending must comply with the general interest rate caps established under the general category of consumer loans which in effect bans payday lending. Payday lenders do not feel they can earn a profit under these existing caps. Several States (Arizona, Arkansas, Georgia, and North Carolina) have passed additional legislation to specifically outlaw payday lending. Yet a majority of States continues to let payday lending exist but place additional hurdles the lender must overcome.[6]

Table 2 summarizes the frequency of State interest rate limits found within Table 1. The average legal interest rate charged by the 50 States is 8.8% with values ranging from a low of 5% in Illinois, Michigan, and Wisconsin to a high of 21% in Ohio. This mean value understates the interest charges since several States allow variable rates. For instance, Delaware's legal limit is 5% plus the Federal Reserve Bank rate, while Louisiana's legal rate is defined as 1% plus the average prime rate, not to exceed 14% nor be less than 7%. The most common legal limits were 6% (13 States) and 10% (11 States).

Averages for both usury rates and judgment rates were higher than the reported legal limits at 13.5% and 9.9% respectively. But these averages may be misleading since many States failed to report any limits beyond the legal rates. The range for the reported usury rates were a low of 5% (found in Alaska, California, and Idaho) to a high of 30% in New Jersey. Similar to the legal rate restrictions, these low rates are misleading since the 5% reported rate is just a base rate in which either the Federal Reserve rate (Alaska and California) or the U.S. Treasury rate (Idaho) is added. Eighteen states did not report any additional restrictions for usury rates. Judgment rates, similar to usury rates, show many States not reporting additional restrictions. From the 28 states that specifically had judgment interest rate limits, the average was 9.9% and ranged from 1% to 18%. The 1% shown for Michigan is again misleading since it is a base rate that is adjusted by adding the 5-year U.S. Treasury note rate. The most common rate for both usury and judgment rates was 12%.

Table 2. Summary Table for Legal, Usury, and Judgment Rates

	Legal Rates	Usury Rates	Judgment Rates
≤ 5%	4	3	4
6%	13	2	1
7%	1	1	0
8%	5	3	1
9%	5	1	3
10%	11	1	7
11%	1	0	0
12%	6	8	9
>12%	3	13	3
Mean	8.8%	13.5%	9.9%
Maximum	21.0%	30%	18%
Minimum	5.0%	5.0%	1.0%

3. State Payday Lending Laws

Table 3 details the specific “Payday Lending Laws” by States to gage the differences between usury laws and payday lending regulations. For example, Table 1 shows that Alabama has a 6% legal limit on the amount of interest that can be charged for a small loan and an overall general usury limit set at 8%. An exception to the usury limit was made for “Deferred Presentment Loans” which include payday loans.[7] This exception to the interest rate limits permits a finance charge up to the limit of 17½ percent of the amount advanced. This higher rate applies to loans of $500 or less with term limits not less than 10 days or more than 31 days. Most payday loans are for 14 days based on receiving a paycheck every two week. Under this relaxed interest rate limit, the annual percentage rate (APR) is 456.25% (i.e., rate charged on 2-week loan times number of 2-week periods per year = 17.5% * 365/14) which greatly exceeds the legal interest rate limit of 8 percent on loans with written contracts.[8] This APR is the partial year rate extrapolated out without compounding for the entire year. But even reported APRs can be confusing. Note that if the loan was for only the minimum term of 10 days, the APR would rise

to 638.75% (i.e., 17.5% * 365/10). Similarly, if the loan went for the maximum term of 31 days, the APR would be reduced to 206% (i.e., 17.5% * 365/31).

Table 3. Payday Lending Laws by States

State:	Maximum Loan Amount:	Maximum Loan Term (T):	Finance Charges:
Alabama	$500	10 days ≤ T ≤ 31 days	May not to exceed 17.5% of the amount advanced.
Alaska	$500	14 days	Nonrefundable origination fee ≤ $5; and a fee ≤ $15 for each $100 of an advance, or 15% of the total amount of the advance, whichever is less.
Arizona	*Prohibited*		
Arkansas	*Prohibited*		
California	$300	Up to 31 days	Deferred deposit transaction fee ≤ 15% of the face amount of the check.
Colorado	$500	T ≥ 6 months	Finance charge for each payday loan ≤ 20% of the first $300 loaned plus 7 ½ % of any amount loaned in excess of $300. The lender may also charge an interest rate of 45% per annum for each payday loan. In addition, the lender may charge a monthly maintenance fee for each outstanding deferred deposit loan, not to exceed $7.50 per $100 loaned, up to $30 per month. Upon renewal of a deferred deposit loan, the lender may assess an additional finance charge not to exceed an annual percentage rate of 45 percent.
Delaware	$1,000	T ≤ 60 days	A licensee may charge and collect interest in respect of a loan at such daily, weekly, monthly, annual or other periodic percentage rate or rates as the agreement governing the loan provides or as established in the manner provided in such agreement and may calculate such interest by way of simple interest or such other method as the agreement governing the loan provides.

Florida	$500 exclusive of the fees	7 ≤ T ≤ 31 days	Fees ≤ 10 percent of the currency or payment instrument provided. However, a verification fee may be charged as provided in §560.309(7). The 10 percent fee may not be applied to the verification fee.
Georgia	*Prohibited*		
Hawaii	$600	T ≤ 32 days	Fee ≤ 15% of the face amount of the check.
Idaho	$1000		None
Illinois	$1,000 or 25% of consumer's gross monthly income, whichever is less	13 ≤ T ≤ 120 days. Except for an installment payday loan.	Fee ≤ $15.50 per $100 loaned. Plus restrictions on multiple loans.
Indiana	At least $50 and not more than $550	T ≥ 14 days	Fees on the first $250, 15% of the principal. Fees on loan greater than $250 and less than or equal to $400 are limited to 13% of the amount over $250 and less than $400. Fees on the amount greater than $400 and less than or equal to $500 are limited to 10% of amount over $400 and less than $500.
Iowa	Total accumulation of $500 or less.	Not to exceed 31 days	Fee ≤ $15 on the first $100 on the face amount of a check or more than $10 on subsequent $100 increments on the face amount of the check.
Kansas	$500 or less	7 ≤ T ≤ 30 days	Fee ≤ 15 percent of the amount of the cash advance. The contract rate ≤ 3%/month of the loan proceeds after the maturity date.
Kentucky	Maximum total proceeds ≤ $500.	T ≤ 60 days	Fee ≤ $15 per $100 on the face amount of the deferred deposit check. Maximum outstanding loans are 2.
Louisiana	$350	T ≤ 30 days	Fee ≤ 16.75% of the face amount of the check issued.
Maine	None		30% per year on balances ≤ $2,000; 24% per year on balances between $2,000 and $4,000; and 18% per year balances > $4,000. Allowable minimum charge ≤ $5 on balance of < $75; $15 on balance between $75 and $250; or $25 on amount financed > $250.

Michigan	$600	T ≤ 31 days	Fee ≤ 15% on first $100; 14% on the second $100; 13% on the third $100; 12% on the fourth $100; 11% on the fifth $100; and 11% on the sixth $100.
Minnesota	$350	T ≤ 30 days	Fee of $5.50 (amount ≤ $50); an additional $5.50 ($50 < amount ≤ $100; a charge may be added equal to 10% of the loan proceeds plus a $5 administrative fee; $100 < amount ≤ $250, a charge may be added equal to 7% of the loan with a minimum of $10 plus a $5 administrative fee; $250 < amount ≤ $350, a charge may be added equal to 6% of the loan with a minimum of $17.50 plus a $5 administrative fee. After maturity, the contract rate must not exceed 2.75%/month of the remaining loan proceeds after the maturity date calculated at a rate of 1/30 of the monthly rate in the contract for each calendar day the balance is outstanding.
Mississippi	$500, including the amounts of the fees	T ≤ 30 days, if balance is ≤ $250. 28 ≤ T ≤ 30 days, if $250 < balance ≤ $500.	Fees ≤ 3% of face amount of the check or $5, whichever is greater, for government checks; Fees ≤ 10% or $5, whichever is greater, for personal checks; or 5% of the face amount of the check or $5, whichever is greater, for all other checks, or for money orders. Maximum fee ≤ $20 per $100 if amount ≤ $250. Maximum fee ≤ $21.95 per $100 if $250 < amount ≤ $500.
Missouri	$500 or less	14 ≤ T ≤ 31 days	Accumulated interest and fees ≤ 75% of the initial loan amount on any single loan.
Montana	$50 ≤ amount ≤ $300, exclusive of fees allowed.		Fee ≤ 36% per annum, exclusive of the insufficient funds fees.
Nebraska	$500 or less.	T ≤ 34 days	Fee ≤ $15 per $100 amount borrowed.
Nevada	loan ≤ 25% percent of the expected gross monthly income of the customer when the loan is made.		Notwithstanding any other provision of law, a violation of any provision of §670 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Public Law 109-364, or any regulation adopted pursuant thereto shall be deemed to be a violation of this chapter.

New Hampshire	\$500	7 ≤ T ≤ 30 days	Payday loans shall incur interest only. No other charges or fees shall apply to or be collected on payday loans. Interest ≤ 6% per year. The annual percentage rate on a payday loan shall be no more than 36% per year.
New Mexico	Loan plus fees ≤ 25% of the consumer's gross monthly income.	14 ≤ T ≤ 35 days	Fee ≤ \$15.50 per \$100 of principal.
North Carolina	*Prohibited*		
North Dakota	\$500/transaction and \$600 total.	T ≤ 60 days and a renewal period ≥ 15 days.	Fee ≤ 20% of balance
Ohio	\$500	T ≥ 31 days	Interest ≤ an annual percentage rate of 28%.
Oklahoma	\$500 exclusive of the finance charge	12 ≤ T ≤ 45 days	Fee ≤ \$15 for every \$100 advanced up to the first \$300; \$10 for every \$100 advanced in excess of \$300.
Oregon	\$50,000	31 ≤ T ≤ 60 days	Rate ≤ 36% per annum, excluding a one-time origination fee for a new loan; Charge during the term of a new payday loan, including all renewals of the loan, more than one origination fee of \$10 per \$100 of the loan amount or \$30, whichever is less.
Rhode Island	\$500	T ≥ 13 days	Fee ≤ 3% of the face amount of the check, or \$5, whichever is greater, if the check is the payment of any kind of state public assistance or federal social security benefit; (2) ≤ 10% of the face amount of the personal check or \$5, whichever is greater for personal checks; or (3) ≤ 5% of the face amount of the check or \$5, whichever is greater, for all other checks; (4) ≤ 10% of the amount of funds advanced.
South Carolina	\$550 exclusive of fees	T ≤ 31 days	A licensee shall not charge, directly or indirectly, a fee or other consideration in excess of 15 percent of the face amount of the check.
South Dakota	\$500		None
Tennessee	\$500	T ≤ 31 days	Fee ≤ 15% of the face amount of the check.

Texas		if loan ≤ $100: 1 month for each multiple of $10 of cash advance; or max of 6 months; and if loan > $100, 1 month for each multiple of $20 of cash advance.	Fee ≤ $1 for each $5 of the cash advance for amount ≤ $30; ≤ 10% of balance if $30 < amount ≤ $100: other fees for installment loans
Utah	None	May not be rolled over beyond 12.	A deferred deposit lender that engages in a deferred deposit loan may not collect additional interest on a deferred deposit loan with an outstanding principal balance 10 weeks after the day on which the deferred deposit loan is executed.
Virginia	$500	T ≥ at least 2 times the borrower's pay.	Rate ≤ 36% plus fees ≤ 20% of the amount of the loan proceeds. A licensee may charge and receive a verification fee in an amount ≤ $5.
Washington	≤ $700 or 30% of the gross monthly income of the borrower, whichever is lower.	T > date of the borrower's next pay date. If next pay date ≤ 7 days due date on or after the borrower's 2nd pay date.	Fees ≤ 15% on first $500 of principal; ≤ 10% of balance in excess of $500 if balance > $500.
Wisconsin	$1,500 or 35 percent of the customer's gross monthly income		No limit on the interest that a licensee may charge before the maturity date of a payday loan; if not paid in full on or before the maturity date, interest ≤ 2.75%/month.
Wyoming	None	One calendar month	Fee ≤ $30 or 20 percent per month on the principal balance.

Source: National Conference of State Legislatures (NCSL) Payday Lending Statutes (9/12/2013)
http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx

Most of the criticism of the APR is that the underlying assumption requires rolling over the same loan with the same terms throughout the year. In most instances this is unrealistic, but this is not so farfetched when discussing payday loans. In a white paper by the Consumer Financial Protection Bureau (CFPB) in March 2014, it is documented that payday loans based on pay periods of less than a month (i.e., weekly, bi-weekly, or twice a month) the majority of loans are rolled over regardless of the restrictions dictated by the State in which the loan originated. Restrictions ranged from States with no limits on roll-overs to States that prohibited roll-overs. Some States forbidding roll-overs require a waiting period after a loan is repaid before a new loans can be undertaken.[9] In States without waiting periods requirements but with laws prohibiting rollovers, "touch and go" renewals are often used. Touch and go "non-rollovers" involves the borrower paying the fee and the money back to the payday lender, technically ending the loan. The lender touches the repayment, which is usually a check that is never deposited, and then grants a new loan. If the fees are also rolled-over, the cost would be more realistically shown by the effective interest rate, which is even higher than the APR.[10]

Another way to avoid adherence to strict usury laws even when the law is not amended in favor of payday lending is the use of credit service organizations (CSOs). A CSO is a firm that matches borrowers with lenders for a finder's fee. Therefore, CSOs are not technically lenders and thus fall outside the regulatory boundaries of both supervision and rate statutes. One case that was upheld in court proceedings showed a borrower obtaining a loan through a third party CSO. The amount financed was $2,013 ($2,000 loan and a $13 filing fee charge for placing a lien on the borrower's car). These funds were contracted to be repaid in 12 monthly installments totaling $3,706.20, which included a perverse $1,500 brokerage fee to the CSO. Although focused on a title loan, this case has been used as support for payday lenders paying exorbitant finder fees to CSOs, which are usually closely related to the payday lender.[11]

Why are the costs associated with payday lending so high? Payday lenders charge a flat fee, not an interest rate. If the fee is $15 per every $100 borrowed, typically over a 2-week term (which is the standard maturity for a payday loan since most paychecks are paid on a 2 weeks cycle), the resulting interest rate for just the fee structure of the loan is 15%, but the annualized rate (APR) is 390% (i.e., 15% * 26 2-week periods). Currently, payday loans do not charge an interest rate in addition to the fixed fee structure. If it had an interest charge in addition to the fixed fee, the overall costs would be much higher.

But payday loans are criticized for more than just the high costs associated with the loans. Additional unfavorable factors include the fact that most borrowers are unable to repay their loans in a timely manner; have to rollover the loan with another charge being tacked on; and face a high probability of aggressive debt collection practices for nonpayment. This criticism is addressed in PEW (2013). This report also documents that 80% of loans are rolled over at least once and 15% of new loans have sequences of 10 rollovers or more.

There are other detriments to payday loans besides their high costs. Clients typically take out payday loans because they fail to see other options for raising the needed funds. But with the high costs associated with the payday loan and the shortfall of funds that lead to the initial need

to borrow funds, the client usually has a hard time paying off the loan and associated fees at the end of this short loan period. That is, the short time period does not provide enough time for the recipient to accumulate the additional funds to pay off the loan and still meet their normal financial obligations. Therefore, they are forced to pay the fees and rollover the loan for another period. Most payday loans also require payment in full, so a partial payment is not an option. Faller (2008) cites a North Carolina study that shows that more than 50% of payday loan borrowers paid more in fees than the initial value of the loan. Lenders claim that the fees charged are proportional to the risks they undertake in writing the loan, but the averages do not support this position. Chessin (2005) documents that the average charge-off rate for losses reported by payday lenders was only 3.34%. This is higher than consumer loans by banks at 2.69% but lower than credit card debt at 5.15%. The industry prefers to cite default rates on initial loans of 5% with an increased rate of 11% for loans with sequences of 11 or more loans. Even for borrowers living on government benefits, the default rate is 4% on the initial loans with an even bigger jump to 16% for sequences over 11 loans.

4. Deflecting Criticism Through Comparisons of Other Loan Categories

Payroll lending is not unique in the charging of excessive interest. Other categories of loans offered by lenders have used a variety of "sleight of hand" procedures to increase the interest rate charged on a loan. For instance, the firm could require a compensating balance. This occurs when a loan requires that some of the funds from the loan to be held as collateral over the life of the loan, thereby increasing the actual cost of the loan.[12]

Within an Interest-only loan, the borrower pays periodic interest payments over the life of the loan, but the amount borrowed is paid at maturity. This is similar to a payday loan that is rolled-over. Only the interest (or fee) is paid at maturity; the principal balance is rolled over for another billing cycle. This balance is eventually paid when the borrower is able to gather enough resources. Another loan with hidden cost is a secured loan, in which the borrower must place some type of collateral in trust with the lender to reduce the risk of the loan. Types of secured loans include auto title loans and pawn shop loans. Since the borrower does not have access to this collateral, there is an additional implicit opportunity cost added to the loan.

There are limited alternatives for payday lending clientele, most of which are equally undesirable. For instance, reloadable prepaid cards (an alternative to checking accounts for those who cannot qualify). These cards are also highly criticized for lack of clarity in disclosure reports of fees, many of which seem excessive. Common fees shown by an in depth report by the PEW Foundation include median charges for card acquisition ($9.95), withdrawal from ATMs ($2.25), monthly maintenance fee ($5.95), point-of-sale signature ($1.00), PIN transaction fee ($1.00), and even speaking with a customer service representative (live−$1.25; automated−$0.50). Although many of these fees could be waived by maintaining a minimum balance ($1,000 median) or using direct deposit to load the card; these options are not viable to the typical user. Another disadvantage is that unlike checking accounts which are protected by the FDIC insurance up to $250,000 per account, preloaded cards offer no protection or oversight. Borne, et. el., (2011) proposes deposit advances as another option for obtaining funds. This type of loan works similarly to payday loans, but are offered by banks and credit unions. Deposit advances

show lower fees on average when compared to payday loans, but also show more rollovers (averaging 16 rollovers per year) and are more complicated and restrictive than payday lending.

The Community Financial Services Association (CFSA), an advocate for payday lenders, tries to deflate the use of APRs since rollovers should never occur for 26 times in a year for a 2-week loan since most States have limits on rollovers or complete bans on them.[13] One method used by CFSA to deflate the shock of such a high APR is to compare this rate with other fees charged within the financing industry. For instance, a $100 bounced check charging $56 non-sufficient funds and merchant fees equates to 56% or a whopping 1,456% (56% * 26) extrapolated over 26 2-week periods. Similarly, a $100 credit card balance late fee of $37 equates to a 37% charge and an annual rate of 962% (37% * 26). High costs can also occur in other shortfalls experienced by typical payday loan users such as a $100 utility bill with $46 late/reconnect fee generating an annual rate of 1,196% (46% * 26). CFSA points out that the assumptions of annualizing these fees are not more outrageous than annualizing the costs of a 14-day payday loan. They further support their position by noting that in the 32 states that allow payday lending, rollovers are severely restricted as outlined in Table 3.

5. Justification for Payday Loans

Why do consumers undertake loans with such high disclosed costs? Two key reasons are simplicity and a lack of a convenient lower cost borrowing option. A payday loan is simple. It does not require a credit check, although some lenders will check for outstanding loans from similar businesses. Typically, the only requirements for a payday loan are proof of a job and the anticipated paycheck. For instance, a potential client goes to a payday loan outlet and requests a payday loan. The lender verifies employment and then grants the loan. Many of the users have no other borrowing alternatives. They have poor credit histories and corresponding poor credit scores. Many do not even have a banking account. Thus, they are very poor prospects for bank loans.

Payday loans are typically used to fund necessities such as food or bill paying (electric, gas, and rent) due to a cash shortfall at the end of a pay period. That is, the loans are typically used to cover ordinary living expenses, not unexpected financial emergencies. Stegman (2007) points out that although not having enough funds for groceries or rent does constitute an emergency, it is typically not unexpected. Another favorable factor associated with payday lending besides speed of the transactions and availability to those with poor credit is access to funds to avoid other fees such as over-drafting on a bank account whether checking or savings or late payment charges for utilities, credit cards, or even other loans.

In PEW (2013), the findings show that 58% of payday borrowers have trouble meeting monthly reoccurring expenses at least half of the time. After undertaking the loan, only 14% are able to adjust their budgets to repay their obligations and thus the need for rolling over the loan. Almost half (41%) of the borrowers need a cash infusion to finally pay off their loans. The cash usually comes from friends or relatives, selling or pawning items, taking out another type of loan, or relying on a tax refund.

The payday lending industry is not trivial. It was reported to loan out $7.4 billion annually through over 20,000 storefronts, hundreds of websites, as well as, banks and credit unions (PEW 2012a, 2012b). The average borrower was found to take out 8 loans of $375 per year and spend $520 on fees and interest. It is not unusual for the fees and interest charges to total more than the initial borrowing amount. Four out of 5 payday loans are rolled over or renewed within a 2 week period of the initial term.[14] This turnover rate is supported by survey findings reported in Caskey (2012).

Payday loan clients, as documented by CFPB (2013), show an income range between $10,000 and $40,000 with the median income of only $22,476. The 25th and 75th income percentiles were $14,172 and $33,876 respectively. The highest income category is employment (75%). This was followed by public assistance (18%), which were the majority of the borrowers on the low side of the income distribution.

6. Innovations from Bad to Worse

Online payday lending currently underwrites a minority of the loans, but is gaining market share. Online procedures deviate slightly from their storefront counterparts. They require an online application and authority to electronically debit or withdraw funds from a checking or savings account. After a loan is made, the funds are deposited. On the due date, the lender debits the account for the fee. Loans are setup to automatically roll-over. The borrower must specifically notify the lender in advance that payment will be made to avoid a roll-over. When the loan is paid off, the account is debited for the loan amount. The size of the loans ($100 to $1500) and the maturity of the loans (5 to 30 days) are similar to storefront businesses. Online lenders usually incorporate in States or foreign countries with no interest rate caps. There are also a few sites that claim exemption from State laws due to tribal sovereign immunity.[15] For instance a leading internet payday lender, Cash Advance.com claims jurisdiction under the Ute Indian Tribe.

6a. Going Forward

What can be done going forward, especially with the advent of internet payday loans that circumvent even the lax laws governing payday loans? Members of Congress, the law making branch of the Federal Government, must be proactive. Similar to the “Talent Amendment” passed by Congress in 2006 which restricts interest payments to a maximum limit of 36% for loans made to active military personnel and their families, Congress must extend these limits to all U.S. consumers.[16] Congress cannot simply continue to encourage all States to set uniform usury limits that apply to all payday loans. The key provision of the Talent Amendment, which applies to payday loans, vehicle title loans, and tax refund anticipation loans, is the requirement that all charges connected with the loan must be disclosed as a total dollar amount and as an annualized rate. This annualized rate, referred to as the “Military annual percentage rate (MAPR), has a maximum rate cap of 36% unless a lower rate applies and includes charges that are not included in the finance charge or APR disclosed under the Truth in Lending Act (TILA). Specifically, the Talent Amendment states:[17]

- "Calculation of the MARP. The MARP shall be calculated based on the costs in this definition but, in all other respects, it shall be calculated and disclosed following the rules for calculating the APR for closed-end credit under Regulation Z (Truth in Lending, 12 C.F.R. Part 226)
- Cost Elements. The MARP includes the following cost elements associated with the extension of a covered transaction if they are financed, deducted from the proceeds of the covered transaction, or otherwise required to be paid as a condition of the credit:
    - Interest, fees, credit services charges, and credit renewal charges;
    - Credit insurance premiums, including charges for single-premium credit insurance, or fees for debt cancellation or debt-suspension agreements; and
    - Fees for credit-related ancillary products sold in connection with and either at or before consummation of the credit transaction."

Piecemeal fixes to the payday lending has been tied without much success. For example, Colorado's Deferred Deposit Loan Act of 2000 set up to regulate payday loans lead to other abusive lending actions. The law set specific maximum allowable charges depending on the amount financed. For loans up to $300 the maximum fee was $20 per $100 borrowed. For the next $200, the fee was $7.50 per $100 borrowed. The maximum borrowing amount was set at $500 with a maximum loan maturity of 45 days. Chessin (2005) outlines the behaviors generated as a result of this Act such as 89.27% of all loans charged the maximum amount allowed by law. Also to circumvent the lower fees charged on the higher loan amounts, there was a tendency to split the loan into smaller amounts. Instead of offering a single loan of $400 with a fee change of $67.50, the lender would offer two $200 loans each with a $40 fee totaling $80 for an increase of $12.50.[18]

Offerings from Credit Unions are not much better. For instance, a survey of payday type loans carried out by the National Consumer Law Center in 2013 show similar costs as storefront payday loans. From the 5 credit unions reported from Florida, the terms for 14-day loans was $31 for $300 with an APR of 269% (i.e., 31/300 * 365/14). Stango (2012) reports that even as credit unions start to enter the payday lending field, they do not offer terms that greatly differ from those offered by payday lenders. They also tend to place greater burdens on potential borrowers by having greater restrictions on who they lend to, i.e., they require greater credit quality, which many potential users cannot meet. This is why the potential borrowers are forced to seek out a payday lender.[19]

The passage of a uniform act patterned after the "Talent Amendment" would eliminate the need to consolidate regulations (federal and state) associated with all fees and charges currently allowed within the payday loan industry as an attempt to end the exemption of payday lending to usury laws. But how to do this without destroying the industry is a key problem, since payday loans offer a perceived life line for many low income individuals. An arbitrary low rate limit could have the negative effect of destroying any incentive for a firm to offer a loan to such a high risk clientele without being justly compensated for their risk. Further restrictions on rollovers also will not help the underlying clients without additional education into budgeting or assistance to better their walk in life so that they would not be in the position of needing a payday loan.

Banks are permitted to charge the interest rate from their State of incorporation, regardless of where the loan was made including branches in other States and also recently over the internet.[20] Therefore, incorporation of payday lenders is in States offering the highest rate limits or no limits. One of the biggest arguments used against mandating a fixed percentage cost on all types of loans is the compensation for potential default on small loans. As mentioned previously, Chessin (2005) documents that the average charge-off rates in the Colorado study were 3.34% of total loan volume. So yes, profits can be made at a 36% maximum interest charge applied to all loans, but the need for consumer education should also be coupled with any lending program. Since most of the borrowers fall into the lower income quartile or are recipients of government supports (unemployment, social security supplemental benefits, or food stamps) there is a need for government sponsored financial education in budgeting, consumer saving, and borrowing options.

An example of the type of education program needed is shown by Mission Asset Fund (MAF), a nonprofit organization spearheading lending circles within San Francisco, California area.[21] The program requires all participants to matriculate through their online financial training class before enrolling in any of their programs. The classes focus on money management. The classes include two group financial education modules or individualized financial coaching.

7. Conclusion

Congress made the first lasting attempt to regulate payday loans with the passage of the "Talent Amendment" in 2006. Unfortunately this law has had only limited success in eliminating predatory loans. Lenders continue to exploit the loopholes within the current regulations. For instance, the law only covers payday loans up to a $2,000 limit and 91 days term. By offering loans over $2,000 or longer than 91 days, lenders can circumvent the intent of the law. The Department of Defense proposes amending the law to encompass a wider range of credit products and terms.[22] Since the Talent Amendment only applies to our U.S. military personnel and their dependents, even with the proposed amendment the vast majority of the American public would still receive no protection. Therefore, Congress must take the bold step to extend this predatory pricing protection with the proposed amendments to all consumers. This type of law will help eliminate the current loopholes that currently allow loans with destructive APRs to doom our poor and least educated to a lifetime cycle of debt.

Endnotes

1. Fifteen states ban payday loans or cap the interest charged at 36% or less which effectively bans them since payday lending firms claim they cannot make a profit at that level of rates. The 15 states include Arkansas, Arizona, Connecticut, Georgia, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Vermont, and West Virginia. See Saunders (2013) for a full discussion on the history of the 36% limit.
2. For instance, Israelites were forbidden from charging interest among their fellow Israelites, but could charge interest on loans to foreigners. See Vincent (2014) for other examples.
3. Faller 2008.
4. Faller 2008.
5. See http://cfsaa.com/what-is-a-payday-advance.aspx#sthash.CP9cLq1y.dpuf
6. National Conference of State Legislatures (NCSL) Payday Lending Statutes (9/12/2013) http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx]
7. See Code of Alabama 1975, Title 5 Banks and Financial Institutions, Chapter 18 Small Loans and Chapter 18-A Deferred Presentation Services Act.
8. The Truth in Lending Act of 1968, more formally called the Consumer Credit Protection Act (Public Law 90-321), was implemented to safeguard the consumer in connection with the utilization of credit by requiring full disclosure of the terms and conditions of finance charges in credit transactions or in offers to extend credit; by restricting the garnishment of wages; and by creating the National Commission on Consumer Finance to study and make recommendations on the need for further regulation of the consumer finance industry; and for other purposes. (82 Stat. 146).
9. No limit states include Kansas, Ohio, Nevada, Utah, and Texas. States prohibiting roll-overs but allow need loans on the same day as a prior loan is repaid include California, Iowa, Kentucky, Michigan, Mississippi, Nebraska, New Mexico, South Carolina, and Tennessee. And finally, the states that require at least a one day waiting period before a new loan can be initiated include Alabama, Florida, Virginia, and Wisconsin. See Burke et. el. (2014) and CFPB (2013).
10. The APR is often contrasted with effective annual rates, which takes into account the compounding effect of the loan. For example, if the stated interest rate cost was reported as 1 percent per month, the APR would be 12% (i.e., monthly interest rate * number of months in a year = 1% * 12) and the effective annual rate would be 12.68% [i.e., $(1 + \text{monthly interest rate})^{\text{number months in year}} - 1 = (1.01)^{12} - 1$)]. Depending on the investment or loan, the effective rate may be a better indicator of the true cost than the APR.
11. See Spector (2008) for a complete summary of the court proceedings and the appeals.
12. For example, if an individual needs $700 and the loan requires a 30% compensating balance, then the individual needs to borrow $1,000. If the stated nominal interest rate is 7%, the effective interest is actually much higher. In this case, the effective rate would be 10% [i.e., $70 interest cost ($1,000 * 0.07) divided by the $700 of usable funds ($70 / $700)]. This is also called a discounted interest loan.
13. See cfsaa.com, the website for CFSA (Community Financial Services Association of America.
14. See America for Financial Reform's website http://ourfinancialsecurity.org/

15. See Consumer Federation of America: CFA Survey of Online Payday Loan Websites, August 2011 for the complete survey results. http://www.consumerfed.org/pdfs/CFAsurveyInternetPaydayLoanWebsites.pdf
16. Officially called the John Warner National Defense Authorization Act (Public Law 109-364). The key provision under Sec. 987 (b) Annual Percentage Rate A creditor described in subsection (a) may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member. The costs and fees covered under the law are fully disclosed within FDIC's compliance manual. http://www.fdic.gov/regulations/compliance/manual/pdf/V-12.1.pdf
17. See http://www.fdic.gov/regulations/compliance/manual/pdf/V-12.1.pdf for the FDIC Compliance Manual—January 2014, Chapter V. Lending—Talent Amendment. Note that on September 29, 2014, the Department of Defense proposed amending the Talent Act to close the existing loopholes that allow lenders to circumvent the law as it is currently written (http://www.defense.gov/Releases/Release.aspx?ReleaseID=16954)
18. Chessin (2005) offers examples of payday lenders attempts to circumvent the law.
19. The push for Federal CU to offer similar loans did not provide much relief. Loans had 18% usury cap, 28% APR, plus a single $20 application fee (National Credit Union Administration—NCUA short-term, small amount loans: 75 Fed Reg 58, 283; Sept 24, 2010). The typical loan was rolled over 8 to 9 times; $300 payday loan @ $15 per $100 borrowed, which generate $45 per $300 loan. That's a $45 charge each rollover period without any reduction in principal. The loan is always a balloon payment at the end unless it is rolled over.
20. Supreme Court decision Marquette National Bank v. First of Omaha Service Corporation, 439 U.S. 299 (1978).
21. See http://missionassetfund.org/ for more information on MAF's programs.
22. See http://www.gpo.gov/fdsys/pkg/FR-2014-09-29/pdf/2014-22900.pdf for the proposed rule as documented in the Federal Register (September 29, 2014, Vol. 79, No. 188, pp. 58601-58641). The Department of Defense is proposing to amend its existing regulation of the Military Lending Act primarily for the purpose of extending the protections to a broader range of closed-end and open-end credit products, rather than the limited credit products currently defined as consumer credit.

References

Ackerman, James M., 1981, Interest rates and the law: A history of usury, *Arizona State Law Journal*, 61.

Borne, Rebecca, Joshua Frank, Peter Smith, and Ellen Schoemer, July 2011, Big Bank Payday Loans: High-Interest Loans Through Checking Accounts Keep Customers in the Long-Term Debt, Center for Responsible Lending http://www.reponsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf

Burke, Kathleen, Jonathan Lanning, Jesse Leary, and Jialan Wan, 2014, CFPB Data Point: Payday Lending. *Consumer Financial Protection Bureau* (March), 1-33. http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf

Caskey, John P., 2012, Payday Lending: New Research and the Big Question, chapter 21 in the *Oxford Hand-book of the Economics of Poverty*, edited by Philip Jefferson, 681-708.

CFPB, 2013, Payday Lending and Deposit Advanced Products: A white paper on initial data findings (April 24), 1-45. http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf

Chessin, Paul, 2005, Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act, *Denver University Law Review* 83:2, 387-424.

FDIC Affordable Small-Dollar Loan Guidelines http://www.fdic.gov/news/news/financial/2007/fil07050a.html

NCLC. Bank payday gone! http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/pr_guidelines small_dollar.pdf

PEW, 2012a, Loaded with Uncertainty: Are prepaid cards a smart alternative to checking accounts? *The PEW Charitable Trusts* (September), 1-39. http://www.pewstates.org/research/reports/loaded-with-uncertainty-85899415043

PEW, 2012b, Payday Lending in America: Who borrows, where they borrow and why, *The PEW Charitable Trusts* (July). http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf

PEW, 2013, Payday Lending in America: Report 2 How Borrowers choose and repay payday loans, The PEW Charitable Trusts (February), 1-66. http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf

Saunders, Lauren K., 2013, Why 36%? The History, Use, and Purpose of the 36% Interest Rate Cap, *National Consumer Law Center* (April), 1-14. http://www.nclc.org/images/pdf/pr-reports/why36pct.pdf

Spector, Mary, 2008, Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences, *DePaul Law Review* 57:4 (Summer), 961-996.

Stango, Victor, 2012, Some New Evidence on Competition in Payday Lending Markets, *Contemporary Economic Policy* 30:2, 149-161.

Stegman, Michael, 2007, Payday Lending, *Journal of Economic Perspectives* 21:1 (Winter), 169-190.

Vincent, Joshua, 2014, Historical, Religious and Scholastic Prohibition of Usury: The Common Origins of Western and Islamic Financial Practices, *Law School Student Scholarship, Paper 600*. http://scholarship.shu.edu/student_scholarship/600