

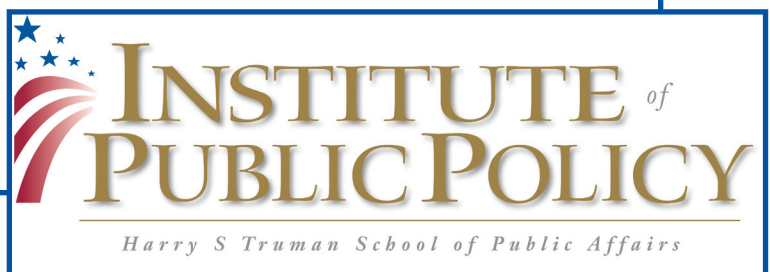
# **Payday Loans in Missouri**

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### Introduction

Payday loan outlets across the U.S. offer short term loans with high interest rates in comparison to credit cards and other consumer credit. Generally, low income and military families are served by payday loan outlets while wealthier consumers have access to lower interest credit. Missouri has some of the most lax regulations in the country regarding payday lending, particularly in comparison to New York and North Carolina. Theoretically, a Missouri payday loan customer can be charged as much as 1,950% APR in comparison to 12.71% annual percentage rate (APR) on the average credit card.<sup>1</sup>

### Payday Loan Overview

Payday loans, cash advance, and fringe banking all describe the same phenomenon: someone needs \$100 - \$500 in order to cover an unexpected expense, pay a bill, or purchase something. In order to get that money immediately, the person goes to an outlet, writes a post-dated check for the desired amount plus a fee, and walks out of the store with the cash. These stores provide small, short term loans to approximately nine million customers each year.<sup>2</sup> Generally, the fees range from \$15 to \$18 per \$100 loan per fortnight across the country, for an annual percentage rate of 391% to 468%.<sup>3</sup> These short term loans are incredibly expensive when compared to the 12.71% APR of an average credit card.<sup>4</sup>

Payday loan enterprises generally locate in poor urban neighborhoods, near military bases, and in other places underserved by traditional banks or other financial services.<sup>5</sup> They advertise themselves as an occasional place to go when an individual needs temporary financial help and/or a place to cash a payroll or government check. Many customers are routine, using these services seven to eleven times a year.<sup>6</sup> The New York Times estimates that approximately 26% of all military personnel use these services.<sup>7</sup>

The Federal Trade Commission has issued a consumer alert describing pay day loans as “very expensive credit,” and urges consumers to seek alternative sources of credit and budget appropriately to avoid needing credit.<sup>8</sup> According to the FTC, credit unions and small community oriented banks generally provide better loan service for low income people than payday loan operations.<sup>9</sup> Furthermore, the FTC suggests credit counselors and similar entities educate people about payday loan debt and how to avoid it.

Presented below are two examples of how payday loans can work. The first describes how repeated loan renewals affected one couple in Washington while the second presents a hypothetical calculation to demonstrate the cost of payday loans.

Example 1: A young Navy couple stationed in Washington recently borrowed \$500 for a fee of \$75 for less than two weeks. When they could not pay back the loan they extended their loan continuously until they soon owed \$4,000 and were under threat of foreclosure.<sup>10</sup>

Example 2: A customer that earns \$12,000 per year (\$5.76 an hour for a 40 hour work week or \$.61 an hour more than current minimum wage) and only cashes his paycheck at one of these institutions will pay approximately \$250 in fees or 2% of his gross income each year for the check cashing service<sup>11</sup> If a similar customer takes out one \$300 loan at 15% per fortnight and takes out loans or renews the original loan for the ten times the typical customer takes out a loan over a year, then he would owe \$450 in fees or 3.75% of his annual income.<sup>12</sup>

The cases above illustrate how much money can be spent on payday loan fees, especially by regular users. Chronic users of payday lenders would pay even more in fees. States such as Washington keep track of the number of loans individuals get in a year. In 2004, 4,402 payday loan customers each took out 27 loans. At an average fee of \$49.79 per loan in Washington, 27 loans would cost a customer \$1,344.33.<sup>13</sup> Because of this, some states have tried to cap the number of loans one could take out.

### Industry Proponents

Supporters of the payday loan industry state that these operations generally meet consumer demand and specifically meet the following needs.

1. Payday loan stores offer financial services to low income residents in areas where traditional banks will not locate.<sup>14</sup>
2. Payday loan stores offer credit to higher risk



customers.<sup>15</sup>

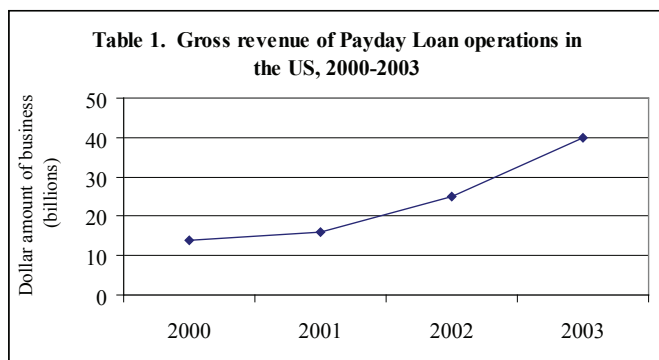
3. Payday loan stores offer quick and simple credit to people who find themselves in emergency financial situations.<sup>16</sup>

In addition, proponents state that fees for one 2 week loan can be lower than overdraft protection at traditional banks.<sup>17</sup>

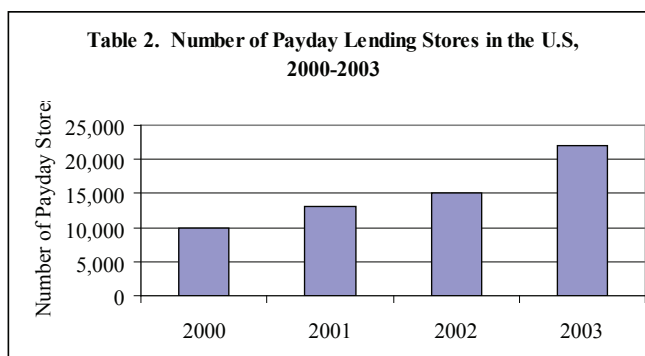
Industry proponents also believe there are unscrupulous payday lenders that should be put out of business but legitimate service providers do not deserve the wrath of consumer organizations and do not require government regulation.<sup>18</sup> Proponents state that the population served by the industry cannot establish traditional lines of credit available to their wealthier banking counterparts and payday lenders fill that void. The higher fees are justified by the idea that the loans are riskier because the customers generally have low credit ratings.<sup>19</sup> Furthermore, other hard-to-find financial services are available to low income people through these outlets including check cashing, money transfers, and long distance phone services. However, in order to get most payday loans, customers have to provide evidence that they have a checking account.

### Payday Loan Industry and the Market

The growth of the industry in recent years demonstrates the demand for these financial service products. According to Stephens Inc., an investment banking firm that monitors the payday loan industry and The Center for Responsible Lending, a Durham, NC based organization that monitors lending practices, the payday loan business has increased exponentially from 2000 to 2003. In 2000 pay day loans were a fourteen billion dollar industry nationwide. By 2003 it was a 40 billion dollar industry. Similarly, in 2000 there were 10,000 payday outlets operating in the U.S. By 2003 there were 22,000 outlets.<sup>20</sup>



Source; The Center for Responsible Lending, Durham, NC



Source; The Center for Responsible Lending, Durham, NC

One of the things driving the trend is the number of large traditional banking and investment firms that have gotten into this business. Some banks have started to open up payday loan stores under different names such as Union Bank in California, and larger operations such as Citibank play a less direct but profitable role, acting as underwriters for payday companies like Dollar Financial's initial public offering of stock.<sup>21</sup> Many traditional lenders have not overtly gotten into the business of payday lending, while others such as Union Bank of California are directly involved in the industry. Richard Hartnack, Vice-Chairman of Union Bank of California explains why his bank is interested in payday lending. He stated when he looks at one of his bank branches in a poor San Francisco neighborhood "I can say without hesitation it's never made money' . . . poor neighborhoods just don't yield enough big account balances to support a conventional branch."<sup>22</sup> That branch stays open only because that was a requirement of California banking regulators when Union Bank merged with California First. While the Vice-Chairman laments having to keep that bank branch open, he is optimistic about his bank's entry into the check cashing and loan business in lower income neighborhoods.<sup>23</sup> The fees charged to this "untapped market"<sup>24</sup> provide healthy profits for his company. Furthermore, if their experience is similar to payday loan stores in Colorado, the default rate on payday loans is actually lower than the defaults on credit card debt, making the business even more profitable.<sup>25</sup>

Another indication of the expansion of payday lending is the number of payday loan operations that have started to go public over the last few years and have started to market their services overseas. These public companies have grown each year expanding their operations exponentially and boosting profits. For example, QC Holdings Inc. (QCCO) which owns 491 stores in 22 states had 23.7 million dollars in profit in 2002, \$36.1M in 2003, and \$48M in 2004.<sup>26</sup> Not all payday lenders have seen this kind of profit increase, but many large brokerages such as Bank of America, and Vanguard see payday lending as profitable investments as evidenced by their recent holdings in payday loan companies such as QC Holdings.<sup>27</sup> Large institutional investment firms invest heavily in other publicly traded payday loan



companies. It should be noted that not all payday lenders are publicly traded companies and some of the larger names in the industry such as Check into Cash and CNG Financial (Check n' Go) are privately held firms. While limited information is available about the private companies, four of the five largest publicly traded payday loan operations doubled their stock price in 2003 indicating the growth of this market.

### State Regulation of Payday Loans

Payday loan establishments and similar enterprises are regulated by state governments and no two states are completely alike in how they regulate the industry. Some states, such as North Carolina and New York, have stringent requirements and regulations for these establishments while states like Delaware and South Dakota provide little oversight, encouraging national chains to establish business in these states.<sup>28</sup> New York is the only state that specifically prohibits these establishments and North Carolina has made the environment uncomfortable for several of the larger payday lending companies to leave the state.<sup>29</sup> New York's Attorney General has sued out-of-state establishments that attempted to set up shop in New York under the premise that they could operate in New York under their home states' laws not New York laws.<sup>30</sup>

States can be grouped into three broad categories concerning how they regulate the industry.

1. States that have specific payday loan statutes separate from the more general usury statutes (22 states)
2. States that require payday lenders to comply with usury restrictions in the state's small loan and usury statutes (20 states – Missouri falls under this category, however, Missouri's usury laws are deemed almost meaningless)
3. States that allow payday lenders to charge any interest rate they want without any payday lender statutes specifically limiting rates (8 states)<sup>31</sup>

Many states do not specifically regulate the payday loan industry. A review of Missouri's neighboring state's statutes shows that Kansas, Illinois, and Iowa specifically mention "payday loans" while Nebraska, Oklahoma, Arkansas, Tennessee, and Kentucky do not. Kansas clearly states how much can be charged for a payday loan, and pegs the charges to the loan amount. The more a customer borrows, the more the fee. Illinois states that payday lenders must report the payment history of every lender to the credit reporting bureaus (Equifax, Transunion, and Experian) but offers little oversight of the industry in terms of fees or direction as to how they conduct business.

Nationally, Congressman Sam Graves (R - MO) proposed legislation (H.R. 97) in February, 2005 that would limit the annual percentage rate payday loan shops could charge military families to 36% nationally.<sup>32</sup> This legislation

has not passed Congress but Representative Graves believes that payday loan shops unfairly target military families leaving them in a particularly tough financial position should they be deployed overseas.

### Payday Loans in Missouri

Missouri posts the name and location of every payday lender in the state on the Missouri Division of Finance website.<sup>33</sup> As of December 2005, there were 1,303 licensed payday lenders in Missouri or one for every 4,450 people in Missouri. Because payday loan operations are looked at as a substitute for traditional financial institutions it would be useful to compare the two. However, trying to compare the payday loan statistics to the number to traditional bank and credit union institutions in Missouri is difficult. For instance, the Missouri Division of Finance which oversees payday lenders also oversees 298 state chartered banks. However, this list mostly includes small local banks with a few branches. Large national banks which may be chartered in any state in the country are not regulated by Missouri. However, Graves and Patterson estimate that there are 2,193 banks in Missouri.<sup>34</sup> The table below provides basic data about the Missouri payday industry from the Missouri Division of Finance, the body that issues annual licenses for payday stores. Complaints and/or evidence of abusive practices are not collected.

**Table 3. Missouri Payday Lenders by the Numbers**

Number of payday licenses issued in FY 2004	1,198
Percent increase in number of payday lenders FY 2003 – FY 2004	37.5%
Number of loans made in FY 04	2.6 million
Average payday loan	\$241
Most frequent amount of loan	\$300
Average loan renewal	2.2 times
Most frequent APR charged	391%
Average APR charged	408%
Percent of loans written off by lenders	5.4%

Source: Missouri Division of Finance

Missouri has some of the most lax laws (RSMo 408.500) in the country concerning payday loans resulting in potential annual interest rates that could customers as much as 1,950% in interest annually.<sup>36</sup> This rate is the highest potential rate in the country for continuous customers of these establishments. Furthermore, Missouri usury laws do not impact the payday loan industry, or any loans, in any meaningful way according to the State Division of Finance because of the plethora of exceptions.<sup>37</sup> Legislation passed in 2002 capped the interest a lender could earn on a loan to 75% and required the Division of Finance to start collecting data about the industry but does not offer regulation in terms of a cap on fees, where they can locate, or how they conduct business. Also, the 75% limit on a loan can be renewed up to 6 times and an individual could simply move the loan



between lenders effectively resulting in more than 6 loans. This is how one could get hit with an APR of 1,950%. While this rate would be exceptional and would only happen in isolated cases, the mere possibility of this rate circumvents other banking and lending legislation which caps interest rates that can be charged. However, these regulations that allow the highest rates in the country to be charged are the most lax in the nation. No other state's regulations allow rates to be as high as 1,950%.

State representative John Burnett (D-KC) introduced HB 1171 in the Missouri House during the 2006 legislative session that would cap interest that payday lenders could charge to \$15 for the first \$100 of principal for the first 30 days of the loan and not more than 3% thereafter. This equates to an APR of 36% which is more in line with what credit card companies' offer. The bill also:

- Prohibits renewals of loans to circumvent interest rate restrictions;
- Grants jurisdiction to the Attorney General to issue cease and desist orders against violators;
- Allows the Attorney General to sue for injunctions, rescission of loan contracts and restitution, and civil penalties for violations; and
- Clarifies that the limitations apply to all lenders, whether or not they are properly licensed pursuant to Chapter 408, RSMo.<sup>38</sup>

**While the bill was introduced, it did not receive a hearing during the 2006 session of the General Assembly. There is the possibility that a similar bill would be introduced in future sessions.**

### Conclusion

Payday lending is a relatively recent phenomenon that has experienced particular growth both nationally and in Missouri over the last five years. These organizations market their services to low income people and military personnel and charge interest rates higher than any other form of credit available.<sup>39</sup> The federal government through the Federal Trade Commission warns against the use of payday lending. Other states financial regulators issue warnings to consumers to avoid payday lenders. States such as New York have passed legislation aimed specifically at keeping payday lenders out of their state because payday loans offer "usurious rates of interest."<sup>40</sup>

Another interesting phenomenon regarding payday lending is the relatively low risk the lender takes on in the relationship with the consumer despite what industry proponents state. Former CEO of ACE Cash Express Donald Neustadt argues that check cashers offer a much-needed service in the community and that their fees are justified because of the costs they must assume. Besides, says Neustadt, "Banks don't want these people in their lobbies."<sup>41</sup> The payday lender on average charges off about 5.4% of all loans due to their customer's refusal to pay, inability to pay,

or irresponsible behavior. The 5.4% loss rate is less than the 8% of loans credit card companies were thought to charge off in 2002 according to a Standard and Poor's 2001 prediction.<sup>42</sup> Therefore, the risk incurred by the payday lender is not as great as one might assume. One study demonstrated that the payday loan industry only charges off 2.6% of all loans.<sup>43</sup>

Financial services may be needed in low income areas; however, providing high interest loans that are difficult to pay back in the time allotted may not be the most appropriate service. Credit unions, community banks, and micro loan programs available through local and state government entities may better help people get out of a financial predicament. Some local governments and libraries also offer financial planning classes and education workshops that attempt to keep people from needing high interest loans. These types of institutions and agencies are better solutions to financial emergencies according to the Federal Trade Commission, consumer advocacy groups such as Consumers Union and the Consumer Federation of America.



**(Footnotes)**

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- <sup>25</sup> *Cracking Down on 'Payday' Loans*, Consumer Reports (March 1, 2000) 65, 3.
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