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PREDATORY LENDING: SACRAMENTO'S CHECK CASHING AND PAY DAY LOAN STORES

In the City of Sacramento, as in the rest of California, poor and working class neighborhoods are home to growing numbers of check cashing stores offering pay day loans. Such stores are seldom found in more affluent neighborhoods, where traditional bank and savings and loan braches are plentiful. Indeed, these stores scarcely existed until the 1990s, when banks and other traditional financial institutions started closing branches in low income communities. It is not accurate to say that traditional banks have abandoned these communities. Instead, they are financing and making money from the check cashing/pay day loan stores that have proliferated there. (See Appendix A). That is because there is big money to be made in the pay day loan business. (See Appendix B)

Check cashing stores generally offer two types of services:

- Check cashing, for which they charge a fee of not less than two percent of the face value of the check, and

- Pay Day Loans or Advances, also called deferred deposit transactions, which typically involve exorbitant interest rates not seen in the products and services offered by traditional lending institutions.

Pay Day Advances are short term cash loans offered to borrowers who have checking accounts and two sequential pay stubs from an employer. A borrower writes a check for the amount of the loan, plus a fee, in exchange for cash. The lender then holds the check for two weeks (i.e., until the next pay day). When the payment for the loan is due, the borrower can redeem the personal check for cash or allow the lender to deposit it. In California, the amount of such loans is limited to $300, and the fee cannot exceed 15 percent of the face amount of the check used to secure the loan. Here's how it works:

- Scenario 1:

  Borrower writes a check for $100 and receives $85 in cash

  In two weeks, the lender cashes the check

  Annual Percentage Rate of Interest for transaction: 459%

  Borrower paid $15 to use $85

- Scenario 2:

  Borrower writes a check for $200 and receives $170 in cash

  In two weeks, the lender cashes the check

  Annual Percentage Rate of Interest for transaction: 459%

  Borrower paid $30 to use $170

- Scenario 3:

  Borrower writes a check for $300 and receives $255 in cash

  In two weeks, the lender cashes the check

  Annual Percentage Rate of Interest for transaction: 459%

  Borrower paid $45 to use $255 (1)

Clearly, people who avail themselves of check cashing services and Pay Day Loans are paying dearly for these products. Account holders can cash checks at their banks for no fee, and even a high interest rate credit card charges only 20 to 30 percent interest on cash advances. Unfortunately, those who avail themselves of these costlier products and services are almost always those who can least afford them. (2) They simply have no other options.

The reality, however, is much worse than the above scenarios reveal. If the check is not covered, the borrower accumulates bounced check fees from both the bank and the lender. In California, the lender may not charge a fee of more than $15 for a bounced check, but the lender can keep submitting the check to the bank repeatedly.

As it happens, borrowers are quite often unable to cover the check they have written for a pay day advance and still have enough money left to pay for rent, food, transportation, and other necessities. To avoid default, borrowers pay another $45 to keep the same loan outstanding (that is, they “roll over” the loan), or they pay back the full $300, but immediately take out another pay day loan, with another $45 fee (this is called a “back to back” transaction). In either case, the borrower ends up paying $45 every two weeks to float a $255 advance – while never paying down the original amount of the loan. The borrower is caught in a debt trap – paying new fees every two weeks just to keep an existing loan (or multiple loans) outstanding.

It is important to understand that creating debt traps for consumers is the business model on which the pay day loan industry operates and prospers. Before making a loan, legitimate lenders make a serious effort to determine whether or not a potential borrower can repay the money. Pay Day lenders don’t do this. It is in their interest to loan funds to people who cannot repay in a timely manner. As a general rule, pay day lenders will not allow loans to be repaid in installments; a borrower must pay the money back all at once. Even when repayment in installments is allowed, pay day lenders almost never give their customers this option. For example, in California, the term of a pay day loan may be extended from two weeks to 31 days, at the discretion of the lender. But, according to the California Reinvestment Coalition (see below), some 70 percent of pay day lenders don’t offer this option to their customers.

Most California consumers who take out these loans do so on average 11 times per year, and over 90 percent of pay day borrowers are repeat customers. (3) They keep borrowing from pay day lenders because they are caught in a debt trap and cannot get out. The pay day loan industry insists that it provides a necessary and valuable service and must charge high fees and interest, because they make high risk loans. In reality, study after study indicates that the repayment rate for pay day loans consistently hovers around 90 percent. (4). There is nothing to prevent these lenders from refusing to make high interest loans other than the handsome profits they reap from people who get caught surrendering more and more of their paychecks in the form of fees and interest.

Military personnel have been especially vulnerable to the debt trap created by pay day loans and to the industry's aggressive collection practices – attaching paychecks, harassing military dependents, and refusing to abide by settlements negotiated by military or private sector credit counselors.

In California, the greatest single concentration of check cashing/pay day loan stores can be found in the zip code bordering Camp Pendleton in San Diego County. Other states that are home to large military installations have been similarly inundated. The Pentagon has reported that payday lenders are targeting their troops and that some service members are losing their security clearances due to debt problems. (5) Military leaders have been central to efforts to curb the practices of pay day lenders, which Retired Admiral Charles S. Abbot of the Navy-Marine Corps Relief Society terms "just legalized loan sharks." (6)

Legislation to protect military personnel has been introduced in a number of states, including California. The California legislation, as introduced (7), capped interest rates of loans to military personnel at 36 percent, provided service members deployed overseas with more time to repay debts, and barred pay day lenders from using military insignias in advertisements. Although the California measure failed passage, Congress recently adopted, and the

President signed into law a 36 percent annual rate cap for consumer loans made to military families, thereby protecting them from predatory pay day loans as well as from many other high cost loan products. The legislation also outlaws taking a security interest in a live check, which effectively shuts down pay day lending to armed services personnel. (8)

The protections now afforded military families should be extended to other consumers as well, but it will not be easy. The pay day loan industry has proven nimble and relentless at evading most efforts to regulate its members. By concealing the long term nature of their loans, these lenders were initially successful in convincing state regulators to exempt them from small loan laws on the grounds that these are emergency two-week loans, not long term obligations.

In states that were uncooperative, pay day lenders simply adopted what they call the "agency model," also known as "rent-a-bank." Under this scheme, large pay day lending companies partnered with small banks located in states with more lenient lending laws. They then used these relationships with partner banks to pre-empt state laws and make pay day loans in states where they would have been otherwise illegal. (9)

Fortunately, the rent-a-bank ploy eventually caught the attention of federal regulators. The Office of the Comptroller of the Currency, which regulates national banks, the Office of Thrift Supervision, which regulates federal thrifts, and the Federal Reserve Board, which regulates member state-chartered banks, prohibited the banks they oversee from partnering with pay day lenders.

Undeterred, the industry found new and willing partners in a few small state banks regulated by the Federal Deposit Insurance Corporation (FDIC) and continued – for a number of years – to make loans in states that had banned their products (10). Finally, in March, 2005, the FDIC issued new guidelines for the banks it regulates. These guidelines banned participation in practices that convert short term loans into high cost, long term debt. The guidelines also established a limit of six pay day loans per borrower, per year, after which the bank would be required to offer a longer-term loan. These guidelines and additional oversight by the FDIC during the last two years have prompted almost all FDIC-regulated banks to end their partnerships with pay day lenders. (11)

With the prohibition of rent-a-bank partnerships by federal regulators, pay day lenders have been forced out of states where their loan products are not authorized. Today, eleven states are free of pay day lending, and the industry now concentrates most of its efforts on those states that specifically permit pay day loans, including California (12)

California has laws and regulations designed to protect the state's consumers from predatory lending practices, but the industry continues to find ways around them. For example, California law prohibits the "roll over" of pay day loans, but it does not prohibit "back-to-back" loans, in which a borrower pays off the principal from an existing loan, them immediately pays a fee to take out a new one.

California's inadequate consumer protection laws are further weakened by lax enforcement. The Department of Corporations, which licenses pay day lenders has no aggressive enforcement program beyond a toll free number for the public to call and report violations. The reporting requirements for pay day loan licensees are so loose that catching violators based upon they reports they file is nearly impossible. (13)

Proof of California's failure to enforce its statutes and regulations is painfully apparent in a March, 2007, survey released by the California Reinvestment Coalition. (14) The Coalition surveyed 253 pay day lending outlets in California, including 39 in the City of Sacramento. This is a summary of their major findings:

- 32 percent of pay day loans outlets statewide (and 21 percent in Sacramento) did not post a complete Schedule of Fees which is required by law and necessary for consumers to be knowledgeable about how much their loan will cost.

- 70 percent of pay day lending representatives statewide (67 percent in Sacramento) either did not know the annual percentage rate for a $255 loan or provided an inaccurate rate. (According to the tellers who did know the correct annual percentage rate for their pay day product, the rate varied from the average 460% to as high as 2,147%).

- 68 percent of pay day lenders statewide (72% in Sacramento) did not allow their customers to extend the term of the loan from two weeks to one month in order for the customer more easily to pay back the loan. (State law allows such an extension at the discretion of the lender, but prohibits the lender from charging an additional fee for the extension.) Of the lenders willing to extend the loans, 24% percent illegally charged fees for doing so.

- 16 percent of lenders statewide (no discreet data available for Sacramento) encouraged or suggested that their customers get additional pay day loans from another pay day loan store owned by the same company or from a different pay day loan establishment close to the vicinity of the lender, and four percent of pay day lenders statewide encouraged existing customers to roll over their loans and pay an additional fee if they were unable to pay the entire loan off at the end of the loan's two week term. Such a practice, in theory at least, is illegal in California. So is the practice of lenders asking for auto titles as collateral for securing pay day loans, but the survey found some lenders doing just that, and 84 percent of lenders statewide did not have legally required postings notifying consumers that "No collateral may be accepted in conjunction with the loan."

- 38 percent of lenders statewide (26% in Sacramento) did not give customers a “Right of Recission,” which allows borrowers who change their minds to give back the money without having to pay a fee. Another 38% of lenders allow borrowers to return the money, but they kept the $45 fee for a $255 loan.

- 51% of pay day lenders statewide (41% in Sacramento) did not provide information or the legally required postings to notify consumers that they cannot be criminally prosecuted in order to fulfill the obligations of the loan.

- 78% of pay day lenders (72% in Sacramento) did not provide the California Department of Corporations toll-free complaint number.

- 80% of pay day loan establishments surveyed statewide (no discreet data available for Sacramento) failed to post the following legally required disclaimer: “The check is being negotiated as part of a deferred deposit transaction made pursuant to Section 23035 of the Financial Code and is not subject to the provision of Section 1719 of the Civil Code. No customer may be required to pay treble damages if this check does not clear.”

Local governments in California and elsewhere are attempting to control the proliferation of pay day loans stores in their communities and to remedy the blight these outlets cause. For example, in Phoenix, Tempe and Mesa, Arizona, local ordinances require that “pay day stores” be at least 1,200 feet apart. In Las Vegas and Clark County, Nevada, stores must be at least 1,000 feet apart and may not located within 200 feet of residential neighborhoods. Here in California, several cities have taken steps to regulate these stores:

- National City – enacted a moratorium on new check cashing outlets and pay day lenders so that it could determine how best to regulate them and minimize their harmful impacts. National City also has a plan under consideration to use its business licensing process to regulate these lenders and limit the number of loans they can make to city residents;

- Oakland enacted an ordinance limiting the concentration of new check cashing outlets and imposing additional obligations upon them to ensure they do not become blights on the community.

- San Francisco enacted a moratorium on new check cashers and pay day lenders and is considering how to regulate them permanently;

- Los Angeles and Chula Vista have measures under consideration to regulate these outlets. (15)

The City of Sacramento should use its land use powers to regulate check cashing/pay day lending stores. Specifically,

- The City Council should declare a moratorium on any new stores;

- City staff should be directed to conduct an inventory of existing check cashing/pay day loan stores in the City of Sacramento, including their locations, and report back with recommendations about requiring a certain distance between stores, a limit on how close such stores may be located to residential neighborhoods, a policy on locating such stores along the City's existing commercial corridors, and any other land use regulations that may seem appropriate and reasonable.

It is unlikely that any local government can ban check cashing/pay day loan stores from their jurisdiction so long as the State of California authorizes them to operate within its borders. However, it may be possible for the City of Sacramento to take an active role in the enforcement of state laws designed to protect consumers from the worst practices of these lenders. For example, the City could inspect pay day loan stores to ensure that all legally required notices are posted and conduct “sting” operations to ensure borrowers are not being forced illegally to provide collateral for these loans. The City Council, therefore, should ask the City Attorney to report back on three questions:

- Can the City of Sacramento require that check cashing and pay day loan stores be licensed in order to operate within the City?
- Can the City of Sacramento enforce all or some of the state laws regulating predatory lending, as it now enforces, through the Tobacco Retailers Licensing Ordinance, state laws governing the sale of tobacco products?
- Can the City of Sacramento enact into its municipal code some or all of the provisions of state law governing pay day lenders and then enforce those standards as part of the City Code?

END NOTES

(1) Scenarios taken from “Payday Lenders and Check Cashiers,” a policy brief by the California Reinvestment Coalition, San Francisco, 2006.

(2) A number of studies clearly show that pay day lending impacts women and African Americans disproportionately. African American households are more than twice as likely to borrow from a pay day lender as white households, and pay day lenders, especially in California, favor locating in communities and neighborhoods with “majority minority” populations. A national survey found that two-thirds of pay day loan borrowers are women, and even an industry newsletter admits women comprise 60 percent of its customer base, while an Illinois study found that more than 60 percent of the customers being sued by a major pay day lender were women. See: “Payday Lending: A Business Model that Encourages Chronic Borrowing,” Michael Stegman and Robert Farris, Center for Community Capitalism, University of North Carolina, 2003; “A Survey of Check Cashers in the San Fernando Valley,” by Robert Barragan and Arthi Varma, Valley Economic Development Center, 2004; “Payday Advance Consumer Satisfaction Survey,” by Patricia Cirillo, Cypress Research Group, 2004; “Tribune Enterprises,” Payday Loan Industry Newsletter, Issue 03-10, 2003; “Greed: An In-depth study of the Debt Collection Practices, Interest Rates and Customer Base of a Major Illinois Payday Lender, 2004; “The Financial Divide: An Uneven Playing Field, Bank Financing of Check Cashers and Payday Lenders in California Communities,” California Reinvestment Coalition, 2005.

(3) “Quantifying the Economic Cost of Predatory Payday Lending,” Keith Ernst, John Farris, Uriah King, Center for Responsible Lending, Washington, D.C., 2004, p.5. “The Financial Divide,” p.2.

(4) “Defining and Detecting Predatory Lending,” Donald P. Morgan. Federal Reserve Bank of New York Staff Report No. 273, January, 2007.

(5) “Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 billion in Predatory Fees Every Year,” Uriah King, Leslie Parrish, Ozlem Tanik, Center for Responsible Lending, Washington, D.C., 2006, p.13. and Pentagon endnote at 49.

(6) “The Financial Divide,” p.7

(7) AB 1965 (Lieu), 2006.

(8) “Financial Quicksand,” p. 13.

(9) “Financial Quicksand,” pp.4ff.

(10) North Carolina is an excellent case in point. Although the state’s legislature had outlawed pay day loans, there were over 500 payday lending stores in the state, all of them affiliated with out of state banks. See “Financial Quicksand,” and The Center for Responsible Lending Review of “Defining and Detecting Predatory Lending,” 2007.

(11) “Financial Quicksand, p.6

(12) The eleven states which currently outlaw predatory lending are: Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia. California authorizes and regulates payday lenders through the Deferred Deposit Transactions Law, Financial Code Sections 23000 – 23106.

(13) “Payday Lenders Evade Regulations: A Summary of Findings from Surveying Payday Lending Establishments,” California Reinvestment Coalition,” San Francisco, March 21, 2007, p.1

(14) *ibid.* The Sacramento Mutual Housing Association provided volunteers to participate in the survey. There were 79 pay day lending stores identified prior to the survey; volunteers were sent to 39 of them. No listing of individual stores in Sacramento is available in the published survey.

(15) “Mesa Plan to Restrict Payday Loan Stores,” Payday Loan Industry Watch (pliwatch.org) news story, August 18, 2006. “Payday Loan Stores Face Checks, Balances,” Las Vegas Sun, December 13, 2005. “Payday and Check Cashing Ordinances,” California Reinvestment Coalition Policy Brief, 2006.

APPENDIX A

PAYDAY LENDERS FINANCED BY BANKS IN SACRAMENTO COUNTY

LENDER	STORES	BANK
ACE Cash Express	13	Wells Fargo, Texas
Advance America	17	US Bancorp; Wells Fargo
Calif. Budget Finance	2	US Bank NA
Calif. Check Cashing	13	Union Bank of California
Cash & Go	7	JP Morgan Chase
Cash 1	3	Banco Popular
Check Into Cash	6	Bank of America
Check 'n Go of Calif.	6	PNC Bank NA
Money Mart	14	Wells Fargo
Sunrise Check Cashing	1	US Bancorp
Travelex Currency Services	1	Barclay's Bank
USA Cash Services	8	US Bank NA

Source: "The Financial Divide: An Uneven Playing Field, Bank Financing of Check Cashers and Payday Lenders in California Communities," California Reinvestment Coalition, San Francisco, March, 2005.

APPENDIX B

CHECK CASHING PAY DAY LOAN INDUSTRY PROFITS AND PRACTICES

Since its inception in the 1990s, the check cashing/pay day loan business has grown into a $28 billion a year industry.

- Nationally, 90 percent of payday lending revenues comes from fees and interest charged to repeat borrowers.
- The typical US Borrower pays back $793 for a $325 loan.
- Predatory payday lending now costs American families $4.2 billion a year in excessive fees.
- States that ban payday lending save their citizens an estimated $1.4 billion in predatory pay day lending fees every year.

Source: "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year," Center for Responsible Lending, November 30, 2006.

In California, data on check cashing and pay day lending reveal a devastating impact on the communities for which these stores have replaced all other financial institutions:

- An estimated 5.2 million Californians use check cashers charging at least a two percent fee. Using calculations based on the state's average annual income, this services costs Californians nearly $5 billion annually.
- An estimated 1.5 million California households use a payday lender 11 times a year for a $300 advance at a $45 fee on each occasion, at a cost of $757 million annually statewide.

In 2004, Dollar Financial Group, which operates as Money Mart in California, reported a per store profit margin of 32.3 percent against gross revenues of $246 million. Assuming that level of profitability is standard for the industry, there is truly big money to be made in these activities:

- Advance America: 2004 Gross National Revenue: $489.5 million

- ACE Check Cashing: 2004 Gross National Revenue: $253 million

[NOTE: These three firms are the giants of the check cashing/payday loan industry, which has begun consolidating as it has grown larger. These numbers in all likelihood understate current profit margins, given the industry's rapid growth in spite of efforts at regulation, and given the large number of smaller chains for which such data are not easily available.]

Source: "The Financial Divide: An Uneven Playing Field" California Reinvestment Coalition, March, 2005.