

# **AkPIRG - Alaska Payday Loan Survey**

## **Payday Loans: Cash Advances Based on Holding Personal Checks until Payday**

Payday loans are small cash advances based on a personal check held for future deposit (or on electronic access to a consumer's bank account.) These loans of \$100 to around \$500 are due in full on the borrower's next payday or generally within two weeks. The fees charged for payday loans result in annual interest rates of around 400% or higher. Loans and finance charges must be repaid in a single payment, without installments. The design of these loans leads to frequent roll-overs and perpetual debt. The holding of personal checks by lenders make these loans inherently coercive, with over-extended borrowers faced with the choice of allowing the check to bounce, paying to extend the loan, or being threatened with "bad" check charges or prosecution.

## **The Payday Loan Industry**

Payday loans are a fast growing phenomenon around the country and in Alaska. Loans are typically made by stand-alone companies, by check cashing outlets and pawn shops, through Internet sites, and via toll-free telephone numbers and faxed applications. A search of Yellow Page listings for loans, pawn, and check cashers reveal several companies in Anchorage that offer "cash advances." Internet searches also turn up many sites offering to make payday loans to Alaska consumers through the electronic funds transfer system. Some payday lenders attempt to cloak their usurious loans as sale-leaseback arrangements, as the purchase of worthless catalog coupons, as a rebate for buying Internet access, or as loans made by out-of-state banks. The essential features remain the same: small cash advances that must be repaid in the future at additional cost with the borrower's check held by the lender.

Industry analysts last year estimated that 95 to 100 million payday loans were made in the United States, with consumers paying \$4 to \$4.3 billion in fees. No statistics are available on the number of payday lenders operating in Alaska or the number of loans made.

## **Payday Loan Customers**

Payday loan borrowers must have an open checking account in relatively good standing and must show proof of employment, a recent bank statement, and other forms of identification in order to get credit. A traditional credit check is not run, but many lenders verify identification and negative information through risk assessment databases, such as TeleTrack. Studies of payday loan customers by state regulators portray typical customers as low to moderate income workers who have pressing financial needs and few resources. Families recently on welfare, members of the military, and minorities are targeted by payday lenders.

## **Legal Status of Payday Lending**

Alaska's Small Loan Act caps interest rates at 36% annual interest but does not apply to loans of \$500 or less. The general usury law caps interest rates for all lenders not specifically exempted at 10.25% annual interest rates. The Alaska legislature has not exempted check-based lending from coverage under the

usury law or authorized lenders to hold personal checks as security for loans or to take advantage of civil bad check laws to collect triple damages for unpaid loans. Payday lending operates in Alaska outside the law, a situation being challenged by a lawsuit filed by Alaska Legal Services Corporation.

### **Alaska PIRG Survey of Payday Lenders in Anchorage**

AkPIRG reviewed Yellow Pages ads in the loan, pawn, and check cashing sections of the Anchorage telephone directory and surveyed six locations listed – two of which did not make payday loans. Surveyors made phone calls to lenders to ask about loan terms, the requirements to qualify for a loan, and about consequences of failing to repay on time. Site visits were also made to identify the local neighborhood served, pick up applications, and note any disclosures or notices available to potential borrowers.

The four payday lenders surveyed were all pawn shops that also make payday loans. They have similar requirements for consumers to receive loans, though the finance charge does vary between the four. Two gave applications or had applications to take, while the other two do not use applications and verify everything prior to the transaction and then simply rely on the check. The maximum loan in Anchorage is \$500 and all lenders set loan terms for a 15 day maximum.

None of the lenders quoted an accurate annual percentage rate when asked the rate for loans, although one lender posted a detailed sign giving APRs. Truth in Lending, the federal credit cost disclosure law, applies to payday loans just as it does to all other forms of consumer credit. TILA requires that the cost of loans be disclosed as both a dollar finance charge and as an annual percentage rate (APR) to assist consumers in shopping for credit. Lenders are required to quote the cost of credit as an APR when asked what the interest is.

Three of the lenders surveyed verbally quoted the finance charge rate (10 to 15% of the amount loaned) as the annual interest rate, while one lender quoted a 20% per month annual interest rate. For lenders charging \$15 to borrow \$100 for two weeks, the annual interest rate is 390%, not 15%. One lender charged 10% of the amount loaned which translates to a 260% annual interest rate for a two-week loan. If payday falls in seven days, the annual interest rate for a 15% finance charge is 780% and the annual rate for a 7-day loan costing a 10% finance charge is 520%.

Frequent loan flipping is typical of payday lending as consumers find it difficult to repay the full amount on their next payday. It doesn't take long to pay in finance charges more than the amount borrowed. If a loan costs \$20 to borrow \$100 and is renewed five times, a consumer has paid \$100 and still owes the original \$100. If the loan costs \$15 per \$100, borrowers repay more in finance charges than they borrowed by the time the loan rolls over 7 times. One of the lenders surveyed sets a six-day waiting period between loans in the application, presumably to allow the deposited check to clear the bank. But all four lenders told surveyors that they could renew loans by simply paying the finance charge on the due date.

The two lenders with application forms available both threaten civil "bad" check charges, the greater of \$100 or triple damages, a \$25 returned check fee, and court costs, legal fees and service costs if borrowers fail to repay their loans on the due date. Borrowers at one payday lender also are required to sign away their legal rights to take disputes to court or participate in a class action lawsuit in order to get a loan.

Both lenders who use written contracts reserve the right to take the borrower to court, but do not give the borrower the same right to take them to court.

## **Four Payday Locations Surveyed in Anchorage:**

### 1. Cash Alaska – four Anchorage Locations

- Pawn Shop in High Traffic Business Area
- Large sign detailing what customer needs to bring to qualify for a loan
- Application with finance agreement on reverse
- Requirements: Pay Stubs, Bank Statement, Phone Bill, Verify Employment
- 15% finance charge
- APR quoted as 20% per month (actual APR for a two-week loan is 390%)
- Rollover as many times as you want by paying finance charge

### 2. Alaska 1<sup>st</sup> Cash – one Anchorage Location

- Pawn Shop in High Traffic Business Area
- Many signs with exact APRs calculated for every payment situation – from 1 day – 15 days
- Application with finance agreement on one page
- Requirements: Pay stubs, Local checking account, Phone bill, 6 month work
- 15% finance charge
- APR quoted as 15% per month (actual APR for a two-week loan is 390%. Annual interest rate cannot be quoted on a monthly basis.)
- Rollover by paying finance charge and writing new check

### 3. Alaska Super Pawn – one Anchorage Location

- Pawn Shop in High Traffic Business Area in Lower Income neighborhood
- No signs inside about Payday Loans
- No application form
- Requirements: Pay stubs, Phone bill, 6 month work verification
- 10% finance charge (actual APR for a two-week loan is 260%)
- APR quoted as 10% (Truth in Lending Act requires that interest rates only be quoted as the annual rate if consumers inquire)
- Rollover by paying finance charge

### 4. Tudor Pawn – Two Anchorage Locations

- Pawn Shop in High Traffic Business Area
- No signs inside about Payday Loans
- No application form given
- Requirements: Checking account, 2 pay stubs, employment verification
- 15% Finance Charge (actual APR for a two-week loan is 390%)
- APR quoted as 20% per month
- Rollover by paying finance charge

## **Conclusions:**

Anchorage consumers needing to obtain small loans under \$500 are subject to APR's from 260% to 390% or more depending on the length of the loan, allowed to continuously flip loans, and are threatened with civil bad check penalties. These short term loans prey upon consumers with financial and credit problems, exacerbating their troubles by putting them on a treadmill of debt.

Legal loopholes expose consumers to usurious loans. Alaska's general usury law which caps rates at 10.25% is not enforced by public officials to protect consumers. **The Alaska Small Loan Act which caps rates charged by licensed lenders at 36% APR does not apply to loans of \$500 or less.** Therefore, companies that lend less than \$500 to consumers are exempt from the Alaska Small Loan Law and are not licensed or regulated as small loan companies by the state. The industry is flourishing in this legal vacuum while vulnerable families are burdened with triple-digit interest rates for quick cash.

Consumers need information and accurate cost disclosures to avoid falling prey to payday lenders. Consumers need affordable alternatives to payday loans and help managing their finances wisely. Lower income Alaskans deserve more access affordable credit, rather than having to resort to short term loans at outrageous interest.

Payday lenders are not complying with the federal Truth in Lending Act which requires that the cost of loans be quoted as an annual percentage rate when borrowers ask as well as on signs and contracts.