Community and Economic Development in North Carolina and Beyond Blog: Payday Lenders & North Carolina's Capital Showdown

By CED Program Interns & Students

Article: https://ced.sog.unc.edu/payday-lenders-north-carolinas-capital-showdown-2/

This entry was posted on March 06, 2014 and is filed under Community Development, Financial Assets

In his *Inferno*, Dante places usurers in the seventh circle of Hell along with profligates, blasphemers, and those violent towards people and property. These damned souls dwell in the innermost ring of the seventh circle, where they must sit in a flaming desert surrounded by falling tongues of fire. Considering there are only nine circles in Dante's Hell, this placement speaks volumes about his attitude towards these "financiers." Few would begrudge an individual for expecting a reasonable interest on a loan payment today; indeed, our entire international banking system has been built upon the idea of lending money on interest. Millions have benefitted from bank loans to help with everything from home purchases to small business creation. However, increasing disparity and barriers to traditional capital markets have given birth to an entity that would make even the *Inferno*'s usurers cringe: payday loans.

Payday loans were created in the 1990s as a way of providing fast cash without the need for a credit check. Payday loans, in their simplest form, work like this: A borrower goes to a payday loan storefront to get a small loan, typically around $300. The loan usually has a term of 2 weeks or the next payday. On payday, the borrower owes the loan, interest, and any associated fees back to the lender. These products have traditionally thrived in low-income communities because of a need for cash without the complications of the traditional banking system.

Of course, the payday loan, and its close relative the car title loan, serve an important function in providing capital to individuals and communities with little access to other capital sources. There exists an intimate but bitter relationship between low-income communities and payday lenders. The individuals seeking these loans typically need the money desperately to pay utility bills or rent. The payday loans allow for quick, no-questions-asked paths to necessary funds. However, the high interest rates charged by these lenders can create an almost unbreakable cycle of indebtedness for some borrowers.

While the quick cash might momentarily save these borrowers, research by The Center for Responsible Lending (CRL) indicates that many of them will find themselves worse off in the long term than they were before taking out the loan. Most borrowers for these types of loans will be repeat borrowers. The majority of these repeat borrowers will take out loans multiple times, oftentimes solely to pay off past loans. Of those repeat borrowers, 87% took out another loan within two weeks of the first and 94% within one month of the previous loan. Considering that the median annual income level for payday borrowers is $22,476, few will ever be able to pay off their high interest (300% APR in many states!) and also cover their basic living expenses. According to CRL's report, "The payday lending business model depends on borrowers' inability to afford their loan and their subsequent need to borrow—paying more fees—multiple times" (2013, p. 2).

Some states have taken the initiative to cap rates, restrict abusive practices, or ban payday lending altogether. In 2004, for example, Georgia passed one of the strongest bans on payday lenders in the country, even going after the out-of-state banks many of these payday lenders partnered with to avoid the state's usury laws. Other states have kept the practice, but have merely restricted loan amounts and interest rates. Illinois, for example, allows payday loans, but stipulates that the loan amount cannot exceed 25% of the borrower's monthly income.

This state level work has curbed some of the payday lending activities around the country, but continuing demand for the service has led to online and over-the-border payday practices. While the number of smaller storefront payday lenders gravitating to the online realm has increased, large national banks have also begun offering products called "direct-deposit loans," which are strikingly similar to the typical payday loan, and which include 3-digit APRs and next payday repayment requirements. Because of the regulatory status of the large national banks, they aren't subject to the same state-level restrictions as the storefront payday lenders. A number of recognizable banks offer these loan products, which are electronically tied to the borrower's checking account. The banks can then withdraw both the loan and fee automatically upon its due date. Thus, borrowers can find themselves in even worse positions with the large banks' short-term loan products than with the smaller storefronts because of the added risk of the bank automatically overdrawing a borrower's account for repayment, further exacerbating the pernicious debt cycle. Even more troubling, research has shown that these types of loans typically lead to higher rates of involuntary bank account closures and a higher likelihood of filling for bankruptcy for borrowers.

On August 31, 2001, North Carolina state legislatures effectively killed payday lending throughout the state. By allowing a general statute that allowed the practice to expire, the state became the first in the nation to ban payday lending. The statute (G.S. 53-281) originally passed in 1997 with an expiration date of July 31, 2001. This later received a one-month extension, but by the end of August 2001, allowed the law to expire. While the act of allowing a law to expire is different than enacting a new law prohibiting the law, the NC state legislators resisted a great deal of political pressure from national industry groups in order to allow the bill to expire.

The payday lenders decided to push against this regulation. Three months after the practice became illegal, the News & Observer reported that "the ranks of payday lenders continue to grow, and some have started charging higher fees." A lobbying group called the Community Financial Services Association of Washington, which represents some of the largest national payday lenders, argued that the state had no authority to regulate payday lending. Particularly, the lobbying group argued that the state had no authority over banks with charters in other states. On the other side of this battle, North Carolina Attorney General Roy Cooper said that operating in North Carolina means businesses must follow North Carolina's laws.

By threatening and pursuing multiple legislative battles with payday lenders, Cooper and the NC Justice Department progressively pushed out lenders one by one. In 2002, Cooper won his first big triumph when the threat of a lawsuit convinced the nation's largest payday lender, ACE Cash Express, to cease all business in the state. Over the past decade, Cooper has threatened or filed suit on numerous payday lenders in an attempt to eradicate the practice from the state. However, while many of these storefront operations began to disappear, national banks began to take their place.

In 2012, Cooper and consumer advocates went after a product called a Ready Advance loan offered by Regions Bank, an Alabama-based bank with branches in various parts of North Carolina. These Ready Advance loans had many of the same characteristics as the illegal payday loans. Regions had been charging interest rates between 120 and 365 APR on loans that were deposited directly into a borrowers bank account. With storefront operations, there was no risk of the lender having access to a borrower's bank account and debiting it even if the money was not available. With the Ready Advance loans, Regions would extract the principal, interest, and fees directly from the borrower's account. Often, this resulted in an overdrawn account resulting in greater fees for the borrower. After a series of legal threats, Regions agreed to cease offering Ready Advance loans earlier this year.

Now the fight against predatory lending has moved to the online realm for Cooper and the NC Department of Justice. These online lenders charge the same high interest rates for their products as traditional payday lenders but without a storefront operation. Many believe this move to online marketplaces is simply in an effort to avoid state regulations on high-interest lending. According to research into online payday lenders, online lending is "just another way for lenders to take advantage of lax regulations in their home states and make loans without complying with licensing requirements or state protections in the borrower's home state" (Stegman, 2007, p. 179). This research cites an example in North Carolina in which a local payday lender reopened its doors shortly after the expiration of G.S. 53-281 offering online services. In addition to the new services, the company also offered a $500 rebate "in return for agreeing to pay periodic fees of $40 to $100 per month for a few hours of Internet access at the provider's office computers for a few hours a week" (p. 179). While many online lenders have no physical operations within the state borders, their borrowers do, which troubles the Department of Justice. North Carolina regulators recently filed suit against two of the biggest online lenders, Western Sky and Cashcall. These two businesses have felt this attack from at least 15 other states and have started to pull back their activities in many of them. How this suit will affect their operations in North Carolina remains to be seen.

Cooper and the NC DOJ will also have to contend with a new, favorable attitude towards payday lenders found amongst some legislators in the NC General Assembly. In 2013, Senate Bill 89 proposed allowing "deferred presentment services", or payday loans to consumers once again. The bill was not enacted into law, but it may only be a matter of time before a similar bill comes before the General Assembly again.

A version of this post focusing on national issues related to payday lending can be found on Ethos Review.

Wil Heflin is a second year graduate student in the UNC-Chapel Hill Master of City and Regional Planning program.