

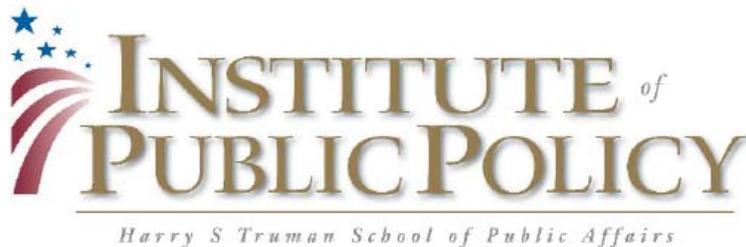
Payday Loans in Missouri

Nathaniel Albers

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*Institute of Public Policy
University of Missouri
137 Middlebush Hall
Columbia, MO 65211*



Conclusions are those of the author, not necessarily those of the Institute of Public Policy or the Truman School of Public Affairs.

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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 loans. Missouri has some of the most lax regulations according to the Missouri Attorney General and *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*.¹ A Missouri payday loan customer can be charged as much as a 1,950% Annual Percentage Rate (APR) in comparison to 12.71% APR on the average credit card.² The average APR Missouri customers will pay is around 420%, but the 1,950% APR demonstrates the extreme that is possible under current Missouri law. Other states, such as Oregon, cap the APR payday lenders can charge at 153%.³

Payday Loan Overview

The terms payday loan, cash advance, and fringe banking all describe the same phenomenon: someone who needs to obtain \$100 to \$500 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.⁴ 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%.⁵ These short term loans are incredibly expensive when compared to the 12.71% APR of an average credit card.⁶

Payday loan enterprises generally locate in poor urban neighborhoods, near military bases, and in other places underserved by traditional banks or other financial services. 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 but the average customer is a repeat customer, using these services seven to eleven times a year.⁷ Additionally, 90% of payday loan store's revenue comes from repeat borrowers who cannot pay off their loans on the due date.⁸

Furthermore, the *New York Times* estimates that approximately 26% of all military personnel use these services⁹ while the industry states that 3.69% of active duty military personnel have taken a loan in the past 5 years.¹⁰ The *New York Times* estimates that approximately 598,000 members of the armed forces use this service¹¹ while the trade group Community Financial Service of America (CFSA) estimate is about 85,000. Clearly there is a discrepancy between these two sources. At any rate, recent federal legislation limits the interest rates that can be charged of military personnel.

The Federal Trade Commission issued a consumer alert describing pay day loans as "very expensive credit," and urging consumers to seek alternative sources of credit and budget appropriately to avoid needing credit.¹² According to the FTC, credit unions and small community oriented

banks generally provide better loan service for low income people than payday loan operations.¹³ Furthermore, the FTC suggests credit counselors and similar entities educate people about payday loan debt and how to avoid it.

How Payday Loans Work - Worst Case

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 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.¹⁴

Example 2: If a customer who makes Missouri's current minimum wage (\$6.65 per hour or \$13,832 per year)¹⁵ takes out one \$300 loan at 15% per fortnight and takes out loans or renews the original loan for the ten times that the typical customer takes out a loan over a year, he would owe \$450 in fees or 3.25% of his annual income.¹⁶ Therefore, that customer pays more in fees to the loan office than he or she would pay for basic phone service.¹⁷

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 in interest and fees.¹⁸ Because of this, some states have tried to cap the number of loans one could have.¹⁹

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.
2. Payday loan stores offer credit to higher risk customers that could not receive credit from other financial institutions.²⁰
3. Payday loan stores offer quick and simple credit to people who find themselves in emergency financial situations.²¹

In addition, proponents state that fees for one 2 week loan can be lower than overdraft charges at traditional banks.²² The Community Financial Services Association of America (CFSA), an industry trade group that represents about half

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Table 1. Fee comparison across loan types²³

Institution	Loan Amount	Typical Fee	Annual APR
Payday loan	\$100	\$15	391%
Bounced Check	\$100	\$54 - Insufficient funds merchant fee	1,409%
Credit Card	\$100	\$37 - late fee	965%
Utility Bill	\$100	\$46 - late/reconnect fee	1203%

of all payday lenders provides the following comparison (Table 1) for how a typical pay loan compares to other credit offers.

Industry proponents such as the CFSA also believe there are unscrupulous payday lenders that should be put out of business but argues that legitimate service providers do not deserve the wrath of consumer organizations and do not require government regulation.²⁴ 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.²⁵ Furthermore, other hard-to-find financial services are available to low income people through these outlets including check cashing, money transfers, pre-purchase debit cards, and long distance phone services. However, in order to get most payday loans, customers have to provide evidence that they have a checking account.

One common critique of the industry is that it preys on the poor, elderly, and other groups with limited resources. The CFSA refutes this, stating the following results from studies of its clientele.²⁶

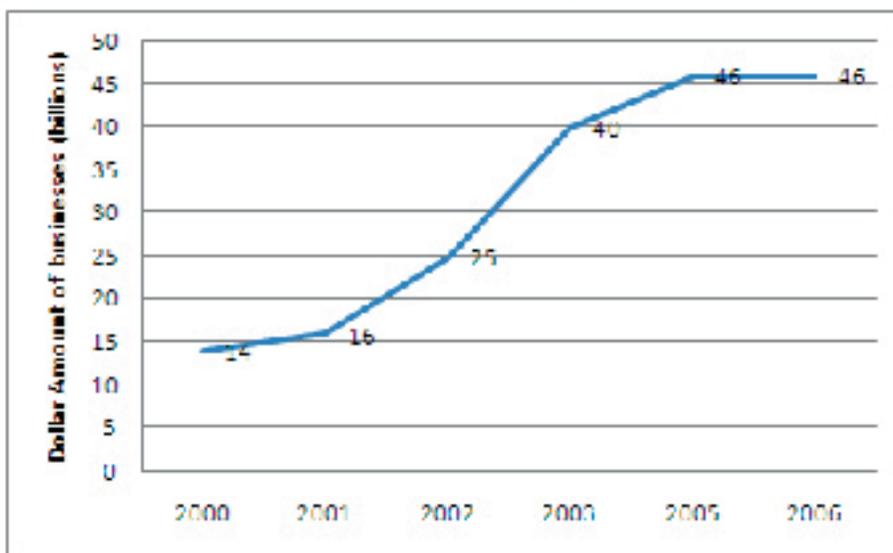
- The majority of payday advance customers earn

- between 25,000 and \$50,000 annually;
- Sixty-eight percent are under 45 years old; only 4 percent are over 65, compared to 20 percent of the population;
- Ninety-four percent have a high school diploma or better, with 56 percent having some college or a degree;
- Forty-two percent own their own homes;
- The majority are married and 64 percent have children in the household; and,
- One hundred percent have steady incomes and active checking accounts, both of which are required to receive a payday advance.

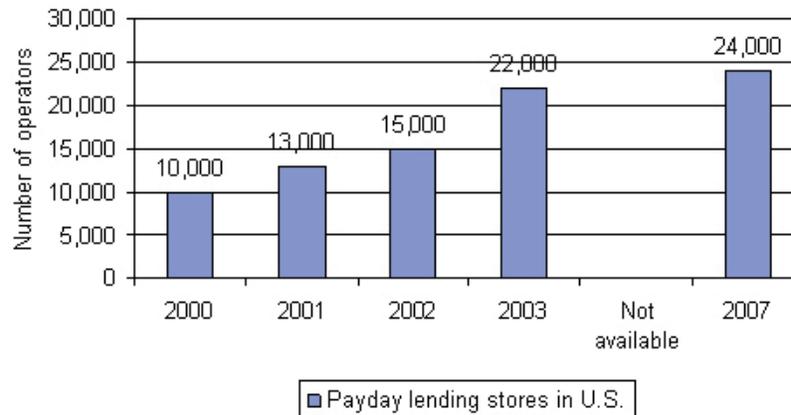
Payday Loan Industry and the Market

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, The Center for Responsible Lending, a Durham, NC based organization that monitors lending practices, and National Public Radio, the payday loan business has increased exponentially from 2000 to 2007. In 2000 pay day loans were a fourteen billion dollar industry nationwide. By 2003 it was a 40 billion dollar industry but has since stabilized at about \$46 billion per year (see Figure 1). Similarly, in 2000, there were 10,000 payday outlets operating in the U.S.²⁷ By 2007 there were 24,000 outlets²⁸ making payday loan stores

Figure 1: Gross Revenue of Payday Loan Operations in the US, 2000-2006



Source: The Center for Responsible Lending, Durham, NC; Payday Loans Cash Advance Consumer Guide; PayDay Loan Consumer information. Comparable data not available for 2004.

Figure 2: Number of Payday Lending Stores in the US, 2000-2007

Source; Stephens Inc, Little Rock, AK, The Center for Responsible Lending, Durham, NC, and National Public Radio, Washington D.C. (2007)

more common than McDonald's restaurants across the country (see Figure 2).²⁹

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.³⁰ Many traditional lenders have not gotten into the business of payday lending overtly, while becoming 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."³¹ That branch stays open only because that is a requirement of California banking regulators. 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.³² The fees charged to this "untapped market"³³ provide healthy profits for his company. Furthermore, if their experience is similar to payday loan stores in Colorado, the default rate on payday loans will be lower than the defaults on credit card debt, making the business even more profitable.³⁴

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 613 stores in 25 states had \$23.7 million dollars in profit in 2002, \$36.1M in 2003, and \$48M in 2004.³⁵ By 2006, QC Holdings had a gross profit of \$152.35 million. This growth was fueled by an

increase of 123 outlets. 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.³⁶ 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 there was steep growth in the first part of this decade in this industry, the growth seems to be slowing both in terms of numbers of outlets and in terms of the success of the companies. There is limited information available about private companies, but four of the five largest publicly traded payday loan operations doubled their stock price in 2003 indicating the growth of this market in the first part of this decade. However, since that time the stock price of these companies seems to be more varied with some such as Dollar (NYSE symbol DLLR) experiencing an 80% increase in stock price since from 2004 to 2007. Advance America, the largest publicly traded payday operation in the US experienced a decline of 62% in that same time frame (see Figure 3).³⁷

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 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.³⁸ New York has specifically prohibited these establishments since 2000 and North Carolina prohibited them starting in early 2007.³⁹ 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.⁴⁰

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)
3. States that allow payday lenders to charge any interest rate they want without any payday lender statutes specifically limiting rates (8 states)⁴¹

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, limits have been placed on the payday loans for military personnel. Senators Jim Talent (R-MO) and Bill Nelson (D-FL) amended the 2006 Defense Authorization Bill to impose a cap of 36% annual percentage rate (APR) on payday loans purchased by military families.^{42/43} Earlier in 2006 Representative Sam Graves (R-MO)

introduced legislation to cap the APR payday lenders could charge to military families at 36% but his legislation did not pass. In early 2007, nineteen state legislatures proposed over 50 different pieces of legislation aimed at regulating the payday loan industry.

Payday Loans in Missouri

Missouri posts the name and location of every payday lender in the state on the Missouri Division of Finance website.⁴⁴ As of January 2007, there were 1,545 licensed payday lenders in Missouri or one for every 3,781 people in Missouri. In comparison, there are 335 state and nationally chartered banks in the state. Because payday loan operations are looked at as a substitute for traditional financial institutions, it is 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. However, Graves and Patterson estimate that there are 2,193 banks in Missouri which includes branches and banks regulated by the federal government.⁴⁵

Similar to the rest of the country, the Payday Loan Industry in Missouri has expanded the number of outlets providing their services. Figure 4 shows that from 2002 to 2006, the Missouri Division of Finance issued 69% more payday loan licenses.

The increase in licenses has led to an increase in the number of loans provided and also an increase in the number of defaulted loans. Figure 5 shows that 60,000 more payday loans defaulted in 2006 than they did in 2002. Out of the 2.87 million total loans made in 2006

**Figure 3: Five Publicly Traded Payday Loan Companies Stock Prices
January 7, 2005 – January 7, 2008**



Figure 4: Number of Licenses Issued by the Missouri Division of Finance

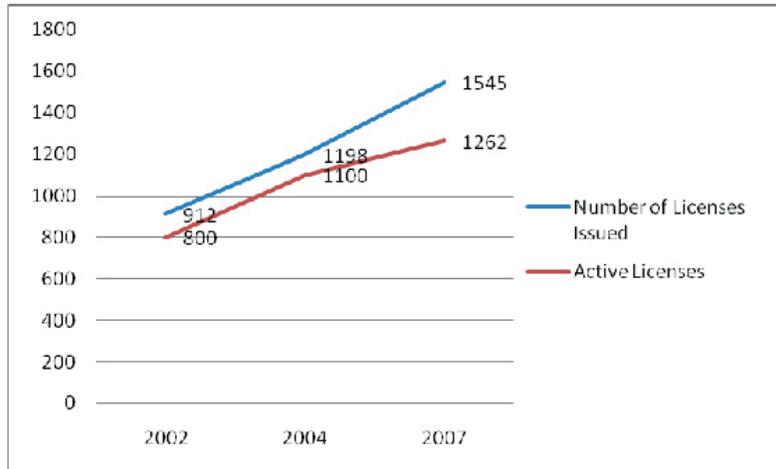


Figure 5: Number of Loans in Default Compared to Total Loans Made— Missouri

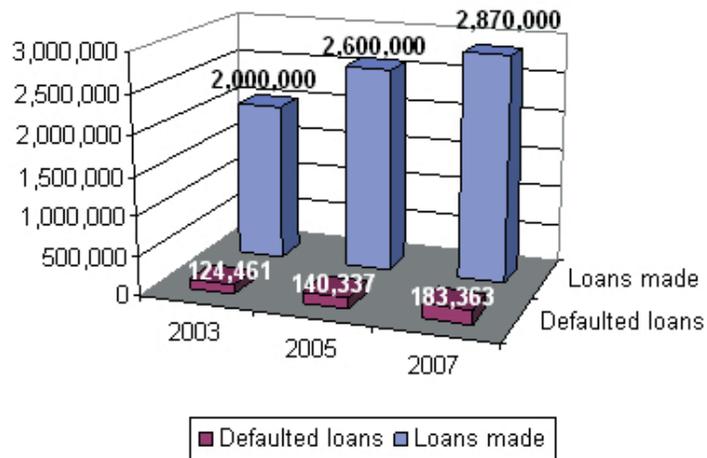
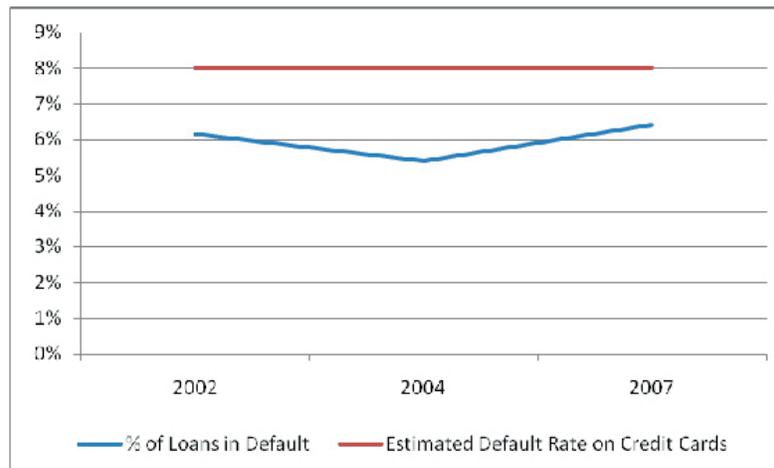


Figure 6: Percent of Payday Loans in Default - Missouri

6.39% defaulted (see Figure 5), compared with the 2 million loans made in 2002 of which 6.22% defaulted. While the default rate does not seem to be changing significantly since statistics have been collected on payday loans, the number of loans and access to these loans continues rise dramatically. This means that more people are using these loans and more people are defaulting on relatively small loans that quickly balloon into large loans.

Figure 6 demonstrates that the risk associated with high interest payday loans may actually be less than the default rate on the average credit card. Standard and Poor's estimated that credit card debts were as high as 8% at the end of 2001.⁴⁶

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 charge customers as much as 1,950% in interest annually.⁴⁷ 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.⁴⁸ 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 did 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 potentially be charged 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. No other state's regulations allow rates to be as high as 1,950%.

State representative John Burnett (D-KC) introduced HB

1462 in the Missouri House during the 2008 legislative session that will 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:

- Prohibited renewals of loans to circumvent interest rate restrictions;
- Granted jurisdiction to the Attorney General to issue cease and desist orders against violators;
- Allowed the Attorney General to sue for injunctions, rescission of loan contracts and restitution, and civil penalties for violations; and
- Clarified that the limitations apply to all lenders, whether or not they are properly licensed pursuant to Chapter 408, RSMo.⁴⁹

On April 8, 2008, voters in Kansas City approved an ordinance that requires payday loan operators to pay an annual permit fee of \$1,000.⁵⁰ The proposal passed with 63.5% of the vote. Kansas City has approximately 110 payday loans establishments, so this ordinance will generate annual revenues of \$110,000. The revenue will be used by the Regulated Industries Divisions to reduce administrative costs associated with payday loans permit process.

Conclusion

Payday lending is a relatively recent phenomenon that has experienced growth both nationally and in Missouri over the last seven years, albeit that growth has slowed over the last three years. These organizations market their services to low and middle income people and military personnel and charge interest rates higher than any other form of credit available.⁵¹ 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 and North Carolina have passed legislation aimed specifically at keeping payday lenders out of their state



because payday loans offer “usurious rates of interest.”⁵²

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.”⁵³ The payday lenders 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 Neustadt experiences is similar to the default rates Missouri lenders have seen from 2003 – 2007 (see Figure 5) This 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.⁵⁴ One study demonstrated that the payday loan industry only charges off 2.6% of all loans.⁵⁵ Still, the CFSA states that it is expensive to run a payday operation and refer to a Federal Reserve Bank study that indicated the cost for a small bank to originate and maintain a loan for one month is \$174.⁵⁶

Financial services may be needed in low income areas; industry proponents and critics seem to agree on this point. 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. According to the Federal Trade Commission, these types of institutions and agencies are better solutions to financial emergencies than consumer advocacy groups such as Consumers Union and the Consumer Federation of America.

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Author Biography

Biography

Nathaniel Albers holds a Masters Degree in Geography from the University of Missouri – Columbia, and was a Research Analyst with the Institute of Public Policy at the Harry S Truman School of Public Affairs. Mr. Albers has been involved in program evaluations and research in the areas of criminal justice, domestic violence, and traffic safety.

James Harrington is a graduate research assistant in the Institute of Public Policy at the Truman School of Public Affairs, University of Missouri-Columbia. He is currently pursuing his Master of Public Administration, and is specializing in Public Policy and Public Management

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Institute of Public Policy
137 Middlebush
University of Missouri
Columbia, MO 65211
<http://www.truman.missouri.edu/ipp>