



 THE UNIVERSITY OF IOWA

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## Predatory Lending

Predatory lending is the common term for various types of consumer loans that charge high interest rates in order to profit from borrowers. This I-CAN report examines three common types of predatory lending: car title loans, pay day loans, and refund anticipation loans.

### **Car Title Loans**

Car-title loans –likely the most familiar among popular predatory lending schemes – are short-term loans secured by the borrower’s vehicle, which can be repossessed in the case of default on payments. Car-title loans tend to be small, over-secured loans.<sup>1</sup>

Car-Title Loans charge up to 1% daily interest –360% APR –even though collateral (the car title and extra keys) is presented. If a payment is late, lenders may begin the repossession process.

### **Who is Affected?**

It is difficult to ascertain the number of Iowa cars repossessed due to defaults on car-title loans. Car-title lenders must have licenses from the Iowa Division of Banking, but they may hold different license types based on the specifications of their business. Because the

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<sup>1</sup> Quester, Amanda and Jean Ann Fox. “Car Title Lending: Driving Borrowers to Financial Ruin.” Center for Responsible Lending and The Consumer Federation of America. “Car Title Lending: Driving Borrowers to Financial Ruin.” 2005.

[http://www.responsiblelending.org/pdfs/rr008-Car\\_Title\\_Lending-0405.pdf](http://www.responsiblelending.org/pdfs/rr008-Car_Title_Lending-0405.pdf). Accessed 13 October 2006.

Division of Banking keeps records on repossession based on license type, we do not know which loans were secured by car titles. Most car-title lenders use regulated loan licenses, as do some non-car-title lenders. Two studies of Iowa car-title loans estimate that number of Iowans who have lost their cars due to car-title lending ranges from 1600<sup>2</sup> to 2000 or more.<sup>3</sup>

## **Legislation**

Last year, the Iowa Senate passed a Car Title Loan bill that would have capped secured car-title loans at 21%. The bill was not debated in the House.<sup>4</sup>

In 1998 Kentucky became the first state to limit rates, fixing them below 36% APR. Florida followed suit, setting rates at 30% per annum for the first \$2000 borrowed.<sup>5</sup> Alabama, Georgia, Mississippi, and Montana limit interest at 25% for the first few months –or until the loan is paid –which still allows rates to reach 300% APR. Tennessee law permits rates totaling 264% APR.

While capping interest rates is the common focus of state legislation, the Center for Responsible Lending suggests that states consider protecting consumers by mandating longer loan terms and permitting repayment in installments or penalty-free prepaying.

## **Payday Lending**

Payday lending agencies, sometimes called payday check cashing agencies, accept post-dated checks in exchange for a cash payment. These short-term loans usually span two weeks, although they can sometimes span a month. Iowa law prohibits loan rollovers, meaning that when it is time to cash a check, a borrower cannot pay a fee to have the loan period extended. However, lenders can hold up to two checks at once, totaling no more than \$500. As a result, loan companies can skirt the rollover ban. A borrower will give the agency a post-dated check for \$250 and get \$220 in cash. If they do not have enough money in their bank account when the check comes due, they can return to the agency and take out a new \$250 loan to pay the balance. This effectively counteracts state legislation against loan rollovers.

The typical interest rate on Payday Loans ranges from 300% to 400% APR;<sup>6</sup> last year, the average APR charged in Iowa for Payday Loans was 284% APR.<sup>7</sup>

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<sup>2</sup> Iowa Citizen Action Network. “Car Title Loans: The Facts.”

<http://www.yawp.com/ican/cjcp/cjcpfactsheet21606.shtml>. Accessed 15 October 2006.

<sup>3</sup> Rob Reed. “Number of auto repossessions by Regulated Loan Licensees in Iowa over the past 4 years.” Iowa Division of Banking. Obtained 13 October 2006.

<sup>4</sup> Iowa Attorney General. “Miller: Pass the Car-Title Loan Law.”

[http://www.state.ia.us/government/ag/latest\\_news/releases/dec\\_2005/Car\\_title\\_loan.html](http://www.state.ia.us/government/ag/latest_news/releases/dec_2005/Car_title_loan.html). 6 December 2005. Accessed 16 October 2006.

<sup>5</sup> Quester, Amanda and Jean Ann Fox. “Car Title Lending: Driving Borrowers to Financial Ruin.” Center for Responsible Lending and The Consumer Federation of America. “Car Title Lending: Driving Borrowers to Financial Ruin.” 2005.

<sup>6</sup> National Conference of State Legislators. “Payday Lending.”

<http://www.ncsl.org/programs/banking/paydaylend-intro.htm#Laws>. 8 September 2006. Accessed 7 October 2006.

<sup>7</sup> Rob Reed. Iowa Banking Division.

## Who is Affected?

There were 237 licensed lenders in Iowa in 2005, making over one million loans. The average payday loan borrower in Iowa last year took out 13.8 payday loans over the course of the year.<sup>8</sup>

## Legislation

On the national level, an amendment to the 2007 Defense Authorization Bill would cap payday lending to military personnel and their families at an interest rate of 36% APR nationwide. It would also prohibit car title lending to members of the armed forces. This bill has been passed by the United States Senate and awaits debate in the House.

At the state level, payday loans are regulated in three ways: by capping the amount of money that can be lent and the number of loans granted at one time, by banning loan rollovers, or by limiting fees and/or loan interest rates.

Currently, 32 states cap the amount of money that can be lent in these payday loans; these caps range from \$300-\$1000.<sup>9</sup>

Thirty states, including Iowa, cap the amount of interest that can be charged per loan. These interest rate caps generally vary from 10% to 25% for the two-week life of the loan, with a high of 75% in Missouri. Iowa caps interest at 15% on the first \$100 borrowed and 10% on each \$100 after that.<sup>10</sup> Since these loans are very short-term –usually fourteen days –these interest rates translate into 200%-1000% APR.<sup>11</sup>

Georgia, Maryland, Massachusetts, and West Virginia force lenders to comply with strict small loan usury laws, which cap yearly interest rates well below the triple-digit interest imposed by most payday lenders.<sup>12</sup> This effectively eliminates payday lending.

In 2006, Oregon enacted legislation that caps payday interest rates at 36% APR, makes the minimum loan term 31 days, and limits fees that lenders can add to the loan cost.<sup>13</sup>

In 2005, Illinois enacted the Payday Loan Reform Act to increase licensing regulation of payday loans and punishment of license violators.<sup>14</sup>

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<sup>8</sup> Rob Reed. Iowa Banking Division.

<sup>9</sup> National Conference of State Legislators. "Payday Lending." <http://www.ncsl.org/programs/banking/paydaylend-intro.htm#Laws>. 8 September 2006. Accessed 7 October 2006.

<sup>10</sup> National Conference of State Legislators. "Payday Lending." 533D.1 *et seq.* <http://www.ncsl.org/programs/banking/paydaylend-intro.htm#Laws>. 8 September 2006. Accessed 7 October 2006.

<sup>11</sup> Credit.com. "State-by-state Payday Loan Summary." [http://www.credit.com/credit\\_information/credit\\_law/PaydayLoanLaws.jsp](http://www.credit.com/credit_information/credit_law/PaydayLoanLaws.jsp). Accessed 8 October 2006.

<sup>12</sup> Credit.com. "State-by-state Payday Loan Summary." [http://www.credit.com/credit\\_information/credit\\_law/PaydayLoanLaws.jsp](http://www.credit.com/credit_information/credit_law/PaydayLoanLaws.jsp). Accessed 8 October 2006.

<sup>13</sup> National Conference of State Legislators. "Enacted Payday Lending Legislation – 2006 Session." [http://www.ncsl.org/programs/banking/PaydayLend\\_2006.htm](http://www.ncsl.org/programs/banking/PaydayLend_2006.htm). 8 September 2006. Accessed 7 October 2006.

<sup>14</sup> National Conference of State Legislators. "Enacted Payday Lending Legislation – 2006 Session." [http://www.ncsl.org/programs/banking/PaydayLend\\_2006.htm](http://www.ncsl.org/programs/banking/PaydayLend_2006.htm). 8 September 2006. Accessed 7 October 2006.

## **Evasion Techniques**

Of concern is payday lenders' success in evading state laws. Although Iowa has relatively strict payday lending laws, payday lenders still charge an average of 284% APR in Iowa.<sup>15</sup> Lenders are able to evade rollover laws by holding two checks at once, essentially giving new loans every two weeks. Additionally, interest rates are capped for the life of the loan, not for annual percentage rates.

In some cases, notably in Georgia<sup>16</sup>, lenders evade state law by partnering with a national FDIC-insured bank; the national or out-of-state bank makes the loan, and the lender buys the debt from that bank to collect the interest. This has been called the "rent-a-bank strategy."<sup>17</sup> Online payday loans are also a threat to state law enforcement.

## **Refund Anticipation Loans**

The Refund Anticipation Loan (RAL) is similar to a pay day loan and is available to those who expect to receive a federal tax refund. The RAL is often presented by a bank's tax preparers as a means of receiving one's refund immediately rather than waiting seven to ten days for its arrival from the IRS. In reality the RAL is a very short term loan that is repaid when the refund arrives at the bank.

The RAL often includes financing charges and interest rates that range from 40-700% APR.<sup>18</sup> While most states have set laws banning loans with such high interest, loopholes exist; for example tax preparers can partner with national banks to avoid following state regulations.<sup>19</sup> Tax preparers H&R Block and Jackson Hewitt, for example, partner with HSBC and Santa Barbara Bank and Trust, to grant the vast majority of RALs each year.

## **Who is Affected?**

RALs attract approximately 10 million Americans every year,<sup>20</sup> 56% of whom also file for Earned Income Tax Credit (EITC), part of a federal program for low-income workers that accounts for 17% of individual taxpayers nationwide.<sup>21</sup> Seventy-nine per cent of RAL users

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<sup>15</sup> Rob Reed. Iowa Banking Division. Fiscal year 2005 number.

<sup>16</sup> Credit.com. "State-by-state Payday Loan Summary."

[http://www.credit.com/credit\\_information/credit\\_law/PaydayLoanLaws.jsp](http://www.credit.com/credit_information/credit_law/PaydayLoanLaws.jsp). Accessed 8 October 2006.

<sup>17</sup> Consumer Federation of America and U.S. Public Interest Research Group. "Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections." The 2001 Payday Lender Survey and Report. <http://www.consumerfed.org/pdfs/paydayreport.pdf>

<sup>18</sup> Iowa Attorney General. "Consumer Advisories: Rapid Tax-Refund Loans."

[http://www.iowaattorneygeneral.org/consumer/advisories/2005\\_02\\_Tax\\_Refund\\_Loans.html](http://www.iowaattorneygeneral.org/consumer/advisories/2005_02_Tax_Refund_Loans.html). March 2006. Accessed 3 October 2006.

<sup>19</sup> Iowa Legal Aid. "Refund Anticipation Loans."

<http://www.lawhelp.org/IA/showdocument.cfm/County/%20/City/%20/demoMode/=201/Language/1/State/IA/TextOnly/N/ZipCode/%20/LoggedIn/0/doctype/dynamicdoc/ichannelprofileid/9095/dynamicdocid/1093/iorganizationid/897/itopicid/796/iProblemCodeID/1990100/iChannelID/133/isubtopicid/1/iProblemCodeid/1990100>. December 2002. Accessed 12 October 2006.

<sup>20</sup> McCoy, Kevin. "Challenges Mount against Refund-Anticipation Loans." *USA Today*. 17 September 2006.

<sup>21</sup> National Consumer Law Center/Consumer Federation of America. "Another Year of Losses: High-Priced Refund Anticipation Loans Continue to Take a Chunk out of Americans' Tax Refunds." [http://72.14.203.104/search?q=cache:QgUiMPr8\\_DsJ:www.consumerfed.org/pdfs/2006\\_RAL\\_report.pdf+%22refund](http://72.14.203.104/search?q=cache:QgUiMPr8_DsJ:www.consumerfed.org/pdfs/2006_RAL_report.pdf+%22refund)

make less than \$35,000 a year; the estimated average income is \$17,800. Roughly two-thirds of consumers do not realize that a RAL is a loan.<sup>22</sup>

## Legislation

In 2005 a bipartisan group of US Senate Finance Committee members introduced the Taxpayer Protection and Assistance Act (S. 832). Under this legislation all RAL facilitators would need to register with the Secretary of Treasury and make specified disclosures to taxpayers.<sup>23</sup>

Also in 2005, Connecticut became the first state to cap RAL interest charges, setting the annualized maximum rate at 60%. In reaction Santa Barbara Bank and Trust has initiated a lawsuit in federal district court against Connecticut, claiming the law is preempted by the National Bank Act. Other states introducing bills to place restrictions on RALs in 2005 included Illinois, Iowa (*Senate File 145*), New York, Ohio, and Texas; such legislation has yet to pass.

In 2005 California passed a requirement that tax preparers provide written disclosures and a conspicuous RAL fee schedule. Washington, too, now requires a written disclosure and loan schedule; however, this new statute preempts a tougher regulation imposed by the City of Seattle in 2004 that demanded oral disclosures and Spanish language disclosures. Oregon followed suit, mandating disclosures but blocking stronger local action.

Illinois, Minnesota, Nevada, North Carolina, and Wisconsin have similar laws regarding disclosure of pertinent RAL information in order to protect consumers.<sup>24</sup>

This report was prepared in November, 2006 by the Iowa Civic Analysis Network (I-CAN), a non-partisan public policy undergraduate research group at the University of Iowa. For additional research on this or other issues, please visit our website at <http://www.uiowa.edu/~ican> or contact us at [studorg-i-can@uiowa.edu](mailto:studorg-i-can@uiowa.edu).

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<sup>22</sup> "Smith Introduces Legislation to Protect Low-Income Taxpayers from Unscrupulous Loan Providers."

<http://www.senate.gov/~gsmith/press/2004/04-21-05.htm>. 21 April 2005. Accessed 10 October 2006.

<sup>23</sup> Library of Congress. "S.832." <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:S.832>:. 28 June 2006. Accessed 10 October 2006.

<sup>24</sup> National Consumer Law Center/Consumer Federation of America. "Another Year of Losses: High-Priced Refund Anticipation Loans Continue to Take a Chunk out of Americans' Tax Refunds."

[http://72.14.203.104/search?q=cache:QgUiMP8\\_DsJ:www.consumerfed.org/pdfs/2006\\_RAL\\_report.pdf+%22refund+anticipation+loans%22,+state+legislation&hl=en&gl=us&ct=clnk&cd=2&lr=lang\\_en](http://72.14.203.104/search?q=cache:QgUiMP8_DsJ:www.consumerfed.org/pdfs/2006_RAL_report.pdf+%22refund+anticipation+loans%22,+state+legislation&hl=en&gl=us&ct=clnk&cd=2&lr=lang_en). January 2006. Accessed 7 October 2006.