

1,000% INTEREST—GOOD WHILE SUPPLIES LAST: A STUDY OF PAYDAY LOAN PRACTICES AND SOLUTIONS

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Would you pay \$1000 in fees to borrow \$100 for a period of twenty weeks? Is it possible that such a loan is even legal? Welcome to the world of payday lending—one of the fastest growing segments of the consumer-credit industry. This Article describes the practices of payday loan companies and then discusses some states' failed attempts to institute regulation. These legislative efforts frequently fail because crafty lenders quickly adapt to new legislation by finding loopholes that undermine any consumer protection provided by the new regulatory laws. This Article also reports on an empirical study of borrower conduct and understanding of payday lending terms. This study is one of the first to gather information about these loans directly from customers at the point of sale. These study data uncover critical facts, including a deep misunderstanding by most borrowers of the true cost of the loans. These data also reveal an apparent inability of many consumers to "do the math" necessary to conceptualize the structure of the loans. This lack of understanding leaves many consumers unable to make important comparisons with other forms of credit which may have been available to them. This study reveals the need for effective regulation through legislation, and suggests that a federal usury cap may be the only real solution.

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INTRODUCTION

A payday loan is a small, short-term, triple-digit interest rate loan, typically in the range of \$200 to \$500 dollars, secured by the consumer's post-dated check or debit authorization. These loans were originally designed to tide a consumer over until payday, and then be paid back in one lump sum when the consumer received her paycheck. A typical¹ short-term loan product in today's market allows a customer to borrow \$400, for fourteen days or less, for a \$100 fee.² The loan is usually designed as an interest-only loan, with the interest payment—here \$100—due every two weeks. Because this is an interest only loan, the principal essentially stays out forever, while the lender recoups the money he has loaned in only four weeks.

As of March 2010, more than 19 million U.S. households had taken out payday loans worth more than \$35 billion.³ Payday and other short-term loan outlets nearly tripled in number between 1999 and 2006.⁴ As of 2006, there were over 22,000 storefronts nationwide.⁵ The Center for Responsible Lending (CRL) reported that, in Ohio, payday loan centers outnumber Burger King, Wendy's and McDonald's locations combined.⁶ There are 11,000 Starbucks locations in America, compared to 22,000 payday locations,⁷ and in twenty-nine of the thirty-five states where payday lending is legal, there are 12,400 McDonald's.⁸ If this trend continues, payday loans could prove to be the fastest growing segment of the consumer-credit industry, and if the economy continues to falter, more and more middle-income people may use this form of credit.

Payday lending and other forms of high-cost, short-term loans are among the most controversial credit products in the marketplace. These loans vary in design. In one form loan common in New Mexico, the customer borrows \$100, to be repaid in twenty-six bi-weekly installments of \$40.16 each, plus a final

1. This Article analyzes data gathered through interviews with payday loan customers. The loans on which we gathered data ranged in interest rates from 100% per annum to 1100% per annum. For additional explanation of the interview and data-gathering process, see *infra* notes 17–19 and accompanying text.

2. This is a 650% interest rate. Moreover, kept out for one year, this loan would earn interest of \$2600, and the borrower would still owe the \$400.

3. *Newshour: Payday Lenders Face Increasing Scrutiny* (PBS television broadcast Mar. 16, 2010), available at http://www.pbs.org/newshour/bb/business/jan-june10/payday_03-16.html.

4. Patrick M. Aul, Note, *Federal Usury Law for Service Members: The Talent-Nelson Amendment*, 12 N.C. BANKING INST. 163, 165 (2008). See also Interview with Study Participant SB11, who noted that a shop with one employee in 2003 has now grown to have six employees.

5. Aul, *supra* note 4, at 165 n.15.

6. Gigi Stone, *Strapped Homeowners Turn to Bad Loans* (ABC television broadcast Apr. 12, 2008), available at <http://abcnews.go.com/WNT/story?id=4641165>.

7. *10 Shocking Facts About Payday Loans*, PAYDAYLOANS.ORG., <http://www.paydayloans.org/10-shocking-facts-about-payday-loans> (last visited June 5, 2010) (stating that there are two payday locations for every Starbucks).

8. *Payday Lenders vs. McDonald's*, http://www.csun.edu/~sg4002/research/mcdonalds_by_state.htm (last visited June 5, 2010).

installment of \$55.34.⁹ In total, this borrower would pay \$100 in principal and \$999.71 in interest, for an annual percentage rate (APR) of 1147%.¹⁰ In addition to charging high interest rates, payday lenders have been criticized for questionable collection tactics and for targeting minorities.¹¹ The ubiquitous presence of payday loan and other short-term loan outlets makes them a far easier method of accessing quick cash than other financing alternatives.

Given both the popularity and the high cost of these loans, they have attracted the attention of scholars from many disciplines, including economics,¹²

9. Felix Salmon, *Loan Sharking Datapoints of the Day*, REUTERS (Jan. 6, 2010, 7:37 PM), <http://blogs.reuters.com/felix-salmon/2010/01/07/loan-sharking-datapoints-of-the-day/>.

10. This assumes the lender is unable to convince the borrower to reborrow the principal before the loan is paid back. *See infra* Part I.C.

11. *See* ARACELY PANAMEÑO & KEITH CORBETT, CTR. FOR RESPONSIBLE LENDING, WEALTH-STRIPPING PAYDAY LOANS TROUBLE COMMUNITIES OF COLOR 7 (2008), available at <http://www.responsiblelending.org/payday-lending/research-analysis/wealth-stripping-payday-loans-trouble-communities-of-color.html> (“Prominent civil rights groups such as the NAACP have condemned the practice of payday lending. . . . The NAACP refuses to accept money from payday lenders for any of its programs.”). The article quotes African American leader Julian Bond: “A drive through any low income neighborhood clearly indicates people of color are a target market for legalized extortion Visits to payday stores . . . are threatening the livelihoods of hardworking families and stripping equity from entire communities.” *Id.* (quoting Dave Anderton, *Payday Lending Fees Add Up: \$3.4 Billion*, DESERET NEWS, Dec. 19, 2003, http://findarticles.com/p/articles/mi_qn4188/is_20031219/ai_n11418408).

The Mexican American Legal Defense and Educational Fund (MALDEF) is also quoted in the CRL Article:

Even if you have a bank account, you can get into trouble if you use payday lenders as a quick solution rather than building a solid relationship with a bank or credit union that you can rely on in times of trouble. These merchants prey upon those who are short of money, but don't feel comfortable asking a bank for a loan.

Id. (quoting MALDEF, MAKING THE MOST OF YOUR MONEY: A GUIDE TO FAMILY FINANCES FOR LATINOS LIVING IN THE UNITED STATES 10 (2007), available at <http://maldef.org/assets/pdf/MALDEF%20Making%20the%20Most%20of%20Your%20Money%20Handbook.pdf>).

As an example of such questionable collection practices, in *Valued Services of Kentucky v. Watkins*, a customer was trapped in a payday lender's store by a store employee for failure to pay his loan. 309 S.W.3d 256, 258 (Ky. Ct. App. 2009). He informed the store manager that he could not repay his loan that day, but that he would be able to do so three days later. *Id.* The manager insisted that Watkins had to repay the entire amount that day and stated that he was not leaving the premises until he had paid in full. *Id.* She pushed a button to lock the office door and would not allow Watkins to leave even though he repeatedly asked to do so. *Id.* She also telephoned her regional manager, and told her that “I have a black guy over here that refuses to pay his bill and he's not going to leave until he does.” *Id.* Watkins later sued for false imprisonment. *Id.* at 259.

12. TOM LEHMAN, PAYDAY LENDING AND PUBLIC POLICY: WHAT ELECTED OFFICIALS SHOULD KNOW 1 (2006), available at <http://www.fisca.org/Content/NavigationMenu/Resources/FortheIndustry/ResearchPublications/WhatElectedOfficialsShouldKnow.pdf>.

business,¹³ finance, law, sociology, and public policy,¹⁴ among others. Even geographers have written about payday lending,¹⁵ yet some of the most basic questions about these loans remain unanswered.¹⁶ Scholars have examined the profitability of payday lenders, the demographic served, the need for the product, the benefits and detriments of the product, whether the loans create a debt trap for consumers, whether regulation works and, if so, what kind of regulation is most effective.

However, no one really knows what is going through a payday lending customer's mind when she enters a payday loan center. What other options do borrowers have, and what is their understanding of the cost of the credit? This Article attempts to answer these and other questions by reporting on one of the only empirical studies to date gathering data at the point of sale. This study explores the following questions, among others: What draws customers to payday lenders in general and to a particular payday store? What are the loans most

13. See Edward C. Lawrence & Gregory Elliehausen, *A Comparative Analysis of Payday Lending Customers*, 26 CONTEMP. ECON. POL'Y 299 (2008); Adair Morse, *Payday Lenders: Heroes or Villains?* (Feb. 2007), <http://ssrn.com/abstract=999408>.

14. See, e.g., Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121 (2004); Lisa Blaylock Moss, *Commentary, Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 ALA. L. REV. 1725 (2000); Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994, 997 (2006); Charles A. Bruch, *Comment, Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257 (2001); Carmen M. Butler & Niloufar A. Park, *Mayday Payday: Can Corporate Social Responsibility Save Payday Lenders?*, 3 RUTGERS J.L. & URB. POL'Y 119 (2005); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002); Ronald Mann & James Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2007); Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385 (1997); Michael A. Stegman, *Payday Lending*, J. ECON. PERSP., Winter 2007, at 169; Michael A. Stegman & Robert Ferris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8 (2003); Therese Wilson, *The Inadequacy of the Current Regulatory Response to Payday Lending*, 32 AUSTL. BUS. L. REV. 193, 198–206 (2004); Michael Bertics, Note, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 133 (2005); Diane Hellwig, Note, *Exposing the Loan Sharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567 (2005).

15. See, e.g., Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location Analysis of Payday Lenders and Banks*, 55 PROF. GEOGRAPHER 303 (2003). The geographic data are among the most interesting. For instance, data show that Minnesotans with lower income levels had a higher probability of living near a payday lending outlet: \$15,000: 88%; \$30,000: 73%; \$45,000: 50%; \$60,000: 27%; \$75,000: 12%; \$90,000: 5%; \$125,000: less than 1%. See H.J. Cummins, *Legislators Seek to Curtail Payday Lending Practices: The Industry Argues that the Proposed Legislation to Limit Interest Rates Would Effectively Put it Out of Business*, STAR TRIB. (Minneapolis), Feb. 24, 2008, at D1 (citing data from the Minnesota Department of Commerce, analyzed by the Legal Services Advocacy Project).

16. See GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, CREDIT RESEARCH CTR., *PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CONSUMER DEMAND 47* (2001), available at http://www.cfsa.net/downloads/analysis_customer_demand.pdf.

commonly used for? Do people understand the repayment terms? Can they estimate how much they will pay for a loan in total dollars over time? Do they understand the meaning of APR? Does disclosure of the APR help them shop around for loans? Do people actually compare different payday loans? Do borrowers have realistic expectations about whether they will be able to pay the loans back? What alternatives do they have?

In addition to the information gleaned through the curbside interviews, this Article offers insight for states considering implementing legislation, or that have already passed payday loan consumer-protection laws. Because these curbside data were collected in a state that had just changed its laws to allegedly protect consumers, the study also captured the creative methods used by the short-term loan industry to get around states' efforts to legislate the industry. Most of the efforts by states to regulate this industry have failed miserably, and this Article details the reasons for regulatory failure.

Effective regulation could save states both time and money, and prevent collateral damage caused by legislation that does not achieve its goals. Ineffective legislation can be more harmful than no legislation at all because it causes the public to believe that the issue has been satisfactorily dealt with, even when there is no appreciable effect on the payday-lending industry in the state. Thus, while the legislative process was not originally a focus of the empirical study described in this Article, our methodology provides insights into the types of industry changes that occur after legislation passes, as well as the legislative process in general.

This study gathers these data in three ways, first through a series of cold calls to lenders to request information about what terms they offer on short-term loans. Lenders were identified through the most recent Yellow Pages as well as web-based directories. The second data set was gathered outside payday loan stores from customers themselves. We interviewed 109 payday or installment loan customers using the survey attached as the Appendix.¹⁷ These customer interviews form the primary data for this study. Additionally, because the study was conducted in a state with a new payday lending statute, the data also revealed industry changes in response to the new law. As a result of these changes, we were able to see how the industry operated both before and after institution of the new law. The final data set consists of twenty qualitative interviews conducted in the Author's office.¹⁸ These interviews were done in order to clarify various questions raised by the initial study data and to gain additional background information about customers' understanding of these loans. In the interviews, respondents were

17. Curbside interviews were conducted June 2009 to December 2009 in Albuquerque, New Mexico and surrounding areas. The interviewees are referred to in this Article as "CS" followed by a number. The Author retains all information in her files.

18. Office interviews were conducted September 2009 to February 2010, by the Author in the Author's office in Albuquerque, New Mexico. The interviewees are referred to in this Article as "SB" followed by a number. The Author retains the interview notes in her files.

asked the survey questions and allowed to expound on their answers, ask further questions, and make any comments they wished.¹⁹

Industry data were generated through borrower interviews and by calling payday lenders to determine what terms they were offering borrowers. We first called the lenders in March 2009. We called a random sample of lenders at this time, some from chains and some from stand-alone lenders. This initial contact was meant to determine whether lenders were in general compliance with the new law, at least by their own self-disclosures. The phone interviews revealed a general shift in the New Mexico small-loan marketplace from payday loans to a new product called the “installment loan.” Curbside interviews of both payday and installment borrowers were conducted next. In June 2009, all short-term or payday lenders listed in the 2009 Yellow Pages were contacted to determine whether they offered payday or installment loans, or both. These data on marketplace shifts provide information highly useful to the legislative process, perhaps more useful than the results of the curbside interviews themselves.

Part I of this Article provides the background needed to understand the short-term loan industry. This Part describes the industry’s self-articulated goals and its business and marketing plans. Part II describes the legislative process in one representative state, New Mexico. Part II also explains the recent amendments to the New Mexico Short Term Loan Act, which was adopted in 2007 and now purports to regulate payday loans in the state.²⁰ Moreover, this Part describes how the payday loan industry in New Mexico changed in response to the new law. Finally, it discusses the relevance of these changes—as well as of the industry’s business and marketing plans—to future legislative efforts, providing useful information for other states intending to legislate short-term lending.

Part III describes the methodology of the curbside empirical study, as well as the qualitative and quantitative results. It also contains some data from the more in-depth office interviews. These data confirm some claims upon which both the industry and scholars agree. Specifically, these data confirm that customers take out loans near home or work out of convenience, rather than shopping around for price, and that customers do not understand the significance of the APR.

The data also show that many consumers cannot easily compare the cost of this form of credit to other forms of credit, and that many customers are unable to accurately describe how much they will ultimately pay for the small sums they borrow. Further, data show: customers generally feel they will pay back the loans in a short time, despite national statistics to the contrary; most payday borrowers

19. The study questionnaire naively asked about what “the” loan was being used for, how the customer could calculate cost of “the” loan, etc., assuming that customers would have just one or at most two loans at a time. It also naively assumed that customers had to pay back their loans and could not roll them over, causing customers to call a loan “one loan” even if it had been out for years. We learned curbside that we had been vastly underestimating both the numbers of loans people had at a time, as well as the duration of those loans, and decided to use a different interview format in the second data collection process in order to learn more. Most of the data from this second set of interviews will be discussed in a subsequent article.

20. N.M. STAT. ANN. §§ 58-15-1 to -39 (2009).

are repeat customers; and payday lending is far more convenient, less intimidating, and less embarrassing than getting a loan from another source. The data further show that while a few payday lending customers use the loans for one-time emergencies, the vast majority use them for regular, recurring monthly expenses.²¹

The data also reveal the ineffectiveness of statutes that define payday loans as those between fourteen and thirty-five days in duration and then: (1) cap fees per pay period; (2) create a database; and (3) prohibit rollovers but contain no cooling-off period. This type of statute was recently enacted in New Mexico and the short-term loan industry tried to get it passed in Arizona as well. However, if a state intends to protect consumers by regulating these products, laws like New Mexico's are ineffective and inadvisable because they do not change lending practices. In fact, they have little effect of any kind.²²

Part IV provides justification for regulating the short-term loan industry in light of the empirical data. The analysis starts from the perspective that many consumer products need not be regulated, but that several unique conditions make payday lending different. These conditions include: (1) market failure;²³ (2) largely innumerate consumers who lack the time, knowledge, or resources to fully comprehend the dollar costs of the loans;²⁴ and (3) failure of consumers to shop around for loans on the basis of price. Information asymmetry between lenders and consumers is another compelling reason for regulation of this industry.

Part V concludes that, while there is still a great deal we do not know about payday lending, we now know that legislation is necessary. This Part concludes that the question of how best to regulate payday loans is an important topic that justifies further inquiry. Ultimately, this Article suggests that an absolute interest-rate cap is one possible solution to the short-term loan problem, particularly in light of the failure of New Mexico-style regulation to have any meaningful effect on the short-term loan practices.

21. Our data also show that payday customers are not, for the most part, middle class, a topic that will be explored in more detail in a subsequent article.

22. The industry may initially fight legislation like this, but will not fight for long because the industry knows that: (1) it will still have plenty of customers under this model; and (2) it can quickly change its products to skirt this form of legislation and perhaps make even more money.

23. See *infra* Part IV.A. But see SHEILA BAIR, ANNIE E. CASEY FOUND., LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 29, 33 (2005), <http://www.aecf.org/upload/publicationfiles/fes3622h334.pdf>. Sheila Bair contends that:

There is no evidence of price collusion or monopolistic concentrations in the payday loan market. This may suggest that payday loans are efficiently priced as compared to the relatively high operational costs associated with the product. *Alternatively, it may suggest that the customers who use the product are sufficiently desperate for cash that the immediacy of the product is more important than the price paid.*

Id. (emphasis added). While the Author agrees with Bair's latter alternative as a partial explanation, she does not agree with the premise that there is no collusion.

24. See generally Ann M. Olazábal & Howard Marmorstein, *Structured Products for the Retail Market: The Regulatory Implications of Investor Innumeracy and Consumer Information Processing*, 52 ARIZ. L. REV. 631 (2010).

I. THE SHORT-TERM LOAN BUSINESS PLAN

This Part describes the short-term loan industry in general, with a focus on payday lending. It describes the industry's self-articulated goals and the publicly available information about the industry's business and marketing plans.²⁵

A. Sky-High Profits

Payday lending is a tremendously profitable business. One need only review a typical industry website to understand the strong profit motivations of such lenders:

The payday loan industry may be the fastest growing financial segment - bar none! Not only can you find a payday loan store seemingly [sic] everywhere but additionally there are payday loan web sites as well. As a matter of fact, the payday loan internet component offers even greater rewards than the payday loan brick-n-mortar!

So, why is this so? Why is the payday loan industry growing at such a rapid rate? And why are a few of the most saavy [sic] financial minds entering this "loan shark" business segment? The answer, of course, is the TREMENDOUS PROFITS AVAILABLE! Depending on the state or province, payday loan consumers are paying \$10 to \$35 per \$100 borrowed for a term averaging 8 days. These cash advance fees are equivalent to 480% to 1200% APR's (Annual Percentage Rate). These returns are simply PHENOMINAL [sic]!

[C]onsumers throughout the world have an insatiable demand for the payday loan product! Small loans ranging from a few hundred dollars to \$1500 or more are in huge demand by cash strapped consumers everywhere on this planet. . . .

Payday loans, just in the USA, are estimated to be a \$40 billion to \$50 billion dollar industry and still growing 20% to 30% annually! . . . A typical 8 day paycheck advance extended to your client will yield an annual percentage rate on your money of 805%!²⁶

25. This information was gathered from existing literature, as well as the websites of both industry and consumer groups. See, e.g., CTR. FOR RESPONSIBLE LENDING, <http://www.responsiblelending.org/> (last visited Aug. 5, 2009); *Resources for Policymakers*, COMMUNITY FIN. SERVS. ASS'N OF AM., http://www.cfsa.net/policymakers_resources.html (last visited Aug. 5, 2009); Trihouse Enterprises, Inc., *How to Start a Payday Loan Business, Start a Cash Advance Company*, <http://www.paydayloanindustry.com/payday-loan-internet.html> (last visited Aug. 5, 2009). We attempted to spend equal time at sites written by consumers and the industry in order to get the full picture of what each side of the debate was saying.

26. *How to Start a Cash Advance Business*, CASHADVANCEPROFITS.COM, <http://www.cashadvanceprofits.com> (last visited July 22, 2010); see also *Payday Pundit: The Latest News and Information About the Payday Lending Industry*, PAYDAY PUNDIT (Jan. 5, 2010), <http://paydaypundit.org/2010/01/05/>. The numbers in these websites are at odds

Dan Feehan, CEO of payday lender Cash America, has said that “the theory in the business is you’ve got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that’s really where the profit is.”²⁷ While some scholars have questioned the profitability of the industry²⁸ and the industry sometimes denies that its returns are excessive, the mere existence of such a large number of lenders belies the conclusion that these loans are not highly profitable.

B. The History of Payday Lending and the Current Lending Practice

According to some, the payday lending industry initially grew from the salary-buying business of the early twentieth century. Salary buyers advanced cash at steep fees on the security of a wage assignment.²⁹ If the loan was not repaid or renewed on time, the salary buyer would threaten to present the wage assignment to the borrower’s employer, who might then terminate the employee.³⁰

Other people in the industry claim that payday lending grew out of the check-cashing business. Professors Ronald Mann and James Hawkins talked to an executive in the check-cashing industry who described the emergence of post-dated check cashing:

Payday loans grew out of that business in the early 1990’s. We would cash a personal check on the weekend for 10% of the check, but most payroll checks or government checks we would cash for 3%. So people would come to us on Thursday and ask if we would cash it then and hold it until Monday. For a while we said no we wouldn’t do that, then we started trying it out, found there was a demand for cashing post-dated checks, and slowly gravitated into that, charging an extra 5% or so for the extra risk and service. People loved it. Their options, when they are in a bind, are that they can write a check that will go on insufficient funds, but they’ll get a charge of \$35/check. So if they write three checks for \$100 they will

with other information promulgated by the payday loan industry that claims it is not that profitable, but these web sites are surely not entirely without basis.

27. *Payday Lending: Research and Analysis*, CTR. FOR RESPONSIBLE LENDING, <http://www.responsiblelending.org/media-center/press-releases/archives/payday-loan-reform-act-must-be-strengthened.html> (last visited July 20, 2010).

28. See, e.g., Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 FORDHAM J. CORP. & FIN. L. 203, 203 (2007).

29. Robert Mayer, *One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County 2* (undated) (working paper), available at <http://lwvmilwaukee.org/mayer21.pdf> (last visited Aug. 6, 2009).

30. *Id.* at 2–3.

Today a post-dated check has replaced the wage assignment as the security for a payday loan. [Lenders] require an open checking account and a steady income source (usually a paycheck, but pension or W-2 income is also accepted) to get a short-term cash advance. The process is quick and convenient, with many chains using the TeleTrack system to assess the risk for this subprime segment of the credit market.

Id.

get \$105 in fees, which is a pretty bad alternative. Or they can accept the late-rent penalty. Or they can put off fixing their car and lose two or three days of work.³¹

In any case, payday lending first emerged in the South in the late 1980s and grew rapidly during the following decade.³² Payday lenders typically assess a borrower's creditworthiness using the industry-wide TeleTrack credit reporting system and then offer a loan through a retail store location.³³ The industry depends heavily on retail store locations because customers usually travel only to the store that is nearest their place of employment.³⁴ The industry is aware that convenience is a main draw of payday lending and accordingly does its best to provide optimal accessibility.³⁵

Payday lending locations are normally small, with outstanding loan portfolios of less than \$100,000 and annual revenues of about \$350,000.³⁶ As stores age, their profitability increases. For instance, a typical new store will make fewer than 1000 loans per year, while a mature store will make more than 8500 loans per year.³⁷ Because a store's costs are fixed, the costs per loan from the mature stores are much lower than the costs per loan from the newer stores.³⁸

31. Mann & Hawkins, *supra* note 14, at 862 (footnote omitted).

32. Mayer, *supra* note 29, at 3.

33. Mann & Hawkins, *supra* note 14, at 863–64. Mann and Hawkins found, through industry information and interviews, that lenders typically look at a borrower's identification, evidence of income, and a current bank statement. *Id.* at 862–63. They also evaluate past borrowing history and the other criteria using a software program functionally parallel to the credit scoring that credit card issuers use to evaluate their customers. *Id.* at 863. They also claim that some lenders use TeleTrack to access information about a borrower's prior-payment history with payday lenders. *Id.* This information is consistent with what payday lenders told customers (and our researchers) was needed to qualify for a payday loan. *See id.* at 863 n.19.

34. *Id.* at 863.

35. When describing a new survey of payday lending customer habits in Alberta, Canada, an industry webpage states that “[a] number of other studies of our industry have consistently pointed out the same thing; IT’S ABOUT CONVENIENCE!” *New Payday Loan Industry Survey Results Available*, PAYDAY LOAN INDUSTRY BLOG (June 6, 2009), <http://paydayloanindustryblog.com/new-payday-loan-industry-survey-results-available>.

36. Mann & Hawkins, *supra* note 14, at 864.

37. *See* Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 9 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), available at http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf. In the Federal Deposit Insurance Corporation (FDIC) study, a mature store was one more than four years old. *Id.* at 8–9.

38. *See* ERNST & YOUNG TAX POL’Y SERVS. GROUP, *THE COST OF PROVIDING PAYDAY LOANS IN CANADA* 39–43 (2004), available at <http://www.cpla-acps.ca/english/reports/EYPaydayLoanReport.pdf>. Chris Robinson at York University has made this same point: large operations have lower costs than small operations, allowing larger lenders to make a profit with stricter rate caps. CHRIS ROBINSON, *REGULATION OF PAYDAY LENDING IN CANADA* (2006); *see also* James Daw, *Consumer Protection in the Wind on Payday Loans*, TORONTO STAR, May 30, 2006, at D6 (discussing the Robinson report).

C. The Importance of Repeat Customers

Both industry experts and small-loan foes acknowledge that repeat customers are important to the payday lending business model.³⁹ Some lenders even offer loyalty programs and rewards cards, like those offered by bakeries and pizza shops. These programs encourage borrowers to become repeat customers with offers such as: if you “pay your interest five times in a row on time, you get your sixth interest payment at half price.”⁴⁰

Multiple empirical studies have reported that repeat customers comprise the vast majority of all payday lending customers. For example, a study by the CRL, using data from North Carolina regulators, reports that 91% of loans are made to borrowers with five or more loans per year.⁴¹ Another CRL study found that 76% of payday lending business comes from repeat customers.⁴² Similarly, a study of Colorado borrowers found that about 65% of loan volume in that state comes from customers who borrow more than twelve times per year.⁴³ Some borrowers avoid renewal limits by alternating between lenders, using the funds from each lender to pay off the other in turn.⁴⁴ Professors Mark Flannery and Katherine Samolyk report in their 2005 Federal Deposit Insurance Corporation (FDIC) study that about 46% of all loans are either renewals of existing loans or new loans that follow immediately upon the payment of an existing loan (“rollovers”).⁴⁵

The costs of serving high-frequency borrowers are less than the costs of serving low-frequency borrowers, both because the loss ratios are significantly lower for high-frequency borrowers and because the operating costs are lower.⁴⁶ As sources in the industry explained to Mann and Hawkins, a loan to a first-time borrower will probably require verification of a telephone number and a bank account, as well as some investigation of the identity of the borrower.⁴⁷ Those steps, which are costly in the context of a loan with a fee of only \$30, are

39. See Mann & Hawkins, *supra* note 14, at 864.

40. Interview with Study Participant SB01 (discussing interest-only loans with Ace Cash Express). One downside is that if customers want to use their loyalty points toward their next interest payment, they cannot pay down any amount toward principal. *Id.*

41. KEITH ERNST ET AL., CTR. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 2, 7 (2004), available at <http://www.responsiblelending.org/payday-lending/research-analysis/CRLpaydaylendingstudy121803.pdf>.

42. LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76% OF TOTAL VOLUME 11 (2009), available at <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf>.

43. See Paul Chessin, *Borrowing From Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387, 411 (2005).

44. *Id.* at 415.

45. Flannery & Samolyk, *supra* note 37, at 12, 13 fig.2.

46. *Id.* at 16–17.

47. Mann & Hawkins, *supra* note 14, at 865.

unnecessary for repeat customers. Also, unlike new customers, repeat borrowers have demonstrated a propensity to repay.⁴⁸

Lenders use time-tested methods to attract new borrowers into their portfolio, including offering a free payday loan to first-time borrowers⁴⁹ and offering money to existing customers for referring new ones.⁵⁰ Since loans to repeat customers are cheaper to administer, lenders do what they can to encourage repeat borrowing, including calling customers as soon as a loan is paid back and offering them even more money.⁵¹ Study data show that people generally return to the original lender unless they have had a bad experience with a particular lender or, as the saying goes, need to “borrow from Peter to pay Paul.”⁵² And, as with credit cards and other forms of consumer financing, lenders discourage paying off the loans by making it difficult or impossible to pay part of the principal on interest-only loans designed to rollover automatically,⁵³ and by encouraging additional borrowing as installment loans get paid off.⁵⁴

Borrowers also frequently take simultaneous payday loans from multiple lenders. A Wisconsin study of bankruptcy data showed that many payday loan customers take out loans from more than one lender, frequently in amounts that exceed their paychecks. Professor Robert Mayer explained that such multiple loans make rollovers inevitable and collectively function like a long-term, high-rate, interest-only cash advance.⁵⁵

Mayer examined a sample of 500 bankruptcy petitions filed by residents of Milwaukee County during the summer of 2004, looking for petitions that listed

48. Mann & Hawkins, *supra* note 14, at 865.

49. PARRISH & KING, *supra* note 42, at 3; *see also* study data *infra* Part III.B. Our calls to payday lenders, as well as the signs outside many of their stores, confirm that a significant portion of the remaining payday lending market is now offering the first loan free.

50. Interview with Study Participant CS05 (discussing lender offering \$20 to refer a new customer, compared to the \$10 they could get doing our study interview).

51. Interview with Study Participant SB12 (discussing that she was called less than a week after paying off her first loan in full and offered “a raise,” meaning a loan in twice the amount she originally qualified for).

52. Interview with Study Participant CS61, who stated she had four loans at one time totaling about \$1000. She got one loan, then got the others to pay back the first one. She eventually declared bankruptcy.

53. *See* Interview with Study Participant SB01.

54. *See, e.g.*, Interviews with Study Participants SB01, CS21, CS27, CS34, and CS44.

55. Mayer, *supra* note 29, at 2–3. Mayer notes that:

[P]ayday advance creditors in Milwaukee County repeatedly make loans to debtors in financial crisis who already have one or more payday loans. Together these loans frequently exceed the amount of the borrower’s next paycheck, making roll-overs inevitable. The debtor has one payday but many payday loans, and when combined in this way these loans function like a large, long-term, very expensive, interest-only cash advance.

Id. at 2.

more than one payday loan.⁵⁶ If his sample is representative of the entire population filing for bankruptcy in Milwaukee County, then roughly 825 households went bankrupt in the county in 2003 while owing more than one payday loan (10.6% of all petitioners).⁵⁷ Some petitions listed as many as nine of these loans, and the median debtor claiming one or more of these debts owed the entire amount of her next paycheck to payday lenders. Most of the debtors had been rolling over the principal for many months.⁵⁸ In fact, 70% of the people who listed a payday loan on their petition had more than one. Almost 30% had four or more.⁵⁹

Installment loans are one of the preferred replacement products for payday loans in New Mexico.⁶⁰ As with payday loans, lenders rely heavily on repeat customers. Lenders encourage employees to get customers to take out as many new loans as possible, and there are no explicit laws precluding these practices. As one former employee explained:

[W]e were trained to encourage customers the day they paid a loan off to make another loan as early as the next day. We tried to get customers to keep getting loans and borrow up to their maximum approval amount whether they wanted it or not.⁶¹

This former clerk went on to explain that store employees were instructed to pressure installment-loan customers to borrow more when they came in to make a payment.⁶² She explained that this would allow the lender to reissue the loan and reset the whole payment plan.⁶³ She said she would be reprimanded by her manager if she did not pressure people into rewriting their loans in a way that would essentially wipe out all the payments previously made on the loans.⁶⁴ She

56. *Id.*

57. *Id.* at 2–3.

58. *Id.*

59. *Id.* at 5.

60. As discussed in further detail in Part II.B.1, *infra*, when the New Mexico payday lending statute passed, lenders quickly began offering a replacement product, called an installment loan, that fell outside the new law. It is entirely unregulated and thus can be rolled over indefinitely. There are neither caps on fees nor other rules, so lenders can offer whatever terms they like. The other replacement product is the interest-only payday-style loan for which no post-dated check is required.

61. CTR. FOR RESPONSIBLE LENDING, FACT V. FICTION: THE TRUTH ABOUT PAYDAY LENDING INDUSTRY CLAIMS (2001), *available at* <http://www.responsiblelending.org/payday-lending/research-analysis/fact-v-fiction-the-truth-about-payday-lending-industry-claims.html>; *see also* Interview with Study Participant CS44.

62. *See* Interview with Study Participant CS44. Another participant, who had both payday loans and title loans, described a title loan on which he had defaulted. The car was repossessed within a short time, but the default did not discourage the lender, who promptly starting calling back and offering another loan in an even greater amount. *See* Interview with Study Participant SB20.

63. The language of this person's interview suggests that she also did not understand how the loans worked, even though she was an employee. *See* Interview with Study Participant CS44.

64. *Id.*

was told to do this every time someone came in to make a payment, in order to increase the lender's interest and fees. It was very clear to this employee that rewriting or resetting, rather than initiating loans, was the bread and butter of the business.⁶⁵

In our survey process, we had an opportunity to look at several installment loan receipts, the documents customers receive when they make a payment. In all cases, the receipt was a half-page statement of what the customer had paid that day and what was still outstanding, as well as this statement: “[y]ou are entitled to borrow \$85.00 more today!” This was the only item in bold on the entire page. The former employee said that clerks were instructed to point this statement out to customers whenever they came in to make a payment.⁶⁶

D. The Importance of Late Fees

Industry websites enthusiastically acknowledge that lenders make more money when customers pay late. For example, one site explains why internet lending is so lucrative, along with the importance of late fees:

Think about it! A typical payday loan customer who applies for and receives 3 payday loans per year for ten years is worth a minimum of \$2400. (Conservatively, a payday loan customer gets 3ea \$400 payday loans at 20/\$100 loaned = \$80 in fees per loan X 3 times/yr = \$240/yr X 10 years = \$2400 life time value. Add on late fees, their family and friend referrals, etc. and each customer is worth \$3000 or more!)⁶⁷

In fact, industry experts suggest dividing payday loans into three or more smaller loans to maximize late fee assessments. They even recommend telling customers their checks have been deposited when they have not, so that the customers will be scared into believing they will bounce checks as a result.⁶⁸

E. Service with a Smile

Finally, these study data suggest that payday lenders are aware that many lower-income people are intimidated by banks.⁶⁹ Thus, the lenders try to create an environment that is as welcoming and friendly as possible. Curbside interviews

65. *Id.*

66. *Id.*

67. PAYDAY LOAN INDUSTRY BLOG, <http://paydayloanindustryblog.com/index.php?s=%22each+customer+is+worth+%243000%22> (last visited Aug 9, 2010).

68. See Michaelmom, Post to *Answers*, DEBT CONSOLIDATION CARE (Aug. 13, 2006, 7:37 AM), <http://www.debtconsolidationcare.com/getting-loan/payday-industry.html>. The post claims that “in 2002, Affordable Payday Loan Consultants, now called Trihouse Enterprises Inc., produced a business plan it sold to people wanting to get started in the payday industry.” *Id.* One tip from the Trihouse website states that “late fees are a very lucrative profit center. You do not need to actually present a client’s check(s) to the bank to have them stamp (non-sufficient funds). Purchase your own stamp! They owe the NSF fee even if you did not take it to the bank. You simply say, ‘My bank verifies funds before accepting my deposit. Unfortunately, (your check was no good). The fee is \$15 per check.’” *Id.*; see also CTR. FOR RESPONSIBLE LENDING, *supra* note 61.

69. See Interviews with Study Participants SB01 and CS46.

confirmed that some customers wanted to protect their “friends” at the lenders and not get them in trouble.⁷⁰ While not addressed directly in the survey, respondents frequently volunteered that the service at payday lenders was good.⁷¹

F. The Debt Trap

The payday lending industry claims it helps people make ends meet.⁷² Given the demographics of the payday loan customers in this study and the typical expenses of people within this demographic, coupled with the loan design, very few customers can afford to pay back the loans. Rather, as discussed above, most customers find it necessary to continue to pay \$1000 to borrow \$500 for twenty weeks, or to pay \$100 in interest every two weeks—for the rest of time—on an original loan of \$400.⁷³

Thus, while people can disagree about the precise definition of a debt trap—and whether these loans create one—given the cost of this credit and the industry’s own business plan and articulated profit margins, it is hard to fathom that anyone actually believes these loans *do not* create a debt trap. It is likely that the industry’s own very detailed TeleTrack data, which comes from the industry’s credit checking system, show precisely that. Short-term loan products like payday loans create a debt trap by design.⁷⁴ In fact, the debt trap *is* the business plan.

In sum, the business plan of short-term lenders appears to include setting up convenient and ubiquitous storefronts, hiring extremely friendly clerks, building a base of loyal customers, maximizing the frequency and amount of lending while maintaining repayment at the minimum amount required by law, and encouraging late payments to maximize fees. With this information as a backdrop, it is worthwhile to consider the legislative process in New Mexico, and attendant industry changes. The New Mexico legislation is increasingly relevant because several other states are currently considering implementing identical laws.

II. CHANGES IN LAW AND SHORT-TERM LOAN PRACTICE IN NEW MEXICO

This Part describes the legislative process in New Mexico as well as the law enacted by the state in 2007. It also describes the changes in the industry in New Mexico following enactment of the 2007 law. Finally, it discusses the

70. See Interviews with Study Participants CS23 and CS57.

71. See Interviews with Study Participants CS23, CS33, and CS45.

72. See Carl Chancellor, *What the Mob Can Learn from Payday Lenders*, CHANGE.ORG (Mar. 1, 2010), http://uspoverty.change.org/blog/view/what_the_mob_can_learn_from_payday_lenders.

According to the CRL, U.S. borrowers who rely upon high-interest payday lending for quick cash are caught in a “*debt trap*” that costs them \$3.4 billion each year. . . . [t]here is no arguing the fact that it’s a very lucrative arrangement for payday lenders to follow a *business plan designed to keep a borrower in debt*.

Id.

73. The \$25 per \$100 every two weeks amounts to 650% per annum.

74. See Chancellor *supra*, note 72.

relevance of these changes on future legislative efforts in light of the industry's apparent sidestep of the law. This information should be useful to other states that choose to regulate short-term lending.

A. *Changes in the Law*

Payday lenders began appearing in New Mexico after the state repealed its General Usury statute (former NMSA 1978 § 56-8-11-1) in 1991. Prior to the summer of 2007, New Mexico was one of only two states⁷⁵ that had no regulation of payday lending. For five very long and frustrating years, the New Mexico legislature debated various payday lending statutes. Finally, during the legislative session of 2007, the New Mexico state legislature adopted a set of changes to the New Mexico Small Loan Act of 1955 intended to address payday lending.⁷⁶ These regulations went into effect in July 2007. The New Mexico law is similar to those of several other states in that the regulations rely on a computer database enforcement mechanism for consumer qualification and reporting.⁷⁷ In fact, thirty-three states have laws that bear some similarity to the New Mexico Act.⁷⁸ This is

75. CTR. FOR RESPONSIBLE LENDING, TESTIMONY OF URIAH KING BEFORE OHIO SENATE FINANCE AND FINANCIAL INSTITUTIONS COMMITTEE 10 n.2 & 3 (May 7, 2008), available at <http://www.responsiblelending.org/payday-lending/policy-legislation/states/king-ohio-payday-testimony-05072008.pdf>.

76. N.M. STAT. ANN. §§ 58-15-1 to -39 (2010).

77. Other states that have enacted similar statutes and use the same database enforcement mechanisms. See FLA. STAT. ANN. § 560.103-.144, .402-.408 (West 2002); 815 ILL. COMP. STAT. ANN. 122/1-1 to 99-99 (West Supp. 2008); IND. CODE ANN. §§ 24-4.5-7-101 to -414 (West 2006 & Supp. 2008); MICH. COMP. LAWS ANN. § 487.2121-.2173 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); N.D. CENT. CODE ANN. §§ 13-08-01 to -15 (West 2004 & Supp. 2007); OKLA. STAT. ANN. tit. 59, §§ 3101-3119 (West, Westlaw through Chap. 170, 2010 2d Sess., 52d Leg.).

78. ALA. CODE §§ 5-18-1 to -23 (LexisNexis 1996 & Supp. 2008); ALASKA STAT. ANN. §§ 06.50.010-.900 (2008); CAL. FIN. CODE §§ 23000-23106 (West 2008); COLO. REV. STAT. ANN. §§ 5-3.1-101 to -123 (West 2002 & Supp. 2008); DEL. CODE ANN. tit. 5, §§ 2201-2213A, 2227-2243 (2001 & Supp. 2006); D.C. CODE § 26-301 to -323 (LexisNexis 2005); FLA. STAT. ANN. § 560.103-.144, .402-.408 (West 2002); HAW. REV. STAT. §§ 480F-1 to -7 (LexisNexis 2005 & Supp. 2008); IDAHO CODE ANN. §§ 28-46-401 to -413 (2005 & Supp. 2008); 815 ILL. COMP. STAT. ANN. 122/1-1 to 99-99 (West Supp. 2008); IND. CODE ANN. §§ 24-4.5-7-101 to -414 (West 2006 & Supp. 2008); IOWA CODE ANN. §§ 533D.1-.16 (West 2001 & Supp. 2008); KAN. STAT. ANN. § 16a-2-404 (2001); KY. REV. STAT. ANN. §§ 286.9-010 to -.991 (LexisNexis 2007 & Supp. 2008); LA. REV. STAT. ANN. §§ 9:3578.1-8 (West, Westlaw through 2009 Sess.); MICH. COMP. LAWS ANN. § 487.2121-.2173 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); MINN. STAT. § 47.60 (West, Westlaw through 2010 sess., Chap. 180-200, 202-214); MISS. CODE ANN. § 75-67-501 to -539 (West 2000 & Supp. 2007); MO. ANN. STAT. § 408.500-.510 (West, Westlaw through Jul. 7, 2010 of 2010 Sess., 95th Leg.); MONT. CODE ANN. §§ 31-1-701 to 729 (West, Westlaw through 2009 Leg.); NEB. REV. STAT. ANN. §§ 45-901 to -929 (LexisNexis 2005 & Supp. 2008); NEV. REV. STAT. ANN. §§ 604A.010-.940 (West, Westlaw through 2009 Sess., 75th Leg.); N.D. CENT. CODE ANN. §§ 13-08-01 to -15 (West 2004 & Supp. 2007); OKLA. STAT. ANN. tit. 59, §§ 3101-3119 (West, Westlaw through Chap. 170, 2010 2d Sess., 52d Leg.); R.I. GEN. LAWS ANN. §§ 19-14.4-1 to -10 (West, Westlaw through Chap. 392 of Jan. 2009 Sess.); S.C. CODE ANN. §§ 34-39-110 to -290 (West, Westlaw through 2009 Sess.); S.D. CODIFIED LAWS §§ 54-4-36 to -69 (West,

remarkable when one considers that none are effective in curbing payday loan abuses.

The stated purpose of the recent New Mexico law is to ensure “more rigid public regulation and supervision” of lenders and to “facilitate the elimination of abuse of borrowers.”⁷⁹ The Act further states that its intention is to “establish a system which will more adequately provide honest and efficient small loan service and stimulate competitive reduction in charges.”⁸⁰

The Act, with a few exceptions,⁸¹ applies to lenders engaged in the business of lending amounts of \$2,500 or less.⁸² A payday loan is defined in the Act as a loan with a duration of fourteen to thirty-five days, for which the consumer gives the lender a check or debit authorization for the amount of the loan plus interest and fees.⁸³ In exchange, the lender agrees to defer presentment of that instrument until the consumer’s next payday, or another date agreed upon by the lender and the consumer.⁸⁴ The lender then pays the amount represented by the check or debit authorization, minus interest and fees, to the consumer.⁸⁵ In the end, this narrow definition of payday lending defanged the legislation. The industry quickly switched to loan products that fell outside the statute, namely longer loans or those not involving a post-dated check; these loans are not regulated at all.

1. Fee Cap

The Act limits administrative fees and interest on payday loans to \$15.50 per \$100 borrowed⁸⁶ plus an additional \$0.50 per loan for fees charged by the consumer-information database provider.⁸⁷ While this appears to be a great improvement over the unregulated rates charged in New Mexico prior to

Westlaw through 2010 Sess.); TENN. CODE ANN. §§ 45-17-101 to -117 (West, Westlaw through 2010 1st Ex. Sess. & Apr. 14, 2010 Sess.) and TENN. COMP. R. & REGS. 0180-28-.01 (West, Westlaw through Mar. 31, 2010); 7 TEX. ADMIN. CODE § 83.604 (Vernon 2006 & Supp. 2008) and TEX. FIN. CODE ANN. §§ 342.251–.259 (Vernon 2006 & Supp. 2008); UTAH CODE ANN. §§ 7-23-01 to -504 (West 2006 & Supp. 2008); VA. CODE ANN. §§ 6.1-444 to -471 (West, Westlaw through 2010 Sess.) and 10 VA. ADMIN. CODE § 5-200-10 to -130 (West, Westlaw through 26:18 V.A.R. May 10, 2010); WASH. REV. CODE ANN. § 31.45.010–200 (West 2008) and WASH. ADMIN. CODE § 208-630-120 to -270 (West, Westlaw through May 19, 2010); WYO. STAT. ANN. §§ 40-14-362 to -364 (West, Westlaw through 2010 Sess.). Fourteen other states have usury caps on all small loans: Arkansas, Arizona, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia.

79. N.M. STAT. ANN. § 58-15-1(D) (2010).

80. *Id.*

81. § 58-15-3(B), (C) (exempting certain individuals and banking institutions from the provisions of the New Mexico Small Loans Act of 1955).

82. § 58-15-3(A). These lenders are required to obtain a license from the New Mexico Financial Institutions Division (FID) and to comply with all aspects of the Act.

83. *See* § 58-15-2(H).

84. *Id.*

85. *See id.* The Act includes in the definition of a payday loan product a payday loan that has been converted to a payment plan pursuant to § 58-15-2(I).

86. § 58-15-33(B).

87. § 58-15-33(C).

implementation of the Act, which sometimes resulted in loans at 2500% per annum, this fee structure still results in an APR of at least 417%, assuming the longest possible repayment period of fourteen days.⁸⁸

2. *The Allegedly Free Installment Plan*

The Act also provides that a lender must offer every consumer the “opportunity to enter into an unsecured payment plan for any unpaid administrative fees and principal balance [owed on] the payday loan.”⁸⁹ The Act specifies that the payment plan must permit payment of the unpaid balance of the loan, in relatively equal installments, over a period of a minimum of 130 days, with no interest or fees added.⁹⁰ While the payment-plan option appears to protect consumers, the Act contains several disincentives for consumers to convert these loans to free payment plans. First, the Act does not require a “cooling-off period,” or waiting period between loans, for a regular payday loan.⁹¹ The statute does, however, require a ten-day cooling-off period after the repayment of a loan that has been converted to a payment plan.⁹² Additionally, the cooling-off period does

88. This is still at the high end of rates permitted in other states that have implemented laws similar to the Act. For example, the following is a sampling of the transaction fees charged by other states per \$100 borrowed:

Florida:	\$10
Oklahoma:	\$15 on first \$300, then \$10
Indiana:	\$15 on first \$250, \$13 on next \$150, \$10 on next \$150
Illinois:	\$15
Michigan:	Stepped from \$15 to \$11, depending on amount borrowed
North Dakota:	\$20

See FLA. ADMIN. CODE ANN. r 69 V-560.905 (West, Westlaw through Chap 279, 2010 Sess., 21st Leg.); OKLA. ST. ANN. tit. 59 § 3108 (West, Westlaw through Chap. 170, 2d Sess., 52d Leg.); IND. CODE § 24-4.5-7-201 (West, Westlaw through 2010 2d Sess.); 815 ILL. COMP. STAT. ANN. 122/2-5 (West, Westlaw through P.A. 96-1015, excluding 96-1000, 1002, 1004, 1008, 1012, 2010 Sess.) (\$15.50 per \$100); MICH. COMP. LAWS ANN. § 487.2153 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); N.D. CENT. CODE ANN. § 13-08-12(2) (West, Westlaw through 2009 Sess.).

89. N.M. STAT. ANN. § 58-15-35(A).

90. § 58-15-35(B), (C).

91. A cooling-off period is a period after the repayment of a loan during which the consumer may not take out another payday loan from any payday lender regardless of whether the consumer would otherwise be qualified for such a loan under the Act. Cooling-off periods generally range from one to seven days and are often limited to the lender with whom the paid-off loan was originated. For example, Florida has a twenty-four hour cooling-off period, North Dakota has a three-day waiting period with the same lender, and Indiana has a seven-day waiting period with the same lender. *See* FLA. STAT. § 560.404(19) (West, Westlaw through Chap. 279, 2010 2nd Sess., 21st Leg.); N.D. CENT. CODE § 13-08-12(4) (West, Westlaw through 2009 Sess.); IND. CODE § 24-4.5-7-401(2) (West, Westlaw through 2010 2d Sess.). Indiana’s cooling-off period takes effect only after the consumer has borrowed five loans. IND. CODE § 24-4.5-7-401(2).

92. N.M. STAT. ANN. § 58-15-36.

not start until the consumer has paid off all other outstanding payday loans.⁹³ Various parts of the law discourage use of the free payment plan.⁹⁴

In March 2009, when at least some lenders were attempting to operate under the new law, very few clerks offered information about this free installment loan to researchers who called to inquire about how to get a loan. After significant prodding (“But isn’t there some requirement that I be allowed to pay over time?”), some clerks attempted to explain the free installment payment plan. The clerks, who were overall exceedingly friendly, sometimes tried to make the caller feel guilty about entering the payment plan. They explained that the customer could pay back the loan over five months (sometimes described as twenty weeks). One clerk explained that “the payment plan is bad for everybody, bad for us, bad for you.” What was so bad for the customer? To start, one cannot enter into another payday loan “for a long time,” as one claimed, or “during the entire time the installment plan is out,” explained another. Also, the *database* reflects that the person went into the payment plan. This seemed to imply that other lenders would be discouraged from lending to someone who had used a payment plan.⁹⁵

3. Rollovers, Cooling-Off Periods, and Touch-and-Go Loans

The Act ostensibly prohibits what are known in the industry as “rollovers,” but does not actually do so.⁹⁶ A rollover is a transaction in which the lender allows the consumer to delay payment of the loan principal for another pay period by paying only the interest due on the transaction. Consumer groups consider rollovers a particularly insidious problem because they trap a consumer into potentially paying the interest on a loan indefinitely without ever reducing the principal balance. The Act refers to rollovers as “renewed payday loans,” and purports to preclude them.⁹⁷ The definition of a renewed payday loan includes using the proceeds from one loan to pay off another loan with the same lender.

93. *Id.* Cooling-off periods are considered beneficial by consumer groups because they help prevent “touch-and-go” rollovers which allow a consumer to repay a payday loan and immediately take out another loan for the same amount. The New Mexico Act does not prevent such abuses. No cooling-off period is required for standard payday loans, only for people who enter into free installment plans.

94. Consumers need not discover this disincentive on their own. Customers in our study reported that lenders openly dissuaded them from using the free installment plan—if they disclosed the free installment plan requirement at all. Thus, this provision may make it easier for lenders to steer consumers away from the payment plan option into more expensive and risky alternatives, such as another payday loan or their new progeny, the non-free installment loan. For a consumer who makes frequent use of payday loans, the requirements for a cooling-off period and payment of all other payday loans may effectively rule out the payment-plan option. This is unfortunate because regular users of payday loans are one of the groups of consumers who might benefit from payment-plan loans as a way to break the cycle of borrowing and debt.

95. Eventually, in the late summer and fall of 2009, discussions with clerks or customers about free payment plans became obsolete, because lenders were offering almost exclusively products outside the statute and thus were under no legal obligation to offer the payment plan.

96. *See* § 58-15-34(A).

97. *Id.*

The Act nominally prevents rollovers by prohibiting lenders from entering into an agreement for a renewed payday loan, or otherwise refinancing or extending the term of a payday loan,⁹⁸ and by prohibiting lenders from requiring consumers to “enter into a new payday loan [in order] to pay [off] an existing payday loan . . . when the existing loan is eligible for a payment plan.”⁹⁹ These provisions do not, however, prevent “touch-and-go” rollovers or “back-to-back” loans—transactions where the consumer repays a loan in full and then immediately takes out another loan for the same amount.¹⁰⁰ While the Act appears on its face to prohibit the lender from loaning the consumer the funds to repay an existing loan, because there is no cooling-off period between standard payday loans, the consumer can repay one payday loan and take out another for the same amount, or more, in essentially a single transaction.¹⁰¹ As discussed above, because of the possible perception of penalties associated with converting standard payday loans to payment plan loans, consumers may choose touch-and-go rollovers as an alternative.¹⁰² The payday loan without the post-dated check, one of the popular products in New Mexico today, is an interest-only loan for the life of the loan. Thus, the loan is designed for a lifetime of rollovers.

4. Loans are Limited to 25% of a Person’s Gross Income

Another protection included in the Act limits the total amount a consumer can accumulate in payday loans at any given time to 25% of the consumer’s gross monthly income.¹⁰³ Because the database used to enforce this provision is not used

98. *Id.*

99. § 58-15-34(E).

100. Remar Sutton, *Avoiding “Loan” Schemes and other “Services” Risky to your Financial Well-Being*, DIGITAL FEDERAL CREDIT UNION STREETWISE (Nov. 2008), <http://www.dcu.org/streetwise/november2008.html>.

101. *Id.*

102. A number of other states have prohibited rollovers by imposing cooling-off periods between loans, either from the same lender or other payday lenders. *See supra* note 91. Additionally, the FDIC, in its *Guidelines for Payday Lending*, recommends that lending institutions under its purview be required to establish “cooling-off” periods between paying off of a payday loan and granting another application as “prudent risk management” for the lending institution. FEDERAL DEPOSIT INSURANCE CORPORATION, FIL-14-2005, GUIDELINES FOR PAYDAY LENDING (2005), available at <http://www.fdic.gov/news/news/financial/2005/fil1405a.html>; *see also* Veritec Solutions, *White Paper Analysis of the Center for Responsible Lending Report: Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform* (2007), VERITECS.COM, http://www.veritecs.com/2008_01_CRL_Whitepaper_Analysis.pdf.

103. Interestingly, the industry’s own best practices do not suggest a cooling-off period. According to the CRL, income-limit requirements do not necessarily help consumers avoid becoming trapped in debt. CTR. FOR RESPONSIBLE LENDING, SPRINGING THE DEBT TRAP: RATE CAPS ARE ONLY PROVEN PAYDAY LENDING REFORM (2007), available at <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>. Because the restriction is based on the consumer’s gross income, and thus on a dollar figure that the consumer does not actually have available, it does not relate directly to the consumer’s ability to repay the loan. Additionally, the income figure is for an entire month, but in most cases the term of the loan is only two weeks, meaning that the consumer only has half of the stated income with which to attempt to repay the loan.

in the case of loans that fall outside the law, these loans do not go into the database. Thus, the database serves no purpose.¹⁰⁴

5. *No Limit on Total Payday Loans per Customer*

The Act does not limit the number of payday loans a consumer may have over a given span of time (e.g., one year). This means consumers could have up to 25% of their gross monthly income continuously tied up in debt to payday lenders, even as the law is written.¹⁰⁵

6. *Right of Rescission*

Additionally, the Act gives the consumer the right to rescind the contract by returning all funds advanced by the lender before 5 p.m. on the business day following the day on which the loan was obtained.¹⁰⁶ The lender may not charge a fee for the rescinded transaction.¹⁰⁷ Of course, this protection does not apply to loans outside the statute.

7. *The Database*

One of the most seemingly significant provisions of the Act requires lenders to use a commercially reasonable method to verify that a consumer's income qualifies her for a payday loan.¹⁰⁸ Lenders were required to begin using this method no later than November 30, 2007,¹⁰⁹ and the New Mexico Financial Institutions Division (FID) certified Veritec, Inc. for this purpose.¹¹⁰ Without this system, a lender could not check whether an individual was currently participating in a payment plan or had payday loans totaling more than 25% of the individual's

104. One customer had five loans on which she paid \$100 a month, and she made only \$685 from disability benefit payments. The loans did not involve a post-dated check, however, so none made it into the database. *See* Interview with Study Participant SB12.

105. The Act limits the various penalties and fees that lenders may charge. Lenders are prohibited from charging penalties for early repayment of a loan. The Act also prohibits charging fees for late repayment. N.M. STAT. ANN. § 58-15-33(E) (2010). This section limits the fee that a lender may charge for insufficient funds in the consumer's account on the date the loan is due to a single \$15 charge. The section also allows the lender to present a given check or debit authorization to the consumer's financial institution only once. However, the Act permits the consumer to waive this protection and permits the lender to present the instrument one additional time. The waiver must be in writing. *Id.*

106. § 58-15-32(C).

107. As set out above, the Act requires clerks to tell customers that they had the right to cancel the loan at no charge any time before 5 p.m. the next day. Of the customers in our study who reportedly took out payday loans, 78% reported that they were not informed about the right to cancel the loan by 5 p.m. the next business day. These data are questionable, however, because we are not sure customers were able to tell if they were getting a payday loan or an installment loan.

108. *See* §§ 58-15-32(A) to -37(A).

109. § 58-15-37(C).

110. *See* Veritec Solutions, *State of New Mexico Payday Loan Transaction System*, <https://www.nmpdl.com/AboutUs.aspx> (last visited July 18, 2010).

gross salary.¹¹¹ Since 2001, Veritec has provided similar services for regulation of payday lending institutions in several other states, including Florida, Oklahoma, Michigan, Illinois, North Dakota, and Indiana.¹¹²

8. *The Results*

New Mexico spent several years attempting to regulate payday lending, the results of which are detailed above. Compared with the lack of regulation in New Mexico before the legislation, the Act appeared to offer substantial mechanisms for regulating the industry and for collecting information that could give state officials the ability to continue to evaluate and improve these laws. One of the most significant of these mechanisms appeared to be the Veritec database system, which seemed to have the potential, over time, to show real statistics on the average number of: (1) loans per borrower per year; (2) back-to-back or touch-and-go loans issued;¹¹³ (3) loans converted to payment plans; and (4) uncollectible loans.¹¹⁴ The database, however, is not capturing the lion's share of the short-term loan data in New Mexico.

Real data in these areas could have been very helpful in understanding both the problems and the solutions associated with payday lending, yet none of this potential will be realized in New Mexico, or in any other state that adopts a similar regime to regulate payday lending. State legislators and consumer groups all over the country still advocate using the Veritec database as a solution to short-term loan abuses, but this is no solution if the industry can change its lending model to avoid implicating the database. The database is little more than a costly chimera if it will not capture the information it is designed to collect.

111. According to its website, "Veritec was established in 1988 to provide program management services to State agencies, and Veritec Solutions, LLC was established in 2001 to partner with the State of Florida Department of Banking and Finance to develop and implement the Florida Deferred Presentment Program as a state regulatory solution for the payday loan industry." Veritec Solutions, *About Veritec Solutions*, VERITECS.COM, <http://www.veritecs.com/About.aspx> (last visited Feb. 9, 2010); see also Veritec Solutions, *New Mexico Payday Loan Transaction System Welcome Package*, N.M. REGULATION AND LICENSING DEP'T, http://rld.state.nm.us/FID/PDFs/Veritec_Welcome_Package.pdf (last visited June 1, 2008). The database is a self-funding project. The sole source of revenue for the database is a \$0.50 charge on each payday loan that is entered into the system. There is no charge for customer eligibility checks, Social Security number validation checks, use of the Veritec help desk, transaction updates, or report generation. In order to register and use the database, lenders must be licensed by the New Mexico Financial Institutions Division to provide payday loans in New Mexico, they must have registered their operators with Veritec, and those operators must complete the Veritec training program and be certified by Veritec to use the system. Finally, as noted above, the lenders must complete the upload of their historical data. *Id.*

112. See <http://www.veritecs.com/PaydaySolution.aspx> (Florida); <https://www.okddl.com/> (Oklahoma); <http://www.midpp.com/> (Michigan); http://www.veritecs.com/Docs/IL_3_Year_PLRA_Report.pdf (Illinois); <https://www.nddpp.com> (North Dakota); <https://www.indpp.com/about.asp> (Indiana).

113. Back-to-back or touch-and-go transactions allow a consumer to repay a payday loan and immediately take out another loan for the same amount.

114. N. M. REGULATION & LICENSING DEP'T., FINANCIAL INSTITUTIONS DIVISION REPORT (2009) (on file with Author).

The New Mexico law, like many others around the country, capped interest rates at a generous 417%, yet payday lenders regarded this as an insufficient return. In order to reclaim the “tremendous profits”¹¹⁵ to which it had become accustomed, the industry invented new products such as the payday loan without the post-dated check and the installment loan described in the next Section, which earn higher lender fees. One conclusion resonates strongly from this game of legislative cat-and-mouse, namely that these types of legislative efforts do not reduce short-term lending, interest rates, or fees for such loans.

While the payday lending industry itself claims that payday legislation *can* effectively protect consumers,¹¹⁶ the industry’s actions tell a different story. The new products offered by short-term lenders suggest what the industry denies—namely that the only type of regulation that really ends the abusive practice of charging 500% or more in interest over long periods of time is an absolute interest rate cap. Any other solution is subject to further end runs.

B. Changes in the Short-Term Loan Industry

To say that the short-term loan industry is resilient, creative, and resistant to piecemeal legislation is a tremendous understatement.¹¹⁷ The amount of legislative time and effort the industry’s shifting business plans have spawned is nothing short of remarkable. The resulting maze of state and federal statutes is complex, ineffective, and inefficient. While some scholars describe the payday lending industry as one of the most highly-regulated industries in consumer credit,¹¹⁸ it is strangely unaffected by the most intrusive legislation, such as that recently passed in New Mexico. Such regulatory regimes are costly because they are time-consuming to pass and require implementation of databases. Moreover, they accomplish nothing.

1. The End Run Around New Mexico’s Small Loan Act and Similar Laws in Other States

A look at the substitute products being offered by New Mexico’s payday lenders quickly reveals the legislative deficiencies. While some lenders in New Mexico in the summer of 2009 were still offering payday loans *with* post-dated checks, most were not. Many had stopped offering payday loans completely, and were instead offering a product called an “installment loan.” These loans are outside the New Mexico payday lending statute because they are written for more than the thirty-five days prescribed by the Small Loan Act. Many are written for twenty weeks or five months, though it is unclear why this particular length was

115. See HOW TO START PAYDAY LOAN BUS., <http://www.paydayloanindustry.com> (last visited July 30, 2009).

116. See, e.g., Brief of Amicus Curiae Community Financial Services Ass’n of America in Support of Petitioner, *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440 (2006) (No. 04-1264), 2005 WL 1941281, at *1.

117. See Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 962 (2008).

118. LEHMAN, *supra* note 12.

chosen. These loans are completely unregulated, so lenders have carte blanche in structuring them.

According to several of the customers interviewed curbside, some of the lenders converted existing payday loans into installment loans without their knowledge once the law changed.¹¹⁹ Others continued to carry the old payday loans since they were not affected by the new legislation.¹²⁰ Overall, this study suggests that a very large portion of the market shifted to installment loans by August 2009.¹²¹ Another product also popped up in place of the payday loan: the payday loan without the post-dated check.¹²²

In June 2009, all listed payday and short-term lenders in Albuquerque were contacted and informally surveyed to estimate what market share installment loans had captured. Later in the fall, results were validated by random calls to one-third of the lenders originally contacted. More lenders offered payday loans in March than in June, and by September, only one lender we contacted offered only payday loans. While some lenders were offering both payday loans and installment loans, most were pushing installment loans.¹²³

So how does an installment loan work? As one lender explained to a customer, these installment loans have to be written for at least 120 days, but can be “paid off early so they can behave like a payday loan.” While the terms vary somewhat, the following example demonstrates the general structure:

You borrow, for example, \$500, and over the twenty week period, you pay back this plus \$585, for a total of \$1,085. For another

119. See, e.g., Interview with Study Participant CS66.

120. One gentleman reported paying over \$2000 over two years for a \$300 loan. This loan is still unpaid, and he does not understand why he still owes the original \$300. See Interview with Study Participant CS27.

121. See data from calls to lenders, gathered March, June, and November 2009. The New Mexico payday lending industry is still in business, but it is unclear whether it is complying with the new law. In order to be in compliance with the new law, the charge for a payday loan should be \$15.50 per \$100 borrowed, with a one-time \$0.50 service fee. Examples of loan amounts we obtained from clerks over the phone or from survey participants include: (1) loans of \$500 for \$78, with \$578 due by payday (1st Payday), whether payday is tomorrow or two weeks from now; (2) \$300 for \$67.50 (Allied Cash and FastBucks); and (3) \$500 for \$7 a day from now until payday (FastBucks), which appears to compute to over 500% per annum. These examples suggest most lenders were in compliance with the fee caps, but some were not.

122. For example, Allied Cash Express appeared to be offering this product in New Mexico during the summer of 2009.

123. We found that by the summer of 2009, the new installment loans made up well over half of the market that was previously known as the payday lending market in the Albuquerque Metro area. This conclusion comes from calling lenders, not from information gathered from customers. We also asked survey respondents whether they were offered a payday loan or an installment loan and they reported that they were offered: 53.75%, just installment; 25.37%, both; 17.91%, only payday; 2.99%, unsure. Unfortunately these data turned out to be questionable when we looked at the actual terms of individual loans. When the data were analyzed more closely, it was clear that consumers simply could not reliably tell the difference between the two, and thus it was ineffective to ask them which type of loan they took out, a payday or an installment loan.

example, you borrow \$400 and you pay back that plus \$468.20, for a total of \$868.20. The clerks are honest with people about the fact that fees are higher with the installment (typically expressed as \$25 per \$100 versus \$15.00 per \$100). They also tell customers that the customers have a better chance of paying back this type of loan.¹²⁴

Once a customer has repaid part of the principal on an installment loan, she is encouraged to reborrow the loan as quickly as possible.¹²⁵

Clerks explain to customers that if they choose an installment loan rather than a payday loan, the customers can protect their identity because their names and other data will not be placed in the statewide database. Several clerks mentioned the ability to avoid the database, and characterized this as a good thing to protect one's identity and also to get more loans. One or two clerks explicitly stated that if there was no database reporting, there was no limit on the number of loans a customer could have. One store prominently posted a huge sign outside stating:

ATTENTION: Come in and Get Your Money Today: If You Have a Loan in Good Standing with Our Competitors, Verifiable Employment and Residence – You Are Guaranteed a Loan with World Finance.¹²⁶

This sign suggests that at least for some lenders, multiple loans are part of the solution rather than part of the problem.

The industry shift away from payday loans toward installment loans also is causing confusion among customers. One woman reported that her family and friends had had experiences with payday and title loans, so she took out an installment loan.¹²⁷ Other customers described their loan as either a payday loan or an installment loan, but when they told the interviewers when the loan was due and how it would be paid back, it clearly was the other type of loan.¹²⁸ One man said he thought he would get a payday loan but instead chose the installment loan.¹²⁹ His description of the terms indicated that he had a payday loan, suggesting that these labels mean very little to the consumer.¹³⁰

124. See Interviews with Study Participants CS44 and CS68.

125. *Id.*

126. The sign displayed at World Finance, located at 965 W Highway 550, Bernalillo, New Mexico 87004-5924.

127. See Interview with Study Participant CS02.

128. See, e.g., Interviews with Study Participants CS13, CS54, CS60, and CS68.

A study participant who was paying interest only on a payday loan without a post-dated check said he did not choose the installment loan because he did not want to be in debt, apparently not realizing that he was failing to pay down any of the principal on his loan. See Interview with Study Participant CS37; see also Interview with Study Participant CS19 (explaining that installment loans seem to cost more over time, but not understanding that he was not paying anything on the principal on the payday loans).

129. See Interview with Study Participant CS09.

130. *Id.*

a. The Payday Loan without the Post-Dated Check

Since the New Mexico Act defines a payday loan as one involving a post-dated check or a debit authorization, loans that exclude these elements but are otherwise identical to a payday loan are currently unregulated in New Mexico. As a result, a lender can make the same loan it made before and just not require the post-dated check. Then it can charge whatever fees it wants because the transaction is completely outside the statute. These are interest-only loans and many prohibit prepayment of partial principal—meaning that if the loan amount is high enough, it virtually precludes paying off the loan without a family or friend bailout. People using payday loans without post-dated checks are not entered in the state database, making the database of very limited utility at this point.¹³¹

While payday loans without post-dated checks did not seem to be the industry loan product of choice in the summer of 2009, by the fall and winter, these seemed to be more popular than the installment loans. Thus, interest-only loans are again commonplace.

b. Some Customers Know about the Law and Know it Doesn't Work

While not every payday loan customer had heard about the modifications to the law in New Mexico, a few offered information about the changes without being asked or prompted. One customer articulately stated that “the new laws are not working. They try not to call it a payday loan but it is. The interest rates are just as high. They have found a way to circumvent the law.”¹³² Another said, “Nothing changed with the new legislation.”¹³³

2. *Similar End Runs in Other States*

The new loan products described above are a complete end run around New Mexico's payday lending statute and should be a wake-up call for other states trying to curb abuses in this industry. Laws of this kind accomplish nothing, yet are passed in various states around the country. For example, Professor Mayer reports on similar Illinois legislation:

Regulators in Illinois imposed rules in 2001 that were designed to [curb the number of simultaneous payday loans and rollovers]. Customers were allowed to borrow no more than \$400; only two renewals were permitted, with some of the principal paid down each time; and a cooling-off period was mandated to prevent borrowers from using the proceeds of a new loan to pay off the old one. The state . . . promised to establish a database to track loan activity and enforce the rules.¹³⁴

131. N.M. STAT. ANN. § 58-15-2(E) (2010).

132. See Interview with Study Participant CS09; see also Interview with Study Participant CS67.

133. See Interviews with Study Participants CS08 and CS10.

134. Mayer, *supra* note 29, at 8.

Unfortunately, the Illinois case is a lesson in failed reform. The database was never established,¹³⁵ and the payday lenders devised a new product to evade the rules.¹³⁶ The reforms applied to cash advances with a term of less than thirty-one days, so the industry created a thirty-one day loan not covered by the rules. As a result, the old abuses persist: a 2003 Illinois Department of Finance report acknowledges that it remains “quite common for borrowers to have multiple payday loans outstanding with several different payday loan companies.”¹³⁷

States other than New Mexico, such as Florida and Oklahoma, have similarly tried to curb perpetual borrowing and lending practices by banning loan renewals.¹³⁸ Proposed federal legislation, H.R. 1214, also attempts to address this problem.¹³⁹ But payday lenders quickly evade this restriction by closing out the current loan and replacing it with a new, identical loan.¹⁴⁰ This system results in no reduction in the average number of loans per borrower or interest paid.¹⁴¹

135. Ironically, based upon New Mexico’s experience, Illinois may have saved itself some time and money by not setting up the database.

136. Mayer, *supra* note 29, at 8 (quoting Tom Feltner & Marva Williams, *New Terms for Payday Loans: High Cost Lenders Change Loan Terms to Evade Illinois Consumer Protections*, REINVESTMENT ALERT (Woodstock Inst.), Apr. 2004, at 3, available at http://woodstockinst.org/document/alert_25.pdf).

137. *Id.*

138. See Veritec Solutions, *Congressional Hearings Confirms That States Are Doing A Good Job At Regulating Short Term Lending*, PR NEWSWIRE (Apr. 4, 2009), <http://news.prnewswire.com/DisplayReleaseContent.aspx?ACCT=104&STORY=/www/story/04-08-2009/0005002727&EDATE=lending> (“Several states, including Florida and Oklahoma, are effectively protecting consumers,” said Thomas Reinheimer, CEO of Veritec Solutions of Jacksonville, Florida. “Veritec is at the forefront of implementing effective regulatory enforcement solutions for strong consumer protections required by state law. We see first-hand the impact of good regulation in enabling access to short-term credit while protecting consumers from getting trapped in a downward debt-cycle.”).

139. Payday Loan Reform Act of 2009, H.R. 1214, 111th Cong. (1st Sess. 2009); Michael Calhoun, *Payday Loan Reform Act Must be Strengthened*, CTR. FOR RESPONSIBLE LENDING (Apr. 2, 2009), <http://www.responsiblelending.org/media-center/press-releases/archives/payday-loan-reform-act-must-be-strengthened.html>.

140. Veritec Solutions, *supra* note 138.

141. Veritec has published detailed white papers and reports about effective regulation of the payday loan industry, which illustrate the following facts: borrowers and lenders are unable to rollover payday loans in Florida and Oklahoma; over 75% of borrowers pay off their loans within two days after the due date; grace periods and repayment plans are available under state law to any eligible borrower who cannot pay off their loans on time; and over 25% of borrowers no longer use the product more than one year and a majority of borrowers no longer use the product after three years.

Could it be that Veritec does not read the industry’s own weblogs? “We are concerned that states considering regulation and enforcement of consumer protections may be swayed by misinformation from CRL. Veritec supports effective regulation of short-term lending that provides borrower access to short-term credit products with enforcement of consumer protections. State bans on short-term credit products often have an unintentional consequence of helping eliminate a consumer’s option to choose a regulated product,” said Mr. Reinheimer. “To better illustrate this, all anyone has to do is to search the Internet for loans available in rate cap states and see that unregulated, unlicensed activity is alive and well.” Veritec Solutions LLC is a regulatory services company that manages statewide

States such as Florida, Illinois, and Michigan¹⁴² have tried to impose interest-free payment plans like those proposed in New Mexico. These laws have produced no meaningful reduction in the number of trapped borrowers, because the requirement that borrowers have only one loan at a time has no effect on the revolving 400+% interest-only loans.¹⁴³

Perhaps most critically, payday lenders can evade attempted reforms by slightly modifying their products. For example, in Virginia, payday lenders have marketed open-end loans to avoid new regulations.¹⁴⁴ In Illinois, as in New Mexico, payday lenders changed their product to high-cost installment loans to sidestep state laws targeted at the industry.¹⁴⁵ Ultimately, whenever payday

lender compliance programs in eight states with statewide databases and related limits included in their respective payday lending (aka deferred presentment, deferred deposit) statutes. Veritec helps state agencies regulate lenders through the management of these programs. Veritec's primary customers are state regulatory agencies; the firm does not supply any goods or services to the payday lending industry. *Id.*

142. Florida's loan interest rates and fee caps actually amount to very large annual percentage rates. The APR for a \$100 fourteen-day loan is 390%. Illinois' payday law caps the fee that can be charged at \$15.50 per each \$100. This amounts to a very high effective APR. The APR for a fourteen-day \$100 loan is 403%. Michigan's legislation, the Deferred Presentment Service Transactions Act, limits loan amounts to \$600 in a thirty-one-day period and allows lenders to charge up to 15% depending on the size of the loan. *See State-by-State Payday Loan Summary*, CREDIT.COM, http://www.credit.com/credit_information/credit_law/PaydayLoanLaws.jsp (last visited Aug. 17, 2010).

143. *Id.*

144. *SCC Plugs Payday Loan Loophole*, RESPONSIBLELENDING.ORG (Mar. 19, 2010), <http://www.responsiblelending.org/tools-resources/headlines/Momentum-for-Payday-Loan-Reform-Growing.html> (citing Jeff E. Schapiro, *SCC Plugs Payday Loan Loophole*, RICHMOND TIMES-DISPATCH, Jan. 1, 2010, http://www2.timesdispatch.com/news/2010/jan/01/b-pday01_20091231-204806-ar-23927/). Shapiro reports that:

Payday lenders started offering open-ended loans, which are treated much like bank lines of credit, after Virginia lawmakers placed restrictions on the industry. Legislators responded by passing a law requiring payday businesses to choose one product or the other: payday loans or open-ended loans, but not both. However, that law included language that enabled payday lenders to also offer car title loans and to continue hawking both products. Consumer advocates say the SCC's corrective actions could help safeguard consumers from being bogged down in debt.

Id.

145. *Momentum for Payday Loan Reform Growing*, RESPONSIBLELENDING.ORG (Mar. 19, 2010), <http://www.responsiblelending.org/tools-resources/headlines/Momentum-for-Payday-Loan-Reform-Growing.html> (citing Adam Doster, *Momentum for Payday Loan Reform Growing*, PROGRESSILLINOIS.COM (May 19, 2010 2:09 PM), <http://progressillinois.com/posts/content/2010/03/19/momentum-payday-loan-reform-growing>).

Illinois state Sen. Kim Lightford and 11 co-sponsors have introduced SB 655, which would regulate small consumer installment loans (CILA) in the state. It comes in an attempt to close a loophole in payday legislation passed by the General Assembly in 2005. That law defined a payday loan to have a term of 120 days or fewer, so the payday lending industry skirted the stipulation by turning to installment loans with slightly longer repayment terms. Lightford's bill would limit interest rates on

lending legislation passes, the industry finds a way to charge even more for loans than it did prior to the legislation.

The new installment loans in New Mexico are not legislated at all, and in practice lenders seem able to start the whole loan over and over again, despite the name “installment loan.” Numerous customers reported they were never able to pay off any of the principal.¹⁴⁶ The data show that customers do not understand the loan in these terms, but imagine if they did. Imagine how popular these products would be if they were described as a loan for \$400 that would require a \$62 payment every month for the rest of the borrower’s life, after which the borrower would still owe the original \$400.¹⁴⁷ Surely those who could find alternatives would do so.

3. Ways Around the 29% Absolute Cap: The Ohio Story

In 2008, the Ohio state legislature voted to rescind the twelve-year-old law that exempted payday lenders from the state’s usury laws—a vote Ohioans supported two to one.¹⁴⁸ The Short Term Loan Act purports to cap interest on all short-term loans at 28%, and also gives customers at least one month to pay off the loans.¹⁴⁹ In response, some payday loan operators chose to close their stores and leave the state.¹⁵⁰ Those that remained resorted to other innovative approaches. As one industry website explains, these lenders are now prospering because there is less competition, and creative tactics allow them to remain in business. They have simply switched their licenses so they can offer payday “clones” under two parallel lending statutes, the Small Loan Act or the Mortgage Lending Act.¹⁵¹ Ohio

installment loans at 99 percent APR, index loans based on a borrower’s ability to pay, and require equal monthly installment payment plans. A similar effort was defeated by House Democrats last session.

Id.

146. See, e.g., Interviews with Study Participants SB01, CS23, CS27, CS35, and CS44.

147. This is the cost under New Mexico’s new payday lending law. N.M. STAT. ANN. §§ 58-15-32 to -38 (2010).

148. Substitute H.B. 545, 127th Gen. Assemb., Reg. Sess. (Ohio 2007); see also Creola Johnson, Dear President Obama: You Protected the Troops; Now Fulfill Your Promise to Protect All Americans from Payday Loans 12–14 (2010), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=creola_johnson.

149. OHIO REV. CODE ANN. § 1321.39–.40 (West 2008).

150. Mary Rice, *Ohio HB 486: Limiting payday lending fees*, PERSONALMONEYSTORE.COM (May 11, 2010), <http://personalmoneystore.com/moneyblog/2010/05/11/ohio-hb-486-payday-lending-fees/> (“After the first round of regulation was passed, more than 700 Ohio payday loan stores closed.”).

151. *Ohio Payday Loans Laws & Legislation*, OHIO PAYDAY LOAN LAWS, <http://paydayloanlegislation.com/ohio.html> (last visited July 19, 2010). Making the change is quite simple. As one industry website instructs:

By adjusting the loan amount to just above \$500, payday loan lenders double the loan origination fees from \$15 to \$30. The Small Loan and Mortgage Lending acts allow the fees on top of the 28 percent interest, something the new payday lending law doesn’t permit.

Under the new HB545 licensing scheme with the check cashing fees added, customers pay the same \$575 to walk out the door with \$500

Attorney General, Rich Cordray, said his office has found payday clones with APRs ranging from 128% to 700%. As the same industry website explains, “[T]here is a lot of confusion in Ohio as a result of the attempt by fools to legislate away a product that millions need, want, use and demand!”¹⁵²

4. Credit Service Organizations and Payday Loans: The Next Face of Hydra

Professor Mary Spector characterizes payday loans as the mythical beast hydra, a nine-headed monster from Greek mythology that grew a new head every time one was cut off.¹⁵³ The industry’s newest incarnation makes the analogy particularly apropos. Many states have statutes that govern entities called Credit Service Organizations (CSOs).¹⁵⁴ CSO statutes were originally established to

in cash. Prior to HB545, Lenders typically charged \$15 for every \$100 borrowed A First American payday loan customer indicated he previously paid \$75 for a \$500 loan. First American charged him a total of \$90 to borrow the same amount after the law changed. More than one Ohio payday loan company has structured their check cashing and loan operations as two separate entities to justify the fees.

Id.

As another industry webpage explains:

With news of the passage of Issue 5 in Ohio on Nov. 4, Check Into Cash began restructuring its loan product offerings throughout the Buckeye state to comply with the new law. On Nov. 5, the company ceased to offer payday loans and began offering a new product, micro loans, which are short-term loans from \$50 to \$600 and permitted under Ohio’s Small Loan Act.

Check Into Cash Committed to Serving Ohio Customers – Repost, PAYDAYFACTS.ORG (Nov. 21, 2008, 10:19 AM), <http://www.paydayfacts.org>.

152. *Payday Loans: Ohio Still Going Strong*, PAYDAY LOAN INDUSTRY BLOG (Feb. 21, 2009), <http://paydayloanindustryblog.com/payday-loans-ohio-still-going-strong>.

153. Spector, *supra* note 117, at 962, 964.

154. Congress and numerous states have enacted CSO legislation to crack down on abuses by companies claiming they could help individuals repair their credit. Most of the credit-repair agencies turned out to be scams, with some even offering to rent other people’s credit scores to borrowers for fees of \$2000 or more. To curb these abuses, states began enacting laws prohibiting agencies from charging fees for these types of services. Congress soon followed suit with the Credit Repair Organizations Act. *See* Credit Repair Organizations Act, 15 U.S.C. §§ 1679–1679j (West 2000 & Supp. 2005). Many states have also passed Credit Repair Organization legislation. *See, e.g.*, CAL. CIV. CODE § 1789.11(b) (West 2007). For additional state statutes, see ARIZ. REV. STAT. ANN. §§ 44-1701 to -1712 (West 2007); ARK. CODE ANN. §§ 4-9-101 to -109 (West 2008); COLO. REV. STAT. ANN. §§ 12-14.5-101 to -113 (West 2007); CONN. GEN. STAT. § 36a-700 (2007); DEL. CODE ANN. tit. 6, §§ 2401–2414 (2007); D.C. CODE §§ 28-4601 to -4608 (2008); FLA. STAT. §§ 817.7001, .7005 (2008); GA. CODE ANN. § 16-9-59 (2007); 815 ILL. COMP. STAT. 605/1–605/4 (2007); IND. CODE §§ 24-5-15-1 to -11 (2007); IOWA CODE §§ 538A.1–.14 (2008); KAN. STAT. ANN. §§ 50-1116 to -1135 (2006); LA. REV. STAT. ANN. §§ 9:3573.1–.17 (2007); ME. REV. STAT. tit. 9-A, §§ 10-101 to -401 (2007); MD. CODE ANN., COM. LAW §§ 14-1901 to -1916 (West 2008); MASS. GEN. LAWS ch. 93, §§ 68A–68E (2008); MICH. COMP. LAWS §§ 445.1821–.1826 (2008); MINN. STAT. §§ 332.52–.60 (2007); MO. REV. STAT. §§ 407.635–.644 (2007); MONT. CODE ANN. §§ 30-14-2001 to -2015 (2007); NEB.

control credit-repair businesses, but in the past few years, short-term lenders have been operating as CSOs under a statutory loophole that allows them to obtain “an extension of consumer credit” for borrowers. The CSOs charge large fees in exchange for purportedly helping consumers repair poor credit histories and gain access to more credit.¹⁵⁵ Most statutes define a CSO as:

[A] person who, with respect to the extension of credit by others, sells, provides, or performs, or represents that he or she can or will sell, provide or perform, any of the following services, in return for the payment of money or other valuable consideration:

- (1) Improving a buyer’s credit record, history, or rating.
- (2) Obtaining a loan or other extension of credit for a buyer.
- (3) Providing advice or assistance to a buyer with regard to either paragraph (1) or (2).¹⁵⁶

The definition is extremely broad, opening the door for payday lenders to redefine themselves as CSOs.¹⁵⁷ Although CSO authorizing statutes provide regulations for disclosure, registration, and operation of CSOs, they do not cap

REV. STAT. §§ 45-801 to -815 (2007); NEV. REV. STAT. ANN. §§ 598.741–.787 (2007); N.H. REV. STAT. ANN. §§ 359-D:1–11 (2008); N.Y. GEN. BUS. LAW §§ 458-a to -k (McKinney 2008); N.C. GEN. STAT. §§ 66-220 to -226 (2007); OHIO REV. CODE ANN. §§ 4712.01–.99 (West 2008); OKLA. STAT. tit. 24, §§ 131–148 (2007); OR. REV. STAT. §§ 646.380–.398 (2006); 73 PA. CONS. STAT. ANN. §§ 2181–2192 (West 2007); S.C. CODE ANN. §§ 37-7-101 to -122 (2007); TENN. CODE ANN. §§ 47-18-1001 to -1011 (2007); TEX. FIN. CODE ANN. §§ 393.001–.505 (West 2007); UTAH CODE ANN. §§ 13-21-1 to -9 (West 2007); VA. CODE ANN. §§ 59.1-335.1–.12 (2008); WASH. REV. CODE §§ 19.134.010–.900 (2008); W. VA. CODE §§ 46A-6C-1 to -12 (2007); WIS. STAT. §§ 422.501–.506 (2007). These states do not appear to have CSO statutes: Hawaii, Idaho, Kentucky, New Mexico, South Dakota, Tennessee, Vermont, and Wyoming.

155. Spector, *supra* note 117, at 988–89. See also Arkansans Against Abusive Payday Lending, *Payday Lenders in Arkansas: Attorney General Cracks Down on PaydayLenders – Most Comply, Some Defy*, PAYDAYLOANINFO.ORG, 7 (July 2008), http://www.paydayloaninfo.org/elements/www.paydayloaninfo.org/File/08_07_attorney_general.pdf.

156. CAL. CIV. CODE ANN. § 1789.12(a)(1)–(3) (West 2008).

157. See Spector, *supra* note 117, at 987. California’s statute, which is similar to statutes in Texas and other states, exempts several categories of businesses, including licensed lenders, federally-insured banks, most attorneys, and most tax-exempt nonprofit organizations. Nevertheless, the breadth of the definition is apparent on first reading and, in some states, unless specifically exempted, entities such as mortgage brokers are included within its terms. Increasingly, the line is difficult to draw. For example, an Ohio court held that a company that advertised “personal loans up to \$50,000” for consumers with credit problems must comply with the Act, but an Illinois court using the same definition held that a car dealership and a home remodeling company, both of which arranged loans with third-party lenders, fell outside the Act’s scope. *Id.* at 987–88 (citing *Ohio ex rel. Petro v. Berks Fin.*, No. 03-CV-8373, 2004 WL 3736495, at *2 (Ohio Ct. Com. Pl. Aug. 4, 2004)); *Cannon v. William Chevrolet/Geo, Inc.*, 794 N.E.2d 843, 851–52 (Ill. App. Ct. 2003) (stating car dealership is not within the scope of the Act); *Midstate Siding & Window Co. v. Rogers*, 789 N.E.2d 1248, 1253–55 (Ill. 2003) (stating remodeling company is not within the scope of the Act).

interest rates or fees, leaving the door wide open for payday lenders to slip into the definition of a CSO and return to business as usual.¹⁵⁸

Not surprisingly, the payday-lending industry has done just that, as this industry website regarding the CSO loophole demonstrates:

If you're not familiar with the CSO payday loan model it essentially consists of a "servicer" that markets the product, services the product, and accepts the risks associated with the product by issuing a "letter of credit" on behalf of the "borrower" to a "lender". A Credit Services Organization typically charges the consumer \$20–\$30 per \$100 loaned for 7 to 31 days. The CSO Credit Services Organization is "registered" with the state rather than "licensed" by the state. The state does not "regulate" the CSO.

....

The CSO Credit Services Organization model yields much better returns than the typical payday loan-cash advance-deferred deposit statutes existing in various states (Texas, Florida, Oregon...) and provinces without all the licensing and regulation. It's no wonder the use of the CSO Credit Services Organization model is on the rise throughout the country.¹⁵⁹

Since at least thirty-eight states have CSO statutes, payday lenders in any of these states may try this approach.¹⁶⁰ CSOs are incredibly prolific in Texas, following its recent regulation of payday loans. In 2005, there were fewer than 100 CSOs in Texas, but now there are more than 2000 CSO storefronts offering high-cost small loans across the state.¹⁶¹ Unlike other short-term or small-dollar lenders, CSOs in Texas are not subject to any limitation on fees they can charge.¹⁶² CSOs also sidestep licensing and enforcement by the state's Office of Consumer Credit Commissioner, which holds other Texas consumer lenders accountable.¹⁶³ Texans now take out an estimated \$2.5 billion in loans through CSO payday lenders each year and pay \$500–600 million in annual fees.¹⁶⁴

Ironically, CSO legislation was originally enacted to protect consumers from credit overextension and to help them make informed decisions about credit.¹⁶⁵ Now CSOs are used to allow payday lending in states that have prohibited it. The states that currently prohibit payday lending—Arkansas, New York, New Jersey, Georgia, Maine, Maryland, Massachusetts, New Jersey, New

158. Spector, *supra* note 117, at 988.

159. Florida Payday Loan Credit Services Organization Issues, PAYDAY LOAN INDUSTRY BLOG (June 17, 2008), <http://paydayloanindustryblog.com/florida-payday-loan-credit-services-organization-issues>.

160. See *supra* note 154 and accompanying text.

161. Rebecca Lightsey, *High Cost Lenders Profit from Desperate Times*, TEXAS LONE STAR FORUM (Mar. 12, 2009, 1:06 PM), <http://amforumbacklog.blogspot.com/2009/03/high-cost-lenders-profit-from-desperate.html>.

162. TEX. FIN. CODE ANN. §§ 393.001–.505 (West 2007).

163. Lightsey, *supra* note 161.

164. *Id.*

165. CTR. FOR RESPONSIBLE LENDING, *supra* note 75, at 1.

York, North Carolina, Pennsylvania, Vermont, West Virginia, and most recently New Hampshire—should keep their eye on CSO legislation. Such legislation already exists in thirty-four states, including Arizona, Arkansas, New York, New Hampshire, North Carolina, Georgia, Maine, and West Virginia.¹⁶⁶ If these states wish to continue their prohibitions on payday lending, they should repeal these CSO statutes. Other states interested in curbing payday lending should follow suit.

5. State Law and Politics

One might wonder why so many legislative efforts to curb payday lending fail, or more specifically, why none of the specific payday lending laws actually change industry practices. The answer lies partially in the political process itself.¹⁶⁷ The \$42 billion-a-year payday lending industry spent \$6.1 million lobbying Washington last year alone.¹⁶⁸ It has spent many more millions lobbying in battlefield states like Wisconsin, Ohio, and Arizona.¹⁶⁹ With this kind of money to spend, it is no wonder these forms of credit are difficult to regulate effectively.¹⁷⁰

166. See *supra* note 154 and accompanying text.

167. See Keith Epstein, *Profiting from Recession: Payday Lender Spend Big to Fight Regulation*, HUFFINGTON POST, Mar. 2, 2010, http://www.huffingtonpost.com/2010/03/02/profitting-from-recession_n_482297.html.

168. *Id.* (noting that the industry paid campaign contributions in the amount of at least \$1,315,841 and incurred lobbying expenditures of at least \$6,110,000 in 2009–2010).

169. Trade groups have financed studies to underscore the small profit margin on each loan. These groups have also created a database of more than half a million customers who can be quickly mobilized to persuade particular politicians. The persuasion often takes the form of personal, handwritten accounts from constituents about how quick cash helped them during times of financial need. *Id.* Forms of these letters are left on the counter for customers to pick up. See Interview with Study Participant SB19. The industry spent more than twice as much lobbying in 2009 as it did in 2008. The Community Financial Services Association, one of many trade organizations of high-interest lenders, increased its spending by 74%, to \$2.56 million. *Id.*

Industry representatives claim to be tracking 178 different pieces of legislation around the country—101 of which they oppose. In thirty-four states and Washington D.C., the payday loan industry and its companies have forty of their own in-house lobbyists, while paying another seventy-five outside lobbyists. An analysis of federal elections records shows political contributions linked to payday lending are streaming into the campaigns of members of Congress. At the current rate—\$1.3 million since the start of 2010—the amount of money spent before the 2010 midterm elections could easily surpass the industry's spending during the 2007–2008 presidential campaign season. *Id.* Wright Andrews, whose lobbying shop Butera & Andrews earned \$4 million in fees for coordinating the subprime industry's lobbying between 2002 and 2006, now represents the payday industry. Records show his firm earned \$240,000 from the Community Financial Services Association in 2009. *Id.*

170. Payday lenders also contribute millions to candidates in state elections, making them among the dozen or so top donors when figures for state and federal campaign contributions are combined. That puts them in the same influential ballpark, for instance, as unions, the gaming industry, and real estate interests. *Id.* In Wisconsin alone, efforts to establish an interest rate ceiling of 36% mobilized at least twenty-seven registered lobbyists against it. On February 16, 2010, Wisconsin lawmakers adopted a bill that could lead to

III. RESULTS OF CURBSIDE AND OFFICE INTERVIEWS

Part III describes the methodology of our empirical study, as well as the qualitative and quantitative results. All of the quantitative data described in this Section are derived from the curbside interviews. The footnotes at times elaborate on these quantitative data with comments made in the qualitative office interviews, but the office interviews were not included in the percentage data analysis set out below.

The curbside data demonstrate that customers do not shop around for payday or other short-term loans, customers tend to take out loans near home or work out of convenience rather than pricing, customers do not understand the significance of APR, most payday customers are repeat customers, payday lending is far more convenient and less embarrassing than getting a loan from another source, and the staff at many payday lending sites are friendly and welcoming. The data also demonstrate that, while some payday lending customers use the loans for the occasional emergency, most use them for regular, recurring expenses or to pay off other payday loans.

The data also indicate that most customers cannot easily compare the cost of this form of credit to other forms of credit; that most customers are unable to accurately describe how much they will ultimately pay for the small sums they borrow; that most customers generally feel they will be able to pay back the loans they borrow in a short time, despite the fact that few ultimately can; and that once a person has taken out one of these loans, it is harder to meet future ordinary expenses.

A. *Description of Empirical Study: Curbside Interviews*

Beginning in spring 2009, after receiving funding from the National Conference of Bankruptcy Judges and obtaining Institutional Review Board (IRB) approval of the methodology, the IRB and the Author trained four University of New Mexico students to conduct curbside interviews of payday lending customers pursuant to the script set out in the Appendix.¹⁷¹ While a much longer interview was contemplated initially, the study methodology called for a cash payment of \$10 in exchange for each study participant's time. Given the small size of these payments, a much shorter interview protocol was designed for the purpose of this initial study. All participants were offered an opportunity to make general open-

regulation of payday lenders for the first time, but not before rejecting the interest-rate limit. *Id.* In Arizona and Ohio, the industry spent \$30 million in 2008 campaigning for ballot initiatives that favor payday lenders; by contrast, reform groups reported spending only \$475,000. *Id.*

171. Thereafter, one student was trained to enter study data and code such data. The questions were initially written by the Author and colleague Erik Gerding, and fine-tuned by a sociologist, Dr. Deborah Thorne. They were tested in the field before the actual study began, and were reviewed and finalized at an empirical conference sponsored by Harvard Law School and the University of Texas School of Law.

ended comments of any kind at the end of the interview, and many chose to do so. Thus, these curbside interviews gleaned both quantitative and qualitative data.¹⁷²

Students interviewed customers in groups of two, usually during the lunch hour, from 4 to 7 p.m., and all day on Fridays. These were found to be the busiest times of the week. The students stood outside payday lenders or sat in their cars in the parking lot. They asked each customer who exited a store if she had just obtained or was paying on a loan she took out within the past month. If the answer was yes, the students asked the customer if she would like to take a ten minute survey in exchange for a \$10 gift card or \$10 in cash. During the summer, the students also offered cold water to respondents. The response rate was 27.8%, with 109 people who qualified accepting interviews out of 391 asked. Most of the questions were open-ended to avoid suggesting an answer and to get as truthful a response as possible from each study participant.

Though the original design contemplated interviews only with payday lending customers who were getting their loan that day, it changed because there were an insufficient number of subjects within that category. The vast majority of the customers were paying on an existing loan, rather than taking out a new one, consistent with the industry's business model.¹⁷³ Among those who were taking out loans, many more (at least during the summer months) were getting installment loans than payday loans. After attempting for several weeks with little success to restrict survey data to customers obtaining a loan that day, the study was expanded to include interviews of installment loan customers as well, and eventually all customers who were either taking out or paying on a recent loan that day.

To generate better data, interviews were limited to the point of sale rather than phone interviews after the fact. This approach was adopted to avoid recall bias,¹⁷⁴ which causes people to forget events that occurred a long time ago.

172. The interviewing process itself started with a zip code and geographical analysis, pursuant to which each lender's zip code was recorded and mapped. Students were then given the zip code maps and asked to randomly visit payday stores within a particular zip code until they had collectively visited all lenders within the zip code. Students were instructed to sit outside each store for a stated period until they saw a customer to interview. Students were not required to sit outside stores with no customers for more than thirty minutes. At times customers were few and far between, particularly in relation to the number of loan outlets. When more than one lender was visible from a particular parking lot, the most fruitful approach was to park within viewing distance of several stores and approach each customer when she left the store.

173. In the beginning, when the students were only interviewing people who were taking out new loans, they could go several days without identifying a customer who was taking out a new loan.

174. Recall bias is likely to have entered into the interviews conducted by Elliehausen and Lawrence, in which the investigators called the customers of several large payday lenders to discuss loans taken out over the past year. ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 60. Studies suffering from recall bias create less reliable data. Eman Hassan, *Recall Bias Can be a Threat to Retrospective and Prospective Research Designs*, INTERNET J. EPIDEMIOLOGY (Feb. 13, 2009), <http://www.ispub.com/ostia/index.php?xmlFilePath=journals/ije/vol3n2/bias.xml>; Francis W. Horvath, *Forgotten Unemployment: Recall Bias in Retrospective Data*, MONTHLY LAB. REV., Mar. 1982, at 40-43.

B. Statistical Data

Some of the more interesting conclusions from the data are described below.

1. Borrowers Are Neither Infrequent nor Occasional and the Loans Are Far From Short-Term

To call this industry the “short-term loan” industry is a misnomer. While the industry repeatedly claims that most borrowers use short-term loans infrequently, the data suggest otherwise.¹⁷⁵ In addition to the curbside interviews, the Author conducted twenty one-hour, in-depth interviews. Most of the random payday borrowers interviewed had been in continuous “short-term” debt for over a year, many with more than one loan. Some of this debt was structured as interest-only debt that did not permit the borrower to make even partial payments on the principal.¹⁷⁶ The never-ending, interest-only nature of the debt is evident in the loyalty programs offered by some payday lenders: after a certain number of timely interest payments, customers can get a discount on the next interest payment.¹⁷⁷ However, none of these payments pay off any of the principal.¹⁷⁸

Nor do customers use these loans only occasionally. A significant number of subjects had used multiple payday loans or direct-deposit advances from multiple lenders for a period of years, including some from traditional banks like Wells Fargo and US Bank.¹⁷⁹ These banks offer payday advances that can be rolled over for about a year and then must be paid off for about a month before the customer can resume using them for another year.¹⁸⁰ When it became apparent that

175. Since the frequency of these products has already been well documented, this was not a focus of our study. Nevertheless, customers were allowed to make any comments they liked at the end of the interview, and some commented on having used the same lender for years. *See, e.g.*, Interview with Study Participant CS45.

176. Interviews with Study Participants CB34, SB01, SB12, and SB13.

177. Interview with Study Participant SB01.

178. *See* Allied Cash Advance loyalty card for interest-only loan (on file with the Author).

179. *See* Interview with Study Participant SB01.

180. As the Wells Fargo website explains:

You may take advances (in \$20 increments) as often as you like—up to your available credit limit. This Service is designed to provide access to cash on a short-term basis when you may need it most. If you use the Service for more than 12 consecutive statement periods, your credit limit will be gradually reduced by \$100 in future statement periods until your credit limit is zero or you do not use the Service for one statement period. (A statement period is approximately a month—your exact statement cycle dates can be found on your monthly statement.) For example, assume your calculated advance limit is \$500 and you have used the *Direct Deposit Advance* service in each of the last 12 consecutive statement periods. In the 13th statement period, your advance limit will be \$400 (\$500 less \$100). If you continue to use the service your advance limit in the 14th statement period will be \$300. If you continue to use the service thereafter, your advance limit will continue to decrease by \$100 each consecutive statement period until it

interviewees were just rolling these direct-deposit-advance loans indefinitely, the Author asked one customer what she did if she could not use one of these loans in a given month. That, she explained, “is when you go to one of these other loan companies.”¹⁸¹

If states wish to regulate payday lending, and the industry claims use of such loans is infrequent, states should consider requesting evidence to support these claims. The short-term loan industry has access to data showing how frequently customers use these loans. Such data, available through Veritec, TeleTrack, or other credit-checking methods used by the industry, could be very useful to states, if the industry made it available.

2. Many Customers Do Not Understand How the Interest-Only Loans Work

There is a marked lack of transparency, not to mention understanding, about how the interest-only loans work. Several customers explained that the clerks did not tell them that the minimum fees do not pay down the principal amount of the loan before they took out the loan.¹⁸² Many customers ultimately figure out that the loan is interest-only, but some do not. Another customer reported hearing an elderly woman in one payday lending store arguing vehemently that there was no way the math could possibly work out the way the clerk said—it was just not right. The customer being interviewed knew what the confusion was because she had also misunderstood the way the loans were structured, at least at first.¹⁸³ Another customer said he chose a payday loan instead of an installment loan because he did not want to be in debt, yet he was not paying down the loan.¹⁸⁴ As another customer explained, “The lender never explained that I could pay down the loan by paying more than the minimum. Unless you pay more than the minimum, the loan amount never goes down.”¹⁸⁵ Yet another said that the clerks did not inform him of the terms of the loan until he took it out.¹⁸⁶ One reported that the “paperwork is usually handed to the customer in a sealed envelope, so you won’t read it.”¹⁸⁷

equals \$0 for one statement period. You can avoid this reduction in your standard credit limit if you do not take a new advance for 1 complete statement period at any time. Your current advance limit appears in the *Direct Deposit Advance* section of your monthly checking account statement.

Direct Deposit Advance Service Questions, WELLS FARGO, https://www.wellsfargo.com/help/faqs/dda_faqs (last visited Oct. 15, 2009).

181. See Interview with Study Participant SB01.

182. See Interview with Study Participant CS32; see also Interview with Study Participant CS23 (stating that “they did not tell me I could pay down the debt by paying more than the minimum, and unless you do that, the whole payment goes to fees”).

183. See Interview with Study Participant SB01.

184. See Interview with Study Participant CB37.

185. See Interview with Study Participant CS28.

186. See Interview with Study Participant CS32.

187. See Interview with Study Participant SB12.

Some customers still did not understand the terms of their loan, even after paying on it for some time. One man had paid more than \$2000 on a \$300 loan and did not know why he had not made a “dent in the loan.”¹⁸⁸ The loan amount, he explained, never went down. This person came in with two other family members. One of them, his daughter, commented that the interest was too high and that the loan principal would not decrease with the payments.¹⁸⁹ The third family member in the group said that “the way they apply the payments, it just doesn’t add up.”¹⁹⁰ A failure to understand the interest-only nature of the loans showed up in other areas as well, including the common misunderstanding about how payday loans differ from installment loans.

3. *Most Borrowers Are Unable to Describe the APR on Loans and Cannot Predict the Total Dollar Cost of the Loans to Them*

a. Complete APR Disconnect

Few of the respondents said they could confidently state the APR on their own loans without looking at the top right corner of their loan documents. Almost 60% of those asked said they did not know what the APR was and that they were not willing to wager a guess of what the APR might be. Of those that said they knew or would guess, the rates described varied widely. They ranged from 0.05% per annum to 586% per annum. Of those who were willing to attempt to state the APR, 39% thought the APR was in the double-digit range of 18% to 96%, despite the fact that the actual annual percentage interest rates on almost all loans was between 417% and 587% per annum.¹⁹¹

Interviewees were almost universally unable to specifically state the APR, even in general terms, unless they were holding the loan paperwork in their hands, as shown in Figure 1. Moreover, the acronym itself meant nothing to them. Many people seemed generally unaware of what APR represented. Even when interviewers told the interviewees that the term meant annual percentage rate, or interest rate, many interviewees could not articulate what the rate represented.¹⁹²

188. See Interview with Study Participant CS27.

189. See Interview with Study Participant CS25.

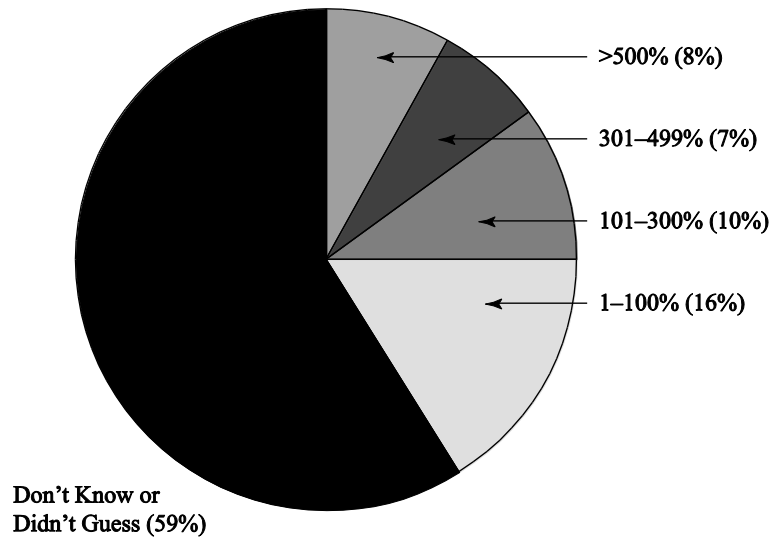
190. See Interview with Study Participant CS26. This same person reported that payday loans are cheaper than credit cards, an issue taken up in Part III.B.4, *infra*.

191. A few lenders in this market, typically local rather than national lenders, did give loans at around 100%. We were familiar with these lenders and considered 100% a correct answer when customers borrowed from them.

192. This is, of course, not unique to payday customers, as many other people also cannot articulate what an APR means.

Figure 1
APR Guesses

Guess	Occurrence
> 500%	8%
301-499%	7%
101-300%	10%
1-100%	16%
Don't Know or Didn't Guess	59%



The industry has long argued that requiring the loan to be stated in terms of APR is a waste of time because people do not borrow the money for a full year. Many times, however, people do borrow the money for a year or more. Nevertheless, disclosing APR is of little value to most consumers, though it does help legislators understand the cost compared to other credit. So why is the industry opposed to disclosing the cost of their short-term loans in terms of APR? Because the APR makes the loans appear very expensive when in reality, claims the industry, the loans are short-term and infrequently used by particular consumers.¹⁹³ Moreover, paying \$15 to borrow a much-needed \$100 once in a great while is well worth it, according to the industry.

193. See Arkansans Against Abusive Payday Lending, *How to Calculate the Interest Rate on Payday Loans*, PAYDAYLOANINFO.ORG, http://www.stoppaydaypredators.org/pdfs2/aaapl_howtocal.pdf (last visited Aug. 18, 2010).

If only this were reality. Numerous studies have shown that a large number of payday loan customers rollover the principal again and again.¹⁹⁴ Customers pay numerous fees for a single cash advance, which means that many of the loans are not truly “short-term.” The Indiana Department of Financial Institutions revealed in 1999 that “91% of customers in the state rolled over their loans; the average number of renewals was ten.”¹⁹⁵ Even the industry-funded Elliehausen and Lawrence study found that 75% of a national sample renewed the loans at least once and more than 39% rolled over the loans five or more times.¹⁹⁶ According to a 2001 report of the Wisconsin Department of Financial Institutions, more than half of the loans it reviewed were rolled over; 38% of customers renewed their loans more than three times.¹⁹⁷ “Other studies show that the bulk of revenue and profits for payday loan outlets is derived from ‘churning’ or back-to-back loans.”¹⁹⁸ More than one study found that at least one-third of payday loan customers reported using the proceeds of one loan to pay off another loan at a different outlet.¹⁹⁹ Study data reported in this Article suggest that this figure is a gross underestimate.

b. Difficulty Understanding the Total Dollar Cost of the Loans

A number of our study questions sought and obtained information about customers’ understanding of the dollar costs of their loans.²⁰⁰ Respondents were

194. Mayer, *supra* note 29, at 3.

195. *Id.*

196. See ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 39.

197. WIS. DEP’T OF FIN. INSTS., REVIEW OF PAYDAY LENDING IN WISCONSIN 10 (2001).

198. Mayer, *supra* note 29, at 3.

199. Stegman & Ferris, *supra*, note 14, at 20. Other studies offer anecdotal evidence about debtors borrowing multiple times against the same paycheck. The state OFI reports note that the average payday-advance customer takes out a dozen loans a year, and not all of these loans are sequential. A team of researchers in Ohio went on a spree to see whether they could borrow from several different stores in a few days. One individual was granted nine loans in three days, even though the creditors used the TeleTrack system. Johnson, *supra* note 14, at 63. Other horror stories have been reported in the media, such as debtors carrying more than a dozen loans at once—but there has been no attempt thus far to determine how common that practice is. As we shall see below, the practice is in fact quite common. Every weekday in Milwaukee County, an average of three or four residents file for bankruptcy owing debts to several different payday lenders. Bankruptcy court is a good place to look for payday loan customers because they are four times more likely to have filed for bankruptcy in the past than the average adult. See ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 46.

200. These questions are:

L1—How much cash did you take away/borrow (in dollars)?

L2—How many days before you are expected to pay it back?

L3—Do you know how much you can expect to pay in fees and/or interest?

L4—Do you expect to be able to pay it back within this time frame?

L5—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a month? For example, do you know the total amount you would be charged in fees and extra charges?

first asked to describe in detail how much they borrowed and when and how they were expected to pay the money back. Thereafter, they were asked to describe their understanding of the total amount they would pay in interest and fees in addition to the principal.

The first data set described here contains each customer's understanding of the fundamental terms of her loan—meaning how much each borrowed, when the loan was to be paid back, and at what total dollar cost. Of the participants, 19% declined to attempt to describe the dollar costs of their loan. That is, rather than describe the total interest and fees for the loan in dollar terms they replied with “not sure,” “not sure, it's high,” “at least the amount of the loan,” “not real clear, a lot,” “tricky, not sure,” or “not sure, they tell you but it seems like a lot more.” This was surprising because it appeared likely to us that, while people might not be able to articulate the APR, they probably *would* understand the short-term cost of the loan and perhaps even the long-term cost of the loan.

Because we knew that most businesses interviewed charged between \$15 and \$25 per \$100 to borrow a payday loan, any time a person said they were paying a fee in that range (to be paid back in a period of fourteen days or less), we counted that person as one who described dollar costs that seemed facially consistent with the terms of the loan. Likewise, because we knew that a typical twenty-week installment loan costs just over double the loan amount, we counted, as facially consistent with the terms of the loan, borrowers who described a loan to be paid over time and as anything at or over the loan amount. Thus, if a person described an installment loan's total fees as anything at or over the loan amount, we counted that person as one who described dollar costs that seemed facially consistent with the terms of the loan.

Of those who attempted to describe the short-term dollar cost of their loan, 59% (or fifty-two people) described short-term dollar costs that were facially consistent with the terms of the loan described by the customer or the in-hand paperwork and/or what we knew about the terms from our own inquiries to the stores.²⁰¹ This left 41% (or thirty-six people) that described fundamental loan terms that were inconsistent with the price being charged, based on what we knew about the lender from calling, from in-hand paperwork, and/or from other customers exiting the same store. Overall, that means that just over half of the

L6—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a year? For example, do you know the total amount you would be charged in fees and extra costs?

L7—Have you heard the term “annual percentage rate”?

L8—Many people don't know the answer to the next question, but if you do, would you tell me what the annual percentage rate for this loan is?

201. For example, someone borrowed \$100 for seven days and said the fees were \$25 at a place that we understood to be charging \$25 to borrow \$100 between now and payday. *See* Interview with Study Participant CS07. Someone else in this family of establishments was borrowing \$200 for two weeks for \$50 in fees. *See* Interview with Study Participant CS22. Another described the fees and costs as \$20 to borrow \$100 until payday, which we considered close enough to constitute a decent understanding of the initial costs of the loan. *See* Interview with Study Participant CS01.

respondents seemed to understand the fundamental terms or overall cost of their loan even in the short term.

Question L5 asks, “Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a month? For example, do you know the total amount you would be charged in fees and extra charges? If so, how much?” Participants were asked to give a dollar figure as the extra monthly cost. Forty-nine of 109 (44.9%) declined to give a dollar figure, simply answering “no” or “I don’t know.” Another five gave nonresponsive answers such as “pay off and re-borrow,” “22–26%,” “an extra 10–15%,” “renew loan,” and “same interest rate.” Two said they did not believe they could not keep the loan out an extra month because “it would go to collections,” or that that they did not think they could because “they automatically debit my account after a five-day grace period.” The remaining sixty respondents attempted to do the math.

Answering this question required study participants to calculate the monthly interest payments by doubling the two-week fee for a payday-style loan or by dividing the total fees by the number of months over which an installment loan was to be paid. To analyze the answers to this question, we simply assumed for this question only that whatever terms the customer described as their loan arrangements were accurate and used the question to measure math capabilities. For payday loans, the exercise was not too difficult, as it simply involved doubling the two-week fee. For installment loans, the math was harder to calculate, but not impossible.²⁰² We attempted to give the benefit of the doubt to a customer whose answer made a reasonable degree of math sense.²⁰³

Of the sixty who attempted the math, twenty-nine answered in ways that were inconsistent with the numbers they described in the prior question. That left thirty-one that answered in a way that came close to what the actual cost of that extra month of credit might be.²⁰⁴ That meant that at most, thirty-one out of 109 interviewees (or 28.4% of those interviewed) were able to calculate the added cost of keeping this credit out for an additional month. Put another way, less than one-third of those interviewed knew the monthly cost of the credit.

202. Again, to answer this question correctly, the customer would need to divide the total fee for the loan by the number of months over which the loan was to be paid.

203. For example, if a customer said they were borrowing \$250 for fourteen weeks for total fees of \$275, then the actual additional cost of keeping the loan out for one month extra would likely be about \$78. If the customer said this would cost about \$100, this was considered a rational answer. However, if a customer said that a \$100 loan was due back in two weeks and that the fees on that loan would be \$20, we would expect the extra month to cost \$40. If the person said \$20 for the month, this was counted as a calculation that showed a lack of math aptitude. *See* Interview with Study Participant CS01. In the case of Study Participant CS17, the customer had a two-week loan that cost \$37, but said that a one-month loan was \$64. We counted this customer as having reasonable math aptitude, even though there was a \$10 math error. It seemed the person knew what she was doing but just made a mistake. The same mistake was made in the reverse by Study Participant CS22.

204. Interestingly, a number of the borrowers described the loan as costing \$20 to borrow \$100. Stated in those terms, these loans sound reasonable even though this amounts to 730% per annum.

Previous studies show that most payday borrowers do not pay back their payday or installment loans after one loan cycle, but rather borrow the money again and again, paying mostly fees and no principal for over a year or longer. For that reason, we also sought to determine if payday and installment loan customers knew the cost of keeping the loans out for this longer period of time. Thus, question L6 asked, “Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a year? For example, do you know the total amount you would be charged in fees and extra costs? How much?”

At this point, only twenty-four of 109 (or 22%) were willing to even try to quantify the dollar cost of keeping the loan out for a full year. Of the twenty-four, ten gave figures that were consistent with the other answers given on the total costs of the loan. The other fourteen gave answers that were implausible based upon the other information we gleaned. This means that less than 10% of the customers we interviewed could estimate the cost of this credit over a year period, even though many probably kept their loans out for a year or more.

This lack of ability to understand should not necessarily be blamed on the customers. In many cases, the paperwork could hardly be more confusing.²⁰⁵ Lenders are no doubt aware that customers do not, and perhaps cannot, do this math. As one customer explained, “I don’t like math, and I don’t want to try to calculate [these things].” Another rather unsurprising reason why customers are unable to calculate the cost of this credit is that many are hopelessly optimistic regarding when they expect to be able to repay the loan, particularly at the beginning of the relationship. One customer explained that she did not realize that it would be so hard to pay her loan back. She had become a hair stylist and needed money to establish clientele while still meeting her other bills and obligations. She quickly found, however, that the payday loan made it harder to fulfill those obligations.²⁰⁶ Many others reported thinking they would be able to pay back the loans much more quickly than they actually could.²⁰⁷

4. Hear No Evil, See No Evil: Customers Cannot Compare the Cost of Alternative Credit Sources and Do Not Understand the Cost of Credit Cards versus Payday Loans

Survey data reveal that some consumers misperceive the cost of credit cards in comparison to payday loans. Thirty-three of 109 customers (or 30%) reported having credit cards. Of the thirty-three, seventeen reported that their credit cards were maxed out.²⁰⁸ Of those surveyed with credit cards, 15% said they

205. For example, for one loan the interview team was unable to find any APR disclosure on any of the in-hand paperwork. Confusingly, the cover page disclosed the original loan amount as \$3612.07, even though the customer took away just \$1000. The second page of the paperwork analyzed the payments in virtually incomprehensible terms, but essentially showed payments of \$3612.07 to borrow \$1000 for seven months.

206. See Interview with Study Participant CS43.

207. See Interviews with Study Participants CS59, CS60, CS69, and CS78. Study Participant CS69 was celebrating the day we interviewed her. She had taken the loan out months ago and was making her last payment. See Interview with Study Participant CS69.

208. See Interviews with Study Participants CS11, CS21, CS35, CS55, CS59,

would not use the credit card at this time because credit cards are for emergencies only.²⁰⁹ This seems to contradict the notion that payday loans are *also* for emergencies only. Another customer said credit cards should be used only when one is trying to build a credit history.²¹⁰ Yet another said he did not want to get into the habit of using credit cards.²¹¹

The idea that credit cards should be used more sparingly than payday or installment loans also suggests that people think it is somehow less expensive or safer to use a payday loan than a credit card. Many of the comments above suggest that people do not know that credit card interest is typically at least five to twenty times less expensive than payday loan fees.²¹² More to the point, in addition to those mentioned above, at least five of the sixteen respondents with credit cards stated outright that the interest paid on a credit card is higher or more expensive than the fees for a payday loan.²¹³ As one man explained, “Credit cards are worse [than payday loans]. You could lose your job. \$1000 becomes \$5000 overnight.”²¹⁴ Another explicitly stated that “interest is cheaper at the payday lender than it is on the credit card.”²¹⁵ All totaled, it appears that more than half of the customers surveyed who had credit cards thought credit cards were more expensive to use than payday loans.²¹⁶ Even some customers who did not have credit cards reported without prompting that credit cards were more dangerous because they grant more freedom to spend without limits.²¹⁷ Yet payday loans did not cause similar alarm to these customers. As one said in response to the question about why she took out a payday loan instead of using a credit card, “no reason, impulse.”²¹⁸

As described above, the majority of people also thought APR for a payday loan was a single- or double-digit number, suggesting that when consumers

CS62, CS71, CS81, CS82, CS85, CS92, CS93, CS98, CS99, CS102, and CS105. Another customer said she needed cash but did not know she could get a cash advance from a credit card. *See* Interview with Study Participant CS18.

209. For example, people made statement such as, “credit cards are strictly for emergencies;” “[my credit card] is in a safe deposit box locked away so I cannot use it;” “I need my credit card for emergencies;” and “I had credit card problems when I was younger, so now I use [it] only for emergencies.” *See* Interviews with Study Participants CS05, CS34, CS36, CS49, CS53, and CS66.

210. *See* Interview with Study Participant CS39.

211. *See* Interview with Study Participant CS64. Again, typical APRs in this market were 100% (two lenders that we know of and visited) to 586% (many of the installment loan establishments).

212. *See* Interviews with Study Participants CS06 (stating that she had no credit cards because she was “afraid of accumulating debt”), CS25 (same), CS45 (stating that “credit cards cost more than payday loans”), CS26 (stating that credit cards cost two times the interest of payday loans), CS93 (credit cards are “too expensive”), and CS98 (interest rates are “too high to take out cash on a credit card”).

213. *See* Interviews with Study Participants CS33, CS74, CS85, CS93, and CS98.

214. *See* Interview with Study Participant CS36.

215. *See* Interview with Study Participant CS33.

216. *See, e.g.,* Interview with Study Participant CS98. This is no secret to the payday-lending industry. *See* ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 37.

217. *See* Interview with Study Participant CS15 (stating that “credit cards are worse because they grant more freedom to spend without realizing”).

218. *See* Interview with Study Participant CS40.

hear that they are being lent money at \$15 or \$20 per \$100, even over a two-week period or less, they may equate this with 15% or 20% per annum. This may appear cheaper than the average 25% many credit-challenged people pay on their credit card balances.²¹⁹

According to Professor Christopher Petersen, American states traditionally had single-digit usury limits, which ultimately inched up into the double-digits, until usury laws were largely abandoned following the 1978 Supreme Court decision in *Marquette*.²²⁰ Professor Peterson explains that consumers have grown used to seeing certain numbers affiliated with the cost of credit and are likely to make certain assumptions about what those numbers mean. More specifically, consumers are accustomed to double-digit interest rates and cannot rationally imagine a rate that is in the triple digits. As Professor Petersen explains:

Saliency distortion is defined as the absolute value of the difference between the annual percentage rate of a usury statute's most expensive permissible loan and the most prominent, or salient, number written in the statutory language limiting the price of the loan Because currency is numerical, in any statute that caps the price of a loan, the legislature must at some point pick a number or numbers. While this is true of every usury law, the specific number a legislature chooses only has meaning in relation to other variables associated with the law in question.²²¹

As Professor Petersen explains, one legislature might adopt a usury limit of 8% per year while another might adopt a cap of 8% per month, and while both would have chosen to feature the same number in the language of the statute, the latter cap would be twelve times higher than the former because there are twelve months per year. A legislature could even adopt an interest rate cap of 8% per century—which would create a price cap much lower than either the monthly or annual cap. To continue the point, “a legislature could adopt a cap of 8% per second, which would generate an extremely high price limit.”²²² In other words, if it chose to do so, any legislature could pick a small number and create a relatively high price limit or, instead, pick a large number and create a relatively low price limit. Legislatures can feature whatever number they want in a usury law.²²³

This might explain why consumers think that a 417% payday loan, described as costing \$15 per \$100 borrowed sounds less expensive than an APR of 25% on a credit card. People in this study actually seemed scared of credit card debt, and one woman claimed that at least with a payday loan she knew what she

219. See *CreditCards.com's Weekly Rate Report*, CREDITCARDS.COM, <http://www.creditcards.com/credit-card-news/interest-rate-report-aprs-record-highs-1276.php> (last visited Aug. 16, 2010).

220. *Marquette Nat. Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Saliency Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1117–22 (2008).

221. Peterson, *supra* note 220, at 1136.

222. *Id.*

223. *Id.*

would be paying. With credit cards, she explained that “you have no idea what it’ll ultimately cost, and there is no one to talk to.”²²⁴ Student interviewers wondered if the media also frightens people away from credit cards with constant television ads for specialists offering to help debtors out of credit card messes. No one working on this project could ever remember anyone on television talking about how to get out from under a rash of payday loans.

5. Loans Are Used Primarily for Recurring Expenses, Not for Unexpected Emergencies

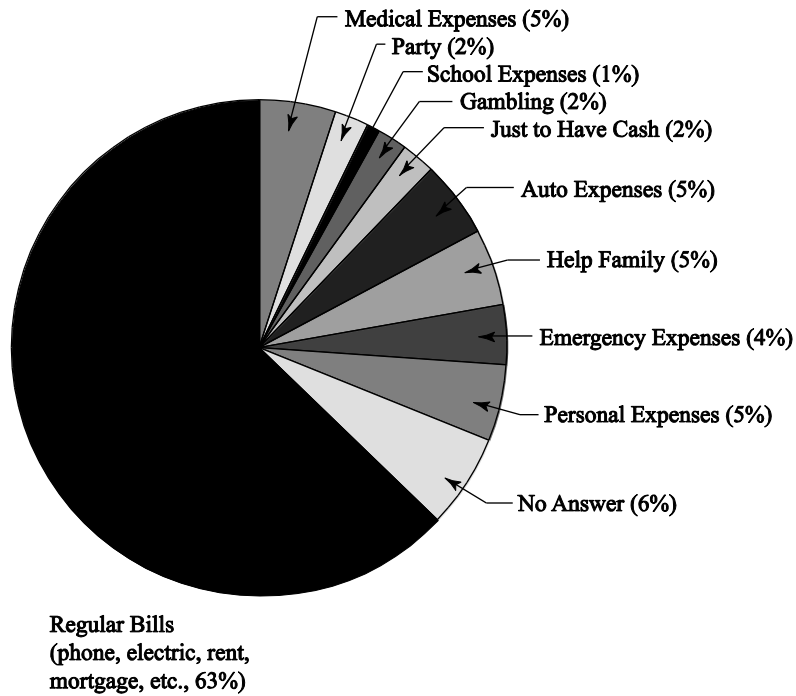
The majority of participants—indeed, 63%—reported using payday loans for regular, recurring monthly bills and expenses, as shown in Figure 2. Initially, these respondents stated that the money was to cover “bills,” but later elaborated that they meant rent, utilities, gas bills, cell phone bills, and so on. This category of usage consists of ongoing expenses, nothing out of the ordinary like a broken car or medical emergency. These data are inconsistent with the 2001 industry-sponsored Elliehausen and Lawrence study, which concluded that nearly half (47.2%) of most recent loans were used to pay an unexpected expense, a third for discretionary uses, and just 12% for regular expenses.²²⁵

224. Interview with Study Participant CS45.

225. See ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 47. Similar to the industry study, another study conducted by Environics Research Group on behalf of the Canadian Association of Community Financial Service Providers reports that 92% of payday customers used their loans for an immediate cash-flow crisis and 4% for immediate consumption. See ENVIRONICS RESEARCH GROUP, UNDERSTANDING CONSUMERS OF CANADA’S PAYDAY LOANS INDUSTRY 18 (2005), available at <http://www.cpla-acps.ca/english/reports/PaydayLoansReportPresentationJune9.ppt>.

Figure 2
Study Participant's Responses
When Asked What They Wanted Loan For

Responses	Percent Responding
Regular bills (phone, electric, mortgage, rent)	63%
No Answer	6%
Personal Expenses	5%
Auto Expenses	5%
Help Family	5%
Medical Expenses	5%
Emergency Expenses	4%
Just to Have Cash	2%
Party	2%
Gambling	2%
School Expenses	1%



6. *Borrowers Choose This Form of Credit Over Cheaper Forms Because It Is Convenient and Available Anywhere, Anytime*

As other studies have found, convenience drew consumers in our study (see Figure 3) to a particular payday lender.²²⁶ Unlike qualifying for other forms of credit, qualifying for money is easy and fast—just as the advertisements say—without the stigma of admitting to friends, family, or a financial institution that the customer is broke.²²⁷ Moreover, many payday loan consumers do not trust mainstream financial institutions.²²⁸ Our participants also noted the friendliness of the clerks in payday lending stores as a reason why they opted for that form of credit.²²⁹ Frankly, we noticed the same thing ourselves when calling around about rates and plans. The lenders train their employees to be friendly to customers.²³⁰ The extended hours of payday lenders were also a big draw in our study.²³¹ And—as expected—location, location, location, is an important factor.²³²

226. Michael Kenneth, *Payday Lending: Can “Reputable” Banks End Cycles of Debt?*, 42 U.S.F. L. REV. 659, 669 (2008).

227. *Id.*

228. *Id.*

229. See Interview with Study Participant CS28.

230. Kenneth, *supra* note 226, at 669. Professor Kenneth reports on a focus group study in California of low-income and ethnic consumers, which identified five ways in which fringe banks, like check-cashers, are superior to mainstream banks: (1) easier access to cash; (2) accessible locations; (3) better treatment of customers; (4) greater trustworthiness; and (5) better service because of the many useful products in one location, better hours, and more Spanish-speaking employees. *Id.*

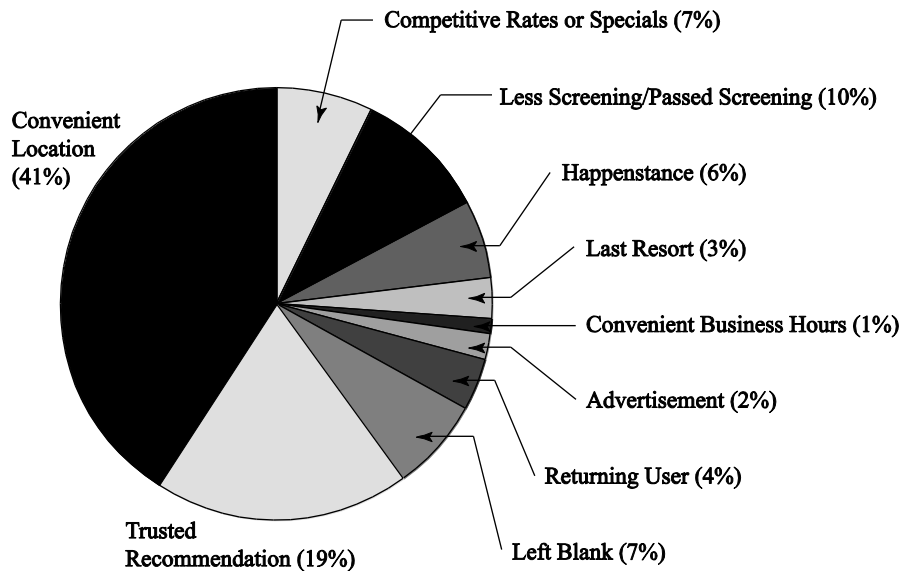
231. *Id.*

232. ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 52.

Figure 3

Why Customers Choose Payday Storefronts Over Lower Cost Credit Options

Answers	Percent Responding
Convenient Location	41%
Trusted Recommendation	19%
Less Screening/Passed Screening	10%
Left Blank	7%
Competitive Rates or Specials	7%
Happenstance	6%
Returning User	4%
Last Resort	3%
Advertisement	2%
Convenient Business Hours	1%



7. Customers Do Not Pursue Lower-Cost Credit Because These Loan Outlets Are Ubiquitous and Convenient

One of the common criticisms of payday and similar loan establishments is that they are *too* available for consumers, and thus cause customers to choose payday loans instead of cheaper or no-cost alternatives. As these outlets have become more ubiquitous and convenient, consumers frequently make payday lenders their first choice of finance. One study participant tells a particularly

perilous story. She was pleased with herself for not taking out any student loans, yet she was at a payday lender, borrowing money.²³³ She was accompanied by her mother who had given her the advice to avoid student loans, even though student loans can be obtained for between 0% and 8.5% APR.²³⁴

This is not an isolated example of people choosing high-cost credit over low-cost credit. Another example is the use of payday loans rather than credit cards discussed previously in Part III.B.4. A large percentage of study participants could have either chosen cheaper credit or foregone the payday loan entirely. Participants were asked what they would have done if they had not been able to get a payday loan. Nearly 43% said they would have asked a friend or family member for the money, a classic no-cost option.²³⁵ A few said they would use a bank, which would clearly be cheaper, and two said they would go to a pawn shop.²³⁶ One gentleman got a loan from a bank once and then later returned to the payday lender.²³⁷ Another initially wanted to avoid borrowing from family, but now had to borrow from a family member just to make “this installment.”²³⁸

Another 13.4% of interviewees said they would use another low- or no-cost alternative such as waiting until payday,²³⁹ not having the party they were planning,²⁴⁰ not going to the casino that day,²⁴¹ not getting dental work done now,²⁴² working overtime,²⁴³ walking for a week until they could afford a car repair or gas,²⁴⁴ going to a credit bureau and entering into a repayment plan,²⁴⁵ calling the utility company to delay payment of their bill,²⁴⁶ or working out a deal with the cell phone company.²⁴⁷ This means more than half of the people asked could have refrained from taking out a payday loan, suffered little or no negative consequence, and saved themselves money.

Of course, some of these alternative sources of cash may be unpalatable for other reasons. For example, loans from family members might be accompanied by an unwelcome inquiry as to how the money is to be used or a lecture on

233. See Interview with Study Participant CS63.

234. See Interview with Study Participant CS62.

235. See Interviews with Study Participants CS61, CS62, CS65, CS72, CS109, and many others.

236. See Interviews with Study Participants CS9, CS36, CS7, CS26, and CS67.

237. See Interview with Study Participant CS90.

238. See Interview with Study Participant CS109; see also Interview with Study Participant CS58 (stating that she “had to borrow from family to pay off payday loans. Sounds too good to be true and it is.”).

239. See Interviews with Study Participants CS15 and CS79.

240. See Interview with Study Participant CS29.

241. See Interview with Study Participant CS40.

242. See Interview with Study Participant CS20.

243. See Interview with Study Participant CS42.

244. See Interview with Study Participant CS66.

245. See Interview with Study Participant CS45. Two of the worst stories I heard during the office interviews were about a credit repair organization that took \$4000 to negotiate bills, ultimately used \$1400 to pay bills, and took \$2600 in fees. See Interviews with Study Participants SB02 and SB03.

246. See Interviews with Study Participants CS16, CS52, and CS70.

247. See Interview with Study Participant CS64.

financial prudence.²⁴⁸ Nevertheless, as set out above, most customers do not seem to understand the cost of this high-cost, short-term debt, in dollar terms or otherwise. Thus, they are generally unable to compare the personal cost²⁴⁹ of the lecture or invasion of privacy by the relative or friend to the dollar cost of the loan. If they *were* able to calculate these dollar costs, they might well decide that avoiding the loan was worth the lecture. Moreover, if payday and installment loans were less ubiquitous, people might be forced to exhaust low-cost options before turning to these businesses for cash.

As for the other half of respondents who had no other alternatives for obtaining cash, one might wonder how badly they could be hurt by the lack of available credit. In many cases, however, the results were not dire. Many people said they would default on their bills or incur overdraft charges. These responses, totaling 16% of those surveyed, ranged from one individual who said she would miss a car payment to another who said his electricity would be cut off.²⁵⁰ No other specifics were provided about the consequences of defaulting on these obligations. In fact, one person who was borrowing money to keep from defaulting on his bills acknowledged that if he could not get the loan, “the bill collectors would have to wait.”²⁵¹ This demonstrates one theme we found among many payday borrowers: many are averse to paying any bill late. Payday lenders provide a highly expensive solution to a potentially cost-free problem: paying some bills late, including some utilities, results in no extra charge at all.

8. *Customers Do Not Shop Around*

When asked if they considered getting a loan from another payday lender, 78.64% of respondents said they had not. If they said they shopped around, they were prompted to explain. Once prompted, only one person said that he called around to check rates.²⁵² It appears that the vast majority of customers do not shop around for short-term loans; instead, they choose their lender based upon convenience, location, and other factors such as recommendations from friends. Some people reported that because they were using the loans to pay for other short-term loans, the primary goal was to find a new lender from which to borrow to pay the old lender. Some respondents had numerous loans outstanding for years at a time with many different lenders.

248. Some people said they were embarrassed to ask a family member for money. *See* Interviews with Study Participants CS10, CS38, CS60, CS71, CS81, and CS85. Two said borrowing from friends could ruin the friendship. *See* Interviews with Study Participants CS23 and CS84. One said she did not want to ask at work because she did not want to “be personal at work or in debt at work.” *See* Interview with Study Participant CS39. Many said getting a payday or installment loan was easier, faster, and more convenient. *See, e.g.,* Interviews with Study Participants CS6, CS38, CS72, and CS78.

249. These are admittedly noneconomic concerns, making the cost even more complex to calculate.

250. *See* Interviews with Study Participants CS52 and CS148.

251. *See* Interview with Study Participant CS03; *see also* Interviews with Study Participants CS13, CS14, CS16, CS18, CS19, CS21, CS28, and CS47 (all indicating that if they could not get the loan, they would have to default on regular bills or just pay late).

252. *See* Interview with Study Participant CS48.

**IV. REGULATION:
SHOULD WE REGULATE PAYDAY LENDING, AND IF SO, HOW?**

Ineffective regulation is extremely costly to society and should be avoided. Situations involving failed markets, information asymmetry, and innumeracy—all of which are problems in the payday and other short-term lending industries—are ripe for regulation. The results of New Mexico-style legislation serve as a contraindication to their implementation, leaving open the question of what might actually work.

A. Classic Failed Market

Perfect markets are competitive.²⁵³ In the perfect market, many sellers offer substantially identical products, so it is easy to shop around and compare costs.²⁵⁴ There are also many buyers.²⁵⁵ All actors in the perfect market act to maximize their own financial well-being.²⁵⁶ There are no barriers to entry into the market by new sellers, and both buyers and sellers are well-informed.²⁵⁷ In a perfect market, supply and demand for products will level out and the price of goods will stabilize.²⁵⁸ The absence of any of these attributes is known as market failure.²⁵⁹

An imperfect market does not adjust in response to competition.²⁶⁰ Sometimes, this is because there is no meaningful competition.²⁶¹ This can occur when sellers create a monopoly or price-fix such that the market can no longer respond to normal supply and demand. Certain conditions create fertile ground for market failure. For example, collusion among sellers may create more profits than competition among sellers, creating temptation to collude rather than compete.²⁶² This temptation is stronger in young industries with few competitors, where buyers have difficulty shopping around on the basis of price.²⁶³ This is particularly true in industries where the primary choice of one seller over another is based on something other than price.²⁶⁴

The payday lending and other short-term lending industries are classic failed markets. The industry is young, having developed primarily in the 1990s. Thus, price competition is not yet necessary to create a strong market share. Rather, most lenders charge similar amounts for the same loan, typically the largest amount permitted by law. In addition, payday customers are not necessarily

253. Bertics, *supra* note 14, at 141.

254. *Id.*

255. *Id.*

256. *Id.*

257. *Id.*

258. *Id.*

259. *Id.* at 142.

260. Pearl Chin, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 740–42.

261. *See* Bertics, *supra* note 14, at 142.

262. *See id.*

263. *Id.*

264. Chin, *supra* note 260, at 742; Bertics, *supra* note 14, at 142.

sophisticated and, as Part III demonstrates, they typically do not understand the cost of these loans. Moreover, they do not shop around.²⁶⁵ Finally, a factor other than price—convenience—drives most borrower choices in this industry. Lenders are therefore able to charge more than they could if the customer shopped around, had perfect information, and understood the cost of this credit.

When market forces are functioning properly, economists disdain intervention in and regulation of markets.²⁶⁶ Even the staunchest libertarian would agree, however, that failed markets create a need for regulation. The current payday lending situation warrants legislation. Ohio State Representative William Batchelder, a conservative proponent of payday lending reform, describes the dilemma as follows:

I have always been a vocal supporter of free enterprise, and have opposed needless and burdensome regulation. However, these abusive practices are a threat to the free markets which are so critical to our state's prosperity. Adam Smith, the great prophet of free enterprise, believed there had to be limitations on interest in order to preserve a free market. What Smith would think of an APR of 300%, I cannot imagine.²⁶⁷

As Representative Batchelder acknowledged, the market has not driven down prices, nor is it likely to do so as the industry ages, since price does not enter into the calculus of most borrowers. The market failure is exacerbated by information asymmetry between the lender and the borrower, and the innumeracy of borrowers.²⁶⁸

B. Information Asymmetry and Innumeracy: 200% of Nothing

Part III of this Article demonstrated that payday and installment loan customers have difficulty understanding the meaning of the annual percentage rate disclosure and the total dollar cost of their loans. There are several reasons for this. First, lenders have far more information about how the loans work than customers do. They control the terms, so they can change the product and even the terms of existing loans. Whether this is designed to confuse customers or not, the result is the same: customers are at a considerable disadvantage. Second, the loans are

265. See Chin, *supra* note 260, at 742.

266. Benjamin D. Faller, *Payday Loan Solutions: Slaying the Hydra (and Keeping it Dead)*, 59 CASE W. RES. L. REV. 125, 139 (2008).

267. *Id.*; see also PARRISH & KING, *supra* note 42, at 22 (suggesting that the lack of state regulation in Texas is responsible for higher payday loan fees).

268. See Faller, *supra* note 266, at 139–40. As Benjamin Faller explains:

Lenders then take advantage of a borrower's financial predicament to trap them in a loan they cannot pay off. This inequality of power is yet another reason why market failure has occurred. It is also a key reason why well-off individuals and people in stable financial situations are not flocking to payday lenders in the same numbers as their less-advantaged counterparts. Consequently, we cannot rely on typical market forces to solve the problems associated with payday loans and must resort to regulatory solutions to accomplish the ends that the market cannot.

Id.

described in terms of a certain amount of fees per \$100 borrowed, which causes many consumers to believe the number—say \$15 or \$20 per \$100 borrowed—represents the annual percentage rate, not the rate for two weeks. Lenders know the truth. Most borrowers do not.

Information asymmetry is not the only problem customers encounter with these loans, however. Americans as a whole suffer from general financial illiteracy.²⁶⁹ This is especially true when the financial information at issue involves long disclosures full of unfamiliar vocabulary. In fact, the disclosures given in connection with consumer-finance transactions in general are of questionable utility.²⁷⁰ Consumers are overwhelmed by too much information in many legally required disclosures, and thus the disclosures do little if anything to educate them about the risk of credit products.²⁷¹ Additionally, consumers do not always read these disclosures.²⁷²

These data suggest that regulating the short-term loan industry through disclosure does not work. These disclosures may even be harmful to consumers. The fact that APR and other terms must be disclosed has led some lawmakers to think they have effectively regulated payday lending, when the reality is quite the opposite.

Math illiteracy, or innumeracy, is widespread.²⁷³ High school math skills in the United States are among the worst in the developed world. The United States also has the most complex, developed, and arguably unregulated, consumer credit market in the world.²⁷⁴ This perfect storm renders the average consumer a lamb to the slaughter for unscrupulous creditors. In his book *200% of Nothing*,

269. See Susan Block-Lieb, *Mandatory Protections as Veiled Threats*, 69 BROOK. L. REV. 425, 431 (2004) (“[I]f a significant portion of the U.S. population struggles to read and write in English on topics of general interest, then most certainly it will fail to comprehend descriptions of financial transactions that necessarily involve more complex concepts and vocabulary.”); see also A.K. DEWDNEY, *200% OF NOTHING: AN EYE-OPENING TOUR THROUGH THE TWISTS AND TURNS OF MATH ABUSE AND INNUMERACY*, v, 1 (Steve Ross & Emily Louse eds., 1993).

270. Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL’Y REV. 233, 261–62 (2002) (relying on recent data on illiteracy to argue that commonly used contract and disclosure forms are incomprehensible to most American consumers).

271. Elizabeth J. Keeler, *The Truth in Lending Simplification and Reform Act of 1980: Is “Simplification” Better for Both Consumer and Creditor*, 8 NOVA. L. REV. 175, 184–85 (1983) (discussing how consumers overwhelmed with information will fail to digest any of the disclosures); Jason Ross Penzer, Note, *Grading the Report Card: Lessons from Cognitive Psychology, Marketing, and the Law of Information Disclosure for Quality Assessment in Health Care*, 12 YALE J. ON REG. 207, 250 (1995) (“Critics of the original Truth In Lending Act charged that Truth in Lending disclosures overwhelmed consumers with too much complicated information and ultimately discouraged them from credit shopping.”).

272. Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* (Univ. Chi. Booth Sch. Bus., Working Paper No. 10-01, 2009), available at <http://ssrn.com/abstract=1532213>.

273. DEWDNEY, *supra* note 269, at 2.

274. *Id.*

A.K. Dewdney notes that, as a general matter, we are beset more than ever by abuses stemming from innumeracy.²⁷⁵ We become prey to “commercial chicanery, financial foolery, medical quackery, and even numerical terrorism.”²⁷⁶

While innumeracy plays a large role in the short-term loan crisis, the problem is not unique to the world of payday or other short-term loans. Credit cards and debit cards are other examples of products that consumers do not understand,²⁷⁷ as are mortgages.²⁷⁸ One study showed that less than one-third of Americans could explain or understand how the fees and interest are calculated on credit cards.²⁷⁹

Another study of adult innumeracy showed that while many individuals can perform simple arithmetic operations when both the numbers and operations are made explicit, they are unable to do so when these same operations are performed on numbers that must be located and extracted from different types of documents that contain similar but irrelevant information, or when these operations must be inferred from printed directions.²⁸⁰ Moreover, while innumeracy is rampant throughout American society, people who are less financially literate tend to pay higher interest on borrowed money.²⁸¹

275. *Id.* Dewdney states:

Literacy, after all, concerns a translation skill—learning to move easily between written and spoken speech. Numeracy concerns thought itself. You might exploit people’s innumeracy through an advertisement, for example, making a claim that seems to be valid but isn’t. But how would you exploit their illiteracy through an ad they can’t even read?

Id.

276. *Id.*

277. RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS (Andrew Brasher & Nick Bunch eds., 2006).

278. New rules require lenders to give borrowers a standard statement clearly showing all details, helping homebuyers avoid financial land mines and other nasty traps. James R. Hagerty, *Rules to Clarify Cost of Mortgages*, WALL ST. J., Dec. 31, 2009, at A2.

279. Annamaria Lusardi & Peter Tufano, *Debt Literacy, Financial Experiences, and Overindebtedness* 1, (Nat’l Bureau of Econ. Research, Working Paper No. w14808, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1366208.

280. Block-Lieb, *supra* note 269, at 438; IRWIN KIRSCH ET AL., NAT’L CTR. FOR EDUC. STATISTICS, TECHNICAL REPORT AND DATA FILE USER’S MANUAL FOR THE 1992 NATIONAL ADULT LITERACY SURVEY (2001), available at <http://www.nces.ed.gov/pubs2001/2001457.pdf>. Professor Block-Lieb analyzes this study in her article. The study, commissioned by the National Adult Literacy Survey found little difference among prose, document, and quantitative literacy. (“The three literacy scales—prose, document, and quantitative literacy—are relatively highly related . . .”). This is not to applaud the quantitative literacy of the respondents, however. Indeed, 22% of the respondents performed at Level One: “able to add numbers on a bank deposit slip, or to perform other simple arithmetic operations using numbers presented to them.” Another 25% of the respondents demonstrated Level Two quantitative literacy skills. “Individuals in Level 2 on the quantitative scale were likely to give correct responses to a task involving a single arithmetic operation using numbers that can easily be located in printed material.” Block-Lieb, *supra* note 269, at 438.

281. Block-Lieb, *supra* note 269, at 438–39.

The adult innumeracy study referenced above, and others like it, may explain why consumers have difficulty understanding the true cost of payday loans and other short-term debt.²⁸² Only 4% of the consumers in the adult innumeracy study were able to calculate the payments on a home equity loan.²⁸³ The cost of payday loan transactions may be even more complex than those of the home mortgage loans asked about in the adult innumeracy study. Based upon the study described in this Article, the actual cost of payday loans over time is not easily translated into an annual percentage rate, making it difficult for consumers to compare the cost of credit.

CONCLUSION

Our curbside empirical study of payday lending customers was designed to discover what brings customers into payday lenders, how customers choose their lenders, and how well customers understand the terms of the loans they request. Before we could actually interview customers and ask them about the terms of their loans, we needed to find out what terms lenders were actually offering. When we investigated the terms offered by the lenders, we learned that few of the lenders seemed to be complying with a new law passed in the state where the study took place. This information led us to a series of loopholes discovered by lenders in order to circumvent the new law. These loopholes became the story within the story, and now create a clear roadmap for states wishing to avoid meaningless payday loan legislation. As a result, this Article provides a detailed description of what not to do.

The findings in the curbside interviews, augmented by the office interviews, however, provide a strong case for why more meaningful legislation is desperately needed. A large percentage of payday customers seem to use payday or installment loans not for occasional emergencies, as the industry would have us believe, but to pay regular bills. At high rates of interest, these loans make it more difficult to make ends meet because the loan (or loans) actually increase the

282. *Id.* Concrete examples of the sorts of quantitative tasks pertaining to the various literacy levels measured by the above referenced adult innumeracy study illuminate the difficulties American consumers must experience when engaging in household commercial transactions. *Id.* at 439. For example, “one task required the reader to locate the appropriate shipping charges in a table before entering the correct amount on an order form and calculating the total price for ordering office supplies.” *Id.* The tasks were given a level number, indicating their difficulty. This task was assigned a scale value of 270, or Level Two. “A score of 312, or Level 3, was assigned to a table of money rates that asked the reader to determine how much more interest would be earned in money market accounts provided by mutual funds than in those provided by savings and loan associations.” *Id.* “One of the most difficult quantitative tasks the survey asked readers to perform involved reading a newspaper advertisement for a home equity loan and explaining how they would calculate the total amount of interest charges to be paid.” *Id.* It asked respondents to imagine they needed to borrow \$10,000, and asked them to find the advertisement for a home equity loan in a provided newspaper. It then asked participants to explain to an interviewer how she would compute the total amount of interest charges due under this loan plan, where the terms offered were a 14.25% fixed-rate mortgage under various payment options. Only 4% of the study respondents were able to successfully complete this task. *Id.*

283. *Id.*

borrower's ongoing expenses. The data show that many customers have low-cost or no-cost options but use payday loans instead because they are more convenient and less embarrassing than some of the alternatives. These data suggest that having an unlimited supply of payday loans available hurts rather than helps customers in the long run.

The data further suggest that payday and installment loan customers generally do not shop around for price when taking out a loan, but rather pick their lender based upon location or the recommendation of a friend or family member. This creates a classic market failure, and thus a need for effective regulation.

Finally, the data show that customers have a difficulty understanding the dollar costs of these loans, stating the annual percentage rate, or comparing the cost of this credit to other forms of available credit. Some even believe that these loans are cheaper than credit cards or even student loans. Innumeracy—or the inability to do math—is partially responsible for these mistaken beliefs, and is not unique to payday lending customers.²⁸⁴ Most of us suffer from innumeracy to some degree, and the evidence of innumeracy here supports the need to regulate these loans, despite the contention that doing so is deeply paternalistic.

One thing this Article does not do is describe the legislation that might be meaningful in this context. A federal interest rate cap is one possible solution to the short-term loan problem, particularly in light of the failure of New Mexico-style regulation to meaningfully effect short-term loan practices in the state. The industry's ability to evade more detailed and invasive laws, as well as states' inability to efficiently regulate all products at once, may make rate caps that apply to all loans one of the few truly effective methods of regulation.²⁸⁵ This question of what solution will ultimately work is worthy of further scholarly discussion.

284. For example, the Author recently had a very hard time convincing a newspaper reporter that \$15 per \$100 for fourteen days was *not* 15% per annum.

285. See Johnson, *supra* note 148, at 43.

APPENDIX

We interviewed 109 payday or installment loan customers using the following survey:

DATE:

Lender Zip Code:

Respondent ID #:

Lender ID:

Greetings! I am a law student at UNM and am working on a study of payday lending. We are offering \$10 or a \$10 gift card in exchange for a ten minute interview. Would you like to participate?

The interviews are anonymous and all you need to do to qualify is to have gotten a payday loan or installment loan here in the last month.

Introduction

Did you get a payday loan or Installment loan? (Y/N)

Which type? (Plus approx. date of loan.)

First, I'm going to ask a couple background questions

D1—What is your zip code at your home address?

D2—What is your work zip code?

Q1—What brought you to this payday lender *when you got the loan*? Write it down verbatim. (If they just say “needed money” or “bills,” ask for what.)

Q2—If you had been unable to get a payday/installment loan today, what would you have done instead. In other words, what would have been your next best alternative?

A4—Did you consider getting this money from another source besides a payday lender? Which? (Maybe ask bank, family member, credit card, pawn shop, employer for an advance on pay?)

A4.5—Why did you decide to take out a payday loan instead?

Next, I have a few questions about the loan that you got

L1—How much cash did you take away/borrow (in dollars)?

L2—How many days before you are expected to pay it back?

L3—Do you know how much you can expect to pay in fees and/or interest?

L4—Do you expect to be able to pay it back within this time frame? How much?

The next couple questions are going to involve a little bit of math

L5—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a *month*? For example, do you know the total amount you would be charged in fees and extra charges? How much?

L6—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a *year*? For example, do you know the total amount you would be charged in fees and extra costs? How much?

L7—Have you heard the term “annual percentage rate?”

L8—Many people don’t know the answer to the next question, but if you do, would you tell me what the annual percentage rate for this loan is?

A few questions about your past experience with payday loans

P1—Payday loans are becoming more and more common. Can you recall how many payday loans, total, you have taken out, say in the past *two years*?

P2—Including the loan that you took out this time, what is the total dollar amount of all payday loans you currently have outstanding now?

Principal owed:

Interest/fees owed:

A few questions about how you chose this lender and this type of loan

A1—Have you used this lender before?

A2—How did you hear about this lender?

A3—Do you remember why you decided to borrow from this particular lender?

L6—Before taking out this loan, did you look into borrowing money from another payday lender instead? If not, why not?

A5—Do you have a credit card? If answered NO to A5, SKIP to E1.

A6—Do you know what the interest rate is on your credit card or cards? How much?

A7—Are your credit cards maxed out?

A8—If no, could you tell me about how much credit you still have available on your cards? For example, how much more could you charge on them without going over the limit?

A9—Why did you choose to take out a payday loan rather than charge (item) to your credit card or get a cash advance?

A few questions about what the payday lender has told you

E1—Were you offered an installment option (e.g. payment plan), a payday loan, or both?

E2—(If offered installment) What, when, and how are you supposed to pay the installment plan back, if you know?

E3—(If offered payday) Did the clerk tell you that you have the right to cancel the payday loan at no charge any time before 5:00 pm on the next business day?

A few questions relating to compliance with the new New Mexico law

S1—A new law here in New Mexico protects consumers by limiting the percentage of their income that can be tied up in repaying payday loans.

Can you tell me about how much money you earned/took home last month?

S2—What is your estimated hourly pay rate? Or salary if no work by the hour? Or social security by the month?

S3—Last week, how many hours did you work?

Finally, just two questions about collection attempts and payday loans

R1—Have you ever been late or past due on repaying a payday loan?

R2—How did the lender follow up? In other words, if they called you, what did they say? Or if they sent a letter, what did it say? Or were there any other types of actions from your lender?

Conclusion

That is the end of my questions. Do you have any questions for me about this research?

Would like to share any other thoughts about your loans or about the interview process?

Here is your compensation, thank you very much for helping us with our research.

Thanks and take care!