

REINVESTMENT ALERT

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New Terms for Payday Loans: High Cost Lenders Change Loan Terms to Evade Illinois Consumer Protections

Payday lending in Illinois continues to prosper despite administrative rules adopted by the state in 2001 to curb the industry's most abusive practices. New products designed to evade these state regulations remain attractive to many customers because they offer a quick solution to temporary cash flow problems. These new high cost loans, however, continue to allow many of the abusive features that the state's rules intended to eliminate. Since the passage of these regulations, payday lending has evolved its product line and increased the scope of its lending. Virtually unheard of in the early 1990s, there are currently over 22,000 payday loan stores nationwide with loan volume of \$40 billion. In 2003 alone, the industry generated about \$6 billion in loan fees.¹ In Illinois, the number of stores offering payday loans has increased by nearly 12 percent since 2002.

Borrowers can use a payday loan to pay for car repairs, medical expenses, or other emergencies and then repay it when they receive their next paycheck. Consider M., a borrower whose emergency made a payday loan his only option. "I needed to have my brakes fixed right away, right away. They were like, grinding really, really bad. I could not wait until next week until I got paid," says M. For borrowers like M., a short-term loan from a local storefront payday lender offers a quick solution to a temporary cash flow problem.²

Despite this lure of quick cash, the costs of payday lending are significant. In Illinois, where no usury laws exist, the cost of a payday loan can be as high as 45 percent of the amount borrowed for a 31 day loan. Each loan can be renewed or rolled over with the payment of an additional fee. However as the number of rollovers grows, the cost of the loan increases. For instance, for a 31-day loan if a consumer borrows a \$100, the total loan cost is \$145 for an APR of 529 percent. A \$100 loan that is rolled over for an additional 31 days, for a total of 62 days, will cost a total of \$190 and a second 31 day rollover costs of \$235, with APRs of 1,059 percent and 1,589 percent respectively.

Even with these high costs, payday loans are made without regard to a borrower's ability to pay because there is minimal underwriting required. Borrowers only need to prove current employment and have a valid checking account. There are no credit checks. Lenders typically will hold a postdated check until the loan is paid or until the check is cashed. In some cases, borrowers will allow lenders to directly debit a bank account.

¹(Lewis. 2004).

²(Monsignor John Egan Campaign for Payday Loan Reform. 2004).

In an attempt to limit some of the industry's worst practices, new Illinois payday loan reforms were established in August 2001. The regulations were advocated by Woodstock Institute and the Egan Campaign for Payday Loan Reform, a statewide coalition that advocates for new Illinois payday loan policies with strong consumer protections. The 2001 regulations corrected some of the worse abuses of the payday loan industry at that time. These regulations were established, according to the Illinois Department of Financial Institutions (DFI)³, to "prevent consumers from over-borrowing, borrowing more than their income would allow them to repay, and being captive to the lender through perpetual refinancing."⁴ The reforms cover loans with a term of 30-days or less:

- Borrowers are only allowed one payday loan at a time.
- The maximum payday loan is the lesser of \$400 or 50 percent of the borrower's gross income.
- A payday loan can be rolled over a maximum of two times, but only when the outstanding balance of the loan has been reduced by at least 20 percent.
- Borrowers must observe a cooling off period of 15 days between each new loan.

Although the new regulation was a major step forward in efforts to curb abusive payday loan practices, it has several shortcomings. First, the regulation does not address the fees or APR of payday loans in Illinois. Currently, the APR of payday loans is still over 520 percent.

Second, the regulation has not been fully implemented. DFI has not established a database of payday loans that would be used to enforce the new regulations. As a result, DFI regulators have no way to determine the number of loans taken out by a borrower at one time or if the cooling off period has been observed. Payday lenders currently rely on a statement from borrowers asserting that they do not have multiple payday loans or have not had a loan within the preceding 15-days.

Third, and most importantly, the impact of the new regulations on payday lending has been more limited than expected. The payday loan industry responded by developing a product that circumvents the new regulations by creating a loan with a term greater than 30 days.

This report describes changes in the Illinois payday loan industry since the new regulations were enacted. It is partly based on data collected by DFI on the Illinois payday loan industry in 2002. However, that data was not released until March 2004. The report includes:

- A description of the new payday products developed by industry
- An analysis of payday loan lenders
- A breakdown of borrower demographics
- Recommendations to improve current Illinois payday loan policies

³DFI is the state agency authorized to regulate payday lenders.

⁴(State of Illinois Department of Financial Institutions. 2003).

Description of New Illinois Payday Loan Products

Thirty-One Day Loans

As mentioned above, the Illinois payday loan industry developed a new payday loan product in order to evade the 2001 regulations that applied to loans with terms of 30 days or less. As a result, these lenders are no longer subject to short-term loan rules and are essentially an unregulated industry. According to a 2003 study by DFI, only about 3 percent of loans are subject to the 2001 regulations.⁵ As noted in Table 1, there are currently no limits to what Illinois payday lenders can charge in fees and interest rates for 31 day loans. A borrower typically pays \$45 per every \$100 borrowed for a 31 day loan at an APR of 529.83 percent.⁶ Although borrowers have the option of prepaying the loan and reducing the finance charge, this is rarely the case.

Table 1
Comparison of Illinois 30 Day Payday Loan Regulations
and 31 Day Payday Loan Offered by Industry

	Fee Restrictions	Fees	APR	Loan Limit	Debt/Income Ratio	Rollover/Renewal Limits	Rollover/Renewal Restrictions	Cooling Off Period
Illinois 30 Day Payday Loan Regulations	N.A.	\$40/\$100 for 28 days	521.4%	\$400	50%	2	Reduce Principal by 20%	15 days
Illinois 31 Day Payday Loan Product	N.A.	\$45/\$100 for 31 days	529.8%	None	None	3	None	None

In addition to costs, other principals of the regulations are being violated. First, borrowers are not paying off their loans within the term of the loan and therefore the loans continue to roll over. DFI has enacted a number of conditions limiting a licensee's authorization to conduct business under the Consumer Installment Loan Act, such as limiting roll-overs to 3 or less.⁷

However, in 2002, almost 70 percent of all loans were rollovers, most of which did not include a reduction in the principal amount of the loan. The average number of rollovers for a 31 day loan is 2.5 for 78 days. Further, the amount of loans outstanding has increased and there is no cooling off period between loans. DFI reports that it is "quite common for borrowers to have multiple payday loans outstanding with several different payday loan companies."⁸ The major reason for this is that the database, which would have enabled payday loan lenders to determine how many loans a borrower has outstanding at one time, was never established by DFI.

⁵(State of Illinois Department of Financial Institutions. 2003).

⁶(State of Illinois Department of Financial Institutions. 2003).

⁷State of Illinois Department of Financial Institutions Other Business Authorization Conditions pursuant to §205 ILCS 670/12.

⁸(State of Illinois Department of Financial Institutions. 2003).

Installment Loans

The Illinois payday loan industry began marketing short-term installment loans in 2001 after the new regulations were established. Unlike payday loans, installment loans amortize both principal and interest payments. The loans range from \$690-\$1,500 and have terms up to nine months. The payment for a \$1,000 loan is \$81 per paycheck (every 14 days) for nine months. A \$690 loan requires a payment of \$56 per paycheck for nine months. The APR is 112 percent.

Installment loans are underwritten similarly to 31 day payday loans. There is no credit check. However, borrowers are required to have a minimum net income of \$300/week and must be employed for at least three months. In addition, borrowers must present past pay stubs, phone bills, and two other utility or department store bills, and a valid Illinois Driver's license or state identification.

Payment terms of installment loans are dependent on how the borrower's salary is paid. For borrowers enrolled in direct deposit programs with their employers, loan payments are automatically deducted from the borrower's paycheck. Borrowers without direct deposit are also eligible for installment loans. However the terms are less flexible. Their employer must be willing to issue two checks as a condition of the loan: one check is made payable to lender for payment of loan and interest and a second check is made out to borrower for their net salary (less loan payment).

DFI licenses and regulates installment loan providers under the Consumer Installment Loan Act (CILA). CILA addresses loans with a maximum principal of \$25,000 and loan terms of no more than 181 months. Its primary purpose is to limit delinquent and collection charges. Unfortunately, CILA provides very few other consumer protections and therefore imposes very few limitations on installment loans. DFI does not provide any public information on the Illinois installment loan industry.

Analysis of Payday Lenders

There were 908 short-term loan stores in the State of Illinois in 2004. Of these locations, 185 offered both payday and auto title loans.⁹

There is a significant concentration of ownership of payday loan and auto title stores. Five companies (out of 118) own almost 37 percent of the branches. Further, the top 20 companies own 77 percent of all branches.¹⁰

Despite arguments to the contrary, the payday loan industry targets lower-income and minority communities and consumers. DFI found that the lower-income counties are more likely to have the highest density of payday lenders than higher-income counties.¹¹

⁹Auto title loans: allows a car-owner to use a title to their car to secure a loan. The amount of the loan is usually a percentage of the value of the vehicle. If the consumer falls behind on the monthly payments, the car is at risk of repossession.

¹⁰(State of Illinois Department of Financial Institutions. 2003)

¹¹(State of Illinois Department of Financial Institutions. 2003)

Table 2
Illinois Payday, Title, and Limited Purpose Branches 2002-2004¹²

Type of Licensee	Number of Licensees		Percent Increase 2002 to 2004	Percent of 2004 Market
	2002	2004		
Payday	423	442	4.5%	48.7%
Title	31	43	38.7%	4.7%
Payday and Title	165	185	12.1%	20.4%
Limited Purpose Branch	194	238	22.7%	26.2%
Total	813	908	11.7%	100.0%

Woodstock Institute also conducted an analysis of payday loan stores in the 6-county Chicago region. The analysis, which is summarized in Figure 2, found that low- or moderate-income communities or communities with a majority minority population have a higher rate of payday loan stores.¹³

Figure 2 shows the number of payday loan stores per 10,000 in population by income and race of community. Middle- and upper-income minority census tracts have the highest rate of stores at 1.6 per 10,000 population. This is followed by white low- or moderate-income and minority low- and moderate-income census tracts, with rates of 1.2 and 0.8 respectively. The lowest number of stores per population is in non-minority, higher income census tracts with a rate of only 0.5 stores per 10,000 in population.

Demographics of Payday Loan Borrowers

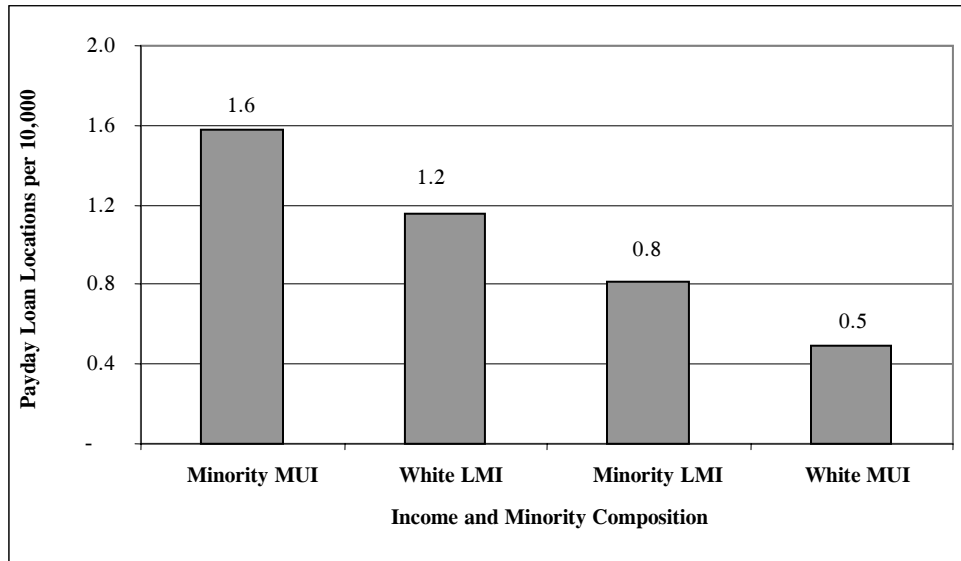
Unfortunately, there is very little publicly available data on payday loan borrowers. A previous Woodstock Institute analysis, published in March 2000, was based on a study conducted by the Illinois DFI at the request of the General Assembly.¹⁴ That study provided extensive data on the income and other characteristics of payday loan borrowers as well as the zip code of the store where they obtained their loan. The 2000 report found that most payday loan borrowers had low- to moderate-incomes. The average income of the borrowers in 2000 was \$23,690 and 19 percent of the borrowers earned less than \$15,000. Only 12 percent of the borrowers earned \$40,000 or more annually. In addition, borrowers from lenders located in zip code areas with higher minority populations had more loans than borrowers in mostly white areas.

¹²Analysis of State of Illinois Department of Financial Institutions Consumer Installment Loan data.

¹³Substantially minority census tract: census tracts where the total minority population is more than 50 percent of the total population.

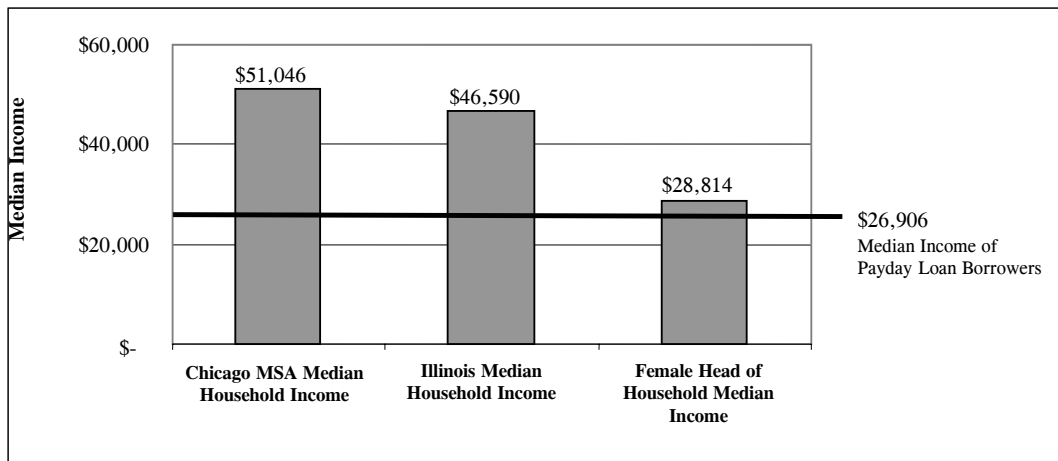
¹⁴(Wiles and Immergluck. 2000).

Figure 2
Payday Loan Stores per 10,000 Population 2004



The 2002 DFI analysis reports similar income statistics. From 2000 to 2002, the average income of payday loan borrowers increased less than \$3,000 to \$26,906. Figure 3 shows the median-income of Chicago area consumer households as compared to the average income of payday loan borrowers. The average income of payday loan borrowers is significantly lower than the Chicago and Illinois median household incomes as well as the income of female heads of household in Illinois.

Figure 3
Median Incomes of Consumers Compared to Payday Loan Borrower Incomes



There is evidence that payday loan borrowers are habitual, multi loan borrowers. The 2000 Woodstock Institute report noted that, for many borrowers, payday loans are not occasional short-term loans. In fact, the average number of contracts per borrower was 12.6. More than half (52 percent) of the borrowers had more than 10 contracts, and more than one-third of the borrowers had more than 15 contracts.¹⁵ This is further supported by the 2002 DFI analysis. From 1999 to 2002, the average age of payday loan borrowers aged by 2-3 years. DFI acknowledged that this “could indicate that many of the borrowers from 1999 are the same borrowers in 2002.”¹⁶ Some consumer protections advocates note that the aging of payday loan borrowers may indicate that the market has become saturated, and point to new products, such as the installment loan, as a way to continue industry expansion.

Recommendations

The Illinois payday loan industry remains effectively unregulated. There are currently no limits on fees and interest rates, terms, or other loan characteristics. At APRs of over 500 percent and onerous features, it is no wonder that payday loan borrowers become mired in an endless spiral of debt.

Reforms are crucial to safeguard Illinois consumers from these predatory loans. These products are offered as a simple solution to a short-term financial crisis, when in reality they leave workers with hundreds, and even thousands of dollars of unpaid debt and sometimes financial ruin.

Woodstock Institute and the Egan Campaign for Payday Loan Reform have developed the following principles for a new payday loan policy:

Loan Definition: The definition of the loan needs to be sufficiently broad to encompass current or future products that may be offered by the Illinois payday loan industry. It may include short-term loans that are secured by a postdated check, a wage assignment, or pledge against a consumer’s bank account.

Loan Amount: The amount of payday loans should be indexed to the borrower’s income.

Limits on Rollovers: Rollovers are a prime reason for spiraling consumer debt and must be limited to two with a reduction of loan principal at each renewal.

Cooling Off Period: To allow a consumer time to stabilize their finances between loans, a cooling off period of at least 15 days should be established.

Fees: Payday loans are high cost. Borrowers should not be subject to usurious fees because they need a short-term loan. Therefore, a flat fee per \$100 borrowed should be instituted. It is also important to limit any hidden fees, such as high costs for returned checks.

Payment Plan: Payday loan debts are often difficult to repay without forgoing rent, groceries, or other basic necessities. Consumers that are unable to pay the entire principal of a payday loan at one time should be given the option of arranging a payment plan.

¹⁵(Wiles and Immergluck. 2000).

¹⁶(State of Illinois Department of Financial Institutions. 2003).

Consumers Protections: A database that can be used to verify rollover limits and cooling off periods is mandatory. Other consumer protections include the distribution of information on credit counseling and debt management services as well as how to file a complaint.

Public Data: The Illinois DFI does not regularly report information on the payday loan industry. It should be required to issue an annual report that describes the number of loans made, loan terms, and information on borrowers.

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