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Scott Andrew Schaaf

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From Checks to Cash: The Regulation of the Payday Lending Industry

I. INTRODUCTION

The payday lending industry has experienced explosive growth since its emergence in the early 1990's, with the number of payday lending stores nationwide estimated at 7,000 outlets. By the end of 2002, the industry is expected to annually generate 180 million transactions, $45 billion in gross check volume, and $6.75 billion in fees.


3. Payday lending was started by two companies in the “cradle of payday lending,” Cleveland, Tennessee. Jerry L. Robinson, Stephens Inc., Payday Advance—The Final Innings: Standardizing the Approach 3 (Sept. 22, 2000) available at http://www.stephens.com. However, there are historical precedents to payday loans. John P. Caskey, Fringe Banking: Check-Cashing Outlets, Pawnsops, and the Poor 31 (1994). At the turn of the century, many states had “highly restrictive usury laws” that prevented many “small-loan companies from operating.” Id. To evade these laws, some “unlicensed dealers began to structure their consumer loans as ‘salary-purchase’ agreements” Id. “In such an agreement, the lender ‘buys' the borrower’s wage at a discount in advance of the borrower's payday.” Id. at 32. Lenders argued that these loans did not fall under usury laws, but the Uniform Small Loan Laws were soon adopted by many states. Id. This law defined salary buying as cash lending, which made them subject to small loan regulations. Id.

4. Robinson, supra note 3, at 5. Check Into Cash, Inc., which is based in Cleveland, Tennessee, opened its first outlet in 1993 and now has more than 300 outlets in fifteen states. Fox, supra note 1. The company reported revenues of $21.4 million in 1997 and almost exceeded that amount in only the first half of 1998. Id. Other large payday lending chains include National Cash Advance and Check & Go. Id. Ace Cash Express, Inc., based in Irving Texas, is the largest chain of check cashing outlets in the nation, operating 725 company-owned stores and 100 franchise stores in 29 states. Michelle Samaad, Payday Loans—an Expensive Choice for Borrowers With No Options, at http://www.bankrate.com/brm/news/chk/19981215.asp (Dec. 15, 1998). Ace's 1997 payday loan revenue of $10.1 million was double the volume of business in 1996. Id.
billion in fee volume. Industry data indicates that payday lending is heavily concentrated in six southern states: Half of the outlets reported by the Financial Service Centers of America (FiSCA) are in Kentucky, Tennessee, Missouri, Mississippi, North Carolina, and South Carolina.°

The large growth of the payday lending industry can be attributed to the deregulation of the banking industry, the absence of traditional small loan providers in the small-sum, short-term credit market, and the elimination of interest rate caps. In the 1980's, banks eliminated money-losing services, which left millions of low-income households with little access to financial services. Payday lenders filled the void in the small loan market left by mainstream institutions that had moved out of this area of the

5. JERRY L. ROBINSON & GERALD L. LEWIS, STEPHENS INC., THE DEVELOPING PAYDAY ADVANCE BUSINESS, 9 (Sept. 28, 1999), available at http://www.stephens.com. This potential market would include 25,000 outlets. Id. at 8. Payday lending outlets “tend to operate in heavily trafficked urban and suburban areas, usually with large concentrations of low and moderate income individuals.” Lesly Jean-Paul & Luxman Nathan, Check Cashers: Moving from the Fringes to the Financial Mainstream, COMMUNITIES AND BANKING (Federal Reserve Bank of Boston, Boston, Mass.), Summer 1999, at 4, available at http://www.bos.frb.org/comaff/pdf/summer99.pdf. Since they depend on volume, they are usually located near busy intersections, in strip malls on major roads, or near large service industry employers. Id.


7. Special Issue: Check Cashers, Pay Day Loans and Pawns, 16 NCLC REPORTS, CONSUMER CREDIT & USURY EDITION, Jan./Feb. 1998, at 14 [hereinafter Special Issue].

8. Id. With the deregulation of banking in the 1980's, banks were forced to pay market interest rates to attract large deposits. CASKEY, supra note 3, at 88. This caused banks to “eliminate money-losing” services that they had previously offered their customers. Id. Banks commonly did so by “introducing minimum balance requirements and raising fees on small accounts.” Id. at 88. “Between 1977 and 1991, the percentage of banks that offered free checking accounts fell from thirty-five percent to only five percent.” Id. at 89. In some parts of the country, bank closings left some communities essentially bankless. Id. at 90-97. Many large banking institutions “prefer not to write small loans, not only because the return on a $5,000 loan is greater than if only $500 is borrowed, but also because the originating and servicing costs are not significantly different.” Special Issue, supra note 7, at 14. Without these relatively small unsecured loans, and in the absence of adequate credit card limits and overdraft protection, many borrowers no longer have access to traditional sources of small loans. Id.
market due to higher returns on larger loans.9 The payday lending industry has now progressed past its initial start-up stage and has grown into a serious business with a meaningful product line.10

This Note addresses payday lending and the policy issues surrounding the regulation of the payday lending industry. Part II explains the mechanics of payday lending and the reasons why this type of loan is attractive to borrowers.11 Part III examines the consumer protection concerns surrounding payday lending.12 Next, in Part IV, this Note explains the payday lending industry’s response to these concerns.13 Part V analyzes the federal and state regulation of payday loans, using North Carolina as a model.14 Finally, in Part VI, the success of the current patchwork of regulation surrounding payday lending is examined, along with potential changes in the government and market response.15

II. THE MECHANICS OF A PAYDAY LOAN TRANSACTION

The mechanics of a payday loan transaction are fairly simple. Typically, “a borrower writes a personal check payable to the lender for the short-term loan amount” he or she wishes to borrow, plus a fee.16 Such fees are “typically a percentage of the face value of the check or a fee per $100 loaned” to the customer.17 For example, consider the borrower who writes a check for $115 and who receives $100 and a promise that the check will not be cashed until the borrower’s next payday.18 The actual cost of the

9. Special Issue, supra note 7, at 14. Check cashing companies were looking for more business since more people were being paid by direct deposit and there were fewer checks to cash. MICHAEL A. STEGMAN, SAVINGS FOR THE POOR: THE HIDDEN BENEFITS OF ELECTRONIC BANKING 67 (1999). Also, the number of people with damaged credit is rising, thus creating more demand for payday loans. Id.
11. See infra notes 16-40 and accompanying text.
12. See infra notes 41-66 and accompanying text.
13. See infra notes 67-104 and accompanying text.
14. See infra notes 105-168 and accompanying text.
15. See infra notes 169-213 and accompanying text.
16. Fox, supra note 1.
17. Id.
The lender and the borrower know that sufficient funds to cover the check are not available when the check is tendered. Fox, supra note 1.

19. Show Me the Money!, supra note 18, at 3.

20. Id.


22. Show Me the Money!, supra note 18, at 3.

23. Id.


25. The “unbanked” are individuals who do not use mainstream bank accounts to handle their personal finances. See CASKEY, supra note 3, at 84-90. These people are prime users of fringe banking services. Id. Nationwide, an estimated thirteen percent of U.S. families currently have no bank accounts. STEGMAN, supra note 9, at 7. One in four renters, one in six of those under thirty-five years of age, and fifteen percent of the working poor do not have checking accounts. Id. at 8. One reason for the lack of bank accounts might be the fact that banks are charging for services that they used to subsidize. Id. at 3. Banks now meet their bottom lines more by charging fees for specific services than by the interest spread from deposits and making loans. Id. By October 1997, thirty-five percent of the total revenue of U.S. banks came from fees, almost double the proportion in 1980. American Banks: The Good Times Keep on Rollin’, ECONOMIST, Oct. 25, 1997, at 83.

26. Jean Ann Fox, supra note 1. Stephen Brobeck, the executive director of the Consumer Federation of America, cites the fact that more than half of African-American and Hispanic households either have no accounts or very small deposits with banks, thrifts, or credit unions. Survey Shows Check Cashers are Cashing In Low Income Americans being hit by High Fees, Aug. 26, 1997, at 1, 1197 WL 11324478. Military serviceman are particularly vulnerable to the lure of payday loans. Forum on Short-Term High-Interest Paycheck Advances, convened by Sen. Joseph Lieberman, ranking minority member, U.S. Senate Comm. on Governmental Affairs, at 2 (Dec. 15, 1999) (written testimony of Capt. Robert W. Andersen, Naval
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Usually, no credit check is run in these transactions, and payday loans are not reported to credit bureaus. Potential borrowers are eligible for payday loans if they have a checking account, a steady job, and no history of writing bad checks. The typical borrower is not only living paycheck-to-paycheck, but is also borrowing against their next paycheck to meet current expenses. Consumers seeking these short-term, small loans find that banks no longer make them; since many of these consumers do not qualify for a credit card, they are forced to go elsewhere to satisfy their credit needs. The customer base for payday loans is largely comprised of individuals and families in the $25,000 to $40,000 annual household income level, who borrow on the average of $200.

27. Jean-Paul & Nathan, supra note 5, at 11. However, payday lenders do use data base companies, such as TeleTrack, to screen out risky borrowers. Fox, supra note 1.


29. Fox, supra note 1. Many argue that these increases in credit opportunities are not helping consumers. Unregulated Payday Lending Pulls Vulnerable Consumers Into Spiraling Debt, supra note 2, at 1. The Federal Reserve Bank of St. Louis found that during the third quarter in 1998, household debt was growing at an annual rate of 8.3 percent, and the total—$5.846 trillion—represented a new high. Lisa Fickenscher, Fed Analyst: People's Debt Grows Faster Than Income, AM. BANKER, Feb. 1, 1999, at 10. As this debt has increased, personal savings are decreasing. Lisa Fickenscher, Bankruptcies Fall; Warning Flags Still Fly, AM. BANKER, Apr. 15, 1999, at 1. More than forty percent of all U.S. households had less than $1,000 of liquid assets in 1995, a problem which is getting progressively worse. Id.

30. Show Me the Money!, supra note 18, at 2. "Families that do not maintain savings often have bad credit records or debt to income ratios that exclude them from mainstream sources of credit." CASKEY, supra note 3, at 6. These families do not have a safety net; even short-term disruptions in family earnings or unforeseen expenses can interfere with their capacity to pay outstanding debt. Id. In addition, families without financial savings often must pay more for basic financial services. Id. at 7. This leads to a system "where the affluent are served by federally insured and regulated banks while poor and moderate-income consumers are left to expensive and, in most states, poorly regulated fringe bankers." Amy Baldwin, Check Cashers Unchecked Firms Offer Ready Cash, Charge Clients Dearly, LEXINGTON HERALD-LEADER, (Lexington Ky.) Oct. 19, 1997, 1997 WL LEXHRLD-L, at AA.

31. JERRY L. ROBINSON & GERALD L. LEWIS, STEPHENS INC., THE EMERGING BUSINESS OF DEFERRED PRESENTMENT, at 3 (Apr. 1, 1999) (on file with N.C. BANKING INST.). However, other surveys produced different figures. Wiles & Immergluck, supra note 2, at 6. In a survey done by the Illinois Department of Financial Institutions, the median annual income of the borrowers surveyed was $23,690. Id. The income group represented the most in the survey was $15,000 to
Consumers in this income range generally have difficulty paying for unexpected expenses and emergencies.\(^3^3\)

Why do consumers use the payday loan service? Some commonly cited reasons include the speed of the service, the ease of the transactions, the convenience, the personal service, and the lack of viable alternatives.\(^3^4\) Since the typical payday borrower's savings are minimal, they tend to value loans with the fastest liquidity possible.\(^3^5\) Consumers are often convenience driven, not price driven, when choosing immediate consumption over delaying consumption.\(^3^6\) They value immediate access to their cash or to a payday loan, and therefore find check cashing and payday outlets more useful than traditional banking products.\(^3^7\) Also, many payday lending outlets are open significantly longer than banks.\(^3^8\) The payday lending industry says that another reason consumers utilize these loans is that they are less expensive and more desirable than writing insufficient fund checks.\(^3^9\) The twenty to twenty-five dollar fee charged by most banks for writing bad checks, plus the fee charged by the merchant, generally exceed those charged by a payday advance company.\(^4^0\)

\(^{32}\) Payday Lenders Adopt “Best Practices,” Seek to Play Role as Mainstream Creditors, 75 Banking Rep. (BNA) 749 (Dec. 11, 2000) [hereinafter Payday Lenders Adopt Best Practices].

\(^{33}\) Robinson & Lewis, supra note 31, at 4. The most commonly cited reasons for utilizing the payday loan service are car repairs and medical bills. \(\text{id}\).

\(^{34}\) Id. at 4-5. Many borrowers have a limited fluency in English and find that many bank staff members not fluent in their native language. Jean-Paul & Nathan, supra note 5, at 9. In contrast, most staffs at most check-cashing businesses “tend to be representative of the local community’s ethnic composition.” \(\text{id}\). This factor adds to the familiarity, comfort, and general ease in the transaction. \(\text{id}\).

\(^{35}\) Id. at 8.

\(^{36}\) Robinson & Lewis, supra note 5, at 5.


\(^{38}\) Id.

\(^{39}\) Id. at 5. Critics of the industry find this argument unconvincing because generally most people do not write bad checks when they are short on money. Lynn Drysdale & Kathleen E. Keest, The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today’s Society, 51 S.C. L. REV. 589, 606 (2000).

\(^{40}\) Robinson & Lewis, supra note 31, at 5. For example, if a consumer wrote a $200 check that bounced (and the bank would not honor it), he/she would be charged $25 by both the bank and the merchant. Robinson & Lewis, supra note 5, at 7. If the consumer redeems the check from the merchant in five days, the fees ($50) would
III. CONCERNS REGARDING PAYDAY LENDING

The proliferation of payday lending indicates that there is a significant demand for short-term credit to manage the cash flow problems of people with low-incomes. These products help customers who are facing financial emergencies and have nowhere else to go; however, the customer’s extreme need is exactly what gives the lender greater leverage. As such, payday lending raises several consumer protection concerns which should be addressed.

First, the interest rate for a payday loan is seen as excessive by many governmental and consumer groups. Because these loans have such short terms to maturity, the cost of borrowing, expressed as an APR, is very high. Consider this hypothetical: an apartment renting for $500 a month is clearly cheaper that one renting for $500 a night. Disclosing the real long-term cost of the transaction would empower the consumer to compare its relatives disadvantages against alternative financial resources. In addition, the short-term nature of the loans adds to the credit risk since the borrower is typically obligated to pay the full amount of principal and fees within a short period of time, usually two weeks.

Second, there is concern that borrowers are becoming dependent on payday loans due to the availability of rollovers. The rollover issue is, and will continue to be, the “Achilles’ heel of

translate to an APR of 1,800%. Id. This APR should be compared to a payday loan APR of 411% Id.

41. Memorandum from Richard M. Riccobono, Deputy Director of the Office of Thrift Supervision, to Chief Executive Officers, at 1, at http://www.ots.treas.gov /docs/25132.pdf (Nov. 27, 2000) [hereinafter OTS Memorandum].

42. Drysdale & Keest, supra note 39, at 662. One judge wrote in his opinion that within “the power of the lender to relieve the wants of the borrower lies the germ of oppression.” Aldens, Inc. v. Miller, 466 F. Supp. 379, 384 (S.D. Iowa 1979).

43. See Fox, supra note 1; Show Me the Money!, supra note 18. “Payday loans are just the latest version of the age old story in America that the ‘poor pay more” because these lenders “capitalize on poverty.” THE COMMUNITY REINVESTMENT ASS’N OF N.C. AND THE CENTER FOR COMMUNITY CAPITALISM, TOO MUCH MONTH AT THE END OF THE PAYCHECK: PAYDAY LENDING IN NORTH CAROLINA 29 (2001).

44. OTS Memorandum, supra note 41, at 2.

45. Drysdale & Keest, supra note 39, at 603.

46. Id. In the study conducted by U.S. PIRG and the CFA, only thirty-seven percent of the surveyed payday lenders quoted “even a nominally accurate APR when asked over the telephone.” Show Me the Money!, supra note 18, at 6.

47. OTS Memorandum, supra note 41, at 3.
The high payments required for payday loans result in a very high renewal rate with little or no principal reduction. According to a Wall Street analyst covering the industry, "the average customer makes eleven transactions a year, which shows that once people take out a payday loan, they put themselves behind for quite some time." In a study conducted by the Illinois Department of Financial Institutions in 1999, the average number of contracts per borrower was 12.6. An Indiana Department of Financial Institutions audit revealed that on average over a twelve month period, borrowers renewed their loans approximately ten times, with one consumer renewing his loan sixty-six times. The high expense of payday loans limits the customer's ability to catch-up, which makes the customer "captive" to the lender.

Consumers generally take these loans out to satisfy a sudden financial need, find themselves unable to meet their budgetary needs on the next payday, take additional loans, and get caught up in a never-ending cycle of high fees and interest. As the number of transactions increases as a result of rollovers, "the cost of the loans increase." For example, "the cost of $250 of payday credit held for six weeks is $150; the cost of borrowing $250 for six weeks is $450."
One consumer in Kentucky ended up paying $1,000 in fees for a loan of only $150 over a period of six months—and she still owed the $150.57

Third, payday lenders enjoy a competitive advantage over other lenders in the market because of the use of the criminal justice system and prosecution for bad checks. Since payday loans are based on a borrower's personal check, collection on the debt is made easier for the lender.58 “Payday lenders use the ‘threat of jail just as a loan shark might have used the threat of physical violence.”59 Consumers can be scared into paying their debt to avoid prosecution for bad check charges.60

Some lenders do not limit themselves to merely threatening criminal prosecution, however.61 In just one year, payday lenders filed over 13,000 criminal charges against their customers in one Dallas, Texas police precinct.62 Abuse of this aspect of payday lending in Kentucky increased so much that the state payday loan statute was modified to require informing loan customers that they cannot be criminally prosecuted.63

Borrowers face substantial fees for bounced checks.64 Not only do the lender and borrower's bank charge fees for bounced checks, but the borrower can be identified as one who writes bad

56. Wiles & Immergluck, supra note 2, at 4.
57. Fox, supra note 1. In Tennessee, $1,364 in fees over fifteen months paid down only $152 of a $400 loan. Id. A student in Kentucky borrowed $350 and ultimately paid about $3,000 in fees. Deborah A. Schmedemann, Time and Money: One State's Regulation of Check-Based Loans, 27 WM. MITCHELL L. REV. 973, 977 (2000). Constance Odim, a borrower in North Carolina, spent more than $2,000 over a two-year period for one $261 loan. THE COMMUNITY REINVESTMENT ASS'N OF N.C. AND THE CENTER FOR COMMUNITY CAPITALISM, supra note 43, at 7. Bill Whalen, a staff attorney at Pisgah Legal Services in Asheville, North Carolina, commented that “people in financial crisis need financial counseling,” “[n]ot a loan that is financial cocaine.” Id. at 5.
58. Moss, supra note 21, at 1731.
59. Id.
60. Fox, supra note 1.
61. Drysdale & Keest, supra note 39, at 610.
62. Id.
63. Id. at 610-611.
64. Show Me the Money!, supra note 18, at 6. More than 70% of the payday lenders who responded to the U.S. PIRG and CFSA study imposed bounced check fees. Id. The fees averaged over $22 and ranged from $7.50 to $40. Id. Only 6% of the respondents would not impose any fees. Id.
checks, which can make it much more difficult to obtain future loan services. States have started to recognize the difficulties for the borrower; one state, Tennessee, does not allow payday lenders to charge additional fees for bounced checks.

IV. THE PAYDAY LENDING INDUSTRY’S RESPONSE

A. National Trade Groups

The payday loan industry maintains that it offers customers “a vital service in today’s world.” Industry trade groups, such as the Financial Service Centers of America (FiSCA) and the Community Financial Services Association of America (CFSA), contend that payday loans are beneficial to consumers because they are able to quickly address an unforeseen money crunch without jeopardizing their existing banking relationship. The CFSA also says that the typical payday advance customer is “a responsible, hardworking middle class American.” The average age of a borrower is 35 years, the average annual income is $33,000, the average time in current residence is 4.5 years, the

65. Jean-Paul & Nathan, supra note 5, at 12.
66. Show Me the Money!, supra note 18, at 6.
69. FiSCA Website, The Consumer’s Choice: The Role of Deferred Deposit Services in Meeting Short Term Financial Needs, at http://www.nacca.org/whitepaper.htm (last visited Jan. 6, 2001). “This argument presumes,” however, “that the solution to indebtedness is to obtain more credit,” which “creates more debt.” Lieberman Forum (Green testimony), supra note 52, at 6.
70. Forum on Short-Term High-Interest Paycheck Advances, convened by Sen. Joseph Lieberman, ranking minority member, U.S. Senate Comm. on Governmental Affairs, at 2 (Dec. 15, 1999) (written testimony of Billy Webster, President of the CFSA) (on file with N.C. BANKING INST.) [hereinafter Lieberman Forum (Webster testimony)].
average time in current job is 4 years, and a third own their own home. Of course, all of them have their own "current checking account and a regular source of income." The payday lending industry defends the high rates by explaining that the "[b]usinesses that offer deferred deposit service take a risk that traditional financial institutions are unwilling to assume" and that "[f]ees are proportional to the risk undertaken and the service provided." The industry maintains "that charges for low cost short term services will be overstated when compared with a larger dollar figure transaction for long term products."

Therefore, disclosing the APR on payday loans is misleading, in the same way it would be to measure "the cost of the taxicab fare for a short trip across town based on the cost of riding a taxicab across the country." They contend the APR for a small payday loan for two to four weeks cannot be compared with a loan of several thousand dollars for a period of a year or more.

The payday lending industry also argues that these outlets are really small businesses, not part of a enormous national industry scheme. They maintain that the customer has a very high degree of satisfaction with the system and efforts to prohibit payday loans in numerous legislatures have failed over the last few years. The industry argues that the "consumer knows and

71. Id.
72. Id.
73. FiSCA Website, supra note 67. The typical cash-advance store has a delinquency rate of about 10%, compared to 6.5% average delinquency rate for credit cards. Rodney Ho, Fees of Quick Cash Chains Draw Scrutiny, WALL ST. J., June 10, 1997, at B1. According to the CFSA, "the national average daily balance required to avoid fees on checking accounts, that is, to qualify for overdraft protection, is about $2,500." Lieberman Forum (Webster testimony), supra note 70, at 3.
74. Lieberman Forum (Rochford testimony), supra note 6, at 14.
75. Id. "Outrageous as cab fare would be for a New York to San Francisco ride, the rate of the charge per mile would be perfectly legitimate on the streets of Manhattan." Id. Some in the industry argue that the APR disclosure is inappropriate for the consumer: "The consumer wouldn't pay 1,800 percent a year to borrow $100. But if you tell the consumer that it costs $18 to borrow $100 for a period of fourteen days, then it seems fair to them." Jean-Paul & Nathan, supra note 5, at 12.
76. Lieberman Forum (Rochford testimony), supra note 6, at 14.
77. Of 257 companies in Tennessee, only eleven had assets over $500,000 and 160 businesses had assets of less than $100,000, almost all of it provided by the owners." Lieberman Forum (Rochford testimony), supra note 6, at 16.
78. Lieberman Forum (Webster testimony), supra note 70, at 5.
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understands this value trade-off and accepts the payday advance company's fee." 79

Even though the industry reports very few complaints received by state agencies about payday lenders, they have responded to public criticism of their practices. 80 On July 18, 2000, the CFSA announced that it had revised its association rules, called "Best Practices," "to address issues raised by legislatures and regulators." 81 The "Best Practices" statement must be endorsed as a condition for membership in the CFSA. 82 These revised "Best Practices" would require member companies that market payday advances made by a federally insured financial institutions to observe the law of the state in which the payday advance office is located governing disclosures and rollovers. 83 In addition to those disclosures required by the federal Truth in Lending Act, 84 CFSA member companies would be forced to comply with the disclosures required by state law where they do business. 85 Rollovers will be permitted "only in states where the law specifically allows such transactions." 86 "In those states, a

79. The Emerging Business of Deferred Presentment, supra note 31, at 5
80. Telephone Interview with Steve Grow, representative of the North Carolina Check Cashers Association (Nov. 8, 2000). "In Tennessee, only 23 consumer complaints have been filed of the 1.22 million payday advance transactions since October 1997." Lieberman Forum (Webster testimony), supra note 70, at 4. In South Carolina, where the law has been in effect for 18 months, only five consumer complaints have been reported to the Board of Financial Institutions. Id.
82. Payday Lenders Adopt "Best Practices," supra note 32. CFSA has fifty corporate participants, representing some 6,000 outlets, or about sixty percent of the payday lending operations in the country. Id. The compliance date for these new association rules was set for January 1, 2001. CFSA Website, supra note 81.
83. CFSA Website, supra note 81. These "best practices" might benefit consumers, but some unscrupulous payday lenders have ways of getting around regulations. In some states, payday lenders try to avoid consumer protection laws by using "sale-leaseback" transactions, catalog sales, personal advertising schemes, or "cash leasing." Jean Ann Fox, Safe Harbor for Usury: Recent Developments in Payday Lending, CONSUMER FED'N OF AM., Sept. 1999, at 2. "Sales-leaseback" companies "claim to buy home appliances from their customers and then lease them back for a rental fee." Id. Catalog sales companies 'sell' catalog certificates to customers who need quick cash." Id. Other lenders advertise "cash back on your check." Id. "Cash leasing" is "where companies claim they are 'leasing,' not loaning funds; "money is leased at the cost of 30% of the amount loaned per 15 days." Id.
85. CFSA Website, supra note 81.
86. Id.
company will only permit the number of rollovers authorized by state law, or a maximum of four, whichever is less.” Where the state law is silent, the new “Best Practices” prohibits rollover transactions.

Also included in the “Best Practices” is a “twenty-four hour absolute right of rescission, allowing the customer to get a full refund within twenty-four hours for any reason,” as well as a “‘no criminal action’ pledge in collection efforts.” Rather than abide by the new restrictions, two big chains, Dollar Financial Group and ACE Cash Express, recently pulled out of the CFSA. Representatives of Dollar Financial Group, which partners with Eagle National Bank of Upper Darby, Pennsylvania, said “it quit because of the rollover limitations in states with tougher laws.” Members of Congress, as well as federal regulatory agencies, have “voiced their approval” for the new “Best Practices.”

B. The North Carolina Check Cashers Association

Consider the case made by the industry in North Carolina. The North Carolina Check Cashers Association says that check cashers, including payday loans, “will contribute $251.5 million to the North Carolina economy this year.” North Carolina consumers “now go to check cashing stores 654,000 times each month, or a total of 7,859,000 times each year.” The North

87. Id.
88. Id.
89. Lieberman Forum (Webster testimony), supra note 70, at 2.
91. Id.
92. Robinson, supra note 3, at 8.
93. Forum on the Check-Cashers Act, the Consumer Protection Committee of the N.C. Gen. Assembly, at 2 (Mar. 1, 2000) (written report presented by Jim Blair, Legislative Chair of the N.C. Check Cashers Association) (on file with N.C. BANKING Inst.) [hereinafter Consumer Protection Forum (Blair Testimony)]. The industry’s payroll will top $71 million for the approximately 2,300 people it employs. Id. “Start-up expenses for each of the 1,139 stores average[d] $120,000 per store, which means that since the bill was passed in October 1997,” $136 million has been put in the North Carolina economy from investment in these businesses. Id.
94. Id. The typical customer has seven to eight transactions a year in North Carolina. Telephone Interview with Steve Grow, supra note 80.
Carolina Deputy Commissioner of Banks recently reported that between three and five million payday loan transactions had been recorded by licensed operators since October of 1997 in North Carolina and that his office had received only forty-one consumer complaints. The industry argues that these figures demonstrate the market acceptance by North Carolinians.

The North Carolina Check Cashers Association (CCA) believes that the only responsibility of state government should be to enact safeguards that would prohibit repeat borrowers from abusing the system. To that end, many payday lenders in North Carolina subscribe to the Teletrack system, which provides a credit report system for payday loan transactions. In North Carolina, eighty to ninety percent of payday outlets will not furnish additional funds to borrowers who already have two outstanding payday loans. The Check Cashers Association is pleased with the North Carolina Banking Commissioner’s regulations that have cleared up some of the ambiguities in the statutes concerning criminal prosecution, multiple checks, and multiple users. However, the CCA believes that measures like a “cooling-off”


96. Consumer Protection Forum (Blair testimony), supra note 93, at 2. In a recent independent study of FiSICA payday loan customer satisfaction, “eighty-one percent of the respondents ranked the overall quality of the service as ‘excellent’ or ‘very good.’” FiSICA Website, What’s New, at http://www.nacca.org/whatsnew.htm (last visited Jan. 6, 2001). In the same survey, “seventy-five percent of the respondents said that their outlet was ‘excellent’ or ‘very good’ in charging reasonable fees for services they receive.” Id. The FiSICA commented that these kind of satisfaction numbers would make any bank, credit union, or brokerage house proud. Id.

97. Telephone Interview with Steve Grow, supra note 80. Mr. Grow said that the industry needs to look out for the needs of the consumer. Id. While they are not legally required to stop these repeat borrowers, Mr. Grow commented that payday lenders are like bartenders in that they must cut-off customers when it appears that they are being irresponsible. Id.

98. Id. This system appears to be very effective in accessing credit worthiness and in protecting store owners. Id. Mr. Grow said that approximately 10 percent of the payday loan customers defraud the industry by writing a check on a bad account or by never paying them back for the loan. Id.

99. Id.

100. Id. See N.C. ADMIN. CODE tit. 4, Ch. 3, Subch. 3L, available at http://www.banking.state.nc.us/rules/t0403toc.htm (July 2000).
period and the prohibition of cash-out transactions go too far in regulating the industry because they punish borrowers who do not abuse the system. Instead, the Association endorses the “Best Practices” to address these issues. To safeguard against abuse, the Association also suggests that North Carolina enact a measure similar to one in Wisconsin which requires consumer credit counseling for repeat payday borrowers who abuse the system, as well as imposing a mandatory waiting period for this class of borrowers. The North Carolina Check Cashers Association says that state government should not limit open access to payday loans because they are vital to serving the consumer’s needs.

V. LEGAL REGULATION OF PAYDAY LOANS

A. Federal Regulation

Until recently, it was unclear whether the provisions of the Truth in Lending Act applied to payday loans. In an early case on the issue, a federal court in Kentucky rejected the payday lender’s argument that the ten percent per week charge imposed for deferring presentment of a personal check was a service

101. Telephone Interview with Steve Grow, supra note 80. Mr. Grow argued that the cooling-off period decides for the customer how long his or her particular financial crisis will last. Id. He also argued that prohibiting cash-out transactions would have the effect of telling customers that they cannot pay off an outstanding debt with cash, which certainly would not serve the borrower’s interests. Id. FiSCA, believes that industry rates and fees should be left to local business and market conditions. FiSCA Website, FiSCA History, at http://www.nacca.org/history.htm (last visited Jan. 6, 2001). “The association opposes rate and fee regulation at the federal level.” Id.

102. Telephone Interview with Steve Grow, supra note 80. The CCA especially endorses the provision that requires payday outlets to report other outlets who violate the law. Id.

103. Id. The Wisconsin provision requires payday lenders to give counseling brochures to borrowers who come to their outlet more than five times, as well as prohibits the borrower’s use of payday loan services for a specific period of time. Id.

104. Id.

105. 15 U.S.C. § 1601 (1994). The Truth in Lending Act (TILA) is an effort by Congress to “guarantee the accurate and meaningful disclosure of the costs of consumer credit” and thereby to enable consumers to make more informed decisions in the credit marketplace. ELIZABETH RENUART & KATHLEEN E. KEEST, TRUTH IN LENDING 33 (National Consumer Law Center 1999).
charge, rather than interest. The Kentucky Supreme Court concluded that a deferred deposit business was not exempt from usury laws and credit disclosure provisions in Kentucky law. A U.S. District Court in Tennessee handed down an order in early 1999 that rejected a claim by E-Z Check Cashing of Cookeville, TN, Inc. that it was merely cashing checks and not making small loans. The court concluded "that the undisputed facts of this case prove that Defendant’s deferred check-cashing transactions with the Plaintiff are essentially consumer loans which violate the Truth in Lending Act, Regulation Z, and the Tennessee Consumer Protection Act." The court found that the transaction did not involve the passing of a “bad” check because the lender knew the customer did not have sufficient funds in the checking account when the loan was made to cover the cash advanced. In a bankruptcy case in Tennessee, the court found that deferred presentment transactions were “clearly...a short term extension of credit.”

The Federal Reserve Board, in an amendment to the Truth in Lending Act’s Official Staff Commentary, has ruled that payday lenders fall under the laws that require lenders to publish annual interest rates. The Board determined in its ruling that payday

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106. Hamilton v. York, 987 F. Supp. 953, 956-57 (E.D. Ky. 1997). The judge examined the law’s definition of credit, creditor, and finance charge under sections 1602(e), 1602(f), & 1605(a) of the Truth in Lending Act, and concluded that the deferral transactions involved payments over time for the privilege of getting money immediately. Id. at 957. The Court concluded that “[i]t is hard to imagine how charges for exchanging money today for more money at a later date could be classified as anything but interest on a loan.” Id. at 956 n.4. Since the plaintiff was incurring debt, deferring its payment, and paying finance charges, these transactions properly fell within the scope of 15 U.S.C. § 1602(e)-(f). Id. at 958. See also In re Miller, 215 B.R. 970, 974 (Bankr. E.D. Ky. 1997) (holding that disbursing funds on the promise of repayment of the sum plus the “service charge” at a later time is an extension of credit, not check cashing).

107. White v. Check Holders, Inc., 996 S.W.2d 496, 500 (Ky., 1999).


109. Id. at 1052.

110. Id. at 1051.

111. In re Brigance, 219 B.R. 486, 493 (Bankr. W.D. Tenn. 1998). Also, the Arkansas Supreme Court recently ruled that an arbitration agreement between a payday lender and its borrowers was skewed in the lender’s favor and therefore not enforceable under Arkansas law. Showmethemoney Check Cashers Inc. v. Williams, Ark., 27 S.W.3d 361 (Ark. 2000).

112. Official Staff Interpretations (Commentary to Regulation Z), 12 C.F.R. § 226
loans were not cash advances, and lenders have to abide by the Truth in Lending Act, which requires them to disclose to borrowers the annual percentage rate of the loan.\textsuperscript{113} The Federal Reserve's staff commentary on Regulation Z serve as guidance to creditors in applying the regulation under TILA to specific transactions.\textsuperscript{114}

Other federal agencies are also taking notice of the industry and have started to take action.\textsuperscript{115} On September 6, 2000, the Federal Trade Commission (FTC) announced it had settled its first ever charges against payday lenders.\textsuperscript{116} The FTC reached an agreement with two Nevada firms, which the Commission charged had "falsely represented to consumers who paid membership fees ranging from $149 to $169 that they would receive a credit line of thousands of dollars along with cash advance privileges."\textsuperscript{117} The FTC charged these lenders with violating Section 5 of the FTC Act (2000).

\textsuperscript{113} Id. In Smith v. Check-N-Go, the U.S. Court of Appeals for the Seventh Circuit rejected claims against a lender that used a hand-drawn circle to highlight the due date on a loan contract. 200 F.3d 511 (7th Cir. 1999). The plaintiffs claimed that the circle drawn by hand around the due date violated the rule (12 C.F.R. § 226.17(a)(2)) that the finance charge and annual percentage rate be more conspicuous than any other disclosure, except the creditor's identity. Id. at 513-14. The Court rejected this conclusion and held that "when a lender employs the model form recommended by the Federal Reserve, an isolated circle or mark cannot create liability." Id. at 516.

\textsuperscript{114} Payday Lenders Must Take APR Disclosures To Consumers Under Revisions to Fed Rules, 74 Banking Rep. (BNA) 606 (Apr. 3, 2000). In Brown v. Payday Check Advance, the U.S. Court of Appeals for the Seventh Circuit ruled on whether a flawed disclosure under one section of the Truth in Lending Act must be treated as a complete failure to disclose under another section. 202 F.3d 987 (7th Cir. 2000), cert. denied, 121 S. Ct. 61 (Oct. 2, 2000). Under this theory, "although the lenders informed the borrowers of correctly calculated finance charges and annual rates, and made all other mandatory disclosures, they did not comply with the sections requiring these disclosures because they did not make the disclosures in the form required by other parts of the statute and regulations." Id. at 991. The Court rejected this theory and held that "the TILA does not support plaintiffs' theory of derivative violations under which errors in the form of the disclosure must be treated as non-disclosure of the key statutory terms." Id. at 992.

\textsuperscript{115} See FTC, in First Move Against Payday Lenders, Reaches Settlement with Nevada Companies, U.S. Law Wk., Sept. 19, 2000, at 2151.

\textsuperscript{116} Id.

\textsuperscript{117} Id. After paying their membership fees, the consumers discovered that they could only use the credit line to purchase items from the lender's catalog and that the cash advance privileges were payday loans (with interest rates of up to 360 % or more). Id.
and the Truth in Lending Act.\textsuperscript{118}

\textbf{B. State Regulation}

When payday loans were first offered in the mid-1990's, most state usury or small loan laws made these transactions illegal.\textsuperscript{119} By labeling the transaction as “check cashing” instead of “lending,” companies sought to avoid such credit laws.\textsuperscript{120} This strategy did not work, however, and payday lenders were found to be subject to state usury laws, loan caps, and state and federal consumer protections laws.\textsuperscript{121}

States have regulated the payday lending industry in three different ways. Some states have effectively prohibited payday loans. A second group permits payday loans with little regulation, and a third group of states have enacted specific payday loan laws or regulations that permit payday loans.\textsuperscript{122}

Nineteen states, along with Puerto Rico and the Virgin Islands, are in the first group and prohibit payday loans due to small loan interest rate caps, usury laws, or specific prohibitions for check cashers.\textsuperscript{123} One way the payday lending industry has

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  \item \textsuperscript{118} Id. The proposed settlement would enjoin the companies from engaging in such deceptive practices, require them to return $350,000 they received from consumers, and forgive $1.6 million in outstanding consumer debt. Id. at 2152. President Bill Clinton has also addressed the issue of payday lending in announcing the Clinton-Gore Plan for Financial Privacy and Consumer Protection in the 21\textsuperscript{st} Century. See \textsc{White House Office of the Press Sec'y, The Clinton-Gore Plan for Financial Privacy and Consumer Protection in the 21\textsuperscript{st} Century}, \textit{at} \url{http://www.pub.whitehouse.gov/retrieve-documents.html-privacy-and-consumer-protection.html} (May 4, 1999).
  \item \textsuperscript{119} Fox, \textit{supra} note 1.
  \item \textsuperscript{120} Id.
  \item \textsuperscript{121} Id. \textit{See infra} notes 106-11 and accompanying text. States generally exempt banks from usury caps, small loan laws, and check cashier laws because there is the belief that banks will not charge rates to trigger such limits. Moss, \textit{supra} note 21, at 1741.
  \item \textsuperscript{122} \textit{Show Me the Money!}, \textit{supra} note 18, at 23.
  \item \textsuperscript{123} Id. The nineteen states are Alabama, Alaska, Arizona, Connecticut, Georgia, Indiana, Maine, Maryland, Massachusetts, Michigan, New Jersey, New York, North Dakota, Pennsylvania, Rhode Island, Texas, Vermont, Virginia, and West Virginia. Id. On July 1, 1998, the Alabama State Banking Department filed cease and desist orders against 150 check cashing outlets in that state that made payday loans. Fox, \textit{supra} note 1 (Appendix B). The Department cited the Alabama Small Loan Act, which prohibits making loans for $749 or less without a license. Id. The Alabama Check Cashers Association counter-sued the state, seeking a ruling on whether the
penetrated these states is through a concept called “exportation” or “charter renting.” In such situations, the loan is offered by the payday lender as a service to the consumer and is underwritten by the bank. The loan originator gathers the information from the consumer, transmits the information on the bank, and “serves as a collection agent for the loan.” The bank and the payday lender share the profits, much like a “typical brokered loan transaction.” By partnering with national banks, payday lenders can use a bank’s authority to circumvent state caps on interest rates. Under the National Bank Act, a national bank is permitted to export the law of its home state nationwide, preempting any state laws restricting “interest” in the borrower’s state. “The Depository Institutions Deregulation and Monetary Control Act of 1980” put federally insured depositories, including those chartered by states, on ‘a level playing field’ with national banks.

Act applied to payday loans. *Id.*

124. Fox, *supra* note 83, at 9. Also, several lenders are now offering payday loan services on the Internet, thereby allowing individuals access to these products in states where other agents cannot offer them. Jean-Paul & Nathan, *supra* note 5, at 12.


126. *Id.*

127. *Id.*


130. Drysdale & Keest, *supra* note 39, at 646. Agents of national banks, located in other states, benefit from the charter renting the most. *Id.*


132. Drysdale & Keest, *supra* note 39, at 646. This flexibility in imposing charges for financial products by national banks has been consistently held up by the courts. Lieberman Forum (Rochford testimony), *supra* note 6, at 8. See e.g. Smiley v.
In the second group, eight states permit payday loans by having no small loan rate cap, usury limit, or minimum finance charge. In these states, payday lenders can operate under existing law without need for special authorizing legislation. Loans are made by licensed lenders, subject to state credit laws and supervision by regulators. Deregulation in these states permits payday lenders to charge interest rates that greatly exceed the typical small loan rate cap.

Finally, twenty-three states and the District of Columbia permit payday loans but have specific statutes that regulate them. Payday loan laws usually set a maximum loan amount, a maximum term, and fees. Lenders are typically required to obtain licenses, use written contracts, and post fees with full disclosure. The maximum legal cost of payday loans in states where these loans are authorized by state law range from $15 to $33.50 to borrow $100 for 14 days. Eight states permit lenders to charge $17.65 per $100, which amounts to an APR of 459%.

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133. Show Me the Money!, supra note 18, at 23. The eight states are: Delaware, Idaho, Illinois, New Hampshire (small loan interest rate caps repealed, effective January 1, 2000), New Mexico, Delaware, Oregon, South Dakota, and Wisconsin.

134. Drysdale & Keest, supra note 39, at 602.

135. Show Me the Money!, supra note 18, at 4.

136. Id.

137. Id. at 23. The twenty-three states are Arkansas, California, Colorado, Florida, Hawaii, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Utah, Washington, and Wyoming. Several of these trends are new. In 1996, California, Ohio, and Wyoming enacted laws; in 1997, North Carolina and Tennessee followed; in 1998, Kentucky, Mississippi, Nevada, South Carolina, and the District of Columbia passed legislation; in 1999, Arkansas, Hawaii, Louisiana, Montana, Mississippi (re-enacted), New Hampshire (removed interest rate cap on small loans), and Tennessee (re-enacted) regulated the industry; and in 2000, Arizona and Colorado enacted regulations.

138. Moss, supra note 21, at 1740.

139. Id.

140. Fox, supra note 83, at 8.

141. Id. at 8. The eight states are: Tennessee, North Carolina, South Carolina, California, Hawaii, Iowa, Kentucky, and Nebraska. Montana has the highest maximum fees allowed, which amount to $33.50 per $100 loan (871% APR).
C. North Carolina

North Carolina is one of the twenty-three states which specifically regulates payday loans. In North Carolina, there are currently 242 check-cashing licensees with 1,204 locations.\(^\text{142}\) In 1997, the North Carolina General Assembly passed a series of statutes in order to regulate check cashing and payday loans.\(^\text{143}\) The provision that regulates postdated or delayed deposit checks is set to expire on July 31, 2001.\(^\text{144}\) Businesses that comply with the state’s licensing requirements may cash postdated or delayed deposit checks as long as the face value of the check does not exceed $300, and the fee for the loan does not exceed fifteen

\(^{142}\) N.C. COMM'R OF BANKS, FACT SHEET, at http://www.banking.state.nc.us/forms/banks/factsjee.pdf (Dec. 31, 2000). North Carolina is in a particularly tough situation regarding these kinds of loans because it is the fifth most expensive state in which to bank, but is only ranked thirty-first in terms of per capita income. Consumer Protection Forum (Ouzts testimony), supra note 24, at 1. Many of the payday loan outlets in the state have concentrated in working neighborhoods in North Carolina’s biggest cities. THE COMMUNITY REINVESTMENT ASS’N OF N.C. AND THE CENTER FOR COMMUNITY CAPITALISM, supra note 43, at 38. Eighty-five percent of all check cashers in Charlotte are in working class neighborhoods with median incomes of $20,000 to $40,000. Id.

\(^{143}\) N.C. GEN. STAT. §§ 53-275-53-289 (1999). The statutes became effective on October 1, 1997 and were passed with bipartisan support. In the N.C. Senate, the measure passed by a vote of 42-1 (with six absent and one vote not cast). Roll Call Vote of the N.C. Senate, Apr. 10, 1997 (Legislative Day 42)(on file with N.C. BANKING INST.). In 1997, there were twenty Republicans and thirty Democrats in the N.C. Senate. Drew Betts and Thad Beyle, NC State Senate Voting Results: 1968-1998, NORTH CAROLINA DATA NET 24 (Odum Institute for Research in Social Science, University of North Carolina at Chapel Hill), Mar. 2000, at 1. In the N.C. House, the measure passed by a vote of 83-16 (with fifteen absent and six votes not cast). Roll Call Vote of the N.C. House of Representatives, Aug. 6, 1997 (Legislative Day 109) (on file with N.C. BANKING INST.). In 1997, there were sixty-one Republicans and fifty-nine Democrats in the N.C. House. Demographic Make-up of the 120 House Representatives, NORTH CAROLINA DATA NET 23 (Odum Institute for Research in Social Science at the University of North Carolina at Chapel Hill), Dec. 1999, at 3. Of the sixteen representatives who voted against the check-cashing statute in the House, four were Republicans and twelve were Democrats. Roll Call Vote of the N.C. House of Representatives, Aug. 6, 1997 (Legislative Day 109). After the election on November 7, 2000, control of both houses of the General Assembly stayed to the Democrats, who had controlled the chambers since the 1998 election. Wade Rawlins, Democrats Retain Majorities in N.C. House, Senate, NEWS & OBSERVER (Raleigh, N.C.), Nov. 9, 2000, at 15A. In the 2001-2002 Session, Democrats will control the North Carolina Senate by a 35 to 15 majority. Id. By losing four seats, Democrats will control the North Carolina House with a slim margin of 62 to 58. Id.

\(^{144}\) N.C. GEN. STAT. § 53-281(1999).
percent of the face amount on the check. In order for a payday loan transaction to be valid in North Carolina, the borrower and the licensee must enter into a written agreement which states the total amount of fees charged. Additionally, the deposit may not be deferred for more than thirty-one days. A licensee may not, directly or indirectly, charge any fee in excess of fifteen percent for cashing a postdated or delayed deposit check. No postdated or delayed deposit check may be repaid by the proceeds of another check cashed by the same payday lender licensee. Rollovers are prohibited in North Carolina; the licensee may not renew or otherwise extend any postdated or delayed check, or withhold such check from deposit for any period beyond the time set forth in the written agreement with the customer.

The rationale behind North Carolina’s payday statute was to “allow individuals to have access to a small amount of credit for a very short period of time to take care of emergencies.” Phil Lehman, an attorney with the Consumer Protection Division of the North Carolina Department of Justice, testified before the Consumer Protection Committee of the General Assembly that there were four main objectives when the law was passed: “1) to ensure the offices were licensed, regulated, and supervised by the Commissioner of Banks; 2) to disclose these transactions as loans with the interest and annual percentage rate to borrowers; 3) to limit the rates; and 4) to prohibit rollovers, so these transactions would not turn into revolving lines of credit.” The General

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146. N.C. GEN. STAT. § 53-281(c) (1999). The fee charged must be expressed both as a dollar amount and as an effective APR. Id.
149. N.C. GEN. STAT. § 53-281(e) (1999). The North Carolina Commissioner of Banks has ruled that the statute is very clear on the subject. HAL D. LINGERFELT, NC COMM’R OF BANKS, DECLARATORY RULING—ISSUES UNDER THE NORTH CAROLINA CHECK CASHERS ACT, at http://www.banking.state.nc.us/ccruling.htm (Nov. 30, 1998). A check casher may not renew, extend, or rollover a check beyond the date that it is to be deposited. Id.
152. Id. at 9.
Assembly specifically indicated an intent to remove the sunset on the statute if there was no evidence of excessive complaints by consumers or unfair practices by lenders.\textsuperscript{153}

North Carolina law authorizes the Commissioner of Banks to regulate the business of check cashing and requires all persons in the business to obtain a license from the Commissioner.\textsuperscript{154} The Banking Commissioner is empowered under the statute to "adopt rules necessary to carry out the purposes of this Article, to provide for the protection of the public, and to assist licensees in interpreting and complying with this Article."\textsuperscript{155} The Commissioner's office has adopted administrative rules in order to carry out its regulatory function.\textsuperscript{156} The posting of fees within the payday lending outlet is heavily regulated to insure the customer has actual knowledge of the fees of the short-term loan.\textsuperscript{157} The

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\item[155.] N.C. Gen. Stat. § 53-288 (1999). The Commissioner's Office has indicated that every twelve months there would be an on-site examination of the practices and compliance with the law of the check cashing facilities. Minutes of the Consumer Protection Committee, supra note 153, at 4. As of March 1, 2000, all of the companies have been examined in North Carolina, but not all of the specific office locations. Id. The reason for the delay is that more offices have opened that was previously anticipated. Id.
\item[156.] N.C. Admin. Code tit. 4, Ch. 3, Subch. 3L, available at http://www.banking.state.nc.us/rules/t0403toc.htm (July 2000).
\item[157.] N.C. Admin. Code tit. 4, Ch. 3, Subch. 3L.0403, available at http://www.banking.state.nc.us/rules/t0403104.htm (July 2000). This regulation states:
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\item[a] The notice of fees required by G.S. 53-280(c) shall be clear, legible, and in bold and blocked letters of not less than one inch in height. The information shall be posted in a conspicuous location in the unobstructed view of the public within the check cashier's premises. Check cashers who offer delayed deposit transactions pursuant to G.S. 53-281 shall also display an example of a delayed deposit check transaction with a face amount of one hundred dollars ($100.00) along with the maximum fee allowed to be charged, which fee shall be expressed both as a dollar amount and
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The Commissioner of Banks is directed to report to the 2001 General Assembly on the practices of payday lenders in sufficient time to let legislators decide how to act on the expiration of the statute. The office was directed to report on the payday lending provision, including any evidence as to consumer complaints, unfair or deceptive trade practices, and the frequency of repeat use by borrowers.

Has the North Carolina statute been a success? Several violations of the payday lending law have already been reported since the statute’s enactment in 1997. Action has been taken against numerous payday lenders for violations of the law, and consumers have been refunded over $300,000. The excess fee charged for rollovers (which are prohibited) was the primary fee refunded, and the refunds have been in small amounts.

Other evidence that payday lenders are circumventing provisions related to postdated or delayed deposit checks also exists. First, the Consumer Protection Committee of the General Assembly found that there was “evidence that some licensees are extending loans beyond the thirty-one days allowed by the law by means of ‘cash out’ transactions.” A bill was introduced during the 2000 Session of the 1999 General Assembly to attempt to close this loophole in the statute. The bill would have required that licensees deposit checks no later than thirty-one days from the date the check is cashed.

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as an effective annual percentage rate (APR). The display shall illustrate identical delayed deposit transactions of 7, 14, and 30 days.

Id.

159. Id. See infra notes 190-198 and accompanying text.
160. LEGISLATIVE RESEARCH COMM’N, supra note 151, at 10.
161. Minutes of the Consumer Protection Committee, supra note 153, at 4. For example, the amounts of the refunds have been $15, $20, $30, or $45. Id. These refunds resulted because some companies were cashing more than one check at a time and charging two separate fees. Id. The Banking Commission ordered violators to refund the second fee. Id.
162. LEGISLATIVE RESEARCH COMM’N, supra note 151, at 16.
164. Id. The bill would add a section (f) to N.C. Gen. Stat. § 53-281, and would
Second, a question has also arisen whether a waiting period is required between the time that a check is deposited by the licensee and when that customer may enter into another delayed deposit transaction. While no express provision in the statute governs this practice, the North Carolina Banking Commissioner has determined that a cash-out transaction, followed simultaneously by another delayed deposit transaction, "raises the appearance of a renewal or extension," which is prohibited by law.

Finally, the statutes leave unresolved whether a licensee may enforce returned checks through civil or criminal actions in North Carolina courts. The Banking Commissioner has declared...
that criminal actions should be unavailable under the statutes.\textsuperscript{167} Since a delayed deposit transaction is in essence a credit transaction, the licensee is "limited to a civil action to enforce the collection of a delayed deposit checks."\textsuperscript{168}

\section*{VI. Evaluation of the Patchwork of Regulation}

Several different agencies and governmental bodies, both federal and state, are involved in the regulation of payday lending.

Beyond the enforcement of the Truth in Lending Act, what could be improved on the federal level? First, the "renting" of bank charters is a problem which should be addressed. Bank charter renting is newly discovered, but is beginning to get the attention of national leaders involved in banking policy.\textsuperscript{169} In August of 1999, Representative Bobby Rush (D-IL), introduced legislation to provide minimum standards for state payday loan laws and to close the federal bank charter loophole.\textsuperscript{170} Under the legislation, "banks would be limited to thirty-six percent interest rates on payday loans and be required to comply with the payday loan law of the state in which the borrower is located, not the state where the bank is domiciled."\textsuperscript{171}

On March 1, 2000, Representative John J. LaFalce (D-NY), ranking minority member on the House Banking Committee, introduced legislation designed to dismantle the payday lending industry by amending the Federal Deposit Insurance Act to prohibit federally-insured banks from offering payday loans either directly or indirectly through an affiliate.\textsuperscript{172} LaFalce's bill would prohibit uninsured lenders from accepting a personal check drawn

\textsuperscript{167} Lingerfelt, supra note 149.
\textsuperscript{168} Id. The Commissioner determined that it would be "inappropriate to pursue collection of these checks" under the (criminal) worthless check statutes (N.C. GEN. STAT. §§ 14-107 and 107.1). Id.
\textsuperscript{169} See OTS Memorandum, supra note 41.
\textsuperscript{170} Safe Harbor for Usury, supra note 83, at 10-11. H.R. 1684, entitled "The Payday Borrower Protection Act of 1999," would require the Federal Reserve to certify that state payday loan laws meet the minimum consumer protection standards contained in the bill. Id. at 11.
\textsuperscript{171} Id. at 11.
\textsuperscript{172} LaFalce Introduces Bill to Dismantle Payday Lending Industry, Provides Penalties, 74 Banking Rep. (BNA) 434 (Mar. 6, 2000).
on a federally-insured account as collateral for a loan. Consumer groups have also suggested regulatory reform by way of model federal legislation. The Consumer Federation of America (CFA) and the National Consumer Law Center (NCLC) released model legislation in 1998 that would provide for minimum loan terms, maximum fees and charges, enhanced disclosure, and consumer protection in states allowing payday lending.

On June 13, 2000, Federal Deposit Insurance Corporation (FDIC) Chairman Donna Tanoue criticized banks for charter renting. On November 27, 2000, the Comptroller of the Currency and the Office of Thrift Supervision (OTS) announced new guidelines for a “consistent supervisory approach” over payday lending. Comptroller John D. Hawke and OTS Director Ellen Seidman warned in an advisory letter that vendors who attempt to evade state consumer protection laws through charter renting should not “automatically assume that the benefits of the bank or thrift charter will accrue to them by virtue of such relationships.” Then Treasury Secretary Lawrence H. Summers


174. See Model Deferred Deposit Loan Act (1998) (CFA & NCLC, Proposed Legislation). However, the FiSCA claims that there is no American jurisdiction in which payday lending could survive under this model legislation. FiSCA Website, Freedom of Choice For Consumers: The Truth About Deferred Deposit Services—A Reasoned Response to the CFA’s Misrepresentations, at http://www.nacca.org/ddresponse.htm (last visited Jan. 6, 2001).

175. Tanoue Attacks Bank Charter ‘Renting,’ Seeks End to Unscrupulous Payday Loans, supra note 128. She admitted that the number of banks renting out their charters is small, but that could easily change, and the possibility of payday lenders getting around consumer protection laws “triggers public policy concerns.” Id.

176. New OCC Proposal Would Charge Banks for Exams of Third Party Service Providers, 75 Banking Rep. (BNA) 710 (Dec. 4, 2000). The OTS and OCC declared that it had a “variety of safety and soundness, compliance, and consumer protection concerns regarding payday lending programs.” OTS Memorandum, supra note 41, at 1. The OTS also declared that it will closely review the activities of these types of lenders and “when the institution is not following prudent lending practices or when examiners consider the institution’s lending practices to be abusive, OTS will initiate corrective measures, including enforcement actions when appropriate.” Id.

177. New OCC Proposal Would Charge Banks for Exams of Third Party Service Providers, supra note 176, at 710. The OTS recommends that “prudent limits should be established on the requirements for and number of times payday loans can be
expressed support for the joint statement at the time by saying that “these advisories are an important part of the [Treasury] Department’s ongoing efforts to ensure that abusive or predatory lending practices do not undermine the important progress we have made in expanding access to capital.”

Alternatives to payday lending should also be explored by the federal government. The Office of the Comptroller of the Currency is exploring the concept of “a special bank charter that would allow banks to form consortia to do business in high-risk, lower income, underserved areas.” In areas where payday lenders are prevalent, these new institutions could offer viable alternatives to payday loans. Banks that are unwilling to bear the risk or cost associated with setting up an institution in an underserved, high-risk neighborhood could join forces with other banks to set up such an institution.

What could be improved on the state level? State statutes would need to be modified or created to avoid abuse by the borrower and the lender. Modification might include strengthening of penalties for violations by licensees, providing provisions to prohibit licensees from charging dishonored check fees and from seeking civil damages, and giving borrowers a

rolled over.” OTS Memorandum, supra note 41, at 3. The OTS also made it clear that payday lenders must comply with the relevant provisions of the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and the Federal Trade Commission Act, as well as applicable provisions of state usury and deceptive practices acts. Id. at 5. Payday lenders could also be subject to class action lawsuits and litigation resulting from violations of these consumer protection statutes. Id. Some have suggested that the federal regulatory agencies have been afraid of this issue because they did not want national banks to switch to a state charter.

178. New OCC Proposal Would Charge Banks for Exams of Third Party Service Providers, supra note 176, at 710. Summers had commented earlier that “in the appropriate regulatory environment, check cashing and payday lending services can provide a legitimate service to low-income Americans.” Sarbanes, LaFalce to Unveil New Legislation Implementing Clinton’s ‘First Accounts’ Plan, 74 Banking Rep. (BNA) 868 (May 15, 2000).

179. Hawke Calls for Consumers to Help OCC By Reporting Predatory Lending at Banks, supra note 128, at 558.

180. Id.

181. Id. Comptroller of the Currency John D. Hawke added: “A consortium bank with a business plan tailored to the specific needs of an inner-city community may be able to bring services to areas that have otherwise been abandoned.” Id.
remedy to enforce the provisions of the law against the licensees. The most aggressive change, suggested by many consumer groups, might be to limit the APR charged by payday lenders to thirty or forty percent. Closing the loopholes in state statutes, like the provisions in N.C. Senate Bill 1137, is another possibility. To deal with the rollover issue, Governor George Ryan of Illinois has proposed a "cooling off" period after a completed payday advance transaction in order to stop repeat abusers. Another possibility is enacting a consumer credit counseling provision similar to the one adopted in Wisconsin. States could also require that payday lenders use credit reporting technology for regulatory purposes. Using this technology, regulators could require all licensed companies to report all payday loans to a reporting agency. Borrowers would be limited to the number of outstanding loans they could hold at any one time, as well as the time that would elapse before they could take out another loan.

On February 22, 2001, the Office of the North Carolina Commissioner of Banks submitted a report on payday lending to the North Carolina General Assembly. The report made several

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184. See supra notes 163-164 and accompanying text.
185. Press Release, Illinois Governor George Ryan, Governor Endorses Tough New Payday Loan Regulations, at http://www.state.il.us/gov/press/00/sep/paydayloans912.htm (Sept. 12, 2000). After a study was released indicating the typical Illinois payday loan customer is a woman in her mid-thirties earning just over $25,500 per year, with an average of thirteen payday loans at 533% APR, Governor George Ryan proposed new regulations to protect payday loan customers. Under the proposed rules, there would be a thirty day cooling-off period between loans. Governor Ryan said that he proposed the new regulations in response to heart-wrenching stories of borrowers "who have borrowed modest amounts of money and made an honest effort to repay their debts, only to find themselves caught in a downward spiral of mounting interest and debt that they can't get out from under." Id.
186. See supra note 103 and accompanying text.
188. Id.
189. Id. Currently, few examiners make efforts to determine whether consumers are borrowing from one payday lender to pay off another or whether they have multiple payday loans outstanding at any point in time. Id.
190. Report to the General Assembly on Payday Lending, supra note 95.
recommendations on needed changes in the law which would benefit borrowers. First, the report recommended that payday lending licensees should be required to provide borrowers with a brochure from the Commissioner’s Office that would inform them of their basic rights in the transaction. Next, the report pushed for a change in the law that would “prohibit a lender from the use or threatened use of the criminal process to collect a delayed deposit check.” The Commissioner’s report also recommended that the lender should be permitted, “solely at an accommodation to the borrower, to modify the contract and extend the agreed date of deposit, but at no additional fee.” Also included was a recommendation that the General Assembly consider some restrictions on “back-to-back or repeated transactions.”

The report also made several recommendations to modify the language of North Carolina General Statute § 53-281 to make it less ambiguous. The report urged the modification of § 53-281(d) from “face amount of the check” to “amount of credit extended.” One last recommendation was that the law should be changed to limit the amount of credit extended to the borrower to $300, so that no lender could issue loans that exceed this limit in

191. Id. Along with these changes, the report also recommended changes that would make supervision of payday lending outlets easier. First, the Commissioner’s Office wants its failure to comply with one of requests for assistance in resolving a complaint to be “grounds for imposition of a civil money penalty and suspension or revocation of license.” Id. at 1. Also, the report recommended that licensees should be required to provide data on their operations at the request of the Commissioner. Id. at 5. This would allow the Commissioner to monitor consumer complaints, unfair or deceptive trade practices, and frequency of repeat use by individuals. Id.

192. Id. at 1. The brochure would inform the payday loan borrower “of the complaint mechanism, the relative cost of this form of credit, availability of other forms of credit, the right of the consumer to elect credit counseling and stop collection efforts, and such other matters as the Commissioner may from time to time believe are necessary or beneficial to consumers.” Id.

193. Id. An exception would be made for those customers who commit fraud. Id.

194. Id.

195. Id. at 5. The report indicated that 14.06% of customers using the delayed deposit service used it nineteen or more times in 1999. Id. at 6. See supra notes 165-166 and accompanying text.

196. Report to the General Assembly on Payday Lending, supra note 95, at 2. From 713 examinations of all licensed outlets during 1998, 1999, and 2000, the Commissioner’s Office noted 8,911 violations of N.C. General Statute § 53-281. Id.

197. Id. This change would “simplify interest calculations and end the collection of interest on the fee already paid for the loan.” Id.
the aggregate. These types of statutory reforms are illustrative of the ways in which states can attempt to stop abuse by both the borrower and the lender without actually prohibiting the entire transaction.

How could the market respond to this problem? Mainstream financial institutions could try to develop services to meet the needs of the segment of the market they have ignored. Comptroller of the Currency John D. Hawke recently recommended that banks should pursue a long-term goal of "migrating use" customers to full service customers. For example, the TCF Corporation is a mainstream bank making most of its money from small balance accounts. Believing that "a little number times a big number is a big number," TCF specializes in the lower half of the financial services market.

Another institution, the Florida Central Credit Union in Tampa, is developing a package of services typically offered by non-bank financial providers. These services will include payday

198. Id. Also, no lender could "require a borrower to prepare more than one check per delayed deposit transaction." Id.

199. Ellen Seidman, Director of the Office of Thrift Supervision, has challenged banks to do a better job competing with payday lenders. Banks Play Important Role in Curbing Predatory Lending, OTS Director Says, 74 Banking Rep. (BNA) 387 (Feb. 28, 2000). In order for banks to combat predatory lending successfully, she said lenders must "create responsible credit and financial service alternatives for customers, and they must market these products and services in ways that actually reach those for whom they are intended—just like predatory lenders are doing." Id.

200. Hawke Calls for Consumers to Help OCC by Reporting Predatory Lending at Banks, supra note 128, at 558. He noted that banks should tailor their services to the needs of specific communities. Id. Hawke also commented that "bank senior management need to commit to the market and the community by being willing to commit to the values and habits of the community." Id. He said banks should take advantage of new technology, such as electronic accounts, which could be less expensive for the consumer. Id.

201. STEGMAN, supra note 9, at 81. TCF is a ten billion dollar institution with branches in 140 supermarkets and 156 other locations throughout Minnesota, Illinois, Wisconsin, and Colorado. Id.

202. Id. For the convenience of its borrowers, TCF branches are open from 7 a.m. to 7 p.m. weekdays, plus Saturday hours, and all of its supermarket branches are open on Sundays and holidays. Id. at 82.

203. According to the CFSA, two-thirds of payday lending customers are credit union members. Frank J. Diekmann, More Questions Than Answers; Issues Related to Credit Unions and Payday Lending are Almost as Numerous as the People in Line, CREDIT UNION J., Nov. 27, 2000, at 6.

204. Forum on Short-Term High-Interest Paycheck Advances, convened by Sen. Joseph Lieberman, ranking minority member, U.S. Senate Comm. on Governmental
loans, without the possibility of rollovers. These loans will have a maximum rate of thirty percent, far less than some of the rates offered by private industry. This credit union will be partnered with nonprofit agencies with close ties to the community to facilitate outreach, education, and trust, while offering products and financial services geared to the needs of the local community.

The State Employees Credit Union (SECU) in North Carolina is also developing a payday loan service for its members. SECU, which is the second-largest credit union in the country, will provide short-term, unsecured loans to members at a rate of 11.75%. The credit union expects the loan period to be approximately fifteen days, which amounts to a fee of about $2.50 for the maximum $500 loan that will be available under the program. Jim Blaine, President of the SECU, believes the concept of payday loans for members fits within the traditional role of a credit union.

Other non-loan options for longer term solutions include consumer credit counseling, asset development, low-cost bank accounts, utility repayment plans, the Low-Income Home Energy Affairs, at 5 (Mar. 1, 2000) (written testimony of Edward Gallagly, Pres., Fla. Cent. Credit Union) (on file with N.C. BANKING INST.). A subsidiary company of the credit union, called the Credit Union Service Organization (CUSO), will offer members and the public a “complete line of fringe banking services.” Id. at 4.

205. Id. at 5. “Loans will not be ‘rolled over,’ but instead will be made with reasonable terms of payment.” Id.

206. Id. The CUSO will obtain a license allowing this maximum rate because they believe it is the most reasonable and fair, yet profitable rate for this higher risk type lending. Id. Customers will be counseled on these financial services and encouraged to join the credit union and open a savings account. Id.

207. Id. at 4. The Credit Union will also offer small loans to persons with marginal or no credit through its “risk based” lending program. Id. at 3. These small loans will be made for realistic periods, six to twelve months. Id. These loans will also be limited to a maximum of eighteen percent (the statutory limit in Florida), and borrowers who choose to repay their loans in a shorter time will pay less interest. Id. These programs will help borrowers to repair their damaged credit, so that the next time they need a loan they can get a much lower rate. Id.


209. Id.

210. Id.

211. Id. Mr. Blaine commented that this is “our natural business” and “we know we’ve got 4,000 members wanting this service.” Id.
Assistance Program (LIHEAP) funds for emergency heat bills, utility bill-payment plan options at zero percent interest, student assistance programs on college campuses, military relief interest-free loans, and the vast number of charitable organizations that assist consumers with financial crises.\textsuperscript{212}

The response to payday lending cannot be solely at the state statutory level. State statutes can and do help, but federal governmental agencies must become more active in providing a consistent and effective solution to the concerns surrounding this industry. Mainstream institutions should also continue to react to the specific needs of consumers who account for the prolific growth in payday loans. Banks, thrifts, and credit unions have a real opportunity to "reach out to these consumers and provide responsible services for their legitimate needs."\textsuperscript{213}

\textsc{Scott Andrew SchAAF}

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\item \textsuperscript{212} Forum on Short-Term High-Interest Paycheck Advances, convened by Sen. Joseph Lieberman, ranking minority member, U.S. Senate Comm. on Governmental Affairs, at 6 (Dec. 15, 1999) (written testimony of Jean Ann Fox, Director of Consumer Protection, CFSA) (on file with N.C. BANKING INST.).
\item \textsuperscript{213} OTS Memorandum, \textit{supra} note 41, at 1.
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