CREDIT UNION NATIONAL ASSOCIATION STATE CREDIT UNION SUBCOMMITTEE REPORT ON PAYDAY LENDING

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EXECUTIVE SUMMARY

"Payday lending" refers to single-payment, unsecured, short term (13-17 days), small loans ($100-$500) based on personal checks. The consumer writes a personal check drawn on a financial institution for the amount borrowed plus a fee. The lender agrees not to deposit the check until the consumer's next payday. The customer is advanced cash immediately. When the loan is due, the borrower can redeem the check for cash, allow the check to clear through the financial institution, or pay another fee, again generally $15 for a $100 loan, to extend or "roll over" the loan for another two-week period. Because payday loans have such a short term to mature, the cost of borrowing, expressed as an annual percentage rate (APR) is extremely high. For instance, the fee that accompanies such a payday loan, stated as a percentage of the check or of the loan, generally $15 per $100 borrowed, usually translates into triple digit APR, which can range from 391% to 443%.

It has been estimated nationally that approximately 20% of payday loan customers are within the field of membership of at least one credit union. In response, credit unions across the country are developing responsible payday loan alternatives. Four alternatives are highlighted in this paper: StretchPay, Salary Advance, Quick Cash, and PAL.

In general, state laws govern payday lending. However, state laws are not uniform in their treatment of payday lending. Thus, several consumer advocates have called on Congress to review this issue and provide reforms.

The Subcommittee's Findings:

- Based on all the information that the subcommittee has gathered, the members have agreed that a Task Force of credit union lenders with expertise in low balance, convenience loans should be assembled to develop a model, or models, of lending products and credit counseling programs that credit unions could offer as an alternative to payday loans.
- Credit unions need to do more to educate their members regarding the high cost of payday lending.
- Credit unions need to do a better job at marketing their products and services to members so that the members are better aware of the options available and the value of using their credit union.
- Credit unions need to reach out to the communities that have embraced check cashers, pawn shops and payday lenders as their regular financial institutions,
- Credit unions need to become more aware of the local and cultural differences of low-wealth and moderate communities that may be unfamiliar with, and distrust traditional financial institutions.

CREDIT UNION COMMITMENT TO FAIR LENDING

The credit union system condemns the practice of predatory lending in any form (ex: mortgage loans, payday, credit card, etc.). Credit unions have a proud history of service to their members and provide products that meet members' needs and are in members' best financial interests. As member-owned, democratically controlled financial cooperatives, credit unions want to protect consumers from abusive predatory lending in the financial marketplace. America's more than 8,600 credit unions have always been committed to help their 89 million members create a better economic future for themselves and their families.

Recognizing that predatory lending is wholly inconsistent with the philosophy and principles unique to the credit union system, the Credit Union National Association (CUNA), the largest trade association representing credit unions, is committed to working with key policymakers, including state and federal credit union regulators, to ensure they support an approach that is designed to raise awareness to all of the issues surrounding predatory lending and highlight consumer oriented solutions.

INTRODUCTION

As payday lending issues continue to gain the attention of both the media and state legislators, the subcommittee was asked to review and update CUNA’s position on this issue. Payday lending is a complex issue with several implications (political, social and economic).

In an effort to comprehensively investigate how this issue could impact credit unions, the subcommittee gathered materials from credit unions, consumer groups, payday lender regulators, and government agencies. The following information represents some of the highlights of the subcommittee's findings:

BACKGROUND

Millions of modest-income households in the U. S. currently turn to alternative financial services (AFS) outlets to meet their basic financial needs. The AFS industry is comprised mainly of payday lenders, check-cashers, refund anticipation loans providers, finance companies, pawnshops, rent-to-own stores and auto title lenders; these businesses operate primarily to generate revenue and make a profit. The AFS industry operates outside of the traditional financial services framework. According to the Filene Research Institute, a non-profit credit union based research organization, AFS businesses provide banking and credit services to primarily low income and working poor consumers, people with less favorable credit or no credit history, residents living in minority neighborhoods and individuals with heavy debt burdens. Consumers use AFS businesses because they offer quick, easy access to cash and/or credit without the requiring the standard credit check.

In addition, AFS offers services, such as cashing checks that are often not available from traditional financial institutions.

The AFS sector is big business. The Fannie Mae Foundation (FMF), the philanthropic arm of the Federal National Mortgage Association (Fannie Mae), reported that in 2001, AFS businesses grossed more than $168 billion. A 2004 report by Stephens Inc., a privately owned investment bank**,** counts 22,000 AFS locations (by comparison, Starbucks has 8,624 U.S. locations and McDonald's has about 14,000) that generate approximately $40 billion in short-term loans annually. The growth of the AFS industry has had a tremendous impact on the financial services industry, as well as society as a whole. Three key issues have arisen from this influence:

a. Whether traditional financial institutions are failing to meet the needs of an increasing number of mainstream Americans who are coming to expect easy, 24/7 access and are willing to pay a premium for it;

b. Whether we are witnessing the emergence of a two tiered financial services market in which the lower economic strata pays higher costs for basic services; and/or

c. Whether the unbanked, underbanked and other AFS customers are exposed to unfair practices found in the sub-prime or AFS sector of the financial system.

PAYDAY LOANS

"Payday lending" (a.k.a. deferred advance loans, cash advance loans, check advance loans, post-dated check loans, or deferred deposit check loans) refers to single-payment, unsecured, short term (13-17 days), small loans ($100-$500) based on personal checks. In a typical payday loan, the consumer writes a personal check, or share draft, drawn on a financial institution for the amount borrowed plus a fee. The lender agrees not to deposit the check until the consumer’s next payday. The customer is advanced cash immediately. Sometimes the loan is made in exchange for the authorization to electronically debit the customer’s checking account for the loan amount plus the fee. When the loan is due, the borrower can redeem the check for cash, allow the check to clear through the financial institution, or pay another fee, again generally $15 for a $100 loan, to extend or “roll over” the loan for another two-week period.

Although the majority of payday borrowers eventually repay their debts, the economics of the industry depends on repeat borrowers. Because payday loans have such a short term to mature, the cost of borrowing, expressed as an annual percentage rate (APR) is extremely high. For instance, the fee that accompanies such a payday loan, stated as a percentage of the check or of the loan, generally $15 per $100 borrowed, usually translates into triple digit APR, which can range from 391% to 443%. This extension or "rolling over" can trap the borrower into a cycle of dependence and eventually insurmountable debt. In short, if a payday loan of $100 for 14 days with a fee of $15 were rolled over three times, it would cost the borrower $60 to borrow $100 for 56 days.

If the borrower is unable to pay back his loan, the lender can deposit the customer's check. If there are insufficient funds in the borrower's checking account and the check bounces, not only is the borrower now liable to the lender for the total loan amount, he is now liable to the bank for the transaction and NSF or overdraft fees, and he/she can be identified as a writer of bad checks.

According to the Center for Responsible Lending (CRL), a nonpartisan nonprofit research and policy organization dedicated to protecting homeownership, 91% of all payday loans are made to borrowers who take out five or more payday loans per year. On average, borrowers receive between 8 and 13 loans per year; only 1% of loans go to one-time borrowers. As a result, almost 5 million people are caught in this never ending cycle of debt.

The credit union industry does not believe that payday loans have to be inherently predatory. CUNA and its member credit unions are committed to providing a safe and affordable payday loan alternative to help their members resolve their short-term financial needs. As unique entities in the financial services industry, credit unions are limited by law to only serving people within their fields of membership and usury rates that cannot exceed 18%.

PROFILE OF A PAYDAY LOAN BORROWER

It has been estimated nationally that approximately 20% of payday loan customers are within the field of membership of at least one credit union. In fact, many credit unions are unaware that a lot of their members may be using a payday loan service. For example, Jim Schrimpf, president of Brewery Credit Union (BCU) in Milwaukee, Wisconsin recently learned that a significant number of his members were using payday lenders to bridge the gap in their weekly income. "We estimate probably 15% of our membership either had a payday loan or were doing business with a payday lender within the last 12 months," said Schrimpf, who is president and chief executive of a 7,000-member credit union.

An all too common story occurred at Florida Central Credit Union (FCCU) in Tampa, Florida. A member of FCCU used a payday loan outlet to borrow $300. By the time she turned to her credit union for help, the woman had paid $1,100 in fees on the $300 loan. Moreover, she still owed the original $300! Further, she also owed money to six different payday lenders, says FCCU CEO and President, Ed Gallagly. "This is very common. Herein lies the real problem with payday loans," explains Gallagly.

According to the CFSA, the typical payday loan customer likely earns between $25,000 - $50,000; is college educated, under 45, and married with children. Sixty-one percent of payday lending customers nationwide are white. In order to meet the personal check requirement to make a payday loan transaction, each borrower has a relationship with a traditional financial institution.

John Caskey, a professor at Swarthmore College and a leading expert on fringe banking issues, such as payday lending, doesn't disagree with the CFSA's profile but adds that 90% of payday borrowers are "financially pressed" - heavy debt or payment obligations. Professor Caskey estimates that credit unions could serve about 10% of payday borrowers, but the other 90% would need to go through some kind of financial counseling program to get better control of their finances, pay down debt and build up savings before qualifying for a standard credit union loan.

WHY CONSUMERS ARE DRAWN TO PAYDAY LENDERS

Why do consumers pay such exorbitant fees when affordable credit is available? In 2004, CFSA commissioned a study conducted by the Cypress Research Group (CRG), a business research firm, to examine why consumers use a payday lender. Some of their findings CRG's findings are below:

- Consumers prefer the speed of a payday loan. If they have an emergency and need $200 in 3 or 4 hours, traditional financial institutions are typically not a reliable source.
- Payday lenders are convenient because they're often located in strip centers and local neighborhoods.
- Hours of operation are more flexible, some check cashing outlets are often open for business 24 hours a day, seven days a week.
- Prefer to talk to a human being. Many consumers get to know their neighborhood payday lender well and feel comfortable doing business with them. They say they do not like using ATMs.
- More than three-quarters of customers were satisfied with the repayment schedule, the amount they could borrow and their ability to refinance or renew if they chose.
- Nine out of 10 customers were satisfied with the courtesy and professionalism of the lending staff; more than 85 percent with how they were treated during the application process and loan term.

Professor Caskey does not disagree that the "fast dispensing loan," $300 in 30 minutes, is a significant attraction for payday borrowers. Caskey contends that the primary reason is that most of these individuals have no where else to go for credit because they either have maxed out their credit cards, or cannot pass a standard credit check to qualify for one. He adds that other reasons for the heavy use of payday lenders is that many consumers are uncomfortable in formal settings and embarrassed by their lack of literacy skills. Indeed, these consumers appear to be more at ease in payday lending facilities because of the anonymity a payday loan service may provide.

CAN CREDIT UNIONS AFFORD TO BE THE ALTERNATIVE?

Both state and federal lawmakers have been looking to credit unions to be part of the solution to this complex problem. As the "consumers' financial institution" there are high expectations for credit unions to offer an affordable alternative to the current payday lending products. Credit unions have a clearly expressed legal mandate that separates credit unions from the rest of the financial services community. The Preamble to the Federal Credit Union Act, Title 12 of U.S. Code 1751, calls for: “An Act to establish federal credit union system and to make available to people of small means credit for provident purposes, thereby helping to stabilize the credit structure of the United States.”

Many credit unions have inquired into offering payday loan-type credit services, either because they want to stay competitive in the market place, or because they want to better serve their members, or because they recognize this as a community problem and want to offer a solution. In response, credit unions pooled their talent and resources to create several credit union alternatives to payday lending. The result was REAL Solutions.

REAL Solutions assists credit union organizations in promoting credit unions as a viable, and sustainable, choice for millions of low-wealth and modest income consumers. Credit unions are adding transaction products to better serve and attract members while helping these same members move up a path towards financial self sufficiency.

REAL Solutions is funded by the National Credit Union Foundation (NCUF), the charitable arm of the U.S. Credit Union movement. As NCUF’s signature program, REAL Solutions is paid for through NCUF’s earnings on the Community Investment Fund (CIF), which is available at all corporate credit unions.

Replicable Alternatives – REAL Solutions
The “REAL,” in REAL Solutions stands for “Relevant, Effective, Asset-building, Loyalty-producing” services. REAL Solutions assists state credit union leagues by working with them to offer a variety of products and services that have been successful in attracting consumers of modest means. The products used by REAL Solution have been developed specifically to meet the needs of credit unions and their members. “REAL Solutions is customized for each potential membership,” explains Program Director Lois Kitsch. Lois Kitsch, REAL Solutions national program director, urges all credit unions to consider offering affordable payday loan alternatives. “An estimated 7% to 15% of credit union members use payday loan products,” Kitsch reminded. “So do some credit union employees. Providing alternatives to payday loans is a good business decision, a good social decision, and a good advocacy decision.”

To learn more about REAL Solutions please go online to:
www.ncuf.coop/home/programs/realsolutions/realsolutions.aspx.

Below are some examples of credit union payday loan alternatives.

A. StretchPay – Wright-Patt Credit Union, Fairborn, Ohio
“StretchPay line-of-credit loans save our members $1.5 million in payday loan fees per year,” reported Doug Fecher, president/CEO of Wright-Patt Credit Union

in Fairborn, Ohio. That's based on the typical borrower's average of seven payday loans costing $350 per year.

In contrast, StretchPay charges an annual fee of just $35, plus interest payments of just $3 per month. "We purposely priced it not to make money," Fecher explained. "We can't save the world, but we can make it a lot cheaper."

Members of at least 60 days can qualify for 30-day cash advances regardless of credit history, as long as they have verified income, are not in the process of filing for bankruptcy, and have no delinquent loans, charge-offs or negative share accounts. One key difference from traditional payday loans: "Credit unions, unlike payday lenders, report to credit bureaus – so we help members build credit and transition them to traditional sources of credit without fees."

Each StretchPay annual fee goes into a pool shared by 20 credit unions. Each credit union offers StretchPay with the same terms, while sharing the risk through the CUSO. The fees are used to cover 90% of the loan losses.

The CUSO is now expanding to other states. "We decided if we could get every credit union to offer StretchPay, we could compete with the payday lenders' footprint," Fecher concluded. "Everyone should be able to get an affordable payday loan from a credit union.

B. Quick Cash – Washington State Employees Credit Union, Washington
Washington State Employees Credit Union (WSECU) offers its Quick Cash program as a responsible alternative to payday loans. WSECU helps its members in need by providing a short-term loan, while avoiding the excessive fees of commercial payday loan services.

If are 18 years or older and have a WSECU checking or savings account with full direct deposit of your paycheck you can apply for a Q-Cash loan by providing a current pay stub or proof of direct deposit and photo ID.

Why is Q-Cash a better alternative?:

- Q-Cash loans range from $50 to $700.
- Q-Cash fees are $10.00 per $100, 1/3 less than typical payday lenders
- Q-Cash loans are due within 45 days
- Repayment over two pay periods, not just one
- Free financial counseling and debt management planning is offered through Balance, a consumer counseling program
- Reasonable rates, combined with the security and convenience of working with WSECU
- Previous borrowers can apply in a branch or by phone at 800-562-0999.

C. The Payday Alternative Loan (PAL) – Air Force FCU, Texas
Air Force FCU is now offering Payday Alternative Loans (PAL). PAL loans not only help you in your time of need, but will help you build a little for the future. The PAL has a built in savings component. When your loan is repaid, you will have established credit, along with a small savings to fall back on for that next time you need funds in an emergency. You'll have a payment plan structured over a reasonable time period and nominal interest rate compared to the fees payday lenders typically charge.

The PAL offers**:**

- No prepayment penalty for early payment
- Reasonable payment plans that coincide with your payday
- An 18% APR*--a rate that is much less than the average effective rate charged by the payday lenders
- Loans from $100 to $1,000

Using the PAL will help you:

- With affordable credit and flexible payment plans that doesn't let you become dependent on the creditor
- Build your savings
- With free financial counseling through Consumer Credit Counseling Services

To get a PAL loan:

- You don't have to have established credit
- You will have to establish a checking account at Air Force FCU
- You will need to have Direct Deposit
- And if you have not defaulted on loans and are not currently subject to a bankruptcy petition, you will be granted a loan

D. Salary Advance - North Carolina State Employees Credit Union, North Carolina
North Carolina State Employees Credit Union offers a Salary Advance Loan program to its members. The Credit Union offers a Salary Advance Loan program that includes an inexpensive, convenient loan along with a Salary Advance Cash Account to assist members in saving for the future.

Each time a loan advance is processed; five percent of the advance will be placed into the "Cash Account" and pledged as collateral for the Salary Advance Loan. The Salary Advance Cash Account belongs to the member and earns interest; however, access will be restricted. A Credit Union Lending Official must approve all withdrawals from the Salary Advance Cash Account. If a withdrawal is approved, borrowing privileges on the Salary Advance Loan may be suspended for a period of time.

In addition to the "Cash Account", information and advice on topics such as money management and credit is available through a partnership with BALANCE. This financial counseling service is available to you at no cost. BALANCE is a wholly-owned subsidiary of the Consumer Credit Counseling Service of San Francisco. BALANCE provides financial counseling and employee assistance programs (EAP) to numerous companies and credit unions nationwide. This financial counseling service will be available to you without cost and encompasses the features described below.

Salary Advance Loan Specifications:

- Maximum ceiling of $500
- 12.00% APR
- No fees
- Balance plus accrued interest must be repaid via Funds Transfer from an SECU deposit account on the next pay date.
- Members must already have their paycheck on direct deposit with SECU.
- A Salary Advance Cash Account will be established for every Salary Advance Loan or advance to provide a means to save money easily and end the payday-to-payday cycle.

The allure and acceptance of payday loans raises the question of alternatives. Credit unions are being recognized as industry leaders in developing payday loan alternatives that help their members avoid the cycle of debt created by traditional payday lenders. Over a year ago, on September 10, 2006, the Washington Post recognized credit unions for taking the lead in developing payday loan alternatives. The Post urged consumers to "try your local credit union" as an alternative to a traditional payday lender because of their rates and terms.

A year later on September 18, 2007, the Washington Post published an editorial stating that credit unions have "filled the gap" created by predatory payday lenders by offering credible payday loan alternatives. The October 8, 2007 issue of Newsweek Magazine reported that "the most promising solution so far (in developing payday alternatives) is an effort by credit unions to create low-cost payday products for their members.

CREDIT UNIONS COMBAT PREDATORY PAYDAY LENDERS THROUGH FINANCIAL LITERACY

Financial Education in High Schools

One of the most important programs that CUNA, the state credit union leagues, and credit unions are currently promoting is financial education for our nation's youth. Credit unions believe that by educating our young people in the area of personal finance they will learn to make sound financial decisions and choose not to use high cost or predatory lenders.

CUNA has partnered with the National Endowment for Financial Education (NEFE), an independent nonprofit financial literacy foundation**,** and the Cooperative Extension Service, a program operated by the U.S. Department of Agriculture, to provide schools with free workbooks on financial literacy that can easily fit into an existing curriculum. CUNA has also partnered with the Jump$tart Coalition, a national coalition which provided advocacy, research, and educational resources to students K-12. In addition, CUNA is a member of the Jump$tart Coalition Board of Directors. Recently, CUNA has developed and announced the "Thrive by Five: Teaching Your Preschooler about Spending and Saving," which is a program aimed at providing free resources to parents to teach basic money concepts to preschoolers.

CUNA established April 17-23, 2005 as National Credit Union Youth Week. The annual National Youth Saving Challenge that takes place during that week brought in $4.62 million--more than triple last year's deposits of $1.39 million--from 280 reporting credit unions.

Currently, 15 states have a mandated personal finance education in schools, or include personal finance concepts in state assessment tests. The number of participating states is expected to increase over the next few years and credit unions plan to continue providing the support necessary to meet these educational objectives.

Credit Rating Education

Many consumers do not understand why they have to pay more for credit. They may know that they have missed a payment a few times but they often do not understand the many other factors that can impact their credit rating. Some credit unions try to build credit education into the loan process - sometimes by offering incentives such as the rate reduction program described previously in this booklet. Credit education informs borrowers about some of the factors that can affect their credit status, such as:

- Their level of unsecured debt;
- Employment history;
- How many times there have been inquiries on their credit rating; and
- How many times they have made a late payment.

A GROWING INDUSTRY

According to the Congressional Research Service (CRS), the public policy research arm of the United States Congress, the number of payday loan outlets nationwide has increased from approximately 300 in 1992, 10,000 in 2000, to nearly 22,000 in 2003. Economic forecast predict that the payday loan industry is expected to continue to grow exponentially over the next 10 years.

The growth of the payday loan industry has increased the media attention the industry has received in the last 10 years. As a result, payday lenders are aware of the unfavorable perception they have in the financial services marketplace. In an effort to enhance the image of its members, the national trade association for payday lenders changed its name from the National Check Cashers Association (NaCCA) to the Community Financial Services Association of America (CFSA).

SOCIAL IMPLICATIONS

Research conducted by academics and non-profit research organizations such as the Consumer Federation of America (CFA) have documented that short-term small loans based on personal checks held for deposit are extremely expensive for borrowers, lead to perpetual debt through loan roll-overs and foster abusive collection practices.

The CFSA contends that the payday lending abuses that have been reported by the media and consumer advocates represent only isolated incidences and should not be used to eliminate the entire industry. There are ample grounds to refute CFSA's contention. In Indiana over 77% of payday loans reviewed in that state were identified as roll-overs, fostering perpetual debt and significantly increasing the cost of these already expensive loans. Within the 77% that rolled-over their payday loan, 66% of those borrowers rolled over their loans more than 10 times per year. Additionally, in Texas regulators reported that in a single precinct in Dallas County, more than 13,000 cases of abusive collection practices were documented by payday loan borrowers.

If as predicted, the size of the payday loan industry continues to grow in the next 10 years at the rate of the previous 10 years, then it is very likely that the full impact of short term, high interest loans has yet to be completely analyzed and understood. If you include the fact that many payday lenders, and the customers they serve, operate outside the traditional financial services framework, it is very likely that we are only beginning to learn the extent to which people use payday loans.

ECONOMIC IMPLICATIONS

Members of the subcommittee are concerned that the perpetual debt cycle that is inherent in the current payday lending product may result in consumers facing serious financial hardships, such as bankruptcy. Since credit union members make up 1/5 of payday loan users, credit unions will be directly affected by this occurrence. The CFSA steadfastly maintains that "their statistics" indicate that the incidence of bankruptcies in connection with payday loans is less than one percent. CFSA also insists that the most common immediate cause of bankruptcy is a creditor's foreclosure on collateral (i.e. house, car, etc.), a collection tactic that never occurs in connection with unsecured payday advance transactions.

Others argue that due to the nature of payday loans, it would not be unusual for payday lenders to be overlooked on bankruptcy documents. The Missouri Credit Union Association (MCUA) has raised additional concerns about the correlation between bankruptcy and payday loans with their observation to the subcommittee on a recent increase of bankruptcies without previous delinquencies. Is it possible that credit union members could be covering up financial difficulties with funds from payday loans that credit unions would have otherwise detected and mitigated through traditional credit counseling methods?

Over 15 percent of payday loan users have filed for bankruptcy in the previous five years. According to one study prepared in 2003, people that have bounced at least one check within the last five years were more likely to become payday loan customers than those who did not bounce a check in the same time period. Furthermore, the same study discovered that that the single strongest predictor of the frequency of use of payday lending services is whether or not the respondent had been called by a collection agency for overdue bills. Households that have received collection calls regarding overdue bills were more likely to use payday lending services than those who had not received collection calls.

POLITICAL IMPLICATIONS

In situations across the country, the CFSA has paraded credit union members who use payday lenders in front of state lawmakers to testify how valuable a financial resource the payday lender is in their community. CFSA has told credit union representatives that if credit unions support the prohibition of payday lenders at their state legislatures, the credit union witnesses CFSA will call to testify will include in their testimony that credit unions are not meeting the community's needs. Moreover, credit union witnesses will also declare that credit unions' NSF fees, overdraft protection costs, and credit card late fees are calculated by credit unions into APRs and used to illustrate credit unions' services as high cost. In fact, an in-depth inspection of CFSA’s website will reveal an awkward attempt by CFSA to portray a payday loan as a more cost efficient alternative than using a credit union. However, it is important to note that the credit union industry refutes these claims. It has always been, and will always continue to be, the credit union philosophy and mission to serve members’ financial needs and to help them resolve short-term financial problems.

Next, the CFSA states that payday loans are the consumer's choice, and as an industry, they are "reluctant, on principles, to impose restrictions to limit choice in the market place." CFSA contends that consumers do not complain about payday lenders and that the characterization by CFA of payday lenders being abusive to consumers is simply based on the "consumer advocates' theoretical issues with payday lending."

CFSA also argues that payday borrowers are actually making "financially sophisticated" decisions when they choose a payday lender over a traditional financial institution. Their argument is based on a comparison between a payday loan and bouncing a check at a grocery store, paying a credit card late or utility bill late. According to CSFA, a consumer has four choices in this situation:

a. $100 payday advance with a $15 fee = 391% APR
b. $100 bounced check with $54 NSF/merchant fees = 1,409% APR

c. $100 credit card balance with a $37 late fee = 965% APR
d. $100 utility bill with $46 late/reconnect fees = 1,203% APR.

Based on these comparisons, CFSA states that "consumers are intuitively doing the smartest thing in a situation where they are going to bounce a check at the market, pay a credit card late, or pay their rent late." Professor Caskey would challenge the premise that additional debt is the "smartest thing" for consumers who are so financially pressed that they are willing to pay triple digit interest rates to survive until their next paycheck. He recommends "some type of counseling or program to get them out of the financial bind they are in at the time they seek out a payday lender."

Another twist to this issue is that payday lenders like to promote self regulation. In response to jurisdictions that are hostile to traditional payday lending practices, one of the strategies advanced by the payday lending industry within state legislatures is that they will impose restrictions and regulations on themselves. Thus, legislative action is not necessary. In essence, the payday lenders are saying "we agree there is a problem and we want to fix it." The consumer groups believe that this self “regulating" legislation, which does not include an interest rate cap, simply legalizes "loan-sharking" and will not curb many of the abuses. Further, the CFSA adopted a set of best practices guidelines called in 2000. However, it is important to remember the guidelines do not have the force of law, and thus, do not have to be followed by any payday lending operation.

CFSA supports and encourages incorporation of its best practices into state legislation so that CFSA's standards “raise the bar” for all providers in the state. In 1999, the American Legislative Exchange Council (ALEC), a group of state legislators and conservative policy advocates, adopted CFSA's model bill. Further, in 2001 the Committee on Suggested State Legislation of the Council of State Governments (CSG), an organization that provides public policy research and education for state governments, unanimously adopted the industry-supported model bill that was enacted in Colorado.

THE HIGH COST OF EASY CREDIT

State Government Action

In general, state laws govern payday lending. State laws are not uniform in their treatment of payday lending. According to the CFA, 37 states and the District of Columbia currently have laws or regulations that authorize payday lending. Eleven states have not authorized specific payday lending legislation or are unfavorable to the industry because of interest rate ceilings. It is important to note that in Maine, where there is no authorizing legislation, lenders can opt for a fee structure that allows payday lending.

In an effort to circumvent state law, some payday lenders have sought arrangements or partnerships with banks and thrifts that might allow them to avoid restrictions or prohibitions. This practice is sometimes referred to rent-a-bank or rent-a-charter payday lending.

In May 2004, Georgia passed the first in the nation law that specifically bars payday lenders from partnering with out-of-state banks to evade state usury caps. After the law was passed, payday lenders and their bank partners challenged the constitutionality of the law (Bankwest v. Baker). The United States District Court for the Northern District of Georgia rejected the lender's arguments and its decision was affirmed on appeal to the Eleventh Circuit Court of Appeals. Then the lenders' request for a hearing before the full court was granted. However, before the rehearing occurred, it was dismissed as moot because of the regulatory action, discussed below, by the Federal Deposit Insurance Corporation (FDIC), the primary supervisor for state chartered banks that are not members of the Federal Reserve Board (FRB), which regulates member state chartered banks.

Federal Regulatory Action

On March 24, 2000, the Board of Governors of the FRS published a rule that modified the Truth in Lending Act (TILA) that requires creditors to disclose the cost of credit as a dollar amount and in terms of APR. The rule also clarified that payday loans are within the definition of credit in the TILA. Before the rule was implemented, some payday lenders argued that their cash advances were not extensions of credit and should not be subject to the TILA.

The increase in rent-a-bank arrangements caught the attention of federal regulators by raising safety and soundness concerns. In 2001 the Office of the Comptroller of the Currency (OCC), which regulates national banks, the Office of Thrift Supervision (OTS) which regulates federal thrifts, and FRB, all issued advisory letters that prohibited the financial institutions they oversee from partnering with payday lenders (third party vendors) to fund payday loans. The advisories specifically discussed non-bank vendors seeking to avoid state laws.

Later in 2001, the FDIC issued guidelines regarding payday lending. The FDIC's guidelines permitted payday lending only if strict requirements were met. In 2005, the FDIC revised its guidelines to state that banks should ensure that payday loans are not granted to borrowers that have outstanding payday loans from another lender for a total of three months in the previous 12 month period. Individuals turned down for payday loans should be given information regarding alternative loan products.

Eventually, the National Credit Union Administration (NCUA), which regulates federally chartered credit unions, urged credit unions to become aware of the risks associated with payday lending. In its letter to the greater credit union community NCUA stressed that payday lending may lead to compliance and reputation risks for credit unions. NCUA's letter closed by encouraging credit unions to proactively protect their members from the potential risks their members may encounter using a payday loan. NCUA also recommended that credit unions provide as much information to the member so that they member may make an informed decision.

Federal Legislation

Last year the 109th Congress passed and President Bush signed into law the 2007 Defense Authorization Act. The law contained a provision which imposes a 36% cap on loans to military personnel, reserves, and members of the National Guard on full time active duty, and their dependents. This law was created in response to lenders that use abusive lending practices to take advantage of military personnel.

The 109th Congress also passed the Financial Services Regulatory Relief Act of 2006. Among four key credit union provisions was one that would allow check-cashing and money-transfer services to be offered to non-members within a credit union's field of membership. Federal credit unions currently can provide check-cashing services to their members. In addition, credit union can also provide some wire transfer services to individuals within their field of membership, but who are not members, under certain conditions. This initiative is wholly consistent with the credit union industry's obligation to reach out and serve traditionally underserved communities.

At the time of this writing, only one bill in the 110th Congress has been introduced that directly addresses this issue. The Payday Loan Reform Act of 2007 (HR 2871) was introduced by U.S. Representative Tom Udall. H.R. 2871 is currently pending in the House Committee on Financial Services. In short, the bill would prohibit payday lending and its derivatives by any financial institution. All payday loan instruments or transactions would be void from inception. It is very unlikely that this bill or a similar bill would be approved by the full committee by the end of this year or next year.

PAYDAY LENDERS ARE HERE TO STAY

The consensus of the subcommittee is that state lawmakers are interpreting the popularity of this product as filling an important financial service niche for consumers who cannot qualify for credit from traditional financial institutions. The subcommittee also agreed that it is critical that effective consumer protections be included in payday loan statutes and regulations. Furthermore, both state and federal lawmakers are increasingly looking to credit unions to develop financially responsible alternatives to the traditional payday loan. It is the goal of the subcommittee to work with state and federal regulators, state credit union leagues, credit unions, and credit union members to develop payday lending solutions that benefit credit union members.

CONCLUSION

In closing, credit unions and their payday lending products will be measured by the number of new members using credit union services rather than the number of participating credit unions. The goal for credit unions should not only be to make a profit on their payday loan alternatives, but rather to educate their members about all the services a credit union can provide. The ultimate goal for the credit union and the member should be for the member to evolve through the credit path from cash withdrawer to saver, from saver to borrower, and from borrower to owner.

Obviously, some credit unions will be concerned that providing a payday alternative may not be cost-effective. That is why it is critical that credit union considering a payday loan alternative should establish success factors before they implement a payday loan alternative program. Factors such as competitive pricing, fast turn around, customer relationship management, and loss mitigation should be considered by a particular credit union before they move forward.