

# **The Payday Loan Industry of Dallas, Texas**

***Issues, Challenges, and Recommendations***



## **INVESTIGATIVE SUMMARY**

**January 2012**

Better Business Bureau of Metropolitan Dallas, Inc  
1601 Elm Street, Suite 3838, Dallas, Texas 75201-4701

## **Purpose**

Within the last 10 years, Texas' payday loan industry has surged to a strong presence in the marketplace, despite efforts to limit the practices of an industry which many consumer advocates consider large-scale predatory lending.

The primary opposition voiced by consumer advocates surrounds the cycle of debt which is often caused by providing high fee loans to the economically disadvantaged.

On its face, paying a little over \$20 for every \$100 borrowed for a two-week loan sounds outrageous enough. However, in practice, fees are usually much higher, since payday lenders allow consumers to extend the due date, or roll-over, their loan by paying another round of fees for each roll-over.

According to the State of Texas, only 25% of consumers pay off their payday loan within the original 2 week period, while 40% of borrowers will roll-over the loan 5 or more times. (See inset graphic) By rolling-over the average \$300 loan 9 times at 521% APR, a consumer would pay over \$840 back to the payday lender.

As it is the BBB's responsibility to ensure that BBB accreditation is only offered to those businesses that embody integrity within the marketplace, this investigation's purpose is to examine the current activities, challenges, and criticism within the payday loan industry to help determine whether the BBB of Metropolitan Dallas should bar the industry from local BBB accreditation.

## **Industry Background**

As a matter of practice, payday loan companies provide consumers with short-term small loans with fees that often exceed 500% APR. 500% APR would generally be considered usurious, or greatly exceeding legal thresholds, if offered by traditional lending institutions. However, Texas payday lenders have historically skirted Texas' 10% interest cap altogether by redefining the way they do business.



### Pre-2005

Prior to 2005, the Texas payday lending industry functioned within a "rent-a-bank" model. The model circumvented state usury laws by having the payday lender function as a loan broker rather than a lender.

Under the authority of the National Bank Act, third-party banks located in states without usury laws were able to export their own interest rates. These banks set up relationships with local payday lenders to act as loan brokers. However, in March of 2005, the FDIC issued new standards for its insured banks which effectively restricted Texas payday lenders. The industry quickly devised a new model.

### 2005-2011

Recognizing its inability to survive under the FDIC's new standards, the Texas payday loan industry quickly reworked its model, this time using laws which were originally designed for companies which provide credit repair services. This came to be known as the Credit Services Organization (CSO) payday model.

The business model's name comes from Texas' 1987 Credit Services Organization Act which allows organizations to register with the State of Texas and provide fee-based services for the purpose of assisting consumers improve their credit and/or obtain an extension of credit through a third-party lender.

Similar to the previous model, the credit service organization (payday lender) functioned as a sub-prime small loan broker.

Even though the industry was accused of exploiting a questionable legal loophole, it successfully defended itself by citing an opinion of a 2004 Fifth Circuit Court of Appeals case, Lovick vs. Ritemoney, which concluded that fees charged by a registered CSO cannot be considered interest. Therefore, a company which does not charge interest will not be held to state usury laws.

In 2006, the Texas Attorney General released an opinion in approval of the Court's decision.

However, in 2011 Texas' state legislature approved new regulations for the industry in an attempt to provide more oversight and licensing requirements for payday lenders, to be carried out by Texas' Office of the Consumer Credit Commissioner (OCCC).

Although the new regulations require better disclosure to both consumers and regulators, consumer advocates feel that the legislation fell short of providing

adequate protections for those consumers who agree to pay the outrageous fees charged by the industry.

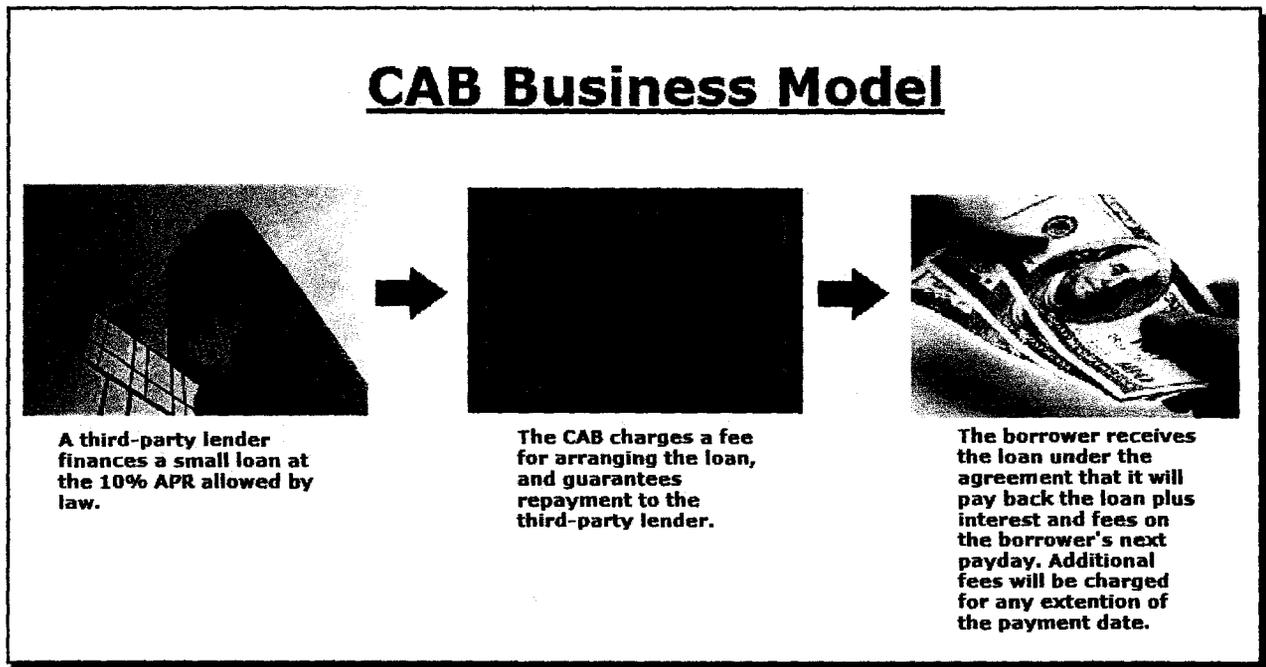
## 2012

After the 2011 state regulations took effect, payday lenders were renamed Credit Access Businesses (CAB).

The business model is identical to the previous CSO model (See graphic below). Yet, the industry has additional state regulations with which it must abide.

Those regulations include:

- Obtaining a CAB license for a fee;
- Clear disclosure of fees at the point of sale;
- CABs providing quarterly business reports to the OCCC.



## City of Dallas Ordinances

In late 2011, the Dallas City Council addressed the shortfalls of the state's new legislation by passing two local ordinances which put tighter restrictions on payday lenders than those required by state regulators.

The two ordinances place tighter restrictions on the industry by:

- Limiting the proximity of payday lending locations to each other;
- Requiring industry participants to attain a special use permit;
- Requiring city-level registration;

- Limiting the amount to be loaned based on the consumer's monthly income; and
- Limiting the terms of repayment.

Recognizing the surge in the number of participants in this industry, these ordinances were not a first for the North Texas area. The Cities of Richardson, Mesquite, Garland, and Irving have all adopted similar ordinances since 2008 in an attempt to restrict the concentration of payday lenders in those cities.

It has been estimated that Texas has approximately 3,300 payday lending locations. As a matter of comparison, that amounts to more than 5 payday lending locations for every Starbucks in the state.

Soon after the passing of the ordinances, the City of Dallas was sued by the Consumer Service Alliance of Texas (CSAT), a trade organization which represents the payday lending industry. CSAT states that the ordinances preempt Texas laws which allow for the existence of payday lenders and that the ordinances will effectively prohibit payday lenders from doing business in Dallas.

The City of Dallas argues that it does not intend to eliminate the industry. Rather, it intends to limit the industry's ability to capture vulnerable citizens into a cycle of debt.

A trial has been set for October, 2012.

### **Actions to Protect Consumers**

According to the Consumer Federation of America, 17 states and the District of Columbia prohibit high-cost payday lending. Texas' neighbor to the northeast, Arkansas is one of the most recent additions to this list. In 2010, Arkansas voters adopted a 17% APR cap for consumer credit, effectively ending payday lending in the state.

In addition, in a move to protect their soldiers and families from the debt cycle created by payday loans, the Department of Defense enacted the Defense Authorization Act of 2006 to prohibit payday lenders from charging military families more than 36% APR on payday loans. The 521% APR charged for Texas payday amounts to 14 times more than the 36% cap for military families.

### **Recommendation**

While the payday lending industry consistently argues the legality and necessity of its practices, the BBB's concern is on the topic of integrity.

Although the industry has been successful in arguing that the fees that they charge are not *legally* treated as interest, the fact remains that the incurred debt, whether it's called a "fee" or "interest," results in the same amount of debt.

Usury laws originate from a long history of accepted practices of charging interest at socially acceptable levels. The laws stem from the generally time-honored notion that designing a loan that potentially exploits the most financially vulnerable in our society is morally unjust.

While the Dallas BBB recognizes that some companies within the payday lending industry have maintained a positive record with the Dallas BBB, 50% of all payday lenders which are rated by the Dallas BBB receive the lowest reliability rating of "F."

### **Resolution**

**Whereas**, one of the BBB's Standards for Trust is that its accredited businesses approach all business dealings, marketplace transactions and commitments with integrity, as well as avoid involvement in activities that reflect unfavorably on, or otherwise adversely affect the public image of the BBB or its accredited businesses; and

**Whereas**, the Dallas BBB recognizes that the current state of the payday lending industry does not embody integrity in a manner worthy of BBB accreditation; be it

**Resolved**, that the payday lending industry be prohibited from BBB accreditation with the Better Business Bureau serving Metropolitan Dallas, Inc.

**Resolution accepted by the Business Standards Committee of the Dallas BBB Board of Directors on February 13, 2012.**