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Legislators seek to curtail 'payday lending' practices

By H.J. CUMMINS, Star Tribune

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Minnesota legislators are taking on the underbelly of the lending industry this session, trying to shore up consumer protections on expensive, short-term loans at a time when a faltering economy might send more people looking for them.

Lawmakers want to create a 36 percent annual maximum on interest rates that now can reach more than 600 percent and require flexible repayment options for the $58 million industry in Minnesota commonly known as payday lending.

Legislators also want to force all the lenders back under the state's consumer-loan statute, after several migrated to another law with more lucrative terms.

Payday lenders argue that the proposed changes are so onerous they wouldn't justify the risk in lending to consumers whom traditional banks won't help. If those changes become law, the lenders add, they'd have to close up shop in the state.

Both bills are expected to be introduced in the House and Senate by week's end.

The bills come at a time when about a dozen other states have outlawed payday loans or set rate caps -- usually around 36 percent -- that both lenders and consumer advocates agree effectively shut down the shops.

They also come as one of the nation's largest payday lenders, South Carolina-based Advance America, is lobbying for a higher interest rate in Minnesota because it wants to expand into the state.

Payday lenders write small loans of several hundred dollars for short periods -- usually two to four weeks -- and often to people who find themselves short of money until their next payday.

Customers leave the lender a check for the amount of money they are borrowing -- plus fees and interest -- postdated to its payoff date. They either return and repay the full amount by then, or the lender cashes the check.

The industry says it provides loans to people -- often for emergencies such as illness or car repairs -- whose financial records likely disqualify them at banks. It objects to the frequent citing of 400 to 600 annual percentage rates (APRs) on their loans, arguing that annual rates don't apply because theirs are weekslong loans.

"It's a business that serves a niche and a need," said Mark Smith, co-owner of MoneyXchange, which has seven payday loan shops in the Twin Cities area.

Critics counter that those high APRs are exactly the point. These typically aren't one-time loans, they say. Instead, the difficulty of quickly repaying the first loan often leads to a chain of more -- taking out a new one to repay the last -- which means the APR does reach 400 to 600 percent.

Six in 10 borrowers visit 12 or more times a year, according to a sampling of four states reported by the Center for Responsible Lending, a North Carolina-based research and advocacy agency. The study didn't include Minnesota.

"Payday lending can end up miring people in debt with outrageous interest rates," said Rep. Jim Davnie, DFL-Minneapolis, sponsor of one bill.

The payday treadmill

Minnesotans took out about 1 million payday loans for more than $215 million from 1999 to 2006, according to state Department of Commerce data analyzed by the Legal Services Advocacy Project, part of Legal Aid. The loans are most common in the suburbs -- 56 percent of the total -- with 27 percent in rural Minnesota and 16 percent in Minneapolis and St. Paul.

From 1999 to 2006, the latest annual data available, the industry grew from five companies and $33 million in loans to 24 companies and $58 million in loans.

Arlene White, 54, of St. Paul, found herself on the payday loan treadmill last fall. Struggling then with a gambling compulsion, White went to PayDay America, Minnesota's biggest payday lender, at least seven times in four months. One 17-day loan of $300 cost her $31.69 in fees and interest. Another two-week loan of $390 cost her $27.15.

She sought treatment for her gambling habit, she said. There have been other crises, such as the time her water heater went out. She's not ready to say there should be no payday lenders, but she hopes never to use one again.

"People do get caught in financial binds," White said, "I just believe they're getting exploited with these interest rates."

Reinforcing a 1995 law

Rep. Steve Simon, DFL-St. Louis Park, who's sponsoring the bill limiting rates to 36 percent, said he picked the figure because it's the federal cap on payday loans to active military personnel.

"This is trying to stop the drainage of wealth from working-class families, which is what we see these products doing," said Brandon Nessen at ACORN, a community organizing agency based in St. Paul that is advocating for the bill.

A second bill would require all payday lenders to work under the Minnesota Consumer Small Loan Act, passed in 1995 specifically to tighten regulations on payday lending. Three of Minnesota's four biggest payday lenders have chosen in recent years to operate instead under the state's industrial loan and thrift statute, which allows them to make bigger loans and charge higher fees. Those lenders accounted for about 70 percent of the payday loans in the state in 2006.

"All we're saying is, let's move everybody under the Minnesota law intended to cover this," said Ron Elwood, an attorney at the Legal Service Advocacy Project who worked on the legislation.

PayDay America moved to the loan and thrift statute so it could make loans larger than $350, the limit under the small loan legislation, said company President Brad Rixmann.

"Customers need more money than that; $350 doesn't get people anything," Rixmann said. "Our average loan is higher than the maximum consumer loan."

But critics say the lenders wanted to raise their fees along with their loan sizes. And it worked, Elwood said. For example, a $100 loan under the Consumer Small Loan Act could carry interest up to a 391 percent APR; a $100 loan at a thrift can go as high as 685 APR.

"We thought we had everything covered, and then it turns out there's this loophole payday lenders found that allows them to evade the rate and loan caps in the statutes," said Sandy Pappas, DFL-St. Paul, who is sponsoring the legislation in the Senate.

The bill already has a long list of supporters, including the Minnesota attorney general, Legal Aid, Lutheran Social Service of Minnesota and the AFL-CIO, Elwood said.

The bill's second feature would give borrowers the option of repaying their loans in five installments over at least 10 weeks, which is expected to be more manageable than the current paid-in-full requirement and the standard two- to four-week deadline.

Keeping the business viable

Smith, of MoneyXchange, had mixed reactions to the legislation.

"The industrial thrifts are a thorn in my side," said Smith, whose stores operate under the consumer small loan statute. "I would be very much in favor of closing that loophole."

But he wonders why legislators don't aim at other targets. For example, he had just stopped at an ATM and paid $2.50 to take out $40. That's a 6 percent fee with an 1,800 annual percentage rate.

"I could give you examples like that all over the map," he said.

Advance America is looking to open shops in Minnesota, but first it wants the state to raise the allowable customer charges, said Jamie Fulmer, director of public affairs. The company has 2,800 stores in 35 states -- none of which has a 36 percent cap, Fulmer said.

"A 36 percent cap on a $100 two-week loan would result in $1.38, and you can't operate a sustainable business model on that," Fulmer said. "We do have folks working with folks in the Legislature there to see if there's a way for our business to exist viably in Minnesota."

He defended his company charging $15 for a $100, two-week loan, saying it does work out to a 391 APR, but only if people take out that loan every two weeks.

"What consumers care about is what it's going to cost them to reach into their pocket and pay for the product -- compared to their alternatives -- and they like our straightforward process," he said.

H.J. Cummins • 612-673-4671