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FRINGE BANKERS: ECONOMIC PREDATORS OR A NEW FINANCIAL SERVICES MODEL?

Jean A. Fox

FRINGE BANKERS: ECONOMIC PREDATORS OR A NEW FINANCIAL SERVICES MODEL?

JEAN ANN FOX*

Cash-strapped families are bombarded with easy credit offers and costly fee-based financial services. Unbanked and marginally banked consumers pay steep fees at check-cashing outlets to perform basic financial transactions, such as cashing checks, paying bills, or wiring funds. Payday and car title loans charge triple-digit interest rates and place important assets at risk if short-term loans cannot be quickly repaid. Tax-refund loans skim hundreds of millions in anti-poverty dollars from tax refunds and Earned Income Tax Credits, from the working poor. Consumer protections are inadequate in most states and resources to assist families and to improve communities are siphoned out of low- and moderate-income neighborhoods by fringe "bankers."

INTRODUCTION

Storefront fee-for-service financial providers are attempting to move into the mainstream through public relations campaigns and image advertising, using updated store design and marketing pitched to a broader range of consumers. Typically, their products and services charge high fees and astronomical interest rates, endangering valuable assets. Consumers who can least afford to pay for high-cost, high-risk financial products are the most likely to use them. Fringe financial transactions impede asset development and trap borrowers in cycles of debt.

A two-tiered financial services market results, in part, from gaps in consumer protections. As long as state and federal governments fail to regulate check cashers and quick-cash lenders, and fail

* The author is the Director of Consumer Protection for Consumer Federation of America, a nonprofit consumer advocacy organization based in Washington DC. She is an author and coauthor of numerous reports on payday lending, car title lending, refund anticipation loans, bank overdraft loans and bounced check fees, and check cashing. *See* Consumer Fed'n of Am., http://www.consumerfed.org (last visited June 28, 2007); Payday Loan Consumer Information, http://www.paydayloaninfo.org (last visited June 28, 2007).

to enforce usury laws or prohibit rate gouging, fringe bankers will continue to be "economic predators" rather than providers of a "new financial services model."

I. Fringe Banking Financial Products

Fringe financial products include both transaction services and small loans secured by bank accounts, car titles, tax refunds, and federal antipoverty benefits. Rent-to-own stores that purport to "lease" household goods, electronics, and jewelry are a form of high-cost retail installment sales but are not dealt with in this Essay.

A. *Payday Loans*

Payday loans, also called deferred deposit loans, are short-term cash advances based on the borrower's personal check or debit authorization held for future deposit. These loans are made at payday loan outlets, check cashers, rent-to-own stores, pawn shops, or via the Internet. As of 2006, there were approximately 25,000 payday-loan outlets, making over $28 billion in loans at a cost to consumers of almost $5 billion.[1] A 2006 Consumer Federation of America (CFA) survey of check cashers found that in the states that authorize payday loans, two-thirds of the cash-change stores also make payday loans.[2]

To get a payday loan, a borrower must have a bank account, identification, and a source of income, but is not required to demonstrate an ability to repay or possession of sound credit. Loans are typically for a few hundred up to a thousand dollars and are due in full on the borrower's next payday. If the loan is not repaid in person, the check used to secure the loan will be deposited and, if sufficient funds are not available, will trigger bounced-check fees from both the payday lender and the borrower's bank. Payday loans are extremely expensive, with a $300 loan costing be-

1. Uriah King, Leslie Parrish & Ozlem Tanik, Ctr. for Responsible Lending, Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year 17 (2006), *available at* http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

2. Jean Ann Fox & Patrick Woodall, Consumer Fed'n of Am., Cashed Out: Consumers Pay Steep Premium to "Bank" at Check Cashing Outlets 2 (2006), *available at* http://www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf.

tween $45 and $90 for a two-week term, which translates to 390% to 780% annual interest rate.[3]

B. *Refund Anticipation Loans (RALs)*

Quick tax loans issued by banks during tax season are principally marketed by commercial tax preparers to the working poor. Loans are secured by anticipated tax refunds, often including federally funded antipoverty tax credits. The average RAL is about $2500 and is repaid in less than two weeks when the IRS direct deposits the borrower's tax refund to an account at the bank that extended the loan.[4] According to a 2007 report by the National Consumer Law Center and the CFA, there were 9.6 million RALs in the 2005 tax-filing season, down from 12.38 million in 2004.[5] Taxpayers paid $960 million in RAL fees in 2005, plus extra fees, for a total cost of over $1 billion.[6] The cost of borrowing against expected tax refunds amounts to an annual percentage rate (APR) ranging from 40% to 500%.[7] The average $2500 loan results in an APR ranging from 85% to 170%, depending on the lender.[8]

RALs are made by a few banks including HSBC, Santa Barbara Bank & Trust, JP Morgan Chase, and Republic Bank & Trust through tax preparers H&R Block, Jackson Hewitt, and Liberty Tax Service, as well as at storefront fringe financial service companies, retailers, and car dealers.

C. *Car Title Loans*

Car title loans provide quick cash secured by the title to a vehicle owned free and clear by the borrower. Loans are typically due in one month but can be extended by paying only the finance charge. Title loans are legal in about half of the states.[9] A national

3. For more information on payday lending see Payday Loan Consumer Information, Facts, http://www.paydayloaninfo.org/facts.cfm.

4. CHI CHI WU & JEAN ANN FOX, NAT'L CONSUMER LAW CTR. & CONSUMER FED'N OF AM., ONE STEP FORWARD, ONE STEP BACK: PROGRESS SEEN IN EFFORTS AGAINST HIGH-PRICED REFUND ANTICIPATION LOANS, BUT EVEN MORE ABUSIVE PRODUCTS INTRODUCED 4-5 (2007), *available at* http://www.consumerlaw.org/issues/refund_anticipation/content/2007_RAL_Report.pdf.

5. *Id.* at 1.

6. *Id.* at 5-6.

7. *Id.* at 11.

8. *Id.* at 2.

9. JEAN ANN FOX & ELIZABETH GUY, CONSUMER FED'N OF AM., DRIVEN INTO DEBT: CFA CAR TITLE LOAN STORE AND ONLINE SURVEY 5-6 (2005), *available at* http://www.consumerfed.org/pdfs/Car_Title_Loan_Report_111705.pdf.

survey of title lenders in 2005 found that the average loan comes with costs amounting to 300% APR.[10] There are no national statistics on the size of this business, but the Tennessee Department of Financial Institutions reported $40 million in outstanding accounts receivable at title lenders in that state on June 30, 2006, with 206 companies at 645 locations extending 92,489 loans.[11] The majority of title loans in Tennessee were for $500 or less.[12]

D. *Check Cashing*

Retail outlets in low- and moderate-income neighborhoods function as fee-for-service financial supermarkets. Check-cashing outlets cash more than 180 million checks worth more than $55 billion annually, according to the industry.[13] Consumers pay a percentage of the face value of checks to get them cashed.[14] A national survey conducted by the CFA in 2006 found that the average fee to cash government benefit checks was 2.44%.[15] The average fee to cash a hand-written payroll check was 4.11% or $19.66 to cash a weekly $478.41 hand-written paycheck for blue-collar workers.[16] A lower fee of 2.52% is typically charged to cash computer-generated paychecks but fees can reach as high as 5% of each paycheck.[17]

Some check-cashing outlets also sell prepaid debit cards as expensive bank account substitutes.[18] The average prepaid debit card costs $10.86 plus monthly or weekly fees totaling approximately $5 per month.[19] Most outlets also charge a fee to load money onto the card ($3.09 on average).[20] Half of surveyed check cashers impose a charge every time the card is used,[21] not counting fees charged for using the cards at automated teller machines.

10. *Id.* at 2.

11. TENN. DEP'T OF FIN. INSTS., REPORT ON THE TITLE PLEDGE INDUSTRY: A SUPPLEMENT TO THE 2006 REPORT TO THE TENNESSEE GENERAL ASSEMBLY 7 (2007) [hereinafter REPORT ON THE TITLE PLEDGE INDUSTRY], *available at* http://www.tennessee.gov/tdfi/compliance/TPLSupplementalReport-FINAL.pdf.

12. *Id.*

13. FOX & WOODALL, *supra* note 2, at 4.

14. *Id.* at 3.

15. *Id.* at 6.

16. *Id.* at 6-7.

17. *Id.* at 6.

18. *See generally id.* at 10.

19. *Id.*

20. *Id.*

21. *Id.*

II. Risks to Consumers and Communities from Fringe Banking

Consumers who rely on fringe bankers for routine financial services risk more than the high fees charged to borrow money, cash checks, or load money onto prepaid cards. Payday loan borrowers are at great risk of becoming mired in a debt trap due to the combination of check holding, extremely high cost, short repayment terms, and lending without determining the borrower's ability to repay. Simply put, most payday loan borrowers cannot afford to repay the loan in full out of the next paycheck and still have enough money left to make it to the next paycheck without borrowing again. The average borrower has eight to nine loans per year from a single lender.[22]

Failure to repay or renew a payday loan puts the borrower at risk of losing bank account or check-writing privileges. Every payday loan involves a personal check or debit authorization unlikely to be covered by funds on deposit when the loan is made. Borrowers are sometimes threatened with adverse action for failure to make good on the check. Some lenders repeatedly attempt to collect on electronic debits, triggering multiple insufficient funds fees from both the borrower's bank and the payday lender. Lenders also sue for nonpayment.

RALs are bank loans that require taxpayers to immediately repay the bank out of current funds, even if the tax refund expected to repay the loan is denied or less than the loaned amount. Consumers who get RALs run the risk of cross-lender debt collection, a unique risk for borrowers. Many RAL contracts include an agreement that permits any bank claiming an unpaid RAL from a prior year to be paid out of the following year's tax refund when a consumer applies for a loan. Consumers who have their taxes prepared at a retailer or car dealership can get a RAL to use as a down payment on a big-ticket purchase. If another bank has already claimed this year's refund to pay a prior RAL debt or if the IRS disallows part or all of the anticipated refund, the consumer who used the RAL as a down payment is still responsible for the purchase.

22. Bureau of Fin. Insts., State Corp. Comm'n, Commonwealth of Va., 2006 Annual Report: Payday Lender Licensees and Check Cashers Operating in Virginia at the Close of Business December 31, 2006, at 7 (2007), *available at* http://scc.virginia.gov/division/banking/forms/ar04-06.pdf; *see also* King, Parrish & Tanik, *supra* note 1, at 7.

Consumers who pledge car titles as security for small loans run the risk of losing their vehicle. For example, Tennessee regulators reported that 10,933 vehicles were repossessed for nonpayment in 2005 out of a total 92,489 loan agreements.[23] If every Tennessee borrower renews a loan just three times, that is a 35% repossession rate. If every loan is renewed seven times, as indicated by an earlier Tennessee Department of Financial Institutions report, more than half of the cars pledged for loans are eventually lost by borrowers.[24] Since these cars provide vital transportation and are often the borrower's most valuable asset, securing small loans with the title to the family vehicle is extremely risky.

"Banking" at a check casher instead of at an insured depository institution adds risk to consumers as well. Instead of keeping money in an insured account, check-cashing patrons carry cash unless they pay to load check proceeds onto a high-fee card or pay for a money order to hold cash. Without a bank account it is more difficult to build savings, adhere to a budget, and keep track of expenditures. Consumers may pay for electronic bill-pay services and wire transfers, or buy money orders to make distant payments. Prepaid debit cards purchased at financial services stores as bank account replacements may not be covered by the federal protections for debit cards tied to a checking account, including federal deposit insurance.

An inherent risk in all fringe credit products is that users do not build the positive credit rating needed to qualify for lower-cost financial services in the future. Most fringe financial services providers do not report successful payment to mainstream credit bureaus. Payday and other lenders use specialty reporting services such as TeleTrack to screen applicants,[25] but this does not result in an improved credit score for successful payment. Fledgling efforts to build thin credit files through fringe loan reporting raise questions of whether payday loan payment-reporting adds to or detracts from scores.

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23. REPORT ON THE TITLE PLEDGE INDUSTRY, *supra* note 11, at 7.
24. *See generally id.*
25. Teletrack, http://www.teletrack.com (last visited Nov. 2, 2007).

III. Vulnerable Consumers Use Fringe Banking Services[26]

Consumers who "bank" in the fringe financial market pay steep fees to conduct routine transactions and can hardly afford the out-of-pocket expense involved or the risk of losing a valuable asset.

A. *Payday Loans*

Despite industry claims to the contrary, most payday loan consumers earn low or moderate incomes and are often minorities. The Colorado Office of the Administrator of the Uniform Consumer Credit Code collected a sample of customer records at supervised payday lenders during four years of inspections.[27] The Colorado study found that the typical payday loan customer "is a thirty-six-year-old single woman, making $2,370 per month."[28] "Consumers earning less than $2,500 per month [($30,000 per year) make up] nearly two-thirds . . . of all [Colorado] borrowers."[29] Almost two-thirds of all Colorado borrowers "occupy the lowest three income occupations" of laborer, office worker, or benefit recipient.[30] Additionally, although military service members represent approximately 1% of Colorado's adult population, they constitute over 4% of those who borrow from payday loan outlets in that state.[31]

Payday loan customers are more likely to be minorities.

> [A] 2001 survey of low-income families in Charlotte (North Carolina[ ] . . .) estimated that African Americans were about twice as likely to have borrowed from a payday lender in a two-year

26. This section contains excerpts from Consumer Fed'n of Am., Testimony of Jean Ann Fox: Director of Consumer Protection Before the Subcommittee on Domestic Policy of the House Committee on Oversight and Domestic Reform (2007), *available at* http://www.consumerfed.org/pdfs/PDL_Kucinich_Hearing_Testimony032107.pdf; Consumer Fed'n of Am., Collecting Consumer Debts: The Challenges of Change (2007); Fox & Woodall, *supra* note 2; Amanda Quester & Jean Ann Fox, Ctr. for Responsible Lending & Consumer Fed'n of Am., Car Title Lending: Driving Borrowers to Financial Ruin (2005), *available at* http://www.responsiblelending.org/pdfs/rr008-Car_Title_Lending-0405.pdf; Wu & Fox, *supra* note 4.

27. Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 Denv. U. L. Rev. 387, 406-07 (2005).

28. *Id.* at 405.

29. *Id.* at 406.

30. *Id.* at 406-07.

31. U.S. Dep't of Def., Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Families 12 (2006).

> period as whites . . . , and that, after controlling for [many] socio-economic characteristics, [African Americans] were five times more likely than whites to take out multiple payday loans.[32]

The same study found that payday lenders clustered in working-class neighborhoods and disproportionately favored neighborhoods with high minority populations.[33]

Texan payday loan borrowers are disproportionately African American and Hispanic, according to an academic study based an on analysis of a database of 145,000 payday loan applicants from 2000 to 2004 from a "large payday and pawn lender" in Texas.[34] While only 11.5% of Texas adults are African American,[35] they represent 43% of payday loan borrowers.[36] Despite lower bank account ownership by Hispanic families (24% nationally are unbanked compared to 10% for the population as a whole),[37] 34% of payday loan borrowers were Hispanic, compared to 29% of Texas adults.[38] The Texas study also found that 62% of borrowers were female and that the median annual pay was $18,540, compared to census data for median annual pay in Texas of $19,617.[39] Only 34% of Texas payday loan borrowers owned their own home.[40]

B. *Check Cashers*

A 2005 survey of more than two thousand representative consumers found that the unbanked were more likely to be lower-income and minority consumers. They were also more likely to use fringe financial services. About one-in-seven (14.9%) consumers earning under $40,000 annually had no bank account, whereas fewer than one-in-twenty (4.3%) consumers earning more than $40,000 were unbanked. African American and Latino consumers were significantly more likely to be unbanked than white consum-

32. Michael A. Stegman, *Payday Lending*, 21 J. ECON. PERSP. 169, 174 (2007).
33. *Id.*
34. PAIGE MARTA SKIBA & JEREMY TOBACMAN, MEASURING THE INDIVIDUAL-LEVEL EFFECTS OF ACCESS TO CREDIT: EVIDENCE FROM PAYDAY LOANS tbl.1 (2007), *available at* http://pskiba.googlepages.com/SkibaJMPaper.pdf.
35. U.S. Census Bureau, Texas-DP-1. Profile of General Demographic Changes: 2000, http://www.census.gov/census2000/states/tx.html (follow "General Demographic Characteristics (DP-1)" hyperlink) (last visited June 30, 2007).
36. SKIBA & TOBACMAN, *supra* note 34, at tbl.1.
37. Maude Toussaint-Comeau, *Changing Hispanic Demographics: Opportunities and Constraints in the Financial Market*, CHI. FED. LETTER, Aug. 2003, at 2-3, *available at* http://www.chicagofed.org/publications/fedletter/2003/cflaug2003_192.pdf.
38. SKIBA & TOBACMAN, *supra* note 34, at tbl.1.
39. *Id.*
40. *Id.*

ers. Nearly one-in-five (19.5%) African American consumers and one-in-seven (15.1%) Latino consumers were unbanked, compared to about one-in-twelve (7.5%) white consumers that were unbanked. Consumers with lower levels of education and consumers with blue-collar or service-sector jobs were more likely to be unbanked than those with higher levels of education and those with white-collar jobs. About one-eighth (13.0%) of blue-collar and service-sector workers were unbanked compared to one-twentieth (4.8%) of white-collar employees. Only one-in-thirty (3.3%) consumers with college degrees or more education were unbanked compared to about one-seventh (15.7%) of those with high school education or less.

Many consumers without bank accounts rely on check-cashing outlets to facilitate financial transactions.[41] The Office of the Comptroller of the Currency conducted a survey of lower-income, inner-city consumers and found that check cashing and money order purchases were significant transactions for the unbanked and that check cashers were market leaders in providing these services.[42] The survey found that about three-fifths (59%) of all unbanked consumers used check cashers for some financial services transactions and nearly three-quarters (71%) of the unbanked who received payroll or benefit checks used check cashers.[43] Minorities are overrepresented in the population that frequents check cashers; one national check-cashing firm estimates that 25% of its customers are Latino and 20% are African American.[44]

C. *Refund Anticipation Loans*

RALs are mostly used by low-income taxpayers. According to IRS data, 83% of RAL applicants in 2005 had adjusted gross incomes of $35,000 or less.[45] This is consistent with statistics from the country's largest tax preparation services. At H&R Block, 57% of

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41. Constance R. Dunham, Office of the Comptroller of the Currency, *The Role of Banks and Nonbanks in Servicing Low- and Moderate-Income Communities*, *in* CHANGING FINANCIAL MARKETS AND COMMUNITY DEVELOPMENT: A FEDERAL RESERVE SYSTEM RESEARCH CONFERENCE 31, 31 (Jackson L. Blanton, Sherri L.W. Rhine & Alicia Williams eds., 2001), *available at* http://www.chicagofed.org/cedric/files/cfmacd_conference_book.pdf.

42. *Id.* at 32.

43. *Id.* at 36.

44. Ace Cash Express, Inc., Annual Report (Form 10-K), at 9 (June 30, 2006), *available at* http://www.secinfo.com/dsvrp.vgHg.htm#_102.

45. Data from IRS SPEC, Return Information Database for Tax Year 2004 (Returns Filed in 2005), Nov. 2006 [hereinafter Data from IRS SPEC 2004].

their customers make less than $30,000 annually.[46] Jackson Hewitt similarly reports that 73% of its customers make less than $30,000 annually,[47] and HBSC states that the majority of its RAL customers have an average household income of $17,800.[48] A 2005 national poll by CFA found that the majority of RAL borrowers (58.7%) earned below $40,000.[49]

RALs seriously impact the working poor who qualify for the Earned Income Tax Credit (EITC). IRS data show that in 2005, 5.9 million (over 60%) families of RAL consumers were EITC recipients.[50] Yet, that year, EITC recipients made up only 17% of individual taxpayers.[51] In addition, IRS data show that 30% of EITC recipients applied for a RAL in 2005.[52] Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers.

D. *Car Title Loans*

According to reports from regulators, consumers who borrow against titles to their vehicles are low income earners.[53] Missouri's auditor reported that 70% of payday and title loan customers earned less than $25,000 per year.[54] In 1999, Illinois title loan users had average annual salaries of less than $20,000, according to a Department of Financial Institutions study.[55] In addition, New Mexico

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46. David T. Rose, et al., *H&R Block's Refund Anticipation Loans: Perilous Profits and the Bottom of the Pyramid*, *in* BUSINESS SOLUTIONS FOR THE GLOBAL POOR: CREATING SOCIAL AND ECONOMIC VALUE 349, 349 (V. Kasturi Rangan, John A. Quelch, Gustavo Herrero & Brooke Barton eds., 2007), *available at* http://www.people.hbs.edu/ptufano/Rose,%20Schneider,%20Tufano%20March%201%202006.pdf.

47. JACKSON HEWITT, TAX SERVICES INC., FINAL PROSPECTUS 46 (2004), *available at* http://www.sec.gov/Archives/edgar/data/1283552/000119312504106600/d424b1.htm.

48. Household International, Inc., Annual Report (Form 10-K), at 7 (2003), *available at* http://www.sec.gov/Archives/edgar/data/354964/000095013704001324/c82697e10vk.htm.

49. CHI CHI WU, JEAN ANN FOX & PATRICK WOODALL, NAT'L CONSUMER LAW CTR. & CONSUMER FED'N OF AM., ANOTHER YEAR OF LOSSES: HIGH-PRICED REFUND ANTICIPATION LOANS CONTINUE TO TAKE A CHUNK OUT OF AMERICANS' TAX REFUNDS 12 (2006), *available at* http://www.consumerfed.org/pdfs/2006_RAL_report.pdf.

50. *See* WU & FOX, *supra* note 4, at 11 n.49.

51. *See id.* at 11 n.50.

52. Data from IRS SPEC 2004, *supra* note 45.

53. *See, e.g.*, CLAIRE MCCASKILL, DIV. OF FIN. & REGULATION OF INSTANT LOAN INDUS., MO. OFFICE OF STATE AUDITOR, REPORT NO. 2001-36, at 3 (2001) [hereinafter MO. OFFICE OF STATE AUDITOR REPORT], *available at* http://auditor.mo.gov/press/2001-36.htm; ILL. DEP'T. OF FIN. INSTS., SHORT TERM LENDING REPORT 26 (1999); N.M. FIN. INST. DIV., SUMMARY OF TITLE LOANS (2004) (on file with author).

54. MO. OFFICE OF STATE AUDITOR REPORT, *supra* note 53.

55. ILL. DEP'T. OF FIN. INSTS., *supra* note 53.

regulators report that the average income of title loan borrowers, as reported by licensees for 2004, was $21,818.[56]

IV. In Most States, Laws Fail to Protect Users of Fringe Banking Services

At the state and federal level, fringe financial services are inadequately regulated to provide necessary protections to vulnerable consumers. While payday and title loans are subject to general federal credit laws, such as the Truth in Lending Act,[57] only military service members are protected from loans secured by personal checks, debit authorization, or vehicle titles under the John Warner National Defense Authorization Act for Fiscal Year 2007, which took effect on October 1, 2007.[58]

Payday and title lenders operate either under safe harbor laws that permit loans at costs higher than usury or exempt them from small loan rate caps, or they operate in states with deregulated small loan rates. Payday loans based on checks held for future deposit are legal in thirty-eight states and the District of Columbia, but are prohibited in states where a quarter of the United States' population lives.[59]

As previously mentioned, car title loans are legal in about half the states, either through deregulated rates for licensed lenders or special legislation that permits triple-digit annual rates for title-secured loans.[60] In Iowa, Kansas, and Virginia, title lenders exploit legal loopholes to charge unlimited fees for open-end title loans, while title lenders in Georgia and Alabama operate under pawn laws.[61] In the sixteen states that specifically authorize title lending, only three states cap rates at double-digit levels (Florida, Kentucky, and Minnesota) while six states permit charges that result in annual percentage rates of 204% to 300% APR for a $500 one-month loan.[62]

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56. N.M. Fin. Inst. Div., *supra* note 53.

57. Truth in Lending Act of 1968, Pub. L. No. 90-321, tit. I, 82 Stat. 146 (codified as amended at 15 U.S.C. §§ 1601-1693 (2000)).

58. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2269 (2006) (to be codified at 10 U.S.C. § 987)).

59. *See* Consumer Fed. of Am., Legal Status of Payday Lending by State, http://www.paydayloaninfo.org/lstatus.cfm (last visited June 30, 2007).

60. Fox & Guy, *supra* note 9, at 7, 21; *see supra* note 9 and accompanying text.

61. *Id.* at 8-9, 21 app. B.

62. *Id.*

RALs are made by banks that export deregulated interest rates from their home states.[63] State efforts to regulate RAL facilitators has happened in only ten states and these typically do not cap rates charged for loans.[64] "With the exception of Connecticut, these laws primarily rely on disclosures to protect consumers from RAL abuses."[65] Connecticut's 60% rate cap, as applied to facilitators of RALs, is being challenged in court by Santa Barbara Bank & Trust. Whether a state can regulate RAL facilitators remains unclear.[66]

State regulations barely protect consumers who use check-cashing services.[67] Check cashers are licensed in the majority of states but only half of the states cap fees charged to cash certain types of checks.[68] Those caps are usually set too high to restrain fees. For example, Indiana permits check cashers to charge 10% of the face value of the check.[69] Newer products, such as prepaid debit cards, are offered with virtually no consumer protections.[70] It is unclear whether, and to what extent, federal protections that apply to debit cards tied to bank accounts also cover consumers who use these cards in place of a bank account.[71] The Federal Reserve expanded Regulation E, which implements the Electronic Funds Transfer Act to cover stored value cards used to hold payroll deposits, effective in 2007.[72] However, the Federal Reserve has not explicitly extended Regulation E protections to cards used as bank account substitutes.[73]

To protect low- to moderate-income consumers in the fringe financial services market, states should either preserve their small loan rate caps or usury laws or reinstitute meaningful protections against rate gouging by lenders subject to state regulation. A typical state small loan rate cap is thirty-six percent annual interest, the

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63. JEAN ANN FOX, CONSUMER FED'N OF AM., UNSAFE AND UNSOUND: PAYDAY LENDERS HIDE BEHIND FDIC CHARTERS TO PEDDLE USURY 13 (2004), *available at* http://www.consumerfed.org/pdfs/pdlrentabankreport.pdf.

64. WU & FOX, *supra* note 4, at 22.

65. *Id.*

66. *Id.*

67. FOX & WOODALL, *supra* note 2, at 1 app. E.

68. *Id.* at 20.

69. *Id.*

70. *Id.* at 9.

71. *Id.*

72. 12 C.F.R. § 205.3 (2007).

73. *Id.*

same maximum loan rate enacted by Congress in 2006 to protect active duty service members and their families.[74]

States should repeal payday loan authorization laws and prohibit lending based on checks or required authorization to debit bank accounts as security for a loan. States should not condone soliciting consumers to deliberately write unfunded checks. While the federal Electronic Fund Transfer Act prohibits conditioning the extension of periodic payment credit on electronic payment, single-payment loans secured by debit authorization are exploited by storefront and online payday lenders.[75]

States should maintain or reestablish requirements for licensed lenders to structure small loans with affordable repayment schedules and base loan decisions on the borrower's ability to repay. Consumers are less likely to become mired in unaffordable debt if loans can be repaid over time without breaking the family budget. Expensive loans made to people with little chance of repayment, but with valuable assets to be seized, are inherently predatory.

State and federal enforcement should curtail deceptive and unfair practices and coercive debt-collection practices that are characteristic of lenders that use sham transactions and ruses to evade consumer protections or to trick borrowers. States should apply the provisions of the federal Fair Debt Collection Practices Act to lenders collecting their own debts.[76]

To safeguard the working poor, Congress should prohibit EITC-secured lending and terminate IRS services that facilitate RALs. Instead of loaning money for a few days to be repaid by the IRS using direct deposit of tax refunds, consumer and community groups should support faster delivery of tax refunds and banking the unbanked.

States should license and supervise check-cashing outlets in order to protect consumers and better insure compliance with money transfer requirements. CFA recommends that state check-cashing laws cap fees for public benefit and paychecks at low rates. States should use the AARP model check casher act as a template for strong regulation, low fee caps, clear disclosures, and prevention of payday lending by check cashers.[77]

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74. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2269 (2006) (to be codified at 10 U.S.C. § 987).

75. 15 U.S.C. § 1693 (2000).

76. *See* Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692p.

77. Fox & Woodall, *supra* note 2, at 20.

Federal laws that protect credit and debit card users should be extended to cover new forms of payment devices and cards marketed to consumers at fringe financial services companies. Protections should include liability limits for unauthorized use, recourse for errors or malfunctioning cards, and clear cost disclosures. CFA also recommends that Congress enact shorter bank check deposit hold periods and reform overdraft fees and practices to make it safer for consumers to use the services of federally insured depository institutions.

Conclusion

Communities can take action to improve the financial services market for working families. Local governments across the country are using zoning and local ordinances in an effort to stem the tide of check-cashing outlets, pawn shops, and payday loan outlets in low- and moderate-income neighborhoods. Zoning is being used to thin out payday loan density. In fact, San Francisco has declared a moratorium on additional check-cashing or payday loan outlets.

Nonprofit groups, employers, and financial institutions can join America Saves, a CFA-led social marketing campaign, to encourage low- and moderate-income consumers to become savers.[78] Studies reviewed by CFA find that low-income families with at least $500 in emergency savings are eight times less likely to use a payday loan as a family making $25,000 per year with no savings. One of the most popular goals for new America Savers is to build up an emergency savings fund to buffer their families from unexpected expenses or gaps in income.[79]

Bringing unbanked consumers into financial mainstream is an important step forward but must be done carefully in order to avoid financial hardships. A family can save the hundreds of dollars it now pays for cashing checks, buying money orders, and paying bills by using a checking account at a credit union or bank, but only if the account is well designed for a low-balance customer. The California Reinvestment Coalition advocates that banks offer their "Essential Bank Account," designed as a gateway into the financial mainstream.[80] This account comes with free money orders in lieu

78. For more information, see America Saves, http://www.AmericaSaves.org (last visited June 30, 2007).

79. America Saves, The Importance of Emergency Savings, http://www.AmericaSaves.org/strategies/emergencies.asp (last visited June 30, 2007).

80. Cal. Reinvestment Coal., Positive Financial Options, http://www.calreinvest.org/banking-insurance/positive-financial-options (last visited June 30, 2007).

of checks, cannot be overdrawn, and is free or low cost. California Reinvestment Coalition recommends direct deposit to get fast access to paychecks and unlimited ATM use.[81]

Community nonprofit tax preparation programs save the working poor the cost of commercial tax preparation and bypass the marketing of quick tax loans that divert antipoverty funds into the coffers of big banks and tax preparation firms. Mayors across the country recognize the importance of EITC dollars flowing into their cities for economic development for both cities and families.

Fringe "bankers" will remain financial predators as long as state and federal consumer protection laws fail to provide protections at least as effective as those enjoyed by affluent consumers using mainstream products. Rate caps and usury laws are essential for restraining high-cost credit when borrowers lack sufficient market clout to drive down the cost of borrowing. Some credit products should be banned as unsafe for consumers, including loans based on access to the borrower's bank account, car title, or EITC delivered through tax refunds. Fee-for-service transactions and products can become the new "financial services model" with the right combination of features, protections, promotion, and information.

81. *Id.* For more information, see California Reinvestment Coalition, http://www.calreinvest.org (last visited June 30, 2007).