Predatory Lending: Payday Lenders and Credit Card Companies

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Introduction

Katherine Brown lives in a two-bedroom brick house outside of Macon, Mississippi. She is obese, diabetic, nearly deaf and mentally retarded. In addition to taking care of herself, she also takes care of her 44-year-old son John, who is also deaf and was born severely retarded. Katherine's first son died while stationed in Germany serving in the U.S. Army leaving Katherine the sole caretaker of John, her "special child of God" who has yet to finish second grade. John still goes to school and is energetic when the "short bus rolls down the dirt road" (Scurlock, 85). John is probably the only man his age who has never lied or sinned, and he is all Katherine has in the world, as she is all he has.

Katherine began to receive credit card applications although she had "no income besides a government subsidy and lives in one of the poorest zip codes in the nation" (Scurlock, 85). Somehow Katherine had made it onto a card company's preferred list. It is unclear whether Katherine knew the consequences or the implications of the credit-card literature she received but she filled it out and sent it back. Many credit card applications are plastered with big flashy 0%'s along with low interest rates. These applications also provide prospective clients with lists of merchandise they could potentially purchase with these cards giving them access to groceries, the ability to make bill payments, entertainment and music. In addition, as MasterCard advertisements solicit, "anything else you could ever possibly think of" is also an option. It is only at the bottom or on the back of the credit card solicitation pamphlet in small writing that the interest rates and terms of payment are explained, important details.

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Katherine started receiving the rude and threatening calls regarding her mounting

credit card bills not long after she started using the credit card. She did not know what to do and was unaware that because credit cards are not secured debt she simply could have ignored the phone calls, but instead she asked God for help (Scurlock, 85). A church acquaintance of Katherine's "just happened to work for Citigroup and just happened to know the solution: a refi" (Scurlock, 85). The acquaintance recommended that Katherine refinance her existing home mortgage, and that this would be the solution to save her credit rating, not that Katherine's credit rating was a factor in her everyday life or ability to survive (Scurlock, 85). This friend knew the credit lending business and clearly did not care that the credit collectors could not collect from Katherine and that she would be fine if she just ignored the calls. Katherine's "friend" saw an opportunity and swooped in to take full advantage of this down-and-out church-going woman. Capitalizing upon Katherine's pride and honor, Katherine's friend presented her with two options: either file for bankruptcy or refinance her home mortgage so she would be able to pay off all her credit card bills and save her credit rating. Both Katherine and John signed the new refinance contract as she spelled out his name for him and he copied it over on a document that essentially replaced their current government subsidized low-rate mortgage with a much longer termed and expensive mortgage. Her friend described it as the right thing to do (Scurlock, 86).

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While it would be just to say that Katherine should have not have been solicited for a credit card in the first instance, solicitation and advertisement is free speech and in terms of credit card advertisements. it is not limited. The fact that her only means of income at the time of the solicitation was government welfare and subsidies makes the situation sound even more unjust although the credit card company did nothing legally

wrong by soliciting Katherine. However, by issuing Katherine a line of credit this particular credit card company took advantage of a person of low income and few resources, a person who did not understand the fine print and high interest rates presented at the bottom of the flashy pamphlet. Credit card companies are capitalizing upon people in similar depressed economic circumstances in order to turn a profit by engaging in predatory lending. They are waiting to swoop in like vultures when people like Katherine miss payments or do not fully pay off the debt, so that the lender can tack on interest at rates up to and exceeding 20%. This lending practice further increases debt to amounts the consumer could never fathom paying. This and other methods of predatory lending plagues the impoverished, perpetuates their fiscal troubles, and strips them of what little collateral or money they may possess.

A "predatory" loan, as defined by the National Community Reinvestment Coalition, "is an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans" (Squires, 3). Predatory lending is an unsuitable lending practice designed to exploit vulnerable and unsophisticated borrowers, mainly affecting the poor who fall into the subprime category. Lenders charge higher interest rates in the subprime category, rates that supposedly compensate them for taking a greater risk. When the interest rate more than compensates for the risk, the lender is participating in predatory behavior.

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Predatory lending includes payday lending, sub-prime mortgages, automobile loans and lines of credit through credit cards. While all of these practices directly affect the impoverished and have great impacts on their lives and their futures, this paper will focus upon short-term loans and money lending. This includes short-term credit card

lending and payday lending as well as wire transfer and tax preparation service fees.

Due in part to bank deregulation and the lack of bank branch locations within low to moderate income areas, a two-tiered banking system has emerged that allows for predatory lending. Bank institutions do not want to and are not currently providing sufficient market financial services that residents in low- and moderate-income areas are seeking. This group has inadequate access to free check cashing, inexpensive wire transfers, and short-term unsecured loans (Engel and McCoy, 95). Between 1975 and 1995, the number of banking offices in low- and moderate-income areas declined by 21 percent, while new bank locations increased nationwide by 29 percent during the same period (Squires, 7). Therefore, banks have been withdrawing from low- and moderate-income areas and increasing their presence elsewhere. There are insufficient banks and resources available to the poor in low-income neighborhoods. This lack of credit resources widens the gap between the poor and the wealthy.

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Coupled with insufficient or inconvenient access to banking institutions, many poor people do not even have bank accounts. These individuals therefore cannot take advantage of the routine services provided by local banks, such as check cashing. While the overall number of those without bank accounts has decreased overall, currently 12 million households are without bank accounts (Blank). Persons who do not have bank accounts may not have a steady job to provide dependable month-to-month income, which could be deposited into a bank. They may not be able to afford the bank fees or have any savings to put in the bank, or may not be able to maintain the minimum balance needed to retain the account. Either way, those who lack bank accounts because they are not feasible or there is not a bank in the area turn to other lending alternatives.

Payday lending services are rampant all across low income areas and allow those who do not have bank accounts or who need immediate money to get an advance in the form of a high-interest loan secured by their next paycheck. These payday lending business usually also provide a money wire transfer service with fees higher than a bank would charge and provide other "services" such as tax preparation for lower income people charging exacerbating service charges. Both payday lending and credit cards have a significant effect on their victims, the poor. Lenders take advantage of economic duress by enticing low-income people with the money that they need to survive, to pay for rent, food and utilities. The lenders also take advantage of the poor by lending for "luxury" items or lifestyle expenses for a life that the wealthy live and that the poor can only dream about. These businesses know that these customers most likely will not be able to pay the money back by the stated payment date. The lenders are then able to take advantage of the situation and charge ludicrous amounts in interest on the money borrowed. This further digs the poor into even more economic difficulties, which perpetuates financial instability that vastly affects their life.

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Payday Loans

"Fringe banking," which is banking outside the institutional bank, encompasses check cashing outlets, pawnshops, and payday lending. As previously stated, many households do not use banks, or if they do use them, the banks are not necessarily conveniently located in low-income neighborhoods. Most banks also restrict check cashing to their depositors causing those who are not a part of the financial institution to find other means of cashing checks and obtaining short-term loans, amenities only afforded to those attached to a bank. Those in low-income neighborhoods in need of

short-term loans have limited options. They may attempt to obtain a loan from a friend, leverage money from pawnshops, or resort to payday lending.

Payday lending in the past ten years has been the most rapidly growing segment of fringe banking. The exact number of payday lenders is unknown as many states do not have regulatory laws that require lenders to hold licensees and or they do not report the number of licensees; however, rough estimates put the number of lenders around 12,000 (Caskey, 24). Small private lending shops make up the majority of lenders; however, payday lending is a growing business and there are at least a dozen national chains that have slowly begun to corner in on the market share (Shipler, 18). These lenders are easily identifiable by large neon signs reading “Payday loans,” “Quick Cash,” “Easy Money,” “Get Cash Now,” that hang in their windows.

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The process of payday lending is as follows. A customer will enter a payday-lending establishment in need of immediate cash. The customer writes a check made out to a lender who then agrees to "hold" the check, typically for two weeks, before depositing it. In exchange, the lender advances the customer a cash payment somewhat less than the amount of the check. The difference between the amount on the check and the amount of the loan is the “finance charge” which is profit the lender makes. Lenders typically charge $15 to $30 for each $100 two-week advance they make. If the lender charged the lower amount such as $15 dollars or 15 percent bi-weekly that still amounts to a 390 annual percentage charge (Fox, 8). If the lender implements a higher charge of $30, this could amount up to a 780 annual percentage charge (Fox, 8). In spite of the high cost, borrowers may prefer this method to others, as it is quick and relatively simple. First time borrowers typically need to present information such as a check, recent pay

stub, evidence of a bank statements, identification and a series of utility bills or other evidence that shows they have a stable residence and will not skip town (Caskey, 18). If the borrower pays back the face value of the check prior to the time the loan has expired, the contract has been completed and the borrower no longer is indebted to the lender.

In many cases, the borrower is not able to pay off the loan within the given two weeks and the lender will allow the borrower to renew the loan by "rolling it over." It is in rolling over the loan that the payday lender, or "loan shark" as they are sometimes called, is further able to take advantage of the borrower. The borrower pays the finance charge at maturity and the lender agrees to hold the check for another period of time. In Illinois, it was found that rollovers made up "77% of all payday loan transactions and the average customer had 10 such renewals which means paying fees totaling up to twice the amount borrowed" (Shipler, 19). Therefore, Joe Smith might have originally gone in for a payday loan on the $100 payday check he was anticipating receiving, paid $25 as a finance charge and then rolled it over 10 times amounting to fees of $250 dollars on a $100 dollar advancement. This in turn increases Joe Smith's amount of debt and need for money.

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Those utilizing payday loans are typically low-income workers who live paycheck to paycheck and have very little savings. Payday borrowers might also be low-income workers who need immediate money to help pay for an emergency situations such as an unanticipated hospital bill. Many payday lenders require that the borrower have a bank account, precluding most without a bank account from utilizing their services. Most borrowers are employed and have a household income between $15,000 and $60,000. Borrowers also tend to be younger adults under the age of 40 who have children. Nearly

half of these borrowers also carry major credit cards (Caskey, 19). These people can range from the welfare-to-work mom, to military personnel, to the local mail carrier. Anyone who "Needs Cash Now," as the signs in the windows of these operations advertises can fall prey to this predatory lending, which is a large market opportunity for lending operations. These "unbanked and underbanked" low-income workers that are a growing proportion of the population bought $3 trillion of goods and services with cash and money orders in 2005 (Fox, 2). The main sources for this readily available cash are these fringe-banking operations.

Payday lenders are situated in local communities of lower income workers. Lenders are highly concentrated in metro areas. Thirty-two percent of check cashers, pawnshops, rent-to-own stores and payday lenders are in inner city neighborhoods (Fox, 18). These lenders also target minority areas, as 56.4% of lenders are located in minority neighborhoods (Fox, 18). In California, payday lenders are nearly eight times more concentrated in African-American and Latino neighborhoods than they are in white neighborhoods (Center for Responsible Lending). Payday lenders are convenient for those who may work odd hours or who not have a car to drive to reach alternative means for short-term loans. Unlike pawnshops, which are slowly being phased out due to the rise of payday lenders, a customer does not need to put up collateral or personal property in order to receive a loan. Therefore, if a person similar to Katherine in socio-economic status were working and needed an advance on her paycheck, she would not have to bring in an item she may need in her home like the microwave or an item of family value in order to receive a cash advance. This method is also very fast; as there is no credit check involved, a person just has to show that he or she is employed and has a bank account.

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This person could potentially address many different payment needs all at one time as payday lenders typically provide other services in addition to providing short-term loans. At the local neighborhood lending shop there are usually other services available that target those who are impoverished. For example, after taking out a cash advance on a paycheck, a person could also purchase a money order. One fifth of money transfers in the United States, which amounts to $20 billion dollars, are serviced through these fringe financial outlets (Fox, 7). In addition, photocopies, lottery tickets and prepaid telephone cards are usually also readily available for purchase in the store. Some of these stores even allow a person to pay utilities through the shop, providing the ease of one stop shopping. Finally, these shops also provide check-cashing services and tax preparation for which they charge high service charges in a predatory manner.

A person without a bank account who needs to cash a government welfare check, the same checks Katherine lived off of, has few options. She could go to a large financial institution if she had the available means to get there, and they would charge her a fee between 2-5 dollars. If however, the check was a handwritten personal check, they may refuse to take it. Therefore, many people in this position turn to check cashing at fringe financial outlets. Even those with checking accounts, while it sounds counter intuitive, many times also turn to these lenders to cash checks and forfeit the cost of the charge. If a person's bank balance is under the minimum needed, many banks might refuse to cash the check and instead have the customer deposit it, leaving them without readily available money at their disposal to pay for needed essentials (Caskey, 33).

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Check cashing at payday lenders is predatory lending. The cost of cashing a check at one of these establishments exceeds the cost of processing the check, amounting

to a huge profit. The check casher reaps the benefit of the profit while the poor customer is stripped of needed government aid or hard-earned money. The Federal Reserve reported that the cost to process a government check under the Federal Reserve Automated Clearinghouse is 4 cents but some lenders charge as much as $25 to cash a government benefit check (Fox, 5). In 2006, on average it cost $24.45 to cash a $1,002 social security check. This provided the lender or outlet owner a $24.41 profit. The cost of cashing a check has also increased among these shops. In 1987, the cost to cash a government issued social security check by a fringe outlet was 1.59 percent of the check's face value but has risen 53 percent and now costs approximately 2.44 percent of the check's face value (Fox, 6).

The cost to cash a payroll or government check (non-benefit) are also high. Lenders charge between 1.5 and 3.5 percent of the face value of the check for cashing payroll or government checks (Caskey, 33). Therefore if an earners bi-weekly check was $500 and she was being charged a 3 percent cashing fee, this would amount to $15 while a bank she was a member of would charge nothing and a financial intuitions she was a non-member of would charge $5. These lenders would be charging $10 over that charged by a financial institution that comes out of the earner's pocket. If this earner had the misfortune of having to cash a handwritten check, it would cost her around 4.11 percent of the value of the check and a personal check would cost 8.77 percent of the check's value. These checks are also deemed to be more risky, and therefore only half of the outlets will accept personal checks (Fox, 6).

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While a $10 overcharge from that of what a bank would charge may not seem like a lot to a middle class American, it is. For a low-income earner like Katherine who may be

living off of $1,000 a month, the cost to cash 5 checks amounting to $50 results in costing her 5% of her potential in fees to gain access to money. This also is not small pocket change for check cashing outlets as more than 180 million checks that are worth more than $55 billion are processed by the industry every year. In 2000, these check cashing outlets generated $1.5 billion in fees, an egregious amount of money (Fox 3).

While in these shops, some also might be enticed to take “advantage” of the lender’s tax-preparation services, which is just another way for the lender to squeeze money out of the already squeezed impoverished person. Many people, those like Katherine and even those who may be better off do not typically have a tax accountant or CPA on the payroll. Therefore, when tax time springs up every year in April, they may struggle to fill out and file their tax forms. This is where the payday lender can “help.”

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These lenders run services to aid in tax preparation. They charge a large fee for what “their clients could do for themselves for free with math skills and courage to tackle a 1040, or with a computer and a bank account to speed filing and receipt” (Shipler, 15). Also, those who have earned income may be eligible for an Earned Income Tax Credit and may want the cash quickly. This tax credit, however, is tied to earnings and therefore is linked to a tax return, which means if a tax return is not filed the person will not be eligible to receive the tax-credit money (Shipler, 15). Many low-income people may not have a bank account, computer or the necessarily skills or understanding to fill out the intimidating government forms. Some may also be intimidated by the process or fear messing up and want it done correctly and “trust” someone who advertises they know how to and can provide the person with a quick tax return. This “trusting person” who knows what he or she is doing though could cost sums up to $95 or $100 for something

that could be done for free. Some tax-preparation services also offer an immediate tax return, which could be collected in a day or two from the operation for a cost rather than waiting a short time for the refund to come in from the Federal Government. Places such as H&R Block charge amounts from $50 on a $200 refund up to $90 on a refund of $2,000 (Shipler, 16). While these tax preparers are performing a service and for that deserve to be paid, they are taking advantage of their client's weaknesses and charging extraordinarily high monetary sums to do so.

The ease of being able to accomplish many tasks at one place, the convenience of location and lack of alternatives allows these lenders to prey off of the poor in many different aspects. They are at times a person's last resort for available cash and therefore use that person's economic duress to their advantage, charging predatory rates for lending, check cashing, and unnecessarily high fees for tax preparation.

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The benefits received by those who utilize these services do not come near to compensating them for the disproportionate amount of harm that these lenders and outlets cause.

CREDIT CARDS

Consumers take on all types of credit in the form of credit cards, auto loans, finance loans and home-equity loans. With the motto of "buy now, pay later" middle- to upper-income Americans may use this credit to "Keep up with the Jones." While some are using their credit to flaunt their possessions and wealth to their BMW friends, low-income families may take on this credit for basic survival to pay for necessities of life or accidentally due to lack of knowledge as to what a credit card actually is.

Over time, the economy and retail industry have become more reliant and open to

credit cards. All major stores accept major credit cards (MasterCard, Visa, Discover) and many stores even have their own store cards to further encourage spending. "Retailing outlets depend on credit cards and installment plans for approximately half of their overall sales volume," thus the credit card holds an important role in our current market (Klein, 79).

Debt is a necessary evil that accompanies credit cards. Americans owe nearly $900 billon in credit card debt (AFFIL-Credit Cards). The credit card debt carried by a low- or moderate-income person is $8,650 on average (AFFIL- Credit Cards). While these low earners are in debt, credit card companies are profiting. In 2006, credit card companies' total profits were $18 billion (AFFIL- Credit Cards). In 2006, credit card companies collected $115 billion in revenue, approximately two thirds of which was from interest payments and 15 percent was from consumer fees (AFFIL-Credit Cards). The interest rate paid by one-third of credit card holder exceeds 20 percent (Center for Responsible Lending, 2007). "Cardholders with household incomes below $25,000 who have credit card balances are two times more likely than households earning $50,000, and five times more likely then households earning over $100,000 to pay interest rates higher than 20 percent" (Center for Responsible Lending, 2007). The figures show that credit cards are widely used but that low-income households have the most difficulty meeting payments. In 2004, only 10 percent of higher income card holders fell behind in their credit card payments whereas 33 percent of lower income earners failed to meet payments on time (Fellowes and Mabanta). Delinquency rates are highest amongst lower income markets found in the more economically depressed areas in the country (Fellowes and Mabanta).

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Credit card companies will lend a person a line of credit, allowing them to spend money they do not possess. The borrower is able to buy immediately but eventually will have to pay the card off. These credit card lenders, however, make money on service fees such as the late fees they are allowed to levy if the balance of the card is not paid off by a stated date. They may also collect if the purchaser exceeds the spending limit on the card or for cash advance fees. These service fees have increased over time. In 1983, service fees on Visa and MasterCard cards averaged $3 annually with annually fees averaging about $18 (calculated in 2002 dollars) but by late 2001 services fees had risen to about $38 and annual fees had grown to $9 (Evans and Schmalensee, 219).

Those that fall into the "subprime category," consisting of the lower-income class, are typically charged higher fees and interest. Unfortunately, persons may not even know they are being charged these higher fees and interest because few states require lenders to reveal the score that determines a consumer's credit rating even when the borrower sees his/her credit report (Shipler, 24). Credit ratings run from 375-900 and are based on punctuality of payment, the amount of debt a consumer has, how long credit has been used (the longer the better), how much new credit has been requested (the less the better), and whether the borrower uses a mix of true credit (mortgages and auto loans are preferred over credit cards) (Shipler, 24). This means that a person can be prey for higher rates and be unaware of it or the reason why. This also puts those who do not have a great credit history at a disadvantage; one small mistake in the past may greatly affect the person's credit rating according to the creditor and cause her to pay higher interest rates. This fact, along with the fact that ratings are based on how long credit has been used and the mix of credit, such as if the borrower has a mortgage or auto loan, favors borrowers

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who have more money and are better situated financially. Therefore, those who are less likely to have a car loan, as they may not own a car, or a mortgage, as they may not own a house, or have a credit card will be forced to pay higher rates and fees. These higher interest rates have not seemed to deter those that fall into the lower income bracket from acquiring credit cards or debt.

The number of low-income households with credit cards has increased, as has the outstanding debt for these households. According to a study conducted in 2002, among the 20 percent of households with lowest incomes, about 2 percent had credit cards in 1970 in comparison to the 38 percent who had credit cards in 2001, an extremely large increase (Evans and Schmalensee, 90). In addition, the average debt outstanding for households with credit cards in the lowest income quintile rose dramatically. In 1970, the debt of these households was approximately $200 whereas in 2001 this amount rose to nearly $1,250 according to the Federal Reserve Board (Evans and Schmalensee, 97). It may be due to the need for items to support a family and lack of immediate resources. It may also be attributed to the fact that people do not fully understand what a credit card is. In either instance, it is evident that the usage of the credit card is more prevalent now than ever before in the lower income bracket and has the potential to harm this group of people the most.

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Visa's 1982 campaign ad stated, "Wherever you go, whatever dream you follow, we'd like to help," but what they forgot to put in the same large writing is their help is not free of charge (Klein, 89). The debtor will eventually pay for where they go, what they buy and what they dream to do usually with interest added on. This is not stated in the large print in the advertisements and solicitations from credit card companies, which no

one is immune from receiving no matter how well off or poor a person is. No one is immune to solicitations or being put on a preferred customer list, as is evidence by Katherine. As a vice president of master card defined it, a preferred customer is, "an individual who has a 'taste' for credit" (Scurlock, 93). A preferred customer is a person who is, "willing to make minimum monthly payments – forever." (Scurlock 93) While Katherine may not necessarily have a taste for credit, she is the type of person who would be a preferred customer. Given her low government subsidies, she most likely would only be able to afford the minimum payments of the card. This in turn would continuously carry over a balance and tack on additional charges and potential late fees, the perfect client for a credit card company. Over 32 percent of lower income borrowers like Katherine struggle to pay bills on time, and about 27 percent now spend more than 40 percent of their income servicing debt (Fellowes and Mabanta). Credit card companies make money on interest payments, and therefore it is to their advantage that card holders are unable to pay bills on time.

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When receiving this solicitation, a person may also not fully understand what the fine print says. A person may simply see the "0%" that boldly stands our or the "$0 annual fee" but neglect to read the miniscule writing at the bottom of the contract that states the interest rate or the consequences of late payment. Therefore, these credit card companies not only feed off of the fact that people will not be able to pay but that they will not even be able to fully understand the contract that they are signing that binds them to these ridiculous payments and charges.

POTENTIAL SOLUTIONS/ALTERNATIVES

Ultimately, consumers are responsible for their own actions. Whether a person

uses a payday lender or takes out a line of credit from a financial institution is his or her own choice. Payday lenders and credit cards should not be eliminated, nor should low-income persons be precluded from using them; however, some practices are abused by lenders who exploit unsophisticated consumers. By educating consumers and encouraging transparency, consumers may more fairly exercise choice. Exorbitant interest rates, which make it impossible for consumers to payoff a loan, should be controlled by government regulation. Through government incentives, private financial institutions may also venture into the growing market of lower income earners and offer short-term loans and checking accounts with lower restrictions. This control will not impede the lenders' ability to lend or the borrowers' ability to borrow, nor will it eliminate competition. Rather, certain regulation may increase competition among lenders promoting the free market.

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An important first step that can be taken to aid those who fall victim to credit card abuse and payday lenders is education. Through educational programs, the borrowers who fall outside of the financial mainstream and who may not have an understanding of money management can learn about proper fiscal management. There are currently non-profit credit counseling agencies such as Debt Counselors of America (DCA) and Consumer Credit Counseling Services which provide this type of assistance (FDIC: Consumer Response Center). Many of the services provided by these non-profits are free of charge. Some of these services do cost a small fee that the assisting agencies are typically open and upfront about. Unfortunately, these non-profits are not easily accessible to all and cannot accommodate the great number of people who could benefit by utilizing them.

Therefore, the government, through the FDIC, has started a program called Money Smart. Money Smart is a training program for adults who fall outside of the financial mainstream. The program aims to enhance personal money skills and to create positive banking relationships (FDIC: Money Smart). The hope of the program is that the more people are aware of banking services the more likely they are to save and improve their financial health. The program helps build financial knowledge and develop financial confidence and enables these adults to use banking services effectively. There is also a Money Smart for Young Adults curriculum that helps young people between the ages of 12 and 20 develop financial skills and money-management knowledge (FDIC: Money Smart). It is of the utmost importance that these skills be developed at young ages, which is why training programs on money management should be offered in schools.

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Programs that are offered in elementary and high school are useful in teaching math skills that will assist lower-income students in the future. The State of Illinois has taken steps in this direction with the creations of The Bank At School Program (Ill. Treasurer). This program is available to third through sixth graders and is offered throughout the school year in the classroom setting. The mission of this program is to teach children to make well-advised and knowledgeable decisions as savers, spenders, borrowers and money managers. The program brings in experts from the financial community to help teach student. The students are afforded the opportunity to open saving accounts in a "bank at school" through partnerships with the financial community (Ill. Treasurer). The accounts earn interest and students receive statements at school just as a typical bank customer would but withdrawals must be made at the participating

financial institution. Students in the program learn about savings, decision-making, goal-setting and budgeting, which are fundamental tools they will need later in life (Ill. Treasurer). By starting financial management programs at an early age, students at risk to predatory lenders will have background information to make more informed decisions. In addition, the program creates a relationship between the student and a financial institution so the student has familiarity with the institution, which will hopefully develop into a long-term relationship. The student becomes familiar with banking procedures, checking accounts, savings accounts and the functions of deposit/withdrawal, and comes away from the program with the skill to use services offered by the financial institution. Students are exposed to the concept of advanced planning about saving and the withdrawal of funds that may assist in their ability for fiscal planning as they get older. Students is also taught about "interest," which will accrue to their advantage on savings and the interest, which will accrue on loans to their disadvantage. This knowledge may prepare the student to be aware of the consequences of predatory lending, particularly regarding the interest rate which is charged outside of the financial institution setting and in the payday loan schemes. Knowledge and education will help inform borrowers, but it will not in itself prevent predatory lending.

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Another set of devices that will help further inform borrowers for better decision making are transparency and disclosure. The lack of transparency and disclosure now as to credit card rates and terms of payment for payday lenders under the law is not considered fraud, which is not to say it shouldn't be. The current use of deception through the lack of, or limited, information needs to be addressed and corrected**.** One out of every ten credit card balances carries a penalty interest rate that the cardholder is either

unaware of, or does not understand. (Center for Responsible Lending, 2008). When a person is penalized there is no warning to borrowers that they are in the "penalty box," and over fifty percent of the consumers paying penalty rates do not know it (Center for Responsible Lending, 2008). Penalty interest rate information should be clearly stated by credit card companies from the outset and updates should be required as the status of the borrower changes in order to keep borrowers informed of where they stand. There also should be a uniform manner in which terms appear on credit card solicitations. The text on these solicitations should be in clearly understandable language and conspicuous print in contrast to the super fine print at the bottom in terms that require a dictionary to comprehend. The same holds true for payday loans. Payday lending outlets should be regulated so that the term of the loan is clear, the interest is clear, and the penalties for late payment are posted. While transparency is not meant to interfere with the market and is not limiting the class of borrowers, it creates a more informed borrower. If the borrower is more informed, hopefully they will be able to make better decisions regarding loans. If borrowers make better decisions about loans, they may chose terms that they can meet and avoid interest and penalties payments, which detract from their ability to meet payments for monthly necessities.

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Finally, the formula through which a person is categorized as sub-prime should be made clear and explained in the terms of credit card application materials. A credit card company should make readily available the explanation and credit score of the applicant on request so it is clear to the card holder why they are paying the rate they are paying. Therefore, if there are any discrepancies regarding credit history, it can be resolved in the beginning and a borrower can discover what past mistakes may have led to a less

favorable rate and what not to do in the future. This also prohibits the credit card companies from charging whatever rates they see fit without any sense of accountability to the customer.

The third change that can be implemented is reform through government regulation to equalize the system making it more equitable to those with lower incomes by curing the current market. This process starts by awareness. The more that public discussion about sub-prime mortgages and the problems it creates occurs, the greater the likelihood the government and public will move to change the current policy and curb lending practices. Groups such as the Americans for Fairness in Lending, which began in 2007, and other large associations are lobbying to bring back some of the consumer protections that have systematically been eliminated by Congress and the Supreme Court (AFFIL: The History of Usury). While individuals can make a difference, they can only do so if they are aware of the problems. The public will need to put pressure on the government if changes to control predatory lending are to occur.

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Over the years, government regulation has become more relaxed, mainly providing benefits to lenders, especially in terms of usury laws. Usury laws control the maximum rate of interest that may be charged by a lender for a loan. Prior to 1929, the federal government had national usury laws that set a national cap on the amount of interest that could be charged on a loan, but after the Great Depression the national usury laws were repealed (AFFIL: The History of Usury). Regulation on usury laws was left up to states to decide and many did not implement a limit or implemented their cap at extremely high rates in favor of lenders. This allowed lenders to set up shop in states that had no, or relaxed, laws on usury limits. This also allowed the lenders to charge the

highest rates possible to debtors. The difficulty with state-by-state regulation of usury laws is that financial institutions operate in more than one state, and they select the state with the most favorable usury laws in which to incorporate. The usury rate of the state of incorporation can then be exported. For example, if a person takes out a loan in New Jersey from a bank that is actually based in South Dakota, which has less stringent usury laws, the South Dakota usury law is exported to the loan in New Jersey. This seems to defeat the purpose of state laws. In a Supreme Court case, *Marquette vs. First Omaha Service Corp.*, the Court ruled that national banks could charge the highest interest rate allowed in their home state to customers living anywhere in the United States including states with restrictive caps (Scurlock, 56). This allows credit card companies and predatory lenders to locate wherever they want as long as their home bank or corporation is based in a state with lenient laws. In the Supreme Court decision *Smiley v. Citibank* the Court ruled that late payment fees on credit cards constituted "interest" and therefore, the bank could charge the interest allowed by the state where they were located rather than the state where they are doing business (Scurlock, 56). This further puts borrowers at a disadvantage.

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The federal government should impose a uniform maximum permitted interest rate making it applicable in all states. While some might argue this would "hurt" the free market, it would simply curb it. People would still be readily able to gain access to capital in terms of credit and creditors. Both payday lenders and credit card companies would stay in business and still make a profit, just not as enormously large as before. By implementing a federal cap, or even disallowing local interest rates to be exported across state lines would provide much needed uniformity for borrowers. In 1987, 33 states had

maximum interest rate caps (Evans and Schmalensee, 47). In 2005, only twenty-five states had legislated maximum interest rates for consumer loans, a decline of eight states (Evans and Schmalensee, 47). This reduction in the number of states with regulated maximum rates clearly exemplifies the lessening of regulation. In the current economic climate, it would appear that reduction in regulation would only promote increased borrowing, indebtness, bankruptcy and unnecessary fluctuations in the market that could be equalized with reasonable regulations that will not harm the taxpayer, the borrower, or the lender. Recently, in 2006, Congress passed the Talent Nelson Act, which prohibits payday lenders from making loans to active duty service members (Center for Responsible Lending, 2008). This act also established a 36 percent annual interest rate cap for military borrowers, which costs taxpayers nothing but saves borrowers money (Center for Responsible Lending, 2008). Payday lenders still have unregulated access to non-military borrowers. It is reasonable to extrapolate that the rest of the population is facing the same adverse impact that was documented by Pentagon for military personnel. Therefore, this law should be expanded to protect all populations of borrowers.

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In addition to usury regulation many states have taken it upon themselves to handle the problem of predatory payday lending. Fifteen states, including DC, have banned payday lending altogether (AFFIL). This action is saving residents of these states a total of $1.8 billion a year in predatory payday loan fees (AFFIL). While the savings of $1.8 billion a year sounds enticing, the number does not account for the people who now cannot get a short-term loan. The $1.8 billion in savings does not take into consideration the consequences people who frequented payday lenders now face, as their options for short-term loans are limited to family and friends. The answer is not to eliminate these

payday lenders, but to curb their power. By eliminating payday lenders, one is also eliminating the ability of a person who may need cash right away to get it. The cost of the loan may be insignificant in comparison to the need, such as being able to get fast cash in order to see a doctor for a medical emergency or have money to fix the car to maintain a job. Thus, a better alternative to simply eliminating payday loan institutions would be to curb their power through usury laws and increase competition among them. This would eventually cause lenders to compete for business and bring terms down to what the borrower demanded and was willing to pay.

By providing incentives to the private sector, competition between lenders will be increased in the market of low-income borrowers. The private sector, with incentives from the government, such as tax credit or program aid, can create the opportunity for change to occur. Some possible changes might be to encourage borrowers to use financial institutions and provide alternatives to payday lending in terms of short-term loans. Banks could offer low cost checking accounts. Many of the current checking products are ill suited to the poor and carry high risk overdraft and high fees. By providing lower cost checking accounts, financial institutions will encourage the people to use their services and eventually see profits through fees they charge and the capture of other potential business the client may bring to them.

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The government can provide incentives for public financial institution to lend money to the lower income population. In 1977, the federal government passed the "Community Reinvestment Act" which required banks to invest in their community (FDIC: Community Affairs Program). The FDIC set up the Community Affairs Program whose mission is to promote stability and public confidence in the nation's financial

system by encouraging financial institutions to invest in and meet the credit needs of the community they serve (FDIC: Community Affairs Program). The Program also promotes laws, regulation, politics and programs that protect and inform consumers. The goal is that by fostering initiatives that create positive banking relationship between the financial institutions and their consumers more persons with no banking relationship, and underserved consumers, will be moved into the mainstream.

The Alliance for Economic Inclusion (AEI) is another FDIC national initiative to establish broad-based coalitions of financial institutions, community-based organizations and other partners in markets across the country (FDIC: AEI). Together, these groups can bring the unbanked and underserved into the financial mainstream. This alliance focuses on expanding basic retail financial services including savings accounts, affordable remittance products, small-dollar loan programs, and other asset building programs for the underbanked and underserved consumers. This Alliance has been rather successful and to date 952 banks and organizations have joined AEI nationwide resulting in the opening of 65,000 new bank accounts (FDIC: Quarterly).

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Finally, under AEI, the small loan pilot program was developed and launched in 2008. This program, which is in its early test phase now, if successful, will bring competition to payday lenders by offering borrowers an alternative to these “Fast Cash” shops. This small loan pilot program has been undertaken by a handful of banks and provides customers with short-term loans up to $1,000, no APR rates above 36 percent, and no prepayment penalties (FDIC: AEI). The origination and maintenance fees are limited to the amount of money necessary to cover the actual costs, in contrast to that of a payday lender who charges fees much higher than that to cover costs (FDIC: AEI). The

purpose of this pilot project is to help banks incorporate small loans, such as those payday lenders provide, into mainstream banking at an affordable price (FDIC: AEI). Through this program these test banks will help identify the most effect business practices in order to accomplish this. The Armed Forces Bank in Fort Leavenworth, Kansas uses small-dollar loans and claims these loans help the bank retain customers (FDIC: Quarterly). This bank has been originating small-dollar loans for about four years and has $4.5 million in loans outstanding targeted solely to military personnel (FDIC: Quarterly). They offer loans from $250 to $2,000 at an 18 percent interest rate with no fees (FDIC: Quarterly). The only requirement aside from being military personnel is the person must open an account with the bank and maintain direct deposit. The loan payments are automatically debited form the borrower's account. This bank is a clear example that programs like these can work with the right structure, and will benefit both the borrower and the financial institution by increasing business.

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CONCLUSION

Predatory payday lenders and credit card companies target lower income earners. Wage earners who utilize these services spend a disproportionate amount of money on interest and late fees. Therefore, these low earners have even less money to pay for basic life necessities. Consumer education, which begins at the elementary school level, is a technique to make low-income persons more knowledgeable about saving, borrowing and money management. This education will provide lower income earners the skills to make informed choices about credit. Clear, direct and obvious disclosure of financial terms will also assist the credit consumer to make informed choices. Therefore, government

regulation of transparency laws should be reviewed to strengthen requirements placed upon credit marketing materials. Nation wide studies have revealed that low-income consumers are subject to predatory interest rates above and beyond a fair return for the creditor. If federal regulations were instituted to established a national cap, it would close the gap left open by current state and federal usury deregulation. If traditional financial institutions were given state and federal incentives to serve and locate branches within low-income neighborhoods, the residents would have ready access to traditional and regulated banking services, which may increase market competition.

Even though the current economic times have caused job loss and depletion of personal assets through market devaluation, credit card companies continue to solicit new cardholders. Individuals are willing to assume the risk of high interest rates in order to use credit cards for available credit and payday lenders for easy cash advances. People have even less expendable money to pay their debts and as a result are relying more on borrowing. As people borrow more and incur more debt, their net worth continues to decline, as does their ability to pay back their debt. Credit card companies that do not properly vet their consumers to ensure their ability to pay, and to limit the line of credit, will be left with uncollectible debt. This in turn results in insolvency both on the part of the consumer and on the part of the credit lender. If these practices are not curbed the results may be equivalent to the subprime mortgage crisis. Therefore, immediate action is required to regulate credit-lending practices and to educate consumers so they may protect themselves.

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