

Sale-Leaseback Lenders Defy Regulation

Payday Lenders Use Subterfuge to
Avoid Application of Fair Regulations
Promulgated Last Year by the
Consumer Credit Commission

In Brief

Since the founding of the Republic, Texas has prohibited usury. Texas' constitution bans the practice and establishes the ability of the Legislature to regulate loan rates. The state's Credit Code clearly outlines the terms and conditions of a legal small loan.

Finance companies may legally charge more than 90% APR interest on small loans, including an up-front \$10 fee to cover processing costs, and \$4 per month per hundred borrowed. Pawn shop loans are also expensive. But neither of these legal short term loan options are as expensive or difficult to repay as a payday loan.

Although they walk and talk like small lenders, many payday loan companies claim that they are not loaning money and holding checks as collateral, but providing services. Most of them now claim to buy a consumer's property and rent it back to them for a high fee. The real service, however, is a quick cash loan under usurious terms.

Last year the Texas Finance Commission created a system for reasonable regulation of short term loans at interest rates comparable to other small loan operations, but payday lenders continue to loan money and collect fees outside the embrace of the regulation. In order to curb usurious lending, the Texas Legislature must clarify that the sale-leaseback company is a payday lender subject to Subchapter F of the Finance Code and the current regulations of the Finance Commission.

Consumers Union study

Consumers Union called 21 payday lenders in six markets to determine the current price of these loans and the

requirements for borrowers. We also reviewed their advertising in the *GreenSheet* and the telephone book to determine if they used a disclaimer common to payday lenders making loans that are not in compliance with the regulations: "this is not a loan."

Finally we reviewed deidentified consumer complaints filed with the Office of Consumer Credit Commissioner. Many of the complaints that were filed included copies of "lease" agreements or other loan contract information for the cash advance companies. Consumers Union reviewed these lease agreements and the terms and conditions of the loans. While these complaints, essentially anecdotal in nature, do not provide a statistical information about the industry as a whole, they show in rich detail exactly what can happen to real consumers who use sale-leaseback or other payday lenders who are acting outside the current law.

Overall Findings

In general, the lenders surveyed give a borrower cash and hold a signed check in the amount of the loan plus the fee as collateral—the definition of a payday loan.¹ Rates range from \$18.40 per \$100 per two-week term, to as high as \$4.64 per day (which works out to nearly \$65 per \$100 per two-week term).

But these fees are significantly higher than allowed under the payday loan regulations. Last year, the Texas Office of Consumer Credit Commissioner attempted to end usurious lending by payday loan companies by instituting a regulation that requires licensing for all payday lenders and caps fees. Licensed payday lenders may charge a \$10 fee up front, plus \$4 per \$100 per month—essentially the same rate that "signature" loan companies may



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charge for loans under \$480. The rule also ensures that the \$10 fee is only charged once every 30 days (not on a renewal at day 14), and loans that roll over more than twice must be turned into a declining balance loan with a repayment schedule.²

None of the companies we called offered us loans in compliance with the rule. Instead, the companies offered cash that was “not a loan” or gift certificates or, in one case, a straight non-compliant payday loan.

Of the 21 companies we called who provide fast cash, 14 identified themselves as “sale-leaseback” companies. A sale-leaseback arrangement looks just like a payday loan, except that the lender records the serial number of two appliances. The borrower signs a paper “selling” the appliances to the lender for the amount borrowed, but keeps the appliances for a “rental” payment of (usually) \$33 per hundred borrowed.

Whether they advertise as a sale-leaseback “alternative” or a simple “payday” lender, most companies still offer long term loan extensions that keep families paying the high loan (or lease) fee every two weeks. Most companies advance the money over a 14-day or 15-day period, then required payment of another fee or they would cash the original check. One company advances the cash on a daily basis, for a minimum of three days or a maximum of 21 days, charging customers a daily fee. This company will also extend the loan period at the option of the borrower.

Regulations require lenders to turn long term extensions into declining balance loans. But sale-leaseback “loan alternative” companies get around the regulations by insisting that they do not make loans. Of the sale-leaseback operations we identified, seven specify in their advertising that “this is not a loan,” and the Yellow Pages now sports a new section entitled “Loan Alternatives.”

Two more sale-leaseback companies identify

themselves as “loan alternatives.”

The largest chain payday lenders now make loans through national banks—banks that take little or no loan risk but shelter the loans from the reach of state interest rate limits. These companies can charge any amount, although other consumer protections in the state regulation related to payday loans still apply (like renewal limitations).

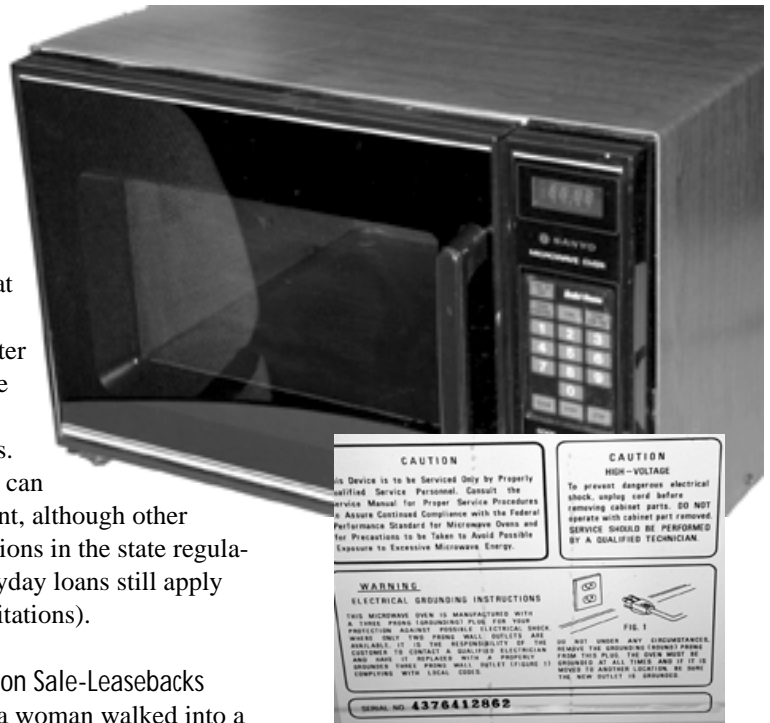
Cashing in on Sale-Leasebacks

In October 1999, a woman walked into a sale-leaseback company in Fort Worth, Texas and borrowed \$200 for a week to pay household bills during her husband’s temporary unemployment. She entered into a sales-leaseback agreement in which the company “purchased” her television and VCR for \$200 and then “leased” the items back to the woman for \$66 every week. She supplied the serial numbers of the appliances, signed a few papers, and left a personal check as security.

After the first week, the woman was unable to repay the amount of cash borrowed, had to extend the loan, and even borrowed an additional \$100. This continued for five weeks until the woman, seeking help, finally contacted the Office of Consumer Credit Commissioner. She had already paid \$563 in “rent” on the loan and still had not paid anything towards the principal to “repurchase” her “leased” property.³

Although formally a “lease” arrangement, this consumer was caught in the same trap as so many others since the tide of payday lending swept the state in the last decade. She could not keep up with the fees, and behind the fees was a principal balance that never declined no matter how many payments she made.

Sale-leaseback operators claim their agreements are short-term solutions to cash-flow problems. But, a study of



payday lenders in Indiana showed that 77 percent of customers roll over existing loans, and the average duration of a loan, including extensions, is between 3 1/2 to 4 1/2 months.⁴ Consumers are often unable to repay the entire amount in two weeks and extend the loan several times until they have paid more in fees than originally borrowed.

Consumer complaints to the OCC reveal that consumers are actually engaging in long-term financial commitments. Lease agreements have an “automatic renewal option” built into them that allows customers to renew the lease at the end of the 14-day period for an additional fee.⁵

Some companies allow customers to turn over the title to their car as collateral to get a larger amount of cash quickly. The lease process is the same as a traditional sale-leaseback, but the lease payments are large and the burden of a non-declining debt even greater.

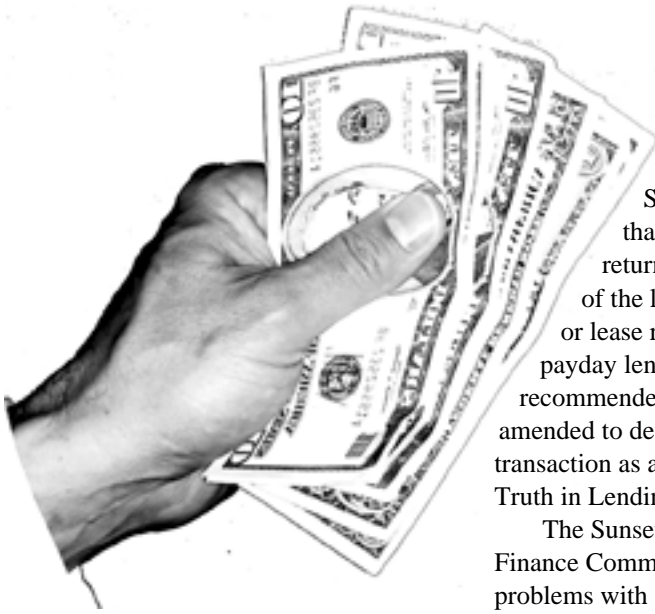
One borrower turned over his truck title to Quick Cash in order to qualify for a loan of \$500. According to the lease agreement, this sale-leaseback lender charged \$125 every two weeks with a four week minimum. After quickly getting in too deep, his mother wrote to the Better Business Bureau, which forwarded her letter to the Consumer Credit Commissioner.



Sale-Leaseback Companies Dominate Short Term Loan Market

(all prices quoted over the phone during a one-week period, February 2001)

Name of Company	City	Type of Loan	Disclaimer	Fee	Term	Rollovers Allowed?
Cash Now	Austin	Payday	not a loan	\$33/\$100	2 weeks	yes
Early Payday Advance	Austin	Sale Leaseback	no disclaimer	\$33/\$100	2 weeks	yes
Advance Cash	Austin	Payday	advance	\$33/\$100	2 weeks	yes
EZ PaydayAdvance	Austin	Sale Leaseback	not a loan	\$18.40/\$100	2 weeks	yes
Money Center	Houston	Sale Leaseback	not a loan	\$19/\$100	2 weeks	yes
Xpress Cash	Houston	Sale Leaseback	Loan Alternative	\$30/\$100	2 weeks	yes
Alliant Funding	Houston	Payday	no disclaimer	\$27/\$100	2 weeks	yes
Instant Cash	Houston	Sale Leaseback	not a loan	\$34/\$100	2 weeks	yes
The Cash Source	El Paso	Sale Leaseback	Loan Alternative	\$30/\$100	2 weeks	yes
Cash and Go	El Paso	Gift certificate	no disclaimer	\$30/\$100	2 weeks	yes
Cash n Flash	El Paso	Gift certificate	no disclaimer	\$30/\$100	2 weeks	yes
Advance Cash Leasing	Dallas	Sale Leaseback	not a loan	\$40.24/\$100	2 weeks	yes
Atlas Finance Service	Dallas	Sale Leaseback	no disclaimer	\$33/\$100	2 weeks	yes
Fast Buck	Dallas	Sale Leaseback	no disclaimer	\$4.64per day/\$100 equal to \$64.94/\$100 over two weeks	3-21 days	yes
EZ Cash Today	Dallas	Sale Leaseback	not a loan	\$33/\$100	2 weeks	yes
Cash on the Spot	Dallas	Sale Leaseback	not a loan	\$33/\$100	2 weeks	yes
Speedy Money	Dallas	Sale Leaseback	no disclaimer	\$20/\$100	2 weeks	yes
Instant Cash	San Antonio	Payday	not a loan	\$33/\$100	2 weeks	yes
Cash on the Spot	Fort Worth	Sale Leaseback	no disclaimer	\$33/100	2 weeks	yes
Instant Cash	Fort Worth	Payday	not a loan	\$33/\$100	2 weeks	yes
Mr. Cash	Fort Worth	Sale Leaseback	not a loan	\$33/\$100	2 weeks	yes
Totals		14 sale leaseback	10 "not a loan"	\$32.07 average	2 weeks	yes



“My son borrowed \$500 and [as of two months later] he paid four payments totaling \$440. Each payment, only \$5 went toward principal...I paid \$560 more to get his title released...these people are robbing people without a gun.”⁶

The payday loan rule is designed to ensure that borrowers do not get caught in a cycle of non-declining debt. Under the rule, a payday loan that is renewed twice must be turned into a declining balance loan.⁷ But sale-leaseback companies renew their agreements week after week and month after month and the consumer may never be able to “buy back” those appliances.

Although sale-leaseback companies claim they are not lenders, five of the companies we called advertise in the phone book under the “loan” section, next to traditional small loan and pawn companies.⁸

While the companies require customers to bring in the serial numbers, make, and model of various appliances, the lenders most often do not ask to see the appliance being purchased and leased. Nor do they appear to require proof that these items have not been “sold” to someone else.

The Texas State Committee on Economic Development’s Subcommittee on Consumer Credit Laws researched the issue of sale-leaseback loans and issued a report in September 2000. The Subcommittee found that these companies

“embrace the subterfuge of renaming the loan transaction in order to avoid regulatory oversight by the Office of Consumer Credit Commissioner.” The

Subcommittee report notes that companies do not accept return of the property at the end of the lease, but only accept cash or lease renewal like any other payday lender. The Subcommittee recommended that Texas law be amended to define a sale-leaseback transaction as a loan and require federal Truth in Lending disclosures.⁹

The Sunset Staff Report on the Texas Finance Commission found similar problems with sale-leaseback transactions. Among recommendations for increasing consumer protection through stronger regulatory authority, the Report specifically proposed strengthening the Office of Consumer Credit Commissioner’s oversight of sale-leaseback loans.¹⁰

National Banks

The two largest chains of check-cashing stores in the U.S. both offer payday loans through a national bank that is exempt from state usury limits. Ace Cash Express, with more than a thousand stores across the country and hundreds in Texas (its biggest market), offers payday loans through an agreement with Goleta National Bank.¹¹ The Dollar Financial Group (DFG), the nation’s second largest chain offering services under a variety of store names, offers payday loans through Eagle National Bank.¹²

In both cases, the payday lender offers loans up to \$500 with a term of 14 days. DFG allows a maximum of four extensions. Ace has no renewal maximum, but requires that borrowers pay down at least five percent of the principal balance in order to extend the loan.

The agreement between payday lenders and a national bank may be little more than a mechanism to ensure that

payday lenders avoid the application of state usury laws. While DFG purports only to act as an agent for a national bank in its payday loan transactions, it recently settled a class-action lawsuit against Eagle National Bank and DFG for \$5.5 million dollars. The suit alleged various violations of state and federal usury and consumer protection laws by both companies.¹³

According to statements filed with the Securities and Exchange Commission, the agreement between Ace and Goleta National Bank gives Ace “*substantially all* of the interest received by Goleta from the borrowers, and subjects the Company [Ace] to *substantially all* of the risk of nonpayment by the borrowers.” [emphasis added] To further distance Goleta from the payday lending practices it facilitates, the agreement makes Ace solely responsible for *substantially all* third party claims that may arise as a result of the bank loans.

Goleta collects only a service fee, takes no risk and collects no interest. Yet Ace may use this arrangement to avoid the application of state usury limits. Since the Goleta Agreement was implemented (March 2000) Ace has expanded its payday loan services from 339 stores to 992 stores.¹⁴ Ace makes loans averaging \$266 and collects an average finance charge of nearly \$40.¹⁵ Under Texas rules, a regulated payday lender could charge no more than \$15.32 for the same average size loan.

Banks rely on Section 85 of the National Bank Act which authorizes national banks to export high interest rates from one state into another state that may have usury laws.¹⁶ Many states have no

maximum interest rate, and banks may charge any rate they can get.

The practical effect of the federal preemption is to allow Texas payday lenders to import the banks’ interest rates from other states and bypass Texas’ limit on interest rates. Serious consumer protection concerns arise in this lending environment. For this reason, Consumers Union is

“My son borrowed \$500 and [as of two months later] he paid four payments totaling \$470.....I paid \$560 more to get his title released.... ..these people are robbing people without a gun.”

one of several groups that have asked federal officials to prohibit national banks from making payday loans at exorbitant rates.¹⁷

In the meantime, however, payday lenders are still responsible for the terms and conditions they impose on borrowers and must abide by the payday loan consumer protections set out in regulations (particularly the requirement that they move borrowers into a declining balance loan). Further, in March 2000, the Federal Reserve ruled that payday lenders are subject to the Truth in Lending Act and therefore must disclose in writing the annual interest rates they are charging. Compliance became mandatory on October 1, 2000. The rule also clearly defines such transactions as loans and fees as finance charges, although some sale-leaseback companies continue to argue that they are not making loans.¹⁸

Alternatives to Payday Loans

Payday lenders argue that they fulfill a need and help poor people make it to the next payday when an unexpected expense arises. But in many cases, payday loan borrowers may have other, less onerous options available. Companies that compete directly with sale-leaseback providers and other cash advance companies acting outside the law include regulated payday lenders, small loan financiers and pawn loan shops.

In addition, credit unions have begun to respond to consumers' small loan needs with new products and services. "Most people turn to the alternative financial sector because they're excluded from the services of deposit institutions," says John Caskey, associate professor at Swarthmore College, in his report "*Lower Income Americans, Higher Cost Financial Services*." But Caskey's study found that one-third of households that used "fringe" bankers (i.e. check cashers, pawnbrokers, payday lenders and rent-to-own shops) were also members of credit unions.

In December of 2000, Credit Union National Association's Alternatives to Payday Lending Task Force State Issues Subcommittee released a report on credit union alternatives to payday loans. This report identified credit unions that have developed reasonably priced alternatives

to payday loans, like the Carolina Trust FCU's "Micro Loan" program. It found that new loan products and debt counseling programs can help credit unions adapt to meet their members need for alternatives to payday loan products.¹⁹

As credit unions begin to ramp up their efforts to serve customers, other small loan alternatives remain available. Regulated signature loans are as simple as a payday loan, and not nearly as expensive. A consumer can walk into a signature loan office and walk out with a small loan after minimal underwriting (the process for determining credit-worthiness). Like payday lenders, signature loan companies frequently take applications by phone and approve the loan while the customer waits. Like payday loans, signature loans are generally small, averaging \$297. And the market is booming. According to the Office of Consumer

Credit Commissioner, signature lenders in Texas make more than 4.1 million loans totaling \$1.2 billion.²⁰

Signature loans are still expensive compared to credit cards or regular bank loans, and lenders sometimes offer borrowers frequent opportunities to refinance. When consumers refinance, they typically return the loan principal to the original amount borrowed, thus slowing final repayment. But in no case does a consumer get a non-declining balance loan, and the costs are not as high as accumulated sale leaseback fees. Because

signature loans are booming and interest rates more than adequate, the OCC crafted a very similar rate for regulated payday lenders.

Recommendations

Texas has set reasonable limits on interest rates since it was a republic. Such usury limits have balanced the interests of lenders with those of borrowers and prevent "loan sharking" and other abusive practices. Unfortunately, loan sharking in Texas is back as lenders use loopholes in the law to increase their interest charges far above statutory caps.

Consumers

Union SWRO concurs with the Texas Sunset Advisory Commission and Texas Senate Economic Development Committee which have concluded that the sale leaseback loophole must be closed.

Unregulated payday lenders prey on cash-strapped people and trap them on a treadmill

Goleta National Bank takes no risk and collects substantially no interest. Yet Ace may use this arrangement to avoid the application of state usury limits. Since the Goleta Agreement was implemented (March 2000) Ace has expanded its payday loan services from 339 stores to 992 stores, collecting nearly \$40 on average for a two-week \$266 loan. Under Texas rules, a regulated payday lender could charge no more than \$15.32 for the same loan.

of debt that they cannot get off. Such abusive lending practices provide a glimpse into what might happen if Texas were to repeal its existing usury limits for consumer loans. To protect consumers in the spirit of the Texas Finance Commission's payday loan rule, Consumers Union SWRO recommends to:

Consumers Union SWRO *Reports*

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Bereaved families suffer even more when funeral plans go bad. Final Committal
Texas is #1 in waste from large-scale animal production operations. Animal Factories
Inequities continue in home purchase, refinance markets. Access to the Dream 2000
Payday lenders disguise usury. Wolf in Sheep's Clothing
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Consumers Union

- Keep existing consumer protections for consumer loans. Usury limits on loans of only a few hundred dollars are already quite high, and should not be increased.
- Close the existing loopholes that allow abusive practices like sale lease-backs. Assure consumers that they will pay reasonable rates, under fair terms, when they borrow money.

Endnotes

¹ "Payday loan or deferred presentment transaction means a transaction in which a cash advance is made in exchange for the consumer's personal check, or in exchange for the consumer's authorization to debit the consumer's deposit account, in the amount of the advance plus a fee and where the parties agree that the check will not be cashed or deposited, or that the consumer's deposit account will not be debited, until a designated future date." Texas Administrative Code, 7TAC Sec. 605(b).

² Texas Administrative Code, Title 7, Part I, Chapter 1, Subchapter F. Alternate Charges for Consumer Loans, 7TAC Sec.

605.

³ Complaint to the Office of Consumer Credit Commissioner, 2/14/2000.

⁴ Sunset Commission. Sunset Staff Report on the Texas Finance Commission Agencies. p. 67. October 2000.

⁵ Lease agreements: Cash-2-U Leasing, Dallas; Instant Rental Service, Dallas; First Capital Leasing, Houston; Hubby Leasing, Dallas.

⁶ Complaint to the Office of Consumer Credit Commissioner, 9/28/98.

⁷ Texas Administrative Code, Title 7, Part I, Chapter 1, Subchapter F. Alternate Charges for Consumer Loans, 7TAC Sec. 605(f)(1).

⁸ Dallas and El Paso Yellow Pages, 2000, "Loans."

⁹ Texas Senate, Committee on Economic Development, Subcommittee on Consumer Credit Laws, Interim Report, 76th Texas Legislature, September 2000.

¹⁰ Sunset Commission Staff Report on the Texas Finance Commission, October 2000.

¹¹ Securities and Exchange Commission Form 10-K, Ace Cash Express, for the fiscal year ending June 30, 2000, "Bank Loans."

¹² Securities and Exchange Commission Form 10-K, Dollar Financial Group, for the fiscal year ending June 30, 2000,

"Cash Til Payday Originations," and "Legal Proceedings."

¹³ Ibid, "Legal Proceedings."

¹⁴ Securities and Exchange Commission Form 10-Q, Ace Cash Express, for the quarter ending December 31, 2000, "Quarter Comparison."

¹⁵ Ibid, "Supplemental Statistical Data."

¹⁶ The Cost of Credit, Regulation and Legal Challenges, National Consumer Law Center, 2d Edition, 2000, Sec. 3.4.5, Interstate Banking: National Banks and Rate Exportation.

¹⁷ Consumer Reports. *Consumers Union in Action*. March 2000. Vol.65, No.3, Pg.6.

¹⁸ Texas Senate, Committee on Economic Development, Subcommittee on Consumer Credit Laws, Interim Report, 76th Texas Legislature, September 2000. Also Omaha World-Herald, April 9, 2000, Business p. 1.

¹⁹ Credit Union National Association, "Alternatives to Payday Loans: The Credit Union Option," December 2000.

²⁰ Office of Consumer Credit Commissioner, response to Public Information Act request by Consumers Union, 2/06/01. Annual report data, 1995-1999.

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