


NMPIRG

Education Fund

SERIES ON PREDATORY LENDING
REPORT 2



Payday, Heyday!

Measuring Growth in New Mexico's
Small Loan Industry (1990-2001)

APRIL 2002

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Series on Predatory Lending: Report 2

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New Mexico Public Interest Research Group (NMPIRG) Education Fund is a non-profit, non-partisan organization dedicated to promoting environmental preservation, consumer protection and good government in New Mexico through research and education. NMPIRG Education Fund works closely with NMPIRG, a consumer and environmental advocacy organization.

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SUMMARY AND FINDINGS

Financial deregulation has led to explosive growth of the so-called predatory lending industry, which includes check cashing outlets, payday loan companies, rent-to-own stores, high cost second mortgage companies, sub-prime auto lenders, traditional pawn shops and the growing business of auto title loans. This report, the second in a series on predatory lending, examines the rapid growth of the payday and title loan industry in New Mexico in the 1990s.¹

Payday and title loans, by definition, are marketed towards cash-strapped consumers who are struggling between paychecks. Although these predatory loans may provide rapid access to cash for many borrowers, their triple-digit interest rates and other industry practices are designed to trap consumers in a cycle of debt. Predatory lending is a serious national problem, but nowhere is it more troublesome than in New Mexico.

New Mexico has the highest percent of its citizens living in poverty (19.6%).² Additionally, New Mexico is one of two states with more than a quarter of its children living below the poverty line.³ These citizens are most vulnerable to predatory lenders.

NMPIRG Education Fund examined the growth of the predatory payday lending and title loan industry since 1990, based on the data available. As the previous report in this series, Payday, Mayday!, shows, the new disclosure regulations are modest first step, yet there is still much to be done. Payday, Heyday! seeks to answer some of these serious questions and further examine the rapid growth of this fast loan industry.

This report examines growth in the small loan industry in New Mexico, with an emphasis on payday loan and auto-title pawn companies over the past decade. This report explores the impact of these services on consumers and includes data on the distribution and ownership of these firms, while making recommendations to consumers and policymakers.

Among our key findings are the following:

- Over the past decade, the predatory lending industry has exploded in New Mexico. In 1992, there were just 23 firms making payday or auto-title loans. At the close of 2001, there were 349 predatory lenders – a 1,417% increase. During this same period the remainder of the small loan industry grew only 35%.⁴ Conversely, the population of New Mexico grew only 20% from 1990 to 2000.⁵

¹ Prushnok, Raymond, *NMPIRG Education Fund*, “Payday, Mayday!,” March 2002, Available from: <http://www.nmpirg.org>; Internet; accessed 11 April 2002. That first report in the series documented that 2/3rds of the industry fails to even comply with the state’s modest disclosure laws.

² *U.S. Census Bureau*, “Poverty in the United States: 2000,” September 2001.

³ *Ibid.*

⁴ The regulatory and licensing agency, the New Mexico Financial Division, does not categorize companies that make loans of \$2,500 or less. Consequently, many traditional banks also have a small loan license and are included as part of this industry.

⁵ *U.S. Census Bureau*.

- Payday and title loan companies are more likely to be found in poorer cities with larger minority populations. The highest average number of residents per licensed predatory lender was found in three towns outside Native American reservations, led by Gallup (880 residents per licensee) and followed closely by Grants (881) and Farmington (1,647). Las Cruces, a southern city with a large Hispanic population, had one predatory lender for every 3,094 residents.
- The per capita ratio of predatory lenders has shifted dramatically in New Mexico. In 1992, there was approximately one predatory lender (payday or title lender) for every 66 thousand citizens. Today, that ratio has shifted to one predatory lender for approximately every 5 thousand people (5,212).
- Albuquerque, by far the state's largest city, had one predatory lender for every 5,680 citizens. Conversely, the affluent suburb of Rio Rancho had only one lender for every 10,353 citizens.
- The survey results refute the industry's claim that most payday and title loan companies are locally owned *Mom-and-Pop* stores. NMPIRG found that the vast majority of lenders are not based in New Mexico. In fact, only 21.5 percent (75 of 348) are New Mexico owned firms while 19 percent (65) are based in South Carolina and 27 percent (94) are based in Texas – (See Table 2). Not only do these firms put consumers in a perpetual cycle of debt, the beneficiaries are outside of our state.
- Most payday loan customers are not occasional one-time borrowers. In fact, the average borrower will take out 7 to 13 loans in one year.
- The composition of the state's small loan industry has reversed since 1990. Just a decade ago, less than one in five (17%) small loan licensees was making predatory loans. Today, nearly seven of ten (69%) licensees are firms making payday loans and/or title loans (See Figures 3 and 4).

Our findings are conservative. Other payday and title lenders are not included in the total count due to their evasion of state licensing requirements. One such example is ACE Cash Express, Inc. Based on an analysis of the yellow pages, there are nine ACE outlets in Albuquerque alone. This firm is affiliated with Goleta National Bank, which claims it is above the jurisdiction of state statutes due to federal preemptions. This so-called “rent-a-charter” agreement is currently being challenged in the courts in several states including Colorado, Florida and Maryland.

PAYDAY, HEYDAY!

I. BACKGROUND

In recent years, the financial services industry has grown considerably, especially the small loan market. Over the past decade, the predatory lending industry has exploded in New Mexico. Yet, according to this NMPIRG Education Fund analysis, in 1992, there were just 23 firms making payday or auto-title loans. At the close of 2001, there were 349 of these predatory lenders – a 1,417% increase. During this same period the remainder of the small loan industry grew only 35%.⁶ Conversely, the population of New Mexico grew only 20% from 1990 to 2000.⁷ These data demonstrate that the growth of predatory lending clearly outpaces that of the rest of the small loan industry and population growth does not account for this explosion.

Traditional, mainstream banks that historically met the needs of consumers seeking small, short-term loans have virtually disappeared from the marketplace.⁸ Additionally, the nationwide finance companies, initially created to attempt to meet these needs, have also moved out of this type of small lending, leaving a vacuum in consumer credit.⁹ Moreover, a report prepared for the City of Albuquerque in 2000 found that traditional banks underserve minority and low-income borrowers.¹⁰ Consequently, minority and low-income borrowers are forced to seek alternative sources of credit that often include predatory lenders such as payday and title loan companies.

Payday loan and auto-title pawn companies have filled this void in short-term credit and nowhere is this more apparent than in New Mexico. There are 19 states that have strict small loan, or “usury”, caps and 25 states that allow triple-digit interest rates.¹¹ New Mexico is one of only six states with no usury ceiling that would regulate licensed payday and title lenders.¹² In New Mexico, the only regulation that applies to these lenders is the New Mexico Small Loan Act. The Small Loan Act merely requires licensing and review of firms that offer loans of \$2,500 or less. So most traditional banks that offer smaller loan products also have small loan licenses and are subject to the same weak regulations that apply.

⁶ The regulatory and licensing agency, the New Mexico Financial Division, does not categorize companies that make loans of \$2,500 or less. Consequently, many traditional banks also have a small loan license and are included as part of this industry.

⁷ U.S. Census Bureau.

⁸ *National Consumer Law Center*, “Payday Loans: A Form of Loansharking,” Available from: <http://www.nclc.org/PayDayLoans/pay-menu.htm>; Internet; accessed 19 March 2002.

⁹ *Ibid.*

¹⁰ *CREDIT and Project Change Fair Lending Center at the Institute of Public Law of the University of New Mexico*, “Mortgage and Small Business Lending in Albuquerque’s Underserved Markets,” prepared for the City of Albuquerque, September 2000.

¹¹ *NMPIRG and Consumer Federation of America*, “Rent-a-Bank Payday Lending,” November 2001.

¹² *Ibid.*

Historically, financial markets have been subject to heavy governmental regulation.¹³ The New Mexico Public Interest Research Group Education Fund (NMPIRG), the Consumer Federation of America (CFA), and other consumer protection groups have documented the effect of financial deregulation on American consumers throughout the 1990's. One consequence of deregulation of interest rates, high credit card interest rates and high bank fees has been the rapid growth of the so-called predatory lending industry, which includes check cashing outlets, payday loan companies, rent-to-own stores, high-cost second mortgage companies, sub-prime auto lenders, traditional pawnshops and the growing business of auto-title loans. Though the rates and fees charged by many of these firms would have once been considered usurious by New Mexican lawmakers, today they are free to charge what they please with little oversight.

Usury has been considered unethical throughout the ages and is a practice delimited in law since biblical times.¹⁴ New Mexico has a long history of anti-usury laws and a recent book credits the foundation of the Santa Fe Trail and its prosperity to this standard. Its rates, says the author, were dramatically lower than those its competitor, the Chihuahuan trail.¹⁵

During the era of deregulation, anti-usury legislation and limitations on interest came under close scrutiny around the United States. They were seen as a burden on the modern banking industry in the early 1980s, a period of recession where laissez faire strategies were used to stimulate the economy. New Mexico eliminated all of its anti-usury laws by 1981 and gave financial institutions the freedom to determine rates on their own – whatever the market could bear. In light of the improved economic climate and disparate access to credit experienced by low-income and minority borrowers, a reinstatement of strict anti-usury legislation is long overdue. Despite these certainties, lenders in New Mexico determine rates and fees with very little regulation aside from federal disclosure requirements, such as those found in the Truth in Lending Act (TILA).

In spite of market forces, there is a risk-rate disparity of abominable proportions between high-cost loans such as payday and title loans and other sources of credit. Borrowers, when applying for nearly any source of credit, are subject to a risk evaluation. This risk is often reflected in the interest rate and fees they are ultimately charged and should accurately account for the likelihood of default. There is no evidence that the loss ratio on payday loans is significantly greater than that for credit cards, however the interest rates are far higher than credit cards, which have average APRs of 14%, as compared to the average New Mexican payday loan at 508% APR.¹⁶

¹³ Mohammed Zebib, "The Regulatory Road to Interstate Banking in the U.S.," *Delta Business Review*, Available from: <http://cber.nlu.edu/DBR/ZEBIB.htm>; Internet; accessed 21 March 2002.

¹⁴ *Macroknow*, "Usury, Money Rule of Law and Debt Release," Available from: <http://www.macroknow.com/books/philosophy/usury.htm>; Internet; accessed 7 April 2002.

¹⁵ Dary, David, *The Santa Fe Trail: Its History, Legends, and Lore*, Penguin: March 2002.

¹⁶ Loss data: *Consumers Union*, "Fact Sheet on Payday Loans," Available from: <http://www.consumersunion.org/finance/paydayfact.htm>; Internet; accessed 1 April 2002.; Credit card APR: Dake, Bradley, *MassPIRG*, "Deflate Your Rate," March 2002; Payday APR: *NMPIRG and Consumer Federation of America*.

Currently, the New Mexico Small Loan Act of 1955 is the only regulation governing the small loan industry, which includes payday lenders and auto-title pawnshops. This makes New Mexico one of just six states with no small loan cap, specific regulations governing short-term small loans, or outright prohibitions.¹⁷

As requested by a 1999 New Mexico House of Representatives Memorial (HM 36) to study consumer-lending practices, specifically of the small loan industry, a Consumer Lending Study Committee was convened. This memorial states:

Many New Mexicans need access to short-term and long-term loans and this need extends throughout the population, affecting persons with . . . little or no income and inadequate financial resources on a daily basis and it [is] possible to offer instant short-term high interest loans to people in dire financial circumstances without requirements for credit establishment or verification and *serious questions arise* about whether this *relatively new fast loan industry* is regulated adequately under current law (emphasis added).¹⁸

This committee's report came forward with thirteen recommendations for the small loan industry.¹⁹ In spite of these recommendations, consumer advocates that took part in this study issued a dissenting Minority Report that found "misrepresentations" in the Majority report.²⁰ However, the Majority Report resulted in two new regulations that were implemented in October 2001: *New Mexico Regulation 12.18.3*, requiring all licensed small loan companies to have an informational brochure readily available consumers, and *New Mexico Regulation 12.18.4*, which requires all licensed title and payday loan companies to display a prominent sign disclosing the schedule of charges readily visible to borrowers and in a reduced form at every workstation. A recent NMPiRG Education Fund study, *Payday, Mayday!*, published in March 2002, found that two-thirds of the payday and title lenders in New Mexico are not in compliance with these regulations.²¹

Although these two new regulations are a positive step, as *Payday, Mayday!* shows, there is still much to be done. In the spirit of this memorial, *Payday, Heyday!* seeks to answer some of these serious questions and examine the rapid growth of this fast loan industry.

This report examines growth in the small loan industry in New Mexico, with an emphasis on payday loan and auto-title pawn companies over the past decade. This report explores the impact of these services on consumers and includes data on the distribution and ownership of these firms, while making recommendations to consumers and policymakers.

¹⁷ *NMPiRG and Consumer Federation of America.*

¹⁸ *New Mexico House of Representatives*, "HM 36: Healthy Economic Environment Study," Available from: <http://legis.state.nm.us/session99.asp?chamber=H&type=M&number=36&Submit=Search>; Internet; accessed 7 April 2002, passed 13 March 1999.

¹⁹ Financial Institutions Division Director, *New Mexico Regulation and Licensing Department*, "Consumer Lending Study Committee Report for the Forty Fourth Session of the New Mexico State Legislature," January 2000.

²⁰ "HM 36: Consumer Lending Study Committee Minority Report," January 2000.

²¹ Prushnok, Raymond, *NMPiRG Education Fund*, "Payday, Mayday!," March 2002, Available from: <http://www.nmpirg.org>; Internet; accessed 11 April 2002.

II. PAYDAY AND TITLE LENDERS DEFINED

Payday and title loans, by definition, are small-loan products marketed towards cash-strapped consumers that are struggling between paychecks. Although they provide rapid access to cash for many borrowers, their lofty rates are often unsustainable and trap consumers in a cycle of debt. Nowhere is this more troublesome than New Mexico, the poorest state in the country, where consumers pay some of the nation's highest rates.

Payday lenders make small, short-term (“until payday”) deferred deposit loans, usually secured by a personal check held for future deposit, at interest rates averaging 508% in New Mexico.²² For example, you write a check for \$360, and receive \$300, and the lender agrees not to cash your check for two weeks. The actual cost of that loan for two weeks is \$60, which works out to be an APR of 521%. If you cannot afford to pay it back within two weeks, you can simply pay the finance charge a second time (\$60) to “roll it over”, still owing the original \$360, ratcheting your total finance charges up to \$120 for a \$300 four week loan.

A title loan is a loan borrowed against the value of a motor vehicle.²³ Unlike payday loans, title loans are secured with the borrowers automobile. Usually, title loans range from \$250 to \$1500, but they may be as high as \$5,000 or even \$10,000.²⁴ The amount extended to the customer is usually based upon a percentage value of the automobile. The industry norm is 33%.²⁵ A typical title loan's monthly cost is \$25 per \$100 borrowed and has an APR of 300%. The borrower keeps their motor vehicle and may drive it after receiving a title loan, but the lender keeps the title to the motor vehicle as security for repayment of the loan and also gets a copy of the borrower's keys. If the borrower cannot make the payments on their loan, the lender will repossess their motor vehicle, sell it, and pocket whatever money he or she gets for it, just like a typical pawn shop would for a clock or guitar. But the result is much worse – the consumer is left without transportation. The lender can often repossess the motor vehicle – even if only one payment is missed.

²² *NMPIRG and Consumer Federation of America.*

²³ Auto-title loans are often referred to as “auto-title pawns” in other states.

²⁴ *Florida Attorney General's Office*, “How to Protect Yourself: Title Loans,” Available from: <http://legal.firn.edu/consumer/tips/title.html>; Internet; accessed 22 February 2002.

²⁵ Department of Financial Institutions, *State of Illinois*, “Short Term Lending Final Report,” <http://www.state.il.us/dfi/ccd/Shortterm.pdf>; Internet; accessed 8 April 2002.

III. UNBRIDLED GROWTH IN NEW MEXICO'S SMALL LOAN INDUSTRY²⁶

Further evidence to dispute industry contentions that the high-risk necessitates high rates is the rapid growth of the industry, both in New Mexico and around the country. The profit margins of payday lenders add to this argument. It is estimated that in 2000 there were 8 to 10 thousand payday lenders nationwide that originated \$14 billion in loans.²⁷ The industry is extremely profitable. A State of Tennessee report stated that the industry return on equity in 1997 was upwards of 30%.²⁸ Other analyses, including a U.S. Treasury survey conducted in 2000, estimate that the industry wide return on equity is close to 35%, the net before-tax earnings for major credit card companies is approximately 3%.²⁹

In spite of the unprecedented growth experienced by the New Mexico small loan industry, largely due to expansion of payday and title loan companies, very little has been done to monitor this trend. As stated previously, payday and title loan companies, which were virtually nonexistent fifteen years ago, have all but taken over the small loan market. These firms will be referred to as the predatory segment of the market. All other firms with small loan licenses will be referred to as the non-predatory segment.

An example of a non-predatory small loan company would be any depository institution that makes loans of \$2,500 or less. For example, Wells Fargo is a licensed small loan company.

The total number of small loan licensees grew from 141 to 507 over the past decade – 88% of this growth is accounted for by new licenses for these two types of predatory lenders (Figure 1). There were just 24 licensed firms in New Mexico making predatory payday and title loans in 1992. This number grew to 349 by the close of 2001 (See Figure 2). The number of small loan licenses to non-predatory firms grew by 35% over the same period.

Also, it is important to note the transition in market share of licensees from a majority of non-predatory lenders to a predatory majority. Just a decade ago, less than one in five (17%) small loan licensees was making predatory loans. Today, nearly seven of ten (69%) licensees are firms making payday loans and/or title loans (See Figures 3 and 4).

²⁶ See the section entitled Methodology of Growth Calculations at the end of this report for more information concerning the tabulation of the figure used in this section.

²⁷ Stegman, Michael, *UNC Chapel Hill Center for Community Capitalism*, "Payday Lending: A Model that Encourages Chronic Borrowing," *The Economic Development Quarterly*, January 2002.

²⁸ *State of Tennessee, Dept. of Financial Institutions*, "Report to the General Assembly on the Deferred Presentment Service Act at 9," 1998.

²⁹ Payday Return: Koerner, Brendan, "Preying on Payday," *Mother Jones*, May/June 2001; Credit Card Earnings: Board of Governors, Federal Reserve Bank "The Profitability of Credit Card Operations of Depository Institutions," June 2001; Internet; Available from: <http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2001/ccprofit.pdf>; accessed 12 April 2002.

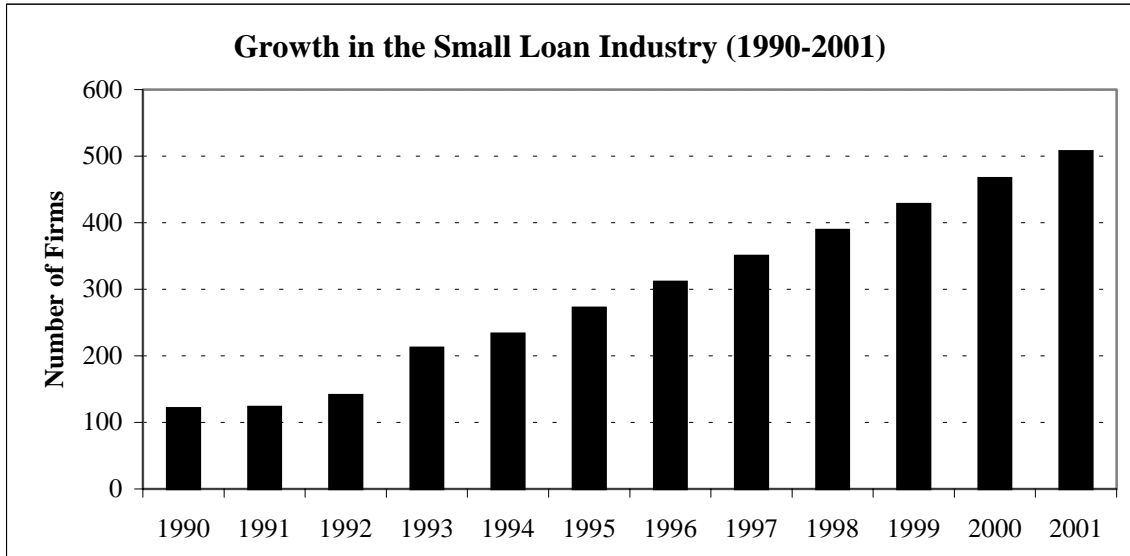


FIGURE 1: This graph shows the growth in firms licensed for the small loan business in New Mexico. The industry as a whole grew 260% over the past decade and 88% of this growth can be attributed to predatory lenders.

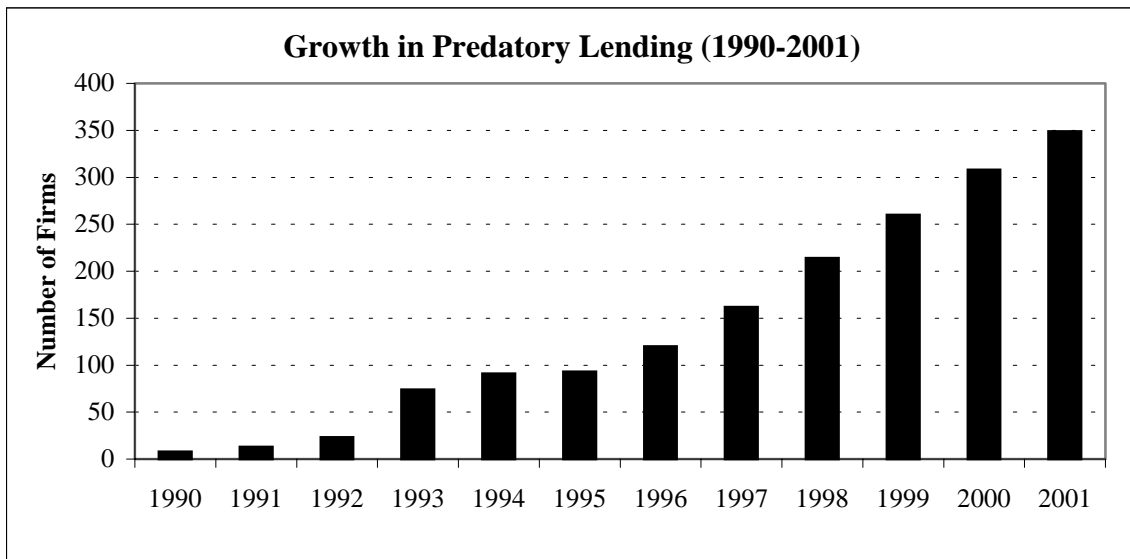
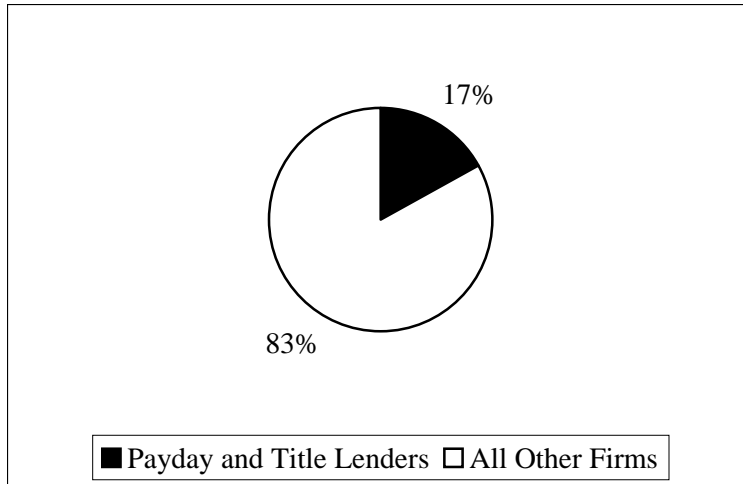
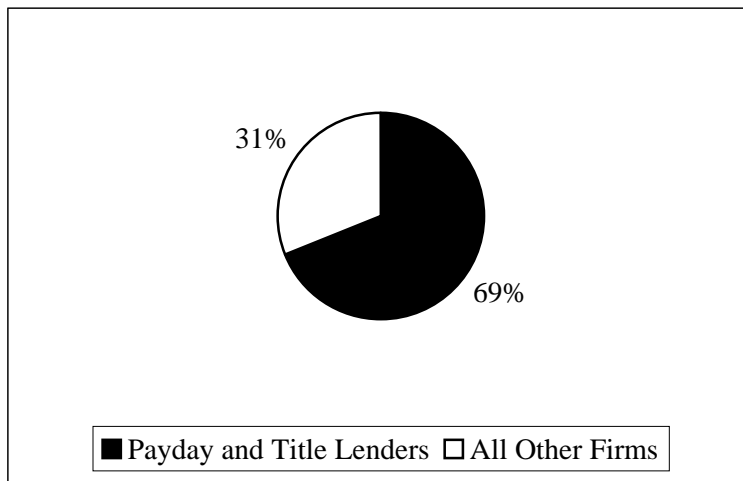


FIGURE 2: This figure shows the number of firms licensed to make payday loans and auto-title loans in New Mexico from 1990-2001. There were 23 firms licensed to make payday and/or title loans in 1992, this number grew to 349 by the close of 2001. Note the explosive growth in the 1990s, when nearly every current lender began operations. In 1990, there were 121 firms in the small loan industry and 8 were predatory lenders.

Small Loan Industry Market Share (1992)



Small Loan Industry Market Share (2001)



FIGURES 3 AND 4: These graphs show the dramatic shift in the market share of payday and title lenders relative to the small loan industry at large. In 1992, there were 23 payday and title lenders in New Mexico as compared to 117 other firms with small loan licenses. In 2001, the number of payday and title lenders had increased dramatically to 349 and the number of licenses to all other firms slightly increased to 158.

The combined growth of the predatory (payday and title loan) and other segments of the small loan industry in New Mexico is significant. However, when the growth of these two segments is compared, the traditional small loan industry's growth is stagnant (See Figure 5). This further illustrates the dramatic shift in the market share of small loan licenses from traditional lenders to predatory lenders in the past decade.

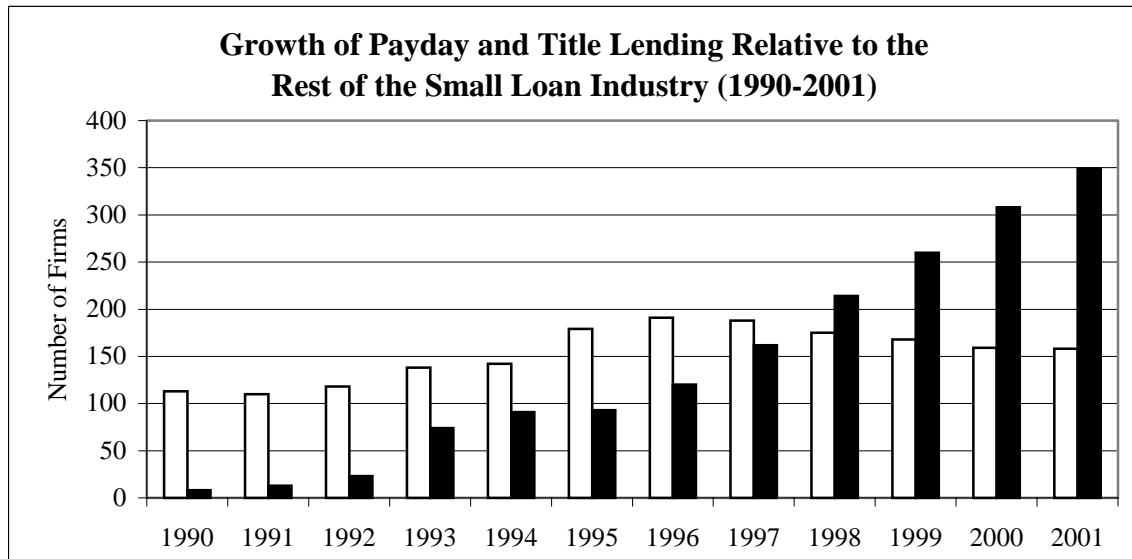


FIGURE 5: This graph shows the growth in the small loan industry in two separate parts: The black portion of the graph indicates the growth in predatory lenders and the white portion of the graph represents all other firms in the small loan business. The predatory lending industry clearly contributes the majority of the growth in the small loan industry and clearly outpaces the relatively stagnant growth of licenses to all other firms.

These figures clearly show the pattern of growth of the small loan industry in New Mexico over the past decade. This growth is a result of the lucrative nature and ease of predatory lending in New Mexico. There is high profitability, low risk, very little regulation, and a vacuum of consumer credit created by traditional banks leaving the small loan industry. This growth can be explained in many ways. Regardless if it is attributed to the high-profitability, low risk or the weak regulatory environment, the trend throughout the 1990s is clear. Many more payday and title lenders have been licensed in New Mexico and very little has been done to review the impact of this explosion in predatory lending.

IV. ANALYSIS OF INDIVIDUAL CITIES AND TOWNS

As mentioned, the predatory lending industry in New Mexico has mushroomed over the past decade. This growth has far outpaced population growth and there are several per capita disparities.

According to U.S. Census Bureau statistics, the population of New Mexico grew approximately 20% between 1990 and 2000. This increase is far outpaced by the 1,240% growth in predatory lending over the timeframe. In addition, certain communities have experienced more intense growth than others.

For instance, the per capita ratio of predatory lenders has shifted dramatically in New Mexico. In 1992, there was approximately one predatory lender (payday or title lender) for every 66 thousand citizens. Today, that ratio has shifted to one predatory lender for every 5 thousand people (See Table 1).

TABLE 1: SELECTED CITIES

<u>Rank in Size City</u>	<u>Citizens per Predatory Lender</u>		<u>Predatory Lenders</u>			<u>Population</u>		
	<u>1992</u>	<u>2001</u>	<u>1992</u>	<u>2001</u>	<u>Growth</u>	<u>1990</u>	<u>2000</u>	<u>Growth</u>
11 Gallup	19,154	808	1	25	2500%	19,154	20,209	6%
22 Grants	0	881	0	10	NA	8,626	8,806	2%
6 Farmington	11,332	1,647	3	23	767%	33,997	37,884	11%
2 Las Cruces	15,532	3,094	4	24	600%	62,126	74,267	20%
1 Albuquerque	64,123	5,680	6	79	1317%	384,736	448,736	17%
4 Rio Rancho	0	10,353	0	5	NA	32,505	51,765	59%
New Mexico	65,873	5,212	23	349	1517%	1,515,069	1,819,046	20%

Some cities have seen more abnormal growth than others. In cities with close proximity to Indian reservations, there is a much higher per capita ratio of payday lenders. The highest average number of residents per licensed predatory lender was found in three towns outside Native American reservations, led by Gallup (880 residents per licensee) and followed closely by Grants (881) and Farmington (1,647). Las Cruces, a southern city with a large Hispanic population, had one predatory lender for every 3,094 residents. These towns had a cumulative 8 predatory lenders a decade ago; today there are 72 total.

In a more wealthy community, such as Rio Rancho, there is only one payday lender for every ten thousand residents. This ratio is well above the state average and shows that there are disproportionate numbers of payday lenders in lower-income and minority communities.

The harsh reality is that New Mexico is the poorest state in the country with more of its citizens living in poverty than any other. According to a recent study by the U.S. Census Bureau, New Mexico has one-fifth of its citizens and more than a quarter of its children living below the poverty line.³⁰ As this data shows, the concentration of predatory lenders has increased dramatically, especially in communities of color. These citizens are most vulnerable to predatory lenders and, unfortunately, New Mexico lags in the regulation necessary to protect consumers from these predatory practices.

³⁰ *U.S. Census Bureau.*

PREDATORY LOANS AND THEIR IMPACT ON CONSUMERS

A large void exists in reasonably-priced credit for low and moderate-income consumers. In New Mexico, unregulated payday and title lenders fill this niche. This market was basically untapped prior to the 1990s, the era examined by this report. In New Mexico, we have seen remarkable growth rates – the industry has grown fourteen-fold in the past decade.

Although the Financial Institutions Division (FID) and other state authorities have not kept precise data mapping these trends, this demand is met by high-cost, short-term loans. Borrowers become dependent on these services and enter a cycle of debt, and in fact, use these predatory loans as long-term credit sources. Further, although the term is shorter and the ratio of initial transaction costs is higher than that of larger loans, the risk associated is not proportionate to proven levels of losses accrued by predatory lenders.

I. NOT OCCASIONAL SHORT-TERM LOANS

The industry often justifies their extreme rates and fees by citing the short-term, occasional nature of their loans. Despite these claims, data from around the country demonstrate that payday and title loan borrowers' tendencies are anything but infrequent.

Because lenders will not take partial payment on the loans and patrons frequently cannot pay the loan back in its entirety, consumers must take out an immediate subsequent loan. By doing so, these repeat borrowers are forced to pay the high loan fees again and again without reducing the principal. This practice is commonly referred to as a "rollover."

In states that have collected data, the trend is clear: Payday loans are most profitable when rolled-over and the average number of loans per borrower per year is high. The Indiana Department of Financial Institutions reports that 91% of payday loan borrowers renew their loan. This study also found that those customers rolled-over their loans an average of 10.2 times. Other studies have found very similar results.³¹ In California, the average customer takes out 11 payday loans per year.³² An Illinois study conducted by the Woodstock Institute showed the average number of contracts per borrower was 12.6 and that 52% of the borrowers had more than 10 contracts and 21% had more than 20 contracts.³³ Even states that have passed legislation to limit rollovers have not limited borrower dependency on these predatory loans. For example, in North Carolina, despite

³¹ It is important to note that many lenders disguise a rollover as a "new" loan by having the consumer write a new check and pay the interest charge. Also, it is possible for borrowers to take out more than one payday loan at a time, though this is difficult to monitor (See *Woodstock* p. 5).

³² Stegman, Michael.

³³ *Woodstock Institute*, "Reinvestment Alert: Unregulated Payday Lending Pulls Vulnerable Consumers Into Spiraling Debt," March 2000.

the state's prohibition of rollovers, the average customer took out 8 loans in 2000.³⁴ In short, all available data points to the same undeniable truth: payday loans trap cash-strapped consumers in an ongoing debt cycle.

II. ROLLOVERS: THE LENDER'S INCENTIVE

The tendency of consumers to rollover predatory loans is clear. The lender, who has a profit-making interest in the consumer's continual renewal of existing loans, further encourages rollover. This is apparent when analyzing the data compiled by regulators in North Carolina and Illinois.

The Community Reinvestment Association of North Carolina (CRA*NC) conducted an analysis of the North Carolina Commissioner of Banks' database of all payday loan transactions made in North Carolina. This report shows that repeat business accounts for 90% of payday lender revenue in North Carolina and that disproportionate levels of revenue come from chronic borrowing.³⁵ Moreover, this study also showed that over half of the revenue generated by North Carolinian payday lenders in 1999 was from consumers with 13 or more payday loans.³⁶ To put this in perspective, one in six consumers (16%) had 18 or more loans and accounted for 36% of the total revenue.³⁷ Conversely, 13% of borrowers used payday lenders just once and accounted for a mere 2% of the fees.³⁸

Likewise, the Illinois Department of Financial Institutions found that repeat business is the main source of revenue for short-term lenders and that customers rarely borrow a single time. A payday lender may have a limited customer base, but with customers making regular refinances their loans, the store may be quite profitable.

This is contrary to the payday lending industry's assertion that payday lending is for occasional one-time use. Simply, predatory lenders actively seek to generate multiple rollovers from each customer due to the high profitability. For example, an inquiry by the U.S. Office of the Comptroller of the Currency, found that one firm, Dollar Financial, gave incentive pay to its employees for their promotion of repeat borrowing.³⁹

The fees incurred through rollovers can easily trap consumers looking for quick cash between paychecks. Borrowers can very easily pay more in fees than they initially

³⁴ N.C. Commissioner of Banks, "2000 Annual Report of Check Cashing Businesses Licensed under Article 22 of Chapter 53 of the North Carolina General Statutes Fact Sheet," Available from: <http://www.banking.state.nc.us/cc/cccon00.pdf>; Internet; accessed 4 April 2002.

³⁵ Skillern, Peter, *Community Reinvestment Association of North Carolina*, "How Payday Lenders Make Their Money," April 18, 2001, Available from: <http://www.cra-nc.org/>; Internet; accessed 8 April 2002.

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ibid.*

³⁹ Stegman, Michael. Also, see: Office of the Comptroller of the Currency, "Fact Sheet: Eagle National Bank Consent Order," January 3, 2002, Available from: <http://www.occ.treas.gov/ftp/release/2002-01a.doc>; Internet; accessed 3 April 2002.

borrowed due to repeat transaction costs. For example, the average New Mexican payday loan borrower will have accumulated fees equal to the amount borrowed in just five transactions without paying a single cent towards the principal. In the states where data has been collected, average payday loan customers average between 7 and 13 loans per year.

Payday lenders claim they are providing an essential service to cash-strapped consumers, but borrowing more money at triple-digit interest rates is never the right solution for people in debt. Payday loans simply worsen indebted consumers' problems. With such broad data already available on this topic, it is imperative that stern regulations go into place assuring that these short-term loans do not become long-term debt traps.

II. EXPORT OF PROFITS, IMPORT OF PROBLEMS⁴⁰

Payday and title loan companies claim to provide a needed service to cash-strapped consumers. Price gouging is never a "service." The rapid access to cash offered by payday and title lenders at exorbitant rates only traps consumers in an on going debt cycle. These practices only benefit one party – the predatory lender, whose most profitable customer is the customer in this debt trap.

The survey results refute the industry's claim that most payday and title loan companies are locally owned *Mom-and-Pop* stores. NMPIRG found that the vast majority of lenders are not based in New Mexico. In fact, only 21.5 % (75 of 348) are New Mexico owned firms while 19% (65) are based in South Carolina and 27% (94) are based in Texas – (See Table 2). Not only do these firms put consumers in a perpetual cycle of debt, the beneficiaries are outside of our state.

Business Type:	NM Owned:	Outside Ownership
All Payday and Title Loan Firms:	75/348 (21.5%)	273/348 (78.5%)
Payday Loan:	38/219 (17.4%)	181/219 (82.6%)
Title Loan Companies:	27/58 (46.5%)	31/58 (53.5%)
Payday and Title:	8/50 (16.0%)	42/50 (84.0%)

TABLE 2: These data do not include payday lenders like ACE Cash Express, which evade state regulation through a "rent-a-bank" agreement.⁴¹

⁴⁰ The data in this section is based on analysis of the New Mexico Small Loan Roster, as of December 31, 2001. The vast majority of the predatory lenders located in New Mexico are affiliated to larger corporations based around the country.

⁴¹ NMPIRG and Consumer Federation of America.

The majority of these out-of-state firms are affiliated with a larger national corporation. Security Finance Corporation, of Spartanburg, SC and Your Credit Inc. of Boerne, TX, the two most prolific predatory lenders in New Mexico, have 49 and 51 stores around the state, respectively. Security Finance Corp. makes payday and title loans and Your Credit Inc. only makes payday loans. Also, in spite of its name, New Mexico Title Loans, a common title lender with three Albuquerque locations and six statewide, is based in Georgia. This list goes on and on and there are only 39 owners that have just one storefront.

Based on these data, the payday and title loan industry can only have an adverse effect on the New Mexico economy. Not only do these firms put consumers in a perpetual cycle of debt, the beneficiaries are outside of our state.

III. LOW RISK MEANS HIGH CONSUMER COST

As mentioned, there is a significant risk-rate disparity between credit cards and payday loans. The best available data demonstrates that the expected rates of default are far lower than industry pundits proclaim and that the rate of default is not the driving force behind the exorbitant rates of predatory loans. For example, the Colorado Attorney General reports these lenders charged-off only 2.3% of their loans in 2000, which carry an average APR of 338%.⁴² Other investment analyses place industry's losses between 1.0 and 1.3% of receivables, barely above bank default rates.⁴³

In contrast, the California Banker's Association reports that California banks charge off 2.7% of credit card debt while having APRs of 15-22%.⁴⁴ Despite relatively low risk – lower than credit cards, New Mexican consumers typically pay 508% for payday loans.⁴⁵ Therefore, industry claims of high-risk are not substantiated by available data and payday lender losses do not vary significantly from those of less expensive credit options. NMPIRG Education Fund finds that the exorbitant rates that payday and title loan firms charge are unconscionable and unjustifiable.

Additionally, these loans are far more expensive than other alternatives. The Woodstock Institute conducted an analysis in March 2000 that examined the cost of a payday loan versus other common alternatives: A credit card cash advance and a credit union loan (See Figure 5).

⁴² *State of Colorado Office of the Attorney General*, "Post-Dated Check Cashers Supervised Lenders' Annual Report for 2000," Available from: <http://www.ago.state.co.us/UCCC/annrep/ddlannrpt2000.pdf>; Internet; accessed 1 April 2002.

⁴³ *Woodstock Institute*.

⁴⁴ *Consumers Union*.

⁴⁵ *NMPIRG and Consumer Federation of America*.

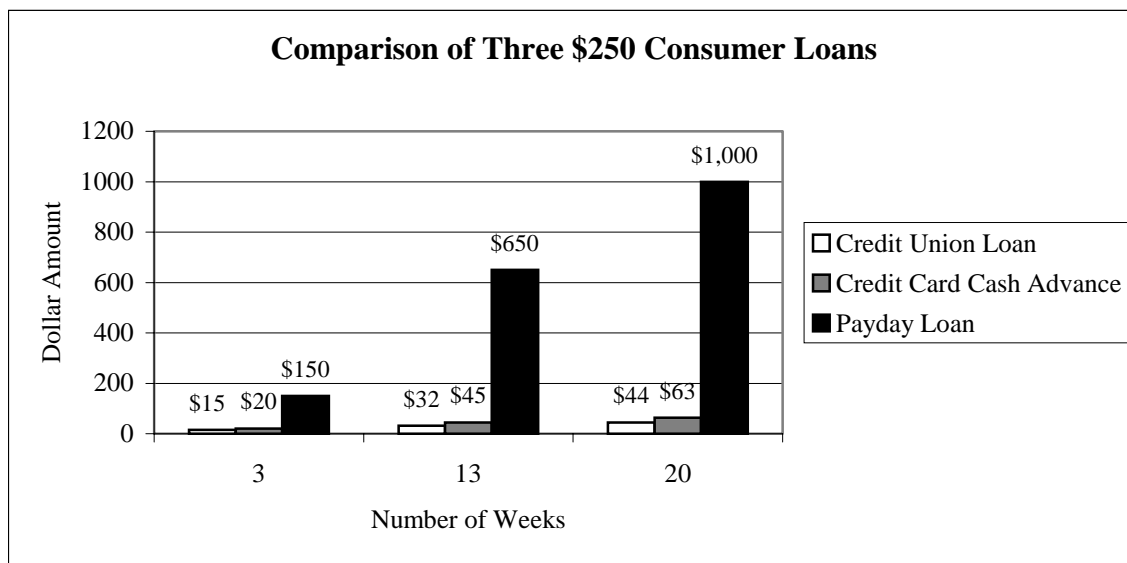


FIGURE 5: This graph compares the cost of three consumer loans: A credit union loan, a cash-advance on a credit card, and a payday loan over three different durations of time.⁴⁶

It is evident that payday and title lenders are far more expensive than other alternatives available to consumers. NMPIRG Education Fund recommends that consumers seek out the best alternative to fit their needs. It is important to remember that payday and title loans are a relatively new phenomenon and, not long ago, consumers met their needs without them.

As mentioned, had the state promulgated regulations addressing the rollover issue, it could have made a considerable impact in reducing the damages caused by these short-term loan instruments being used as longer-term sources of credit. The reforms suggested by the 2000 Consumer Lending Study Committee Report sought to accomplish these same goals, but never went into place.

⁴⁶ *Woodstock Institute*. "Credit union loan assumes a \$10 application fee and 16.5% interest. The loan amortizes over one year, but that is not assumed here to make it comparable to payday loans, which do not amortize. It requires a one-year membership in the credit union but no credit check. Credit card cash advance assumes a 5% fee and 24% interest rate. This is a card designed for people with less-established or imperfect credit. The payday loan assumes a 20% fee per two-week loan."

CONCLUSION

The intent of this report was threefold: To examine the extent of the growth in payday and title lending in New Mexico in recent years, to explore the impact of these predatory loans, and to debunk myths promoted by the industry.

Payday and title lending have experienced extreme growth growing from just eight licensed predatory lenders in 1990 to 349 in 2001. This growth can be attributed to a variety of causes; nonetheless, the myriad consumer protection issues that arise from these high-cost loans should be addressed.

RECOMMENDATIONS:

Consumers in need of short-term cash should avoid payday and title loans, and to instead, build up a savings nest-egg to cover financial emergencies, seek budgeting and debt management assistance from non-profit consumer credit counseling services, and shop for credit based on both the dollar finance charge and the Annual Percentage Rate.

Consumers should seek alternatives to predatory loans. These alternatives include:⁴⁷

1. Negotiate a payment plan with creditors: The best alternative to payday loans is for consumers is to deal directly with their debt. Most creditors will accept partial payments if one sets up a payment plan. Consumers can negotiate such plans themselves or contact the local nonprofit Consumer Credit Counseling Services office for help (In Albuquerque: 505/880-1881).
2. Credit cards/Secured credit cards: Some credit card companies specialize in consumers with financial problems or poor credit histories. Consumers should shop around and not assume they do not qualify for a credit card. Secured credit cards are another option. A secured card is basically a credit card tied to a savings account (\$500 for example). The card's credit line is the amount deposited in the savings account.
3. Advances from employers: Many employers will grant paycheck advances to employees. Because this is a true advance, and not a loan, it obviously is a better alternative than payday lenders.
4. Credit unions: Credit unions offer small, short-term loans to their members. Many more consumers can join credit unions now that requirements are less strict.
5. Overdraft protection: Most banks offer checking accounts with overdraft protection. Payday lenders claim their fees are lower than paying bounced check fees, but a better alternative is to prevent bounced check fees in the first place.
6. Lines of credit from finance lenders: Finance lenders offer small lines of credit to consumers with less than perfect credit histories. These credit lines range from \$2,000-\$5,000 with interest rates from 25-35% APR.

⁴⁷ These recommendations are adapted from recommendations made by Consumers Union, non-profit publishers of *Consumer Reports* magazine.

RECOMMENDATIONS FOR REGULATORS:

The Financial Institutions Division should use its discretionary power and record and report the extent of the problems posed by payday and title lenders in New Mexico. In specific, many of the recommendations from the Consumer Lending Study Committee have yet to be realized such as:

1. Regulations to “address the renewal/rollover” component of payday and title loans. At the very least, regulations should be promulgated that would provide funds for a detailed industry wide analysis like those of North Carolina, Indiana and Illinois. Though every such study has already shown that these loans are not short-term, this type of study would refute industry assertions with respect to the average length of a payday loan in New Mexico.
2. A “cooling off period” between payday loans should be implemented immediately.

In addition, the FID should receive adequate resources to implement these changes and to require and review more comprehensive annual reports that would include individual consumer data such as: Customer incomes, debt levels, savings rates, demographics and frequency of use. Such information would provide a more precise image of the impact these predatory loans have on our communities.

RECOMMENDATIONS FOR LEGISLATORS:

NMPIRG Education Fund recommends that the legislature consider policies that would:

1. Create a reasonable small loan interest rate cap, ideally 36%.
2. Limit the number rollovers on loans to 2.
3. Create a 30-day cooling off period between loans.
4. Provide the funds to create a statewide database to track the industry, monitor the number of rollovers, ensure there is a cooling off period, to prevent multiple transactions, and to prevent the disguise of rollovers as “new” loans.

RECOMMENDATIONS FOR BANKS:

Lastly, NMPIRG Education Fund recommends that banks, thrifts, and credit unions should serve their account customers with fairly priced overdraft protection and credit arrangements to provide alternatives to these predatory practices.

METHODOLOGY OF GROWTH CALCULATIONS

The data used to measure the growth of the small loan industry in New Mexico is based on the best available data from the New Mexico Financial Institutions Division (FID). The FID keeps an ongoing list of firms licensed in the small loan business called the “Small Loan Roster.” The firms labeled predatory were determined to be payday or title lenders through site visits, telephone calls, and Internet searches.

Additionally, there may be an undercount of payday and title lenders. Many lenders were not included in the total count due to their evasion of state licensing requirements that are, therefore, not included on the small loan rosters. One such example is ACE Cash Express, Inc. Based on an analysis of the yellow pages, there are nine ACE outlets in Albuquerque alone. This firm is affiliated with Goleta National Bank, which claims it is above the jurisdiction of state statutes due to federal preemptions. This so-called “rent-a-charter” agreement is currently being challenged in the courts in several states including Colorado, Florida and Maryland.

To obtain copies of the New Mexico Small Loan Roster, contact:

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Regulation and Licensing Department, State of New Mexico
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P.O. Box 25101
Santa Fe, N.M. 87504
Phone: 505/827-7100 – Fax: 505-827-7107