Facts & Issues

Payday & Auto Title Loans in Texas

A Study by League of Women Voters of Texas Education Fund August 2015

STUDY FOCUS

Study focus: Explore payday and auto title lending in Texas. This *Facts & Issues* reviews historical background, describes interested stakeholders; details accessibility, demand, and economics; and presents policy options, related issues, and approaches to reform. Payday and auto title loans are presently the subject of intense scrutiny at all levels of government and widely discussed in the media, making this a compelling public policy issue.

INDEX

HISTORICAL BACKGROUND

Origin of Payday & Title Loans

Short-term lending is centuries old. In the late 1800s, workers in financial distress commonly borrowed from unlicensed lenders, promising repayment when wages were obtained. In the early 1900s, the Russell Sage Foundation—a driver of progressive social policy—aggressively promoted regulation of small dollar loans by developing a model Uniform Small Loan Law. By 1940 34 states and Washington DC, the Territory of Hawaii, and the Dominion of Canada had comprehensive small loan laws. In the 1970s and 1980s, federal deregulation of the financial industry allowed mortgage, credit card, and other lenders to disregard state usury laws that limit the rate of interest that may be charged. Subsequently the payday lending industry grew rapidly.

Development Since 2000

In 2000 the Texas Office of Consumer Credit Commissioner adopted rules to ensure that payday lenders would abide by state law that capped interest rates and administrative fees on cash advances at varying levels according to the size and duration of the loan. The majority of Texas payday lending companies soon partnered with out-of-state banks not subject to these restrictions. This practice was eliminated in 2005 when the Federal Deposit Insurance Corporation issued restrictions on the use of third party banks in payday lending transactions. However, opinions by the Court of Appeals for the 5th District of Texas (2004) and the Office of the Attorney General of Texas (2006) have permitted payday and title loan businesses to operate as *credit services organizations*. Credit services organizations have no restrictions on administrative fees for arranging loans.

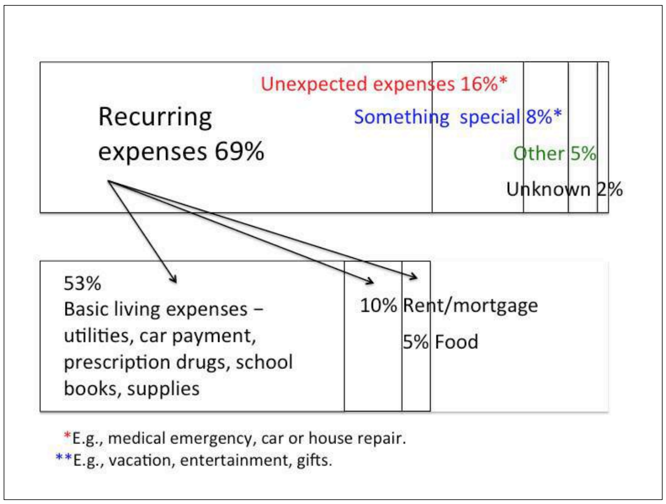
THE STAKEHOLDERS & THEIR PERSPECTIVES

The Borrowers

Characteristics. In 2013, two thirds of Texans who had ever used a payday loan were younger than 45 years of age, while the majority of those who had ever used an auto title loan were 45 years of age and older. Two thirds of borrowers lived in metropolitan areas. African American and Hispanic Texans used payday (70%) and auto title (62%) loans at rates disproportionately high compared to their share of the state's population (51%). One third of all payday and auto title loan borrowers had obtained some college education. Half lived in households with annual incomes between $15,000 and $50,000, and two thirds were employed. One in six payday and title loan borrowers in Texas were disabled.

Perspective. Interviews revealed that payday and auto title loan consumers use small dollar loans to overcome financial shortfalls whenever money is tight for basic living expenses, unexpected or emergency events, and special occasions. They choose payday and title loans because these loans are easy to apply and qualify for, accessible at any time, available nearby, and their lenders are friendly in comparison to mainstream lenders. Borrowers believe a payday or title loan to be the best alternative to the disruption and financial penalties for shutoff utilities or bounced checks.

% Payday Loan Borrowers (*N*=451), by Reason for 1st Loan, Aug 2011-Apr 2012



The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why,* 2012, p. 14

Interviews found that payday and title loan consumers are overwhelmingly satisfied with their loan experience, primarily because of the convenience of obtaining the loan. A majority of payday loan borrowers favored no limitation on the number of loans they can get per year. Most auto title loan borrowers reported that the terms of the loan were clear. Without the loans, most payday and title loan borrowers would cut back on basic expenses, delay paying bills, borrow from family or friends, and/or sell or pawn personal possessions.

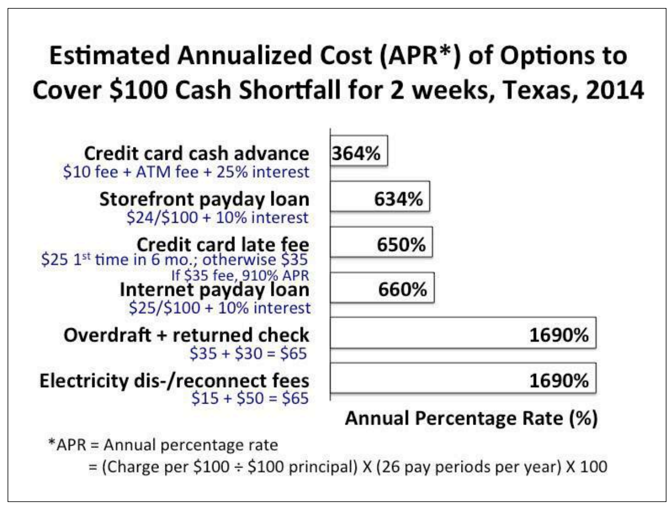
The Lenders

Characteristics. In 2014 the Texas Office of the Consumer Credit Commissioner reported that 3,941 payday and title loan storefronts operated in Texas, nearly 13% of the estimated 29,500 in the United States. Two thirds of the companies licensed in Texas operated only one store and were independently owned. Nationally, individual stores are relatively small businesses averaging three employees, an annual outstanding loan portfolio around $85,000, and annual revenue of $350,000.

Perspective. Payday and title loans allow consumers with an inadequate consumer credit score or a blemished credit report to obtain small dollar loans. These loans help borrowers cope with a financial shortfall or unexpected expenses (e.g., medical emergency, car or property repair) without having to approach friends, relatives, or loan sharks for money.

Handy location, long business hours, and immediate access to cash serve consumers with an urgent need to cover a financial shortfall. Storefront lenders are located in neighborhood shopping centers. Many are open 24 hours a day. And the loan can be obtained within an hour by completing a simple application and verifying income, bank account, and identification. In contrast to banks, payday and auto title loan lenders must conspicuously display their schedule of fees to the public, provide the consumer with an easily readable disclosure of terms, and state alternative loan comparisons.

Admittedly, payday and title loans are high-cost. However, other options to cover a cash shortfall can be even more expensive:



Sources listed in *Facts & Issues References*

Profit margins for the payday and title loan industry were 8% to 14% in the late 2000s, comparable to those of other major lenders (13%) and businesses (e.g., Starbucks, 9%). High fees offset high personnel and overhead costs and the large loss from bad debt write-offs.

From their viewpoint, payday and auto title lenders do not take advantage of the poor, minorities, mentally ill, elderly, or military personnel. Instead, storefronts are located where they will attract the most customers and provide them with convenient locations−areas in which a large proportion of residents have low credit scores, if any; densely populated areas with businesses and banks, low-income neighborhoods, and near military bases and veterans facilities. No direct association has been found between location and minority neighborhoods, although low-income areas have higher proportions of minority households.

The Opposition

Characteristics. Several interest groups and faith-based organizations have sounded an alarm about drawbacks to payday and auto title lending, seeking to educate the public and lobbying for increased regulation. Major Texas opponents include the Texas Fair Lending Alliance, Faith Leaders for Fair Lending, Texas IMPACT, and Texas Municipal League. Major national organizations with advocacy positions to increase regulation of payday and auto title lending include AARP, Center for Responsible Lending, Consumer Federation of America, Corporation for Enterprise Development, INSIGHT Center for Community Economic Development, National Consumer Law Center, and The Pew Charitable Trusts.

Perspective. Opponents argue that payday and auto title lenders take advantage of cash-strapped consumers. Lenders charge high fees, demand full payment on the next payday, and fail to screen a borrower's ability to repay the loan while meeting recurring expenses. When unable to make the whole payment, borrowers may have to refinance the loan and incur additional high fees. After multiple loan renewals, borrowers have paid fees that amount to more than that borrowed, but still owe the principal. Thus a short-term loan becomes a longer-term cycle of debt. Auto title loan borrowers who default on their loan are threatened with repossession of their vehicle.

The high cost of payday loans cannot be explained by loan losses. The payday loan default rate is only slightly larger than that of bank consumer loans. And the credit card default rate is higher than that of payday loans.

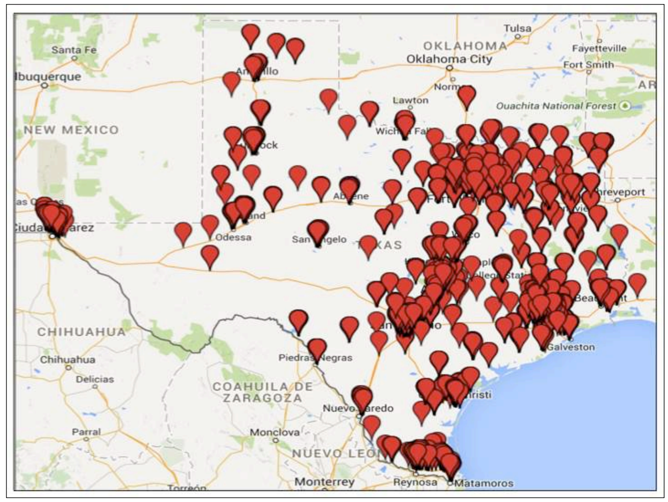
For the faith community, high cost small dollar loans contradict the religious values that most Texans hold−the costs are immoral and unethical. Scriptures of all traditions deplore exploitation of the poor for financial gain.

ACCESSIBILITY & DEMAND FOR PAYDAY & TITLE LOANS

Accessibility

In August 2014, the Texas Office of Consumer Credit Commissioner reported that 207 companies were licensed as *credit access businesses* in Texas, operating 3,296 storefronts in 2,232 cities and towns. Over half operated only one storefront. The 2012-2014 3-year average in number of storefronts was 3,510. Payday and auto title lenders tend to cluster around major metropolitan areas, military installations, and veterans facilities.

Texas Payday & Auto Title Storefronts, 2014



Texas Appleseed, 2014

Demand

According to the Texas Office of Consumer Credit Commissioner, 1.7 million borrowers in Texas took out over 2.7 million new payday and auto title loans in 2014. While the number of borrowers decreased by 11% from 2013 to 2014, the number of loans decreased only 9%. Payday loans outnumbered title loans by over 7 to 1. Single payment loans outnumbered installment loans 2 to 1. Nearly half (45%) of all loans were refinanced at least once. Among refinanced loans, 70% were ultimately refinanced more than once, usually two to four times.

THE ECONOMICS OF PAYDAY & TITLE LOANS

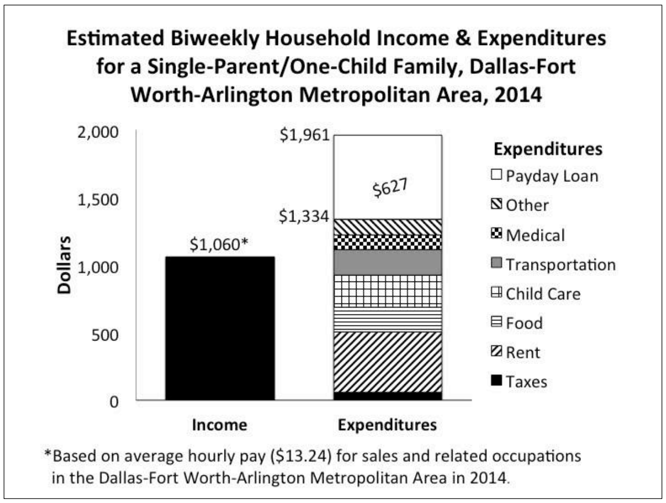
Size

Most (62%) new payday and title loans in Texas in 2014 were $500 or less, and nearly 90% were $1,000 or less. The average Texas auto title loan ($1,197) was 2.4 times as large as the average payday loan ($501).

Impact on Consumers

Cost. In 2015 the estimated initial cost of financing a single payment 2-week $500 payday loan is $126.92 (660% annual percentage rate [APR]) while that of a single payment 30-day $500 auto title loan in Texas is $137.63 (310% APR). With multiple renewals, fees and interest may surpass the loan principal. For example, when a $500 payday or auto title loan has been refinanced three times, the fees and interest exceed $500−$510 and $549 respectively−and the principal is still owed.

Affordability. According to the Center for Public Priorities, most working class jobs in Texas pay less than the wages needed to cover basic household necessities. For example in 2014, 63% of jobs in the Dallas-Fort Worth-Arlington Metropolitan Area paid less than the $16 per hour needed for a single parent with one child to pay for basic household expenditures−nearly $275 less per 2-week pay period. To pay off a $500 payday loan along with the fees and interest would require foregoing other necessities or acquiring an additional source of income. A payday or title loan is one way to cover a financial shortfall.



Center for Public Priorities, *Better Texas Family Budgets*, 2015

Default rate. Texas does not track payday or title loan default rates. But according to the Texas Office of Consumer Credit Commissioner, 44,052 (11%) vehicles were repossessed from Texas auto title loan consumers in 2014−an average of 125 vehicles per day. Regarding default on payday loans in Texas, Skiba and Tobacman (2008) found that 12% of borrowers defaulted on the initial loan. Within 1 year of refinancing their initial loan, 51% had defaulted. This study had tracked over 51,600 bi-weekly paid workers for 1 year who had taken out nearly 335,400 payday loans from one Texas outlet during 2000-2004.

Impact on the Texas Economy

The Texas Office of Consumer Credit Commissioner reported that in 2014 payday and title loan businesses in Texas extended $1.6 billion in consumer credit for new loans and collected $1.5 billion in fees and interest for new and refinanced loans. We estimate that the fees and interest that were collected added an estimated $2.5 billion in value to the Texas economy directly through employee compensation, taxes, owner income and profit; indirectly through purchasing done by the businesses; and through induced spending by employees. The economic impact of payday and title loan fees and interest resulted in an estimated gain of 28,643 jobs in Texas in 2014. On the other hand, if payday and title loan consumers had spent or saved the money that was paid in fees and interest, household income and spending would have created $2.8 billion in private household economic activity, adding an estimated 36,018 jobs. Thus the resulting economic impact on the Texas economy in 2014 was an estimated net loss of approximately $351 million in economic value and 7,375 jobs.

State & National Comparisons

Accessibility

According to the U.S. Census Bureau, there were nearly 29,500 payday and auto title loan businesses operating in the United States in 2013−less than one third the number of bank branches in the United States, but more than twice the number of McDonald's restaurants. After reaching a peak in 2007, the number of payday loan storefronts in the United States declined steadily from 24,043 in 2007 to 17,862 in 2013. In 2013 Texas had twice as many businesses making or arranging unsecured cash loans as the next highest state, California (Texas, 4,441; California, 2,603).

The concentration of payday and title lenders varies with the degree of state regulation. In 2013 states with less stringent regulation had twice the ratio of lenders to adults 18 years and older as more restrictive states. Texas ranked 8th highest in concentration of lenders to adults.

Ratio of Payday & Auto Title Lenders to Adults (18+ Years), Selected States, 2013

State	# Adults/Lender	Rank
Degree of State Regulation		
Less stringent states	5,536	
More restrictive states	12,809	
State Rank		
Mississippi	2,156	1
Texas	4,381	8
Vermont	125,998	50

U.S. Census Bureau sources listed in *Facts & Issues References*

Demand

Although the percentage of Americans using payday and title loans is low, the number is large: Nearly 12 million Americans use payday loans annually, while between 2.3 to 2.4 million use auto title loans. Texans disproportionately use payday and title loans compared to adults in the nation as a whole:

% Adults (18 Years+) and Households Using Payday and Title Loans, Texas and US, 2013

Area	Adults (%)	Households (%)
Payday Loans		
Texas	7.9	2.7
United States	5.8	2.0
Auto Title Loans		
Texas	1.4	1.7
United States	0.7	0.9

Sources listed in *Facts & Issues References*

Use of payday and auto title loans varies by degree of state regulation. According to The Pew Charitable Trusts, the proportion of households in 2011 that reported using payday loans during the past 5 years was twice as high in states with less stringent regulation of title loans as in states with more restrictive regulation (6.3% vs. 2.9%). Similarly, the Center for Responsible Lending reported that the proportion of adults that had ever used a title loan was twice as high in states with less stringent regulation than in states with more restrictive regulation (4.0% vs. 2.1%).

Economics

Short-term loans cost more in states with less stringent regulation of fees and interest:

Cost of a $500 Short-Term Loan, by Type, Maximum Charge, & State, 2015

State	Maximum Charge	Cost ($)	APR
Single Payment, 2-Week Payday Loan			
Minnesota	33% APR + $25	33.10	172%
Oklahoma	<$301 = $15/$100 + $301-$500 = $10/$100	65.00	338%
N. Dakota	20% of principal + $0.50	100.50	523%
Texas	10% APR + any fee	126.92	660%
Single Payment, 30-Day Auto Title Loan			
Florida	30% APR	12.50	30%
Arizona	15%/month	75.00	180%
Alabama	25%/month	125.00	300%
Texas	10% APR + any fee	137.36	310%

Sources listed in *Facts & Issues References*

Loan characteristics*.* The size, fee, term, and APR of Texas single-payment auto title loans differed little from national characteristics in 2012. However, the average sized single-payment payday loan in Texas was $468, nearly 20% higher than the national average of $392. Texas payday loan consumers paid on average $23 per $100 borrowed. This was 60% higher than the $14 national average. And the 604% APR was nearly 80% higher than the national average of 339% in 2012.

Impact on the national economy*.* In 2012 Texas accounted for 3% of the payday loan volume in the United States ($1.3 out of $48.7 billion). However, Texas accounted for 27% of the storefront auto title loan volume in the nation ($518.2 million out of $1.9 billion).

We estimate that while the payday and auto title lending industry added nearly $13.3 billion in value to the United States economy in 2012, the loss of $15.2 billion in consumer household economic activity resulted in a net loss of over $1.8 billion in economic value. In addition, the industry generated an estimated 152,931 jobs in 2012. However, had payday and title loan consumers spent or saved their loan fees, an estimated 192,631 jobs would have been generated. Thus the economic impact of the payday/title loan industry on jobs was an estimated net loss of 39,442 jobs nationally.

REGULATION OF THE PAYDAY & AUTO TITLE LOAN INDUSTRY

Texas Law

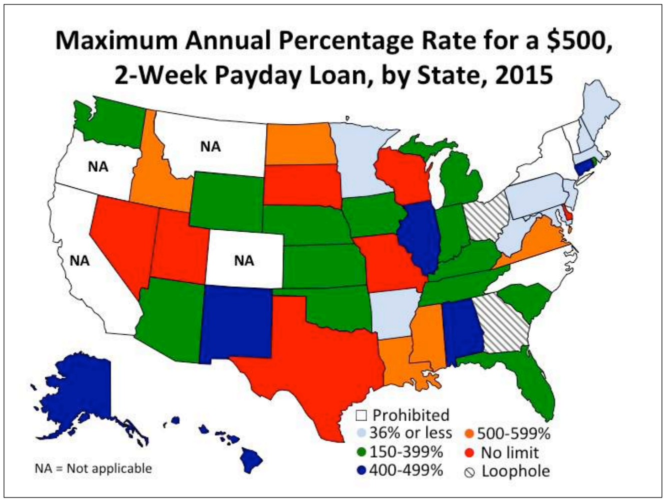
Interest and fees*.* 4 TEX. FIN. CODE § 342 and 5 TEX. FIN. CODE § 393 govern interest and fees on consumer loans in Texas. The third-party lender interest rate is limited to no more than 10% a year by § 342.004, while limits to fees on a *cash advance* are prescribed by §§ 342.251-259*.* However under §§ 393.601-602, a payday or auto title loan company that arranges for loans with a third-party lender is defined as a *credit access business* and may operate as a *credit services organization*. According to § 393.602(b) of this law, "A credit access business may assess fees for its services as agreed to between parties" as long as disclosed to the borrower. Consequently payday and auto title loan businesses are not subject to the fee limits on cash advances. If the limits to a cash advance were enforced on payday/title loans, the fee for a $500 2-week payday loan would be $60 rather than the $125 that is commonly charged by payday lenders in Texas.

Disclosur*e*. 5 TEX. FIN. CODE §§ 393.221-223 requires credit access businesses to provide consumers with a disclosure statement and post it at the business site and on its website. It must include a schedule of fees, interest, and APR. The disclosure must compare these rates to alternative forms of consumer debt, include information on accumulated fees to be incurred from refinancing the loan, and state the typical pattern of loan repayment.

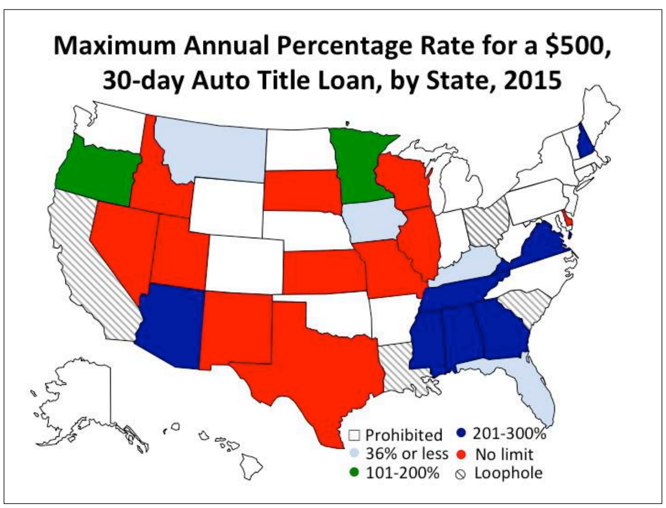
Oversight. The Texas Office of Consumer Credit Commissioner is responsible for oversight of credit access businesses. Payday and title loan companies were first subject to licensing and reporting in January 2012. Registration, licensure, bonding, and reporting are required by 5 TEX. FIN. CODE §§ 393.601-628.

How Does Texas Law Compare to Other State Laws?

Texas is 1 of 7 states with no rate or fee restrictions on payday loans and 1 of 11 states with none on auto title loans. The cost of payday and auto title loans is related to the degree of state regulation, as shown below:



CFED Asses & Opportunity Scorecard, 2015; National conference of State Legislators, 2015; and individual state statutes



Center for Responsible Lending, 2013; CFED *Assets & Opportunity Scorecard*, 2015; Loans Org, LLC; and individual state statutes

Local Ordinances

Texas cities are prohibited from setting interest rates and overriding state and federal laws. For this reason, 35 cities in Texas have regulated payday and auto title loan businesses through business and/or land use ordinances as of May 2015. Business ordinances have been enacted by 21 cities, land use ordinances by 11 cities, and both business and land ordinances by 3 cities.

Most of the local business ordinances resemble a model ordinance developed by the Texas Municipal League. The model ordinance limits (a) a payday loan to 20% of the consumer's gross monthly income, (b) an auto title loan to the lesser of 3% of the consumer's gross annual income or 70% of the retail value of the vehicle, (c) installment loans to 4 payments, each used to repay at least 25% of the principal with no refinancing, and (d) refinancing of a lump sum loan to 3 times, with each used to repay at least 25% of the principal. Of the eight legal challenges to local ordinances in Texas, all have been dismissed.

Federal Laws & Regulations

Laws. A number of federal laws protect consumer borrowing. Among them are Dodd-Frank Wall Street Reform and Consumer Protection Act, Electronic Funds Transfer Act, Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Federal Trade Commission Act, Gramm-Leach Bliley Act, and Truth in Lending Act. A discussion of applicable federal law and regulations is found in *Reshaping the Future of Small-Dollar Lending in Texas,* Appendix A, a 2012 publication by Texas Appleseed*.*

The Military Lending Act protects military personnel and their families against predatory lending through Department of Defense regulations. As amended July 2015, consumer loans under MLA protection include "all forms of payday loans, vehicle title loans, refund anticipation loans, deposit advance loans, installment loans, unsecured open-end lines of credit, and credit cards." Key regulations cap APR at 36% (including interest, fees, credit insurance premiums, and ancillary charges), (b) prohibit securing a loan with a personal check, debit authorization, wage allotment, or vehicle title; (c) prohibit rollovers, same-creditor refinances, renewals, and consolidations; and (d) outline disclosure requirements, legal rights, and violations. The amended rule is effective October 1, 2015, and has staggered compliance dates.

Regulations*.* In March 2015 the Consumer Financial Protection Bureau (a federal agency established by the Dodd-Frank Act of 2010) proposed rules aimed at providing safeguards for borrowers using high-interest loans. The suggested rules would apply to payday and auto title loans as well as deposit advance products and open-ended lines of credit. Lenders would choose one of two options for compliance: prevention or protection. The prevention option would require preloan eligibility verification to determine whether or not a borrower has the resources to repay the loan after covering all other expenses. The protection option requires that lenders offer affordable repayment options, accept restrictions on the amount and duration of loans, and restrict the number of loans per consumer. All lenders would be prohibited from bank account collection practices that tend to produce excessive fees, such as repeated, unsuccessful withdrawal attempts.

The Big Question

Do payday and auto title loans ultimately help or harm consumers? Research findings are mixed, reaching opposing conclusions. All of the studies to date have design flaws that reduce the believability of their results and limit confidence in their conclusions.

Policy Options

The issue. How can the payday and auto title loan market be regulated so it is financially viable and maintains access to credit while safeguarding consumers from abusive lending practices? To what degree should payday and auto title lending be regulated in Texas?

Considerations. Will the policy produce the desired outcome? Will it produce optimal results for the cost of implementation? Is it achievable given available monetary, technical, and human resources? Will lenders be able to evade the statute and regulations that implement the policy change? Is this a policy that elected officials would want to see realized by law?

The policy options outlined below range from less stringent to more restrictive.

1. Continue operation of payday and auto title loan companies under current state law and administrative regulations

Payday and auto title lending companies, acting as a credit services organization, may broker a short-term, small-dollar loan for an individual with a third-party lender. Lender interest is limited to 10%. Administrative fees are not limited as long as they are displayed to the public and disclosed to the borrower.

2. Enable a small dollar loan market that maintains access to affordable credit while safeguarding consumers

A loan is affordable if the borrower can repay the loan and cover basic expenses without borrowing again or obtaining money from another source. A loan is generally unaffordable if payments exceed 5% of gross periodic income. Colorado regulation of the payday loan market has demonstrated that both industry and consumer advocate interests can be accommodated: Colorado enacted an interest rate cap of 45% APR, but allows additional fees to increase lender revenue to a maximum, fee-inclusive APR around 200%.

3. Prohibit all payday and auto title loans whose combined interest and fees exceed the Texas consumer lending rate limits

Under Texas law, an interest rate greater than 10% APR is usurious. Under Texas consumer lending rate limits, acquisition fees for payday and auto title loans would range from 170% APR for a 30-day loan to 310% for a 2-week loan.

4. Prohibit all payday and auto title loans whose combined interest and fees exceed the limit set by the Military Lending Act

The Military Lending Act, as amended July 2015, applies to "all forms of payday loans, vehicle title loans, refund anticipation loans, deposit advance loans, installment loans, unsecured open-end lines of credit, and credit cards" for military personnel and their families. Combined fees and interest, including auxiliary fees such as credit insurance premiums and application fees, are limited to 36% APR. Securing a loan with a personal check, debit authorization, wage allotment, or title to a vehicle is prohibited. In addition, loan rollovers, same-creditor refinances, renewals, and consolidations are prohibited. According to The Pew Charitable Trusts (October 2013), a 36% APR for combined interest and fees essentially eliminates the payday/title lending market.

Related Policy Issues

Governance of Small Dollar Loans

Should local government be able to regulate payday and auto title lending within their jurisdictions? Or should state law preempt local ordinances that regulate credit access businesses with more restrictive requirements than current state law?

As of May 2015, 35 Texas cities had ordinances that regulated credit access businesses. According to the Texas Municipal League, cities adopted their ordinances in response to the Legislature's failure to enact substantive statewide regulation of payday and title lending. From another point of view, these ordinances make it more complicated for credit access businesses to comply with the law, create disparate impact on consumers borrowing from credit access businesses that are subject to different requirements, and cause the possibility of costly litigation due to potential conflict with state law.

Criminal Penalties for Loan Default

Should Texas law be amended to allow credit access businesses to file criminal charges against defaulting borrowers for writing bad checks or for theft by check? Presently, credit access businesses are prohibited from pursuing criminal charges related to insufficient funds for a check or debit transaction. Nevertheless, the *Texas Observer* and Texas Appleseed documented over 3,200 criminal complaints that had been filed by credit access businesses against their borrowers between January 2012 and May 2014. Texas Appleseed found that $166,022 had been collected as a result of 1,508 complaints in Bexar, Collin, Dallas, and Harris Counties. In Harris County Justice of Peace Court #4, arrest warrants were issued in 42% of cases and jail time or jail credit served in nearly 6% of cases.

APPROACHES TO REFORM

Approaches to reform of payday and auto title lending include loan rationing, loan restructuring, or long-term debt prevention.

Loan Rationing

Loan rationing increases restrictions on issuing and refinancing loans and their fees to lessen consumer harm from the lump-sum payment structure of short-term loans. This approach requires a statewide database to track loan use by consumers.

Responsible underwriting. Underwriting is an assessment of the borrower's ability to repay debt. An underwriting requirement would filter out very high-risk borrowers. If traditional underwriting were required, the companies would incur new costs. However, establishing an affordability threshold would not incur new costs because borrowers already provide proof of income. An affordability threshold means that the loan payment cannot exceed a given percentage of a borrower's periodic income. Colorado law effectively established a threshold of approximately 4%. The Pew Charitable Trusts recommends a 5% threshold. Innovative lenders are already using a wealth of data on creditworthiness of millions of consumers with poor or no credit scores.

Limit the amount, number, and/or refinancing of small-dollar loans. A number of states have imposed restrictions on issuance of payday and auto title loans. They track the number of loans per borrower using a statewide database. In the 3-year period after Washington limited borrowers to eight payday loans per year, substantial decreases were found in the number of loans, borrowers, and storefronts.

Increase regulation of collection practices. Frequent electronic withdrawal attempts by lenders from borrowers' bank accounts can lead to multiple insufficient funds charges, adding to borrowers' financial burden. Limiting the allowable number of withdrawals would prevent this practice.

Remove incentives for lenders to encourage borrowers to refinance their loans. Spread the cost of the loan out evenly during its duration, as frontloading charges during the early weeks of the loan is an incentive for lenders to persuade borrowers to refinance their loan before it is fully paid off. Prohibit fees for early loan repayment. When a loan is repaid early, require that fee refunds be prorated. Prohibit nonrefundable administrative fees for issuing loans.

Loan Restructuring

Loan restructuring converts lump-sum repayment to installment payments over time, making each payment affordable and amortizing the loan to a zero balance. This approach requires that lenders offer more affordable loans.

Increase regulation of loan repayment practices. Prohibit short-term, lump-sum payday and auto title loans. Require equal installment payments that reduce the principal, fees, and interest to zero at the end of the term. Set a minimum-maximum loan term that enables the borrower to repay the loan in full but avoids excessively long terms that increase loan costs.

Ensure affordability. Establish an affordability threshold for loan payments to make certain that borrowers can make a payment and also cover basic expenses without borrowing again or obtaining money from another source. An example is that payments not exceed 5% of the borrower's gross periodic income. The Texas Municipal League model ordinance includes the following affordability provisions: (a) cash advanced for a payday loan capped at 20% of the consumer's gross monthly income, (b) cash advanced for a auto title loan capped at the lesser of 3% of the consumer's gross annual income or 70% of the retail value of the vehicle, (c) no more than four payments for installment loans and each payment must repay 25% of the principal, and (d) refinancing of single lump sum loans limited to three times and each must be used to repay at least 25% of the principal.

Long-Term Debt Prevention

Financial education measures. Require a disclosure method that attempts to match the impact of the disclosure message with the lender's in-person sales message, such as an on-site or online video. Strengthen the Texas public school personal financial literacy course requirement to include evaluation of the use of small dollar loans to meet needs for immediate cash. Require lenders to refer clients seeking refinancing of their loans to free consumer credit counseling services, such as a HUD-approved nonprofit consumer credit counseling service.

Financial support and incentives. Financially support the development and expansion of initiatives to increase use of bank accounts by low-income individuals. For example, support public-private partnerships that provide a free or low-cost starter bank account and access to financial education to individuals with an inadequate consumer credit score or a blemished credit report. Provide financial incentives to banks and credit unions for the development and availability of affordable loans with sustainable repayment arrangements. Mainstream lenders that have established low-cost bank accounts or affordable loans include Amarillo National Bank, Fort Worth City Credit Union; Oportun in San Antonio, Fort Worth and Houston; Rio Grande Valley Multibank Community Loan Center, and Society of St. Vincent de Paul Predatory Loan Conversion Program in Austin.

CONCLUSION

Consumer protection laws aim to prevent unfair business practices. In Texas "A greater rate of interest than 10 percent a year is usurious *unless otherwise provided by law* [emphasis added]." A payday or auto title lender acting as a credit services organization may "assess fees for its services as agreed to between the parties" despite a law that limits the maximum acquisition charge on 2-week cash advance to 310%. Should these inconsistent regulations be changed? To what degree should payday and auto title lending be regulated in Texas? How can the small-dollar loan market be regulated so that lenders function both as a consumer service and a successful business? The role of the League of Women Voters is to provide opportunities for diverse groups of people to come together to discuss this issue of concern in our communities. (4 TEX. FIN. CODE § 302.001[b], 5 TEX. FIN. CODE § 602[b], 4 TEX. FIN. CODE §§ 342.251-259)

REFERENCES

For the references to the sources used in this report, see: *Facts & Issues References* available at: http://www.LWVTexas.org/issues.php

GLOSSARY

The Loans

Auto title loan. "A loan in which an unencumbered motor vehicle is given as security for the loan" (5 TEX. FIN. CODE § 393.601[5]). The amount of a title loan is based on an appraisal value of the vehicle, for example, a percentage of the vehicle's consumer retail value. When the loan principal, administrative fee, and lender interest are repaid, the lien is removed, and the title is returned to its owner. If a borrower is unable to repay when due, a refinance fee is charged. This fee is typically the same amount as the initial administrative fee. If the loan is not repaid, the lender may claim ownership, including the right to sell the vehicle.

Payday loan. A deferred presentment transaction.

Deferred presentment transaction. A "transaction in which: (A) a cash advance in whole or part is made in exchange for a personal check or authorization to debit a deposit account; (B) the amount of the check or authorized debit equals the amount of the advance plus a fee; and (C) the person making the advance agrees that the check will not be cashed or deposited or the authorized debit will not be made until a designated future date" (4 TEX. FIN. CODE § 341.001[6]).

Payment Arrangements

Cash advance. "The total of the amount of cash or its equivalent that the borrower receives and the amount that is paid at the borrower's direction or request, on the borrower's behalf, or for the borrower's benefit" (4 TEX. FIN. CODE § 341.001[3]).

Single payment loan. The principal, fee, and interest are due in full on the next payday, typically in 2 to 4 weeks.

Installment loan. The principal, fee, and interest are repaid in multiple payments coinciding with upcoming paydays.

Lending Organizations

Credit access business. "A credit services organization that obtains for a consumer or assists a consumer in obtaining an extension of consumer credit in the form of a deferred presentment transaction or a motor vehicle title loan" (5 TEX. FIN. CODE § 393.601[2]).

Credit services organization. "A person who provides, or represents that the person can or will provide, for the payment of valuable consideration any of the following services with respect to the extension of consumer credit by others: (A) improving a consumer's credit history or rating; (B) obtaining an extension of consumer credit for a consumer; or (C) providing advice or assistance to a consumer with regard to Paragraph (A) or (B)" (5 TEX. FIN. CODE § 393.001[3]).

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