No. COA06-447 FIFTH DISTRICT

NORTH CAROLINA COURT OF APPEALS

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JOHN R. KUCAN, JR. and TERRY COATES, on behalf of themselves and all other persons similarly situated,	)	
Plaintiffs-Appellants,	)	From New Hanover County
	)	No. 04-CVS-2860
v.	)	
ADVANCE AMERICA, CASH ADVANCE CENTERS OF NORTH CAROLINA, INC.; ADVANCE AMERICA, CASH ADVANCE CENTERS, INC.; and WILLIAM M. WEBSTER, IV,	)	
Defendants-Appellees.	)	

BRIEF AMICUS CURIAE FOR THE CENTER FOR RESPONSIBLE LENDING IN SUPPORT OF PLAINTIFFS-APPELLANTS' BRIEF

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Amicus curiae Center for Responsible Lending ("CRL") is dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL is affiliated with Self-Help, one of the nation's largest community development lenders. Self-Help has provided more than $3.9 billion in financing to help over 43,000 low-wealth borrowers buy homes, build businesses, and strengthen community resources. Self-Help's 26 years of experience in lending to low and moderate-wealth individuals provides a practical basis for CRL's policy work.

CRL has conducted landmark studies on the impact of predatory lending laws and worked to ensure that consumers, both nationally and in North Carolina, are protected from predatory lending. *Amicus* submits this brief in support of Plaintiffs-Appellants' Brief. In this brief, *Amicus* will provide an overview of the payday loan industry's business practices and its history in North Carolina.

ARGUMENT

I. Introduction

Payday loans are short-term loans for immediate cash, typically secured by a borrower's written check or authorization for automatic withdrawal from the borrower's bank account. They are called "payday loans" because they are marketed as a tool for cash-strapped borrowers to make it to the next paycheck. Rather than help borrowers through financial challenges, payday loans drain their income, damage their credit, and worsen their financial situation.

To ensure repeat borrowing, the industry disproportionately targets financially vulnerable communities. For example, according to a 2005 study, "[t]he counties with the greatest number and densities of payday lenders tend to be those with significant military activity."[1] "It was clear that within the military counties overcrowded with payday lenders, the ZIP codes adjacent to bases were the hottest spots for payday lending."[2] In addition, CRL has found that "African-American neighborhoods have three times as many stores per capita as white neighborhoods. This disparity increases as the proportion of African-Americans in a neighborhood increases."[3]

The payday lending industry has experienced explosive growth in recent years.[4] CRL conservatively estimates that predatory payday lending fees – those

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[1] Stephen M. Graves & Christopher L. Peterson, PREDATORY LENDING AND THE MILITARY: THE LAW AND GEOGRAPHY OF "PAYDAY" LOANS IN MILITARY TOWNS, 66 Ohio St. L.J. 653, 771 (2005). "Military personnel – particularly those in the lower ranks – are an ideal demographic for payday lenders because they usually have a steady government paycheck with little to spare at an average of $1,200 a month for new recruits." Amy Klamper, *Double Whammy: Payday Loan Victims Face Security Clearance Problems*, SEAPOWER, June 2006, at 13.

[2] Graves & Peterson, *supra*, at 773.

[3] Uriah King, *et al.*, *Race Matters: The Concentration of Payday Lenders in African American Neighborhoods in North Carolina* (Cntr. for Responsible Lending, Durham, N.C.), Mar. 22, 2005, at 2. *See also* Mark L. Burkey & Scott P. Simkins, *Factors Affecting the Location of Payday Lending and Traditional Banking Services In North Carolina*, *in* 34 REVIEW OF REGIONAL STUDIES 2, at 191-205 (Fall 2004).

[4] According to the investment firm Stephens, Inc., revenues at the 6 largest publicly-traded payday lenders increased by 31% from 2003-2004, and an additional 24.5% from 2004-2005. Stephens, Inc., *Industry Note* (Mar. 2, 2006).

extracted from borrowers caught in a debt trap of repeated transactions – cost U.S. families at least $6.7 billion annually, up from $3.4 billion in 2003.[5] In North Carolina, this activity, which has been illegal in the state since 2001, cost N.C. citizens more than $100 million in 2005 alone.[6]

II. The Payday Lending Business Model Intentionally Traps Borrowers in Debt

Payday loans are typically originated without traditional underwriting and thus disregard debt-to-income standards. While these loans are marketed as single-use, short-term credit, lending patterns do not reflect this. CRL estimates that only one percent of payday loans go to one-time users, while 91 percent of all payday loans are made to repeat borrowers trapped in a cycle of debt with five or more payday loans per year.[7]

Borrowers who do not have the funds to repay the loan and meet other expenses must either: (1) extend or "rollover" the loan; (2) pay off the loan but borrow again from the payday lender immediately in a "back-to-back" transaction; or (3) default, and consequently incur bounced check fees by the payday lender and insufficient fund fees by the borrower's bank while still owing the full amount

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See also, Diana B. Henriques, *Seeking Quick Loans, Soldiers Race Into High-Interest Traps*, NEW YORK TIMES, Dec. 7, 2004 ("From 1999 to 2003, the total payday loan volume nationwide increased fourfold, to $40 billion.").

[5] Ozlem Tanik & Uriah King, *The Rising Cost of Predatory Payday Lending* (Cntr. for Responsible Lending, Durham, N.C.), forthcoming June 2006, at 2; Keith Ernst *et al.*, *Quantifying the Economic Cost of Predatory Payday Lending* (Cntr. for Responsible Lending, Durham, N.C.), Dec. 2003, rev. Feb. 2004, at 2.

[6] Tanik & King, *supra*, at App. 2. Since December 2005, the four largest payday lenders in N.C. have stopped making payday loans. See Section IV, *infra*.

[7] Tanik & King, *supra*, at 3.

of the original post-dated check.[8] Pressure not to default includes bounced check fees, aggressive collection tactics, and even threats of criminal prosecution, although such threats are illegal. To avoid default, the borrower pays another fee – typically 15 percent of the amount borrowed – every two weeks to float or renew the loan. In this way, what appeared to be a one-time loan becomes revolving, high-cost debt that traps borrowers, rather than being beneficial credit that helps borrowers resolve financial emergencies.[9]

New information available from several sources confirms the industry's predatory business practices. Six states have begun collecting information from payday lenders on the details of their transactions,[10] and two of the largest payday lending companies, Advance America and QC Holdings, recently offered their stock for sale to the public, submitting reports to the Securities and Exchange Commission. Additional academic and industry research further confirms the dependence of the industry on the debt cycle created by the payday loan product.[11]

For example, Florida limits borrowers to a single loan outstanding at any one time, and Oklahoma limits borrowers to two at one time.[12] To enforce the rule, the states require lenders to record each transaction in a central database supervised by

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[8] Ernst *et al.*, *supra*, at 3.
[9] *Id.*
[10] These states include Florida, Oklahoma, Washington, Colorado, Iowa, and Virginia.
[11] *See e.g.*, Michael Stegman and Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing, in* 17 ECONOMIC DEVELOPMENT QUARTERLY 1, at 8 (Feb. 2003); Tanik & King, *supra*, at 3.
[12] West's F.S.A. § 560.404(19); 59 Okl.St.Ann. § 3109.

the respective state regulators.[13] In both states, the limits appear to have reduced the rate of repeat borrowing slightly, but they have not declined enough to show elimination of the debt trap. In Oklahoma, 91.1 percent of loans go to borrowers with five or more transactions per year, while the rate in Florida is 88.7 percent.[14] In all, the state databases show that half of all revenues come from borrowers who enter a payday transaction almost once a month.[15] In Oklahoma, half of the industry's revenues come from borrowers who have 16 or more loans per year.[16] Given this persistent pattern of repeat borrowing across the country, the industry's claim that it provides an important service to one-time borrowers is patently false.

III. 100 Year History of Subterfuge in North Carolina

The practice of making small loans at triple-digit annual interest rates that must be repaid at a borrower's next payday is not a new phenomenon. Instead, the practice began in the late 1800's and, by the turn of the twentieth century, it was wreaking "social havoc."[17] Over the course of the next 100 years, the industry has proved to be remarkably adept at making minor changes in the business model to skirt each attempt by lawmakers to put an end to the abusive practice.

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[13] West's F.S.A. § 560.404(19)(a); 59 Okl.St.Ann. § 3109(B)(2)(b).

[14] Veritec Solutions, *Oklahoma Trends in Deferred Deposit Lending*, at 8 (Sept. 2005), *available at* http://www.veritecs.com/OK_trends_11_2005.pdf; Veritec Solutions, *Florida Trends in Deferred Presentment*, at 12 (Jan. 2006), *available at* http://www.veritecs.com/FL_Trends_Jan_2006.pdf.

[15] This figure is not available from the Virginia database.

[16] Veritec Solutions, *Oklahoma Trends in Deferred Deposit Lending*, *supra*, at 8.

[17] Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historic Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 850-55 (2003).

North Carolina enacted its first usury law in 1907 to address these lending abuses. The abuses remained widespread, however, leading state legislators to revisit the issue beginning in 1923.[18] By 1927, the General Assembly had amended the state's usury law to forbid lending money at a rate greater than 6 percent per annum on assignment of future wages, transactions that presaged modern payday loans.[19] Despite these efforts to regulate the small loan industry, an investigation in 1932 by the North Carolina Civic Association uncovered "a number of complaints" indicating that wage earners were taking out small loans from "loan sharks," paying monthly fees for long periods of time, yet never paying down the principal.[20]

Dr. William Hays Simpson, a researcher at Duke University, interviewed 1181 borrowers in 1940 and found "that the average annual interest rate on loans of $10.00 and less varied from 335 to 522 per cent and on loans between $10.01 and $25 the rate ranged from 279 to 444 per cent in 7 different cities in North Carolina."[21] The subterfuge did not end when, in 1945, the General Assembly brought loan agencies under the supervision of the Commissioner of Banks and

[18] William Hays Simpson, PhD., THE SMALL LOAN PROBLEM OF THE CAROLINAS, 55 (Duke University 1941) (*hereinafter* "Simpson, THE SMALL LOAN PROBLEM").
[19] Pub. Laws of NC, 1927, c. 72.
[20] Simpson, *supra*, at 59, *citing The Charlotte Observer*, December 13, 1932. "A number of complaints were submitted to Mr. Sims, among which was a report by a wage-earner in Charlotte, who said he had borrowed $25, paid $5 a month for 13 months, and still owed the $25. Another man reported that he had borrowed $15, received only $13.60, paid back $28, and still owed the $15. Another borrower said he obtained a loan of $10, paid back $2 a month for more than a year, and still owed the $10." *Id.*
[21] William Hays Simpson, AMERICA'S SMALL LOAN PROBLEM: WITH SPECIAL REFERENCE TO THE SOUTH 70 (Duke University 1963) (*hereinafter* "Simpson, AMERICA'S SMALL LOAN PROBLEM"), *citing* Simpson, THE SMALL LOAN PROBLEM, *supra* at 25.

allowed a $2.50 fee in addition to 6 percent interest for loans of $50 or less. "The new regulations had hardly gone into effect before it became obvious that the control was inadequate to care for the small loan problem in the state. Loan agencies began to require that life insurance be purchased on each loan; later accident and health was added; and some agencies required borrowers also to purchase mortgage non filing insurance."[22]

The actions by the General Assembly and regulators to address the persistent subterfuge emphasize that the lending practices of today's payday lenders have been illegal in North Carolina for almost a century. Nonetheless, the modern payday industry consistently evades the law much as small loan lenders did throughout the 1900s.

IV. Recent Developments Confirm the Ongoing Illegality of Payday Lending in North Carolina

Prior to 1997, payday lending as it exists today was illegal in North Carolina under both the Consumer Finance Act and criminal law.[23] The General Assembly authorized payday lending in 1997 for four years, but refused to reauthorize the law in 2001.[24] As a result, payday lenders were once again subject to the North Carolina Consumer Finance Act, which caps the annual interest rate for small loans

[22] Simpson, AMERICA'S SMALL LOAN PROBLEM, *supra*, at 71. North Carolina was by no means the only state that struggled with early forms of payday lending. Simpson documents similar patterns in Arkansas, South Carolina, Georgia, Tennessee, Mississippi, and Texas. *See id.* at 5-50.
[23] N.C. GEN. STAT. 53-164 *et seq.*; N.C. GEN. STAT. 14-107(b); *see also* 60 NCAG 86 (1992) (an opinion by the N.C. Attorney General concluding that payday lending violated the two statutes).
[24] N.C. GEN. STAT. §53-281 (repealed 2001).

at 36 percent.[25] The N.C. Commissioner of Banks notified the state's payday lenders of the change in the law on August 30, 2001, stating that "there is no lawful basis for 'payday lending' without such a law, including 'payday lending' transactions effected by 'agents' or 'facilitators' of out-of-state institutions" and that "licensees should *make no further payday loans after August 31, 2001*."[26]

Not surprisingly, the industry continued its century old trend of skirting state law. Four years after the sunset, researchers found that "North Carolina ranks 10th of 20 states [surveyed] in the total number of payday lenders, and 16th in per capita density of payday lenders at 7.60 per 100,000."[27] This rate was "above the 6.64 per 100,000 density found in Virginia, despite the fact that under state law payday lending is legal in Virginia and illegal in North Carolina."[28] In addition to the storefront shops, other payday lenders continued to target consumers via the internet.[29]

The tide began to turn in September 2005 when Advance America, the nation's largest payday lender, announced that it would stop making new loans pending the outcome of an investigation by the Commissioner of Banks into the

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[25] N.C. GEN. STAT. §53-173 (2004) (capping annual interest rates at 36% for loans under $600, and at 15% for any amount loaned between $600 and $3,000).
[26] *See In re Advance America: Order*, N.C. Comm'r of Banks, 05:008 (Dec. 22, 2005) at 24 (emphasis in original).
[27] Graves & Peterson, *supra*, at 770-71.
[28] *Id.* at 771.
[29] *See, e.g.*, N.C. Dept. of Justice, *Press Release: AG Cooper Shuts Down Phony Rebate Payday Loan Scheme* (June 8, 2004), at http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=American%20 funding.pdf.

company's business practices.[30] The Commissioner issued his decision on December 22, 2005, finding that the company was operating in violation of the Consumer Finance Act and, because it was the true lender rather than its purported state bank partners, could not avail itself of federal preemption under the Federal Deposit Insurance Act.[31] The decision chronicles attempts by Advance America's North Carolina subsidiary ("AANC") to evade North Carolina law by working with out-of-state banks between August 2001 and September 2005.[32] Throughout this time, Advance America continued to operate essentially as it had before the sunset of the North Carolina bill,[33] and enjoyed tremendous profits from its activities in the state even after 2001.[34] The State Banking Commission upheld the Commissioner's ruling on May 23, 2006.[35]

Following the ruling by the Commissioner of Banks, the N.C. Attorney General announced consent agreements with the three largest payday lenders remaining in the state – Check Into Cash, Check 'n Go, and First American Cash

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[30] Advance America, Inc., *Press Release: Advance America Announces Lending Bank's Temporary Suspension of Payday Cash Advance and Installment Loan Originations in North Carolina*, (Sept. 14, 2005), at http://aea.client.shareholder.com/ReleaseDetail.cfm?ReleaseID=173091.
[31] *In re Advance America: Order*, *supra*, at 53.
[32] *Id.* at 9-23.
[33] Despite its relationships with banks, AANC continued to be "the lender on the notes executed by customers, … reviewed and approved operating policies and procedures" and "established or agreed to underwriting criteria that were applied by AANC, Parent and [a third party service provider] in a way that allowed the automated system of loan origination operated by Parent." *Id.* at 27.
[34] For example, Advance America's "[n]et revenues from the Company's North Carolina operations were $12.7 million, or 5.5% of the Company's net revenues, and $13.4 million, or 5.4% of the Company's net revenues, for the six months ended June 30, 2004 and 2005, respectively." Advance America, Cash Advance Centers, Inc., SEC Form 10-Q, at 17 (June 30, 2005).
[35] *In re Advance America: Final Agency Decision,* N.C. State Banking Comm'n, 05:008:CF (May 23, 2006).

Advance.[36] These lenders agreed to stop making payday and other unauthorized loans in North Carolina, stop collecting interest and fees on existing loans, and pay $700,000 to fund efforts to help consumers impacted by payday loans.[37] Each of these actions confirms that the payday lending activities are illegal in the state and that the loan agreements entered into after 2001 should be considered invalid.

VI. Conclusion

For the foregoing reasons, the Court should overturn the Superior Court's December 30, 2005 Order compelling arbitration and instead allow Plaintiffs to pursue their claims as a class in state court.

DATED: June 9, 2006.

Respectfully submitted,

By: ________________________________

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[36] Around the same time, the FDIC took action against a number of state-chartered banks, leading them to exit the payday loan business. *See, e.g.,* Ben Jackson, *FDIC Actions Indicate Less Tolerant Stance on Payday*, 171 AMERICAN BANKER 43, Mar. 6 2006. The FDIC's actions round out efforts by federal regulators to prevent banks and thrifts subject to federal supervision from engaging in payday lending activities. *See* OCC Advisory Letter AL 2000-9, *Third Party Risk*; OCC Advisory Letter AL 2000-10, *Payday Lending*; Office of Thrift Supervision, *Memorandum for Chief Executive Officers, Re: Payday Lending*, Nov. 27, 2000.

[37] N.C. Dept. of Justice, *Press Release: Payday Lending on the Way Out in NC* (Mar. 1, 2006), *available at* http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=paydaylenders3.06.pdf.

CERTIFICATE OF SERVICE

I certify that a copy of the Center for Responsible Lending's foregoing Brief *Amicus Curiae* has been served by UPS on June 9th, 2006 on the following persons:

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