



# APR Matters on Payday Loans

*Interest rate disclosures allow apple-to-apple comparisons, protect free market competition*

CRL Issue Brief

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## **APR, or Annual Percentage Rate of Interest**

Loan terms are often complex and may include a number of extra fees that make the real cost to the borrower difficult to decipher and difficult to compare across credit options. Congress developed the APR, or Annual Percentage Rate of Interest, as a standard measure that calculates the simple interest rate on an annual basis (including most fees), accounts for the amount of time the borrower has to repay the loan, and factors in the reduction in principal as payments are made over time.

For centuries, the standard has been to compare interest rates on an annual basis, whether the loan is scheduled to be paid off in less than one year, more than one year, or in multiple years. U.S. consumer lending law applies this measure across the board, whether for car loans, mortgage loans, cash advances on credit cards, or payday loans.

## ***The Truth in Lending Act: Consumer Protection, Free Market Competition***

Congress passed the Truth in Lending Act (TILA) in 1968, a central feature of which was the requirement that lenders disclose the APR for all types of loans. The intent was to give consumers an accurate measure of the cost of the various credit options they might be considering, so that they need not pay unnecessarily high rates of interest or be caught in loans with hidden fees or arduous terms that make it more difficult to pay off the loan.

TILA has the effect of protecting free market competition by ensuring that consumers can comparison shop and choose the form of credit that best fits their needs and their budget.

As Senator Paul Douglas, co-author of the Act said in 1963, TILA gives a consumer “the right to be informed-to be protected against fraudulent, deceitful, or grossly misleading information, advertising, labeling, or other practices and to be given the facts he needs to make an informed choice.” He also noted that it serves to “invigorate competition” by protecting the “ethical and efficient lender.”<sup>1</sup>

## ***Fed Ruled on APR and Payday Lending in 2000***

In 2000, the Federal Reserve Board formally clarified, over objections from the payday lending industry, that APR disclosures are required specifically for payday loans.<sup>2</sup> The Fed made explicitly clear that the legal definition of credit includes payday loans, whether they are called cash advances, deferred deposit checks, or other similar terms, and, as such, their cost must be disclosed in terms of APR under TILA.

**APR Matters For a Two-Week Loan, Even Though Most Payday Debt Is Longer Term**

Since APR disclosures are legally required, lenders do usually post them on loan documents, websites, and signs within payday stores. But payday loans are often advertised as costing around \$15 per \$100 borrowed, and lenders frequently quote a simple interest rate of 15 percent or so. Moreover, payday lenders have engaged in an extensive campaign to discredit the use of APR, targeting policymakers as well as the general public.<sup>3</sup>

Even if a payday loan is paid off in two weeks on payday, and no new loan is opened from the same lender (which is not usually the case), the APR is important because it tells the borrower the true cost of the loan compared to other options, including both time and dollars. Without both of those elements, the borrower lacks the necessary information to make an informed judgment regarding whether he or she can repay the loan or whether there is a more affordable option.

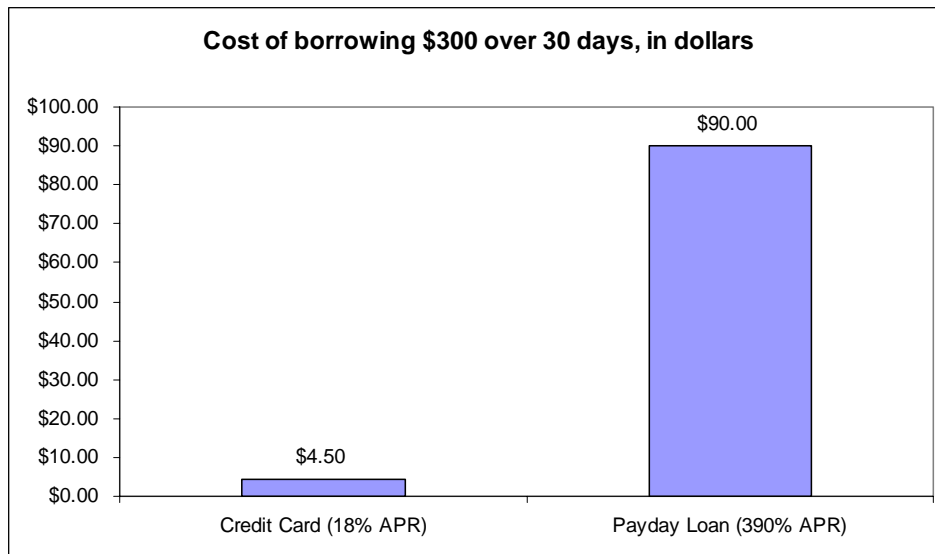
For example, a consumer considering the following two options might believe that a payday loan is the less expensive option if costs are expressed this way:

Credit Card Cash Advance = interest rate of 18%  
Payday Loan = interest rate of 15%

But if expressed in terms of APR, the true cost is easier to understand. The APR is calculated by taking the simple interest and multiplying it by the number of times the term goes into one year:

Credit Card Cash Advance = APR of 18%  
Payday Loan = 15% times 26 two-week terms = APR of 390%

In terms of dollars, the difference is stark. Say a person needs \$300 for a month for an emergency car repair. If the person takes out a payday loan and has a typical two-week pay period, the borrower must carry the loan for two terms to have it for one month. In this case, the real cost of the payday loan—\$45 per term, or \$90 total—would equal 20 times more than the credit card cash advance carried for one month.<sup>4</sup>



Assumes borrower takes an initial two-week payday loan and then re-opens that payday loan for an additional two weeks. If borrower is paid monthly and so is eligible for a 30-day loan, the cost would be \$45, still ten times the cost of a credit card advance.

### ***APR Matters For Long-term Payday Debt, The Norm For The Industry***

Most borrowers are stuck in payday debt for much longer than the time they expect to carry the loan.<sup>5</sup>

- One of seven Colorado borrowers has been in payday debt every day of the past six months. (The business works similarly in other states where payday lending is legal; we cite Colorado because this particular data point is available.)
- The average payday borrower nationally conducts nine transactions per year, generally on a consecutive or “back-to-back” basis.

In fact, the industry depends on this cycle of indebtedness for its business model to work. As documented in our report, *Springing the Debt Trap*.<sup>6</sup>

- 60% of payday loans go to borrowers with 12 or more transactions per year.
- 24% of payday loans go to borrowers with 21 or more transactions per year. Assuming a typical two-week term, that equates to ten months of indebtedness.

Industry insiders and analysts alike confirm the industry’s dependence on payday customers being caught in a cycle of long-term, high-cost debt. During a legislative battle in Virginia, a lobbyist for Advance America commented that the company could not live on five loans per year per borrower.<sup>7</sup> A payday lender in Washington State acknowledged that a limit of eight loans per year per borrower would likely put him out of business.<sup>8</sup>

And Morgan Stanley had this to say about long-term borrowing in an analysis of Advance America’s financials: “...38.1% of customers took out 9 to 14 or more advances per year. This statistic is worrisome. These customers bore the exceedingly high APRs associated with payday loans for almost half a year, or longer. At a 300% APR, the interest on a payday advance would exceed the principal after about 4 months. In these circumstances, the loan starts to look counterproductive: rather than bridging a gap in income, the payday advance may contribute to real financial distress.”<sup>9</sup>

### ***APR Matters***

APR matters whether a borrower takes out a single loan or is indebted to a payday lender for an entire year. Regardless of how often borrowers use payday loans, they must be able to compare these loans with other options, such as a cash advance on a credit card or an unsecured loan from a finance company. Disclosure of the APR also signals to consumers, policymakers, and regulators that this type of loan carries costs that are far above what is considered acceptable. In times of economic stress, corrective measures take on an importance that is hard to overestimate.

### ***A Cap for Economic Recovery***

Congress should support the “*Protecting Consumers from Unreasonable Credit Rates Act of 2009*,” introduced by Senator Dick Durbin (S. 500) and Representative Jackie Speier (H.R.

1608), as a quick and essential step toward economic recovery. Such a cap will cost taxpayers nothing and protect the earnings and government benefits of American households, thereby allowing these families to save, spend, and recover from their financial shortfalls in the long term.

**See Attachment: Real TILA Disclosures**

This Advance America contract from a North Carolina payday lending store shows an APR disclosure of 456.25% for a two-week loan of \$200. Because new documents were issued for each loan, what this one sample does not show is that the borrower was in continuous debt with Advance America for five years and paid over \$5,000 in interest for one small loan. Following “best practices” of the Community Financial Services Association of America, Advance America did not roll over this loan, but repeatedly closed and immediately re-opened it.

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<sup>1</sup> 109 Cong. Rec. 2029 (1963) (remarks of Sen. Douglas)

<sup>2</sup> Truth in Lending, 65 FR 17129, 17130 (March 31, 2000). Available at [http://www.newyorkfed.org/banking/circulars\\_archive/11241.pdf](http://www.newyorkfed.org/banking/circulars_archive/11241.pdf)

<sup>3</sup> “FISCA supports the development of an alternative measure of the cost of credit that is meaningful and understandable.” *Currents*, Financial Services Centers of America newsletter, p. 17, 30. (March 2009). Also, a consumer survey found that 94.5% of respondents cited the finance charge for a payday loan at around 15 percent. Only 34.5% offered a guess of the APR. Of those, only about half (49%) knew that their loans had an APR of over 200 percent. Thirty-four percent thought the APR was below 30 percent. Overall, this means that only 17 percent of all payday customers know what their loans really cost in terms of APR. Gregory Elliehausen, *An Analysis of Consumers’ Use of Payday Loans*, George Washington University School of Business, (January 2009). Available at <http://www.business.gwu.edu/research/centers/fsrp/pdf/m41.pdf>. Also, in a survey of California borrowers, most respondents were aware of the fee associated with borrowing, but did not understand the APR that is associated with long-term borrowing. They could articulate the amount of the fee, but most could not articulate the interest rate being charged or how it was calculated. *2007 Department of Corporations Payday Loan Study*, Applied Management and Consulting Group for the California Department of Corporations (December 2007). Also see materials from payday lending companies: from Check into Cash cartoon entitled “6 Scary Myths”: “There is a logical explanation for these rumored 391% APR “sightings”... and as with most myths, it’s because people think they’re seeing one thing when they’re actually seeing something else. Call it “fuzzy math” or “an error in judgement,” but when it’s all said and done, it’s a story fabricated to entertain, frighten, and baffle the storyteller’s audience.” As of June 17, 2009, available at <http://paydayfacts.org/?q=node/10>. Also see Check N Go video downplaying the importance of the APR for payday loans. As of June 17, 2009, available at <http://www.youtube.com/watch?v=mSWnN9BAoI8>.

<sup>4</sup> 54.4 percent of payday borrowers have a bank-issued credit card. Gregory Elliehausen, *An Analysis of Consumers’ Use of Payday Loans*, George Washington University School of Business (January 2009). Available at <http://www.business.gwu.edu/research/centers/fsrp/pdf/m41.pdf>.

<sup>5</sup> Uriah King, Leslie Parrish, Ozlem Tanik, *Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year* (November 2006). Available at [http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial\\_Quicksand-1106.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf). And Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Reform* (December 13, 2007). Available at <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>.

<sup>6</sup> Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Reform* (December 13, 2007). Available at <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>.

<sup>7</sup> Jeff Shapiro, “Payday-loan fights loom,” *The Richmond Times-Dispatch* (February 29, 2008).

<sup>8</sup> Russell, James. *Payday loans: Reform, but too fast*. Posted May 22, 2009 at <http://wenatcheeworld.com/article/20090522/OP03/705229867/-1/OP>

<sup>9</sup> Morgan Stanley Report, *Advance America: Initiating with an Underweight-V Rating*, January 25, 2005.

No:

CUSTOMER AGREEMENT

Date: 06/19/2003

REPUBLIC BANK AND TRUST COMPANY  
601 West Market Street  
Louisville, KY 40202



In this Customer Agreement, the words "you" and "your" mean the customer who has signed it. The words "we", "us" and "our" mean Republic Bank and Trust Company (the "Bank"), an FDIC insured Kentucky State Bank, which engages in deferred deposit services. You hereby deliver to us at the office of our marketer and servicer, Advance America, Cash Advance Centers of North Carolina, Inc. ("Advance America"), your check no. 0376 drawn on First Union National Bank in the amount of \$ 235.00 (the "Check"). In consideration of your payment of a service fee in the amount of \$ 35.00, and delivery of the Check to us, we will cash the Check, hold it and defer our right to deposit or present it for payment until 07/03/2003 (the "Presentment Date"). On the Presentment Date or thereafter, we may negotiate the Check. If the Check is dishonored for any reason and is returned to us from your financial institution, you agree to pay us \$ 2.00.

TRUTH-IN-LENDING DISCLOSURES

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	Amount Financed	Total of Payments
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
456.25 %	\$35.00	\$200.00	\$235.00

Payment Schedule: One payment in the amount of \$ 235.00 due on Thursday (day of week), July (month) 3 (day), 2003 (year).

Security: You are giving a security interest in the Check.

Prepayment: If you pay off early, you may be entitled to a refund of the finance charge.

See the terms below and on the other side of this Customer Agreement for any additional information about nonpayment, default and prepayment refunds.

Itemization of Amount Financed: Amount given to you directly. \$ 200.00.

**Prepayment.** In connection with CFSA's Best Practices, we will rebate and refund the finance charge we have earned if at any time prior to the close of business on the second business day immediately following the date of this Customer Agreement, you prepay to us at the office of Advance America the Amount Financed in cash in full satisfaction of your obligations under this Customer Agreement. Thereafter, you may prepay in full at any time the amount due under this Customer Agreement and will not incur any additional charge or fee. However, because the finance charge is earned by us upon your execution of this Customer Agreement, you will not be entitled to a rebate and refund of any part of the finance charge.

**Default and Assignment.** You will be in default under this Customer Agreement if you do not pay us something you owe us under this Customer Agreement or you cause the Check not to be honored on or after the Presentment Date. We may assign or transfer this Customer Agreement or any of our rights hereunder.

**Method of Payment.** The Check is payment for your obligations under this Customer Agreement. We may negotiate the Check on the Presentment Date or thereafter. However, we will negotiate or transfer the Check to you if you pay us at the office of Advance America the Total of Payments in cash or other immediately available funds on the Presentment Date.

**Security.** The Federal Reserve Board, acting under federal Truth-in-Lending law, has expanded the provisions of Regulation Z to cover our deferred deposit transaction with you. Both federal and Kentucky law do not clearly address whether our interest in the Check is a "security interest." Therefore, pursuant to Comment 2(a)(25) of the Federal Reserve Board Official Staff Commentary to Regulation Z §226.2, we have disclosed to you that our interest in the Check is a security interest for Truth-in-Lending purposes only. However, the federal Truth-in-Lending disclosures are not intended to create a security interest under Kentucky law and shall not be evidence of or an admission by us that this transaction is anything other than a deferred deposit transaction.

**Governing law.** This Customer Agreement is made not only under the federal laws applicable to state banks engaging in deferred deposit transactions with out of state customers, but also Kentucky state law. To the extent such federal laws do not preempt state law, then this Customer Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Kentucky. To the broadest extent possible, any state law claims you may assert against us relating to this Customer Agreement, and any state law claims we may assert against you relating to this Customer Agreement will be governed by the laws of the Commonwealth of Kentucky. The Waiver of Jury Trial and Arbitration Agreement shall be governed by the Federal Arbitration Act, 9 U.S.C. §§ 1-16.

**Warning:** This deferred deposit transaction is intended to address short-term, NOT long-term, credit needs. Repeated or frequent use can create serious financial hardships. You should evaluate the costs and benefits of all alternatives before entering into this Customer Agreement. Other forms of short-term credit that may be less expensive include a loan from another institution or from family or friends, a credit card cash advance, an account with overdraft protection, or a salary advance.

**Please note that this Customer Agreement contains a binding arbitration provision.** By signing this Customer Agreement you acknowledge that it was filled in before you did so and that you have received a completed copy of it. You agree that the information you provided to us prior to entering into this Customer Agreement is accurate. You also warrant that you are not a debtor under any proceeding in bankruptcy, and have no intention to file a petition for relief under any chapter of the United States Bankruptcy Code. You further acknowledge that the account on which the Check is drawn is a legitimate, open and active account. You further acknowledge that you have read, understand, and agree to all of the terms on both sides of this Customer Agreement, including the provision on the other side entitled, "Waiver Of Jury Trial And Arbitration Agreement."

Republic Bank and Trust Company

Customer's Signature \_\_\_\_\_

Date: 06/19/2003

*Kenn Siggs*, President

Any comments or questions may be directed to the Customer Comment Line at the following toll-free number: 1-888-310-4238.

## WAIVER OF JURY TRIAL AND ARBITRATION AGREEMENT

Advance America is the marketer/servicer in connection with your deferred deposit transaction with the Bank, which is evidenced by the Customer Agreement on the other side of this Waiver of Jury Trial and Arbitration Agreement ("Arbitration Provision"). In consideration of the services Advance America provides to you as the agent of the Bank in connection with this Customer Agreement, and in consideration of the Bank entering into a deferred deposit transaction with you, and in consideration of your promises made under this Customer Agreement, and for other good and valuable consideration, the receipt of which is acknowledged, you, the Bank and Advance America agree to this Waiver of Jury Trial and Arbitration Provision ("Arbitration Provision") as set forth below.

Arbitration is a process in which persons with a dispute: (a) waive their rights to file a lawsuit and proceed in court and to have a jury trial to resolve their disputes; and (b) agree, instead, to submit their disputes to a neutral third person (an "arbitrator") for a decision. Each party to the dispute has an opportunity to present some evidence to the arbitrator. Pre-arbitration discovery may be limited. Arbitration proceedings are private and less formal than court trials. The arbitrator will issue a final and binding decision resolving the dispute, which may be enforced as a court judgment. A court rarely overturns an arbitrator's decision. **THEREFORE, YOU AND WE ACKNOWLEDGE AND AGREE AS FOLLOWS:**

1. For purposes of this Arbitration Provision, the words "we", "us" and "our" mean the Bank and/or Advance America. Furthermore, the words "dispute" and "disputes" are given the broadest possible meaning and include, without limitation (a) all claims, disputes, or controversies arising from or relating directly or indirectly to the signing of this Arbitration Provision, the validity and scope of this Arbitration Provision and any claim or attempt to set aside this Arbitration Provision; (b) all federal or state law claims, disputes or controversies, arising from or relating directly or indirectly to this Customer Agreement (including the Arbitration Provision), the information you gave us before entering into this Customer Agreement, including the Applicant/Personal Information Form, and/or any past agreement or agreements between you and us; (c) all counterclaims, cross-claims and third-party claims; (d) all common law claims, based upon contract, tort, fraud, or other intentional torts; (e) all claims based upon a violation of any state or federal constitution, statute or regulation; (f) all claims asserted by us against you, including claims for money damages to collect any sum we claim you owe us; (g) all claims asserted by you individually against us and/or any of our employees, agents, directors, officers, shareholders, governors, managers, members, parent company or affiliated entities (hereinafter collectively referred to as "related third parties"), including claims for money damages and/or equitable or injunctive relief; (h) all claims asserted on your behalf by another person; (i) all claims asserted by you as a private attorney general, as a representative and member of a class of persons, or in any other representative capacity, against us and/or related third parties (hereinafter referred to as "Representative Claims"); and/or (j) all claims arising from or relating directly or indirectly to the disclosure by us or related third parties of any non-public personal information about you.

2. You acknowledge and agree that by entering into this Arbitration Provision:

- (a) **YOU ARE WAIVING YOUR RIGHT TO HAVE A TRIAL BY JURY TO RESOLVE ANY DISPUTE ALLEGED AGAINST US OR RELATED THIRD PARTIES;**
- (b) **YOU ARE WAIVING YOUR RIGHT TO HAVE A COURT, OTHER THAN A SMALL CLAIMS TRIBUNAL, RESOLVE ANY DISPUTE ALLEGED AGAINST US OR RELATED THIRD PARTIES; and**
- (c) **YOU ARE WAIVING YOUR RIGHT TO SERVE AS A REPRESENTATIVE, AS A PRIVATE ATTORNEY GENERAL, OR IN ANY OTHER REPRESENTATIVE CAPACITY, AND/OR TO PARTICIPATE AS A MEMBER OF A CLASS OF CLAIMANTS, IN ANY LAWSUIT FILED AGAINST US AND/OR RELATED THIRD PARTIES.**

3. Except as provided in Paragraph 6 below, all disputes including any Representative Claims against us and/or related third parties shall be resolved by binding arbitration only on an individual basis with you. **THEREFORE, THE ARBITRATOR SHALL NOT CONDUCT CLASS ARBITRATION; THAT IS, THE ARBITRATOR SHALL NOT ALLOW YOU TO SERVE AS A REPRESENTATIVE, AS A PRIVATE ATTORNEY GENERAL, OR IN ANY OTHER REPRESENTATIVE CAPACITY FOR OTHERS IN THE ARBITRATION.**

4. Any party to a dispute, including related third parties, may send the other party written notice by certified mail return receipt requested of their intent to arbitrate and setting forth the subject of the dispute along with the relief requested, even if a lawsuit has been filed. Regardless of who demands arbitration, you shall have the right to select any of the following arbitration organizations to administer the arbitration: the American Arbitration Association (1-800-778-7879) <http://www.adr.org>, J.A.M.S./Endispute (1-800-626-5267) <http://www.jamsadr.com>, or National Arbitration Forum (1-800-474-2371) <http://www.arb-forum.com>. However, the parties may agree to select a local arbitrator who is an attorney, retired judge, or arbitrator registered and in good standing with an arbitration association and arbitrate pursuant to such arbitrator's rules. The party receiving notice of arbitration will respond in writing by certified mail return receipt requested within twenty (20) days. If you demand arbitration, you must inform us in your demand of the arbitration organization you have selected or whether you desire to select a local arbitrator. If related third parties or we demand arbitration, you must notify us within twenty (20) days in writing by certified mail return receipt requested of your decision to select an arbitration organization or your desire to select a local arbitrator. If you fail to notify us, then we have the right to select an arbitration organization. The parties to such dispute will be governed by the rules and procedures of such arbitration organization applicable to consumer disputes, to the extent those rules and procedures do not contradict the express terms of this Customer Agreement or the Arbitration Provision, including the limitations on the arbitrator below. You may obtain a copy of the rules and procedures by contacting the arbitration organization listed above.

5. Regardless of who demands arbitration, we will advance your portion of the expenses associated with the arbitration, including the filing, administrative, hearing and arbitrator's fees ("Arbitration Fees"). Throughout the arbitration, each party shall bear his or her own attorneys' fees and expenses, such as witness and expert witness fees. The arbitrator shall apply applicable substantive law consistent with the FAA, and applicable statutes of limitation, and shall honor claims of privilege recognized at law. The arbitration hearing will be conducted in the county of your residence, or within 30 miles from such county, or in the county in which the transaction under this Customer Agreement occurred, or in such other place as shall be ordered by the arbitrator. The arbitrator may decide, with or without a hearing, any motion that is substantially similar to a motion to dismiss for failure to state a claim or a motion for summary judgment. In conducting the arbitration proceeding, the arbitrator shall not apply any federal or state rules of civil procedure or evidence. If allowed by statute or applicable law, the arbitrator may award statutory damages and/or reasonable attorneys' fees and expenses. If the arbitrator renders a decision or an award in your favor resolving the dispute, then you will not be responsible for reimbursing us for your portion of the Arbitration Fees, and we will reimburse you for any Arbitration Fees you have previously paid. If the arbitrator does not render a decision or an award in your favor resolving the dispute, then the arbitrator shall require you to reimburse us for the Arbitration Fees we have advanced, not to exceed the amount which would have been assessed as court costs if the dispute had been resolved by a state court with jurisdiction, less any Arbitration Fees you have previously paid. At the timely request of any party, the arbitrator shall provide a written explanation for the award. The arbitrator's award may be filed with any court having jurisdiction.

6. All parties, including related third parties, shall retain the right to seek adjudication in a small claims tribunal for disputes within the scope of such tribunal's jurisdiction. Any dispute, which cannot be adjudicated within the jurisdiction of a small claims tribunal, shall be resolved by binding arbitration. Any appeal of a judgment from a small claims tribunal shall be resolved by binding arbitration.


7. This Arbitration Provision is made pursuant to a transaction involving interstate commerce and shall be governed by the FAA. If a final non-appealable judgment of a court having jurisdiction over this transaction finds, for any reason, that the FAA does not apply to this transaction, then our agreement to arbitrate shall be governed by the arbitration law of the Commonwealth of Kentucky.

8. This Arbitration Provision is binding upon and benefits you, your respective heirs, successors and assigns. The Arbitration Provision is binding upon and benefits us, our successors and assigns, and related third parties. The Arbitration Provision continues in full force and effect, even if your obligations have been paid or discharged through bankruptcy. The Arbitration Provision survives any termination, amendment, expiration or performance of any transaction between you and us and continues in full force and effect unless you and we otherwise agree in writing.

Advance America, Cash Advance Centers of  
North Carolina, Inc.

By: 

Republic Bank and Trust Company

By: 

Customer's Signature