Don Baylor: Rapacious Loan Sharks Stalk Low, Middle-Income Texans

Loan sharks are preying on families across the nation, especially in Texas. At the federal level, Congress is helping to protect military families. But millions of working families remain vulnerable. Amarillo families—who earn 15% less than the average Texas family—are particularly at risk.

Nationwide, many workers are falling victim to "payday" loans—short-term loans that give workers a cash advance on their paychecks. Large numbers of military families use these loans to help make ends meet between pay periods. So do millions of low- and middle-income people across the country.

The problem is that these loans come with a major catch—exorbitant interest rates that begin at 400 percent Annual Percentage Rate (APR) and can surpass 1,000%.

It is typical for a worker to pay $180 in interest on a 10-day, $700 loan.

These high interest rates make it nearly impossible for workers to repay the loan on time, causing many workers to refinance and borrow again just to pay off the interest on the first loan. One emergency can lead to a debt spiral, as borrowers take out an average of nine loans per year. The result? More loans, more debt, and more bankruptcies.

Congress concluded that military indebtedness is a threat to national security. It passed legislation to protect military families by capping the interest rate at 36 percent, beginning in October.

While this law protects military families in Texas, it leaves millions of families who support the troops exposed to the sky-high costs of payday lending.

In 2003 alone, Texas workers took out 1.8 million payday loans, yet Texas has not gotten serious about cracking down on these lenders. While the state technically has laws on the books, major payday lenders use loopholes to brazenly ignore these state laws. Since July 2005, they have taken cover under the broad definition of a Credit Services Organization (CSO). By law, these entities—and the interest rates they charge—cannot be monitored.

Payday lenders are left without a watchdog, and consumers are left without a defender. The state is unable to enforce rate limits, keep tabs on business practices, or collect loan data.

Texas payday lenders charge among the highest interest rates in the nation and offer much larger loans. Most states limit payday loans to $500 or less, but in Texas, single loan amounts can be as high as $2,500.

Conservatively, payday loans cost Texas workers $280 million in lost earnings in 2005, according to the Center for Responsible Lending.

The Texas Legislature recognizes that working Texans need access to credit with real consumer protection. In reforming payday lending, many legislators are struggling with how to strike the right balance. For example, Rep. Warren Chisum (R-Pampa) has introduced a bill that seeks to reform payday lending. Although the bill offers some consumer protections, it would fall short of its goal. Here’s why:

HB 2134 would allow workers to borrow up to 25% of their monthly gross income. In reality, payday lenders would be able to take up to 75% of the average Amarillo worker’s paycheck.

For example, the bill would allow a worker who earns $12 an hour to qualify for a $500 payday loan ($580 after fees). However, this formula is calculated before taxes. Once payroll taxes are taken into account and the loan and fees are deducted from the worker’s paycheck, the worker is left with only $170 for the rest of the pay period.

Inevitably, the worker would need to take on another loan to pay the bills, taking on more debt.

The legislation would not solve the payday lending problem for other reasons:

First, the legislation mandates that payday lenders offer a payment plan option if the borrower cannot repay the loan. While such a plan sounds good in theory, it is too little too late. In order for a worker to take advantage of the plan, he would have to make a written request before the payday lender cashed his check. This is unrealistic.

Second, the legislation enables workers to take out multiple loans with different lenders, a practice banned in other states because it leads to a massive debt trap.

Finally, the legislation fails to close the CSO loophole, a key first step in reforming payday lending in Texas.

This legislative session, Texas needs to fight against such anti-consumer legislation and close the loopholes that let predatory lenders get away with charging sky-high interest rates.

At the same time, we need to promote low-cost, short-term lending products.

After all, all hardworking Texans—military and civilian—deserve fair loans at a fair price.

Don Baylor is a Senior Policy Analyst at the Center for Public Policy Priorities in Austin.