Payday Lending: Reforming this Predatory Practice in Minnesota

Authors: Courtney Colton, B.S., MSW Candidate; Karmy Luker B.A., MSW Candidate; Addy Haarstad-Mead, B.A., MSW Candidate; Sarah Turpen, BSW, MSW Candidate

Minnesota State University Mankato, Department of Social Work — April 2022

REFORM SHORT-TERM LENDING. INVEST IN LONG-TERM SOLUTIONS.

Disclaimer: We acknowledge that payday lending is not the only contributor to many Minnesotans' inability to attain financial well-being. Many factors contribute to financial inequities for Minnesotans including low minimum wage, gender and race wage gaps and increasingly restrictive state and federal assistance programs. This brief examines payday lending as it exists today and how reforms can be made to make this practice safer for those who rely on short-term loan

Issue Statement

Payday lending is a service that was intended to provide emergency financial relief to those who cannot afford an unexpected expense. However, 7 out of 10 borrowers use loans to cover monthly living expenses such as rent, utilities, and maintaining food security. With steep annual percentage rates averaging 391% and subsequent repeat borrowing, communities targeted by predatory lending companies fall deeper into the cycle of debt. Minnesota must reform their policies surrounding payday lending implementing legislative changes to protect Minnesotans who rely on payday loans and invest in long-term solutions that eliminate the need for a payday loan.

What is a Payday Loan?

Simply put, "a payday loan is a short-term, high-interest loan targeted at borrowers who need money between paychecks". Payday loans allow individuals to borrow against an anticipated paycheck or other anticipated earnings. According to the Minnesota Department of Commerce, payday lenders make small loans of up to $350 for short terms of generally less than 30 days.

Click **HERE** to watch a video by The Pew Charitable Trusts further explaining payday lending.

"Being financially well means you can meet your current and ongoing financial obligations, feel secure in your financial future, and are able to make choices that allow you to enjoy life – in other words, financial freedom"

The Need for Reform

Financial well-being is inaccessible to most Americans. According to a poll conducted by Forbes, "7 in 10 Americans live paycheck to paycheck".

Deborah, and thousands of Minnesotans like her, have an income gap problem that the payday lending industry is allowed to exploit.

Deborah is a young mother who works full-time as a teacher and is studying for a graduate degree. She has struggled to make ends meet. Deborah stated, "I can't seem to catch up."

She has used student loans, bank loans, and credit cards when she was short on money. Deborah is one of many facing the inability to afford basic cost of living and in addition unable to establish a safety net of savings.

"38,000 Minnesota customers took out 260,000 such loans that totaled nearly $110 million, or about $425 per loan. The average was seven loans per borrower and the average annual percentage rate was 275%" (MN Commerce Department, year).

While payday lending in theory can be a helpful tool, the reality is that families and individuals across the country rely on payday loans to survive. Payday lending is intended to assist families in covering unexpected expenses or to make ends meet when an electric or water bill is high. However, data indicates that at least 69% of payday loan borrowers use these loans to cover regular and recurring expenses such as rent or groceries. The average size of a payday loan is $375, and borrowers typically pay $525 in fees on the original $375 loan.

Unbanked Minnesotans, typically individuals and families living in concentrated areas of low-income and no wealth, are easy targets for the payday lending industry. Unbanked people often lack access to brick-and-mortar banks. Rather, payday storefronts are most typically located in communities with higher proportions of people of color, people with lower income, and lower levels of education, immigrants, and renters.

> "An analysis of Census shows that African-Americans are twice as likely as Minnesotans as a whole to live within 2.5 miles of a payday loan store. There is a long history of overt and covert social policies – for example through mortgage and homeownership restrictions and through redlining – that converged to create less income and wealth for people of color broadly, and African Americans specifically. Payday lenders take advantage of these racial inequities in income and wealth by targeting certain borrowers, ultimately magnifying their financial strain." (Human Impact Partners, 2016)

While payday lending in itself is considered an unsavory practice, what tips it into the realm of predatory are the incredibly high interest rates. Payday lenders don't refer to their rates as interest, rather as upfront fees. However, the reality is that those fees accumulate when loans are not paid back. The average annual percentage rate (APR) on payday loans is 300%.

Payday lenders use tactics such as "rolling over" loans to keep borrowers in the debt cycle.

To roll over a payday loan is to only pay the interest on the loan and leave the principal amount untouched. While this practice is illegal in Minnesota, it *is* legal to "**TOUCH AND GO**" on a payday loan. To touch and go is to repay the original loan and the interest by using the proceeds from a *new* payday loan. The effects of these practices are the same - borrowers pay more in fees and take out more loans to cover the cost of their initial payday loan.

Policies and Practices Governing Payday Lending in Minnesota

Neither the Small Loan or Industrial Loan and Thrift laws in Minnesota require providers to verify a borrower's reasonable ability to repay the loan (JRLC, 2013).

Small Loan Provider. Payday lenders are regulated under Minn. Stat. § 47.60 Consumer Small Loans. The law set the interest, finance charges, or fees, a consumer small loan lender may charge. If a payday loan is $350 or less, Minnesota rates are capped on a sliding scale as show in the table. For loans between $350.01 and $1,000, payday lenders cannot charge more than 33 percent annual interest plus a $25 fee. Storefront and online loan providers in Minnesota are required to be licensed by the Minnesota Commerce Department using the Nationwide Multistate Licensing System.

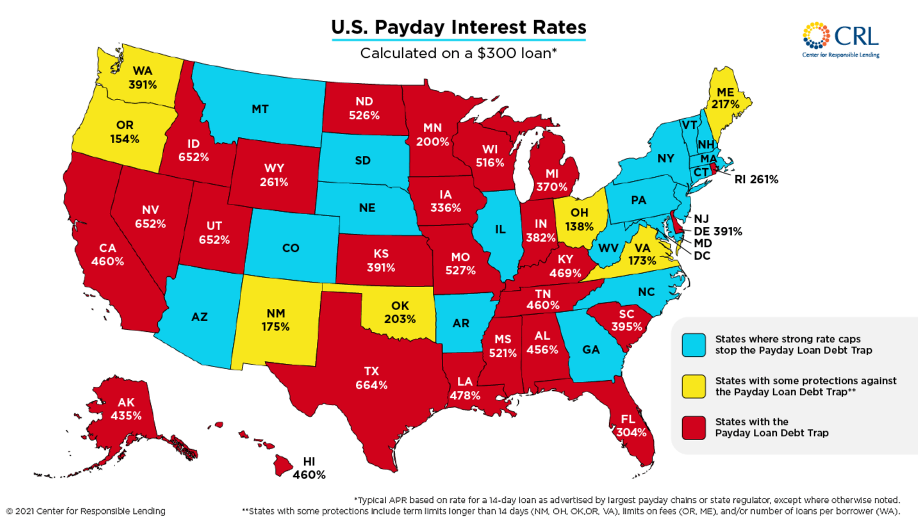
Loan Amount	Fee
$50 or less	$5.50
$50.01 - $100	10 percent, plus a $5 fee
$100.01 - $250	7 percent (minimum of $10), plus a $5 fee
$250.01 -$350	6 percent (minimum $17.50), plus a $5 fee

Three of the largest payday lenders in Minnesota bypass payday lending regulations by operating as Industrial Loan and Thrifts (ILT).

Industrial Loan and Thrift Providers. Lenders in Minnesota with sufficient net worth can qualify as an Industrial Loan and Thrift and fall under the provisions of Minn. Stat. § Chapter 53. These corporations form for the purpose of conducting the business of loaning people money. Similar to small loan providers, they are required to be licensed by the Minnesota Department of Commerce. Unlike small loan providers, they may charge significantly higher rates for the same payday loan that lenders that do not qualify as ILT's are prohibited from charging.

Reforming Payday Lending

MapThere are efforts across the nation to address the payday lending trap. The National Conference of State Legislatures documented 21 states with pending legislation pertaining to payday lending and payday lending alternatives in the 2021 legislative session.



Currently, 25 states including Minnesota have predatory APR caps on payday loans; the lowest being 200% and the highest being 664% (calculated on a $300 loan) (Center for Responsible Lending). Other states have some protections against the payday loan debt trap, such as limited fees, term limits longer than 14 days, or limits to how many loans a borrower can take out at once. Additionally, states that offer protection from predatory loan practices have strong interest rate caps to prevent borrowers from entering or staying in the debt cycle.

Policy Position Statement

Minnesota must also invest in long-term solutions that get at the underlying issues that lead people to seek a payday loan in the first place. While, simultaneously reforming the policies surrounding payday lending by enacting legislative changes to protect Minnesotans who rely on payday loans. Safer alternatives are needed for Minnesotans who do not earn a wage that supports the cost of living in their communities.

For these reasons, we recommend the following:

- Put protections in place to prevent the payday loan trap, including limits on fees and capping interest rates at significantly lower rates than are permitted today.

- Fix the loop-hole that allows Industrial Loan and Thrift providers to operate outside the rules governing small loan providers.

- Incentivize and support **Credit Unions** to decrease the need for payday lending, pawn lenders, and car title loans. "Nearly 50% of credit unions have a specific focus on serving low-income communities—providing affordable interest loans, higher savings yields, and lower fees. Minnesota's credit unions create competition forcing banks to offer more services at better prices to customers".

- Broaden eligibility for emergency financial aid. Federal poverty guidelines are used to determine eligibility for public assistance programs. Current Minnesota SNAP assistance standards set the annual income cap at $26,498 . The average annual income of payday loan borrowers is $30,000. The eligibility gap is what leaves payday loan borrowers *just* out of reach of receiving food assistance and turn to payday loans as a source of supplementary income.

To access this and other policy advocacy briefs go to: https://ahn.mnsu.edu/academic-programs/social-work/master-of-social-work/policy-briefs/

References

Full text online sources were used to create this policy advocacy brief and are **linked** throughout the document.

Urahn, S. k, Bourke, N., Horowitz, A., & Roche, T. (2012). *Payday lending in America: Who borrows, where they borrow, and why*. Pew Charitable Trusts.

The policy recommendations are not endorsed by Minnesota State University, Mankato.