

Avoiding the Cash Advance Debt Trap

By Tracey Taylor



It's no small coincidence that outside most military installations, there is one or more cash advance companies. While these small establishments look enticing to the cash-strapped service member, they are frequently designed to ensnare the unwary member into a cycle of increasing debt.

In fact, according to a recent report released by the Consumers Union Southwest Regional Office, military personnel are one of the main target groups of payday lenders.

According to the Center for Responsible Lending's article titled, "Payday Lending: How the Debt trap Catches Borrowers," payday lenders or cash advance companies loan borrowers a specified amount of cash, but require that the borrower issue the lender "a postdated personal check or an authorization for automatic withdrawal from the borrower's bank account."

For example, with a \$500 payday loan, borrower might pay \$75 in fees and receive \$425 in cash. The lender holds the check or

electronic debit authorization for a week or two (usually until the borrower's next payday). At that time the loan is due in full, but most borrowers cannot afford to pay the loan back and still make it to the next payday. But if the check is not covered, the borrower then accumulates bounced check fees from the bank and the lender, who can resend the check through the borrower's account repeatedly, potentially accruing more NSF fees from the bank. In addition, the lender attaches extra fees onto the loan that is usually automatically rolled over for another week or two—another fine-print provision.

Although illegal in some states, some payday lenders use strong-arm tactics to trap borrowers. For instance, many payday lenders will threaten that they will turn in the check as fraudulently written to the proper legal authorities if the borrower doesn't pay the loan and fees back immediately or rollover the loan, thereby accruing more fees every week or two. Ultimately, the borrower is never able to pay the original loan

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Who Do You Turn to If You Need Money Fast?

And, for those service members considering going to a payday advance company, there are alternatives available, according to the Center for Responsible Lending.

Alternatives include:

- Working with creditors to negotiate a workable payment plan
- Asking an employer for a paycheck advance
- Seeking consumer credit counseling
- Obtaining a short-term loan from a credit union
- Obtaining a credit card cash advance, which is actually cheaper than a payday loan advance
- Obtaining a short-term loan from a small consumer finance or military finance company.

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down and is doomed to what the Center for Responsible Lending calls “the debt trap.” Some companies go so far as to make the borrower sign an agreement that permits the lender to go to the borrower’s employer to ask the employer to deduct the loan amount plus all the fees directly out of the borrower’s paycheck.

According to an article published on the Consumers Union website, www.consumersunion.org, cash advance companies can also creatively circumvent state usury laws by disguising their cash advance loans as “legitimate” products.

For instance, the sale-leaseback agreement is very similar to a payday loan, but involves collateral. In this loan transaction, a payday lender “purchases” a belonging from the borrower, such as the borrower’s plasma television, as collateral against the loan. The lender then “leases” it back to the borrower for a “rental payment.” This is in lieu of actually offering the borrower a loan. Customers are required to bring in identification

about the item, such as serial numbers, model numbers, etc. The catch is that the payday lender usually requires a signed check in addition to the item in case the borrower fails to make their “lease” payment. Many of these salesback agreements include an automatic rollover after 14 days, with additional and late fees tacked on.

Another type of cash advance agreement requires the borrower to buy a product. Two increasingly popular agreements are called cash back ads and catalog sales.

In a cash back ad agreement, borrowers purchase an advertisement (1 line per \$100 loaned, for instance) and pay an ad fee of \$33 per hundred dollars borrowed. The company claims the borrower is purchasing a service. The company again holds the customer’s signed check as insurance that they will repay in full on the spot or roll over the loan or else they will face prosecution for illegally writing a fraudulent check.

A catalog sales agreement is very similar to a cash back agreement, except a borrower purchases a

What is a Responsible Small Loan?

According to the Center for Responsible Lending’s website, a responsible small loan is one that:

- Has at least a 90-day repayment term, repayable in installments
- Does not have a personal check mechanism or an unfair collateral system (such as a car title)
- Has reasonable limits on renewals (If borrowers are renewing short-term loans more than four times per year, the loans aren’t helping them financially)
- Does not include a mandatory arbitration clause
- Takes into consideration the borrower’s ability to repay the loan.

Nine Signs of a Predatory Payday Loan

There are the nine signs of a predatory payday loan according to the Center for Responsible Lending website:

1. Triple digit interest rate

Payday loans carry very low risk of loss, but lenders typically charge fees equal to 400 percent APR and higher.

2. Short minimum loan term

75 percent of payday customers are unable to repay their loan within two weeks and are forced to get a loan "rollover" at additional cost. In contrast, small consumer loans have longer terms (in NC, for example, the minimum term is six months.)

3. Single balloon payment

Unlike most consumer debt, payday loans do not allow for partial installment payments to be made during the loan term. A borrower must pay the entire loan back at the end of two weeks.

4. Loan flipping (extensions, rollovers or back to back transactions)

Payday lenders earn most of their profits by making multiple loans to cash-strapped borrowers. 90 percent of the payday industry's revenue growth comes from making more and larger loans to the same customers.

5. Simultaneous borrowing from multiple lenders

Trapped on the "debt treadmill", many consumers get a loan from one payday lender to repay another. The result: no additional cash, just more renewal fees.

6. No consideration of borrower's ability to repay

Payday lenders encourage consumers to borrow the maximum allowed, regardless of their credit history. If the borrower can't repay the loan, the lender collects multiple renewal fees.

7. Deferred check mechanism

Consumers who cannot make good on a deferred (post-dated) check covering a payday loan may be assessed multiple late fees and NSF check charges or fear criminal prosecution for writing a "bad check."

8. Mandatory arbitration clause

By eliminating a borrower's right to sue for abusive lending practices, these clauses work to the benefit of payday lenders over consumers.

9. No restrictions on out-of-state banks violating local state laws

Federal banking laws were not enacted to enable payday lenders to circumvent state laws.

certificate and is charged a fee for it. Borrowers purchase \$20-\$30 certificates for every \$100 loaned for products sold through a company catalog. Again, customers write a check for the loan amount plus the certificate fees, which the borrower rarely can pay back before the loan expires. For military borrowers, "the debt trap" not only affects the military service member financially, but can adversely affect their military careers as well. In fact, UCMJ Articles 123a and 134 prohibit service members from failing to repay a payday loan or that member may face imprisonment, court martial, loss of security clearance, a transfer to another unit or even discharge from the military. Consequently, a service member may be reluctant to go to his commander or Financial Assistance office on base for help.

But the public is fighting back.

In July of last year, Virginia passed a law that greatly restricts the ability of payday advance companies to operate near military installations in that state. Payday advance companies cannot lend more than \$500 to the borrower; charge more than 6 percent interest per year on late payments; must accept early payment for all or part of the loan

amount without penalty, accept only personal checks from the borrower, dated on or before the day the loan was made; cannot offer the borrower multiple loans to increase fees; threaten or instigate criminal proceedings for a bounced check; and they cannot renew, refinance or extend loans.

Furthermore, California officials announced in 2005 an educational and enforcement campaign called TAPS (Troops Against Predatory Scams) that is designed to help protect troops from falling into payday advance debt.

And last year, Congressman Sam Graves (R-Missouri) introduced H.R. 97, The Service Members Anti-Predatory Lending Protection Act, which proposes to cap interest rates at 36 percent and place restrictions on loan renewals and disclosure statements for payday loans. The bill was referred to the House Subcommittee on Economic Opportunity.

Thankfully, service members aren't alone if they are caught in "the debt trap." Military organizations, such as the Army, Navy-Marine Corps and Air Force Relief Societies are providing much-needed financial counseling and assistance for service members caught in this vicious cycle of debt.