

Viewpoint The Consumers Union Perspective

Consumer Reports Magazine, February 2009

Payday lenders: small loans, hefty fees, big problem

Borrowing Trouble

Andrea Felts ended up paying \$600 in fees on a \$400 payday loan.

Andrea Felts had money troubles after her divorce. To cover expenses, the high school principal from Albuquerque, N.M., took out a \$400 loan from an online lender, which charged her an additional \$120 to borrow the money for just 16 days. That's comparable to an annual interest rate of 684 percent.

Felts didn't have the full \$520 to repay at the end of the 16 days, so she rolled over the loan for another \$120 in fees. Before she was able to get together enough money to pay off the total, she had rolled it over five times and paid \$600 in fees on the \$400 loan.

Payday lenders hold a borrower's post-dated check or tap directly into his or her bank account to withdraw the money on payday. With most traditional loans, the principal and interest are paid down in regular installments. With a payday loan, the borrower must pay off the whole loan on the next payday. That's often impossible, so those people repeatedly pay hefty fees with nothing going to the principal.

New Mexico allows payday lenders to charge up to 417 percent annual interest. But as Felts' situation shows, rate caps might be ignored by online lenders peddling payday loans. Felts' attorney says she is pursuing a class-action suit in New Mexico.

Consumer protections vary widely by state. Only 15 states have caps below 60 percent. But the payday-loan industry is working to weaken even those laws. During the 2008 election season, the industry spent almost \$30 million on Ohio and Arizona ballot initiatives that would have removed caps. But voters in both states roundly defeated the industry's efforts.

In 2007, Congress passed the Military Lending Act, which caps interest rates at 36 percent for certain loans made to military personnel and their dependents and bars lenders from using post-dated checks or electronic debits. Consumers Union, the nonprofit publisher of Consumer Reports, supported those protections and supports a federal cap for all consumers. U.S. Senator Dick Durbin (D-Ill.) has introduced a federal bill that would cap interest rates, including all fees, at 36 percent and would let states set a lower cap. CU believes such a law is needed to protect borrowers.

What you can do

Don't take payday loans; you're giving your personal financial information to a stranger.

Start an emergency savings account. A small sum in the bank can save thousands in loan fees.

For the law in your state, go to www.paydayloaninfo.org. The site also has a calculator to convert loan fees into the annual percentage rate.

Posted: January 2009 - Consumer Reports Magazine issue: February 2009