

## Curbing Abusive Lending Practices

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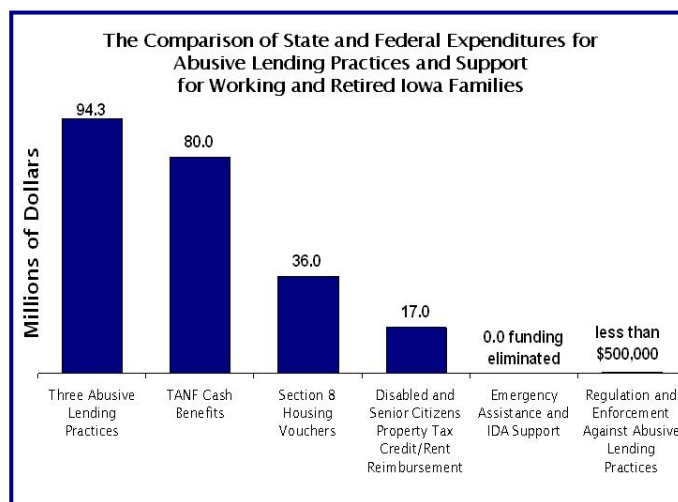
*When Donna Jones' car broke down, she felt she had to go to a payday loan company to get the \$200 to fix it. Making \$365 per week (\$18,960 per year) and raising two children, she didn't have any savings she could draw upon – she was still repaying the hospital for an emergency visit for treatment of a broken arm six months previously. The payday lender was happy to make her a \$235 loan for two weeks. That loan included the \$200 she needed to fix the car plus \$35 in fees and interest on the loan (an annual percentage rate of 304%). At the end of two weeks, a higher than expected utility bill forced her to “roll-over” the loan for another two weeks for an additional \$35. For a \$235 loan, Donna already had paid out \$70 in fees in less than a month.*

All families face unexpected financial demands. The difference is in the opportunities families have to meet such demands. For more affluent families, these are strains and inconveniences, which may involve dipping into savings or scrimping and doing without for a period of time.

For lower-income working families, however, they can represent much more than strains and inconveniences. They can force families to choose between necessities, to damage their credit ratings, and even to lose employment, face eviction, or lose their homes. Inability to pay medical bills is now the leading cause for bankruptcy in Iowa, and a top reason for low credit ratings that compound family problems in getting financial help or building equity through purchasing a home.

Unfortunately, the precarious economic nature of these families has given rise to new businesses that prey upon them – in the home mortgage market, in the emergency loan market, and even in the tax

refund field. Payday lenders, car title lenders, and subprime mortgage lenders all have developed in Iowa specifically to prey upon working and retired Iowans who struggle to get by and get ahead. Collectively, these practices strip nearly \$100 million annually in savings and income from working and retired Iowa families – more than many major federal and state programs designed to help families in poverty (see chart below).



Almost everyone in today's society needs access to financial services and to some

form of credit. There is an increasing array of both financial services and products to meet these needs, with much greater complexity in mortgages and lending structures.

The primary market for these financial services is competitive and regulated, and most middle-income families have access to forms of credit that meet their needs and are provided at reasonable rates.

A secondary market of lenders has developed, however, that is subject to less regulation and the self-control that a competitive environment brings. This includes:

- Subprime mortgage lending and contract sales, which usually involves marketing to people with existing mortgages under the guise of providing lower rates and often include hidden fees and deceptive practices that add unnecessarily to the cost of home financing and can be used to strip the equity in homes that people have built up over years of paying into mortgages;
- Check cashing and payday loan companies, which charge exorbitant fees for short-term loans and rely upon “rolling over” those loans to make their profits;
- Car title loan companies, recently established in Iowa and growing quickly, which use car titles as collateral for loans but still charge huge interest rates (up to 260% annually) for those loans; and
- Refund anticipation loans, which provide exceedingly high fees and interest rates for obtaining federal income tax refund checks that customers could receive

almost as quickly through normal tax preparation.

### The Challenges of Getting By and Getting Ahead: Curbing Abusive Lending Practices

Many states have stepped in to establish regulations that would curb these practices, lowering overall interest rate ceilings for small loans and establishing additional buyer protections for financing and refinancing homes. While several bills were introduced in Iowa to address these abusive lending practices, no final action has been taken and Iowa ranks well behind others in providing important protections.

Specific policy proposals needed to curb abusive lending practices in Iowa are to:

- **Establish limits on the interest that payday lenders and car title loan companies can charge and the rollover loans they can provide.**
- **Create regulatory policies and enforcement provisions to ensure secondary subprime mortgages meet minimum standards, there are ways to police the appraisal market, and buyers have access to information and legal action to address abuses.**
- **Establish consumer reporting requirements for refund anticipation loans and information on alternatives to those loans.**

In addition to curbing abusive practices, policies can support the development of credit alternatives from the responsible lending communities and address issues of medical debt. While these do not necessarily require state policy, state government can work proactively with the responsible lending community and medical institutions to fashion approaches to address these issues.