Short Term Lending

Final Report

Illinois Department of Financial Institutions

This report on short term lending has been prepared by the Illinois Department of Financial Institutions, Consumer Credit Division, pursuant to Illinois Senate Resolution 42 and presented to the Illinois Senate Financial Institutions Committee, Senator Patrick J. O'Malley, Chairman.

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The Department of Financial Institutions has prepared this report pursuant to Senate Resolution 42. The Department has analyzed the short term loan industry as it exists today in Illinois and throughout the country. We have defined the various businesses that make up the industry and clarified their differences. We have offered a brief historical review of how and why the industry has spread so quickly and documented the overall size of the industry in Illinois by graphically displaying the number of licensees by county. This report will present a snapshot view of how widespread the industry has become in a relatively short period of time.

The Department has reviewed other states' regulation of the short term loan industry and has provided a concise analysis of their legislative schemes. We have also met with representatives of the industry and various consumer groups and have noted many of our experiences in this report.

The Department of Financial Institutions regulates the short term loan industry in Illinois along with other lending institutions under the Consumer Installment Loan Act. Newspaper articles written about short term loan companies have used the phrase "Unregulated Industry" when referring to how companies are allowed to charge such high interest rates. The term "unregulated" is incorrect. These companies are regulated under the provisions of the Consumer Installment Loan Act. These companies are subject to the same licensing, regulatory and examination standards as the traditional installment lenders that are regulated under the statute.

Short Term Loan Companies

The short term loan industry in Illinois is comprised of two different types of companies; payday loan and title loan companies. Payday loan companies are individually licensed offices that lend relatively small amounts of money to individuals for terms not usually exceeding two weeks. The loans are unsecured, except for a post dated check held by the licensee until the loan is paid or until the check is cashed. The loan process is quick and easy and a customer is usually in and out of the office within minutes. Payday loan companies require customers to write a post dated check for an amount equal to the amount financed plus the finance charge. Finance charges are usually set between $20-$22 per $100 borrowed per two weeks.[1]

Some companies, whose origins stem from the check cashing business, charge flat fees for their loans according to a customer's payday and incorporate the Annual Percentage Rate (APR) to abide with state and federal statutes. This creates overly inflated APR's for loans less that 14 days. These companies may charge Annual Percentage Rates exceeding 1000% due to the inverse effect of the number of days to the APR (as the number of days in the loan increase, the APR for the loan will decrease, and vice versa).

(Example: If a customer borrows $200 for 14 days with an APR of 521.43%, the customer will pay a finance charge of $40. If the same customer borrows $200 for 10 days at another licensed location and is charged the same finance charge of $40, the APR will increase to 730%.)

The inverse effect on APR's only exists at the time the loan is written. If a customer takes a 14 day loan at a given APR and decides to pay the loan off before its maturity, he/she is refunded the unused interest and the effective APR is therefore lower than initially calculated.

Title loan companies are also individually licensed offices that offer single payment loans usually for 30 days. Unlike payday loan companies, title loan companies securitize their loans with a customer's automobile. Customers must provide a vehicle title (without any liens) as collateral on their loan. The amount extended to the customer is usually based upon a percentage value of the automobile. These percentages vary amongst the licensees, but 33% seems to be the industry norm. As with other short-term lenders, title loan companies do not perform credit checks, have minimum residency requirements and do not require copies of the borrowers tax returns.

Payday loan companies may also operate Limited Purpose Branches (LPB's) under a single licensed office. LPB's are off-site locations where consumers can apply for and receive loans that are maintained at a centralized, licensed location. The centralized, licensed location maintains all customer files and records. Many branches are licensed currency exchanges that have received permission from the Department to operate under specific rules initiated for LPB's. The statute prohibits the LPB's from accepting payments, servicing accounts, or making collections. LPB's are not

[1] On the average, payday loan companies in Illinois charge $20 per $100 borrowed per two weeks, which computes to an APR of 521.43%.

individually examined each year as are the licensed facilities.[2] Payday loan companies are examined under their Department issued license.

[2] Limited purpose branches operated from currency exchanges are examined through their centralized main office. Although the Department will examine the currency exchanges once a year through our Currency Exchange Division.

Historical Background

The genesis of the short term loan industry began in the mid 1980's in rural southern American cities supported by large factory businesses and a blue-collar customer base. By the early nineties the businesses developed into an industry with over 3000 locations and an economically diverse customer base. According to the U.S. Treasury Department, the number of "Payday Loan Stores" has since doubled with over 6000 locations throughout the United States and, if industry estimates are correct, we can expect a 600% increase during the next decade.[3]

The industry flourishes as its customers are introduced to the idea of a higher cost for convenience. The industry advertises that rising bank fees for returned checks coupled with the inability to secure small cash advances with ease, create a need for this type of loan.

The short term lenders' managers and customer service employees are usually paid less and have less education than their counterparts in the banking industry. These employees closely mirror their customer base.

Our examiners have encountered many employees of short term loan companies that are themselves customers of neighboring short term loan companies. These employees are aware of the costs of a short term loan and the potential dangers of abusing the availability of easy credit.

Initially, short term loan companies sought to provide a service that would assist customers in "making ends meet" at times when their pay checks occasionally fell short of their spending needs. They would provide a couple hundred dollars so people would not fall behind in paying their bills. That philosophy, while still being reiterated by the industry, may not accurately depict the average customer scenario. Customers rarely borrow a single time, in fact, repeat business is the main source of revenue. A single licensee may have a limited customer base, but if the customer regularly refinances a loan the store may be quite profitable.

According to a Consumer Federation of America report: "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry"[4], other industries, recognizing the profitability of short term loans, have decided to enter the business.

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[3] NaCCA Response Paper: Freedom of Choice for Consumers: The Truth about Deferred Deposit Services. Abby L. Hans, Chairman of the Board, National Check Cashers Association.

[4] Consumer Federation of America, "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry", Jean Ann Fox, Director of Consumer Protection, November 1998.

"A seminar at the National Check Cashers Association 1998 convention drew standing room only crowds for check cashers interested in going into payday lending. As check cashers lose a portion of their traditional business to electronic delivery of state benefits and federal payments, check cashers are searching for profitable financial services to replace check cashing."

In addition to the check cashers' sole involvement, partnerships have been formed between check cashers and national banks to make payday loans. Eagle National Bank, a federally chartered bank from Pennsylvania, makes loans through Dollar Financial Group's Check Cashers in several states. Dollar Financial Group claims that Eagle National Bank is able to export Pennsylvania's deregulated bank loan fees to consumers in other states.

In Illinois, we have seen involvement by several national payday loan chains, the currency exchange industry, and entrepreneurs that learned of the industry and decided to enter the market place without any prior lending experience. Early on, our examiners would find a number of exceptions in the course of an examination. Most of these exceptions were the result of the licensees' inexperience and ignorance of the laws governing consumer installment lending.[5] Recently, the number of exceptions at payday loan licensees has declined. The reason for the decline could be attributed to increased awareness of the Department regulations of the short term loan industry arising out of the Department's annual examination. After a licensee is examined they receive a report of all exceptions noted by the examiner and are instructed in what changes they must make to achieve compliance.

[5] The Department considers any infraction of the Consumer Installment Loan Act or any other state or Federal statute to be a Department noted exception.

Understanding the Short Term Loan Industry

The best way to understand the short term loan industry is to categorize each sector within the industry. Subtle, yet important, differences exist within the industry. The first differentiation must be made between payday and title loan companies. These two types of companies operate as different industries with a few similarities that bind them together. They both contract single payment loans with high interest rates in a relatively new industry. Payday loans are note loans secured only by a post dated check given to the company by the customer. The post dated checks are rarely cashed, due to high rates of insufficient funds, so customers are asked to make cash payment every two weeks or until the loan is paid in full, which is a violation of the current statute.

Title loans are single payment loans, usually for a term of 30 days, secured by an auto title. Similar to payday loans, title loans are rarely paid off within the initial term of the loan. Customers are asked to make cash payments covering the accrued interest and the loan is rolled over for another month. Unlike payday loans, title loan companies are not limited in the number of times they can rollover a loan.

The payday loan industry itself could be divided into several different categories. National chains operate different than the single store independents and both operate different than the LPB's. Chain stores maintain a homogenous atmosphere about their stores with locations throughout the state linked via computer. Their offices resemble a relaxed banking atmosphere. Independents do not always maintain records on a computer. Many independents manually write their contracts on a customer by customer basis. This often leads to human errors and truth in lending violations. Some independents use computers but have experienced software problems due to poorly designed programs or improperly altered software fashioned to handle payday loans.

Several of the Illinois Community Currency Exchanges have become LPB facilities. These branch offices are limited to assessing a finance charge not to exceed $7.00 per $100 borrowed for a term of one week. Based on representations made by the industry, this has resulted in confusion to both the licensee and the consumer, since a consumer utilizing the currency exchange would be charged one rate as compared to a consumer utilizing the same service at the licensed location being assesed a higher rate. Additionally, due to the current regulatory provisions, a consumer cannot satisfy the debt in person at the limited purpose branch, but rather, would be required to go to the licensed location. In some instances this can be several miles away from the licensed location, which may result in an inconvenience to the consumer.

Examination Procedures

The Department's examination procedures include an annual unannounced on-site examination of each licensed office for the purpose of verifying compliance with the Illinois Consumer Installment Loan Act. This examination includes a random sampling of active and paid account files. The examiner verifies that each contract has been completed in full. Contracts are then inspected for improprieties or omissions that may have occurred during the loan closing procedure. The examiner then tests the terms of the contract to verify proper disclosure. This is achieved by entering the data from each contract into the Department's software application to verify the calculations. Once the terms of the contract are verified and the examiner is confident with the contracts overall compliance, he/she continues the examination by examining other files. If an exception is noted, the examiner will document it on the examination and give the licensee an opportunity to correct the problem before the examiner completes the examination. If the licensee is unable to correct the exception during the examination, it will be submitted to the Department as an "uncorrected exception" and the licensee will be expected to correct it within 45 days of receiving the examination findings in the mail. If the licensee is able to correct the exception during the examination process, the exception will be listed on the examination as a corrected exception and no additional follow-up will be required.

Paid customer accounts are handled in a manner that is similar to that of active files. Each inspection made on the active file is performed on the paid file along with the addition of a simple interest test to verify proper refunding of any unearned interest, and that the licensee has returned original documents stamped "Paid" to the consumer.

The examiner will then examine a random sampling of Judgment and Repossession files to verify compliance with the Consumer Installment Loan Act.

Before completing the examination, the examiner conducts an oral closing procedure with the licensee's representative. This procedure permits the examiner to elaborate upon his findings and explain the course of action needed to be taken by the licensee to comply with the Department's requirements.

Subsequent to the examination, the Department will forward a letter to the licensee noting any exceptions identified during the examination. The licensee will then have 45 days to respond back to the Department with an adequate resolution to the noted exceptions.

Illinois Department of Financial Institutions

The Department of Financial Institutions is comprised of several different divisions, each statutorily responsible for conducting compliance examinations of their licensed offices. The Consumer Credit Division has been overwhelmed during the past two years due to the growth of short term loan companies. As of June 30, 1999, our Division licensed 1443 individual lending offices throughout the state. Better than 75% of those were consumer installment lenders (1097), while the remaining 346 were sales finance licensees. Out of the nearly 1100 consumer installment licensees, just about half (548) are short term lenders. During the peak of the short term loan industry growth, our Department was receiving in excess of 60 applications a month. The growth has since slowed and we are reviewing less than 20 new applications per month.

The following exhibit of county data demonstrates that the short term loan industry is not targeting areas of specific personal income levels. We have combined data generated from the U.S. Census Bureau and the Bureau of Economic Analysis to verify that areas with the lowest personal income levels are not being inundated by the presence of these businesses. The counties with the densest population of short term lenders are usually the counties with the highest average personal income levels.

County	Average Personal Income 1997	PAYDAY LOANS	TITLE LOANS	TOTAL
Adams	22113	3	1	4
Alexander	15438	0	0	0
Bond	19989	0	0	0
Boone	24419	4	0	4
Brown	15718	0	0	0
Bureau	20988	0	0	0
Calhoun	19980	0	0	0
Carroll	20222	0	0	0
Cass	20154	1	0	1
Champaign	21964	10	1	11
Christian	21653	0	0	0
Clark	18760	0	0	0
Clay	19513	0	0	0
Clinton	21401	0	0	0
Coles	20225	3	0	3
Cook	29343	202	47	249
Crawford	18166	0	0	0
Cumberland	19031	0	0	0
DeKalb	23097	5	0	5
DeWitt	22222	0	0	0
Douglas	20882	0	0	0
DuPage	38825	24	4	28
Edgar	19172	0	0	0
Edwards	20768	0	0	0
Effingham	22404	2	0	2
Fayette	17166	0	0	0
Ford	22647	0	0	0
Franklin	16381	1	0	1
Fulton	18906	2	0	2
Gallatin	18633	0	0	0
Greene	16425	0	0	0
Grundy	26395	1	0	1
Hamilton	18510	0	0	0
Hancock	20393	1	0	1
Hardin	15688	0	0	0
Henderson	18885	0	0	0
Henry	21304	1	0	1
Iroquois	20368	0	0	0
Jackson	17399	8	1	9
Jasper	19783	0	0	0
Jefferson	19971	3	0	3
Jersey	19365	1	0	1
JoDaviess	24174	0	1	1
Johnson	12985	0	0	0
Kane	26374	19	2	21
Kankakee	21673	5	1	6
Kendall	25108	1	0	1
Knox	21054	2	1	3
Lake	40259	21	2	23
LaSalle	21110	7	0	7
Lawrence	22166	0	0	0
Lee	19591	2	0	2
Livingston	22104	0	0	0
Logan	19201	1	0	1
Macon	24111	8	3	11
Macoupin	21787	0	0	0
Madison	23059	10	4	14
Marion	20175	2	0	2
Marshall	20445	0	0	0

Mason				18803	0	0	0
Massac				18147	2	1	3
McDonough				18100	1	0	1
McHenry				29651	5	1	6
McLean				25203	7	2	9
Menard				22857	0	0	0
Mercer				20926	0	0	0
Monroe				24653	0	0	0
Montgomery				19403	1	0	1
Morgan				20942	2	0	2
Moultrie				19540	0	0	0
Ogle				21838	1	0	1
Peoria				25436	11	1	12
Perry				17903	0	0	0
Piatt				23311	0	0	0
Pike				17397	0	0	0
Pope				14337	0	0	0
Pulaski				15818	0	0	0
Putnam				25994	0	0	0
Randolph				17296	0	0	0
Richland				21052	0	0	0
Rock Island				24730	8	2	10
Saline				18521	2	0	2
Sangamon				24801	8	3	11
Schuyler				16549	0	0	0
Scott				16391	0	0	0
Shelby				18691	0	0	0
Stark				20994	0	0	0
St. Clair				21153	5	5	10
Stephenson				23827	3	0	3
Tazewell				23959	6	1	7
Union				17774	0	0	0
Vermilion				19572	4	1	5
Wabash				19128	0	0	0
Warren				18075	0	0	0
Washington				21879	0	0	0
Wayne				19277	0	0	0
White				20250	0	0	0
Whiteside				22070	5	0	5
Will				24831	11	2	13
Williamson				19721	2	0	2
Winnebago				24381	21	3	24
Woodford				23063	0	0	0

Exhibit 1 (continued)

The following pages include maps of the state divided by counties. We have listed the number of licensees per county along with a breakdown between payday loan companies and title loan companies. The purpose of these maps is to clearly illustrate the wide spread permeation of this industry throughout the State of Illinois.

Total Number of Payday & Title Loan Companies in Illinois as of 6/30/99

Number of Payday Loan Companies in Illinois as of 6/30/99

Number of Title Loan companies in Illinois as of 6/30/99

State Regulation

Currently, the Illinois Department of Financial Institutions licenses short term loan companies under our Consumer Installment Loan Act. The Act, which has been amended over the years to incorporate changes in the finance industry, has not been amended enough to adequately regulate both conventional consumer installment loans and short term loans. In the absence of a specific short term loan statute, the Consumer Installment Loan Act has served in safeguarding the public against possible deceptive practices.

Illinois is not the only state that is confronted with these issues. Due to the relative infancy of the short term loan industry, state legislatures have not been able to compose an effective piece of legislation that could be adopted throughout the United States. According to the Consumer Federation of America, only nineteen states and the District of Columbia have adopted legislation or regulations that authorize and regulate payday loans.

Typical payday loan laws exempt these transactions from usury or interest rate caps, set a maximum fee and term for loans, restrict roll-overs or multiple loans, and require licensing by state regulators. Six states have instituted specific payday loan laws or regulations that require lenders to disclose their fees as an Annual Percentage Rate. Thirteen of the twenty jurisdictions set a maximum loan term, but only Oklahoma sets a minimum term of 30 days to repay loans of $101 or less.

Most states have created some type of criminal or administrative penalties. However, only seven states provide for some type of limited private right of action allowing the consumer to obtain relief against the lender. Only a small number prohibit the lender from threatening to file or filing criminal charges against a consumer as a mechanism to collect on the debt.

The following chart depicts the states with specific payday loan regulations

State	Max. Fee% / $	APR 7 day/ 14 day	Max Term/amt.	TILA Required	Rollover Prohibited	Max. loan # / $
CA	15%	782%/391%	30/$300	N	N	1
CO	<25% or $25	1250%/625%	$500	Y	Y	2
DC	10% up to$10	782%/391%	31/$1000	N	N	No Limit
FL	>10% or $5	521%/261%		N	N	No Limit
IO	$15/$100	782%/391%	$500	N	Y	2
KS	Scale*	782%/391%	30/$780	Y	Y	No Limit
KY	$15/$100	782%/391%	60/$500	Y	N	2
LA	Scale**	521%/261%	30/$500	N	Y	No Limit
MN	Scale ***	782%/391%	30/$350	N	Y	No Limit
MS	18%	938%/469%	30/$400	N	N	No Limit
MO	$15/$100	782%/391%	10 mon/$500	N	N	No Limit
NE	$15/$100	782%/391%	31/$500	N	N	2
NV	Set by reg.			N	N	No Limit
NC	15%	782%/391%	31/$300	N	Y	No Limit
OH	5%/mon.+	782%/391%	6 mon/$500	N	Y	No Limit
OK	20%	1042%/521%	30/$101	Y	N	$100
SC	15%	782%/391%	31/$300	Y	Y	No Limit
TN	15% or $30	782%/391%	31/$500	Y	Y	3
WA	15%+	782%/391%	31/$500	N	Y	No Limit
WY	$30 or 20%	1042%/521%	30/	Y	Y	No Limit

* $5.50 for loans $0-$50, 10% of loans + $5 for $50-$100, 7% +$5 for $100-$250, 6%+$5 for $250-$300.

** $5 for loan$0-$99, $10 for loans $100-$200, $15 for loans $201-$500.

*** $5.50 for loans $0-$50, 10%+$5 for loans $50-$100, 7%+$5loans $100-$250, 6%+$5 loans $250-$500[6]

[6] Consumer Federation of America, November 1998

Nineteen states and the U.S. Virgin Islands have made it unprofitable to operate payday loans companies due to small loan interest rate caps and because of specific prohibitions against payday lending by check cashers. States have enforced this ban with varying degrees of enthusiasm. As you will see from the chart below, some states have implemented small loan rate caps which are being avoided by companies operating as check cashers who believe they are charging fees for their service and should not be bound by current lending laws.

The following chart depicts states that have implemented small loan rate caps and those that have prohibited check cashers from skirting their rate caps.

State	Cap Small	Check Cashers
	Loan Rate	Law Prohibits
Alabama	36%	
Alaska	36%	
Arizona	36%	
Arkansas	17%	
Connecticut	28.52%	Yes
Georgia	57.68%	Yes
Hawaii	24%	
Maine	30%	Yes
Maryland	33%	
Massachusetts	39.86%	Yes
Michigan	25%	
New Hampshire	24%	
Pennsylvania	23.57%	Yes
Puerto Rico	25%	
Rhode Island	36%	
Texas	31.65%	
Vermont	24%	
Virginia	36%	Yes
Virgin Islands	26%	
West Virginia	31%	Yes

Other states, (including Illinois), permit payday lending under current laws that govern loan companies without the use of a usury cap. Twelve states do not cap interest rates for small loan companies, permitting payday lenders to get licenses and charge any rate they choose. Indiana permits payday lending due to its minimum $33 finance charge

for consumer loans. Three of these states (Delaware, New Jersey and New York) only prohibit check cashers from making payday loans.

States that permit payday loans through small loan act provisions

State	Small Loan Act	Permitted for
	APR on $200	Check Cashers
Delaware	No Cap	No
Idaho	No Cap	Yes
Illinois	No Cap	Yes
Indiana	****	Yes
Montana	No Cap	Yes
New Jersey	No Cap	No
New Mexico	No Cap	Yes
New York	No Cap	No
North Dakota	No Cap	Yes
Oregon	No Cap	Yes
South Dakota	No Cap	Yes
Utah	No Cap	Yes
Wisconsin	No Cap	Yes

**** $33 minimum finance charge / 36% cap

Who Uses Short Term Loans?

According to the industry, short term loan customers are middle class workers who have incurred unexpected expenses. The industry contention is opposed by consumer groups who believe that the companies focus on people with severe financial hardships and are on the verge of bankruptcy. In order to accurately depict the short term loan customer base, we have included information provided to us by one of the largest title loan companies in the state, along with our own Department's survey.

Illinois Title Loan Company, which operates 38 licensed offices in Illinois, provided our Department with a partial segment of a customer predictive analysis prepared for them by an outside accounting firm. [7] The report provides a statistical model identifying the significant combinations of household and neighborhood characteristics that best distinguish their customer base from the total population.

The information provided in their report details a demographic sketch of the "average title loan customer". A customer model consists of two columns. The first depicts the percent of customer households having a particular characteristic such as age or income. The second is a measure of how concentrated customer households are among households having the characteristic. In referencing the following chart, an index of 100 indicates average concentration, while an index of 250 indicates a concentration 2 1/2 times above average, and an index of 50 indicates a concentration that is only half of the average.

Included in the information provided to us by Illinois Title Loans were responses to inquiries made by the Department with regard to various elements of their title loan operating experiences. According to their internal records, the company's repossession rates are approximately 4% since initiating operations in Illinois two years ago. Of the total number of cars that were repossessed by the company, twenty percent have been redeemed by the customers, which results in a net repossession experience of approximately 3.2 %.

Approximately 46 % of their borrowers are repeat customers. The average duration of a loan, including extensions, is between 3 1/2 to 4 1/2 months, which resembles our own survey's findings. Less than 1 % of their customers file for bankruptcy protection.

The remaining statistics were taken directly from their R.L. Polk Analysis and provided to our Department.

[7] Illinois Title Loan Company's Demographic Analysis conducted by R.L. Polk

Income Model

	Customer	Customer
Income	*Percent*	*Index*
< $15,000	*11.9*	*103*
$15,000-$19,999	*8.6*	*125*
$20,000-$29,999	*17.1*	*130*
$30,000-$39,999	*16.6*	*128*
$40,000-$49,999	*15.6*	*122*
$50,000-$74,999	*21.4*	*94*
$75,000-$99,999	*5.4*	*55*
$100,000-$124,999	*2*	*38*
$125,000 >	*1.5*	*32*

Vehicle Ownership Data

Recreational Vehicle	*7.5*	*87*
Motorcycle	*1.6*	*64*
Economy Car	*23.4*	*155*
Mid Size Car	*41.1*	*151*
Large Car	*10.9*	*138*
Sports Car	*13.7*	*159*
Luxury Car	*15.2*	*155*
Multi Luxury Car	*2*	*200*
Minivan	*5.7*	*97*
Sport Utility	*4.6*	*82*
Truck	*26.7*	*115*
Import	*30.6*	*124*

Credit Card Model

Misc. Credit Cards	*1.1*	*38*
Retail/Specialty Card	*16.2*	*56*
Bank Card	*11.3*	*41*
Oil/Gas Card	*1.7*	*53*
Finance Card	*1.1*	*44*
No Credit Cards	*77.2*	*136*

Household Age

18-24	*3.4*	*148*
25-34	*25.2*	*132*
35-44	*39.1*	*133*
45-54	*17.1*	*94*
55-64	*9*	*72*
65-74	*5.1*	*43*
75+	*1*	*15*

Tenure Category

Definite Renter	*3.7*	*128*
Probable Renter	*3.7*	*206*
Probable Owner	*2.1*	*75*
Definite Owner	*39.2*	*69*
Unknown	*51.3*	*143*

Department Survey

Our Department conducted a survey of payday and title loan licensees throughout our state to identify what constitutes the "normal short term loan customer". The survey was conducted between June 21, 1999 and July 2, 1999 by seven Consumer Credit Division examiners. The Consumer Credit Division's review examiner chose the licensees in a random manner. Our intent was to select a wide variety of these companies from throughout the state.

The actual survey, which is included on the following page, draws demographic details for each customer polled in the survey. Due to the limited time frame given to conduct this survey, our examiners used data already compiled by the licensee from their customer applications or information sheets. The files chosen by the examiners were selected in the same random manner as they would for a normal examination.

Each examiner, in addition to their normal examination procedures, selected 10 random customer files and documented the following information on our customer survey sheets. A sample of the survey is included on the following pages.

After the examiner completed the 10 survey sheets, a compilation sheet was prepared to document the averages for each particular licensee. Our intent by creating this compilation sheet was to more readily categorize the different short term loan sectors and to be able to draw conclusions from our data. Each compilation sheet was designed to help determine if any particular licensee was more appealing to a particular demographic. A copy of the compilation sheet is also included on the following page.

Customer Survey

Consumer Installment Number _______________

Name of Licensee ___________________________

Address ____________________________________

____

Account number ______________

Number of contracts present in File? _________

Gender of customer _____________

Age of customer _____________

Occupation of customer _____________________________

Annual salary of customer _______________

Does the customer rent or own? _____________

Customer Survey
Compilation Sheet

Name of Licensee _________________________

Number of people included in poll? _______

Average number of contracts present in files? ___________

Percentage of Men _______ **Percentage of Women** _________

Average age of customers polled? __________

Average Annual Salary of Customers polled? ____________

Percentage of renters ________ **Percentage of owners** _________

Prepared by: _____________________

In total, our Department examined 60 licensees throughout the state. We examined over 600 different customer applications or information sheets and found the following results:

The data collected has been averaged for each question and included in the results below. There were 12 licensees where the data collected on the first question was not used due to a lack of time the offices were open. (If an office was only open for a month or two, the number of contracts a customer could have would be limited to that time frame.) Our results indicate that the average customer is usually a woman in her middle thirties earning just over $24,000 a year. She usually rents her home and once she becomes a customer of a short term loan company she usually remains a customer for at least 6 months.

Survey Question	*All Short Term Loan Companies*	*Payday Loan Companies only*	*Title Loan Companies only*
Avg. # of contracts Present in files	*10.93*	*13*	*2.4*
% of Men	*40%*	*40%*	*50%*
% of Women	*60%*	*60%*	*50%*
Avg. Age	*36.6*	*36.9*	*35.1*
Avg. Salary	*$24,104*	*$25,131*	*$19,808*
% Renters	*75%*	*75%*	*80%*
% Owners	*15%*	*15%*	*10%*
% Other	*10%*	*10%*	*10%*
Avg. APR's[8]	*486.00%*	*533%*	*290%*

[8] Average Annual Percentage Rates have been calculated based on 14 day loans.

While our survey focused on the entire state and the broad-based short term loan borrower; many consumer advocates have focused on particular demographic groups. Groups that have always been targeted by high rate lenders due to their limited financial resources and inability to satisfy their existing financial needs.

Many high school students are required to take a consumer education class prior to graduation. However, despite this requirement, a good number of these graduates are not truly prepared in the area of personal finance and consumer economics. The law requires prominent disclosure of the APR on all loans and credit card applications yet it is apparent that many consumers do not truly understand the meaning of APR.

High school graduates and college students are one of the many target areas for the credit card and short term loan industry. These industries do not ignore the demand that this young age group has for short term loans. These industries recognize that college students can make up a large portion of the market.

Because students may not be adequately educated in consumer economics, some may make poor financial decisions. College students view credit cards and short term loans as quick and easy solutions to their immediate need for cash and may end up finding themselves caught up in an endless cycle of debt. Whether the money is needed to buy books for the next semester, to make the next tuition payment, to pay off the previous loan or credit card, or simply to finance social activities, these companies provide a means to attain cash without many requirements.

People living on fixed incomes are also targeted due to their inability to keep pace in a world of rising costs. They avoid traditional lenders because the complicated language and amount of paperwork involved in processing a small loan often intimidates them. The public is attracted to the short term loans because of their simplicity and quickness. An example of the processing of a payday loan is included on the following page.

Example: A customer enters a licensed payday loan office. The licensee asks the customer to complete an application. The application includes personal information about the customer, employment information, references, and in some cases marketing information to assist the customer in the future. The customer is then asked to provide the following items:

1) A drivers license or state identification card
2) A recent checking account statement from their bank
3) A utility bill showing their current address
4) A paycheck stub
5) A post-dated check for the principle and interest of the loan

While the customer is completing the application, the licensee calls the customer's bank to verify their checking account. The processing of the application consists of employment verification and calling their residence to make sure their phone is in working order. Some licensees are beginning to use a service called "Teletrack", that can, within minutes, verify if the customer has a loan out with another payday loan company subscribing to the same system. Some licensees do not subscribe since they do not want to incur the added cost, while others do not want to lose the added volume of customers that would be eliminated.

If the customer is approved, the licensee has them execute a contract and issues a check or gives them cash for the amount of the loan.

The terms of the contract are stated within the Truth in Lending box. Which discloses the following:

- Amount Financed
- Finance Charge
- Annual Percentage Rate
- Number of payments
- Amount of payments
- Maturity date of the loan

Our Department requires each licensee to file a copy of their loan documents with the Department as prescribed in the statute. We maintain copies within the licensee's file.

Are Short Term Loan Customers Truly "Captive"?

In order to determine if short term loan borrowers are truly "captive" we must define the term "Captive Borrower". The Department saw several meanings behind the somewhat ambiguous term. The first referred to customers who had no other alternatives than to borrow from short term lenders. These customers could have been denied loans at other lending institutions and either do not qualify or have reached their limit on their credit cards.

People earning comfortable salaries, who pay their bills on time and have maintained a primary residence for an extended period of time, normally would not borrow money at rates offered by the short term loan companies. Some Illinois citizens find themselves living from paycheck to paycheck and occasionally fall behind in paying their bills. These people are usually considered bad credit risks by the banks. Credit card companies, who tend to be less restrictive in their borrowing requirements, pay closer attention to customers exceeding their means of repayment.

Title Loans of America, which operates in Illinois as Illinois Title Loans, Inc. has provided our Department with a market analysis of its customers. The analysis, which deals exclusively with title loan borrowers, demonstrates the limited ability of the title loan borrowers to obtain credit from companies issuing credit cards. According to the analysis, 77.2 % of their borrowers do not possess any credit cards.[9] These borrowers must then turn to the higher rate finance companies, which lend to customers with less than perfect credit or payment histories. These companies assume the added risk and in turn charge the borrowers higher rates. These rates can range, depending upon the credit rating given to the customer, from 10% to 40%. Since there are no rate caps in Illinois, finance companies rarely exceed their own rate limits to accommodate a customer who is unable to qualify for a loan.

Customers unable to obtain a loan at any other lending institution must turn to the various short term lenders for assistance and are therefore "captives" in their borrowing options.

The second meaning construed by our Department referred to the circumstance in which a short term borrower was unable to end the cycle of rolling over their account due to the excessive costs.

Some short term loan customers consider the use of these loans to be a cash-flow decision rather than a loan or credit decision. A portion of the other customers are small business owners who come to a short term loan company to meet payroll needs or to purchase material needed to complete a job.These customers utilize the service in order to avoid the traditionally higher banking fees that could arise from bouncing a check. These customers do not pay much attention to the prominently placed Annual Percentage Rate required on all loans. They are only concerned with the cost of borrowing their principle balance. Paying $20 to avoid bouncing several checks is preferred to borrowing $200 for one week at an interest rate of 521.43%.

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[9] Totalist Customer Predictive Analysis prepared for Title Loans of America, Inc. by The Polk Company, 1996

The problems arise when customers consistently incur expenses which exceed their income and are unable to free themselves from this biweekly financial cycle. These are the truly "Captive Borrowers". Our Department's survey exposed this problem to some degree. The examiners were finding customers who were borrowing continuously for over a year on their original loan. Industry members, who have testified at the two public Illinois Senate hearings, have referred to their customers as average citizens who encounter unexpected financial hardships. What they have failed to mention was that the financial strains placed on consumers were rarely short-lived. Customers playing catch-up with their expenses do not have the ability to overcome unexpected financial hardships because their budgets are usually limited. The high expense of a short term loan depletes the customer's ability to catch-up, therefore making the customer "captive" to the lender.

Rate Analysis

To determine if rates being assessed by short term lenders are excessive, one must first review the finance charge assessed as compared to the charges of other alternative lending sources.

It is not uncustomary for banks to assess a consumer approximately $18.00-$20.00 when a check is returned unpaid. Added to this cost, the consumer may also incur a $25.00 returned check fee assessed by the payee. This may result in total fees in excess of $43.00. Provided a consumer would pay a fourteen (14) day loan in full on the contractual maturity date, a $100.00 loan with an annual percentage rate of 521.43%, would cost the consumer $20.00.

The utilization of a credit card may be another alternative available to the consumer. Consumer credit statistics released by the Federal Reserve on July 8, 1999, indicate that in 1998 there was over $1.3 trillion in outstanding consumer debt of which $560.7 billion was of a revolving credit nature. Additionally, a survey conducted by the American Bankers Association noted that the average credit card holder has four credit cards with approximately $4,000.00 in outstanding debt.

A consumer who obtained a $2,500.00 revolving loan in 1996, with an annual percentage rate of 18% and only makes the scheduled minimum monthly payment, would not pay the loan in full until the year 2033. The total finance charges paid during this period of time would be in excess of $7,500.00.[10]

It is also important to analyze the method which is utilized to measure the rate being assessed. As prescribed under the provisions of Regulation Z of the Federal Truth-in-Lending Act, the cost of the loan must be expressed as a yearly rate known as the annual percentage rate. Components considered in this calculation include the finance charge as compared to the amount financed over a stated period of time.

In many instances the consumer is only concerned with the amount of the periodic payment or fee being assessed. Due to the short term nature of this type of loan, various consumers may only be attentive to the fee being charged.

This is not to suggest that the annual percentage rate is an inaccurate method of calculating the yearly cost as a percentage or that it should not be used by the consumer to compare other short term loan rates. However, due to the complexity of this formula, combined with the fact that the consumer may only be concerned with the dollar cost of this loan, the annual percentage rate may be of little interest.

[10] GKM Banking industry Repoert, Bank Credit Cards: Loans Loss Risks are Growing, George M. Salem and Aaron C. Clark, June 11, 1996.

Complaints Levied Against Short Term Lenders

The Department, as the regulator of short term lending companies, responds to all complaints levied against our Department's licensees. Most complaints received involve misunderstandings or miscommunications between the customer and the licensee rather than violations of statutes or regulations. It is the Department's policy to carefully evaluate each complaint and determine if any violation has occured. We also assume an active role in investigating the complaint. If the Statute does not address the existing problem, we try to work as an intermediary between the parties to help foster a fair and understanding resolution.

In the past two years the Department has received a total of twenty one complaints regarding short term loan licensees. Each complaint was individually processed by our Division's Review Examiner and in all instances resolved to both parties' satisfaction. Out of the twenty one complaints brought to our Department's attention, eleven were determined to be unfounded and resolved through a careful explanation of the Consumer Installment Lending Statutes. The remaining ten complaints were resolved through our Department's mediation with the customer and licensee.

The number of complaints forwarded to our Department may be low for a myriad of reasons. Customers may not be aware of the Department's regulatory responsibilities of enforcing compliance with applicable state and federal laws regarding consumer lending. Secondly, the customers may be unaware of the process of registering a complaint with the Department. Lastly, the customers may lack the proper understanding of the consumer lending laws and not realize that violations have occurred. The Department will focus its efforts to better educate the consumer and working with our licensees to ensure compliance.

Debt Counseling and Consumer Education

Any effective piece of legislation that is written to protect Illinois citizens from excessive interest rate lending must include consumer education.

According to the National Foundation for Consumer Credit, more than 1.4 million Americans sought help last year from credit counseling agencies. Some 504,000 Americans, with total debts of $2.3 billion, received formal debt management counseling.

Debt management programs and counselors work with consumers and their creditors to establish a workable budget and repayment plan for each consumer. The consumers agree to destroy their credit cards and make monthly payments to the counseling agency, which in turn distributes these funds to the creditors.

In an effort to educate the public, the Department is preparing an informative brochure that will be made available in all Illinois short term lending offices.

The brochure will define the various terms used in a standard loan contract and further elaborate on calculations needed to compute a finance charge. It will encourage all customers to fully read each contract before execution. It will also inform the customer of the adverse effects of prolonged use of short term loans and will advise them to contact the Department at a toll free phone number with any questions or complaints regarding consumer installment loans.

Summary

The short term loan industry can be one of many vehicles available to serve the citizens of Illinois. It offers a solution for people with questionable credit or those that have incurred unexpected expenses. The fees being levied by these companies, while exorbitent can be compared to the increased cost of banking services throughout the country.

The increased banking fees for returned checks coupled with the added charges placed onto the account by the recipient of the check, make it less expensive for a person to borrow from short term lenders than to risk having their check returned NSF. That is not to imply that customers who abuse the system will not find themselves further in debt and unable to correct their financial situation. Short term loans provide a service as long as they are used as intended. It is only when customers use them for extended periods of time or for reasons other than financial hardship that problems can occur. The short term loan industry has thwarted such efforts by having its customers pay off their current loan with proceeds from a new loan, in effect opening a new account to pay off an old account. In Illinois we have experienced this practice first hand, as our three rollover rule has been ineffective in stopping people from converting a short term loan into a long term headache. Mandatory waiting or cooling-off periods between loans will not rectify all the industry's ills, but could help to deter the self-inflicted abuses of continuous rollovers.

An effective piece of legislation must deal primarily with the abuses of the industry. A carefully worded statute limiting a customer's ability to continuously carry a principal balance on their account should be implemented. Such a provision would have to address the licensees' desire to have its customers making regular payments as if they were installment lenders. Having customers who make regular payments without paying down their principal balance helps to ensure profitability for short term lenders. Limits on profits made by lenders from rollover accounts would assist in ensuring the financial stability of the consumer.