

State of Wisconsin
Department of Financial Institutions

**Review of Payday Lending
in Wisconsin
2001**

REVIEW OF PAYDAY LENDING IN WISCONSIN

INTRODUCTION

The deferred deposit industry, or “payday lending” industry as it is commonly called, has generated a significant amount of interest both among regulators and policy decision makers. This document provides a basic explanation of the industry, its growth in the state of Wisconsin and provides statistical results of a study conducted by the Wisconsin Department of Financial Institutions (DFI) during the latter half of 2000.

This report does not attempt to cover the full scope of the payday lending industry. Several studies by other state regulators, including Illinois, Indiana, New Mexico, and Iowa, and those by consumer advocacy groups provide additional information on the history and development of the payday lending industry across the nation.

BACKGROUND

In a typical payday loan transaction, a borrower will provide to the lender items such as a paycheck stub, photo identification and a recent bank statement. The borrower completes a loan application and submits a postdated check or other checking account information to the lender in order to receive the loan. If approved, the customer signs a loan agreement. The lender generally holds the check until the loan comes due, unless the borrower extends the loan or pays it in full. These lenders typically do not perform credit checks, have residency requirements or require a copy of a borrower’s last tax return, as do traditional lending institutions.

The loan agreement is a legal document that obligates the borrower to repay the loan. It also sets forth the general terms of the loan, including:

Amount Financed: The amount of credit provided to the borrower or on the borrower’s behalf.

Finance Charge: The dollar amount the credit will cost.

Annual Percentage Rate (APR): The cost of the credit expressed as a yearly rate.

Total of Payments: The amount paid after all payments are made as scheduled (typically, this will be the amount of the debtor’s postdated check).

Disclosures: In addition to those items above, the loan agreement must also include myriad other disclosures required by the Federal Truth in Lending Act and the Wisconsin Consumer Act.

REGULATION

Several newspaper articles have used the phrase "unregulated industry" to describe the payday lending industry in Wisconsin. The term "unregulated" is inaccurate. These lenders are subject to the same licensing, examination and reporting requirements as other "traditional" lenders under the "loan company" statutes. The Division of Banking (Division) licenses and regulates loan companies that charge interest on consumer loans at a rate in excess of 18 percent per annum. This includes lenders that make "payday loans."

Before a payday loan company can do business in Wisconsin, it must apply for and be granted a loan company license under Section 138.09, Wis. Stats. Upon receiving a loan company application, the relevant facts are investigated by the Division. This includes reviewing information on the applicant entity as well as the company's principals. The applicant is required to submit a current financial statement, which the Division reviews to determine if the company is financially responsible. The balance sheet must reflect a net worth of at least \$50,000 for the application to be considered. The applicant entity is also required to obtain, and maintain in force, a surety bond in the amount of \$5,000 per location, up to a maximum of \$50,000.

The principals must answer questions regarding their business, financial, and any criminal background. In most cases, the Division also works directly with the Department of Justice to determine if any of the principals have a criminal background. A license is issued if the Division finds that the character, general fitness, and financial responsibility of the applicant, and its principals, warrant the belief that the business will be operated in compliance with the applicable rules and regulations.

Every loan company is subject to examination by the Division. The purpose of the exam is to discover violations of applicable rules and regulations, and includes a review of disclosures, finance charges, late charges, refunds, and the procedures a licensee follows when a loan is not paid as scheduled. A review of the company's financial position and the history of complaints filed against it with the Division is also conducted during the exam.

WISCONSIN TRENDS

As of April 27, 2001, the Division licensed 40 payday lenders with 211 locations. On January 1, 1996, the Division licensed 2 payday lenders with 17 locations. The industry began in Wisconsin in 1993. The number of payday lenders, the number of payday loans made, and the dollar amount of these loans has increased over the past 6 and a half years as follows**:

Date	Companies	Offices	Number of Loans	Volume of Loans
12/31/95	2	17	*	*
12/31/96	8	64	80,000	\$11.2 million
12/31/97	16	126	351,000	\$73.9 million
12/31/98	25	162	630,000	\$147 million
12/31/99	31	174	839,285	\$200 million
12/31/00	37	202	*	*
4/27/01	40	211	*	*

* Data not available

** All numbers are approximate

REVIEW OF PAYDAY LENDING IN WISCONSIN

A detailed analysis of licensed payday loan companies has been conducted in several states, including Indiana and Iowa. During the summer of 2000, DFI conducted an onsite review of payday lenders in the state to determine usage and growth patterns, determine how Wisconsin compared to other states and provide policy makers with information that may be useful when making decisions about the future of this industry.

DFI reviewed the records of 17 payday loan locations throughout the state. A random sample of open and closed accounts was reviewed at each location. Data for each account was collected for a period of 12 months preceding the date of the visit. The files of 450 borrowers were reviewed. The following loan data was collected:

- Loan date
- Due date
- Loan term in days
- Annual percentage rate (APR)
- Finance charge
- Amount financed

In addition, customer demographic information was compiled to determine the makeup of those using the service. Information collected included:

- Gender of customer
- Birth date of customer

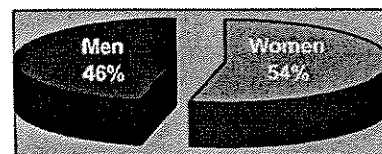
- Whether the customer rented or owned
- Income
- Occupation

The identities of the individual borrowers were not recorded as part of this study. The locations visited were across the state, in cities and towns of various populations.

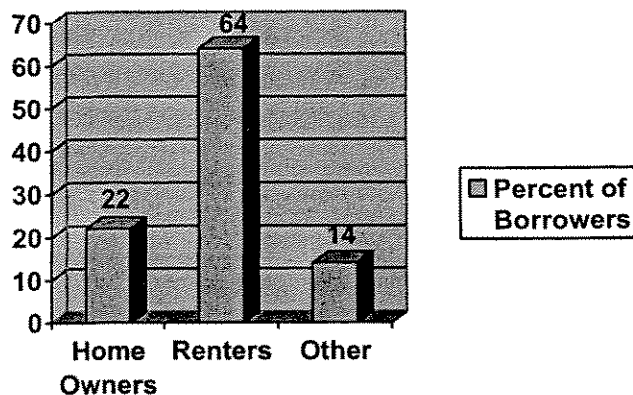
DEMOGRAPHIC ANALYSIS

Wisconsin Deferred Deposit Users		
Number of males/females taking out loans:		149 males, 172 females
Average age of borrowers:		39
Average annual individual income	229 Customers	\$18,675 (net income or "take home" pay)
	54 Customers	\$24,673 (gross income)
	38 Customers	Income was not reported
Number of borrowers who rent/own:		204 rent
		72 own their home
		45 did not report

DFI analyzed the demographic information of borrowers to determine who uses the deferred deposit services. Statistically, 54 percent of the payday loan borrowers were female, 46 percent were male. The average age of all borrowers was 39.



The income of borrowers was reported on loan applications in one of two different ways. The first, which was reported by 229 borrowers, was net-income, which is the average monthly take-home income (pay minus taxes or other deductions). The second was gross annual income, which was reported by 54



borrowers. For those 229 borrowers reporting net income, the average was \$18,675. For the 54 borrowers reporting gross income, the average was \$24,673. These averages do not reflect spousal or family income.

Of the 321 borrowers, 72 indicated that they own the home in which they live. This represents 22 percent of the sample. Over 60 percent, or 204 borrowers, indicated they were renters. The remaining 14 percent of the borrowers did not indicate a housing status.

LOAN DATA ANALYSIS

LOAN DATA	
Average Loan Term:	13.99 days
Average APR:	542.20 %
Average Finance Charge:	\$49.73
Average Loan Amount:	\$246.19

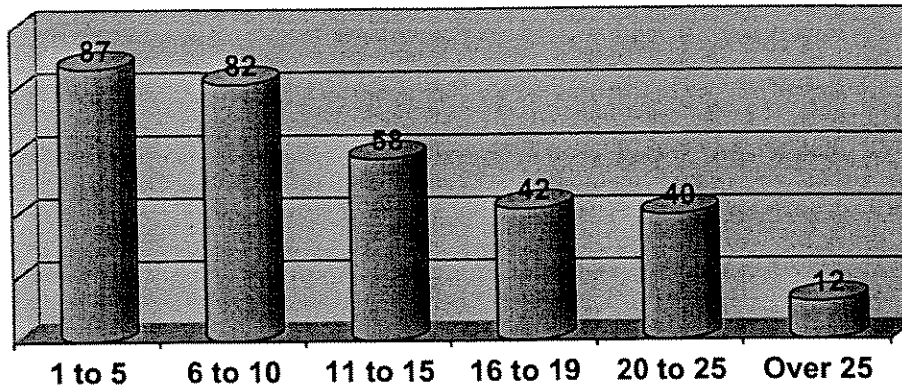
The average loan length among those reviewed is approximately 14 days. Most of the payday loan companies reviewed required all loans to be a 14-day period. The average disclosed annual percentage rate (APR) of all loans reviewed was 542.2 percent. The average finance charge was \$49.73, while the average loan amount was \$246.19.

On an average 14 day payday loan, the lender charged the customer \$20 for every \$100 borrowed. However, a shorter loan term results in a higher APR. For example, if a loan term is three days instead of the typical 14 days, a borrower could have a disclosed APR of over 1,000 percent. If the borrower pays the loan off early, the lender is required to refund the unearned portion of the finance charge.

DFI also analyzed the number of loans taken out by individual borrowers over a one-year period. This data includes loans that would be treated as "rollover" loans under the definition used in a subsequent section of this document.

Of 321 persons, there were 87 customers that took out one to five loans in the span of one year. There were 12 people in the sample that took out at least 25 loans in a twelve-month period. The highest number of loans taken out in a one-year period by an individual borrower was 30.

of loans per borrower - 12 month period

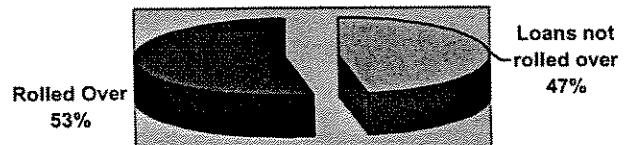


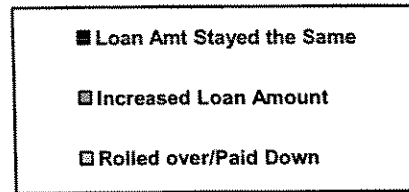
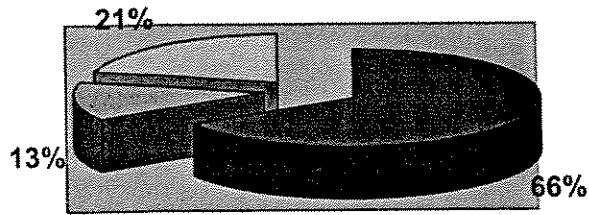
“ROLLOVER” DATA ANALYSIS

For the purposes of this study, a “rollover” is considered any loan that is paid off by the proceeds of a new loan or any loan that is paid off in full on the same day a new loan is taken out.

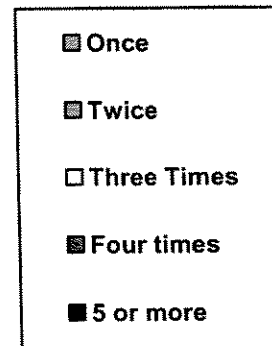
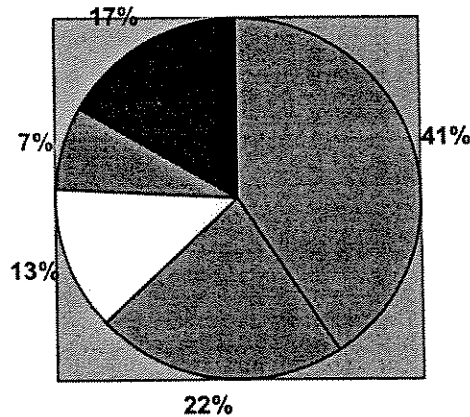
When the debtor uses the proceeds from a new loan to pay off their current loan, the debtor may choose to increase the amount of the new loan, decrease the amount of the new loan, or keep the amount of the new loan the same. If the amount of the loan remains the same, the debtor would only pay the finance charge earned on the first loan. For example, a customer may take out a \$200 loan for a two-week period. Typically, the finance charge on a loan of this size would be \$40. If the customer is unable to pay the loan off after two weeks, the customer takes out a new \$200 loan, pays \$40 for the finance charge on the first loan, and uses the loan proceeds from the new loan, \$200, to pay off the first loan. If the amount of the loan was increased, the debtor would not pay the full finance charge earned on the first loan. The amount of the new loan would be increased by the amount of the finance charge that was not paid on the first loan. If the amount of the loan was decreased, the debtor would pay the full finance charge earned plus an additional amount to reduce the amount of the loan.

Of the 3,678 loans that DFI analyzed for rollover data in the time frame studied, 1,947 or 52.94 percent were rolled over. In 404 of the 1,947 loans that were rolled over, or 21 percent, the borrower paid down the balance.





Of the loans that were rolled over, 41 percent of the loans were rolled over once, 22 percent were rolled over twice, and 17 percent were rolled over more than five times.



Of the 321 customers that DFI studied for rollover information, 133, or 38 percent rolled over a loan more than three times in a row.

OTHER STATE STUDIES

The Indiana Department of Financial Institutions looked at a total of 1,434 customers with loans totaling 17,075. A total of 13,189 of these loans were identified as rollovers for a rate of 77.2 percent. The average number of renewals per customer was 10.10. The average income of payday loan users was between \$25,000 to \$30,000 and the average cost of payday loans was \$30-33 per \$100 financed.

The Iowa survey found an average loan amount of \$239.23, an average loan term of 14.14 days and an average APR of 342.10 percent. According to a study conducted by the Public Interest Research Group and the Consumer Federation of America, the average interest rate on payday loans across the nation was 474 percent.

Indiana has no limit on rollovers; Iowa, theoretically, does not permit rollovers; and Illinois has a 3-rollover limit.

Wisconsin Pay Day Loan Centers studied have a significantly higher APR than neighboring Iowa.

CONCLUSION

While the "Review of Payday Lending in Wisconsin" yielded no surprising results, it has clarified a number of issues surrounding the practice of payday lending. First, the payday lending industry has significantly expanded since 1995 because of demand and other factors, not because of a lack of regulation. Second, the demographic analysis regarding those who use payday lenders indicate usage across a broad spectrum in terms of age and income. Third, 100 percent of those consumers in this study who have used payday lenders have checking relationships with depository institutions. Fourth, most consumers using payday lenders do not roll over their loans in excess of three times.

One of the myths surrounding this industry is the idea that it is unregulated and that it has grown only since the Wisconsin State Legislature took action to lift usury limits. It is important to understand that payday loans are considered "closed-end credit," which is a loan that has a specific end date. Wisconsin law eliminating interest rate caps on "open-end" credit, such as credit cards and home equity lines of credit, was effective on May 17, 1996. Limitations on closed-end credit, however, were repealed and effective as of October 31, 1984, almost ten years before Wisconsin licensed its first payday lender.

As pointed out in this study, payday lenders are licensed as "loan companies" and are regulated as stringently as any other loan company doing business in the State of Wisconsin. Consumers are also afforded additional protections, as payday lenders must comply with the Wisconsin Consumer Act, a series of state statutes that govern consumer credit transactions of \$25,000 or less. Payday lenders are also examined for compliance with loan company regulations and the Wisconsin Consumer Act.

The demographic analysis regarding those who use payday lenders indicate usage across the board in terms of age and income.

There is a myth that consumers who use payday lending services are "unbanked" and do not have access to other financial services. In fact, 100 percent of those in this study who have used payday lenders have checking relationships with depository institutions, as they must have a valid checking account through which they can secure a payday loan.

Finally, there is a perception that most consumers who use payday lenders become a victim of the "rollover," a loan that is paid off by the proceeds of a new loan or any loan that is paid off in full on the same day a new loan is taken out. In fact, while 53% of the transactions analyzed in this study were rolled over, only 24% of the loans rolled over were rolled over in excess of three times.