Big Interest Rates under the Big Sky: The Case for Payday and Title Lending Reform in Montana

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COMMENT

BIG INTEREST RATES UNDER THE BIG SKY: THE CASE FOR PAYDAY AND TITLE LENDING REFORM IN MONTANA

Jessie Lundberg*

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You load sixteen tons, and what do you get?
Another day older and deeper in debt.
Saint Peter, don't you call me, 'cause I can't go;
I owe my soul to the company store . . . .

I. INTRODUCTION

Easy money! Fast cash! No credit check required! Payday and title loans are a booming business, as the growing numbers of brightly colored shops attest. However, darker stories of financial devastation and unanswered questions hide behind the circus-like storefronts and catchy jingles. One question in particular demands an answer: are the loans a lifesaver for the borrowers who use them, or the straw that breaks their financial backs? The answer, of course, depends on whom you ask. The lenders tout themselves as benevolent friends to borrowers in need. Consumer advocates claim the lenders are wolves in sheep's clothing.

One thing is clear. While payday and title loans may indeed provide much-needed cash quickly, it is far from certain that they constitute easy money. Instead, the loans have several features that characterize them as "predatory," including extremely high interest rates, miniscule repayment times, little or no consideration of borrowers' abilities to repay the loan (underwriting), and requirement of one single "balloon" payment at the loan's end. Mounting evidence confirms that these features undermine borrowers' financial stability, which in turn increases demands on social service agencies, public assistance programs, and, ultimately, the taxpayer. Any fleeting benefit to borrowers quickly becomes a collective burden on the community and the state.

Consumer advocates across the country have responded by developing alternative loan programs, providing financial education, and raising public awareness about the dangers of payday and title loans. However, borrowers will continue to struggle with the loans' triple-digit interest rates and extremely short repayment terms until lawmakers fortify the existing payday and title loan laws with adequate consumer protections.

Part II of this Comment presents a short history and overview of payday and title lending in Montana and nationally. Part III explains the current Montana Deferred Deposit Lending Act and

2. Infra nn. 116-23 and accompanying text.
Montana Title Loan Act,4 and federal regulations applicable to state consumer protection efforts. Part IV outlines the ongoing battle between these lenders and consumer advocates, both of whom claim to have the best interests of consumers at heart. Part V provides specific recommendations as to how Montana's laws can better protect consumers from the potential abuses of payday and title loans.

II. SOME THINGS NEVER CHANGE: A BRIEF HISTORY OF PAYDAY AND TITLE LENDING

When it comes to payday and title loans, this isn’t exactly the nation’s first rodeo. The loans are a modern take on nearly identical high-interest, short-term loans that existed in various forms at the beginning of the twentieth century.5 “Salary lenders” and “wage buyers” bought workers’ upcoming wages at discounted rates—“five for six boys,” for example, paid borrowers five dollars in exchange for repayment of six.6 Other lenders offered to “buy” a borrower's vehicle and then “lease” it back to him, with repossession as the penalty for missing a lease payment.7 The worst of the lenders charged triple-digit interest rates, and society labeled them “loan sharks.”8

The first loan sharks sparked judicial scrutiny, public outrage, and legislative condemnation. At first, the lenders insisted the transactions were not loans and were thus outside the reach of usury laws, an argument echoed by their modern counterparts.9 However, in determining whether a transaction is a loan subject to usury laws, courts have long followed a judicial principle of sub-

6. Drysdale & Keest, supra n. 5, at 618; Bruch, supra n. 5, at 1267; Renuart & Keest, supra n. 5, at § 7.5.5.1, 292.
7. Drysdale & Keest, supra n. 5, at 619.
8. Id. at 620.
9. Chessin, supra n. 5, at 392; Bruch, supra n. 5, at 1268.
stance over form,\textsuperscript{10} with the aim to prevent “the betrayal of justice by the cloak of words, the contrivances of form, or the paper tigers of the crafty.”\textsuperscript{11} Thus, the courts frequently saw through the lenders’ facades and recognized the transactions as usurious loans.\textsuperscript{12}

Social service agencies, legal aid organizations, and labor unions countered the lending practices with charitable alternatives and public awareness campaigns.\textsuperscript{13} The Russell Sage Foundation, a philanthropic foundation devoted to research and improvement of social and living conditions, developed the first small-loan laws, and in 1916, the first draft of a Model Uniform Small Loan Act was issued.\textsuperscript{14} It recommended states rein in the small-loan industry by allowing a “high rate of return”—eventually fixed at 36% for small loans of $300 or less—in exchange for increased regulation.\textsuperscript{15} By 1930, every state but Arkansas had enacted small-loan laws, and the majority had adopted some version of the Model Act.\textsuperscript{16} Arkansas had already gone one step further: since 1874, the Arkansas State Constitution has contained specific usury provisions prohibiting lenders from charging interest of more than 17% per year on consumer loans.\textsuperscript{17} While the new laws allowed legitimate lenders to continue offering small loans at the lower interest rates, the laws branded the high-interest transactions as loans subject to state usury laws, and effectively drove the “loan sharks” out of business for several decades.\textsuperscript{18}

In the 1980s, however, deregulation of the banking sector spurred traditional financial institutions to flee the small-loan market in favor of larger loans that cost the bank the same amount to make, but provide much greater returns.\textsuperscript{19} At the same time, credit cards emerged as the primary source of personal credit for mainstream America.\textsuperscript{20} Consumers who could not ob-

\footnotesize{\textsuperscript{10} Drysdale & Keest, supra n. 5, at 637; Moss, supra n. 5, at 1744.  
\textsuperscript{11} Wilcox v. Moore, 93 N.W.2d 288, 291 (Mich. 1958) (holding that courts must “look squarely at the real nature of the transaction”).  
\textsuperscript{12} Chessin, supra n. 5, at 392 n. 21.  
\textsuperscript{13} Renuart & Keest, supra n. 5, at 38; Drysdale & Keest, supra n. 5, at 620; John Kilgore, Organization of Public Opinion for Effective Measures against Loan Sharks, 8 L. & Contemp. Probs. 173, 182 (1941).  
\textsuperscript{14} Renuart & Keest, supra n. 5, at 16; Drysdale & Keest, supra n. 5, at 621.  
\textsuperscript{15} Drysdale & Keest, supra n. 5, at 621.  
\textsuperscript{16} Id.  
\textsuperscript{17} Ark. Const. art. XIX, § 13(b).  
\textsuperscript{18} Drysdale & Keest, supra n. 5, at 621.  
\textsuperscript{19} Id. at 624–25; Pearl Chin, Payday Loans: The Case for Federal Legislation, U. Ill. L. Rev. 723, 727 (2004).  
\textsuperscript{20} Drysdale & Keest, supra n. 5, at 625.}
tain credit cards because of insufficient income or poor credit history were left to fend for themselves.\textsuperscript{21}

By the early 1990s, entrepreneurs smelled untapped profits in the dormant small-loan industry,\textsuperscript{22} and by 2000, over 10,000 payday lenders had opened their doors.\textsuperscript{23} They skirted usury laws by calling themselves “check-cashers” who merely deferred depositing the customer’s check.\textsuperscript{24} As state banking regulators began deciding the transactions were actually usurious loans, the payday and title loan industries worked overtime through the 1990s to convince state legislatures to exempt them from usury laws.\textsuperscript{25} Currently, thirty-six states have enacted laws specifically permitting payday lenders.\textsuperscript{26} Data regarding current state title loan laws are less widely available, but based on information available from state banking regulators in mid-2006, the author estimated fifteen states expressly prohibited title loans, twelve had no statutes yet either prohibiting or capping the loans, seventeen capped title loans at an annual percentage rate (APR) less than 100% (generally 36% or less), and six states (including Montana) had passed specific title loan acts allowing fees of 200% to 300% APR.\textsuperscript{27} Montana law exempts both payday and title lenders from

\begin{footnotes}
\footnote{21. Id.; Chin, supra n. 19, at 727.}
\footnote{22. Bruch, supra n. 5, at 1270.}
\footnote{23. Michael S. Barr, Banking the Poor, 21 Yale J. on Reg. 121, 149–50 (2004) (estimating that payday loan industry revenue exceeds $2 billion annually).}
\footnote{24. Chessin, supra n. 5, at 392.}
\footnote{25. Drysdale & Keest, supra n. 5, at 653–54; Amanda Quester & Jean Ann Fox, Car Title Lending: Driving Borrowers to Financial Ruin 10 (Ctr. for Responsible Lending/Consumer Fed. of Am. (CFA 2005).}
\footnote{27. The following states prohibit title lending: Colorado, Hawaii, Illinois, Indiana, Iowa, Louisiana, Maine, Massachusetts, North Dakota, Ohio, Oklahoma, South Carolina, Washington, West Virginia, and Wyoming. The following states have not enacted a title loan act and regulate any title lending under a small loan or other consumer loan act: Delaware, Idaho, Kansas, Missouri, Nevada, New Hampshire, New Mexico, Oregon, South Dakota, Utah, Virginia, and Wisconsin. The following states have a fee cap that limits title lenders to charging less than 100% APR, either under a title loan, consumer loan, or usury statute: Alaska, Arkansas, California, Connecticut, Florida, Kentucky, Maryland, Michigan, Minnesota, Nebraska, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, Texas, and Vermont. The following states have enacted title loan acts permitting title loan fees exceeding 200%: Arizona and Tennessee (204% to 264%); Alabama, Georgia, Mississippi, and Montana (300%).}
usury laws, and allows fees at the highest level enacted by any state in the country.\textsuperscript{28}

By 2001, a Consumer Federation of America (CFA) survey estimated that payday lenders alone were making about 65 million loans per year, with loan revenues exceeding $2 billion.\textsuperscript{29} Today around 22,000 payday lenders extend around $40 billion in loans per year, and it is estimated that over 15,000 title lenders operate in the United States.\textsuperscript{30} Only recently has the industry's growth begun to level off as the market has become saturated with competitors, which are increasingly associated with national chains and online lending.\textsuperscript{31}

III. \textbf{Is That \textit{Legal}? The Landscape of Payday and Title Lending in Montana}

\textbf{A. Background}

When the Montana State Legislature enacted the Deferred Deposit Lending Act in 1999 and the Title Loan Act in 2001, legislators probably believed they were doing consumers a favor. Prior to state regulation, payday and title lenders operated outside the reach of usury laws by characterizing their schemes as check-cashing rather than lending transactions.\textsuperscript{32} A better law seemed necessary.

Around this time, consumer advocates and the lending industry were quickly forming opposing camps, and each proposed its own version of model legislation. In 1998, the CFA and the National Consumer Law Center (NCLC) released model payday loan legislation that included consumer protection features like a 36% annual interest rate cap and two weeks of repayment time for every $50 of principal borrowed.\textsuperscript{33} In early 2000, the Community Financial Services Association of America (CFSA), a payday loan

\textsuperscript{28} Intra n. 84.
\textsuperscript{31} Quester & Fox, \textit{supra} n. 25, at 9–10.
\textsuperscript{32} Chessin, \textit{supra} n. 5, at 392.
\textsuperscript{33} Model Deferred Deposit Loan Act §§ 6(a), 8(b) (NCLC & CFA 1998) (available at http://www.consumerlaw.org/initiatives/payday_loans/paydayac.shtml).
trade association, unveiled its "model law," which recommended a fee of 20% of the loan amount, not to be "deemed interest for any purpose of law."34 (The proposed 20% fee, in the context of a two-week payday loan, amounts to an APR of 520%.)

The Montana Legislature enacted payday and title lending laws that more closely resemble the industry's model legislation than legislation encouraged by consumer advocates. The acts "capped" fees, but at 25% of the loan value,35 exceeding even the maximum fees proposed by the industry. Montana's cap is the highest allowed in the nation, equating to an APR of 300% for a thirty-day title loan and 650% for a two-week payday loan. With little data available regarding rates charged by lenders prior to the laws' enactment, it is not clear whether the new laws actually capped the fees or merely codified them.

In addition, the acts mandated short repayment terms because the industry claimed this would prevent the loans from being misused as long-term credit options.36 Consumer advocates argue that the industry skillfully presented one of the riskiest features of the loans, their extremely short repayment terms, as a "consumer protection" provision.37

B. The Montana Deferred Deposit Loan Act

Most discussions of payday and title loans begin with and center around payday loans, and this Comment will do the same. The controversy surrounding payday loans tends to overshadow that of title loans, because payday loans tend to be discussed first and in more depth. While some consumer advocates believe payday loans pose a higher risk of trapping borrowers in a cycle of debt,38 this Comment argues in the next section that title loans'...

34. Deferred Presentment Services Act § 113(q) (CFSA 2000) (proposed model legislation). Consumer advocates argue that regardless of whether the finance charge is characterized as interest, the federal Truth in Lending Act (TILA) clearly requires disclosure of all finance charges as an APR. Infra nn. 92–93.
38. Bruch, supra n. 5, at 1273 (suggesting title loan borrowers do not get trapped in a cycle of debt and can simply "walk away" from their vehicles, whereas payday loan borrowers face more serious consequences).
potential for wreaking financial devastation can equal or exceed that of payday loans.

In Montana, payday lenders achieved legislative approval first—the payday loan act was enacted in 1999, the title loan act in 2001. Payday lenders are also more prolific—116 payday lenders are currently licensed to operate in Montana, compared to forty-two title lenders.

Finally, the provisions of the payday loan act are much more extensive, and many general provisions reappear in the title loan act. In fact, many commentators consider title loans simply a variation on the payday loan scheme. Thus, an introduction to the payday loan act serves as an introduction to the title loan act as well.

In 1999, the Montana Legislature enacted the Deferred Deposit Lending Act (DDLA), authorizing a short-term, high-interest loan that has come to be commonly known as the payday loan. The DDLA states that its purpose is to "protect consumers who enter into short-term, high-rate loans with lenders from abuses that occur in the credit marketplace when the lenders are unregulated." Ironically, a closer look at its provisions raises the question whether it protects consumers from abuses now that lenders are regulated. The DDLA defines a deferred deposit loan as an arrangement, including all representations made by the deferred deposit lender whether express or implied, in which:

(a) a person accepts a check dated on the date on which the check is written and agrees to hold the check for a period of days prior to deposit or presentment;

(b) a person accepts a check dated subsequent to the date on which the check is written and agrees to hold the check for deposit or presentment until the date written on the check; or

(c) a person accepts written authorization from a consumer to electronically deduct from the consumer's account on a specific date the amount of the loan and fees that are authorized under this part.

The Federal Reserve Board similarly defines a payday loan as a credit transaction

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40. E-mail from Christopher Romano, Mont. Div. of Banking and Fin. Instn., to Author (Sept. 19, 2006) (copy on file with Montana Law Review).
41. E.g. Barr, supra n. 23, at 164.
44. Mont. Code Ann. § 31-1-703(5).
in which a cash advance is made to a consumer in exchange for the consumer's personal check, or in exchange for the consumer's authorization to debit the consumer's deposit account, and where the parties agree either that the check will not be cashed or deposited . . . until a designated future date.\textsuperscript{45}

For a consumer, the key factors in any loan are its principal, repayment term, and finance charge. The DDLA authorizes a licensed payday lender to provide loans of up to $300 in principal, not including the loan fee.\textsuperscript{46} While relatively small in amount, a payday loan also has a very short repayment term, which cannot exceed thirty-one days.\textsuperscript{47} However, payday lenders frequently use an average loan term of only fifteen days.\textsuperscript{48} This ostensibly allows the borrower to repay the loan with his or her next paycheck (hence the name "payday loan").

A payday lender may charge a "loan fee" of up to 25\% of the loan principal, or $75 for a $300 loan.\textsuperscript{49} The fee percentage is the same regardless of whether the loan term is seven days or thirty-one days. For a typical two-week loan, the allowable finance charge translates to an APR of 650\%.

When the loan is due, the borrower has two options. She can pay it off, or she can allow the lender to present the check or electronic debit against her checking account for payment. If she has the funds to pay off the loan, either in hand or in the bank, the options are equivalent.

If she does not have the money to pay off the loan, or perhaps has some money but needs it to pay some other expense, she faces a more difficult choice. If she does not repay the loan, the lender will present the check or debit for payment, and may charge a non-sufficient funds fee of $30.\textsuperscript{50} Of course, the financial institution may also charge its own fee, and possibly close the borrower's checking account. If, after several attempts, the lender is unable to obtain payment through the check, it can then seek repayment


\textsuperscript{46} Mont. Code Ann. § 31-1-715(2). For a licensing fee of $375, and a $125 annual renewal fee, one may become a licensed payday lender. Mont. Code Ann. §§ 31-1-705(2), -706(1).

\textsuperscript{47} Mont. Code Ann. § 31-1-715(1).

\textsuperscript{48} Chessin, supra n. 5, at 406.

\textsuperscript{49} Mont. Code Ann. § 31-1-722(2).

\textsuperscript{50} Mont. Code Ann. §§ 31-1-722(3), -722(4).
through a collection agency or a court judgment, adding collection and legal fees to the borrower's growing tab.\(^5\)

Alternatively, the borrower can "rob Peter to pay Paul." For example, she can pay off the loan with money earmarked for rent, then turn around and take out another payday loan to pay the rent. Montana law specifically prohibits "roll-overs" or any payment of existing payday loans with proceeds of a new loan.\(^6\)

However, lenders have thus far managed to skirt the law with back-to-back transactions that exact the same high cost from the borrower.

\section*{C. The Montana Title Loan Act}

In 2001, two years after authorizing payday lending, the Montana Legislature enacted the Montana Title Loan Act (TLA),\(^5\) permitting a second form of high-interest, short-term loan. The TLA defines a title loan as "a loan secured by an unencumbered state-issued certificate of title or certificate of ownership to personal property, with an original term of 30 days."\(^6\)

The TLA also purports to protect consumers.\(^5\) Yet, like payday loans, title loans require no underwriting and allow triple-digit APRs.\(^6\) Like payday lenders, title lenders may also charge a monthly finance fee of up to 25\% of the loan amount, at least for the first $2,000 loaned; higher amounts are subject to slightly reduced rates.\(^7\) Whereas payday lenders frequently elect to use a shorter term of around fifteen days, title loans generally use a thirty-day term, which is the maximum allowed by law.\(^8\) Based on this thirty-day term, a title lender may charge an APR of over

\begin{itemize}
  \item \(^5\) Mont. Code Ann. § 31-1-722(5).
  \item \(^6\) Mont. Code Ann. §§ 31-1-723(6), -722(13), -722(15).
  \item \(^7\) Mont. Code Ann. § 31-1-801.
  \item \(^8\) Mont. Code Ann. § 31-1-803(8).
  \item \(^9\) Mont. Code Ann. § 31-1-802 ("The purpose of this part is to protect consumers who enter into short-term, high-rate loans with lenders from abuses that occur in the credit marketplace when the lenders are unregulated.").
  \item \(^10\) Quester & Fox, supra n. 25, at 4–6.
  \item \(^11\) Mont. Code Ann. § 31-1-817(a). Any portion of a loan over $2,000 but less than $4,000 is subject to 18\% interest per thirty-day period, which is equivalent to an APR of 216\%. Any portion of a title loan over $4,000 is subject to 10\% interest per thirty-day period, which is equivalent to an APR of 120\%. Mont. Code Ann. §§ 31-1-817(b), -817(c).
  \item \(^12\) Mont. Code Ann. § 31-1-803(8). As noted above, the industry argues that the short term is necessary to "protect" borrowers from abusing the loans, which are only intended to provide a short-term form of credit. Otherwise, the loans' expensive finance charges would begin to look more like the triple-digit interest rates consumer advocates argue they are.
\end{itemize}
300%. Although the statute sets no limit on the amount a title lender may lend, national studies suggest most title lenders stick to a conservative percentage of the securing vehicle’s value, often one-third, in order to ensure sufficient collateral should the borrower default.

Title loans can be every bit as disastrous as payday loans. The borrower risks losing a vehicle that he owned free and clear, and transportation he may need for his employment. As with payday loans, the short repayment term and lack of underwriting used in title loans increase the likelihood that a borrower will be unable to repay a title loan when it is due. As the repayment term of a title loan cannot exceed thirty days regardless of the amount borrowed or the borrower’s income, a borrower who earns $2,000 per month could receive a title loan of $500 or more with full payment due in one month. With uncanny foresight toward just such a predicament, the TLA allows for up to five “renewals” on a title loan in which a customer is required to pay another finance charge but not any part of the principal. In exchange, he is given an extension of one more month for each additional finance charge paid. Thus, a title loan can essentially be an “interest-only” loan for up to six months. Beginning with the sixth renewal, either the customer must pay at least 10% of the principal per month, or the lender must reduce the amount of principal each month by 10% of the original principal, solely for the purpose of calculating the finance charge.

A hypothetical more clearly illustrates the long-term possibilities of a title loan (see Table 1). A borrower who borrows $2,000 on January 1, 2007, may be charged a finance fee of 25% of the principal, or $500. If she cannot repay the $2,000 by February

59. Approximate APR based on a 25% finance fee per thirty-day term, multiplied by twelve terms per year. Because there are actually 12.17 thirty-day terms in a 365-day year, the exact maximum APR is 304.17%.
60. Mont. Code Ann. § 31-1-817(c).
61. Barr, supra n. 23, at 164; Quester & Fox, supra n. 25, at 5.
62. Quester & Fox, supra n. 25, at 8.
63. Barr, supra n. 23, at 166; Quester & Fox, supra n. 25, at 6.
64. Mont. Code Ann. § 31-1-803(8).
67. Id.
1, she can renew the loan by paying another month’s finance fee, or another $500. Of course, any renewal is solely at the option of the lender, who may instead demand payment in full. However, it clearly serves the lender’s financial interest to allow the renewal: if the borrower renews five times (February through June) as allowed by statute, she will have paid $3,000 in finance fees (including the first month’s finance charge), and still owe the entire principal.

On July 1, 2007, the lender must begin reducing the principal each month by 10% of the original principal, or $200, when calculating the interest (although the entire principal amount is still owed by the borrower). What if the borrower can only pay the required interest payment? Ten months later, in April of 2008, the borrower will have paid a total of $5,250 in finance fees over a period of sixteen months. The borrower will also still owe $2,000, the principal amount of the original loan.

Finally, the TLA also contains a provision specifying it does not apply to pawnbrokers. The title lending industry interprets this provision to mean that a title lender may call itself a pawn shop or title pawn and escape regulation under the TLA. Consumer advocates argue that the exemption clearly applies only to traditional pawn transactions in which the pawned vehicle is left in the possession of the pawnbroker.

**D. But What about the Usury Law?**

For over 5,000 years, since the earliest recorded credit transactions, society has been concerned with lenders charging interest rates it perceives as too high. The first major codification of Roman law capped interest rates at about 8% per year, which was

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69. Id.

70. Mont. Code Ann. § 31-1-802(3).

71. Barr, supra n. 23, at 165 (title lenders claim advantages under pawnbroker laws despite differences between the loans).

72. Id.

73. Renuart & Keest, supra n. 5, at 42.
TABLE 1

<table>
<thead>
<tr>
<th>Month</th>
<th>Renewal</th>
<th>Principal Owed</th>
<th>Principal for Purpose of Calculating Interest</th>
<th>Finance Fee Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$500</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
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</tr>
<tr>
<td>16</td>
<td>15</td>
<td>$2,000</td>
<td>-0-</td>
<td>-0-</td>
</tr>
</tbody>
</table>

At 16 months: Principal Owed: $2,000 Total Finance Fees Paid: $5,250

raised to 12% about 400 years later, in 88 B.C.E. Blackstone explained

[I]n calculating the rate of interest, the Romans divided the principal sum into a hundred parts, one of which they allowed to be taken monthly; and this, which was the highest rate of interest permitted, they called usurae centesimae, amounting yearly to twelve per cent. 75

This rate remained in effect for centuries and was adopted by the later Roman Empire and the Byzantine Empire in Constantinople. 76 Blackstone later wrote of England's usury statute permitting interest of 5% per year, and commented that


75. William Blackstone, Commentaries vol. 2, *373 n. m.

76. Homer & Sylla, supra n. 74, at 47, 49.
Irish, American, Turkish, and Indian interest, have been allowed in our courts to the amount of even twelve per cent: for the moderation or exorbitance of interest depends upon local circumstances; and the refusal to enforce such contracts would put a stop to all foreign trade.\(^\text{77}\)

Thus, an annual interest rate of 12\% (modest compared to today's consumer lending rates) was viewed as a necessary evil enforced only to maintain foreign trade. The early American colonies followed suit, enacting interest rate caps from 4\% to 10\%.\(^\text{78}\) Today, Congress defines usury as the charging of an interest rate greater than that allowed by statute.\(^\text{79}\)

Upon hearing an explanation of Montana's payday and title lending laws, the public generally asks two questions: "Is that legal?" and, after the affirmative answer, "But what about the usury law?" As many Montanans are aware, state usury law prohibits a lender from charging an interest rate above 10\% per year.\(^\text{80}\) However, few realize it contains two loopholes so sizeable as to render it largely irrelevant in the context of consumer lending.

First, it allows parties to circumvent the law and agree to an interest rate up to "15\% or an amount that is 6 percentage points per annum above the prime rate of major New York banks," so long as they do so in writing.\(^\text{81}\) The second exception specifically prohibits application of the usury rate to "regulated lenders."\(^\text{82}\) Regulated lenders include banks, credit unions, savings and loan companies—any entity engaged in the business of lending.\(^\text{83}\)

When the Montana Legislature enacted the DDLA and the TLA, payday lenders and title lenders became regulated lenders exempt from state usury statutes.\(^\text{84}\) The Montana Department of Administration's Division of Banking and Financial Institutions (Division of Banking) licenses, examines, and oversees the lenders,\(^\text{85}\) and the legislature sets the rates of interest regulated lenders may charge. Thus, the disappointing yet inevitable conclusion is that the usury statute applies only to non-commercial lenders and provides no protection when it comes to regulated lenders like payday and title lenders.

\(^{77}\) Blackstone, supra n. 75, at *374.
\(^{78}\) Peterson, supra n. 74, at 844.
\(^{81}\) Mont. Code Ann. § 31-1-107(1).
\(^{82}\) Mont. Code Ann. §§ 31-1-107(3), -112(1).
\(^{83}\) Mont. Code Ann. § 31-1-111(1).
\(^{84}\) Mont. Code Ann. §§ 31-1-702(2), -802(2).
\(^{85}\) Id.
E. Federal Regulations Affecting Payday and Title Lending

To date, Congress has not passed any comprehensive laws regulating payday and title lenders, leaving states scrambling to piece together regulatory frameworks. Nonetheless, federal legislation and regulation have significantly impacted state consumer protection efforts regarding these lenders. Three examples are critical in understanding the current regulatory scheme: the federal Truth in Lending Act (TILA), oversight attempts by the Office of the Comptroller of the Currency (OCC), and Congress’s recent move to protect military personnel from predatory payday and title loans.

1. The Truth in Lending Act

Congress originally enacted TILA in 1968 as part of the Consumer Protection Act. TILA’s purpose is “to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit,” and to protect the consumer against inaccurate and unfair credit billing.

The Federal Reserve Board has implemented TILA’s consumer credit provisions through Regulation Z, which instructs lenders regarding compliance with TILA. Regulation Z applies to any individual or business that regularly offers personal, family or household credit to consumers for a finance charge.

Because payday and title lenders meet these criteria, the regulation requires that they disclose certain information to their borrowers, including the lender’s identity, the amount financed,
the finance charge, and the APR.\textsuperscript{92} Courts have generally agreed that TILA applies to payday and title loans.\textsuperscript{93}

Under Regulation Z, creditors must make disclosures "clearly and conspicuously in writing, in a form that the consumer may keep."\textsuperscript{94} The regulation requires that disclosures "shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under § 226.18."\textsuperscript{95} Finally, "[t]he terms 'finance charge' and '[APR]' . . . shall be more conspicuous than any other disclosure, except the creditor's identity under § 226.18(a)."\textsuperscript{96}

2. Interest Rate Exportation

The National Bank Act allows a national bank to "export" the interest rate permitted by its home state to any other state where it does business, preempting the other state's laws restricting interest.\textsuperscript{97} Likewise, federally insured depositories claim a similar right to export interest rates regardless of individual states' consumer protection laws,\textsuperscript{98} because the Depository Institutions Deregulation and Monetary Control Act requires that those depositories (including state-chartered institutions) participate on a "level playing field" with national banks.\textsuperscript{99}

The OCC has not officially preempted the field of regulating national banks' lending activities. However, it has "asserted a virtually unlimited power to override state laws" so that banks may operate unfettered by state restrictions.\textsuperscript{100} The OCC's rules of

\textsuperscript{92} Id. at § 226.18. Whether the lenders actually give the disclosure is a different issue. One national study found that less than one third of payday lenders provided an even approximately accurate APR disclosure on charts or brochures, and only 21% provided a verbal APR disclosure upon a customer's request. Fox & Mierzwinski, supra n. 29, at 14.

\textsuperscript{93} E.g. Yarnall v. Four Aces Emporium, Inc., 322 B.R. 422, 426 (Bankr. App. 9th Cir. 2005).


\textsuperscript{95} Id.

\textsuperscript{96} Id. at (a)(2).

\textsuperscript{97} 12 C.F.R. § 7.4001(b); 12 U.S.C. § 85 (2000) (defining permissible rate of interest as that allowed in the state where a bank is "located"); Marquette Natl. Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 301 (1978) (holding that a bank may "export" the usury law of the state in which it is headquartered to customers in another state where it does business).

\textsuperscript{98} Drysdale & Keest, supra n. 5, at 646.


\textsuperscript{100} Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1908 (Jan. 7, 2004) (codified at 12 C.F.R. pts. 7, 34); Arthur E. Wilmarth, Jr., The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the
preemption override any state law that applies to a national bank or its subsidiaries, unless Congress has expressly incorporated a state law standard into a federal statute, or the state law is of a general nature, like contract, tort, or criminal law. This far-reaching view of the OCC's authority has been criticized as contradictory to Supreme Court jurisprudence, Congressional policy intended to maintain a competitive balance between state and national banks, and the doctrine of sovereign state power set forth in the Tenth Amendment to the United States Constitution.

When payday lenders began partnering with national banks in order to gain the protection of these federal laws, consumer advocates were highly concerned with what they viewed as a “rent-a-bank” lending scheme. When the OCC declared in 2003 that it completely preempted Georgia's application of state predatory mortgage lending laws to national banks operating in the state, consumer advocates feared the OCC would extend similar protection to the payday and title lending partnerships with banks. Instead, the OCC began issuing warnings to national banks to cease partnering with payday and title lenders, or face heightened scrutiny and possible penalties. National banks have had little choice but to ease out of the payday and title lending industry, although states' hands may remain tied with regard to predatory mortgage lending.

3. Military Personnel Exemption

In a partial victory for consumer advocates, Congress recently acted to protect military personnel from high-interest payday and title loans by including a 36% APR cap and other consumer protection provisions in the Department of Defense authorization bill for fiscal year 2007. In addition to the cap, the bill bans mandatory arbitration clauses, prepayment penalties, and lenders' use of service members' checks as security for loans. Congress approved the protections in response to Pentagon concerns that the loans

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101. Wilmarth, supra n. 100, at 235.
102. See generally id.
103. Fox & Mierzwinski, supra n. 29, at 3.
106. Id.
targeted young, financially vulnerable military personnel, and affected military readiness by hampering security clearances and hurting morale.107

These provisions are not new ideas but have been promoted by consumer advocates for years to protect all consumers from the most predatory features of payday loans. It remains to be seen whether the concerns that spurred this federal legislation will result in extension of the same protections to all consumers. In many states, military personnel and their families are among the most financially vulnerable citizens.108 In Montana, where the median household income hovers at around 80% of that earned nationally,109 civilian households struggle alongside their enlisted neighbors to get by from month to month.

To date, Congress has stepped in to protect only military families, in recognition of the great sacrifices and financial pressures they face. In Montana, we now face the question whether we want lending practices that Congress has condemned as abusive to military personnel to continue for teachers, nurses, construction workers, and the rest of Montana’s citizens.

IV. REINING IN HIGH-COST PAYDAY AND TITLE LENDING IN MONTANA

Consumer advocates and lenders agree on one thing: payday and title loans are in high demand, as evidenced by the explosion of payday and title lending businesses since their legalization in several states.110 However, when the conversation turns to regulating the loans, advocates and lenders rarely see eye to eye. Lenders characterize consumer protection efforts as paternalistic and meddling, claiming consumers should be free to choose their own financial products.111 Consumer advocates counter that the loans are designed to trap borrowers in a cycle of debt, and can be

108. Steve Tripoli & Amy Mix, In Harm’s Way—At Home: Consumer Scams and the Direct Targeting of America’s Military and Veterans 8 (NCLC 2003) (estimating that nearly 75% of all active-duty military personnel earn from $20,000 to just over $30,000 per year).
110. Fox & Mierzwinski, supra n. 29, at 6.
so financially detrimental that consumers are better off without them.

Lenders also point to the low number of complaints received by state regulatory agencies as evidence the loans are not as problematic as consumer advocates claim.\(^\text{112}\) However, the low numbers of complaints received by state lending regulators does not mean the loans are problem-free. Borrowers may not know where to complain, and may not be sufficiently aware of applicable lending laws to know whether their rights were violated. Some borrowers are hesitant to seek help because of the stigma attached to admitting financial problems. In addition, many of the most problematic characteristics of the loans are currently legal under state laws, and thus do not form the basis for a complaint.

Regardless, consumers are complaining, just not to the Division of Banking. They complain to social workers, credit counselors, housing agencies, and other social services. A fifty-two year old Billings man seeking assistance from a social service agency wrote,

> Once you get locked in to those places it’s extremely hard to get out of them. It took my whole Social Security check each month to pay them which left me with nothing so I had to go back to them every month so I could pay my rent and household expenses. The ones mostly using these places are the ones who can afford it the least.\(^\text{113}\)

A husband and wife from Kalispell who needed emergency housing assistance wrote,

> We were told that the loan would be due in two weeks . . . [t]he payday lender cashed our check after holding it for only a week. We do not know how they did this, but . . . when our landlord went to cash our rent check, it would not clear because there wasn’t enough money left in the account. Instead, our family was evicted . . . [w]e found ourselves homeless . . . .\(^\text{114}\)

A registered nurse from Missoula who took out a payday loan to cover expenses after an injury wrote,

> [P]ayday came around again and I didn’t have the money to cover expenses plus the loan with interest . . . so I decided to get another loan. I was so nervous that they wouldn’t give one to me if they knew I had one already [but] the next service didn’t ask, they simply handed me another $300. I ended up with 7 payday loans equaling . . . [over] $900 a month in interest . . . I am drowning. I feel humiliated and devastated by this situation. I am working on pay-
ing each loan down $50 each payday...I think I have paid over $6,000 in interest on these loans.\textsuperscript{115}

The loans negatively affect not only individual consumers, but extend to entire communities and the taxpayer as well.\textsuperscript{116} When borrowers become trapped in a cycle of expensive loan renewals, society foots the bill in several ways. Borrowers who use high-interest loans are more likely to prioritize payment of those loans, meaning they will generally be paid before low- or no-interest loans, utilities, or rent.\textsuperscript{117} The loans also discourage savings, both by providing a seemingly easy solution in case of emergency, and by reducing borrowers' disposable income that could otherwise be put into savings.\textsuperscript{118} Lack of savings in turn requires society to subsidize services that the individual could otherwise pay for, like retirement, education, and health care.\textsuperscript{119}

Rising levels of consumer debt have contributed to increasing consumer bankruptcies, which deprive legitimate creditors of payment while requiring taxpayers to pay for the increased administrative costs incurred when lenders and debtors seek judicial resolution of their debts.\textsuperscript{120} In 2005, Congress attempted to address this problem by passing the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which imposes financial counseling requirements on debtors who wish to file for bankruptcy, and requires those earning more than their state's median income to file under a Chapter 13 repayment plan.\textsuperscript{121} However, for many payday and title loan customers, the new law does not affect their ability to file for bankruptcy at all, other than the counseling requirement. Under BAPCPA, debtors earning less than their state's median income may still wipe out their consumer debts through a Chapter 7 bankruptcy.

Predatory payday and title loans also undermine public assistance and income tax refund programs by trapping the borrower in high-cost debt and diverting part or all of the taxpayer-funded benefit away from the intended recipient, directly into the lender's

\begin{itemize}
  \item \textsuperscript{115} Letter on file with Author.
  \item \textsuperscript{116} Diane Hellwig, Student Author, \textit{Exposing the Loansharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense}, 80 Notre Dame L. Rev. 1567, 1578 (2004–2005) (arguing government should increase regulation of the consumer credit market to prevent society from bearing the burden of inefficient decision-making and resource allocation by individual consumers).
  \item \textsuperscript{117} \textit{Id.}
  \item \textsuperscript{118} \textit{Id.}
  \item \textsuperscript{119} \textit{Id.} at 1580.
  \item \textsuperscript{120} \textit{Id.} at 1579.
  \item \textsuperscript{121} Pub. L. No. 109-8, 119 Stat. 23 (2005).
\end{itemize}
pocket. In return, the individual receives only a small temporary benefit, if any, and society as a whole receives a reduced benefit for the money it has invested in state and federal programs like Temporary Assistance for Needy Families and the Earned Income Tax Credit.\footnote{122. Cf. Hellwig, supra n. 116, at 1580.}

Finally, struggling borrowers rely heavily on community services to stay afloat. While official complaints against payday and title lenders may be few, beneath the radar their customers turn to social service organizations to provide assistance with food, clothing, rent, and mortgage payments. Anecdotal evidence suggests payday and title loan customers express a strong sense of obligation to repay those debts, to the extent they would rather seek assistance from social services than renege on their agreements with the lenders.\footnote{123. For example, in 2003, an elderly couple came into the non-profit office where the author provided foreclosure prevention assistance. While going through their monthly expenses, they reported that they were paying $300 per month to a payday lender. When the author offered to contact the lender to request an extended repayment plan, as was routine for homeowners in foreclosure, the couple dismissed the suggestion, saying, “They are always nice to us. It’s the mortgage company that calls us and harasses us.” The couple was four months delinquent on their mortgage payment. They ended up signing their home back over to the lender in a last ditch “deed-in-lieu” transaction to avoid foreclosure. To the author’s knowledge, they never missed a payment to the payday lender.}

However, service-providing non-profits generally survive on a hard-won mixture of funding from state and federal government and charitable organizations, sources of funding that largely originate in the taxpayer’s pocket. Whether we like it or not, the strain caused by predatory lending has a ripple effect that spreads through the entire community.

In August 2003, community development and social service agencies around Montana perceived a growing problem in the number of clients they were serving who were struggling with predatory loans, including payday and title loans. In response, the agencies convened the Montana Alliance for Responsible Finance (MARF), which has grown to seventeen organizations across the state.\footnote{124. Members include AARP, Beartooth Rural Conservation and Development, Inc., Billings Community Housing Resource Board, Consumer Credit Counseling Service of Montana, Family Service, Inc., Helena Area Housing Task Force, homeWORD, Montana Credit Unions for Community Development, Montana Fair Housing, Montana Homeownership Network, Montana Legal Services Association, Montana Women Vote, Neighborhood Housing Services of Great Falls, North Central Montana Rural Conservation and Development Area, Inc., Women’s Opportunity and Resource Development (WORD), Working for Equality and Economic Development (WEEL), and YWCAs of Montana. Points of Interest (newsltr. of MARF) 1 (Summer 2005) (copy on file with Montana Law Review).} MARF adopted a three-pronged approach for
addressing predatory lending practices in Montana: (1) provide consumer education and outreach to raise public awareness regarding the dangers of predatory lending; (2) develop and promote affordable community-based alternatives; and (3) increase the effectiveness of state lending laws to better protect consumers from predatory lending practices.  

While this Comment focuses on legislative recommendations, changing existing laws alone is not sufficient. Consumers need affordable options for short-term credit. Mainstream financial institutions like banks and credit unions use underwriting criteria that pose several barriers for many borrowers, including the ability to pass a credit check, maintain an open account, and most importantly, repay the loan.  

While these barriers are intended to minimize losses rather than shut anyone out of the financial services market, they nonetheless deny credit to borrowers with lower incomes and credit problems. For better or worse, payday and title lenders have stepped in to fill the void.  

Consumer advocates argue that traditional financial institutions like banks and credit unions must develop and offer their own versions of payday and title loans in order to increase consumer choices and drive finance fees down. Competition from larger lenders is essential because increased competition between payday and title lenders has had little effect on loan fees. Economists predicted that as numbers of payday and title lenders increased, interest rates charged for these services would fall, but they have not. Real competition in the industry from mainstream lenders may reduce interest rates to a level that is profitable for lenders and affordable for borrowers.  

Both nationally and in Montana, credit unions have increasingly stepped up to the plate by developing affordable alternative loan products for their members. For example, Montana Credit

125. MARF Objectives, Points of Interest (newsltr. of MARF) 4 (Summer 2005).
126. E.g. generally Barr, supra n. 23.
127. Id. at 124.
128. Id.
129. Chin, supra n. 19, at 740–41.
130. Id.; Chessin, supra n. 5, at 408–09.
131. Chin, supra n. 19, at 741.
132. Michael Bertics, Fixing Payday Lending: The Potential of Greater Bank Involvement, 9 N.C. Banking Inst. 133, 134 (2005) (arguing payday lenders are collecting “economic rent” and banks’ entry into the market would create a new equilibrium that would extinguish that rent).
133. Colleen Kelly, Credit Union National Association, CUNA’s Alternatives to Payday Lending Task Force 3–4 (available at http://www.cuna.org/download/alternatives_hand-
Unions for Community Development has developed an affordable small-loan product to be offered through credit unions, which is being piloted in the Helena area.\footnote{E-mail from Jeanne Saarinen, Exec. Dir., Mont. Credit Unions for Community Dev., to Author (Oct. 18, 2006) (copy on file with Montana Law Review).}

Consumers also need basic financial skills so they may effectively manage their finances and evaluate their credit options. The Montana Financial Education Coalition (MFEC), an organization dedicated to promoting financial health for Montanans of all ages through personal financial education, incorporated in 2005.\footnote{Mont. Fin. Educ. Coalition, About Us, http://www.mtmfec.org/aboutus.asp (accessed Feb. 23, 2007).} MFEC-affiliated organizations across the state, including several MARF members, have implemented regular financial education programs aimed at teaching the knowledge and skills necessary for personal financial health. Most of these organizations use nationally recognized financial education curricula, all of which include modules on the dangers of high-interest loan products like payday and title loans.\footnote{E.g. FDIC, Money Smart, http://www.fdic.gov/consumers/consumer/moneysmart/overview.html (accessed Feb. 23, 2007); NeighborWorks Am., Financial Fitness, http://www.nw.org/network/neighborworksprogs/financialfitness/default.asp (accessed Feb. 23, 2007).}

Finally, community service providers need a better understanding of payday and title loans in order to help their struggling clients. Communities were somewhat blind-sided by the rapid appearance of payday and title lenders offering relatively new financial products with ramifications which are not yet well understood by consumers or the general public. In 2005, MARF provided statewide training for service providers concerning how to help clients struggling with payday and title loans.\footnote{MARF, Caught in the Trap: How to Help Clients Struggling with Payday and Title Loans (Aug. 2005) (workshops provided by Consumer Credit Counseling Serv. of Mont., Mont. Legal Serv. Assn., and homeWORD).} Over 100 individuals from twenty Montana communities attended.\footnote{Registration records on file with Author.}

Consumer advocates in Montana have made headway in developing alternative small-loan products and raising the awareness of consumers and communities regarding the pitfalls of predatory lending. However, stronger state regulations are necessary to prevent consumers from becoming trapped in predatory loans in the first place.
V. THE FINAL PIECE OF THE SOLUTION: LEGISLATIVE RECOMMENDATIONS

The Montana State Legislature has the opportunity and the responsibility to enact state laws that protect consumers from predatory payday and title lending practices. The payday and title lending industries lobbied aggressively to get laws on the books that look like regulation but actually do little more than legalize loan sharking. Now state legislators need to revisit the key consumer protection provisions that consumer advocates have consistently argued are necessary to adequately protect borrowers.

At the national level, Congress recently enacted most of these provisions for all enlisted military personnel to protect service members and their families from the most abusive of the lenders' practices. Although the Montana Attorney General’s office and consumer advocates introduced similar legislation at the 2007 legislative session, the legislature has yet to extend these basic protections to all Montana borrowers. The following provisions would ensure that the DDLA and TLA actually serve their stated purpose of protecting consumers.

Cap fees at an annual percentage rate of 36%. Regardless of how serious a borrower's financial crisis is, desperation cannot justify an APR of 300% for a title loan, or 650% for a payday loan. In fact, the greater a borrower's financial need, the less likely he will be able to repay such an expensive form of credit. Loans that actually worsen a borrower's financial situation do not benefit anyone except the lender.

The lenders acknowledge that their loans are more expensive than traditional forms of consumer finance, but argue that for the occasional borrower, the loan is a welcome alternative to the fees

139. Supra nn. 25, 37 and accompanying text.
140. Supra n. 105 and accompanying text.
141. Recommendations adapted from draft legislation prepared by the author for the Montana Attorney General's Office in 2006 and based on model legislation prepared by NCLC (Model Deferred Deposit Loan Act, supra n. 33).
142. As of February 23, 2007, the 2007 Montana Legislature had tabled two bills attempting to cap payday and title loan interest rates. HB 29, which included many of the consumer protection provisions recommended in this Comment, was tabled in the House Business and Labor Committee on January 19, 2007. A narrower Senate bill, SB 455, attempted only to cap the interest rates at 36% per year and was tabled in the Senate Business, Labor, and Economic Affairs Committee on Feb. 21, 2007.
charged for returned checks and late payments.143 In support of this argument, the industry cites statistics showing that 70% to 80% of customers take out about one loan per month or less, as proof that most of its customers use the loans “responsibly.”144

Not only does such an argument imply the loans are an inherently dangerous product that must be used “responsibly,” it is far from clear how monthly use of a loan product with a triple-digit interest rate is “responsible.” Payday and title lenders actually advertise heavily that their loans will enable borrowers to take vacations with their friends, pamper themselves, or splash on gifts or other purchases.145 The lenders encourage instant gratification in their advertising, then turn around and insist to legislators that they are providing a critical service to borrowers who may not otherwise be able to obtain “emergency” credit. Whether the loans are for impulse purchases or basic necessities, the fact remains that too many borrowers find that the loans are not a one-time stopgap measure. Rather, they become a revolving door of debt, a situation upon which a large percentage of the lenders’ profits depends.146

Lenders also argue that the risks associated with payday and title loans are far greater than those associated with traditional loan products, and thus justify the much higher interest rates charged.147 However, the industry’s justification of higher fees based on higher expenses and risks does not hold up to available statistics. In a Colorado study, payday lenders reported an average charge-off rate of 3.34% of total loans between 1996 and 2004.148 During the same period, the Federal Reserve reported an average charge-off rate of 5.15% for credit cards and 2.69% for all consumer loans.149 The industry reports gross margins of 30% to

144. Id.
145. E.g. Golden Title Loan, Advertisement, Missoula Indep. “Fresh Facts” (Fall 2006) (a publication targeting new and returning university students, offering to “pamper your wallet” to allow a “weekend getaway”).
146. Barr, supra n. 23, at 157.
147. Chessin, supra n. 5, at 408.
148. Id.
45% of revenue (approximately three times that of banks) and average returns on capital exceeding 24%.\(^{150}\)

In addition, a majority of profits come from "rollover" fees, or back-to-back transactions,\(^{151}\) which many payday loan borrowers use frequently.\(^{152}\) If the lenders do most of their business with repeat customers who have an established history of repaying their loans, the risk of default may not be as high as the lenders claim. Either way, payday and title lenders have yet to produce data that justifies charging consumers ten to twenty times the rates other consumer lenders must follow.

**Require lenders to disclose fees as an APR.** TILA requires lenders to disclose their total loan cost as an APR, and the act applies to payday and title lenders.\(^{153}\) While the TLA currently requires disclosure of APR, the DDLA does not. Both acts must expressly require such disclosure to dispel any misperception that TILA does not apply to payday lenders just because it is not mentioned in the DDLA.

Payday and title lenders insist that their finance fees must be viewed in the context of an extremely short-term loan that is only intended for emergency purposes. They argue that converting the fee to an annual interest rate or an APR is unfair as it does not accurately reflect the brief nature of the loan product.

However, consumer advocates have insisted from the beginning that lenders are required to disclose loan costs using an APR, as mandated under TILA.\(^{154}\) Indeed, the point of TILA's mandatory APR disclosure is to allow consumers to compare different credit options using similar terms.\(^{155}\) Because the disclosures are clearly already required under federal law, adding a similar provision to Montana's payday and title lending acts will simply foreclose any arguments of non-applicability and increase the likelihood of consumers receiving the information they need to make informed comparisons of credit costs.

\(^{150}\) Barr, *supra* n. 23, at 150; Daniel A. Edelman, *Testimony Regarding Payday and Title Loans*, http://www.edcombs.com/CM/News/news20.asp (accessed Feb. 23, 2007) (citing studies showing payday lender returns on capital between 30% to 40%, or about three times the returns received by banks).

\(^{151}\) Barr, *supra* n. 23, at 157.

\(^{152}\) *Infra* nn. 156–57.

\(^{153}\) *Supra* nn. 92–93 and accompanying text.

\(^{154}\) *Supra* n. 95.

\(^{155}\) See *supra* n. 91 and accompanying text.
Prohibit back-to-back transactions. The “revolving door” nature of payday loans is one of their worst features. As noted earlier, lenders earn most of their profits from “rollover” fees, or back-to-back transactions. An Illinois study showed that payday loan borrowers used a median of over ten loans in two years, with 20% of borrowers using twenty or more loans in that time. A Wisconsin study found that over half of payday loan borrowers took out eleven or more loans in one year. In Indiana, 77% of all payday loan transactions were rollovers, and borrowers averaged ten payday loans per year. Payday and title lenders characterize the loans as an occasional credit option that is not to be used for long-term financial needs. A mandatory “cooling off” period prohibiting lenders from making a loan to a customer within seven days after the customer paid off her most recent loan will ensure the loans are used in a manner that is consistent with the lenders’ intent.

Require consideration of borrowers’ ability to repay. If a borrower has insufficient income to both repay the loan and meet his regular living expenses, extending the loan is not helping him—it is setting him up for failure. Payday and title lenders generally forego traditional underwriting requirements, which is one of the primary advantages a payday or title loan presents for a borrower with poor credit. However, minimal safeguards are necessary to avoid extending credit that cannot realistically be repaid and only creates further financial difficulty for the borrower. Thus, a loan should be limited to no more than 25% of the borrower’s gross monthly income during the repayment term.

Require lenders to accept partial payments. Montana law does not currently require payday and title lenders to accept any partial payments toward the principal of a borrower’s loan. Thus, many lenders refuse any payment less than the full amount owed. This prevents the borrower from paying down the principal as she is able to do so, and increases the likelihood that she will be unable to repay the loan when it is due. Model legislation from NCLC recommends borrowers be allowed to make minimum payments of at least $5 toward the principal of their loans at any time.

156. Barr, supra n. 23, at 157.
157. Id. at 156.
Require lenders to allow repayment plans. Payday and title lenders advertise their loans as “easy money,” but many borrowers find that the loans are not such easy money, after all. A borrower who cannot repay his or her payday or title loan currently faces two choices: renew the loan by paying another finance fee,159 or face the consequences of a bounced check or repossessed vehicle. Repeated payment of finance fees at an APR of 300% to 650% only delays the borrower’s ability to repay the principal and get out of the loan. Rather than lock borrowers into a cycle of sky-high finance charges, the loans should provide reasonable repayment provisions for borrowers who find themselves sinking under the weight of the high-cost loans. If most borrowers use the loans responsibly and in moderation, as lenders claim, this provision should only affect a small percentage of borrowers who find themselves unable to repay the loans.

Prohibit lending to any borrower with an outstanding loan. If a borrower is unable to repay a payday or title loan, or any loan for that matter, taking out another loan is generally not the solution. This is even more dangerous when the loans being stacked up have APRs of 300% to 650%. Lenders in Montana currently rely on voluntary borrower disclosure of any outstanding loans with other lenders, if they inquire at all. Mandatory use of a database system to track outstanding loans will assist lenders in assessing a borrower’s ability to repay, and protect the consumer from getting into serious financial trouble with multiple high-interest loans.

Increase oversight and regulation. A lack of quantitative data regarding the use and impacts of payday and title loans poses a significant challenge in attempting to evaluate the effect of these loans on Montana consumers. National statistics are both widely available and very helpful. These studies often focus on impacts to lower income households and minority groups like African Americans and Hispanics. However, Indians, Montana’s largest minority population, are largely absent from national studies, and Montana’s per capita income trails behind the national average. Thus, Montana must take the initiative to ensure sufficient data

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159. In the case of a payday loan, the lender is technically prohibited from renewing the loan or allowing a borrower to repay a loan with the proceeds of another loan, but back-to-back transactions are common and have the same effect as a renewal. *Supra* n. 52 and accompanying text.
collection to evaluate the impact payday and title loans have on Montana consumers.

To date, a handful of states have taken similar measures, in the form of a mandatory lender database as described above. While one of the primary purposes of the database is to prevent lending to borrowers who already have outstanding loans from other lenders, it also allows state regulators to collect a wealth of information regarding who really uses these loans, and how.

The fiscal burden for such a system falls not on the state, but is spread out on the industries being regulated through a small fee per transaction. There is little room for lenders to pass the fee along to customers by raising their finance charges, because at some point the lenders run up against the proposed 36% APR cap and must simply absorb the database fee.

Until sufficient quantitative data exist to allow meaningful analysis of the loans, the debate between the lenders and consumer advocates will continue, often based on anecdotal evidence, with no satisfactory answers in sight. Montana should follow Indiana's example and require, through its Division of Banking, the collection and evaluation of payday and title loan data to shed light on questions like who uses these loans, and how, and whether they actually benefit borrowers. Such oversight is essential for the Division of Banking to fulfill its stated mission of protecting Montana consumers.

Close the pawnbroker loophole. Finally, if Montana's title loan laws are to be effective, they must apply to all lenders extending title loans. The TLA currently specifies that it does not apply to pawnbrokers, which has led to various interpretations. Some title lenders interpret this provision to mean that if they instead call their loans "title pawns," the TLA does not apply to them. Pawnbrokers have interpreted it to mean they can offer title loans, but are not required to comply with the TLA.

Consumer advocates argue that the legislature intended to differentiate between title loans, where the borrower leaves a vehicle's title with the lender but keeps the vehicle, from a vehicle

163. Barr, supra n. 23, at 165.
pawn, where the borrower leaves the vehicle at the pawn shop. The TLA should apply to all loans secured by a vehicle’s title when the borrower keeps the vehicle, regardless of who gives the loan or what they call it.

VI. Conclusion

Borrowers need options to meet short-term credit needs. However, options that charge APRs of 300% to 650% only worsen the borrower’s financial plight in the long run, and in turn increase burdens on local social services and taxpayers. An industry that collects excessive profits to the detriment of its customers and the community in which it operates is a negative participant in the local and state economy, and should be regulated with aims of deterring its exploitation of unwary consumers and mitigating its negative social impacts. A long-term solution requires collaborative efforts to increase consumer awareness and education, offer reasonably priced credit options, and regulate payday and title lending to protect the long-term financial well-being of Montana consumers.