Regulating Sharks in our Waters: Predatory Lending Practices in Hawai'i

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Abstract

Are payday loans crucial for the financially underserved, or are they preying on the most vulnerable of our communities? One of the biggest arguments the payday loan industry makes is that without them, the underbanked and unbanked would have no other financial alternative to needed loans. According to a 2012 Auto Finance News article, one in four U.S. households fall in this category, meaning they conduct some or all of their financial transactions outside traditional banking institutions (Zulovich, 2012).

Payday loans provide for a population in need, or do they feed on a population in need?

The same demographic that finds no other alternative for emergency cash is then subject to high interest rates – in some cases in the triple digits – with an average two-week turn around to repay the loan. According to the Consumer Financial Protection Bureau, 80 percent of payday borrowers roll over or renew their loans because they are unable to repay on these high rates. It results in 200% to 300% or more in interest rates, creating a debt cycle that can spin out of control.

A Hawai'i family taking out a $1,000 payday loan at 459 APR could look at repaying $5,590 if gone unpaid for a year. This all-too-common scenario drives the question if payday loans help provide financial access to the underserved, or are they hurting our communities deeper into debt? Strong arguments on both sides have grown loud enough for states to take legislative action towards fairness and consumer protection. But whether or not it will be enough action will depend on the outcome.

Regulating Sharks in our Waters: Predatory Lending Practices in Hawai'i

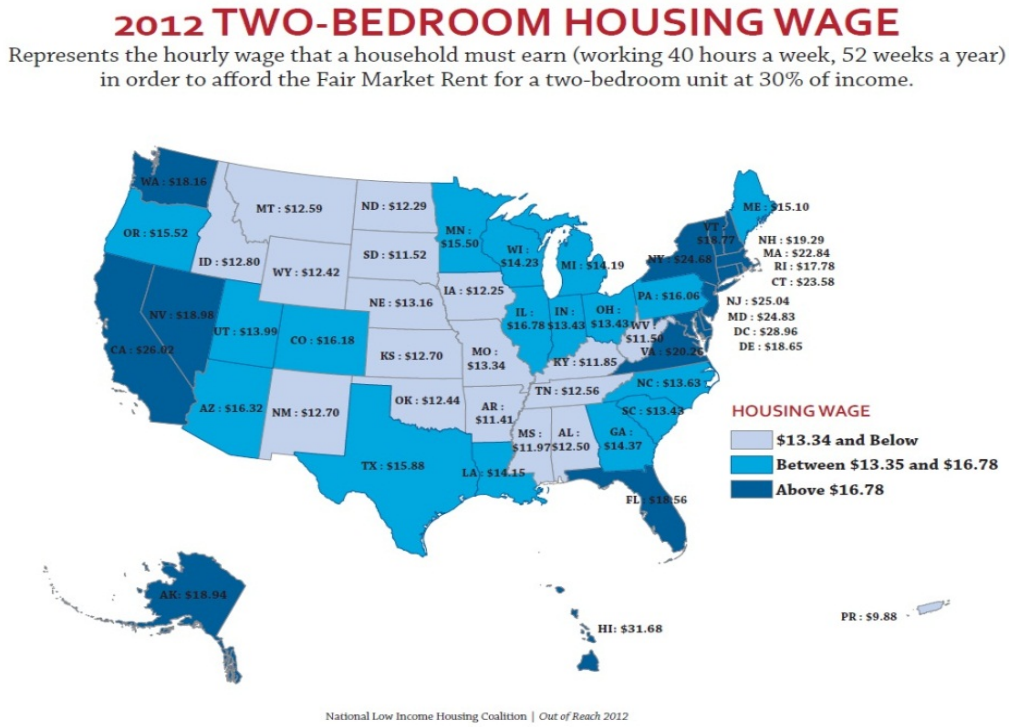
Our Aloha State has one of the most permissible lending rates favoring the industry over the individual. In paradise, payday lenders are not required to be licensed and are able to offer up short-term loans with interest rates up to 459 percent. Hawai'i is only one of four states that does not require a license, meaning borrowers are not under any obligation to repay the loan. Nor are lenders registered with the State Department of Commerce and Consumer Affairs (Hill, 2015). Additionally, Hawai'i is one of 37 states that allow for triple digit interest rates without a cap. Here, payday lenders can:

- Lend up to the maximum amount of $600;
- Issue finance charges of $17.65 per $100 borrowed; and
- Defer repayment up to 32 days.

Payday lenders originally came to the 50th State in 1999 under the guise of offering quick help in a financial pinch. "When these loans first came to Hawaii and other places, they were presented to the Legislature as something that was available to people in an emergency, sort of a one-shot deal," remembers Stephen Levins, Director of the State Department of Commerce and Consumer Affairs in an August 2015 Hawaii Business article. "Unfortunately, most people who take these loans out, don't take them out as a one-shot deal, they take them out repeatedly." This safe harbor for payday lenders offers little protection to consumers, particularly Hawai'i's low income and middle class that compete with the uphill battle of a high cost of living. According to a 2015 study by money-rates.com (Barrington, 2015), Hawai'i ranks at the top as the worst state for making a living. The driving factors are our higher than average median home values (estimated at $537,300) outbalanced by lower salaries and high income taxes.

When compared to the rest of the nation, an hourly wage earner in Hawai'i would have to make at least $31.68 per hour to afford a two-bedroom unit – by far the highest among all 50 states, including the territory of Puerto Rico (Sharp, 2012).

Figure 1 – Average wage per state needed to afford rental of a two-bedroom unit.



With combined elements of a high cost of living, mis-matched lower salaries, high taxes and unregulated payday APR limits, Hawai'i has become a perfect breeding ground for predatory payday lenders. In 2011, payday lenders in Hawai'i made an estimated profit of $3,132,600. (National People's Action Profiting from Poverty, 2012)

Today, over 12 million people across our nation use payday loans each year to borrow an average of $375, yet spend an estimated $520 in interest to repay that very same loan, leaving them in worse financial condition than when they started. (Payday Lending in America, 2013).

This past State Legislative session, Hawai'i Senate Bill 737 was introduced to reduce the 459 APR to a 36 per annum on payday loans. Supporters cited that the 459% rate was "predatory" and "unregulated" causing Hawai'i families to become trapped in a debt cycle. While a 36% cap would provide greater protections for low-income workers from unfair lending practices. Opponents of the Bill argued that capping the APR at 36 percent would basically put an outright ban on payday lenders in Hawai'i making it impossible for them to stay in business and leaving consumers with little choice in credit alternatives.

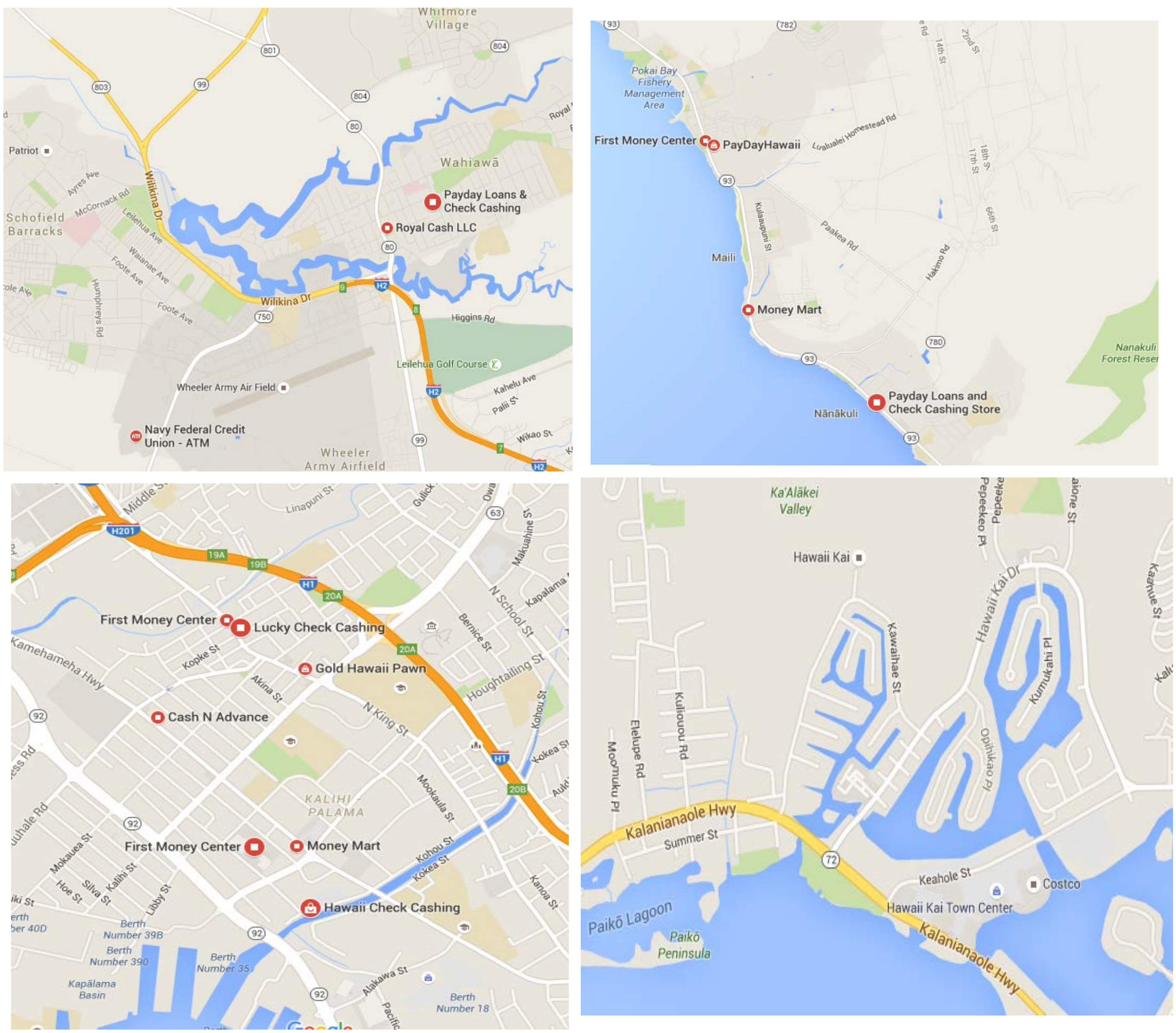
Falling Prey, Again

Predatory payday loans disproportionately target low-income Native Hawaiian and Pacific Islander communities**.** Besides predatory interest rates, an equally strong argument against payday lending cites their marketing and location viability. Supporters of industry regulation have claimed payday loan locations congregate in low-income neighborhoods and disproportionately target vulnerable populations such as our military and minorities. To prove their point, regulation supporters often refer to the 2007 Military Lending Act signed into law by then President George W. Bush. In the year prior, The Department of Defense (DoD) conducted a report on predatory loan practices targeting military personnel and their families. Their research discovered 17 percent of military personnel used payday loans and concluded that if continued, such loans would undermine military readiness, commit adverse effects on personnel stress, job attentiveness and negatively impact the overall morale of the troops and their families. The DoD lobbied Congress to pass the Military Lending Act to protect their military personnel by banning short-term loans and setting an interest cap at 36%. If the DoD felt so strongly to lobby Congress to protect their own military personnel, who will protect our low and middle class population from falling prey to payday lending?

Since 2011, Native Hawaiian and Pacific Islanders in Hawai'i using payday loans have tripled from 0.8% to 2.4% in just two years – that's 0.4% above the national average, according to a 2013 survey from the Federal Deposit Insurance Corporation. The same article argues that payday loans target low-income neighborhoods "like Waianae and Kalihi on Oahu." (Hofschneider, 2015).

A general Google map search of check cashing and payday locations in O'ahu produced results that support these target neighborhood claims:

Figures 2 – 5: Payday locations in four different O'ahu communities (Clockwise, Top Left) Proximity to O'ahu's Military bases, Wheeler Army Air Field and Schofield Barracks; Top Right-O'ahu's westside where the highest concentration of Native Hawaiians reside; Bottom Right- Hawai'i Kai town area, the state's 2nd most wealthiest neighborhood next to Diamond-Head/Kahala with zero payday loans; and Bottom Left – Kalihi-Palama urban district.



The Unbanked and Underbanked

A 2011 FDIC National Unbanked and Underbanked Survey reinforced the upward trend that Native Hawaiians and Pacific Islanders are indeed relying on alternative financial services like payday loans, but also at an alarming rate of 30.2 percent nationwide. This means that "our Native Hawaiians and Pacific Islanders are second in the nation only to African Americans in terms of their underbanked rate" (National Survey of Unbanked and Underbanked Households FDIC, 2012).

It's no surprise then that even within the state, underbanked and unbanked Native Hawaiians and Pacific Islanders rank higher (34%) than the state average of 23.5%. Addressing the causes for our underbanked and unbanked is just one side of the puzzle towards balancing the business ethics of payday lending. The other part includes regulated policies that protect consumers from unfair business practices.

The Sunrise Analysis

Almost a decade ago, the Hawai'i State auditor conducted an analysis on check cashing in our state in the *Sunrise Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans).* This was prompted by legislation of Senate Bill No. 1413 during the regular 2005 legislative session that proposed to expand regulation of deferred deposit agreements. The analysis was meant to ensure if such regulation was necessary to protect the safety, welfare and health of the public.

Senate Bill No. 1413 proposed a cap of 36 percent per annum and reducing the maximum allowable loan amount from $600 to $300. Additionally, the bill would increase penalties for violations and prohibit lenders from such acts as including in their agreements provisions like a mandatory arbitration and waiver of the right to a jury trial. Under this same proposal, payday lenders would also be required to file annual reports disclosing assets, liabilities, income, resources, balance sheets as well as maintaining books, accounts and records enabling the director of the commerce department to check for lawful compliance.

At that time, the Sunrise Analysis concluded that Senate Bill No. 1413 should not be adopted because:

- ***No harm, no complaints:*** They found little evidence of harm and complaints against payday lenders in Hawai'i and therefore, the proposed Bill did not meet the necessary criteria "to protect the health, safety and welfare of consumers";
- ***No debt trap in Hawai'i:*** They found no evidence that rollover loans and borrowers falling victim to a debt were occurring in Hawai'i. However, the report did note that the Better Business Bureau of Hawai'i during that time did not keep complaints against payday lenders as its own specific category, but rather grouped them in a general loans category; and
- ***No alternative for consumers:*** The State Auditor's report also concluded that the additional reporting requirements and 36 per annum cap were restrictive, cost-prohibited to payday lenders and did not support activities towards helping consumers avoid debt. Instead, these requirements would be an unfair burden to the payday industry in Hawai'i, thereby reducing or eliminating these alternative financial services from being accessible to a needed population in our State.

Resurrecting the APR Argument

That was 2005.

Today, the data, research, analysis, studies and statistics against predatory loans are both undeniable and well-documented throughout the nation. So although our state legislature was ahead of the game in acting to ensure consumer protection against payday lenders in 2005, the extensive data to support these positive legislative policies didn't exist like they do today.
But even with strong data, is it enough to influence change for fairness and protection for our communities? Enter Senate Bill 737.

Very similar to Senate Bill No. 1413, the 2015 Hawai'i Legislative session on Senate Bill 737 proposed to cap payday lenders APR from 459 percent to 36 percent. Additionally, it created standards such as authorization for the Department of Commerce and Consumer Affairs to adopt rules for check cashing like registration, recordkeeping, examinations, surety and confidentiality. It would also establish penalties for those payday lenders who violate established standards.

Championing this bill was Senator Rosalyn Baker from Maui and the 36 percent cap stood as her deal breaker. Leading the House negotiations on the bill was fellow House Rep. Justin Woodson, also from Maui, with a stance that "he didn't think the APR is an appropriate way to measure their [payday loans] cost," considering the law states loans must be paid back within 32 days. Testimony on both sides recounted again the renewal and rollover of loans causing a cycle of debt, as well as an APR cap having the adverse effect of putting payday lenders out of business in Hawai'i and driving consumers to utilize unregulated online lenders. In the end, the effort to cap the per annum at 36 was sent to conference committee where it died due to the clash between the House and the Senate. Additionally, a Senate Concurrent Resolution requesting the State Auditor of Hawai'i to conduct a follow up analysis to the *Sunrise*

Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans), Report No. 05-11 was issued.

This might sound like history repeating itself, yet the difference here is whereas the original Analysis was to ensure if the new regulations were necessary to the protection of the health, safety and welfare of the public, the focus of this follow up Analysis will be to:

1) "Compare regulation of payday loans under chapter 480F, Hawaii Revised Statues, with regulation in other states;
2) Analyze the economic impact on consumers and payday loan providers of the regulations in other jurisdictions that have imposed a cap on fees equal to an annual percentage rate of thirty-six percent; and
3) Analyze the availability and cost of alternative credit products to payday loans;" (Hawaii SCR 180, 2015)

Gaining Momentum on Regulation

Whereas Hawai'i is just beginning its fight against predatory loans, 18 states across the nation and the District of Colombia have already taken their stand in either prohibiting or severely restricting payday lending. Among their arsenal used to combat predatory lending practices are:

- Closing payday lenders who have failed to obtain a local license for operation;
- Leveraging local ordinances against payday lender locations if contributing to neighborhood blight;
- Issuing local constraints such as:
    - Moratorium during a study period when considering a payday lending ordinance;

  - Limits on density and/or distance that allow a determined number of payday locations per resident ratio as well as regulating how far locations must be from one another;
  - Special zoning that would limit payday location to special zoning districts, similar to how certain types of businesses are restricted in a community setting such as liquor stores, bars, strip clubs and adult videos/bookstores;
- State reforms to cap the annual interest rates (most cite between 35% - 36%);
- Partnering with non-profit and other community-based organizations to testify and advocate for consumer protection against payday loans
- Incorporating safeguards in new policies that include a cooling-off period between rollover loans, requiring payday lenders to track and record borrower transactions that can be used by the state to determine consumer data and if specific demographics or populations are being targeted.

Whether or not these same strategies will work in Hawai'i is yet to be determined. However, it is clear research on effectiveness and process of these tactics can be measured, and that data can be used to push harder against anti-consumer protection policies that damage our communities.

The Senate Concurrent Resolution No. 180 is on the right track in comparing payday regulation in other states. As more and more states ban together, it will be harder for the sharks to bite when their feeding pool becomes unsustainable.

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