

Protecting Wisconsin Consumers for 75 Years

Payday loans

“I just need enough cash to tide me over until payday.”

The ads are on the radio, television, the Internet, even in the mail. They refer to payday loans, cash advance loans, check advance loans, post-dated check loans, or deferred deposit loans. Regardless of their name, these small, short-term, high-rate loans by check cashers, finance companies and others all come at a very high price.

A payday loan is a cash advance secured by a personal check. Here is how they work: A customer writes a personal check to the business for the amount the person wants to borrow, plus the fee they must pay for borrowing. The business gives the customer the amount of the check, and agrees to hold the check or authorization for electronic fund transfer(s) for a period of time, usually the customer's next payday, before presenting the check(s) or initiating the electronic funds transfer(s) in payment of the loan.

The fees on these loans can be a percentage of the face value of the check, or they can be based on increments of money borrowed: for example, a fee for every \$50 or \$100 borrowed. The

borrower is charged new fees each time the same loan is extended or “rolled over.”

The federal Truth in Lending Act treats payday loans like other types of credit: the lenders must disclose the cost of the loan. Payday lenders must give you the finance charge (a dollar amount) and the annual percentage rate (APR – the cost of credit on a yearly basis) in writing before you sign for the loan. The APR is based on several things, including the amount you borrow, the interest rate and credit costs you are being charged, and the length of your loan.

A payday loan is very expensive credit. How expensive? Say you need to borrow \$100 for two weeks. You write a personal check for \$115, with \$15 as the fee to borrow the money. The check casher or payday lender agrees to hold your check until your next payday. When that day comes, either the lender deposits the check and you redeem it by paying the \$115 in cash, or you “roll over” the loan and are charged \$15 more to extend the financing for 14 more days. If you agree to electronic payments instead of a check, the company would debit the full amount of the loan from your checking account

electronically, or extend the loan for an additional \$15.

The cost of the initial \$100 loan is a \$15 finance charge and an annual percentage rate of 391 percent. If you roll-over the loan three times, the finance charge would climb to \$60 to borrow the \$100.

Alternatives to payday loans

Before you decide to take out a payday loan, consider some alternatives.

1. Consider a small loan from your credit union or a small loan company. Some banks may offer short-term loans for small amounts at competitive rates. A local community-based organization may make small business loans to people. A cash advance on a credit card also may be possible, but it may have a higher interest rate than other sources of funds: find out the terms before you decide. In any case, shop first and compare all available offers.
2. Shop for the credit offer with the lowest cost. Compare the APR and the finance charge, which includes loan fees, interest and other credit costs.

You are looking for the lowest APR. Military personnel have special protections against excessively high fees or rates, and consumers in some states and the District of Columbia have some protections dealing with limits on rates.

3. Even with these protections, payday loans can be expensive, particularly if you roll-over the loan and are responsible for paying additional fees. Other credit offers may come with lower rates and costs.
4. Contact your creditors or loan servicer as quickly as possible if you are having trouble with your payments, and ask for more time. Many may be willing to work with consumers who they believe are acting in good faith. They may offer an extension on your bills, but ask if that service will incur a penalty such as a late charge, an additional finance charge, or a higher interest rate.
5. Contact your local consumer credit counseling service if you need help working out a debt repayment plan with creditors or developing a budget. Non-profit groups in every state offer credit guidance to consumers for no or low cost. You may want to check with your employer, credit union, or housing authority for no- or low-cost credit counseling programs, too.
6. Make a realistic budget, including your monthly and daily expenditures, and plan, plan, plan. Try to avoid unnecessary purchases: the

costs of small, every-day items like a cup of coffee add up. At the same time, try to build some savings: small deposits do help. A savings plan; however modest can help you avoid borrowing for emergencies. Saving the fee on a \$300 payday loan for six months, for example, can help you create a buffer against financial emergencies.

7. Find out if your bank and other financial institutions offer overdraft protection on your checking account. Overdraft protection can help protect you from further credit problems. Banks may charge a flat fee each time you overdraw, or they may link your purchase account to a line of credit or savings account to fall back on if you overdraw. As of 2010, you must “opt in” before your bank may charge overdraft protection fees. In other words, if you do not specifically authorize your bank to charge overdraft fees, your debit or ATM transaction will simply be declined. Note that the new rules do *not* cover checks or automatic bill payments you set up – your bank may choose to automatically enroll you in their standard overdraft protections for these types of transactions.

The bottom line on payday loans: Try to find an alternative. If you must use one, try to limit the amount. Borrow only as much as you can afford to pay with your next paycheck, and still have enough to make it to next payday.

Protections for military consumers

Payday loans (and certain other financing) offered to service members and their dependents must include certain protections, under Federal law and a Department of Defense rule. For example, for payday loans offered after October 1, 2007, the military annual percentage rate cannot exceed 36%. Most fees and charges, with few exceptions, are included in the rate. Creditors also may not, for example, require use of a check or access to a bank account for the loan, mandatory arbitration, and unreasonable legal notices. Military consumers also must be given certain disclosures about the loan costs and your rights. Credit agreements that violate the protections are void. Creditors that offer payday loans may ask loan applicants to sign a statement about their military affiliation.

Even with these protections, payday loans can be costly, especially if you roll-over the loan. You instead may be able to obtain financial assistance from military aid societies, such as the Army Emergency Relief, Navy and Marine Corps Relief Society, Air Force Aid Society, or Coast Guard Mutual Aid. You may be able to borrow from families or friends, or get an advance on your paycheck from your employer. If you still need credit, loans from a credit union, bank, or a small loan company may offer you lower rates and costs. They may have special offers for military applicants, and may help you start a savings account. A cash advance on your credit card

may be possible, but it could be costly. Find out the terms for any credit before you sign. You may request free legal advice about a credit application from a service legal assistance office, or financial counseling from a consumer credit counselor, including about deferring your payments.

Military consumers can contact the Department of Defense, toll-free 24 hours a day, 7 days a week, at 1-800-342-9647, or at www.militaryonesource.com. Information on the Department of Defense rule, alternatives to payday loans, financial planning, and other guidance is available.

For more information

In Wisconsin, payday lenders are licensed under Wis. Stat. §138.14. This section is enforced by the Department of Financial Institutions, Banking Division. Their website includes payday lender forms and a “Frequently Asked Questions” page, and can be found at wdfi.org/fi/lfs/pdl.

For more information or to file a complaint, visit our website or contact the Bureau of Consumer Protection.

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(Information taken from the FTC Consumer Alert: Payday Loans Equal Very Costly Cash)

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