

Cash Advance Loans

Cash advance loans--also called payday loans, check advance loans, post-dated check loans, or deferred deposit check loans--are small, short-term, high-rate loans.

In a typical cash advance loan transaction, the borrower completes an application, provides a paycheck stub, photo identification and a recent bank statement, and submits a postdated check. This check is made payable to the lender for the amount to be borrowed plus the fee charged for the loan. The lender generally holds the check until the loan comes due, usually two weeks.

Cash advance loans are quick and simple. The lenders typically do not perform credit checks that might reveal credit problems. Instead they use a third party to check the borrower's check writing history and likelihood of writing a bad check.

Regardless of what they are called, cash advance loans, like other types of credit, are regulated by the Truth in Lending Act. The lender must disclose the following information in writing:

Amount financed: The amount of credit provided to the borrower.

Finance charge: The dollar amount the credit will cost.

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

Total of payments: The amount paid after all payments are made as scheduled. (Typically, this will be the amount of the borrower's postdated check.)

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

Fees charged for these loans are usually a percentage of the amount borrowed, for example 15-25% for each \$100 borrowed. Or it can be a flat fee, \$xx for up to \$xxx. Loans are typically made for two weeks. Borrowers who extend or "rolls-over" the loan for another two weeks, are charged an additional fee each time the loan is rolled over.

A cash advance loan secured by a personal check is very expensive credit. For example, to borrow \$100 for 14 days would require a personal check for \$120.00. The lender agrees to hold the check for two weeks. At that time, the lender deposits the check or the borrower redeems the check by paying the \$120 in cash. Or the borrower can pay another fee to extend the loan for another two weeks. In this example, the cost of the initial loan is a \$20 finance charge with an annual percentage rate (APR) of 542%. If this loan is rolled over two times, the finance charge would be \$60 to borrow \$100 for two months.

A review cash advance loans conducted by the Wisconsin Department of Financial Institutions in 2001 found the following:

Loan Data Analysis*	
Average loan term	13.99 days
Average APR	542.20%
Average finance charge	\$49.73
Average Loan Amount	\$246.19
Average charge per \$100 borrowed	\$20.00

*321 loans WI Dept of Financial Institutions, 2001

Of 321 borrowers analyzed, 87 took out one to five loans in a year; 12 individuals took out at least 25 loans in a twelve-month period. The highest number of loans taken out in a one-year period by an individual borrower was 30.

Myths surrounding payday loans

“It’s an unregulated industry.” Perhaps because these loans are an expensive source of cash for the consumers who use them, it is a commonly held myth that the payday lending industry is unregulated. In truth, these lenders are subject to the same licensing, examination and reporting requirements as other “traditional” lenders under the “loan company” statutes. Before a payday loan company can do business in Wisconsin, it must apply for and be granted a loan company license.

Limitations on the interest rate that could be charged on closed end credit were repealed in Wisconsin in 1984.

“Consumers who use payday loans are “unbanked.” In fact, they must have a valid checking account in order to secure a payday loan. Often times they use a cash advance loan to avoid the insufficient funds or late fees.

“Most consumers who use payday loans become victims of the “rollover” loan.” In the review conducted by the Wisconsin Department of Financial Institutions, 53% (170/321) of the loans were rolled over at least once, however, only 24% (77/321) were rolled over in excess of three times.

Sources of information: Federal Trade Commission Consumer Alert—“Payday Loans = Costly Cash” and “Review of Payday Lending in Wisconsin, 2001, State of Wisconsin, Department of Financial Institutions.