Predatory Financial Practices and Wealth Stripping in Iowa:

Costs and Consequences to Families and Society and Needed Policy Remedies

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CHILD & FAMILY POLICY CENTER

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PREFACE

A variety of predatory lending practices have emerged over the last decade that strip wealth from working and retired Iowa families, particularly those struggling to get ahead on modest incomes. Three of these – abusive subprime mortgage lending, payday lending, and tax refund anticipation lending – together strip nearly $100 million annually from Iowans. That is more than the state provides to families on the temporary assistance to needy families (TANF) program and more than twice that provided through the federal Section 8 rent assistance program. Meanwhile, Iowa's laws and regulations to protect working and retired Iowa families from these abusive practices are among the weakest in the country.

This working paper describes each of the three predatory lending practices, offers an illustration of its impact upon families, and describes legislative actions that can help protect Iowans from them. It is designed to serve as a resource for concerned citizens, organizations, and policy makers in developing strategies to address these issues: through public and consumer education, development of alternative financing institution, and enacting of state policies providing consumer protections against predatory practices.

The Coalition Against Abusive Lending, formed in May, 2004, includes housing, labor, human services, and faith-based and civic organizations committed to curbing these abusive practices. This fall, the Coalition co-sponsored six forums around the state to hear testimony and promote action. On December 4th, the Coalition convened a Statewide Summit that called for legislative action to address these issues.

The term "predatory lending" encompasses a variety of lending practices that take advantage of people seeking credit by charging excessive fees, selling unnecessary products, or establishing terms that perpetuate the debt and cause additional financial hardship. Predatory lenders often pressure consumers into loans they cannot afford or simply are not in their best interests, often employing deceptive practices and failing to disclose the true nature of the loan.

Chapter 1
Introduction—A Description of Predatory Financial Practices

Almost everyone in today's society needs access to financial services and to some form of credit. This includes places to deposit or cash checks and to secure financing for homes, automobiles, and other major purchases. There is an increasing array of both financial services and products to meet these needs. Home mortgage options have expanded and become more complex – involving interplays of interest rates, down payments, and various points and other fees. Features available on checking accounts have expanded dramatically, including options for short-term loans or cash advances as part of these options. Credit card companies offer a variety of features, also including cash advance features. Most of these services operate in a competitive environment and are subject to significant oversight and regulation that limits the likelihood of abuse. Most focus upon consumers who have good credit histories and a variety of choices in selecting financial services.

Low income working families and persons on fixed incomes, however, particularly those living in poorer neighborhoods or rural areas, often have a difficult time getting conventional credit. They have to pay more than other families for the same goods and services, such as groceries and home products, simply because the options for getting goods and services are fewer in their localities, and the costs are greater there.

Further, they are likely to have to make more purchases on installment, with additional interest charges and fees. Their credit histories may be such that they do not quality for conventional mortgage loans, car loans, credit cards, or other conventional financial services. They are likely to be subject to charges for some basic financial services, such as cashing their paychecks, most Iowans do not encounter at all.

There exists a set of financial services and institutions, generally subject to different (and often lesser or nonexistent) financial regulations, that has developed to serve these customers. These include subprime mortgage lending and contract selling in the home mortgage market, payday loans and check cashing services in the immediate credit department, and rent-to-own companies as well as subprime automobile lending arrangements in the installment sales arena. These also include refund anticipation loans as part of tax preparation services, which have become increasingly prevalent with the creation and expansion of the federal earned income tax credit.

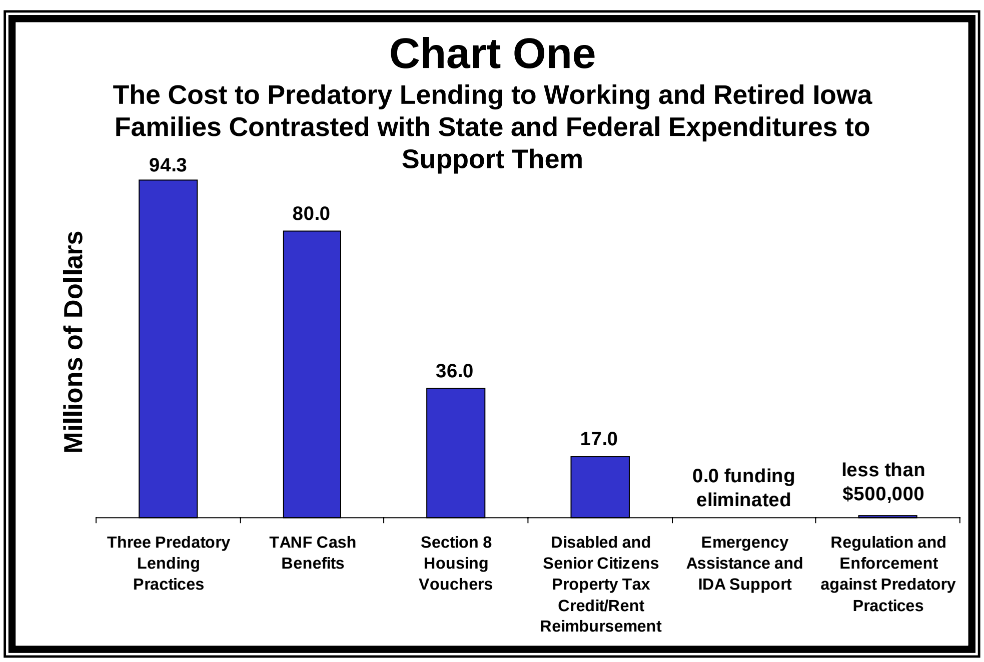
There is a place for some of these institutions and financial services, and there is a reason that their services have higher costs. At the same time, these institutions and services often must comply with only minimal state or federal regulations, even regarding their disclosure of terms and conditions. They are not necessarily held to the same standards as conventional financial institutions regarding their lending and credit provisions, and certainly not to the same marketplace controls.

In short, they are ripe for establishing abusive or predatory practices that actually strip wealth from the families that they serve – through excessive fees, hidden charges, unscrupulous sales tactics, and deceptive marketing that misrepresents the benefits and costs of the services.

This paper describes three of the areas where these predatory practices are most pronounced and costly – subprime mortgage lending in the home mortgage field, payday loans in the access to credit field, and refund anticipation loans in the tax preparation field.

The Costs of Predatory Financial Practices

At the national level, the Center for Responsible Lending (CRL) has been a leader in examining these practices and has conducted research to estimate their costs to customers. CRL estimates that the costs of predatory lending practices in the home mortgage industry are $9.1 billion annually.[1] In Iowa alone, the estimated costs of these predatory mortgage lending practices are $47.5 million annually.[2] CRL estimates the costs of predatory payday lending practices are $3.4 billion annually, [3] The National Consumer Law Center and the Consumer Federation of America similarly have estimated the costs of refund anticipation services, preparation fees, and check cashing services at $1.706 billion, annually.[4] The costs of predatory payday lending and refund anticipation loans to Iowans, based upon a population-based estimate of the national costs, is $46.8 million.[5] These estimated costs to Iowans are shown in Chart One, in contrast with public expenditures on selected programs designed to help low income families. A more detailed discussion of these costs is found in the Appendix.



Iowans most affected by predatory lending are working families who have sources of income but struggle to make ends meet and build any savings, and persons on fixed incomes.

As Chart One shows, these three predatory practices strip more wealth away from Iowans than is provided by any of the major economic assistance programs operated by government to help families stay afloat economically. Further, there are very minimal enforcement and regulation resources devoted to addressing these predatory practices.[6]

Iowans Affected by Predatory Practices

Iowans most affected by predatory lending are working families who have sources of income but struggle to make ends meet and build any savings, and persons on fixed incomes, such as retired people, who have a special need that requires borrowing. Predatory lending affects rural as well as urban Iowans. It is more common in poorer or resource-limited neighborhoods or areas, as there are fewer responsible lending sources and there is a concentration of people to whom to market. Predatory practices generally do not affect people with little or no income, as they do not have a source of repayment.

Individuals who have poor credit histories and recent immigrants are particular targets to such practices, as they do not have access to conventional credit. Medical expenses and unpaid medical debt is playing an increasing role in producing poor credit histories for families. Often, this is the result of an emergency room visit or needed operation for a family member who is not covered by health insurance. In Iowa as in the country, costs of health care coverage have risen dramatically and more people are uninsured as a result. Between 1999 and 2003, the number of uninsured Iowans increased by 95,000, from 8.1% of the population to 12.1% of the population.[7] Unpaid medical debt is a major cause of poor credit histories that then places families in situations where their only access to credit is through potentially predatory lenders.[8]

The consequences of falling victim to predatory financial practices are often long-term; once involved, these practices often trap individuals, preventing them from saving, developing better credit records, and investing in their own and their family's future.

The Public Role in Curbing Predatory Practices

The impact of predatory practices extends well beyond those who fall victim to them. Predatory practices also depress overall economic growth in their communities and the state, by stripping wealth not only from the individuals but also from the neighborhoods and communities where they are practiced. As will be discussed later, most of these practices result in the money that is stripped from individuals quickly leaving the area and community, and often the state, rather than being expended within those areas and communities to strengthen the local economy.

Therefore, both for reasons of consumer protection and for reasons of economic growth, it is in society's interest to address these predatory practices and provide better access to financing and credit. Ultimately, this requires:

- Establishing state regulatory policies (laws and regulations) that prohibit

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specific deceptive and abusive practices and provide consumers with greater information regarding the true costs and charges of the credit they receive;

- Creating enforcement capacity to identify, prosecute, and receive compensation on practices that violate these policies, both through public and private channels;
- Establishing consumer education campaigns and workshops to make potential consumers aware of the costs and their own rights in such processes; and
- Creating or supporting alternative financial services to meet the demand for financial and credit from this population.

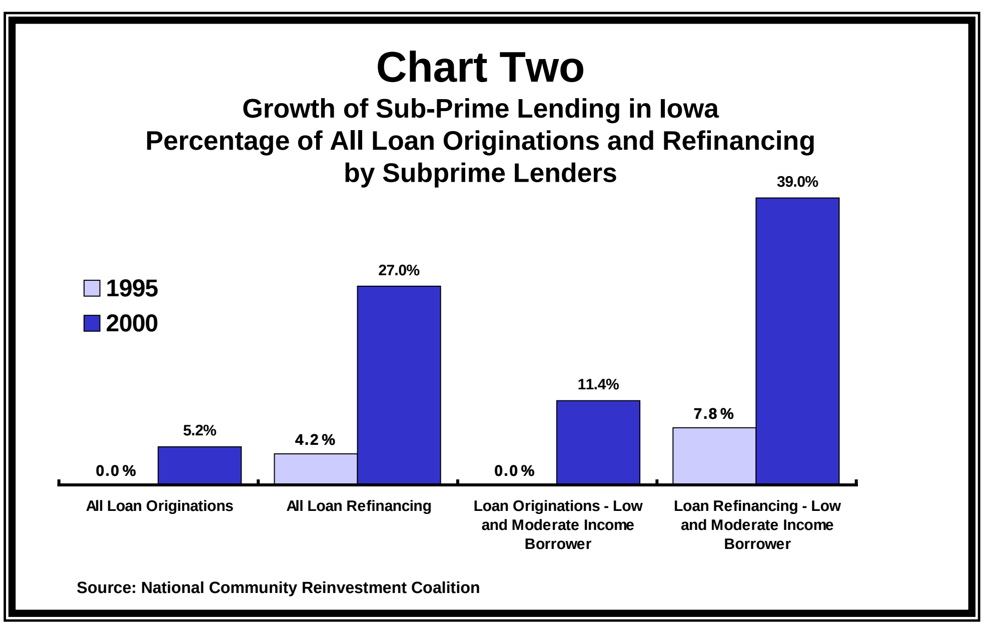
This paper offers a starting point for taking these actions. The next sections of this report describe in more detail each of these three predatory practices. For each practice, the paper describes:

- the nature of the predatory practice and its growth in use in Iowa;
- an example of how the predatory practice operates and its impact upon borrowers; and
- specific state policies that could be developed to curb that practice.

CHAPTER 2
Subprime Mortgage Lending

Predatory mortgage lending takes many forms. While it can occur with any mortgage, predatory lending most frequently occurs in the subprime mortgage market, where people who have limited or poor credit histories must go to obtain financing. Over the last decade, the subprime mortgage lending market has grown dramatically in Iowa and the nation, particularly in the refinancing of existing mortgages. Interest rate declines in the 1990s made home refinancing attractive for many homeowners and provided an opportunity for unscrupulous practices in the low-income end of the mortgage market. Chart Two, drawn from a study by the National Community Reinvestment Coalition,[9] shows the growth in subprime mortgage lending in Iowa between 1995 and 2000 as a share of the overall market, both for loan originations and for refinancing of existing mortgages.

As Chart Two shows, the growth was most pronounced in low and moderate income housing markets. This was the direct result of subprime lenders going into low and moderate income neighborhoods to aggressively market refinancing and loan consolidation opportunities. In the 1990s, individuals with existing mortgages often were lured into refinanced mortgages by promises of better rates, only to later find themselves in substantially worse financial situations as a result. The complexity of these refinancing contracts and the absence of full and understandable disclosure often made it very difficult for customers to make meaningful comparisons between what was beneficial to them and what was not, which makes the situation ripe for abusive practices. More recently, subprime lenders have moved into offering debt consolidations through refinancing – encouraging mortgage holders to refinance and include their credit card, automobile, and other debt into a mortgage payment. Again, these transactions and their terms can be exceedingly complex and often are not in the best interests of borrowers, particularly as these refinancing agreements can involve inflated appraisals and inflated



estimates of borrower earnings and ability to repay. Branch offices of subprime lenders are under pressure to generate more loans each year, and these refinancing and consolidation vehicles offer the opportunity to do so, even when they are not part of the official main office's policies regarding lending.

A five-year analysis of subprime lending growth in the refinancing market, based upon Home Mortgage Disclosure Act (HMDA) data, is provided in the Appendix and shows that conventional refinancing by subprime lenders has grown by 103.6% from 1997 through 2002 – from 3,297 in 1997 to 6,712 in 2002.[10] This growth has occurred even as overall refinancings have fluctuated, based upon the attractiveness of the market, during this period, suggesting the continued aggressive marketing of refinancing by the subprime market.

In fact, predatory financial practices in subprime mortgage lending change and adapt over time, as financial conditions and opportunities change. This makes it difficult to establish inflexible or static definitions of what constitutes abusive or predatory practices. At the same time, there is enough history to recognize some practices as needing specific regulatory control.

Predatory mortgage lending can include any or all of the following:

- Unnecessary fees, such as excessive points or requirements to purchase different forms of insurance protection
- Risk-rate disparities that impose higher rates than the borrower's credit actually warrants
- Unaffordable loans made based upon the assets of the borrower (frequently the current equity in the home) rather than the borrower's ability to repay an obligation, even based upon a loan officer or broker inducing a borrower to overstate or falsify income
- Inflated appraisals resulting in loans for more than the value of the house, keeping borrowers trapped in the loan and unable to refinance to a responsible mortgage

Carl and Donna Smith

Carl and Donna Smith had a first and second mortgage loan on their home, with a combined balance of $59,000 and combined monthly payments of $712. The home was worth about $70,000, giving them $11,000 of equity. Their monthly payments put them at an affordable debt-to-income ratio of less than 20%. The subprime lender solicited them to refinance and consolidate other debts, using confusing – and misleading – figures to show false "advantages" of the consolidation. By the time the subprime lender finished with a bewildering series of paperwork transactions over the next several months, the outstanding mortgage debt on the $70,000 was $109,000 and the monthly payments were more than doubled – to $1500 per month. The loan costs and fees were approximately $10,000. The loss of equity in their home – leaving them almost $40,000 "under water" – meant they could not refinance with another lender to take advantage of declining market rates and again reduce their monthly housing debt to within the recommended debt-to-equity ratio.

Currently, Iowa is the only state in the nation that does not allow a private right of action against predatory lending practices.

- Prepayment penalties and balloon payments that trap borrowers into a contract
- Inducements to refinance an existing loan (often repeatedly) or consolidate debts which do not confer any benefit to the borrower, but simply to charge additional points or fees or to bank new loans for the company to show growth to shareholders
- Deceptive marketing that conceals the true nature of the mortgage loan.

The impact on families can be devastating, as the example of Carl and Donna Smith shows. This example is similar to a tragic, real-life case in Iowa, which was the subject of a major recent *New York Times* expose on such practices.[11]

Legislative Remedies. In addition to better enforcement, more consumer education, and more access to responsible lenders, a growing number of states have taken action to curb predatory practices in mortgage lending. North Carolina was among the first states to establish strong legislation curbing predatory mortgage lending. New Jersey, New York, New Mexico, Michigan, Massachusetts, and California all have enacted regulations that provide substantial protections.

Model legislation, based upon these states' experiences, has been developed by the Center for Responsible Lending and includes:

- Prohibitions against refinances that do not provide a substantial benefit to homeowners (loan flipping)
- Limitations on points and fees that can be charged up-front
- Prohibitions on pre-payment penalties
- Requirements for disclosure and mandatory pre-loan counseling
- Prohibitions against certain additional requirements for credit and other forms of single premium insurance
- Provision for meaningful damages against lenders who engage in predatory practices.
- Provisions that bring responsible accountability to the secondary market.

Studies of the North Carolina statute, in particular, have shown reductions in predatory lending saving homeowners millions of dollars annually, without any loss in access to legitimate mortgage credit.[12]

Iowa could develop its own legislation, based upon the model legislation. In addition, existing Iowa statutes also could be better aligned and provide additional rights of enforcement, through:

- Enacting a private rights of action under the consumer fraud act, ensuring that predatory lending practices are covered,
- Strengthening the Iowa Consumer Credit Code
- Addressing the issue of inflated appraisals.

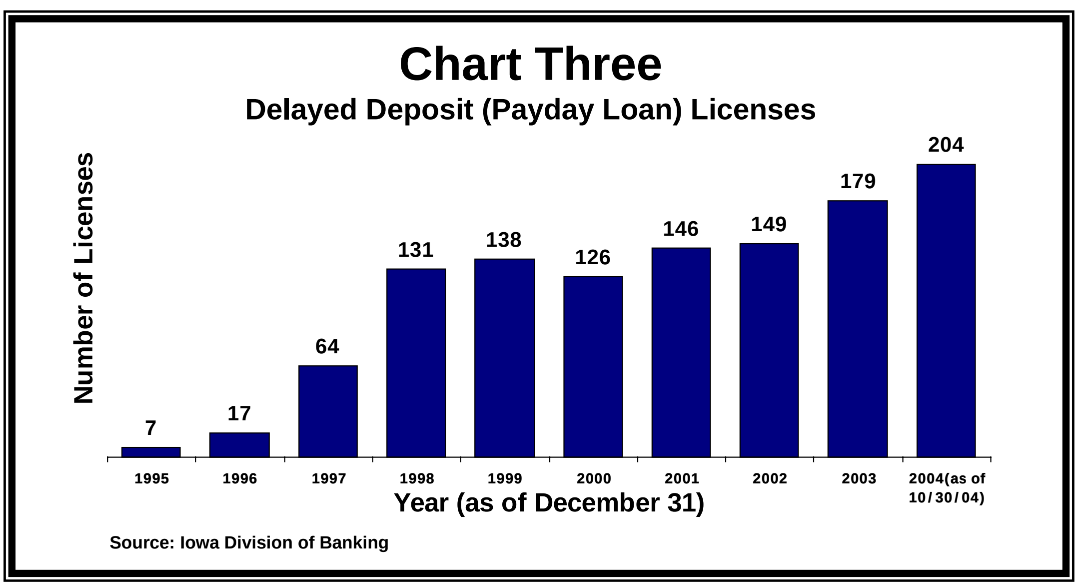
Currently, Iowa is the only state in the nation that does not allow a private right of action against predatory lending practices. While the Attorney General's office can and does file suits against predatory lenders and has been successful in many instances in changing practice, the limitation on private suits weakens Iowa's enforcement powers. Attorney General Tom Miller has included expansion of the right of action in his legislative agenda, as well as serving as a leader among state Attorneys General in pursuing both state and national regulations to curb such practices.[13]

CHAPTER 3
Payday (a.k.a. Delayed Deposit) Lending

A payday loan, also known as a delayed deposit loan, is money advanced to a borrower from an agency, company, or financial institution for a very short period of time. Payday loans are high-cost loans, most often secured by a live check. They are repayable in a single balloon payment usually due in two weeks on the borrower's next payday.

In 1995, Iowa established a statute legalizing payday loans up to $500 in size, but provided few customer protections for those loans. Lenders can charge high fees for payday loans and frequently encourage customers to roll-over those loans when they come in to repay them, in effect establishing a new high interest loan. On a $100 loan, payday loan companies can charge $15 for a two-week period, amounting to an effective annual interest rate of almost 400%. Low and moderate income households may have a sudden, unexpected financial crisis that a payday loan can temporarily resolve, which is why the services have been used. Once into a payday loan, however, borrowers often become trapped into rolling over those loans, as their other basic living expenses make it difficult for them to fully pay off the loan. This ends up stripping income each week from them, that they could use for covering basic expenses. Payday loan companies also usually provide check cashing services, with significant charges to customers.

Since their authorization by statute in Iowa in 1995, the number of Iowa payday loan licenses has grown dramatically – from 7 in 1995 to 131 in 1999 and over 204 in November, 2004 (see Chart Three, below). Many of these licenses are to out-of-state parent companies. The Iowa Division of Banking website list of current licenses shows that the largest six license



The impact of payday lending in Iowa is to strip money not only from the individual borrower but also from the neighborhood or geographic area and the state, as well.

holders representing 107 of the 204 current licenses all have out-of-state corporate addresses, and 83% of the dollar volume of payday loans is done by national payday loan chains with corporate headquarters outside Iowa.[14] Clearly, the impact of payday lending in Iowa is to strip money not only from the individual borrower but also from the neighborhood or geographic area and the state, as well. A national investment firm describes this period of payday company development as the "land grab" phase of growth, as companies are seeking to stake out geographic areas where paycheck-to-paycheck or security check to security check families reside.[15]

Most people at some time face financial emergencies and the need for temporary cash assistance. Particularly for individuals without established relationships with mainstream financial institutions, friends or family who they can comfortably approach for emergency loans, payday loan companies can fill a particular void. The problem is that their existence is premised on marketing such services, even when they are not needed and in ways that lock borrowers into long-term wealth stripping arrangements. They are ripe for over-marketing and particular forms of abusive lending practices, both around excessive fees and around rolling over or flipping loans.

Legislative Remedies. Payday lending is a relatively recent phenomenon in the financial industry and requires state authorization and regulation, or they would fall under much lower interest rate ceilings providing for small loan companies. Some states do not allow payday loan companies to operate at all and others

Donna Jones

Donna Jones is a single mother with two children earns $365 per week or $18,960 per year. She gets paid every two weeks. Her car breaks down and requires $200 worth of repairs. Donna has few savings and poor credit. She goes to a pay day loan company to borrow $200 of the money she needs and pre-dates a check deposited with the lender to be repaid within 14 days. The pay day lender charges a fee of $27.78 (that represents an annual percentage yield, or APR, of 362.13%!). Donna's utility bill then comes in at a higher amount than she anticipated, and she is unable to repay the loan and rolls it over for another 14 days for an additional fee of $27.78. Donna now has paid $55.56 on a $200 four week loan. If she continues to roll over her debt, in sixteen weeks she will have paid more than the $200 in fees, and still owe the full $200 to the pay day lender. If she had actually borrowed the $200 with an annual interest rate of 30%, her payments of this period would have totally erased the $200 initial loan and she would have no continuing debt. As it is, Donna is likely to have to continue rolling over her payday loan and stripping herself of more than $50 in needed income monthly because of her first emergency with her car. Donna's case in by no means extreme; according to the 2003 census Iowa has 66,828 single parent families headed by a women and their median family income of $20,704 is slightly above what Donna makes.

Statutes need to be carefully and yet flexibly drafted, as narrowly drawn statutes often are easy to circumnavigate by slightly changing the specific features of payday loans.

have different levels of regulation and control. Iowa's current statutes governing payday lending are considered among the weakest in the country. In general, efforts to regulate payday lending have focused upon limiting the effective amount of interest or charges that can be made, restricting the turnover or "flipping" of such loans, and requiring clear disclosure and strong consumer remedies to curb deceptive practices. Statutes need to be carefully and yet flexibly drafted, as narrowly drawn statutes often are easy to circumnavigate by slightly changing the specific features of payday loans.

Georgia enacted legislation prohibiting payday lending, deferred deposit lending, and cash advance services of $3,000 or less that charged more than 16% interest and made it a felony to make such loans. The law appears effective because of its broad definition of payday lending. Maryland enacted legislation prohibiting brokering of loans that do not comply with the state's 33% annual percentage rate cap for small loan companies. Ohio prohibited payday loan companies from suing for triple damages under its bad check law. Montana reduced the maximum finance charge to a percentage of the loan amount rather than a per check basis. Oregon established regulations that restrict payday loan terms, with a particular emphasis upon roll-overs of such loans. North Carolina has enacted what is considered the most comprehensive legislation regarding payday lending, and Minnesota and Wisconsin are other states with recent statutes.[16]

The National Consumer Law Center has developed a model Deferred Deposit Lending Act, based upon the experiences of states in enacting provisions.[17] General recommendations for statutory actions include the following:

- Use broad definitions of payday loans
- Include the borrower's income as a consideration to qualify for payday loans
- Limit loan roll overs and require a balance reduction before allowing roll overs
- Set a lower and reasonable maximum flat fee for each $100 borrowed
- Require lenders to offer a repayment plan if loans cannot be repaid by the end of the original term.

Legislation to provide stricter controls over payday lending was introduced in Iowa in the last legislative session as Senate File 2083. That legislation, with Senator Joe Bolkcom (Johnson County) as lead sponsor, would:

- Limit total fees to no more than a $5 per $100 transaction fee for a loan
- Limit the size of loans to no more than $300
- Limit default fees
- Provide greater consumer notification of terms
- Prohibit immediate flipping of loans.

Iowa could develop and enact legislation in 2005 similar to or expanding upon SF2083, drawing upon Model Act provisions.

CHAPTER 4
Refund Anticipation Loans

Refund anticipation loans are short-term loans that are guaranteed by a borrower's expected tax refund. They offer the borrower immediate money instead of waiting until a check is issued by the Internal Revenue Service. These loans are often marketed by the industry as “rapid refunds” and represent a way for tax preparers to get new business and profit from it. Companies providing these loans can charge high interest rates or fees for the actual loan, in addition to charging administrative fees for loan processing, and fees to set up an account to receive the tax refund. All these fees are in addition to fees charged for actual tax preparation that determines the size of the tax refund.

The refund anticipation loans are not made by the tax preparer but by a separate lender, usually a bank that has an arrangement with the tax preparer. One standard model for these loans is for the bank to open a temporary ("dummy”) account for the borrower to receive an electronic deposit of the tax refund from the Internal Revenue Service. These arrangements usually include a right of set off that enables the lender to take money directly out of the account without the borrower's further authorization. The IRS now conducts a great deal of its tax refund business electronically and provides refunds quickly. This has opened up the door for tax preparation businesses such as H&R Block and Jackson Hewitt to market these “rapid refund” services, although such electronic refunds also are available to individual tax filers. Voluntary tax assistance sites, or VITAs, generally perform income tax assistance services for low and moderate income taxfilers without charge, although they are not available in all areas of the state.

The effective annual percentage rate for these tax anticipation loans generally range from about 70% for a $5,000 refund loan to over 700% for a $200 refund loan. In addition, tax preparers charge other fees for the convenience and immediacy of these tax refunds. Many of the actual charges remain hidden in these transactions, and the customer does not realize that he or she could have received a much larger check from the Internal Revenue Service in nearly the same amount of time, employing alternative filing methods.[18]

The growth in tax refund anticipation loans is the result of several factors:

- The increase in the size and value of the earned income tax credit (EITC), meaning that more low and moderate income working families qualify for tax refunds of significant size,
- The computerization of IRS processing practices of refunds, both enabling quicker returns and checking for liens on those returns (child support obligations and student loan repayment requirements) that provide assurance that quick payments can be made by tax preparers, and
- The marketing and profit potential for such loans as a “rapid refund” and sure way to get money back from the IRS.

The continued expansion of the Earned Income Tax Credit (EITC) as a tool to reduce poverty among working Americans has created a much bigger market for refund anticipation loans. Initially established in 1975, the EITC has been expanded in size and scope during every

Presidency since that period, broadening the number of individuals who qualify, the size of the credit they receive, and the income levels at which they can still receive a credit. Between 1976 and 1988, the EITC provided between $4 and $5 billion in benefits to Americans, and then rose sharply with expansions – to $10 billion in 1991, $25 billion in 1995, $30 billion in 1997, and remaining relatively constant through 2002.[19] Table One below shows the growth in the earned income tax credit in Iowa simply between1997 to 2002 and the federal growth in RALs between 2000 and 2002.[20]

From the data provided by the National Consumer Law Center and the Consumer Federation of America, it can be estimated that nearly three-quarters of RALs are the result of taxfilers receiving refunds from the EITC. As shown earlier, the growth in the EITC has been dramatic over the last thirty years and currently represents the largest federal anti-poverty program effort in the country. It has been responsible for lifting millions of working American above poverty and toward economic self-sufficiency. At the same time, it has created the opportunity for stripping some of the income gained from them – particularly through refund anticipation loans.

Table One
Growth in Earned Income Tax Credit in Iowa: 1997 and 2002
and Federal Growth in Refund Anticipation Loans 2000 % 2002

State Growth in EITC	Tax Year 1997	Tax Year 2002	% Growth 1997-2002
Returns with EITC	153,575	167,854	9.3%
Total Value of EITC	$212.2M	$262.6M	23.8%
Returns with EITC Refund	113,127	140,450	24.2%
Total Value of EITC Refund	$162.2M	$228.1M	40.6%
Federal Growth in RALs	10.8M	12.7M	17.6%
RAL Charges	$1.134B	$1.446B	27.5%

Sources:
Internal Revenue Services for Iowa EITC data; National Consumer Law Center, Consumer Federal of America for RAL data

As the figures for Iowa show in Table One, even over the last five years, while the overall growth in filers with an EITC has been modest (9.3%), the growth in the numbers of those filers receiving a refund has been very substantial (24.2%). The market for refund anticipation loans through EITC growth alone has been over $65 million in Iowa during this period. While figures are not available on RAL use in Iowa, national figures show a similar trend even between 2000 and 2002.

Tax preparation fees are not included in these figures and were not used in calculating the $12.8 million of such RAL predatory practices in Iowa.[21] At the same time, almost any use of refund anticipation loans should be considered unnecessary and therefore stripping wealth. Further, a large share of the actual loans are made through banks that operate outside the state of Iowa (choosing locations where they can charge high fees), contributing to wealth stripping not only from individual Iowans but from communities and the state.

Legislative remedies. Because of the growth in this industry, which has expanded dramatically as the EITC has expanded, states are beginning to develop regulations to limit abuses. Fifteen years ago North Carolina adopted comprehensive regulations for refund anticipation loans. These regulations require full disclosure of charges and fees that must be posted on site. Persons preparing refund anticipation loans must be registered with the state. The North Carolina Commissioner of Banks can review refund anticipation loan charges and can prohibit charging fees.

Dennis Wilson

Dennis Wilson is among the working poor with a wife and two kids. He is nervous and unsure of his ability to fill out his tax forms properly and promptly. He goes to Blank and Blank to have his taxes prepared, at which time he learns he is eligible for a refund of $1600, largely due to the value of the EITC. Blank and Blank informs him that it will file his taxes and qualify him for the EITC. In addition, it informs him that he can have his refund within two days instead of waiting for the IRS to process his tax forms and mail him a refund check. Blank and Blank files Dennis' taxes and sets up a "dummy" account at an out-of-state bank to receive Dennis' tax refund. Dennis is charged a combination of fees totaling $270. These fees include: a charge for filing Dennis' taxes, an administrative fee, a fee for setting up a dummy account, and a fee for receiving his refund about two weeks earlier than he would have had to wait for IRS to issue his refund to him. These fees are automatically paid from the dummy account upon the account's receipt of Dennis' tax refund. As an alternative, Dennis might have used a tax preparation service through a Voluntary Tax Assistance site (VITA), that also would have filed his taxes electronically and assured almost as quick a refund as did Blank and Blank, particularly if he had a checking or savings account where the refund could be deposited electronically.

Minnesota's regulations include specifications on how the charges, terms, and fees on refund anticipation loans are displayed (including requiring them to be on a separate sheet and setting minimum font sizes). Illinois includes similar

Curbing these abusive Refund Anticipation Loans (RAL) practices is essential to ensure that the Earned Income Tax Credit (EITC) and other tax provisions.

disclosure requirements but does not specify how to disclose such information and Wisconsin also has enacted legislation.

The National Consumer Law Center has developed a Model Refund Anticipation Loan Act to address some of the most serious problems associated with refund anticipation loans. This model legislation includes provisions that:

- Limit fees
- Prohibit debt collection abuses
- Prevent referral to check cashing agencies
- Require mandatory disclosure of conditions both in wall postings and a separate disclosure sheet accompanying the application
- Require registration and bonding of lenders
- Grant borrowers a private right of action to recover damages, costs, and attorney fees[22]

In addition to developing state regulations regarding refund anticipation loans, Iowa also could:

- Support the development and expansion of VITA sites, as alternatives to relying upon tax preparation services and refund anticipation loans.

Curbing these abusive RAL practices is essential to ensure that the Earned Income Tax Credit and other tax provisions that produce refunds for low and moderate income workers achieve their intended purposes. It also is necessary to ensure continued support for and expansion of those provisions.

CONCLUSION

An economic development strategy in the state should include provisions to retain wealth and savings, not see it stripped from families and communities through predatory financial practices.

Clearly, the three predatory financial practices described here – subprime mortgage lending abuses, payday loan abuses, and refund anticipation loan abuses – have adverse impacts on working and fixed income families who have the greatest need for protection of their income. As the paper has shown, there are legislative remedies to each that can help to curtail the most abusive and predatory practices. When coupled with actions that increase access to legitimate credit, the lives of working and fixed income low and moderate income families can be made substantially more secure.

The potential effects of providing these safeguards against predatory lending practices are substantial – and failure to do so erodes many of the other government income support programs designed to provide a safety net for struggling families. While the consequences to families are economic, they also are social, and several in Iowa have resulted in suicides.[23] Families struggling to get by and get ahead deserve greater protections against abusive and predatory lending than currently exist in Iowa. Legislative action is needed.

In addition, however, these predatory practices have a larger impact than on the families directly affected. They strip wealth out of neighborhoods, rural areas, and communities. A significant share of the profits reaped from these practices quickly leaves the community and even the state of Iowa. Families generally would use the money locally and contribute to the economy in their neighborhoods and communities. Particularly in poorer neighborhoods or rural areas seeking to rebuild themselves, the loss of these financial resources can hold down growth. Economically, communities and the state of Iowa, as well as working and fixed income borrowers, lose as a result of these predatory practices. An economic development strategy in the state should include provisions to retain wealth and savings, not see it stripped from families and communities through predatory financial practices

APPENDIX
Estimations of the Cost of Predatory Lending Practices to Iowans

The estimates used in this report on the costs to Iowans of predatory lending practices are based upon a mixture of both state and national sources of information. These are discussed below.

Predatory Subprime Mortgage Lending

In 2001, the Coalition for Responsible Lending produced a report, *Quantifying the Economic Cost of Predatory Lending*, that made national estimates on the costs of four separate predatory practices (financed credit insurance; $2.1 billion; exorbitant up-front fees, $1.8 billion; subprime prepayment penalties, $2.3 billion; and excess interest charged, $2.9 billion).[24] These combined to provide a national overall estimate of $9.1 billion. The report acknowledged, but did not calculate a dollar cost, for excessive foreclosures due to a lack of concern for ability to pay. The report covered most of the major, but not all, of the predatory practices in place at that time.

The report also estimated the costs by state; based upon the share of the country's total overall loan volume. Iowa's share was 0.5%, leading to the estimate of $47.5 million in costs to Iowa customers.

Most of the subprime lending abuses occur in the refinancing of loans. Another way to look at Iowa's share of conventional refinancing mortgage loans provided by subprime lenders, is by looking at the Home Mortgage Disclosure Act (HMDA) reporting requirements.

The following table provides subprime refinancing mortgage loans over the period from 1997 through 2002 in both Iowa and the United States.

Conventional Refinancing Subprime Mortgage Loans
1997 through 2002

Year	Iowa	United States	Iowa as % of U.S.
1997	3,297	542,458	0.61%
1998	5,621	781,314	0.72%
1999	5,429	649,278	0.84%
2000	5,250	589,834	0.89%
2001	5,604	736,637	0.76%
2002	6,712	948,728	0.71%
Growth 1997-2002	103.6%	74.9%	
Iowa Subprime as % of US, 6-yr avg.			0.75%

Source:
HMDA data as retrieved from the Fannie Mae Foundation website:
www.dataplace.knowledgeplex.org

The table shows that Iowa has a larger share of the subprime refinancing market than the overall lending market than that used by the Coalition for Responsible Lending in developing their estimates. It also shows that the growth rate for these subprime refinancing loans has been greater in Iowa than in the United States as a whole, with a substantial increase even from the time the national estimates were made by the Coalition. Making Iowa's share of the national cost 0.75% would represent an estimated cost to Iowans of $68.25, and adjusting that by 25% to represent the growth in the subprime market since 2000 would increase it to $85.3 million.

The Coalition for Responsible Lending's estimate of $47.5 million is conservative, based upon this updated information.

Predatory Payday Lending

The Center for Responsible Lending also developed estimates for the costs to consumers of payday lending, *Quantifying the Economic Cost of Predatory Payday Lending.*[25] The methodology is based upon the predatory practice of flipping loans, considering the costs of payday loans only to customers who have five or more loans in a given year. The paper considers this a very conservative estimate, as it does not include what may be excessive costs for a single, or even several, payday loans to a customer. The Center does not provide state-by-state data; nationally the cost is estimated at $3.4 billion. At about one percent of the country's population, Iowa's share is estimated at $34 million.

The Superintendent of Banking retains figures on payday lending volume in Iowa, with figures from 2003 showing a loan volume of 743,000 with average finance charges of $35.05, equaling $26 million in payday lending gross receipts, with an average annual percentage yield of 315% on the loans. From the perspective of excessive fees, at least ninety percent of the gross receipts could be considered predatory, or $23.4 million. Since its inception in 1995, there has been rapid growth in the payday lending industry, with over one-third more payday locations in 2004 than in 2003, making the figure of $34 million a reasonable estimate for 2004.

Predatory Refund Anticipation Loans

The National Consumer Law Center and Consumer Federation of America have estimated the costs, nationally, of predatory refund anticipation loans. According to the most recent report, for the 2002 tax year customers paid $1.14 billion in RAL fees and an additional $406 million in administrative or electronic filing fees to get their refunds. [26] EITC recipients paid an additional $161 million in check-cashing fees associated with obtaining RALs. Altogether, this amounts to $1.706 billion. It does not include the actual tax preparation fees, estimated for EITC recipients (who make up more than half the RAL customers) of $810 million, some of which may be considered excessive. The report does not provide state-by-state breakdowns.

In 2002, Iowans paid approximately 0.75% of the federal income tax and the number of EITC returns receiving a refund was 0.75% of federal EITC returns,[27] so this percentage has been multiplied by the national predatory costs for RALs of $1.706 to come up with an Iowa cost of $12.8 million.

Tax preparation costs do form another expense paid by customers who use refund anticipation loans that would not be required, if they qualify and use voluntary tax assistance sites. While not considered a predatory practice, including these fees would add another $6 million to potentially avoidable customer costs.

ENDNOTES

[1] Stein, E. (2001). *Quantifying the economic cost of predatory lending*. Durham, DC: Coalition for Responsible Lending. The $9.1 billion figure includes $2.1 billion for unnecessary financed credit insurance, $1.8 billion for exorbitant up-front fees, $2.3 billion for prepayment penalties, and $2.9 billion for excessive interest charges. The paper indicates that this is a conservative estimate and does not include all costs, as it does not include costs associated with excessive foreclosures due to channeling customers into agreements whose payment schedules they cannot afford to meet.

[2] ibid. p. 18. Iowa's share of the total was calculated by multiplying the $9.1 billion by Iowa's 2000 share of the national mortgage loan volume, according to 2000 Home Mortgage Disclosure Act (HMDA) data.

[3] Ernst, K., Farris, J., & King U. (2003). *Quantifying the economic cost of predatory payday lending*. Durham, NC, Center for Responsible Lending. The methodology is based upon the predatory practice of flipping loans, considering the costs of payday loans only to customers who have five or more loans in a given year. The paper considers this a very conservative estimate, as it does not include what may be excessive costs for a single, or even several, payday loans to a customer. See the Appendix for additional information.

[4] Wu, C.C. & Fox, J.A. (2004). *All drain, no gain: Refund anticipation loans continue to sap the hard-earned tax dollars of low-income Americans*. Washington, DC: National Consumer Law Center and Consumer Federation of America. According to the report, for the 2002 tax year customers paid $1.14 billion in RAL fees and an additional $406 million in administrative or electronic filing fees to get their refunds. EITC recipients paid an additional $161 million in check-cashing fees associated with obtaining RALs. Altogether, this $1.706 billion.

[5] See Appendix for derivation of the Iowa figures.

[6] The Office of the Attorney General's consumer protection division is the primary vehicle for investigating instances of predatory and abusive practices, and its annual budget is $ 1.8 million. The consumer protection division covers a wide array of consumer issues, however, and not those related solely to the predatory practices identified here, a very rough estimate of 10% devoted to addressing these practices.

[7] For a summary of this information, see: Bruner, C. (2004). *The Iowa health care crisis without Medicaid: The role of Medicaid and hawk-i in covering children.* Des Moines, IA: Child and Family Policy Center.

[8] When families do not have health care coverage and need emergency medical services, they are usually charged at rates much above those negotiated by private health insurers or paid by Medicare, Medicaid, and other public insurers. Some states have begun to examine these practices as imposing unrealistic burdens on the uninsured and increasing the likelihood that families fall into debt that they cannot repay and impact their credit histories. This is another area for examining practices that can strip wealth from low-income families.

[9] National Community Reinvestment Coalition, *RHI report on CRA and fair lending in Iowa* (2002), Washington, D.C.

[10] Home Mortgage Disclosure Act data retrieved from the Fannie Mae Foundation website, www.dataplace.knowledgeplex.org. December, 12, 2004.

[11] Moss, M. (October 10, 2004). Erase debt now. (Lose your house later). *New York Tim*es, Sunday Business Section.

[12] Quercia, R, Stegman, M, and Davis, W, (2004) *Assessing the impact of North Carolina's predatory lending law*, Housing Policy Debate, volume 15, issue 3. This study of the North Carolina law found that the number of home purchase loans was not affected. The study also found that while refinancing fell, about 90 per cent of the decline were in predatory loans. A second study found that North Carolina's law saved 31,500 borrowers over $100 million by preventing predatory terms on subprime loans, and that low-income borrowers continue to have access to a wide range of choices in selecting a home loan. Ernst, K, Farris, J, and Stein, E (2002), *North Carolina's subprime home loan market after predatory lending reform.* The Center For Responsible Lending,

[13] See: Testimony of Thomas J. Miller, Attorney General, State of Iowa (July 26, 2001). Senate Committee on Predatory Mortgage Lending: The Problem, Impact and Responses.

[14] The Iowa Division of Banking maintains a list of all payday loan licenses in Iowa on its website. The information provided here was retrieved November 18, 2004 from http://www.idob.state.ia.us/public/license/Financesrch/license_results.asp. As of November 18, 2004, six payday loan companies had ten or more licenses. They are shown with their Corporate Office and CEO and address:

Check Into Cash Advance America Cleveland, TN	26 IA licenses	CEO Stephen Scroggins
Cash Advance Centers, Inc. Spartanburg, SC	24 IA licenses	CEO William Webster
MM Finance LLC Bellevue, NE	16 IA licenses	CEO Michael Medved
Check 'n Go Mason, OH	16 IA licenses	CEO Stephen Curtis
B'n'T Loan, LLC Springfield, MO	15 IA licenses	CEO Robert Maker
Mister Money Financial Services, Inc. Fort Collins, CO	10 IA licenses	CEO Ralph Will

[15] Stephens Inc. Investment Bankers, "Industry Notes, The 3U Consumer Finance Monthly," (March 29, 2004)

[16] For a description of some of these state activities and references to specific legislation, see*: Predatory small loans a form of loansharking (2003)*. Washington DC. National Consumer Law Center.

[17] Deferred deposit lending act. Retrieved on November 27, 2004, at: http://www.consumerlaw.org/initiatives/payday_loans/paydayac.shtml

[18] The National Consumer Law Center and the Consumer Federation of America report that these "rapid refund services" at best reduce the waiting time for tax refunds by two weeks over individual or VITA site electronic filing. For a $500 refund, the actual costs of an RAL generally are even higher than that for a payday loan of the same size!

[19] Carasso, A. & Steure, E. (2003). *Growth in the earned income and child tax credits. Tax facts from the tax policy center.* Washington, DC: Urban Institute and Brookings Institution.

[20] Iowa data is from the Internal Revenue Service. Federal RAL data is from two National Consumer Law Center reports, one using 2002 data and one using 2000 data. 2004 data: Wu, C.C. & Fox, J.A. (2004). *All drain, no gain: Refund anticipation loans continue to sap the hard-earned tax dollars of low-income Americans*. Washington, DC: National Consumer Law Center

and Consumer Federation of America. 2002 data: Wu, C.C., Fox, J.A., & Renuart, E. (2002). *Tax preparers peddle high priced tax refund loans: Millions skimmed from the working poor and the U.S. treasury*. Washington, DC: Consumer Federation of America and the National Consumer Law Center.

[21] See note 6.

[22] Model refund anticipation loan act. Washington, DC: National Consumer Law Center. Retrieved on November 22, 2004 at http://www.consumerlaw.org/initiatives/refund_anticipation/ral_commentary.shtml

[23] For instance, see the Iowa family highlighted in a recent New York Times article: Moss, M. (October 10, 2004). Erase debt now. (Lose your house later). New York Times, Sunday Business Section.

[24] Stein, E. (2001). *Quantifying the economic cost of predatory lending*. Durham, DC: Coalition for Responsible Lending.

[25] Ernst, K., Farris, J., & King U. (2003). *Quantifying the economic cost of predatory payday lending*. Durham, NC, Center for Responsible Lending.

[26] Wu, C.C. & Fox, J.A. (2004). *All drain, no gain: Refund anticipation loans continue to sap the hard-earned tax dollars of low-income Americans*. Washington, DC: National Consumer Law Center and Consumer Federation of America.

[27] Internal Revenue Service Tax statistics reports for 2002 federal tax year. Retrieved from the IRS website: www.irs.gov on December 12, 2004.

About the Coalition Against Abusive Lending

The Coalition Against Abusive lending is a broad-based coalition of housing, human service, civic, church, and labor groups working to curb abusive lending practices in Iowa. These groups formed the Coalition in May 2004 because they realized these abusive lending practices were stripping wealth from moderate to low income working and elderly Iowans, and from the communities in which they live.

The Coalition's purposes include:

- increasing public awareness and public education on predatory lending practices, including the need for state policies to curb abuses
- developing dialogues and building partnerships with other interested groups, including members of the responsible lending community, to refine strategies and build broad-based support for policy and practice change
- identifying model state policies to address issues of predatory lending and to expand access to responsible lenders by people with credit needs

The Coalition Against Abusive Lending conducts research, produces reports, conducts community and regional meetings, and raises electoral awareness of policy solutions that both eliminate predatory lending and create avenues to responsible lending for people who need credit.

Coalition Against Abusive Lending Members:

- Child and Family Policy Center
- Community of Christ-Cedar Valley-Nauvoo Mission
- Cross Ministries/Presbyterian Church
- Davenport Civil Rights Commission
- Family Housing Advisory Services
- Fannie Mae, Iowa
- Institute for Social and Economic Development
- Interreligious Council of Linn County Iowa
- Iowa Citizen Action Network
- Iowa Citizens for Community Improvement
- Iowa Commission on the Status of Women
- Iowa Conference of the United Methodist Church
- Iowa Home Ownership Education Project
- Iowa Community Action Association
- Iowa Federation of Labor, AFL-CIO
- Iowa Human Needs Advocates
- MidAmerica Housing Partnership
- National Community Reinvestment Coalition
- Operation Threshold
- State Public Policy Group
- United Neighbors, Inc.

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