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Recommendations to the Federal Trade Commission On Payday Lending

Payday loans are predatory loans that attract borrowers with offers of "fast cash" on terms such as $15 per $100 for a two week loan. With APRs of 300-500% or more, they quickly mushroom into thousands of dollars of long term debt. In addition to their destructive cost, payday loans require the borrower to pledge as security money the borrower does not have, by turning over a post-dated check or electronic debt authorization. This gives the lender undue power over the borrower, including the power to use self-help to seize wages and federally exempt income.

The FTC should prohibit check holding and the electronic equivalent as form of security similar to the other forms prohibited in the Credit Practices Rule. In the Credit Practices Rule, the FTC determined that it was unfair for creditors, as a condition of a loan, to demand a wage assignment, waiver of protection from attachment or execution, security interests in household goods, or waiver of the right to notice and opportunity to be heard. These collection practices were coercive, injured consumers, and gave creditors the unwarranted ability to exercise self-help.

The practice by payday lenders of holding a post-dated check or a deferred electronic debit authorization is the modern day equivalent to the practices banned under the Credit Practices Rule. These practices are unfair and coercive for similar reasons. Asking for a post-dated check against an account that does not have the funds to cover it is meant merely as a form of terror against the consumer. It exposes the consumer to bounced check fees, extortion that leads consumers to rollover their loans or take out multiple payday loans to cover the first, and the threat of criminal prosecution for a bad check. It gives the creditor a self-help remedy that prevents the consumer from asserting the claims and defenses, including wage exemptions, generally available against debt collection or predatory loans. The pressure to rollover loans results in a pyramiding of fees similar to the pyramiding late fees prohibited by the Commission.

These practices impose the same substantial injury on consumers as the practices prohibited by the Credit Practices Rule. They are an essential part of the abusive payday lending cycle that explodes a small loan into an enormous debt several times the size and buries the consumer in inescapable debt. They are unavoidable for the same reasons as the other banned practices (contracts of adhesion). And, because payday lenders retain other debt collection remedies, their check kiting practices are not outweighed by countervailing benefits for the same reasons as the collection and security practices currently prohibited.

Whether by rulemaking or by an enforcement action seeking injunctive relief, the FTC should declare that the practice of holding a post-dated check or deferred electronic authorization is unfair. Addressing the electronic equivalent is especially important as internet payday lenders threaten to reach into states that have banned triple-digit payday loans.