



Payday Loans: Laws Protecting Montana Borrowers

by Britta A. Schernthanner, former intern, Consumer Sciences, Montana State University and Marsha A. Goetting, PhD., CFP®, CFCS, Professor and Extension Family Economics Specialist, Montana State University

Payday loans are one way for consumers to get short-term loans for up to \$300. However, they have very high annual percentage rates. This publication shows you how to calculate the final cost of the loan and includes the rights and responsibilities of the borrowers and lenders.

***Quick Money! No Credit Checks!
Need Money Until Payday?
Fast Cash Loans!
Payday Advances!***

The ads are on the radio, the TV, the Internet, and even in the mail. The payday loan industry has emerged in response to consumer demand for small loans (from \$50 to \$300) for short periods of time (from one to 31 days) that typically are not made by traditional lenders.

Borrowers who habitually overuse these types of loans can find themselves on the road to financial disaster because of the relatively high costs of obtaining the loans compared to the costs from other sources. Nationwide consumer groups have criticized payday lenders for annual percentage rates (APRs) of 900%, which well exceed the rates offered by traditional lenders.

In Montana, a group of payday loan lenders, who were concerned about protecting their reputations and the rights of borrowers, encouraged passage of the Montana Deferred Deposit Loan Act that was effective October 1, 1999.

This MontGuide outlines the rights and responsibilities of borrowers and businesses who make deferred deposit loans. In Montana such loans are more commonly known as payday loans, cash advance loans, postdated check loans,

or delayed deposit checks.

The finance charges (termed fees under Montana law) and Annual Percentages Rates (APRs) quoted on the following pages are only examples. Actual finance charges and APRs vary from lender to lender. Borrowers who want the lowest finance charge on payday loans should compare APRs among lenders. A payday loan advertised at an APR of 391% is less costly than one quoted at an APR of 565%.

Who are payday lenders?

In Montana a deferred deposit lender or payday lender is defined as a business that provides loans from \$50 to \$300 for up to 31 days. The Division of Banking and Financial Institutions within the Department of Administration issues annual licenses authorizing lenders to make payday loans. The Division conducts annual examinations to ensure that lenders are in compliance with the provisions of state law. In July 2002, there were 88 licensed payday lenders in Montana.

How does a payday loan work?

There are two alternative methods for making payday loans. For the first method, a payday lender loans money to the borrower and accepts a check for the loan amount plus fees. The check is dated on the day it is written and the lender

holds the check for the agreed number of days before depositing it. The borrower has the option of buying back the check with cash before the lender deposits it.

Example: Mary's employer issues monthly paychecks. In January Mary realizes she needs \$100 to get her through the end of the month. She obtains a payday loan and writes a check to the lender for \$113 (\$100 plus a \$13 fee). Mary dates the check on the day she wrote it, January 22nd. She knows that in seven days her check will be deposited and \$113 will be withdrawn from her checking account unless she buys back the check with cash.

For the second method, a payday lender loans money to the borrower and accepts a postdated check (a check that the borrower dates several days in the future). The lender agrees to hold the check until the date written on it. The borrower still has the option of buying back the check with cash before the lender deposits it.

Example: Mike borrowed \$100 from a payday lender. On September 10th he wrote a check payable to the lender for \$118 that included the loan plus fees of \$18 for a 12-day loan. Mike postdated the check for September 21st. The lender said that the check would not be deposited until 3:00 PM that

day. On September 16th Mike bought back his check by paying \$113 in cash to the lender. By paying off the loan early Mike saved \$5 in fees.

What is the cost of a payday loan?

The finance charges for a payday loan make them relatively expensive compared to many other types of loans. No credit history or collateral is required for a person to receive a payday loan. Consequently, a high fee is applied to protect the lender from default loans.

The Montana legislature set the fee cap. The fee cannot exceed 25% of the face value of the check written for the loan. The face value of the check includes the loan and finance charges.

Federal law requires payday lenders to disclose the finance charges on the agreement form as a dollar amount and as an Annual Percentage Rate (APR). For example, the fee on a \$100 loan for four days is \$10 and the APR is 913%. In comparison, loans from traditional financial institutions such as banks, savings and loan associations, and credit unions could have APRs ranging from 10% to 18%. The APRs for cash advances on a credit card could range from 16% to 21%.

How are payday loan fees calculated?

Because payday lenders must disclose the fee percentage as a dollar amount and as an APR on the loan agreement, a borrower does not have to make the calculation to determine the fee. However, a borrower wanting to check the accuracy of the information provided may use the methods in the box (above right)

Federal law requires that a payday loan fee be expressed as an APR. The APR is influenced by the length of time over which the fee is applied. As an example, the APR on a \$100 loan with a fee of \$16 for 10 days is 584%. The APR on a \$100 loan with a fee of \$22 for 15 days is 535%. Examples of fee amounts, annual percentage rates, and fee per-

centages per \$100 for loans from 4 to 31 days are shown in Table 1 .

How much money may be borrowed?

The **maximum** payday loan in Montana cannot exceed \$300 plus fees. The **minimum** payday loan is \$50 plus fees. A payday loan cannot exceed 25% of the monthly net income of the borrower. Monthly net income means take-home pay, or, the amount after taxes and any employer deductions. A borrower cannot have more than two loans outstanding at any one time with a single payday lender. The total of the two loans cannot exceed the \$300 limit.

Example: Josie paid her utility bills anticipating that her refund check from the IRS would arrive to cover them. Now she is worried about her checks bouncing at the bank. She knows that the utility companies charge a returned check fee of \$25 per check. And, the bank also charges \$25 per check for insufficient funds. If all three checks bounce, Josie could have charges of \$150.

Josie asked a payday lender for a \$300 payday loan. However, the payday lender could loan her only \$275 because the lender had to limit the loan to 25% of Josie's monthly take-home income of \$1,100. The lender has a fee of \$91.67. Consequently the total amount Josie will have to pay the lender is \$366.67 (\$275 + 91.67 = \$366.67). She decides that the fee of the payday lender is less expensive than letting her three checks bounce.

To calculate the total amount of the check:

$$\frac{\text{Loan Amount}}{1 - \text{fee expressed as decimal}} = \text{Total amount of check}$$

Example:

$$\frac{\$100}{1 - .25} = \frac{\$100}{.75} = \$133.33 \text{ amount of check}$$

To calculate the fee:

$$\text{Total amount of check} - \text{loan amount} = \text{Fee}$$

$$\text{Example: } \$133.33 - \$100 = \$33.33$$

To calculate the fee percentage:

$$\frac{\text{Fee}}{\text{Amount of Check}} \times 100 = \text{Fee percentage}$$

Example:

$$\frac{\$33.33}{\$133.33} \times 100 = 25\%$$

What's in the loan agreement?

The written loan agreement between the lender and borrower must include:

- name, address, and phone number of the lender making the payday loan;
- signature, initial, or other written means of identifying the employee who signs the agreement on behalf of the lender;
- list of fees and interest charges to be paid by the borrower, including the cost of the loan as an Annual Percentage Rate (APR) and the finance charge of the loan in actual dollars;
- clear description of the borrower's payment obligations under the loan; and statement immediately preceding the signature of the borrower in 14-point bold typeface print that states: "you cannot be prosecuted in criminal court for collection of this loan."

If the above information is not provided by a payday lender, DO NOT accept the loan. Call the Division of Banking and Financial Institutions to report the business. (1-406-444-2091).

What if a borrower can't pay the loan when it is due?

A lender can take civil action to have the loan collected. The civil court can charge the defendant for all court fees and reasonable attorney's fees. The court can also garnish wages, place a lien on a home or other asset, or use other means to have the loan and court fees paid.

Can a payday loan be extended?

No. In Montana, payday lenders are prohibited from renewing, repaying, refinancing, or consolidating a payday loan with the proceeds of another payday loan to the same borrower. The lender may however, without charge, extend the term of the loan beyond the due date.

What if the check used to pay off the loan bounces?

If funds are insufficient upon deposit of the check, the lender can apply a maximum charge of \$15. This charge can only be applied once, even if the same check is deposited and returned a number of times. However, a bank, savings and loan, or credit union can charge a bounced check fee each time a check is returned.

What does the lender require from a borrower?

Payday lenders typically require that borrowers bring with them:

- photo ID proving they are at least 18 years old;
- most recent local checking account statement;
- most recent payroll stub;
- proof of physical address (for example, utility bills).

Some lenders require additional information such as a local checking account with imprinted checks and proof that the account has been open at least three months, a Montana drivers license, vehicle registration, or proof of vehicle insurance.

Most lenders have an application form that requests employer information, financial information, references, and if married, spouse information and spouse's employer information.

What does the lender have to provide to a borrower?

Before granting a payday loan, the lender is required to give the borrower a copy of the written loan agreement and a pamphlet that:

explains, in simple language, all of the borrower's rights and responsibilities for a payday loan, includes the telephone number for the Division of Banking and Financial Services, and

Table 1. Example fees, annual percentage rates and fee rates per \$100 loan from 4 to 31 days

Days Requested for Loan	Fee Amount per Days Requested	Annual Percentage Rate	Fee Rates
4	\$10.00	913%	9.09%
5	\$11.00	803%	9.91%
6	\$12.00	730%	10.71%
7	\$13.00	678%	11.50%
8	\$14.00	639%	12.28%
9	\$15.00	608%	13.04%
10	\$16.00	584%	13.79%
11	\$17.00	564%	14.53%
12	\$18.00	548%	15.25%
13	\$19.00	533%	15.97%
14	\$20.00	521%	16.67%
15	\$22.00	535%	18.03%
16	\$24.00	548%	19.35%
17	\$26.31	565%	20.83%
18	\$28.62	580%	22.25%
19	\$30.93	594%	23.62%
20	\$33.24	607%	24.95%
21	\$33.25	578%	24.95%
22	\$33.25	552%	24.95%
23	\$33.25	528%	24.95%
24	\$33.25	506%	24.95%
25	\$33.25	485%	24.95%
26	\$33.25	467%	24.95%
27	\$33.25	449%	24.95%
28	\$33.25	433%	24.95%
29	\$33.25	418%	24.95%
30	\$33.25	406%	24.95%
31	\$33.25	391%	24.95%

informs the borrower that the Division of Banking and Financial Services provides information about a lender's license.

Are payday loans a good way to borrow money?

Payday loans provide access to money for consumers who believe they do not have other borrowing options. Some borrowers turn to payday lenders only in emergency situations and do not use payday loans on a regular basis. Others, however, find they need extra money repeatedly. Before taking out a payday loan, ask yourself: If you are low on money now, will you have the money in the next 31 days to pay off the loan?

Example: Melody wants to visit her sister. She found that the

airline is having a sale on tickets. However, Melody does not have enough money to buy the ticket. Having heard about payday loans, Melody explored taking one out to buy the ticket. She would have to borrow \$300 for three weeks (21 days). The lender charges a fee of \$100. In 21 days, Melody would owe \$400 to the payday lender. The APR on the loan is 578%.

After considering other bills that are due by the end of the month, Melody concludes that she would not be able to repay the loan with her next paycheck. She decides instead, to start a savings account and visit her sister in a few months. Her first deposit will be the \$100 she would have used to pay the fee on the payday loan. With three additional deposits of the same amount she can visit her sister and not worry about having to pay back a loan.

Are there alternatives to a payday loan?

There are many sources of short-term credit:

- Check out the cost of a loan from a credit union, bank, or savings and loan institution.
- Ask an employer for an advance on a paycheck.
- Ask family or friends for a short-term loan.

Is the cash advance on your credit card at a lower APR than on a payday loan?

Use a credit card to make your purchase and pay monthly. The APR on credit card purchases may be lower than on a payday loan. Use a credit card for the purchase and then pay the total balance by the due date and avoid any finance charges on the purchase. Are there any local community-based or faith-based organizations in your area that make small loans to individuals?

Ask creditors for more time to pay bills. Do they charge for this service? Is the charge less than a payday loan? Another alternative is to obtain overdraft protection on your checking account. Is the cost less than a payday loan?

How can a borrower avoid needing a payday loan?

Better management of money may help avoid the need for payday loans. Tracking income and expenses can help borrowers develop a spending plan for all expenses, including savings and emergencies.

The MSU Extension Service has many financial management publications to help borrowers get a grip on their money. The checklist at the end of this MontGuide provides helpful resources. Contact a local Consumer Credit Counseling Service or your county MSU Extension Service for assistance in creating a spending plan.

Establish an emergency fund. The fund will help savers avoid the need for a payday loan. By saving the fees that would be

incurred if a payday loan was taken out each month, a sizeable fund can be generated.

Summary

Payday lenders offer consumers an alternative to traditional borrowing options. Traditional financial institutions often do not make small loans ranging from \$50 to \$300. However, because of the high APRs on payday loans, carefully examine other alternatives.

Compare the APR that includes loan fees, interest, and other types of credit costs of all credit options and choose the lowest one. If a payday loan is decided upon, borrow only as much as can be afforded and paid off with your next paycheck.

Acknowledgment

This MontGuide was reviewed by representatives from the following agencies and professional organizations:

Banking and Finance Division,
Department of Administration,
Business, Estates, Trusts, Tax and
Real Property Section, State Bar
of Montana.

Appreciation is also expressed to reviewers who have had experiences with payday loans and reviewers from the payday loan industry.

MSU Extension Resources:

The MSU Extension Service has many publications on the web that can assist you in managing your money. Download those of interest at: <http://www.montana.edu/wwwpb/pubs/index.html#Consumer>

The free publications below are also available from Marsha A. Goetting, P. O. Box 172800, Montana State University, Bozeman, MT 59717. E-mail: goetting@montana.edu.

Developing a Spending Plan (MT 9703 HR)

Helping People Cope with Financial Crisis (MT 8608 HR)

Montana Families: Taking Control During a Financial Crisis (Bulletin 1342)

Managing a Seasonal Income for Family Living Expenses (MT 9110 HR)

Using a Check Register to Track Your Expenses (MT 8703 HR)

Financially Fit Me (2B1326)

Schedule of Non-Monthly Family Living Expenses (MT 8910 HR)

Reduce Your Debts the PowerPay Way (HO 0009)

References

Montana Codes Annotated. September, 2000. Montana Deferred Deposit Loan Act. Sections: 31-1-701 through 31-1-725.

Copyright © 2002 MSU Extension Service

We encourage the use of this document for nonprofit educational purposes. This document may be reprinted if no endorsement of a commercial product, service or company is stated or implied, and if appropriate credit is given to the author and the MSU Extension Service. To use these documents in electronic formats, permission must be sought from the Ag/Extension Communications Coordinator, Communications Services, 416 Culbertson Hall, Montana State University-Bozeman, Bozeman, MT 59717; (406) 994-2721; E-mail - publications@montana.edu. To order additional publications call your local county Extension office, or visit www.montana.edu/publications.



The programs of the MSU Extension Service are available to all people regardless of race, creed, color, sex, disability or national origin. Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, David A. Bryant, Vice Provost and Director, Extension Service, Montana State University, Bozeman, MT 59717.

**File under: Consumer Education
J-13 Money Management
July 2002 (ST)**