Credit Services Organizations:

Flaws in the Law Allow a Loophole for High-Cost Unregulated Lending

Growing Group of Businesses Buck Texas Lending Laws

- High-cost lenders, like those offering payday and auto title loans, are using a loophole in the Credit Services Organizations (CSO) Act to get around state consumer lending laws. Laws governing CSOs in Texas were established to control credit repair businesses. A provision of the law allows CSOs to obtain "an extension of consumer credit for a consumer."[1]
- Operating as CSOs, high-cost lenders avoid licensing and fee regulations applicable to other consumer lenders in the state. CSO loans often exceed 500% APR.
- As of November 2008, there were nearly 400 registered CSOs in Texas. Since January of 2007, the number has more than doubled.
- Only 7% of registered CSOs provide credit repair services as their primary business; 75% are payday lenders and 8% are auto title lenders.

Credit Services Organizations in Action

A recently widowed young Houston mother took out a $500 auto title loan from a credit services organization to help pay burial and medical expenses. The payment terms: $650 due in 30 days, and the title for her car as collateral. Three months later, after paying $450 on the loan, she still owes $650. All the money she has paid thus far is for renewal fees and interest. None reduced the loan's principal. Her means of transportation remains at the lender's mercy.

Family Services of Greater Houston Client—December 2008

CSO Case Study: Payday Lending in Texas

- By operating as CSOs, payday lenders dodge the rate and fee limits for payday lending passed by the Texas Legislature.[2] Nearly 3,000 CSO payday storefronts cover Texas.[3]
- A payday loan is a small, short-term loan secured by a personal check or electronic access to a debit account. Generally, Texas CSO payday lenders charge $20 in fees per $100 borrowed, or 521% APR—among the highest charges in the country.
- Payday lenders do not perform traditional underwriting and only require a source of income and a checking account.
- 2008 survey of low-income Texas payday borrowers found that at least 58% could not payoff their loan, plus fees and interest, by the next payday.[4]

The CSO Loophole

- CSOs use the loophole to make unregulated high-cost loans. They claim they are not lenders, yet they bear most of the risk of the loans and reap most of the profits. The CSO is also the consumer contact, selling loans and collecting payments.

How It Works:

- CSOs obtain loans for customers through third party lenders. The lenders provide the loan at 10% interest. In addition to the interest, the CSO charges customers a high fee to arrange the loan and to issue a letter of credit guaranteeing that the lender will receive payment if the customer defaults. CSO fees are not capped, leading to 500% plus APRs on the loans.

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[1] Texas Finance Code § 393.001 (3) (b).

[2] Texas Finance Code 342.201 (requires payday lenders to be licensed and adhere to fee limits determined by the Texas Finance Commission). Texas Administrative Code, 7 TAC 83.604 (rules governing payday lending).

[3] Payday Lending in Texas: Bucking the Trend, Don Baylor, Center for Public Policy Priorities, presented at Federal Reserve Bank of Dallas & IC2 Institute Payday Lending Conference, University of Texas Etter-Harbin Alumni Center Nov. 14, 2008. Available at http://dallasfed.org/news/ca/2008/08payday_baylor.pdf

[4] Short-term Credit and Payday Loans: A Look at Low-Income Texas Consumers, Ann Baddour, Texas Appleseed, presented at Federal Reserve Bank of Dallas & IC2 Institute Payday Lending Conference, University of Texas Etter-Harbin Alumni Center Nov. 14, 2008. Available at http://dallasfed.org/news/ca/2008/08payday_baddour.pdf. The survey was conducted by the

Credit Services Organizations in Action

An Austin woman took out two payday loans, $1000 and $800, from a registered credit service organization. She continues to make renewal payments on the loans, but is not allowed to make payments towards the principle without paying the loan in full. As a result, she has taken on a second job, just to pay the renewal fees, which exceed $400 per pay period. She has already paid $600 towards the $1000 loan and still owes $1200. "I've paid so much money into it and it's not going anywhere. It hurts."

Texas Appleseed Interview—December 2008

The Hidden Costs of the CSO Loophole

- Texans take an estimated $2.5 billion in loans through CSO payday lenders each year and pay an additional $500-$600 million in annual interest and fees.[5]
- Low-income Texans disproportionately use payday loans, as do women and minorities.[6]
- Payday loan usage causes higher incidence of bankruptcy filing.[7]

Create a Fair and Vibrant Market: Close the CSO Loophole

- Cities are standing up to the rapid growth of these fringe financial services within their limits. Since January 2008, Richardson, Mesquite, and San Antonio have passed ordinances restricting the location and concentration of these high-cost lenders.
- The ordinances show growing opposition to unregulated CSO lenders in Texas, but do not affect the core product model, which keeps borrowers trapped in debt.
- Fifteen states and the District of Columbia have enacted legislation capping charges on small, short-term loans at or around 36% APR.[8]
- In 2007 Congress enacted a 36% APR rate cap on the costs of consumer loans for members of the military.
- Texas must close this loophole which threatens the financial health of borrowers and communities.
    - Cap CSO fees and hold CSOs accountable to the regulatory standards that protect Texas families from financial abuse.
    - As a long-term solution, the state should urge financial institutions to provide all Texans access to opportunities for savings and to safe, short-term financing solutions in order to ensure a robust, affordable financial market.

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FDIC's Texas Alliance for Economic Inclusion in partnership with community organizations in Austin, Dallas, Houston, and San Antonio.

[5] The Hidden Costs of Payday Lending. Don Baylor, Center for Public Policy Priorities, Texas Business Review (Apr. 2008).

[6] Do Payday Loans Cause Bankruptcy?, Paige Marta Skiba, Vanderbilt University Law School and Jeremy Tobacman, Wharton School, University of Pennsylvania, Oct. 10, 2008.

[7] Id.

[8] Arkansas, Connecticut, Georgia, New Hampshire, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, West Virginia.

RAISE Texas is a statewide network moving Texans along a path toward financial success and economic stability.

April 27, 2009

Stop Unlicensed Lenders from Hurting Texas Families and Communities: Make CSOs Accountable

Laws governing Credit Services Organizations (CSOs) in Texas were established to control credit repair businesses. Now, high-cost lenders, like those offering payday and auto title loans, are using the CSO Act as a loophole to get around state consumer lending laws. As a result, these lenders have no state watchdog, and working Texans have no protection from unfair and deceptive business practices.

Payday loans and auto title lenders make up nearly 85% of all registered Credit Services Organizations in Texas. These lenders are known to trap consumers in a cycle of debt. They charge usurious fees, with the loans reaching over 500% APR. Texans take out an estimated $2.5 billion in loans through CSO payday lenders each year and pay over $500-$600 million in interest and fees.

In addition to the high fees, payday and auto title lenders do not require traditional underwriting and ask only that the borrower have a source of income and a checking account—a lending approach that is irresponsible and only leads to trouble for borrowers.

A 2008 survey of low-income Texas payday borrowers found that at least 58% could not pay off their loan, plus fees and interest, by the next payday. National studies show that nearly 90 percent of repeat payday loans are made shortly after a previous loan was paid off. The same pattern holds true for auto title loans.

In this time of financial and economic crisis, the state of Texas must step up and put the interests of our families over those of lenders who are evading accountability under Texas lending laws.

Here the undersigned, we urge the Texas Legislature to limit CSO fees and hold CSOs accountable to regulatory standards that protect Texan families from financial abuse.

AARP Texas
Assoc. of Rural Communities in Texas
Baptist General Convention of Texas
Casa de Amigos (Midland)
Center for Public Policy Priorities
CDC of Brownsville
Mayor John Cook, City of El Paso
Covenant Community Capital Corp. (Houston)
El Paso Affordable Housing CUSO
El Paso Collaborative
Family Services of Greater Houston
Foundation Communities (Arlington, Austin)
Goodwill Industries of San Antonio
Grow Assets, LLC (Abilene)
Mexican Amer. Legal Defense & Educational Fund
Midland Affordable Housing Alliance
Midland Community Development Corporation
Midland Asset Building Coalition
Motivation Education & Training (New Caney)
Neighborhood Centers (Houston)
One Voice (Houston)
Peoplefund (Austin)
RAISE Texas
S. Texas Adult Resource & Training Center
South East Texas CDC (Beaumont)
Texas Appleseed
Texas Association of Community Development Corporations
Texas Association of Goodwills
Texans Care For Children
Texas Low Income Housing Information Service
Texas Impact
Texas Tenants Union
The Woodlands City Alliance of Tenants (Dallas)
United Way Capital Area
United Way of the Coastal Bend
Unity National Bank
Urban Progress CDC (Dallas)
Vision Weavers Consulting, LLC (Houston)
YWCA of Metropolitan Dallas