

Payday Loans: What to Do If You Get Caught in the Debt Trap

What is a payday loan?

A payday loan is a short-term, high-cost loan that must be paid back on or before your next payday, whether your income is from employment or government benefits. Payday loans are made by storefront lenders, check cashers, pawn shops, credit unions, and Internet-based providers. In Washington, anyone providing a payday loan, including Internet payday lenders, must be licensed by the Washington State Department of Financial Institutions (DFI).

The maximum loan term in Washington is 45 days, and there is no minimum loan term. The term for most payday loans is 14 days. The maximum amount of money any one lender can loan you at one time is \$700. (It is not uncommon to see financially strapped borrowers with payday loans from more than one lender, which compounds the problems described below.)

Payday lending was illegal in Washington until 1996. Since then, the payday loan industry has grown exponentially, as the number of payday loan locations increased 97% since 2000. Almost 3.5 million payday loans -- totaling a staggering \$1.33 billion -- were made in Washington in 2006 alone.

These loans are not approved based on any check on creditworthiness as is done with a standard loan. Payday loans are not loans that would be reflected on a credit report, and cannot therefore *improve* a borrower's credit rating if the loan is paid back on time. These loans can only *harm* a borrower's credit rating, which occurs if a delinquent account is referred to collections and reported to a credit reporting agency.

How does the process work?

You write a post-dated personal check to the payday lender, or you authorize the payday lender to take the money directly out of your bank account on the date of the check or authorization. Generally, this is on your next payday. On the date the payday loan is due, you either give the payday lender cash in return for your post-dated check, or you let the lender deposit your check. If you authorized the payday lender to take the money directly from your account, the lender will do so on the due date.

Should I take out a payday loan?

Payday loans are extremely expensive and difficult to pay back on a tight budget. You should avoid taking one out and look for other options (see "What other options do I have ..." paragraph below). Otherwise, you could get stuck in a cycle of debt by using one payday loan to pay off another.

How much do payday loans cost?

In Washington, payday lenders commonly charge the maximum amount allowed by law (RCW 31.45), which is 15% for the first \$500 borrowed, and 10% above \$500 up to \$700. The following chart shows the maximum amount that a payday lender can charge you.

Amount Borrowed	Cost of Loan (in dollars)
\$100	\$115
\$200	\$230
\$300	\$345
\$400	\$460
\$500	\$575
\$600	\$685
\$700 (maximum)	\$795

Payday lenders are required to tell you, in a contract that you sign, how much the annual percentage rate (APR) is for the money you borrow. The APR is the interest rate for your loan spread over a period of a year. *The less time you have to pay back the loan, the higher your APR will be.*

Are payday loans more expensive than other types of credit?

Yes. Some less expensive types of credit include a personal line of credit at your bank, a credit card cash advance, and one overdraft charge on one bounced check. Below is a comparison chart with examples of several credit options.

	Payday Loan	Personal Line of Credit	Credit Card Cash Advance	Overdraft Fee (one bounced check)
\$ Borrowed	\$300	\$300	\$300	\$300
Days to repay loan	14 days	14 days	14 days	14 days
Interest rate	None	12.81%	18.8%	None
Fee	\$45	None *	\$13.50	\$28.75
Total Cost	\$45	\$1.47	\$15.66	\$28.75
APR	391%	12.81%	135.75%	250%

* Some personal lines of credit may have an annual fee; if there is one, the corresponding APR may be higher than what is reflected on this chart.

Is the payday lender required to tell me how much my loan will cost?

Yes, the lender is required to tell you the terms of the loan, including the amount of fees and the APR.

While most storefront lenders provide this disclosure in the paperwork you sign, many Internet-based payday lenders do not provide this disclosure until after you have clicked “yes” to taking out the loan. This is illegal and the loan may be unenforceable. All payday lenders must provide these disclosures before you agree to take out a loan. You should contact the Department of Financial Institutions (DFI) immediately to report the problem by calling 1-877-RING-DFI (746-4334) (TDD: 360-664-8126) or contacting them online at www.dfi.wa.gov.

While lenders must provide this disclosure to you, lenders are not required to explain to you in plain terms how much your payday loan will cost if you are unable to pay it back by the due date or if you take out successive loans.

What other options do I have instead of taking out a payday loan if I'm out of money and still have bills to pay?

- Make arrangements with creditors. Utility companies, credit card companies, and landlords often allow extra time to pay. Also consider the cost of late fees, as they may be less than the cost of taking out a payday loan.
- Borrow from friends or relatives.
- Seek assistance from religious institutions or social service agencies. Contact the Washington State Department of Social and Health Services (DSHS) to find out if you are eligible for one of their emergency assistance programs.
- Shop around. Banks, credit unions, and finance companies offer alternatives to payday loans including small consumer loans.
- Check with your employer to see if they have a program that allows employees to get an advance on their next paycheck.
- Contact a credit counselor. A counselor can help you get out of debt and avoid a payday loan. Check with your bank or credit union about in-house credit counseling.

What happens if I took out a payday loan but I can't pay it off?

Remember that the payday lender has your check and can cash it on the date that payment is due. If you don't have enough money in your account, your check will bounce and your bank will charge you a fee. The payday lender also will charge you a bounced check fee. Some payday lenders might try to cash the check several times. Each time the check bounces, the bank will charge you an overdraft fee. While some types of government benefits (SSI, for example) are normally not garnishable by a debt collector, payday loans are different. By writing a check on your account or authorizing the payday lender to remove money directly from the account, you are giving permission to the payday lender to take money out of your account – regardless of what types of funds are in the account.

You can try to talk to someone at your bank, in person at a branch or on a customer service line. You can explain the situation, and ask if the bank would be willing to reverse any fees or charges on your account resulting from the bounced check. If you are having the payday loan money automatically deducted from your bank account, you can ask the bank to stop that automatic deduction. In extreme cases, consumers caught in the debt trap have stopped payment on the check, terminated their bank account, and reopened a new bank account. You should contact an attorney to discuss these considerations.

At some point, the payday lender might send your debt to collections. In the end, you may still owe the amount you borrowed, plus the fee, plus the overdraft charges, plus the bounced check fee, plus possible collections fees, plus possible court costs if the payday lender or collection agency sues you for the debt.

Can I ask the payday lender for a payment plan?

Yes. Before your loan comes due (even if it's your first loan), you can ask if the payday lender offers an "extended payment plan." Although not required by state law, some of the larger payday lenders claim to offer this plan. All lenders in Washington are required to provide a payment plan if you request one after you take out four payday loans in a row from the same lender and before the due date on the fourth loan. While by law the lender must agree to enter into a payment plan after four successive loans, you and the lender can agree to a payment plan any time before that point. Any payment plan must be in writing and signed by you and the lender.

The lender can charge you a one-time fee for entering into a payment plan. The fee cannot be more than the original loan fee (e.g., \$75 if the loan was \$500). The payment plan must allow you at least 60 days to make three or more payments. If you pay off the loan before 60 days, the lender cannot charge you another fee for paying early.

If you miss a payment on your payment plan, the lender can charge you a one-time default fee of \$25 and initiate collection on your defaulted loan. If you give the lender a postdated check for payments under the agreed plan, and your check bounces, the lender cannot charge you an extra fee for the bounced check.

If a lender refuses to give you a payment plan after you take out four loans in a row, you should contact DFI immediately to report the problem.

Your loan documents should include information about your right to a payment plan. If your loan documents did not include this information, you should contact DFI.

Can I cancel my loan?

Yes, but you must cancel (or "rescind") it on or before the close of business on the next day of business after you took out your loan. You must cancel your loan at the same location where you got your loan. For example, if you took out a payday loan on Tuesday, and you later decide that you don't want the loan, you must return to that same payday lender before it closes on Wednesday. If the lender is open 24 hours, you should return to the lender before midnight the next day.

When you go back to the payday lender to cancel your loan, you must return the money that was loaned to you. In return, the lender must return your postdated check or cancel any electronic withdrawal from your bank account.

You should not be charged any fee for canceling your loan. If you attempt to cancel your loan by the deadline but the lender charges you a fee or refuses to cancel your loan, you should contact DFI immediately to report the problem.

Your loan documents should have included information about your right to cancel your loan. If your loan documents did not include this information, you should contact DFI.

Should I deal with my overdue payday loan by paying a fee and taking out another payday loan?

No. Any payday lender that has you pay an additional fee to "roll over" your payday loan to make the entire loan due later is violating Washington law, and you should contact DFI.

Washington law requires that the borrower pay off an existing loan first before taking out another loan with that lender. To avoid being caught in a debt trap, you should avoid taking out another payday loan to pay back the first payday loan. Because these loans are so easy to get, many people think that paying them back will be just as easy. Once a borrower gets into the cycle of paying off a loan and immediately taking out a new one to cover other bills, this cycle is hard to break. Many borrowers end up taking out 10-30 loans or more in a year because they end up taking out one at every pay day to pay the last one back or to pay other bills. This is extremely expensive, and you will end up paying far more in fees and costs than you actually intended to borrow. If at all possible, try to use the alternatives listed in the “What other options do I have ...” paragraph above.

Can I close my checking account to try to stop a payday lender from removing money from my account?

Yes, but there may be consequences. You should expect that the payday lender will take collection action quickly. When you take out a payday loan, you either write the lender a personal check or give the lender permission to debit money directly from your checking account. If you close the checking account to prevent the lender from taking out the money you owe, the payday lender might continue to try to take money out of the account by attempting to cash the check or debit money from the account, which could result in overdraft fees owed to your bank.

The payday lender might send your loan to collections. If the lender does this, additional fees and costs will be added to the amount you owe. If you don't pay the debt while it is in collections, the collection agency might try to sue you in court to try to get you to pay the money you owe.

To avoid the collection actions described above, you could first try talking to the manager of the store where you got the payday loan to see if the manager would be willing to let you pay what you owe in a repayment plan. You could explain to the manager what your situation is, why you cannot pay all the money that you owe at one time, and that you need to pay it back over a period of several months. If you are allowed to repay the money owed in a repayment plan, you should make your payments on time to avoid the collection actions described above.

Additionally, if you close your account at one bank and then attempt to open an account at a new bank, you could have difficulties. Some banks will not open a new account if the prospective customer owes money to another bank. If this happens to you, you should contact DFI, or whatever regulatory agency has jurisdiction over the bank that refuses you service.

If a payday lender sues me and gets a judgment against me, can they collect on that judgment if my only income is from social security or a pension?

If the only money in your bank account is from social security or a pension that account cannot be garnished by a judgment creditor. While there are exceptions to this general rule, including exceptions for the collection of taxes and child support, there is no exception for the benefit of payday lenders.

However, even if you have not been sued, if your income is exempt, you must be vigilant to protect it from being seized by a payday lender. If the payday lender has your checks, or authorization to access your account, it does not need to sue you to get paid. Accordingly, you can try to terminate the payday lender's access to the funds in your account. To do so you may have to close the account and move your money to an account at another bank. However, as noted above, some banks will not open a new account if you owe money to another bank.

If your social security benefits or pension payments are automatically deposited into a bank account that a payday lender has your permission to access (via your check or authorization), you can redirect where your automatic deposits are made. Information on changing automatic deposits of social security benefits can be obtained at www.socialsecurity.gov. **Be sure to avoid any lender that wants you to have your social security checks deposited directly into a bank account that the lender controls.** Recent reports from around the country describe how seniors are left with little or no income after receiving what is left of their monthly benefits check under this arrangement.

Do not commingle nonexempt funds with your social security and pension money. For example, if a birthday check from a family member is deposited into the same account as your exempt social security funds, you will not be able to argue that all funds in the account are exempt from garnishment.

If you get sued, be sure to answer the lawsuit and any subsequent garnishment notice by notifying all parties in writing that your bank account cannot be garnished because it contains only exempt funds.

More information about protecting exempt assets can be found in the following brochures available at www.washingtonlawhelp.org:

- [Debtors' Rights with Collection Agencies](#)
- [Debtors' Rights in a Lawsuit](#)
- [How to Answer a Lawsuit for Debt Collection](#)
- [How to Claim Personal Property Exemptions](#)

Can the lender threaten me with criminal prosecution as a method of collecting a payday loan?

No. It is illegal for a payday lender to threaten to throw you in jail or threaten to prosecute you criminally for an unpaid debt. If this happens to you, you should immediately file a complaint with DFI. You can also complain to DFI if payday lenders are harassing you by calling your home or work more than a few times per day, showing up at your worksite, talking to your children about the debt owed, etc.

What are my rights as a military borrower?

As of October 1, 2007, payday lenders must comply with a new federal law that limits the APR that can be charged to military families on payday, tax refund anticipation, and auto title loans to

36%. In addition, lenders are not allowed to accept checks or authorization to remove money from a military family's checking account as collateral for a loan.

Under current state law, it is illegal for a payday lender to contact the military chain of command to try to collect on a payday loan taken out by a military borrower. It is illegal for payday lenders to garnish any wages or salary paid to service members in the armed forces. In addition, payday lenders cannot attempt to collect debts from either the military borrower who has been deployed to a combat or combat support post, or the military borrower's spouse, for as long as the military borrower is deployed.

I took out a payday loan on the Internet, and the payday lender is charging a higher rate than permitted under Washington law. What can I do?

Effective July 22, 2007, Washington law requires every lender offering a payday loan to Washington residents be licensed by DFI. All payday lenders offering loans to Washington citizens must comply with Washington law. If the payday lender is not licensed, then the payday loan is unenforceable and uncollectible. In addition, if the payday lender is charging a higher rate than allowed by law in Washington, the payday loan is unenforceable. You should contact DFI immediately to report this violation.

Can I file a complaint about a payday lender?

Yes. DFI takes complaints from consumers about their experience with payday lenders and investigates those complaints. For example, if the payday lender repeatedly bounced your check with your bank or harasses you to pay back the loan, you should report the problem to DFI. You can contact DFI by filling out a complaint form online at www.dfi.wa.gov/consumers/complaint.htm, or calling 1-877-RING-DFI (746-4334) (TDD: 360-664-8126).

Who can I call for help if I am in a payday loan debt trap or I think the payday lender has violated the law?

- **Solid Ground:** The Predatory Lending program at Solid Ground can provide advice and assistance to help consumers statewide, regardless of income, get out of the payday loan debt trap. This program can be reached by calling (206) 694-6776 or 1-866-297-4300.
- **Northwest Justice Project (NJP):** NJP provides legal advice and assistance to low-income people statewide. If you are low-income and live outside of King County, call Northwest Justice Project's CLEAR line for advice and referrals at 1-888-201-1014, Mondays-Fridays from 9:15 a.m. to 12:30 p.m., and on Tuesdays from 3:30 p.m. to 6:00 p.m. If you are low-income and live in King County, call (206) 464-1519 for an intake appointment. If you are age 60 or over, whether you live inside or outside King County, call CLEAR*Sr at 1-888-387-7111. You can also dial 211 to reach an operator who can refer you to a host of legal services. If you are not low-income, call a lawyer referral service listed on the Washington State Bar Association website: www.wsba.org/atj/contact/lawref.htm.
- **Washington State Department of Financial Institutions (DFI):** Reach DFI by calling 1-877-RING-DFI (746-4334) (TDD: 360-664-8126) or online at www.dfi.wa.gov.

- **Federal Trade Commission (FTC):** The FTC takes consumer complaints online at www.ftc.gov. Just click on “contact us.” You can also make a consumer complaint by phone by calling toll-free 877-FTC-HELP (382-4357) between 9:00 a.m. and 5:00 p.m. Eastern Standard Time, Monday through Friday. You can write the FTC at Northwest Region, Federal Trade Commission, 2896 Federal Building, 915 Second Avenue, Seattle WA 98174.

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