



# POLICY PERSPECTIVES

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## IT COSTS A LOT OF MONEY TO BE POOR: CONSUMER FINANCE FOR POOR AND WORKING CLASS CITIZENS

Every day South Carolinians borrow money—to buy a used car, to purchase a television, to pay a light bill. When school opens, the kids demand new, brand name clothes. As Christmas approaches, every message we receive is: “If you love your family, you’ll show it with gifts at Christmastime.” Those among us who have low incomes or poor credit cannot just put that money on a credit card or home equity loan or walk into a regular bank and borrow the money.

Instead, you go to one of the consumer finance or “fringe credit” companies to borrow that money. Those lenders include pawn shops, lenders who will take a check but not cash it for two weeks to a month (deferred presentment services), companies that mainly make loans under \$600 (Restricted Lenders), and lenders who mainly make loans over \$600 or through car and furniture companies (Supervised lenders). A particular type of Supervised lender is an Auto Title lender who will make a loan over \$600 on the security of your car title.

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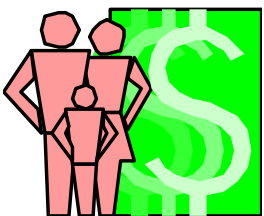
*The Company generally serves individuals with limited access to other sources of consumer credit from banks, savings and loans, other consumer finance businesses and credit cards. The Company's customers typically use their loans to meet temporary or unanticipated cash needs, such as holiday gift purchases, car repairs, medical bills and back-to-school needs.*

World Acceptance Corporation, SEC Form 10-K, 1998

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If you can go to a bank to borrow money, you might pay between 7 and 15 percent per year interest (Annual Percentage Rate or APR). These fringe lenders may charge you between 50 and 300 percent per year APR finance charge. This is a very expensive way to borrow money.

In 1995 the General Assembly passed significant revisions to our lending laws which, among other provisions, made all consumer loans under \$600 subject to caps on finance charges, provided for refunding certain charges on early payment or renewal of smaller loans, and prohibited continual renewing of loans where there was little or no cash advance to the borrower. The latter two changes were intended to reduce flipping (continuous renewal of loans). The \$600 threshold was designed to make Restricted and Supervised lenders operate under same rules for small loans. Some Supervised lenders were making unregulated small loans at 100%+ APRs while lower Restricted lender rates were set out in statute.



Act 135 of 1995 introduced significant changes in small loan laws.

The differences between Restricted and Supervised lenders are disappearing.

In the past year, several Restricted lenders (notably World Acceptance and Regional Finance) have switched their licenses to Supervised licenses. The average Restricted loan has been going up—reaching \$510 in 1996. The number of Restricted licensees dropped from 450 in 1996 to 392 in 1997. By switching their licenses, these former Restricted lenders can both charge more for over-\$600 loans and make loans over \$7,500. Legislation which would have raised

the threshold to \$1,000 and indexed it to inflation failed in 1998. Charles Walters, President of World Acceptance, and then spokesperson for the Restricted lenders, had proposed the change. Once he figured out the advantages to World Acceptance of license-switching, Walters started attacking the higher threshold.

<b>Different Kinds of Lenders Regulated by South Carolina Law</b>		
<b>Restricted</b>	<b>Supervised</b>	<b>Deferred Presentment</b>
Small loans under \$7,500. Average loan in 1996–\$510; in 1997–\$492. Finance charges are regulated by statute. On a \$550 loan for 10 months, interest rate is 61.5% with all allowable charges. Title 34, Chapter 29. 450 Restricted licensees in 1996; 392 in 1997 as many licensees switch to Supervised licenses .	Larger consumer loans and sales financing where interest rate exceeds 12%. Average consumer loan in 1997–\$3,140. No limits on finance charges on loans over \$600 but can charge no more than a maximum amount filed with the Department of Consumer Affairs and posted in the loan office. Title 37, Chapter 3. Consumer loans over \$600 typically range from 18-43 % Annual Percentage Rate (APR). Loans under \$600 governed by Restricted Lender statutes. 837 Supervised licensees in 1996; 1,141 licenses at December 31, 1997 and 1,409 at August 26, 1998..	Small loans (under \$301) secured by a check to lender. Typical term is 2 weeks. Maximum term–1 month. Cannot be renewed. Maximum charge–15% of amount loaned. Title 34, Chapter 39 [Act 433 of 1998].
<b>Pawn Shops</b>	<b>Rent-To-Own</b>	<b>Auto Title Loans</b>
Loans on security of pledged goods. Maximum interest rates are specified by statute. Range from 300 % APR on \$50 loan, 158% on \$550 loan and 114% on \$1,000 loan. Title 40, Chapter 39.	Consumer leases product and owns it—at a very high price-- if makes all payments. Not strictly a loan but is a way to back into financing of purchase. Statutes regulate terms and condition of lease but with no explicit limits on costs. Title 37, Chapter 2, Part 7.	These are Supervised loans. Typically loan money on security of an auto title for 30 days at finance charge of 25 percent of loan (300 % APR). No loan smaller than \$601 to avoid Restricted loan caps.

In 1995, the legal small loan market encompassed only: Restricted Lenders, Supervised lenders, pawn shops and Rent-to-Own.

New types of lenders are coming into South Carolina.

Since then, two additional kinds of lenders have appeared. Deferred Presentment Services make loans on the security of a check which will not be cashed for two weeks to a month. In other areas these are called payday loans or postdated check loans. Act 433 of 1998 instituted regulation and fee caps for Deferred Presentment Services which limit the fee to 15% of the amount loaned. These loans cannot be renewed.

Auto Title Lenders make very expensive (300 % APR) loans while holding a lien on a car title. These loans are for a month, but are frequently extended with interest growing daily. Although charging much higher interest rates than typical Supervised lenders, Auto Title Lenders have only the limited regulation of other Supervised lenders. Legislation to put them under the pawnbroker statute failed in 1998.

**A ROLLING LOAN GATHERS NO LOSSES--FLIPPING**

*The Company believes that the development and continual reinforcement of personal relationships with customers improve the Company's ability to monitor their creditworthiness, reduce credit risk and generate repeat loans. It is not unusual for the Company to have made a number of loans to the same customer over the course of several years, many of which were refinanced with a new loan after two or three payments.*

World Acceptance Corporation, SEC Form 10-K, 1998

Small loan lenders keep lending to the same people over and over again. For Restricted lenders, the vast majority—72% in 1997—of all loans were renewals—or flips—of existing accounts before they were paid out. Supervised lenders flipped 61% of their 1997 consumer loans.

On typical Restricted loans and loans under \$600, a major part of the cost of money is for charges in addition to interest: an initial charge (7% up to \$56); a maintenance fee (\$1 per month for the term of the loan); charges for accident and health, credit life and property insurance (typically \$3.25 per coverage or \$9.75); and an \$8 fee for insurance to protect the lender because he doesn't bother to perfect his security interest in your collateral. On a 10 month loan for \$550, interest makes up only \$111.67 of your \$166.92 cost of money.

If you pay off your loan by renewing it, you are credited with a rebate on only the interest, the initial fee and the maintenance fee. That rebate after 90 days is figured using "The Rule of 78s" which front-loads the interest and fees "earned" to the benefit of the lender. You get back none of the insurance fees when the lender charges you the standard \$3.25 fee per coverage.

The lender has an incentive to flip loans. He gets to recharge all of those fees much more often. If he flips a borrower every four months, the lender has the opportunity to charge those fees three times in a year rather than once or twice.

Although he has had to refund or rebate some charges, the Rule of 78ths calculation of the rebate on the interest and the initial charge effectively mean that he "earns" those funds sooner than he would have if the loan matured. In addition, the amounts of those insurance fees were part of the first loan. So, when he flips the borrower into a new loan, the lender is financing part of the interest and fees from the first loan in the subsequent loan.

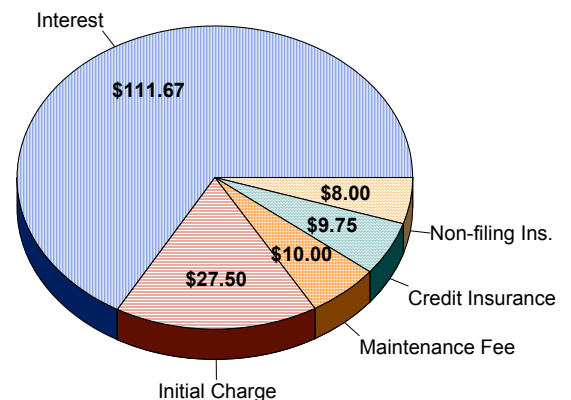
The unrebated fees and the Rule of 78ths rebates on other charges reduce significantly the cash advance available to the borrower on the new loan. We have seen at least one renewal loan document with a nickel and a dime taped to it as the whole cash advance. Act 135 of 1995 limited to one the number of such low-cash advance flips in a 15 month period.

Auto Title Lenders don't choose to charge all the fees that Restricted lenders get. Their loans are for thirty days. A borrower with poor credit who doesn't have \$600 today is not likely to have it a month from now. But the lender takes a partial payment and continues to add on very high interest on a daily basis. The cycle continues the next month and the next month . . . until the borrower has repaid the amount originally borrowed plus a hefty amount of interest. At that point, the borrower may still owe more than they originally borrowed and lose their car to repossession.

*If you follow the cash flows on a loan as it is repeatedly flipped or continued, you see a borrower paying the lender multiples of the value of the cash advances and still owing essentially the beginning amount or more.*

**Cost of \$550 - 10 Month Loan**

Under South Carolina Restricted Lender Law



**RULE OF 78S**

Back before there were electronic calculators, computers and Excel spreadsheets, financial institutions developed short-cut calculations to figure out how the payments on a loan paid off early should be allocated between interest “earned” and principal paid. A widespread short-cut was the Rule of 78s or the Sum of the Digits method.

If you add up the months (1+2+3+4+5+6+7+8+9+10+11+ 12), they come to 78. For the first month of a 12 month loan, the lender has earned 12/78 (15%) of the finance charge. For the second month, the lender will have earned (12+11)/78 (29%) of the finance charge.

If you compare this to *actuarial* or *pro rata* calculations such as most of us have on our mortgages, use of the Rule of 78s moves the “earning” of interest earlier in the loan. The Rule of 78s front-loads finance charges. If the loan is paid out in the original term, it makes no difference. If the loan is paid off early—as it is when a loan is flipped, the lender credits himself with more “earned” finance charge than if an actuarial calculation had been made.

*Adding to the unfairness of the Rule of 78s, is a Department of Consumer Affairs determination that a loan going even one day into an additional month “earns” the lender the finance charge for the whole month.*

Although small in terms of any one flip on a small loan, the difference is significant over several flips and hundreds of thousands of loans. The Rule of 78s is a powerful financial incentive to small loan makers to flip loans repeatedly. That’s why two of every three consumer loans are flips.

For the borrower, the flip is offered to a strapped borrower as the way to “save their credit.” Instead of salvation, with each flip the borrower only digs herself further and further in the hole.

**CREDIT INSURANCE—YOU PAY ME TO PROTECT ME**

Credit insurance is an interesting product. Although the borrower pays for it, it protects the lender. On Restricted loans, the lender usually makes you buy credit insurance. And he typically earns a 40% commission to sell credit life to you. He may share in the profits if you don’t collect on that insurance. If he’s really slick, he then turns around and gets the insurance company to pay him to reinsure part of the business. In 1997, insurance commissions made up 24% of the profits of Restricted lenders..

Credit insurance is big dollars. In 1997, South Carolinians paid \$156 million for credit insurance.

Coverage	Earned Premium
Life	57,413,000
Disability	51,427,941
Property	34,437,736
Unemployment	13,038,609
Other	177,791
Total	156,495,077

There are four credit products sold. Credit life pays off the balance of the loan if the borrower dies. Credit accident and health—also known as credit disability—make your loan payments if you’re sick or injured and can’t work. Credit unemployment pays off your loan if you’re fired. Credit property insurance insures your collateral.

Only Restricted lenders generally require credit insurance products. They usually charge the statutory minimum. If credit insurance is an option, the lender can charge you interest on the premium.. So the lender makes more money if it is optional.

Many borrowers believe that agreeing to credit insurance is necessary if they are going to get the loan. Thus, 71 % of those who make consumer loans with Supervised lenders also buy

credit life insurance. In 1997, \$156 million in premiums were paid by South Carolina borrowers for credit insurance.

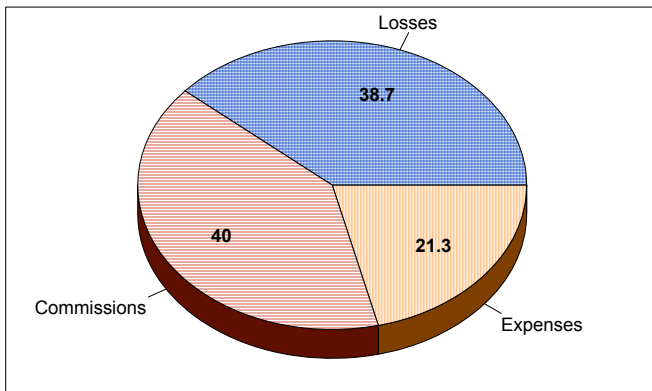
The price of credit accident and health insurance is regulated by the Department of Insurance. By statute, the price is supposed to ensure that the insurer pays out 50 cents for every dollar of premium. The price of credit life insurance is set by the General Assembly—not by the Department of Insurance. As a result, credit life insurance premiums are higher than they would otherwise be. Regulated credit accident and health insurance has a loss ratio of 53%. That means 53 cents on every premium dollar pays for losses. Credit life insurance pays only 38 cents of every dollar on losses.

**GOTCHA!**

An elderly borrower purchases credit life. He pays the statutorily prescribed price. When he dies, his spouse discovers that the insurance only ran for three years while the loan ran for ten years.

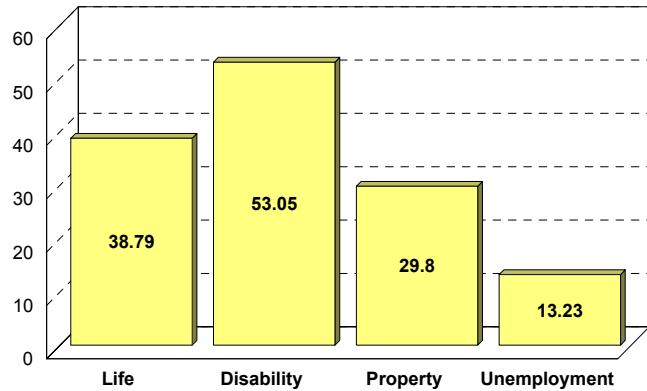
**Where Each Dollar of SC Premium Goes**

Credit Life Insurance - 1997



**% of Premium Going to Losses**

SC Credit Insurance 1997



In 1998, the Consumer Finance Joint Study Committee recommended moving regulation to the Department of Insurance with a floor 60% loss ratio. The insurance and lender industries turned out in force to stop that proposal. The Insurance Subcommittee of the Senate Banking and Insurance Committee is holding public hearings around South Carolina in late September and early October on credit life insurance.

Credit insurance is notoriously difficult to collect on. Aside from schemes in which the wrong person is insured or the term runs for less than the term of the loan, lenders frequently fail to inform borrowers of ways to have their debts paid when the insurance should kick in. Lender profits on insurance may depend upon the insurance not paying off. American Bankers Life Assurance Company of Florida is the largest writer of credit life in South Carolina.

*The majority of the Company's business utilizes contracts which afford the Company's clients the opportunity to participate in the underwriting results of policies they market to their customers. The "Retro Plan" contract links a client's overall commission to the claims experience on policies marketed to its customers, so that low loss ratios result in higher commissions for the client and high loss ratios result in lower commissions. Another form of participation is a profit sharing contract under which the client participates in up to 50% of the profits generated from its insurance business. The Company also cedes premiums generated by certain clients to the clients' own captive insurance companies or to reinsurance subsidiaries in which clients have an equity interest.*

American Bankers Insurance Group, Inc., and Subsidiaries,  
SEC Form 10-K, 1998

**CREDIT INSURANCE HEARINGS**

Wednesday	9/23	5:30 p.m.	McNair Science Bldg.	Francis Marion Univ.	Florence
Thursday	9/24	10:30 a.m.	308 Gressette Bldg.	State House	Columbia
		5:30 p.m.	McBryde 101	Winthrop Univ.	Rock Hill
Monday	9/28	5:30 p.m.	N. Charleston City Council Chambers		N. Charleston
Tuesday	9/29	5:30 p.m.	Lecture Rm. 118	Orangeburg/Calhoun Tech.	Orangeburg
Wednesday	10/7	5:30 p.m.	J. V Smith Auditorium	Greenville Tech.	Greenville

**COLLECTIONS**

Fringe lenders make loans to folks with lower incomes or poor credit histories. Frequently, they make loans which any reasonable person could see are not likely to be repaid in the time and according to the terms of the debt. It should surprise no one that fringe lenders don't always get paid on time.

Patient lenders know that poor borrowers generally pay their bills. They are "slow pay"—not "no pay."

When middle class borrowers have a problem paying on time, banks and credit cards companies will spend considerable effort trying to find a way to "work it out." When you're poor or working class and have a problem paying a bill, collectors descend on you like the Hounds of Hell.

How bad is bad debt for consumer loans? In 1997 only 4% of Supervised and Restricted consumer loans were written off.

Horror stories abound about methods used to collect debts—late night phone calls, repeated calls, loud berating of debtors in public places, calls to the boss, notes posted on doors, complaints to the neighbors about the "dead beats" next door, dunning letters made to look like lawsuits, threats of arrest for bad debt, and on and on and on.

Federal Fair Debt Collection Act restrictions only apply to third-party bill collectors. There were few rules limiting what a lender collecting on his own loans could do—and some did it all. Act 135 of 1995 (which was a compromise negotiated between lenders and S.C. Fair Share and S.C. Legal Services Association) brought most of the protections of the federal law into South Carolina law and applied them to persons collecting on their own loans.

**THAT PESKY BROCHURE**

No change required by Act 135 of 1995 has angered lenders more than a requirement that they give each new borrower a brochure prepared by the Consumer Affairs that lays out what creditors can and can't do in collecting a debt. These lenders hate borrowers knowing their rights.

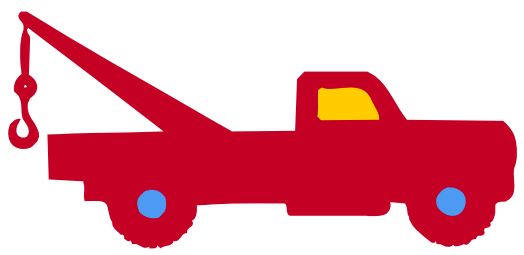
Although the 1995 changes brought important improvements, problems remain. Act 385 of 1998 prohibits sham legal process and provides someone damaged by that process with the ability to sue for damages and attorneys fees. However, no legislation has addressed the not uncommon practice of hiring uniformed law enforcement officers to act as bill collectors outside their police jurisdictions. The average borrower behind on a debt is not an authority on issues of jurisdiction. She is terrified when an armed uniformed officer shows up to collect a debt.

An additional area which the General Assembly needs to address is automobile repossessions—taking and selling a car which secures a loan. Supervised lender reports to the Board of Financial Institutions don't track automobile repossessions. However, we hear reports that auto title lenders routinely repossess.

Legislation proposed in 1998 by the Consumer Finance Joint Study Committee would limit repossessions where the loan amount was not at least 55 percent of the fair market value of the car or the borrower had already paid an amount equal to the original principal plus thirty percent interest. The first provisions would address borrowers losing their cars for relatively small loans. In addition, the Study Committee recommended requiring that sales of repossessed cars be consistent with the Uniform Commercial Code. Then sham sales at below value would not cost borrowers the value of the car above what they owed.

**WANNA' BE  
A REPO MAN?**

South Carolina has no licensing requirements or standards for bill collectors or repossessioners. As a result, many in the business proceed as if none of the legal protections provided borrowers exist.



### NON-FILING INSURANCE

Folks who make consumer loans to poor people have little interest in the tricycles, jewelry, and encyclopedias that they list as collateral on the loans. Their value is psychological—as a threat when collecting on later payments. They help scare the borrower into flipping the loan.

Small loan makers do not file the liens that would put them first in line for this collateral if the loan goes bad. Instead, they make every borrower pay them an \$8 “non-filing insurance” fee. That fee is not rebated when a loan is renewed early. The lender charges another \$8 on every flip. So far as we can tell, this is not insurance. Instead, it is a misleading charge that reimburses the lender for uncollectible debt. For Restricted lenders alone, that’s \$6.3 million a year—nearly as much as their total \$7.3 million charge-offs for bad debt.

### COMPETITION

When South Carolina deregulated credit in 1982, the theory was that borrowers would protect themselves by shopping in a free and open market.

The small loan market (Restricted lenders) and pawn shops remained regulated. In 1982, Restricted lenders wanted protection from the market. Statutory prices ensured that different companies did not have to compete on the basis of price. Their claims to the contrary, small loan companies have not competed at all. Instead, they have shared a market of poor folks who borrow from several lenders at a time. Those lenders stay in touch about their shared customers. Frequently, one loan is used to pay another as

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*The Company believes that competition between small-loan consumer finance companies occurs primarily on the basis of the strength of customer relationships, customer service and reputation in the local community, rather than pricing, as participants in this industry generally charge comparable interest rates and fees.*

World Acceptance Corporation, SEC Form 10-K, 1998

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cash flows from one lender to another, wearing an ever-deeper pathway of debt for the borrower.

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*... many customers borrow from more than one finance company, enabling the Company to obtain information on the credit history of specific customers from other consumer finance companies. The Company generally seeks to open new offices in communities already served by at least one other small-loan consumer finance company.*

World Acceptance Corporation, SEC Form 10-K, 1998

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Price competition does not exist for small loans (under \$1,000) for poorer South Carolinians. Auto title lenders get 300 percent interest from folks who could borrow at closer to 50 percent from a Restricted lender. Supervised lenders charge over 100 percent on a loan that a Restricted lender

would only charge 50 percent for. In a competitive market, those loans would not happen.

The lender of choice—banks—won't lend to these borrowers except through their captive finance companies. Lenders do not advertise finance charges and do their best not to reveal them until papers are already signed. "You're not concerned about the rate—you just want to know what the monthly payment is." In addition, with different charges and add-ons among different lenders, it's hard to follow what's being charged. And borrowers—many of whom are elderly or poorly educated—have very poor consumer skills.

Gas stations sell in a competitive market. There are only a few products from which to choose. A large sign on the corner tells the potential buyer what each will cost her. She can look across the street and see if that fellow will give her a better deal. It's not that easy when shopping for money.

**Borrow Here**  
  
Pay three times  
what you borrow  
in interest.  
300 % A.P.R.  
  
Get a Loan Today.

### WHAT SHOULD THE GENERAL ASSEMBLY DO TO PROTECT SOUTH CAROLINA BORROWERS?

#### Finance Charge Limits and Rebates

1. Increase from \$600 to \$1,000 the threshold under which Restricted lender rates apply and index that

#### WHAT CAN CONSUMERS DO?

- **Save - save - save**  
The best person to borrow from is usually yourself. The cost of borrowing is part of the cost of the things you buy. If you save before you buy, you pay a lot less to buy that thing. That means that you can buy more and better things for you and your family.
- **Shop - shop- shop**  
The cost of borrowing can be very different from one kind of lender to another—or one lender to another if they aren't regulated. If the lender won't give a straight answer—up front—about how much you will have to pay over the life of the loan, walk out. Go somewhere else.
- **Don't borrow to pay off a debt**  
If you can't pay this loan easily, why will you be able to pay the higher amount that a new loan will cost? Lenders and creditors want to keep you paying them. They don't want to sue you. They don't want your kid's trike. They don't want to cut off your power. You can almost always buy time if you can pay anything to the creditor. That is almost always a better deal for you than another debt.
- **Don't renew your loan ahead of time**  
Renewing your loan usually means that you're borrowing to pay off your old loan. You don't get full credit for what you have already paid. And you have to pay a bunch of fees all over again.
- **Don't buy credit insurance if you don't have to**  
Credit insurance (life, disability, unemployment or property) only protects the lender. And it's very expensive for what you get. You're mostly paying the lender to sell you the insurance. If you have assets you need to protect in case you die—such as a house, buy regular life insurance.
- **If you get in a bind, go to a non-profit credit counseling service**  
These are not "credit repair" companies. Most of those will rip you off. They just want to charge you fees and lend you money at high rates. Non-profit credit counselors help you figure out how to pay the bills you already have—they don't lend you money.

threshold to inflation.

2. Prohibit use of Rule of 78s rebating methodology. Require *pro rata* or actuarial refunding.
3. Require full *pro rata* refundability on all charges.

### **Auto Title Lenders**

4. Create a separate regulatory category for lenders who accept auto titles as security on loans.
5. Prohibit repossession of cars if the loan was for less than two-thirds of the fair market value of the car.
6. Prohibit repossessions if the borrower has already paid the lender the principal amount of the loan plus 18 % interest from the date of the initial loan.

### **Collections and Repossessions**

7. Prohibit any person in a uniform appearing to be a law enforcement uniform from participating in collection efforts except serving or executing a valid court order.
8. Establish licensing and regulation for any person engaged in collection or repossession business.
9. Prohibit sale of repossessed automobiles at other than a commercially reasonable sale at a public auction conducted by an independent third-party.

### **Non-Filing Insurance**

10. Prohibit charges for non-filing insurance on loans.

### **Rent to Own**

11. Require Rent-to-Own entities to disclose the Manufacturer's Suggested Retail price of rented product on rental documents and in advertising.

### **Credit Insurance**

12. Shift rate-setting on credit life insurance from the General Assembly to the Department of Insurance.
13. Require that all credit insurance products pay out at least 60 % of premiums in losses.
14. Limit lender commissions and other earnings on credit insurance to 20 % of premiums.
15. Require lenders to credit to the borrower's account any commissions which they earn on a product which they require a borrower to buy.
16. Prohibit lenders from profit sharing with insurance companies or earning commissions based on loss levels.
17. Establish a fiduciary responsibility to the purchaser of credit insurance policies for anyone who sells credit insurance.

### **Regulation**

18. Prohibit any lender or insurer from doing business in South Carolina if it, its affiliates, or any of its officers, directors, owners has been denied a license or had its license revoked in any state on character and fitness grounds or for engaging in illegal activities.
19. Consolidate Supervised and Restricted licenses. ***This should happen only if the loan threshold is raised to \$1,000.***
20. Improve the Annual Reports of the Board of Financial Institutions by making Restricted and Supervised lender reports comparable and breaking out Supervised lender reports by kind of lender.
21. Make individual lender reports to the Board of Financial Institutions public documents.

**SOUTH CAROLINA FAIR SHARE POLICY PERSPECTIVES**

This is the first *South Carolina Fair Share Policy Perspectives*. If the Lord is willing and the creek don't rise, we will publish quarterly. The *Policy Perspectives* are an addition to our regular *Legislative Update* and *Margins of Health* which go to SCFS members.

Our intention is to explore more fully than the *Legislative Update* format allows important issues facing everyday South Carolinians. We hope to provide a better explanation of the roots of problems and creative approaches to solving them.

South Carolina Fair Share's interests and concerns are broad. This month's subject is credit and finance for lower income citizens. Future months will cover the variety of consumer and family issues that occupy our advocacy work.

We look to our community to assist us in preparing *Policy Perspectives*. We invite other organizations and persons who are working to better South Carolina to join us in producing future *Policy Perspectives*. If you have an issue that you think should be a subject of a *Policy Perspective*, please give us call.