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The Perils of Borrowing Online

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Online lending is an \$8 billion a year business, with some companies hiding offshore or on tribal lands while peddling high-priced, short-term loans that cripple families—and are illegal in some states. Gary Rivlin reports.

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In the old days, the desperate borrowed money from a loan shark, who would tack on finance charges typically working out to an annual interest rate of maybe 200 percent. Now, there are online lenders who charge fees that work out to interest rates of just under 800 percent per year. They don't break bones like their more infamous brethren, but by comparison, the online lenders make loan sharks look like a low-cost alternative for those seeking a collateral-free loan with few questions asked.

Another difference between the old and the new is that those in this "industry" never held conferences. This week, members of the Online Lenders Alliance are meeting in Denver at a facility the trade group describes as a "luxury 4-diamond property." There, the wannabe online kingpin can attend workshops for those thinking about going international or learn more about the future of mobile payments. There's an orientation session for newbies to this industry—which makes more than \$8 billion in loans a year, according to Stephens Inc., an investment bank specializing in the world of fringe financing—and a workshop pitched to those interested in drawing new customers to their sites. A plenary session features a keynote address on "unleashing creativity" from the founder of a promotions site called ePrize.

Yet the sessions that will draw the biggest crowds are no doubt those focused on questions of the law. That's because in many states it's no more legal for an online payday lender to make one of these high-priced, short-term loans than it is for a mobster to play loan shark on the street. Literature for the

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Online Lenders Alliance dubs these “regulatory concerns” but at least a few attorneys general are less ambiguous in their judgment. West Virginia Attorney General Darrell V. McGraw, Jr. , for instance, has said that online lenders, whom he has dubbed “the loan sharks of today,” charge rates “more than 45 times greater than the maximum allowable rate”—18 percent—in his state. Arkansas AG Dustin McDaniel doesn’t make the loan-shark comparison but, if anything, he’s harsher in his judgment of these lenders that he unequivocally states operate “illegally” in his state.

“A lot of these online lenders are not reputable businesses,” McDaniel says. Getting one of these two-week loans may be easy; all you needed is a job (a Social Security or disability check will do) and a checking account—except, says McDaniel, “I tell consumers, ‘The last thing you’d want to do is give one of them access to your bank account.’”

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The online lenders don’t permit media to attend their conferences but it’s a safe bet that Arkansas is on the lips of more than a few people in Denver this week. Beyond his rhetoric, it’s McDaniel’s policy whenever a consumer calls his office to complain about any of these lenders. “We say, ‘Stiff ‘em!,’” says Jim DePriest, the McDaniel lieutenant charged with handling online lending complaints. “We say don’t pay back the loan because it wasn’t legal in the first place.”

And when the phone calls from the collection agency start? "We tell them, 'You put us in touch with that collection agency,'" DePriest says. "If they want to take the position that the consumer owes them the money, we're fine with that. We say, 'Come on down to Arkansas and sue one of our people and see how far you get.'" So far, McDaniel and his people have persuaded the operators of more than 50 websites, including LoanPointUSA.com, run by Mark Curry ([PDF](#)), until recently chairman of the Online Lenders Association, to stop making loans in Arkansas. They've also scared off nine collection agencies trying to collect on past-due bills. Yet, despite their best efforts, DePriest and his staff still hear from people like Mary, an Arkansas resident who was paying more than \$2,500 in monthly fees on the \$4,800 she borrowed from nine online lenders by the time she contacted the AG's office at the end of September.

First it was the storefront payday lenders. These lenders offering loans at rates hovering around 400 percent moved into Arkansas starting in the late 1990s, despite a provision in the Arkansas constitution that prohibits lenders from charging an annual interest rate exceeding 17 percent. (Credit card companies get away with charging higher rates than that on cash advances because of a decades-old U.S. Supreme Court ruling that dictated that banks need only abide by the usury laws of the state in which it houses its credit card operations, not the state where a customer lives.) By 2008, when the Arkansas Supreme Court declared they were operating in violation of the constitution, there were roughly 250 payday stores operating around the state. Dustin McDaniel braced himself for a fight but, within the year, the last of the payday stores had shuttered their doors.

"The industry dried up—except then we were hearing about these Internet lenders," McDaniel says.

The online lenders have proven a more elusive foe than their brick-and-mortar cousins. Where kicking the storefronts out of the state was largely a matter of sending "cease and desist" orders to each, the online payday lenders are invariably harder to find. "One of the greatest challenges is just figuring out who the principal might be," McDaniel says. "Finding the website doesn't really do any good until you find the source of their funds and who the boss is."

Another challenge: like the online gambling sites, some are located overseas and therefore outside the reach of the Arkansas attorney general. McDaniel's people can advise a customer to close a bank account, and therefore stop a lender

from drawing down funds, but that hardly helps the next resident happening upon that same site. And then there are those operations located on tribal lands, which McDaniel's office has started to encounter over the past year.

There are online lenders who charge fees that work out to interest rates of just under 800 percent per year.

"We've only started to discuss these tribe-based operations," McDaniel said. "It definitely provides additional challenges." Uriah King of the Center for Responsible Lending describes McDaniel as "one of the very best state AGs on payday lending," but that only seems to underscore the challenge of taking on the industry. "We're very proud of what we've accomplished here," McDaniel says, "but we also know that there are still many, many more sites out there."

For customers, the stakes are high, in no small part because they are paying fees typically twice those charged by a storefront—\$15 per \$100 every two weeks in a store, compared with \$30 every other week for that same \$100 online. The online lenders are also proving willing to make larger loans. Where a storefront in Arkansas would lend up to \$500, the online lenders typically prove willing to make loans of up to \$1,500—meaning consumers can dig themselves into a hole that much faster.

"People in a jam, they think this is their solution," says Hank Klein, who for years ran Arkansas Federal Credit Union, the state's largest credit union. "This is the \$500 they need to fix their car—and before they know it, they owe four or five or six or 10 of these lenders at once." It was when he noticed customers of his credit union bouncing checks to several payday lenders in the same week that Klein in 2004 created a group called Arkansans Against Abusive Payday Lending.

"It's the same with these payday lenders, whether a storefront or on the Internet," Klein says. "You go to one in an emergency, but eventually you fall behind so you go to another and then another and then another."

That's what happened to Mary, a single mother with three children who ended up owing nearly \$5,000 to nine lenders. At first borrowing from an online lender was just a once-in-a-while habit that started in early 2009. She had a special-needs child, and so she would turn to one of these online

lenders to make ends meet whenever extra medical expenses and lost hours at work meant she couldn't make that month's bills. It was expensive but she managed—until getting socked with some steep medical bills at the start of 2011. She took out a second loan and then a third. The deeper into debt she fell, the more eager people seemed to lend her money.

"They'd email me offers, they'd send me texts, they were calling constantly," she said. "I'd say I was getting seven or eight phone calls a day from different people offering to lend me money." Eventually, despite a salary of more than \$40,000 a year ("That's not so much money in this economy when you're a single mom with three kids," she says.), she couldn't even afford the finance fees she needed to make to buy herself another two weeks. That's when she went to the Internet and found Arkansans Against Abusive Payday Lending and Hank Klein, who pointed her to the attorney general's office and Jim DePriest.

"Until then, I had no idea it's illegal to make these loans in Arkansas," Mary says.

There's something shocking in a tale like Mary's but for DePriest, it was just another day at the office. He's received "hundreds of complaints" about online lenders doing business in their state, and they more or less they all sound alike. "People will call owing four or five or six or 10 outstanding payday loans at one time," he says. "They get in over their head." It's then that DePriest or one of his people tells them to immediately close down their checking account and send his office all the bank records they can get their hands on. Sure, he's telling them to stiff the lenders of the money they owe, but he also points out that by the time a consumer contacts his office, he or she typically will have paid \$400 in fees on every \$100 borrowed.

Over the past few years, the Online Lenders Alliance has hosted dozens of fundraisers in and around Washington, D.C. Federal disclosure records show its PAC has made nearly \$500,000 in campaign contributions since 2007. Chris Dodd, then chairman of the Senate Banking Committee, spoke at its 2009 conference. Richard Shelby, the ranking Republican on that same committee, was the special guest at a reception the group held the next night. Mark Curry, the alliance's chairman that year, has given just under \$90,000 to various members of Congress since 2005.

The online lenders, of course, claim they are providing a legitimate service. What else would the little guy do if not for

the fast and convenient service they provide? “Short-term loans provide consumers across the country with access to credit in times of need,” Lisa McGreevy, the CEO of the [Online Lenders Association](#), said in a written statement she provided through a PR contact. She talks about the “best practices” that members of her organization have adopted, along with a “code of conduct.” If there’s some ambiguity about the legality of their product, that’s because theirs is so new an industry.

“From retailers, to travel agencies, to insurance and financial services, many industries are in the process of modernizing brick and mortar rules for a digital world,” McGeevy wrote. “Consumers are flocking to the Internet to purchase goods and services and short-term lending is no exception.”

More than from McGreevy, I wanted to hear from Curry, who had been doing business in Arkansas until May of this year through a site called [LoanpointUSA.com](#). Curry, however, turned down my request for an interview through the same PR contact.

Jim DePriest told me that typically he sends a “cease and desist” letter to the owners of a website and they agree to stop making loans in Arkansas without kicking up much of a fuss. But not Curry. “They refused to shut down, so we sued them,” DePriest says. Eventually, Curry agreed to a consent judgment ([PDF](#)) that had him promising to no longer do business in the state. He would admit no guilt, but he did agree to write off some \$700,000 in loans and pay an additional \$60,000 fine.

“We worked it out to make sure between the canceled loans and refunds, he took a loss here,” DePriest says.

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Gary Rivlin is a special correspondent for *Newsweek* and The Daily Beast. He is the author of five books, including *Broke, USA: From Pawnshops to Poverty, Inc.—How the Working Poor Became Big Business*. He has worked as a staff reporter for *The New York Times*, where his beats included Silicon Valley and New Orleans after Hurricane Katrina.

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