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## Legal Advocacy

### **Arkansas Supreme Court Agrees with AARP, Ending Unconstitutional Payday Lending**

#### **Payday Lending Law Ruled Unconstitutional in Arkansas**

AARP filed a string of “friend of the court” briefs as McGhee v. Arkansas Board of Collection Agencies worked its way up and down the courts. The litigation finally ended when the Arkansas Supreme Court unanimously ruled that the state Check Cashers Act “clearly and unmistakably” violates the Arkansas Constitution by allowing payday loans at interest rates above the 17% cap set by the constitution. Arkansas is unique in setting a cap in its constitution, while other states do so by statute. Those caps remain controversial, as seen in two state ballot initiatives defeated by voters despite tens of millions of dollars spent by the industry on advertising and other efforts in support of the initiatives. With help from AARP offices in both states, Ohioans voted not to repeal a recently enacted law capping payday loan interest rates at 28%, and Arizona voters defeated a proposal that would have extended a state law that exempts payday loans from the state’s 36% cap on small loans beyond its July 2010 expiration date.

#### **Background**

The issues raised by high-cost payday loans generated increased attention when these lenders began targeting Social Security beneficiaries and other older people who receive federal benefits – as well as those who were expecting economic stimulus checks. As studies show that older people are incurring greater debt than ever before, and are filing for bankruptcy in record numbers, they may find that their usual sources of credit are no longer available. They may join the ranks of other low- and moderate-income consumers, those dependent on programs such as Social Security, and those with blemished credit histories who cannot obtain credit on reasonable terms from mainstream lenders and turn to non-traditional credit sources for very expensive loans.

Payday loans are one of the most common forms of these transactions -- they are for relatively small amounts, usually \$100 to \$500 -- with annual percentage rates (APRs) typically ranging from around 390% to 500% but sometimes exceeding 1,000%,

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despite much lower state caps on interest rates. The loans typically involve a borrower writing a personal check payable to the lender and receiving cash minus a fee. Both parties know the borrower's bank account does not have sufficient funds to cover the check, and the lender agrees to hold the check until the borrower's payday or another designated date. At the end of the loan term, usually 1 or 2 weeks, the borrower can redeem the check by paying the face amount or allow the lender to deposit it. What happens much more frequently, however, is borrowers cannot repay the loans when they come due and have to pay additional fees to "roll over" or extend them many times. This creates a "debt treadmill," causing the borrower to pay finance charges that far exceed the original amount borrowed, while still owing the face amount of the check presented to obtain the loan.

### **The Arkansas law**

The current dispute involves the Arkansas Check Cashers Act, which authorizes check cashing companies to charge borrowers as much as 10% of the face amount of a personal check used to obtain a payday loan plus a \$10 fee. The law originally stated that the fee would not be considered interest and that "deferred presentment transactions" (another name for payday loans) would not be considered loans. Borrowers challenged the law and the Arkansas Supreme Court ruled in 2001 that it was an unlawful attempt to evade the state constitution's 17% interest limit and that the legislature could not avoid that cap merely by calling interest and loans by other names.

Despite that ruling, the Arkansas Board of Collection Agencies continued to license and assist check cashing companies in making payday loans at rates above the constitutional limit, and the state legislature continued to fund the Board. Payday borrowers filed a class action lawsuit seeking to force the Board to stop those activities, alleging its actions constituted a misuse of public funds. They sought an injunction to stop the state from using public monies to license, assist, and legitimize payday lenders, and an order striking down the Check Cashers Act. The case moved up and down several times between the trial court and state Supreme Court, but each time the Supreme Court ruled on other issues and avoided the constitutional claim. Finally, the state's top court issued a definitive ruling that the Act violates the state's constitutional protections against usury.

The court ruled that the deferred presentment transactions authorized by the law are, in fact, loans and the fees charged for the transactions "unmistakably constitute interest." The court also found "no question" that the Act "authorizes usurious interest rates," and thus "it cannot stand."

### **AARP's efforts**

AARP Foundation Litigation attorneys have filed AARP's briefs in this case dating back to 2004, emphasizing the vulnerability of payday loan borrowers, the vicious cycle of insurmountable debt in which these and similar predatory loans trap borrowers, and the variety of ruses used by payday lenders to evade state interest limits. Numerous legislative investigations, academic research, and news reports have documented the explosive growth of lenders in this "fringe banking" market and their pernicious effects as vulnerable borrowers sink deeper and deeper into debt. The briefs also discuss the many times Arkansas courts have enforced interest rate limits to protect necessitous borrowers from abusive lending practices, and the courts' tradition of looking at the substance, rather than merely the form, of a transaction to determine if it is a loan and whether it meets the state constitution's requirements.

"I am so proud that the Arkansas Supreme Court has confirmed what advocates against abusive payday lending have asserted all along – that the Check Cashers Act violates the state constitution," said Maria Reynolds-Diaz, Senior State Director, AARP Arkansas. AARP Arkansas has been a leading member of the Arkansas Against Abusive Payday Lending (AAAPL) coalition which conducted a multi-year campaign to rid the state of payday lenders charging outrageous interest of more than 300%. The campaign included a three-pronged approach attacking the problem on the legislative, judicial and regulatory fronts. "AAAPL fought to protect Arkansas pocket books, by making educational presentations around the state, and by urging state lawmakers to change the state law," she added. "We supported the efforts of Todd Turner, attorney for the borrowers, and encouraged the outstanding efforts of Attorney General Dustin McDaniel to protect consumers from financial abuse. Today all our hard work has paid off for Arkansans and I couldn't be happier." AAAPL's founder, Hank Klein, is now an AARP volunteer, and was just named Arkansas' Andrus Award recipient for 2008.

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