Payday Lending:
Helpful Credit or a Debt Trap?

EARN Conference, Detroit MI
September 22, 2009

Uriah King
Senior Policy Associate
Center for Responsible Lending

Self-Help & CRL

- **Self Help, 1980**
  - Nonprofit community development financial institution
  - Mission: Create & protect ownership for people of color, women, rural residents & low-wealth families
  - $5.3 billion to over 63,000 borrowers
  - Home loans and small business loans

- **Center for Responsible Lending, 2002**
  - Nonprofit, non-partisan policy organization
  - Protect homeownership & family wealth
  - Work to eliminate abusive financial practices

What are payday loans?

- $28 billion/year industry; 20,000 locations in 35 states
- Borrower needs $325, writes a check for $377 that will be cashed on their next payday, i.e. <u>must pay back in less in two weeks or less</u>
- 391%-521% APR for a typical two-week loan
- To qualify, borrowers only need:
  - personal identification
  - a checking account
  - an income from a job or government benefits
- Ability to re-pay is not considered

Why aren't payday loans paid back in two weeks?

	$25,000 Salary	$35,000 Salary
Before tax income	$962	$1346
Minus taxes*	-$65	-$120
After tax income	$897	$1227
Minus two week expenditures on food, housing, transportation, healthcare, and clothing*	-$882	-$1018
Money left over	$15	$208
Payday loan balance plus fee due	$377 ($325 loan plus $52 fee)	$377 ($325 loan plus $52 fee)
Deficit	**-$362**	**-$169**

Payday Lenders in Public

"Since a payday advance is a short-term solution to an immediate need, it is not intended for repeated use in carrying an individual from payday to payday…we're here to help. But a payday advance is not a long-term solution for ongoing budget management. Repeat or frequent use can create financial hardship"*

Community Financial Services Association, *the FACTS about payday advance services*, consumer information brochure, 2005:

Payday Lenders' Dirty Secret

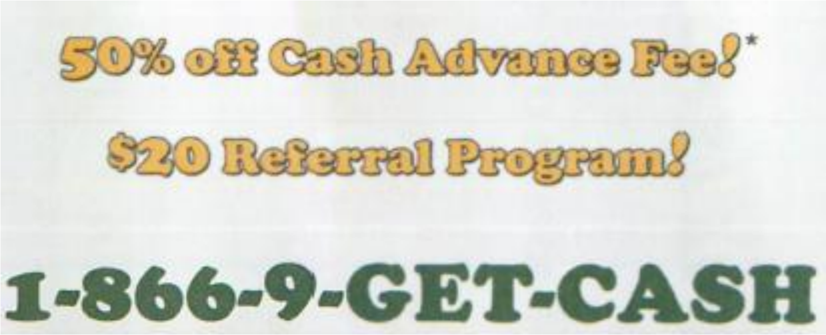
"The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers."

UNC-Chapel Hill

"And the theory in the business is you've got to that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is."

Dan Feehan, CEO of
Cash America

"…we're here to help"



Source: Direct Mail collected from Mintel Comperemedia

"Repeat or frequent use can create financial hardship."

Save Your Way To 30% Off

Source: Cash America website, accessed Sept 17, 2008

The Debt Trap, by the numbers

- Only **<u>two percent</u>** of loans go to borrowers who take out their loan, pay it off in two weeks, and do not need to borrow again
- 9 loans per borrower every year, on average
- 90% of loans go to borrowers with 5 or more loans
- 62% of loans go to borrowers with 12 or more loans
- The industry depends on revenue generated from trapped borrowers (“churning”)

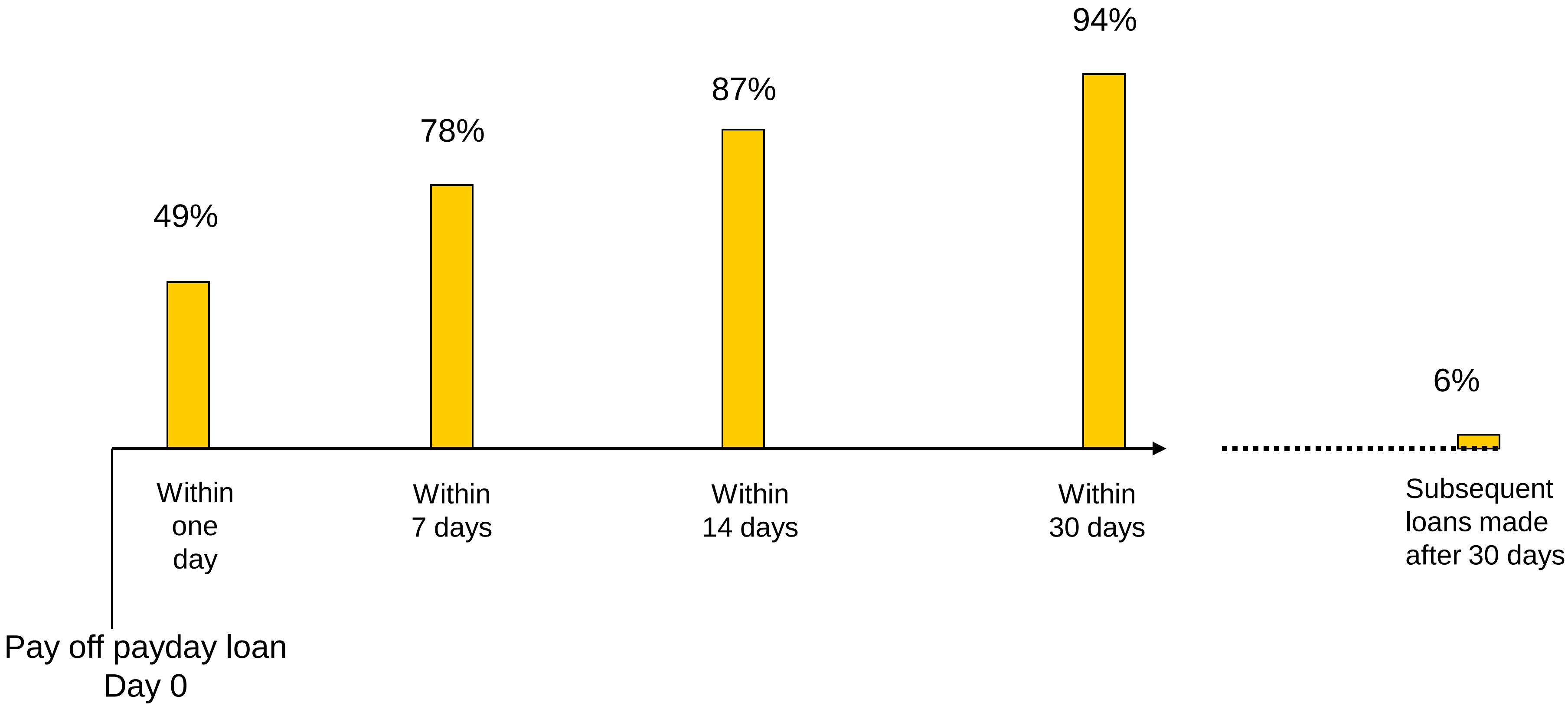
New Research: Phantom Demand

- Our most recent research paper asks the question:

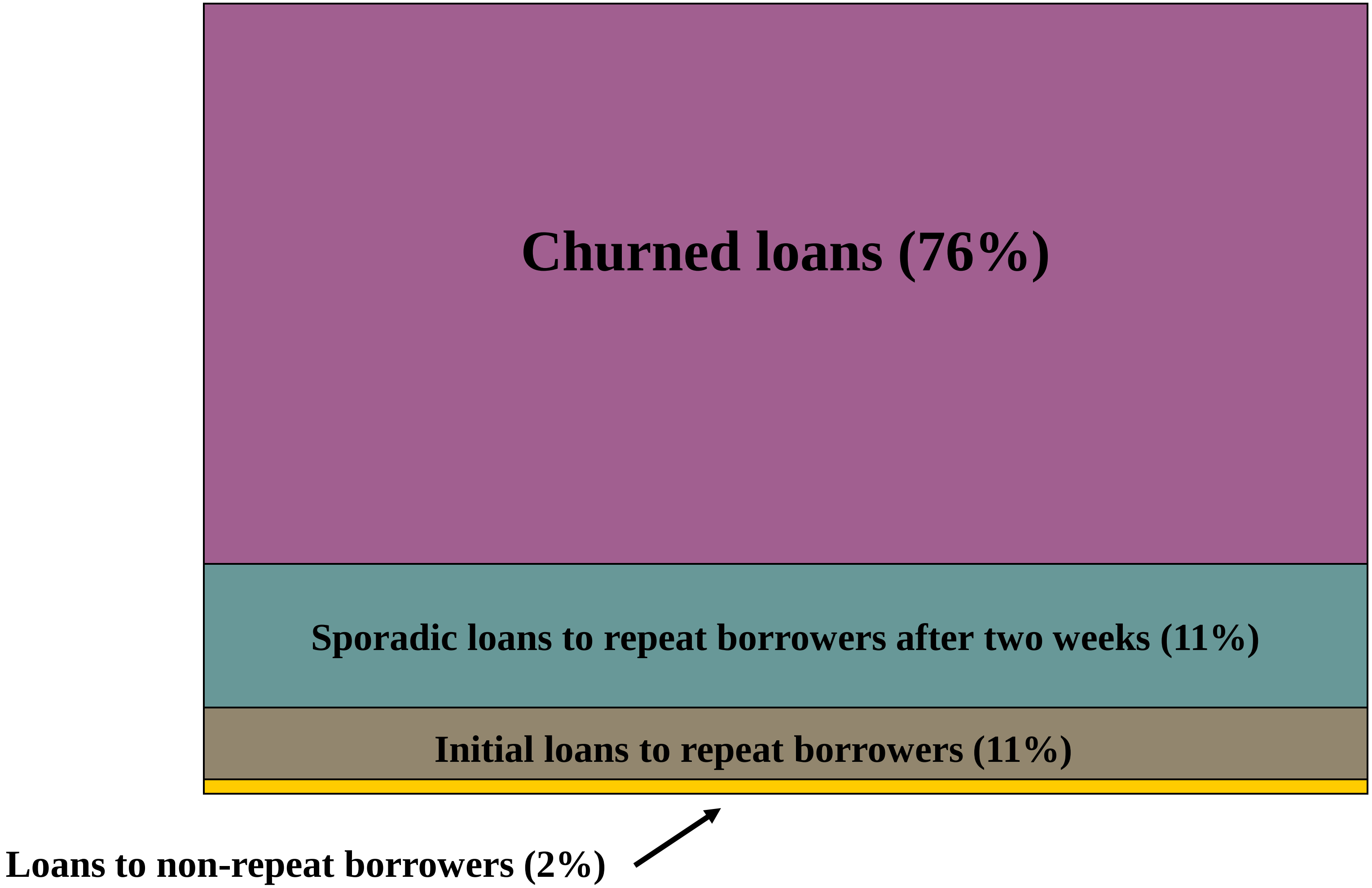
- Are payday loans taken sporadically for different financial emergencies or one right after the other?

- Is industry volume a result of strong demand <u>OR</u> an indication of how consistently borrowers become trapped in payday loan debt?

Consecutive borrowing in the norm



Churning, not demand



Stark Consequences for the Borrower

- Nationally, the typical payday borrower pays about $800 for a $325 loan
- 25-50% of borrowers will default in the first twelve months
- Payday borrowers twice as likely to default on their credit cards or file for bankruptcy
- Indirect evidence shows correlation between delayed medical care, late bills and involuntary loss of bank accounts

States' Attempt to Address the Debt Trap

Some states have tried to both legalize payday lending and protect borrowers from the debt trap.

Payment Plans: Most payments plans are only available after the borrower is trapped and are more expensive week-to-week

Roll-Over/Renewal Limits: Most limits are largely unenforceable and exclude back-to-back transactions

Empirical Results of State "Reforms"

Oklahoma with multiple loan restrictions, cool-off periods, payment plan, renewal ban and database sees two of every three loans go to borrower with twelve or more loans and less than one percent of transactions employ the payment plan.

Florida with one loan at time, cool-off period between every loan, grace period, data base and renewal ban results in 57% of loans to borrowers with twelve or more loans and less than one percent usage of grace period

Payday Lenders' Rebuttals:

- *APR doesn't matter, it's a two-week loans.*

  APR is the only way borrowers can compare products and it is <u>not</u> a two-week loan

- *We're better than the banks' overdraft fees*

  Overdraft and payday are not substitutes and the empirical evidence suggests payday lending <u>increases</u> overdraft fees

- *Where else can borrowers go?*

  Industry's own surveys show that the typical borrower has a credit card and traditional small loans increase when a rate cap is re-imposed (i.e. Gresham's Law)

Ex-Payday Customers Say Payday Bad

"Two thirds of people who had been payday loan borrowers say that the absence of payday lending has had absolutely no effect on them at all. Of the one-third remaining, a 2 to 1 margin say that payday lending is a bad thing, as opposed to a good thing."

Mark Pearce
NC Deputy Commissioner of Banks
Testimony at DC Committee on Public Services and Consumer Affairs
June 21, 2007

A tipping point?

States without payday lending—ban or rate cap

- Arkansas
- Arizona (July 2010)
- Connecticut
- District of Columbia
- Georgia
- Maine
- Maryland
- Massachusetts
- New Hampshire
- New Jersey
- New York
- North Carolina
- Ohio
- Oregon
- Pennsylvania
- Vermont
- West Virginia

Plus…

- 36% rate cap for military
- Universal 36% rate cap introduced in Congress
- FDIC "strongly encourages" 36% for small loans
- Citizen mandates for rate caps in AZ and OH

Nearly a third of Americans live in a state without payday lending

Policy Recommendations

- Enact a 36% APR rate cap
  - Discourages high-cost balloon payment loans
  - Encourages ability-to-repay
  - Level playing field for traditional small loan lenders
- In addition:
  - Establish "suitability" standard for payday loans
  - Discourage other abusive credit practices
  - Expand access to small loans and emergency savings

Failed Business Model

Payday loans don't solve a financial crisis they create a new crisis every two weeks.

Time for reform.

Uriah King
Center for Responsible Lending
919.956.4400; uriah.king@responsiblelending.org