



The Perils of Payday Lending: Helpful Credit or a Debt Trap?

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Paul Leonard
California Director
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
 - California retail credit unions: Modesto, Porterville, Bakersfield

- **Center for Responsible Lending, 2002**
 - Nonprofit, non-partisan policy organization
 - Protect homeownership & family wealth
 - Work to eliminate abusive financial practices
 - California Office, 2006

What are payday loans?

- \$28 billion/year industry; 20,000 locations in 35 states
- Borrower needs \$255, writes a check for \$300 that will be cashed on their next payday, i.e. must pay back in less in two weeks or less
- 459% Annual Percentage Rate (APR)
- 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

The problem with payday loans: Borrowers can't afford to pay them back



The CA Payday Lending Debt Trap	
Annual income before tax	\$40,000
Bi-weekly income (after taxes)	\$1450
Household Expenses	-\$1298
Total After Expenses	152
Pay period deficit if \$500 payday loan paid in full	-\$348
Pay period deficit if \$300 payday loan paid in full	-\$148

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



“And the theory in the business is you’ve got to get 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 can't live on five [loans]"

Carol Stewart, Vice President
of Governmental Affairs
Advance America

“...we’re here to help”

NO FEE on First Transaction!



When you've gotta

MONEY MAYDAY

It's Quick, Easy and Confidential



Show us a photo I.D., latest 30 day bank statement and most recent pay stub or proof of income.



Write us a personal check and get the money you need.

*Limit one discount per customer. May not be used in combination with other discounts. Discount is valid on first transaction, up to amount of transaction fee. In some states checks are issued in lieu of cash.

call 1-877-262-CASH for the nearest location

PSRT STD
U.S. POSTAGE

50% off Cash Advance Fee!*

\$20 Referral Program!

1-866-9-GET-CASH

NEW
CUSTOMERS
YOUR 1ST
\$100.00
ADVANCE
IS FREE

1-2-3 CASH
PAYDAY LOANS

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

(CA DoC Data)



- **Most Borrowers Are Regular Users:** Average of 10 loans per family in 2006, roughly 1 million families.
- **Most Loans Go to Borrowers Caught in a Debt Trap:** Nearly 450,000 borrowers had back-to-back spells of 6 loans or more, conservatively, accounting for more than 50 percent of all loans.
- **Very Few Borrowers Take Just One Loan:** Less than 4 percent of loans went to one time borrowers.
- **For Many, There is No Way Out:** 4% of borrowers account for 25% of 10 million loans in 2006. 57,147 borrowers with more than 19 consecutive loans.

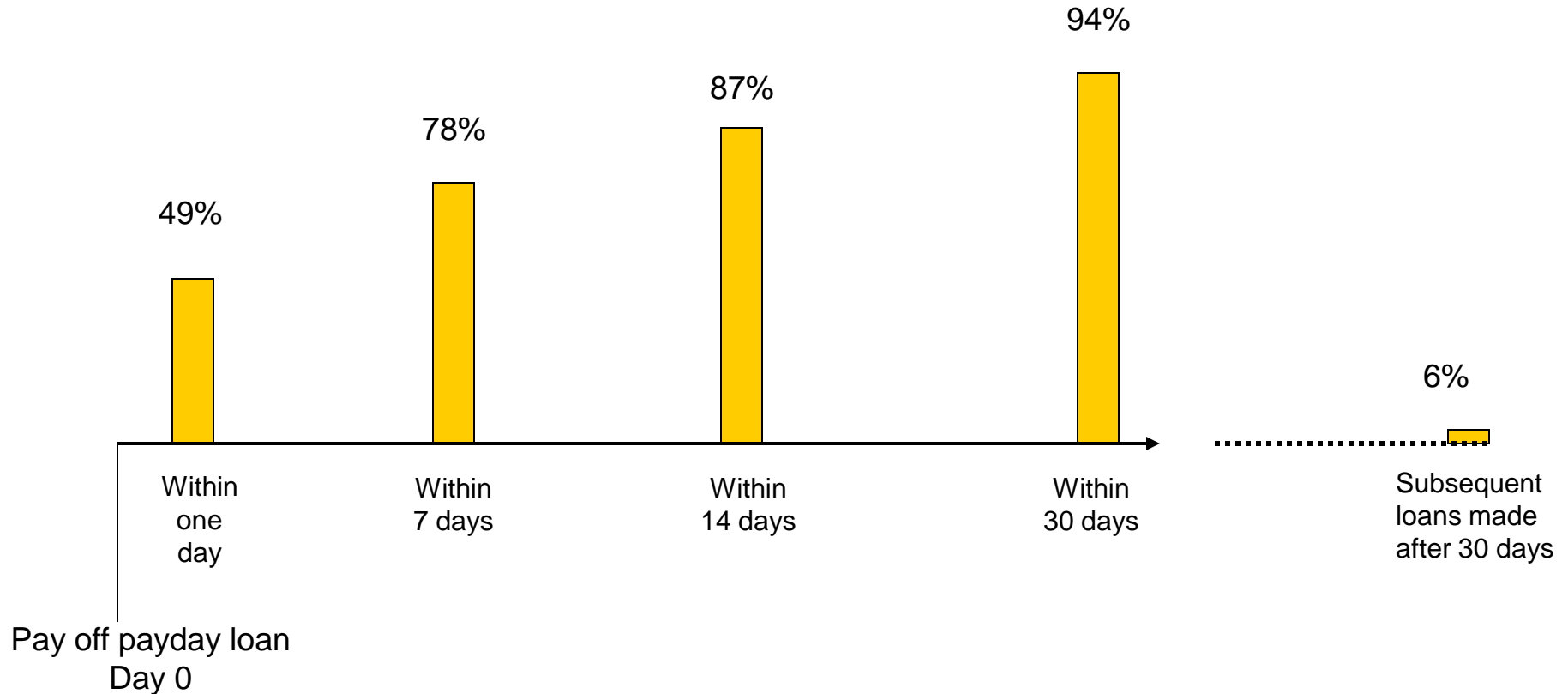
New Research: Phantom Demand



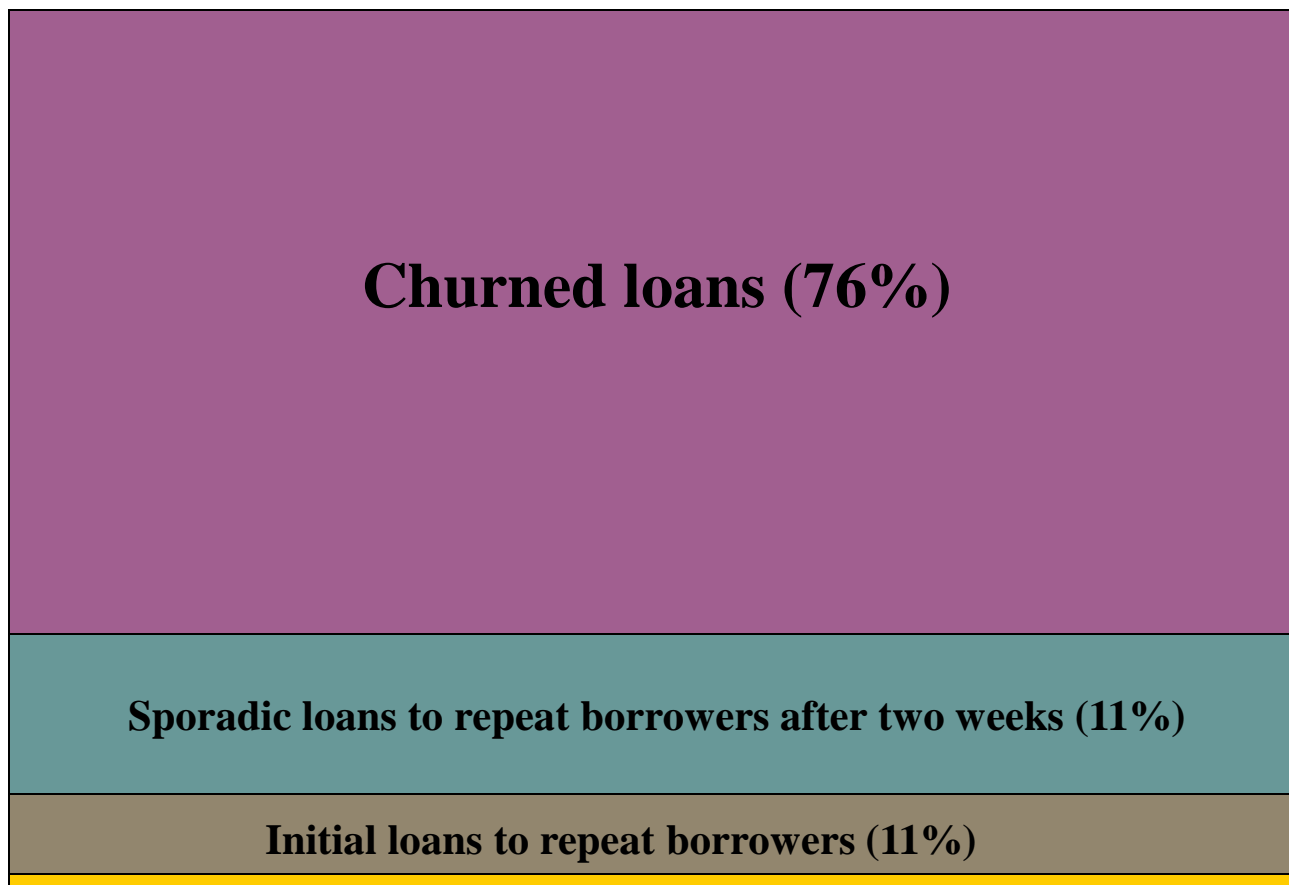
2 Key Questions:

1. Are payday loans taken *sporadically* for different financial emergencies *or one right after the other*?
2. Is industry volume a result of strong demand OR an indication of how consistently borrowers become trapped in payday loan debt?

Consecutive borrowing is the norm



Churning, not new demand



Loans to non-repeat borrowers (2%)

Stark Consequences for Borrowers



- 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

Strips Wealth from Communities of Color



- California:
 - African Americans, Latinos, and Native Americans represent 56% of all payday borrowers even though they make up 35% of the adult population. *(CA Dep't of Corp.'s, 2007)*
 - Payday lending **drains \$247 million annually** from California communities of color *(CRL, Predatory Profiling, 2009)*

Payday Lenders' Rebuttals:

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

APR is the only way borrowers can compare products and it is not 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 increases overdraft fees. Stronger regulation of overdraft is also needed.
- ***Where else can these 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
- ***Ending 459% will cause job loss***

Threats of job loss are highly exaggerated. For Advance America more than 90% of payday employees leave within a year, with half leaving in the first 6 months. (2007 and 2008 10K). And, for every payday employee, 179 people are trapped in debt.

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

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

Policy Recommendations

- Reject Proposed Growth in Maximum Loan
- Enact a 36% APR rate cap
 - Discourages high-cost balloon payment loans
 - Encourages ability-to-repay
 - Level playing field for traditional small loan lenders
- Cap Number of Loans per Borrower
- Establish Interest Rate Caps for Larger Loans (>\$2,500)

Policy Recommendations

- Other Necessary Changes
 - Discourage other abusive credit practices
 - Expand access to small loans and emergency savings
 - Pressure banks to serve communities instead of payday lenders

- Local Ordinances
 - Use land use regulation to limit spread.

Industry Proposed “Reforms” Don’t Break the Debt Trap

- Payment Plans
- Cool Off Periods
- Data Base
- States with many of these reforms have not substantially reduced debt trap
 - Florida
 - Oklahoma

Ex-Payday Customers Say Payday is 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

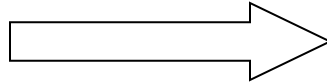
What About the Banks?

- **They say:** Small loans are unprofitable.
- **Reality:** Overdraft fees are too lucrative.
 - \$24 billion from debit card fees.
 - \$34 fee for average \$17 overage.
 - New rules require opt-in, but no limits on number of fees or amounts.
- Some banks (Wells, US Bank) offer payday loans and more considering doing so.
 - 120% APR vs 459 APR for Payday Loans
 - Virtually no risk with direct deposit and first draw.

Big Banks' Dirty Secret: They Finance the Payday Lenders



Bank of America

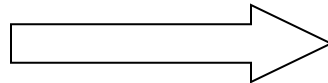


Advance America

- Nearly 12 million payday loans originated annually
- Largest payday lender, with 2,580 locations
- B of A serves as administrator for all of Advance America's lines of credit



Wells Fargo
(Wachovia)

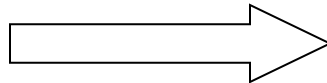


Advance America

- First Cash Financial Services**
- Dollar Financial**
- EZ Corp**
- Cash America**
- Ace Cash Express**



JP Morgan Chase



First Cash Financial Services

Cash America

- high volume on-line payday lender

Loans for the Unbanked: Car Title Lending

- Installment loans greater than \$2,501 secured by signing lender on to the title of the car.
- Interest rates: 6 - 15% PER MONTH! =
APR: 70 – 144%
- Longer terms: usually 36-48 months.
- Limited underwriting.
- Miss payments = lose your car.

Failed Business Model



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

Time for reform.

Paul Leonard

Center for Responsible Lending

510-379-5510, paul.leonard@responsiblelending.org