Big Bank Payday Loans:
High-interest loans through checking accounts keep customers in long-term debt

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July 2011

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INTRODUCTION

The economic meltdown of the past few years has undermined the financial security of millions of Americans. U.S. household wealth has dropped by $6 trillion since 2006,[1] the national unemployment rate hovers north of 9 percent,[2] and nearly half of Americans do not have the capacity to cope with a financial shock.[3]

In this environment, some "fringe" financial services firms are prospering by offering high-cost, short-term credit to financially-strapped consumers.[4] Payday loans—small loans due in full on the borrower's next payday—are marketed as a quick solution to a financial shortfall. But research has repeatedly shown that the typical payday borrower ends up trapped in a cycle of repeat loans.

This "debt treadmill" is created by the structure of the loan itself. Repayment in full from a single paycheck or benefits check is a tall order for a household already living close to the financial edge. Borrowers routinely find themselves unable to repay the loan in full and the fee *plus* meet their monthly expenses; so shortly after repaying the previous loan, they require another loan. Ultimately, this series of so-called "emergency, short-term" loans is essentially long-term debt carrying annual interest rates averaging 417 percent and leading to a host of negative financial outcomes for borrowers.

While payday loans have typically been offered by non-bank payday loan shops in states where it's permitted, a few mainstream banks—who themselves are enjoying historically low-cost loans from the U.S. taxpayer through the Federal Reserve[5]—have started making payday loans themselves, directly to customers through their checking accounts.

They call these products "checking account advance" loans, but they are structured just like payday shop loans[6]—carrying a very high-cost and requiring full repayment upon the customer's next paycheck—with the added feature of providing the bank direct access to the borrower's financial lifeline, their checking account.

CRL has begun investigating payday loans by banks to determine how their use compares to patterns of use for non-bank payday loans.

As described in this paper, CRL's research finds that:

- Bank payday loans are very expensive, carrying an annual percentage rate (APR) of 365 percent based on the typical loan term of 10 days;
- "Short-term" bank payday loans often lead to a cycle of long-term indebtedness—*on average,* bank payday borrowers are in debt for 175 days per year (twice as long as the *maximum* length of time the FDIC has advised); and
- Nearly one-quarter of all bank payday borrowers are Social Security recipients, who are 2.6 times as likely to have used a bank payday loan as bank customers as a whole.

BACKGROUND

Overdraft Loans

Expensive short-term lending by mainstream banks has been a growing problem over the last two decades. The most dramatic growth has been in high-fee overdraft loans. Banks charge overdraft fees when a customer lacks sufficient funds in his or her checking account to cover a payment but the bank chooses to advance the funds to the depositor and pay the transaction anyway. The fee averages $34 per transaction, often for small debit card transactions that average only $17, which banks used to simply decline (for no fee) when a customer lacked sufficient funds.[7] The loan and fees are repaid in full an average of three to five days later, when the bank repays itself from the customer's next incoming deposit.[8]

Research has shown that the majority of overdraft fees are paid by customers who are least able to recover from them.[9] Over time, these fees leave financially-struggling consumers worse off and less likely to be able to meet their ongoing expenses, and contribute to greater numbers of unbanked households.[10] These fees also hit older Americans very hard: Those heavily reliant on Social Security income paid $1.4 billion in overdraft fees in 2008.[11]

Automated high-cost overdraft programs were not always widespread. What began as an ad-hoc occasional courtesy that banks and credit unions provided to their customers grew to a $10.3 billion "service" in 2004 and to a $23.7 billion one in 2008.[12] This growth was spurred in the late 1990s and early 2000s by automated overdraft programs that were heavily marketed by consultants promising dramatic fee increases to banks.[13] Some consultants even offered the software at no risk, simply charging banks a percentage of the increased fee revenue generated.[14] Bank and credit union regulators generally allowed these programs, only recently issuing rules requiring banks to obtain consumer consent before enrolling them in fee-based overdraft coverage for debit card transactions.[15]

Payday Loans

More recently, a few large banks have added another high-cost, short-term, balloon repayment product to the mix: payday loans. The bank deposits the loan amount directly into the customer's account and then repays itself the loan amount, plus the fee, directly from the customer's next incoming direct deposit. If direct deposits are not sufficient to repay the loan within 35 days, the bank repays itself anyway, even if the repayment overdraws the consumer's account, triggering more fees.

These loans are structured just like loans from payday shops, where borrowers typically are stuck in multiple payday loans per year—usually in quick succession and with a new fee each time, because they cannot afford to repay the loan in full, plus the fee, *and* meet ongoing expenses. So shortly after repaying the previous loan, they require another loan.[16]

Research has found that the typical non-bank payday borrower takes out nine loans per year;[17] that borrowers borrow more and more over time as they are driven deeper into debt;[18] and that significant numbers of borrowers—after years of cyclic debt—ultimately default.[19] Research has further shown that payday lending can lead to negative financial outcomes for borrowers; these include difficulty paying other bills, difficulty staying in their home or apartment, trouble getting health care, increased risk of credit card default, loss of checking accounts, and bankruptcy.[20] Finally, payday loan shops have been shown to target people of color when locating their stores.[21]

In a replay of the growth in overdraft programs, consultants now are actively pushing bank payday loans, touting dramatic increases in fee revenue. A recent industry webinar recommended that banks consider issuing high-cost, triple-digit APR loans,[22] and payday loan software is being marketed to banks with promises that, within two years, revenue from the product "will be greater than all ancillary fee revenue combined."[23] Bank payday programs are not pushed as a way to *substitute* for overdraft fees; rather, they promise to be an additional way for banks to generate revenue. One marketing flier promises that offering the payday loan product will result in little-to-no "overdraft revenue cannibalization."[24] Indeed, prior research has found that non-bank payday loans often exacerbate overdraft fees.[25]

"They get to charge a 120 percent interest rate on what is essentially a risk-free loan."

Rochdale Securities analyst, September 2009.

Bank payday loans have already caught on with several regional and national banks, which combined hold approximately 13 percent of total deposits at national banks and savings institutions.[26]

Banks making payday loans claim their product is different from a loan from a payday shop, but it's not. By calling their payday loan product a "direct deposit advance" or "checking account advance," banks attempt to differentiate it from other payday loans.[27] The national bank regulator, the Office of the Comptroller of the Currency (OCC), has tried to distinguish the product as well, stating: "It's not a payday loan. It's available through banks and bank branches. It's something you don't get at a storefront . . . [and] customers . . . don't have to use it."[28]

But these distinctions are superficial at best and fiction at worst. Payday loans by banks have all the hallmarks characteristic of those made by payday shops:

Comparison of Loan Features: Bank Payday Loan vs. Non-bank Payday Loan

	Bank Payday Loan	Non-bank Payday Loan
Cost of typical loan	365% APR[29]	417% APR[30]
Repayment timing and amount	Due in full upon the customer's next electronic deposit	Due in full at customer's next payday
Access to checking account funds for repayment	Bank repays itself automatically from the customer's next electronic deposit, whether it is a paycheck or public benefits, like unemployment or Social Security	Lender has customer's post-dated check or electronic access to the customer's checking account
Underwriting borrower's ability to repay loan without funds provided by an additional payday loan	None	None

As described below, CRL research also shows that bank payday lending has many of the same problems as non-bank payday loans, including high cost and a long-term debt trap.

KEY FINDINGS

For our analysis, we used checking account data from a nationwide sample of U.S. credit card holders, generally representative across geography, household income, and credit scores, tracked by Lightspeed Research Inc. Participating account holders provide Lightspeed access to all of their checking account activity occurring during their period of participation, including the deposits, paper checks, electronic bill payments, debit card purchases, fees, and miscellaneous charges or credits that are posted to the account. Our analysis included transaction-level data for 614 checking accounts, over a 12-month period; this was the total number of checking accounts in the consumer panel held at banks that were found to offer payday loans, based on observing instances of payday loans in the panel.[31] We identified instances of bank payday loan repayments within 55 of those 614 accounts, and analyzed these for loan term, loan frequency, repayments, and other relevant factors.[32]

As banks have not made data on this product public themselves, our only means of obtaining detailed data on bank payday loans was to purchase transaction activity from a data aggregator. Lightspeed has the most robust transaction level data of any aggregator of which we are aware. Our findings based on the instances of bank payday loans we identified in this dataset are deeply troubling; we call on regulators to immediately collect and make public data from the banks themselves to learn more about the impact this product has on banks' customers.

Our analysis finds the following:

Finding 1: Bank payday loans are very expensive, carrying an annual percentage rate (APR) of 365 percent based on the typical loan term of 10 days.

The typical bank payday loan was outstanding for only 10 days.[33] Banks typically charge $10 per $100 borrowed,[34] amounting to a 365 percent annual percentage rate (APR).

Cost of Bank Payday Loan	
Length of Loan	Annual Percentage Rate
10 days (average length)	365%
14 days	261%
One month	120%

Even when the loan was outstanding for a full month, the APR of 120 percent is significantly more expensive than alternative credit products such as credit cards or consumer finance loans. For example, in the second quarter of 2011, the average credit card interest rate paid was 13.10 percent and the average interest rate on a 24-month personal loan from a commercial bank was 11.47 percent.[35]

Finding 2: Short-term bank payday loans often lead to a cycle of long-term indebtedness; *on average,* bank payday borrowers are in debt for 175 days per year (twice as long as the *maximum* length of time the FDIC has advised).

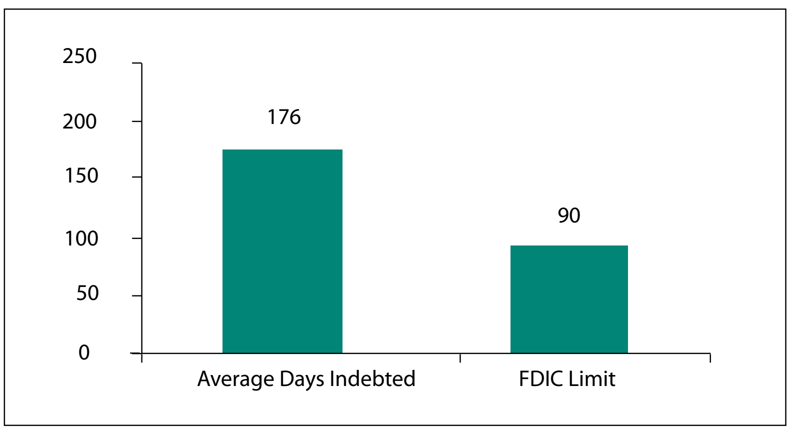
Our analysis shows that, on average, bank payday borrowers have 16 loans and, assuming these loans were not concurrent, stay in payday debt for 175 days per year.[36]

In 2005, the FDIC issued guidelines in response to the growing problem of payday lending. The payday lending industry had been asserting that the high cost of these loans was justified because borrowers did not remain in these loans for a long time; rather, the loans were short-term and used only rarely, when customers were in a pinch. The FDIC found that this justification was not valid when payday loans were repeated many times. Thus, it advised that if a borrower had payday loans outstanding for any more than 90 days in a one-year period, the product was not being used as short-term credit, and further payday loans to the borrower were inappropriate.[37] The FDIC has issued guidelines for responsible small dollar loans, which include reasonable interest rates and affordable installments that reduce loan principal over time.[38]

Along the same lines, the National Credit Union Administration (NCUA) recently advised that short-term loans more expensive than 18 percent APR be limited to three every six months (equating to six per year).[39]

Banks making payday loans are keeping borrowers trapped in payday debt, *on average,* for nearly twice as long as the *maximum* length of time the FDIC advised, and in many cases for much longer.

Bank Payday Loans: Average Number of Days in Debt vs. FDIC Limit



Like payday loan shops, banks require that a borrower have a source of income, which can be public benefits, and a checking account to qualify for a payday loan, but they do not underwrite the borrower's ability to repay the loan without having to take out another payday loan to meet recurring obligations. This practice harms not only borrowers, but legitimate lenders and businesses. By ensuring they are first in line to grab what they can from borrowers' incoming deposits, banks leave their customers with fewer funds to repay lenders who *do* perform meaningful underwriting and less to spend on needed goods and services.

Banks allow loans of up to half of a customer's monthly direct deposit income or up to $750, whichever is less. As a result, it is not surprising that CRL's analysis found 44 percent of customers' next deposits go toward repayment of their loan.[40] This large proportion no doubt contributes to the long-term debt cycle experienced by many bank payday borrowers.

"Many [bank payday loan borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken."

Bank employee quoted in San Francisco Chronicle, October 2004.

Banks claim to offer consumers "protections" against long-term use, specifically cooling-off periods (breaks between payday loans) and payment plans.[41] But even the non-bank payday industry's "Best Practices"[42] call for limits on rollovers (repaying one payday loan with funds from a new one) and encourage lenders to offer the option of an extended payment plan. These "protections" do not stop the cycle of repeat loans, at payday shops or at banks:

- Breaks between payday loans. While technically prohibiting rollovers, payday shops continue to put borrowers in "back-to-back" transactions because they do not consider repaying a loan and immediately taking out another to be a rollover (even though, effectively, it is).[43]

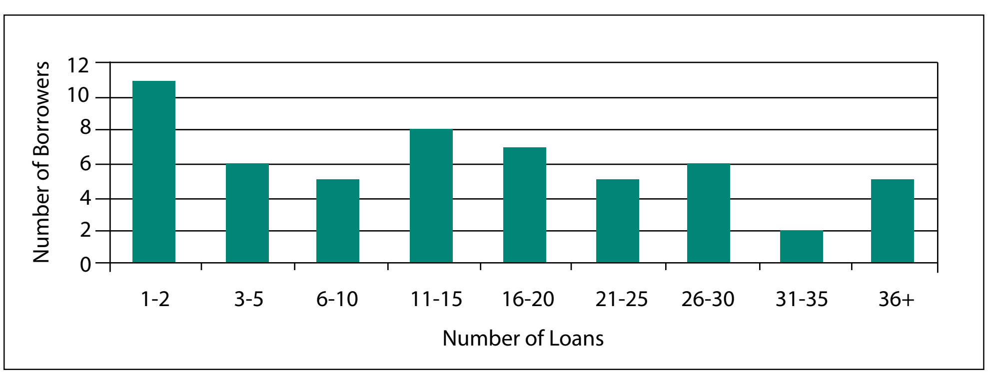
Similarly, banks restrict customers from "renewing" their payday loans but allow back-to-back transactions. They also provide for cooling-off periods, but only after a customer has been in debt for many months. As a result, bank payday borrowers end up indebted for a significant portion of the year. Indeed, an insider at one bank offering payday loans admitted, "Many [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken."[44]

- Payment plans. At payday shops, borrower use of installment plans is extremely rare.[45] Lenders have little incentive to encourage these plans and often make them available only to borrowers who have already been in debt to the lender for a considerable period of time and/or in exchange for a considerable upfront fee, among other eligibility restrictions.[46]

Similarly, some banks offer payment plans but only in limited circumstances, such as when a customer has already taken out a payday loan in three consecutive months, or in exchange for an additional $50 fee, which must be paid at the time the loan is made.

The failure of these "protections" to curb long-term use of bank payday loans is illustrated by the graph below; CRL's analysis of 55 panelists showed that many borrowers took out 10, 20, or even 30 or more loans in a year:

Bank Payday Loans Taken in One Year



Finding 3: Nearly one-quarter of all bank payday borrowers are Social Security recipients, who are 2.6 times as likely to have used a bank payday loan as bank customers as a whole.[47]

We were not able to determine to what extent the higher likelihood for Social Security recipients to use a bank payday loan arose from seniors being targeted by banks for payday loans (versus being offered lower-cost checking account lines of credit), or from financial pressures pushing seniors into these loans. We did find, however, that on average, when a Social Security recipient had an outstanding bank payday loan, the bank took a sizeable proportion (33 percent) of the borrower's next deposit to repay the loan and fee.[48]

DISCUSSION

A. The payday shop model that banks are adopting has well-known problems, and, as a result, public sentiment—and state and federal law—trend against it.

As discussed earlier, the well-documented "debt treadmill" problem that payday loans cause for consumers is created by the structure of the loan itself, which must be repaid in full from a single paycheck or benefits check. Borrowers routinely find themselves unable to repay the loan in full and the fee *plus* meet their monthly expenses without taking out another payday loan.[49] The average non-bank payday borrower takes out nine payday loans each year and remains in debt for 212 days during the first year—long-term indebtedness at a very high cost.[50]

Because bank payday loans are structured the same way, we would expect the same pattern of repeat loans to be true in the bank payday context. The table below illustrates how a bank payday borrower earning $35,000 a year would be hard pressed to pay back a $200 bank payday loan, plus a $20 fee, in just one pay period. The bank would, of course, repay itself, but the borrower will be left with insufficient funds to make it to the end of the next pay period without having to take out another payday loan.

Cost of a Two-week, $200 Bank Payday Loan

Income and Taxes	
Income per two-week pay period	$1,342.47
Federal, state and local taxes	($11.16)
Social Security tax (at 4.2% rate)	($56.38)
Income after tax	$1,274.93
Payday loan payment due on $200 loan[51]	($220.00)
Paycheck remaining after paying back payday loan	$1,054.93
Household Expenditures per two-week pay period	
Food	$181.69
Housing	$498.09
Utilities	$126.15
Transportation	$242.07
Healthcare	$102.95
Total essential expenditures	$1,150.95
Money from paycheck remaining (deficit)	**($96.02)**

Source: 2009 Consumer Expenditure Survey, households earning $30,000-$39,999. This example is of a borrower earning $35,000 per year and excludes other costs such as childcare and clothing.

Public sentiment and state law are moving against payday lending. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected payday lending, despite payday industry campaigns costing tens of millions of dollars.[52] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support of a 36 percent annual rate limit on payday loans, rather than 400 percent which they typically charge.[53]

In addition, since 2007, seven states have enacted or enforced meaningful reform to address payday lending[54]—while no state without payday lending has authorized it. Federal law, too, has moved against payday lending. In 2006, Congress limited loans made to active duty military personnel and their families to 36 percent annual percentage rate, aiming to prohibit lenders from making payday loans to this population across all states. In 2005, the FDIC imposed the guidelines described above limiting the length of time banks should allow borrowers to be in payday loan debt. And in 2010, the NCUA opted to permit higher cost loans (even then, at no more than 28 percent APR) only three times in a six-month period.

B. More financially insecure customers, like seniors, are especially vulnerable to problems caused by bank payday loans.

Just as overdraft fees hit more vulnerable bank customers especially hard, so do bank payday loans. Indeed, both products have a significant impact on older Americans receiving Social Security.

Since 2006, the wealth of American households dropped $6 trillion, due to decreased home values and losses in stock market-based retirement savings.[55] The impact of this financial shipwreck can be especially severe for older Americans, who have less time and ability to rebuild their wealth and financial security. And the problem is even more acute for older African-American households, who have only one-sixth of the wealth of older white households.[56]

Many seniors also are finding that their homes are no longer the bedrock of their financial security. Over one-third of seniors report a high housing cost burden,[57]and the proportion of older homeowners carrying mortgages has grown to 53 percent in 2007, up from 34 percent two decades earlier.[58] Both these developments increase the financial vulnerability of older households.

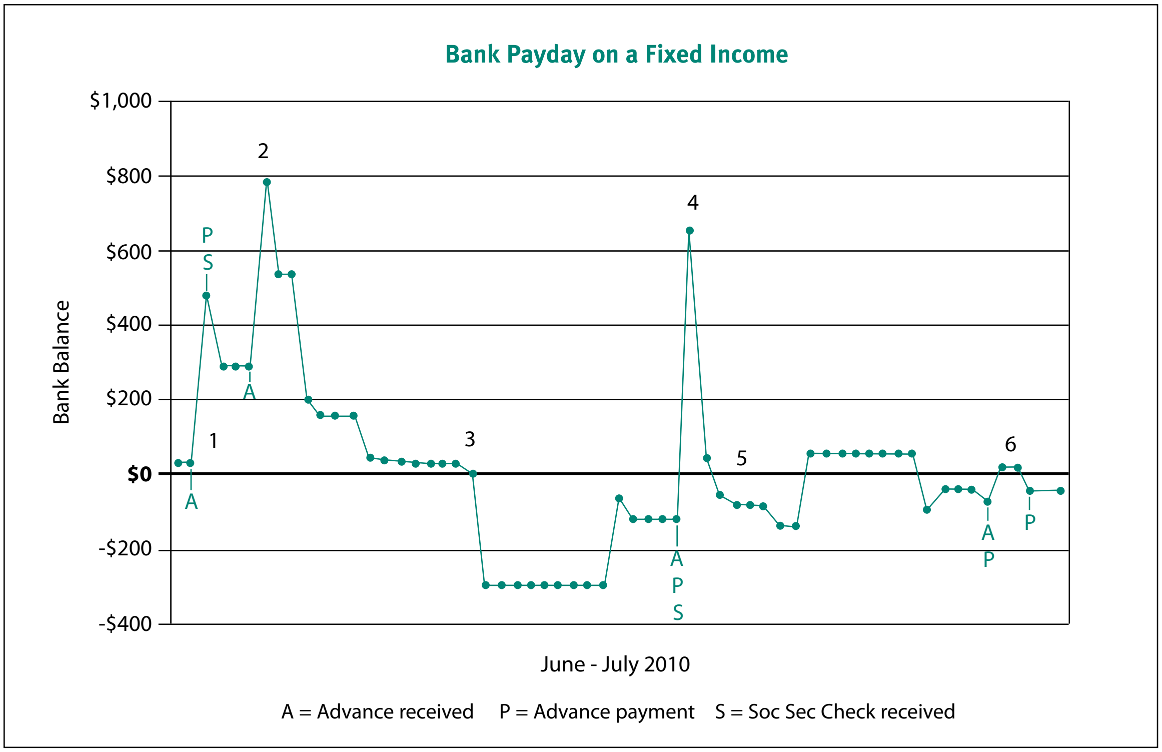
Coupled with declines in the value of their largest assets—homes and retirement assets—many older Americans struggle with limited incomes. More than 13 million older adults are considered economically insecure, living on $21,800 or less.[59] Senior women in particular face diminished incomes because of lower lifetime earnings and Social Security and pension benefits.

Faced with insufficient incomes, many older Americans take on debt to cover medical and living expenses. The average balance of credit card debt for older households in the US is now about $10,000, and this has grown much faster than for other age groups.[60] Other seniors turn to checking account overdraft loans, payday loans and car title loans.[61]

The result is not just more debt, but *unaffordable debt*. One-fifth of older households with annual incomes below $50,000 report spending more than 40 percent of their income on debt payments.[62] The results are sadly predictable: Those over age 65 make up the fastest-growing segment of people seeking bankruptcy protection.[63]

The following graph maps two months of checking account activity of one bank customer in our database whose primary source of income is Social Security. The line on the graph represents the borrower's account balance. It goes up when the customer receives a direct deposit, other deposit, or a payday loan or overdraft loan. It goes down when checks, bill payments, debit card transactions, or other withdrawals are posted to the account, or when the bank collects the payday loans (after a direct deposit is received) or overdraft loans (when any deposit is received) and the associated fees.

This graph shows that payday loans and overdraft loans only briefly increase the customer's account balance before it decreases dramatically a few days later when the loan and fees are collected in one lump sum, leading to another high-cost loan. At the end of the two-month period—having been in payday debt, overdraft debt, or both, for 57 out of 61 days and paid $219 in fees to borrow less than $650—the borrower is again left with a negative balance, in an immediate crisis, in need of another loan.



1: Checking Account Advance takes balance up to $500.

2: Borrower receives June Social Security Check, and bank uses deposit to pay off first Checking Account Advance. Panelist then takes out second Checking Account Advance, reaching his highest balance for the two-month period.

3: Several large bills and payments put the panelist on the verge of overdraft, and the repayment of the Advance is about to come due.

4: July's Social Security Check and a new Checking Account Advance bring the panelist out of an overdraft, which costs him $57 in fees.

5. More bills and the Advance repayment take him right back into overdraft.

6: Small bills and Advance fees and repayments offset small deposits, transfers, and Advances, and our panelist begins August in the red.

C. Payday lending by banks circumvents state laws.

In most states in which payday lenders operate, they are allowed to charge triple-digit rates because of special exemptions from the state's traditional interest rate caps, which apply to consumer finance loans and other small loan products. Payday lenders do not operate in 17 states and the District of Columbia, either because those jurisdictions have re-instituted interest rate caps in recent years, or they have never allowed these loans to be part of their small loan marketplace.[64]

Despite these interest rate caps, at least two national banks are currently offering payday loans in at least seven of the 17 states with interest rate caps on payday loans.[65] Banks argue that this is permissible under national bank preemption standards, which permit national banks to override state law in some circumstances. At least two state-chartered banks regulated by the Federal Reserve are also making payday loans in states where traditional payday lending is not permitted.[66]

D. Payday lending by banks undermines federal law aimed at protecting military service members.

> ***"This problem with... payday lending is the most serious single financial problem that we have encountered in [one] hundred years."***
>
> Admiral Charles Abbot, US (Ret.), President of Navy-Marine Corps Relief Society, testifying before U.S. Senate Banking Committee, September 2006.

In 2006, the federal government capped interest rates on payday loans at 36 percent APR to active-duty members of the military and their families. The protection grew from concern by the Department of Defense and base commanders that troops were incurring high levels of high-cost payday loan debt, which was threatening security clearances and military readiness.[67]

But banks structure their loans in a way that evades the caps on military lending in federal legislation: the law covers "closed-end" loans made to service members[68] and banks call their payday loans "open-end" instead, allowing multiple draws on a line of credit during a statement cycle, even though the due date for the loan, much like a closed-end loan, is fixed as the next deposit date or, at the latest, 35 days later.

E. The combination of payday loans and overdraft fees exacerbates the financial harm to consumers.

Loans from payday shops have been found to increase the odds that households will repeatedly overdraft and eventually lose their checking accounts.[69] There is no reason to believe that payday lending by banks would not have the same effect. Bank payday loans enable banks to collect additional fees from consumers who are already struggling with overdrawn accounts, as evidenced by the case study of the Social Security recipient above, who, over two months, paid $162 in payday loan interest plus $57 in overdraft fees.

Moreover, if funds are not directly deposited into a borrower's account from which the bank payday loan can be repaid within 35 days, the institution pays itself back automatically by pulling funds from the borrower's bank account. If this withdrawal overdraws the customer's account, all subsequent withdrawals posted to the account (like checks, automatic bill payments, or debit card transactions) may incur an overdraft or insufficient-funds fee until the next deposit is made.

F. Banking regulators have looked the other way as more banks enter payday lending.

Just as federal banking regulators failed to stop the spread of early overdraft loan abuses,[70] the regulator of national banks (the OCC) and the regulator of many state-chartered banks (the Federal Reserve Board) have not taken meaningful action to address payday lending directly by banks.[71] Most recently, the OCC proposed guidance on payday lending that accepts many current bank practices and essentially condones the most harmful aspects of the product:

- High cost. The OCC recommends only that banks disclose that these loans "may" be costly, even though our research shows the APR for the typical payday loan averages 365 percent.
- Short-term balloon repayment. The OCC recommends only that banks "permit" installment repayment. Some banks already do this, but only if a customer jumps through additional hoops or pays additional fees. Further, this "protection" has already been shown to be grossly ineffective at stopping the debt trap at payday shops.

- Repayment directly from customer's next deposit. Among other shortcomings in this area, the OCC does not instruct banks to treat Social Security or other protected benefits any differently than ordinary income.

- Lack of underwriting. Among additional shortcomings in this area, the OCC suggests stopping the product if a customer's direct deposits stop; this does not amount to a meaningful upfront assessment of a borrower's ability to repay the loan without having to take out another payday loan.

RECOMMENDATIONS

Prudential banking regulators

Prudential federal banking regulators, especially the OCC and the Federal Reserve, who supervise banks that are making payday loans, should immediately take meaningful steps to address this product. Payday loans are not consistent with the long-term safety and soundness of financial institutions. They damage consumers' balance sheets, drive families out of the banking system, and pose serious legal and reputational risks to banks—all of which ultimately threaten banks' deposit bases. The federal banking regulators should:

- Use immediate supervisory and enforcement authority to stop the banks they supervise from making payday loans. In the 2000s, the federal banking regulators used their supervisory authority to stop banks from partnering with payday loan shops to allow the payday shops to skirt state laws. They should similarly stop banks from making payday loans directly.

- In the alternative, impose a moratorium on payday loans offered by banks they supervise while they collect and make public data directly from the banks, including the amount and source of borrowers' income, frequency of use and rollovers, impact on people of color, impact on overdraft and nonsufficient funds (NSF) fees, impact on account closures, and the cost to the institution of making payday loans.

- Require that loans be repaid in affordable installments, rather than in lump sums, be reasonably priced, and be underwritten based on an ability to repay without needing to take out another loan shortly thereafter.

Consumer Financial Protection Bureau (CFPB)

Effective this week, the Consumer Financial Protection Bureau (CFPB) becomes the primary consumer protection regulator of large financial institutions. Particularly in light of the prudential regulators' failure to rein in payday lending by banks, the CFPB must take an active role to protect consumers from this abusive product. It should:

- Immediately, collect and make public data directly from banks demonstrating the usage patterns of this product and its impact on consumers, including Social Security recipients, military service members, and people of color.

- Prepare to use supervisory and enforcement authority to stop the banks they supervise from making payday loans.

Moreover, in an early action addressing overdraft fees, the CFPB should tell banks to stop manipulating the order in which transactions are posted in order to increase overdraft fees, and it should explicitly state that posting transactions in order from highest to lowest is not appropriate.

NOTES

1 Federal Reserve. *Balance Sheet of Households and Nonprofit Organizations* available at http://www.federalreserve.gov/releases/z1/current/z1r-5.pdf

2 Bureau of Labor Statistics. *Current Population Survey* available at http://www.bls.gov/cps/

3 Phil Izzo. *Nearly Half of Americans are "Financially Fragile".* The Wall Street Journal (May 2011) available at http://blogs.wsj.com/economics/2011/05/23/nearly-half-of-americans-are-financially-fragile/. More than half of those surveyed said they could not come up with $2,000 within 30 days to deal with an unexpected expense.

4 Bernard Condon. *Hot Growth Investment: Poor People.* Available at http://www.msnbc.msn.com/id/43690855/ns/business-stocks_and_economy/t/hot-growth-investment-strategy-poor-people/

5 The primary discount window rate was 0.75 percent as of July 18, 2011, http://www.frbdiscountwindow.org/currentdiscountrates.cfm?hdrID=20&dtlID=.

6 Throughout this report, "payday shops," "payday stores," and "non-bank payday lenders" are used interchangeably to describe payday lenders that are not banks.

7 As recently as 2004, 80 percent of institutions denied debit card transactions that would have overdrawn the account. Mark Fusaro, Are *"Bounced Check Loans" Really Loans?,* note 4, at 6 (noting 20 percent of institutions in June 2004 were applying "bounce protection" to debit cards or ATM) (Feb. 2007), *available at* http://personal.ecu.edu/fusarom/fusarobpintentional.pdf. Bank of America, the country's largest debit card issuer, and HSBC returned to this practice in 2010 when they stopped charging overdraft fees on debit cards. Citi has never charged these fees. For average overdraft fee and average size of debit card overdraft, see Eric Halperin, Lisa James, and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts,* Center for Responsible Lending, at 25 (Jan. 25, 2007), available at http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf.

8 *Debit Card Danger, supra,* at 25.

9 FDIC Study of Bank Overdraft Programs (Nov. 2008) at v; Two CRL surveys, conducted in 2006 and 2008, found that 71 percent of overdraft fees were shouldered by only 16 percent of respondents who overdrafted, and those account holders were more likely to be lower income, non-white, single, and renters when compared to the general population. Respondents reporting the most overdraft incidents were those earning below $50,000. Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options,* CRL Research Brief (Apr. 16, 2008).

10 Overdraft fees are a significant reason that individuals who had bank accounts at one time are no longer banked. *See* Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School (June 6, 2008) (noting that virtually all involuntary bank account closures, when the financial institution closes a consumer's account, occur because the account became overdrawn an excessive number of times).

11 Leslie Parrish and Peter Smith, *Shredded Security: Overdraft practices drain fees from older Americans,* Center for Responsible Lending (June 18, 2008), *available at* http://www.responsiblelending.org/overdraft-loans/research-analysis/shredded-security.pdf, at 6, Table 1. "Heavily dependent" was defined as recipients who depended on Social Security for at least 50 percent of their total income.

12 Leslie Parrish, *Overdraft Explosion: Bank fees for overdrafts increase 35% in two years,* Center for Responsible Lending (Oct. 6, 2009), *available at* http://www.responsiblelending.org/overdraft-loans/research-analysis/crl-overdraft-explosion.pdf.

13 *See, e.g.,* Impact Financial Services' website, https://impactfinancial.com/portal/AboutIFS/FromPresidentsDesk/tabid/66/Default.aspx (visited July 7, 2008 and Apr. 22, 2011) ("our clients have increased the NSF fee income from 50-150% or more"); Moebs $ervices, Inc.'s website, http://www.moebs.com/Default.aspx?tabid=102 (visited July 9, 2008 and Apr. 22, 2011) ("overall fee income is increased by 200%").

14 *See, e.g.,* Impact Financial Services' website, https://impactfinancial.com/portal/WhatisIOP/HowTheProgramWorks/tabid/65/Default.aspx (visited July 7, 2008 and Apr. 22, 2011).

15 Federal Reserve Board, Final Rule, Electronic Funds Transfers, Regulation E, Docket No. R-1343, 74 Fed. Reg. 59041 (Nov. 17, 2009).

16 *See* Leslie Parrish and Uriah King, *Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76 percent of total volume,* Center for Responsible Lending (July 9, 2009), *available at* www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf. In fact, among the large majority of payday borrowers who borrow repeatedly, nearly 90 percent of all new loans are taken during the same pay period in which the previous loan was repaid. *Id.*

17 *Id.*

18 CRL's recent analysis of data out of Oklahoma showed that payday borrowers borrowed more over time (an initial $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

19 *Id.*

20 *See* the following studies for discussions of these negative consequences of payday lending: (1) Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), available at www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; (2) Sumit Agarwal, Paige Skiba, and Jeremy Tobacman. *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), *available at* http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf; (3) Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School (June 6, 2008), *available a*t www.bos.frb.org/economic/eprg/conferences/payments2008/campbell_jerez_tufano.pdf; and (4) Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market,* University of Chicago Business School (November 15, 2007), *available at* http://home.uchicago.edu/%7Ebmelzer/RealCosts_Melzer.pdf; (5) Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans" (April 1, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

21 In California, payday lenders are 2.4 times more concentrated in communities of color, even after controlling for income and a variety of other factors. State surveys have found that African Americans comprise a far larger percentage of the payday borrower population than they do the population as a whole. Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis, P*redatory Profiling The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (March 26, 2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf.

22 Overdraft Rules, Part II: Interpreting the Ambiguous Guidance, Web Seminar, Banking Technology News, February 8, 2011.

23 Fiserv Relationship Advance program description available at http://www.relationshipadvance.com/; *see also* Fiserv unveils Relationship Advance: *Full-service solution provides a safer, more cost-effective alternative to courtesy overdraft programs,* Press Release (Nov. 18, 2009), *available at* http://investors.fiserv.com/releasedetail.cfm?ReleaseID=425106; Jeff Horwitz, *Loan Product Catching On Has a Couple of Catches,* American Banker, Oct. 5, 2010.

24 http://www.relationshipadvance.com/.

25 *See* Center for Responsible Lending, *Payday Loans Put Families in the Red,* Research Brief, February 2009, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

26 Based on total bank and savings institutions deposits of $9.4 trillion for 2010, as reported by the FDIC *Statistics on Depository Institutions.*

27 For example, see statements by spokespersons from one bank offering payday loans about how its products differ from payday loans because customers cannot rollover loans and cooling-off periods exist, in Chris Serres, *Biggest banks stepping in to payday arena: The big guns' entry into payday lending may finally bring fringe financial product out of the shadows and into the financial mainstream, despite howls of protest from consumer groups and the risk of tighter regulation,* Star-Tribune (Sept. 6, 2009) and Lee Davidson, *Do banks overcharge?*, Deseret Morning News (Jan. 22, 2007).

28 Katherine Reynolds Lewis, *Watchdog Group Raises Alarm Over 'Payday Loans' at Mainstream Banks,* Washington Independent, April 5, 2010 (quoting OCC spokesperson Dean DeBuck).

29 Calculated based on the cost banks typically charge for payday loans – $10 per $100 – and the typical loan term our analysis found, 10 days.

30 Calculated based on a typical cost of $16 per $100 borrowed (Stephens Industry Report, Payday Loan Industry, June 6, 2011. at 23, Figure 14) and a common pay cycle, two-weeks.

31 Lightspeed requires that participants have internet access, which may lead to selection bias. A survey conducted by the Pew Internet & American Life Project from October 24-December 2, 2007 reveals that while 72 percent of adults 50-64 use the internet, only 37 percent of adults 65 or older do.

32 CRL found instances of bank payday transactions in 55 separate accounts from 2010. From these accounts, we randomly sampled 50 instances of automatic repayment of bank payday loans. We derive our average number of days per loan and average number of days of indebtedness from this 50-loan sample. We derive all other general figures from the entire 55-account population. With respect to findings specific to Social Security recipients, we found instances of Social Security deposits in 55 accounts at the banks we identified as making payday loans. Of those accounts, 13 accounts contained bank payday lending activity. Our findings related to Social Security recipients are based on these accounts.

33 The median loan term of our 50-loan sample was 10 days.

34 One bank offering payday loans charges $7.50 per $100 loaned; the others we are aware of charge $10 per $100. Even at a fee of $7.50 per $100, the APR for a 10-day loan is 275 percent.

35 Federal Reserve Board's G19 release.

36 The average duration for all panelists was 10.7 days. Statistically, we can say with 95 percent certainty that the mean loan duration is between 9 and 12.6 days. The mean number of loans per person per year was 16.4 loans.

37 FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

38 FDIC Financial Institution Letters, Affordable Small Dollar Loan Guidelines, FIL 50-2007, June 2007, *available at* http://www.fdic.gov/news/news/financial/2007/fil07050.html.

39 Even these more expensive loans are limited to 28% APR. NCUA, Short-Term, Small Amount Loans, Final Rule, Sept. 2010, http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

40 The 95% confidence interval is 36 to 51%.

41 *See,* e.g., *Biggest banks stepping in to payday arena: The big guns' entry into payday lending may finally bring fringe financial product out of the shadows and into the financial mainstream, despite howls of protest from consumer groups and the risk of tighter regulation,* Star-Tribune (Sept. 6, 2009) and Lee Davidson, *Do banks overcharge?*, Deseret Morning News (Jan. 22, 2007).

42 *See* Best Practices for the Payday Advance Industry, Community Financial Services Association, *available at* www.cfsa.net/industry_best_practices.html.

43 *See* Uriah King and Leslie Parrish, *Springing the Debt Trap. Rate caps are only proven payday lending reform,* Center for Responsible Lending (Dec. 13, 2007). In the vast majority of states that ban renewals or refinancing of existing payday loans, the borrower, lacking the funds to both repay the loan and meet other obligations, simply repays one loan and immediately takes out another. This is often called a "back-to-back" transaction, and the effect it has on the borrower's finances is identical to a renewal.

44 David Lazarus, *120% rate for Wells' Advances,* San Francisco Chronicle, Oct. 6, 2004.

45 *Springing the Debt Trap, supra.* Take-up rates for installment plans typically hover in the 1 to 2 percent range.

46 *Id.*

47 With respect to proportion of all borrowers who are Social Security recipients, the 95% confidence interval is 14% to 36%. The difference in likelihood to take a bank payday loan for Social Security recipients was statistically significant at the $p<5\%$ level.

48 The 95% confidence interval is 26% to 40%.

49 CRL's recent analysis of data out of Oklahoma showed that payday borrowers borrowed more over time (an initial $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

50 *Phantom Demand, supra.*

51 Based on banks' typical cost of $10 per $100.

52 In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans; this was the verdict in every county in the state. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

53 In Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. See Ronnie Ellis, *Payday Lenders Targeted for Interest Rates,* The Richmond Register (Feb. 8, 2011), *available at* http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates. *See also Poll Reveals strong bi-partisan support for payday lending reform,* Iowapolitcs.com (Jan. 26, 2011), *available at* http://www.iowapolitics.com/index.iml?Article=224730. *See also* Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House,* WHSV.com (Jan.18, 2011) *available at* http://www.whsv.com/home/headlines/Virginia_Payday_Lending_Bill_Dies_in_Senate_Survives_in_House_114169549.html.

54 Arkansas, Arizona, the District of Columbia, New Hampshire, Ohio, Oregon, and Montana.

55 Federal Reserve. *Balance Sheet of Households and Nonprofit Organizations* available at http://www.federalreserve.gov/releases/z1/current/z1r-5.pdf

56 Federal Interagency Forum on Aging-Related Statistics. *Older Americans 2010: Key Indicators of Well-Being.* (July 2010). Available at http://www.agingstats.gov

57 Ibid. Housing cost burden is defined as spending more than 30 percent of household income for housing and utilities. Between 1985 and 2007, the housing cost burden for households with older people increased from 30 percent to 37 percent.

58 David Newville. *Older Americans and the Foreclosure Crisis.* Center for American Progress. (September 2008) available at http://www.newamerica.net/blog/asset-building/2008/older-americans-and-foreclosure-crisis-7241.

59 National Council on Aging. *A Blueprint for Increasing the Economic Security of Older Adults.* (March 20110. Available at http://www.ncoa.org/news-ncoa-publications/publications/blueprint-for-economic-security.html

60 Tamara Draut and Jose Garcia. *The Plastic Safety Net: How Households are Coping in a Fragile Economy"* Demos (2008). This study reports that since 2005, those Americans ages 65 and older have increased credit card debt by 26 percent (to $10,235), compared to an average 3 percent increase across all age groups.

61 Recent government rules requiring direct deposit of Social Security in most cases place these benefits at greater risk of being lost to abusive bank loans, without regulatory action to rein them in. For further discussion of this issue, *see* National Consumer Law Center, *Runaway Bandwagon. How the Government's Push for Direct Deposit of Social Security Exposes Seniors to Predatory Bank Loans* (July 2010), *available at* http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf.

62 See National Council on Aging, *supra.*

63 John A. E. Pottow. *The Rise In Elder Bankruptcy Filings And The Failure Of U.S.Bankruptcy Law (Working Paper No. 10-015)*. University of Michigan Law School (June 2011). Available at http://www.law.umich.edu/centersandprograms/elsc/abstracts/2010/Documents/10-015pottow.pdf

64 High-cost payday loans are not available in the following states/jurisdictions: Arkansas, Arizona, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Jersey, New Hampshire, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. While the exact interest rate cap varies by state, most are about 36 percent APR.

65 These states are Arkansas, Arizona, Georgia, Montana, Ohio, Oregon, and Pennsylvania.

66 *According to these banks' payday product account agreements, these states are Arkansas, Georgia, North Carolina, Ohio, and Virginia.*

67 *See Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents,* Department of Defense (August 9, 2006), *available at* www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf.

68 32 CFR 232.3(b).

69 In North Carolina, payday borrowers paid over $2 million in NSF fees to payday lenders in addition to the fees assessed by their banks in the last year payday lending was legal. 2000 Annual Report of the North Carolina Commissioner of Banks. Moreover, a Harvard study found an increase in the number of payday lending locations in a particular county is associated with an 11 percent increase of involuntary bank account closures, even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures.* June 6, 2008. *Available at:* http://www.bos.frb.org/economic/eprg/conferences/payments2008/campbell_jerez_tufano.pdf.

70 For further discussion, *see* Comments of the Center for Responsible Lending to Board of Governors of the Federal Reserve System on Proposed Rule to Amend Regulation E—Overdraft Practices (Mar. 30, 2009), *available at* http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/comments-regulation-e_overdraft-practices.pdf.

71 The Office of Thrift Supervision recently shut down one bank's payday product being offered through a prepaid card, but the other federal regulators have not followed suit. Form 8K of Meta Financial Group, Inc. filed with the Security and Exchange Commission, October 6, 2010, *available at* http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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