



Payday Mayday: Visible and Invisible Payday Lending Defaults

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INTRODUCTION

Payday loans are small, expensive loans that are marketed as quick credit but often create long-term debt traps. The loan payments are timed to be repaid on the borrower's next payday and are not meaningfully underwritten for ability to repay; as a result, in order to ensure repayment, payday lenders secure their loans with a post-dated check or electronic access to the borrower's bank account. In doing so, they become "first in line" to be repaid.

There is ample evidence that payday loans create great financial distress for borrowers. One key indicator is "loan churn," when borrowers take out a new loan shortly after repaying a prior loan. The Center for Responsible Lending (CRL) first documented this phenomenon in 2008's *Phantom Demand*, which found that 76% of payday loan volume is due to loan churn (Parrish & King, 2008).¹ A more recent Consumer Financial Protection Bureau (CFPB) research report similarly found that 80% of loan volume is due to churn (CFPB, 2014). As a result of loan churn, borrowers effectively re-borrow the principal and pay the fee over and over again, staying in debt over long periods of time.² Loan churn is costly for borrowers, adding at least \$2.6 billion in fees each year (Montezemolo, 2013).

This paper seeks to examine another key indicator of unaffordability: payday loan defaults (sometimes called "return events"), which we define as occurring when a borrower's check or electronic transaction is returned for insufficient funds. Because payday lenders secure their loans with a post-dated check or electronic access to the bank account and make payments due on the borrower's next payday, the default rate ought to be relatively low. A high default rate when the payday lender is first in line to be repaid is a clear sign that borrowers do not have the ability to repay the loan and may provide an indication that the borrower is insolvent.

This paper uses two data sources to examine two indicators of distress in the payday lending context, both of which carry both immediate and cascading financial consequences for the borrower. The first is what we term a "visible default"—a default that is visible to both the borrower and the payday lender because the borrower fails to make a payment on the loan and the check or electronic payment that secures the loan bounces. When this occurs, the borrower typically pays two "non-sufficient funds" (NSF) fees—one to the bank and one to the payday lender itself. Depending on state law, some payday lenders may charge late fees as well.³ In addition, defaulting on a payday loan will typically prompt an internal or external collections process. Borrowers also face other potential consequences; for example, Agarwal, Skiba, & Tobacman (2009) found that payday borrowers nearly double their chances of becoming delinquent on their credit card payments.

1 The 76% loan churn figure represents the percentage of all loans that are taken out within two weeks of having paid off another loan. Using a one-month definition of loan churn—which we view as conservative, as some people may be able to float their expenses longer than 30 days between loans by strategically timing bill payments—*Phantom Demand* found that 82% of overall payday loan volume is due to loan churn. The paper also found that half of repeat loans were opened at the borrower's first opportunity, 87% within two weeks of the prior loan, and 94% within one month of the previous loan (Parrish & King, 2008).

2 According to CFPB (2013), the typical borrower takes out ten loans per year from a single lender. Because most of these loans are taken out in rapid succession, borrowers effectively re-borrow the principal and re-pay the fee many times over. As a result, borrowers typically pay back over \$450 in interest alone for a \$350 loan at triple-digit annual interest rates (Montezemolo, 2013).

3 For example, Advance America's last 10-K filing with the Securities and Exchange Commission (for FY 2011) states, "If the customer does not repay the outstanding cash advance in full on or before the due date, we will seek to collect the amount of the cash advance and any applicable fees, **including any applicable late and NSF fees due**" [emphasis ours].

The visible default rate should be considered a conservative measure of financial distress, however, as the borrower's financial institution⁴ may allow a payment to go through even when there are insufficient funds in the account, charging an overdraft fee for doing so. As a result, this paper examines a second source of borrower distress, which occurs when the payment to the payday lender goes through because the bank covers it with an overdraft. We call this an "invisible default." From the payday lender's perspective, an invisible default looks like an on-time payment. From the borrower's perspective, though, it is a sign of an inability to repay the loan, resulting in financial harms, including substantial overdraft fees (typically \$35) (Borné & Smith, 2013), which in turn can eventually lead to lost bank accounts (Campbell, Jerez, & Tufano, 2008).

In addition to visible and invisible defaults, this paper examines a third sign of financial distress: when a borrower is assessed an overdraft or NSF fee after a payday loan is made (but not necessarily on the day of the loan itself). This is another sign of financial instability.

VISIBLE DEFAULT When a borrower bounces a check or electronic transaction to the lender. It is a visible default because the payday lender can see it. Example: a borrower provides electronic access to a bank account for the lender, and when the lender tries to electronically debit the payment, it bounces. The borrower typically pays two NSF fees after a visible default—one to the bank, the other to the payday lender.

INVISIBLE DEFAULT When the check or electronic payment to the payday lender goes through, but the account is overdrawn on the same day as the payment. Example: a borrower does not have enough money to cover a payment to a payday lender, but a bank covers the payment and charges a \$35 overdraft fee to the borrower. The borrower still did not have enough money to make the payment, but the default is invisible to the payday lender.

Summary of Findings

This paper's findings, listed below, highlight that the lack of underwriting for payday loans creates economic distress for borrowers from the very first loan:

1. Nearly half of all payday borrowers defaulted within two years of their first loan.
2. Of borrowers who defaulted, nearly half did so within the first two payday loans.
3. Default does not necessarily signal the end of payday borrowing, with many defaulters going on to repay their loan and even borrow (and possibly default) again at a later date.
4. Nearly one in five borrowers had a loan charged off by the lender.⁵
5. One-third of payday borrowers experienced at least one invisible default in which their account was overdrawn on the same day that they made a payment to a payday lender.
6. For payday borrowers, overdrafts and bounced transactions frequently occurred close in time to the use of payday loans. Nearly half of payday borrowers incurred an overdraft or NSF fee in the two weeks after a payday loan transaction, and 64% paid overdraft or NSF fees at some point.

⁴ We use the term "financial institution" to discuss any institution holding a payday borrower's bank account, including a credit union.

⁵ I.e., taken off the books for being more than 60 days past due.

VISIBLE DEFAULTS

Prior research on payday loan defaults has indicated that, despite payday loan payments being due on borrowers' payday, when they should have the most money available, default rates are high. For example, CRL's *Payday Loans, Inc.* found that 37% of payday borrowers in Oklahoma defaulted within one year of taking out their first payday loan, and 44% did so within two years (King & Parrish, 2011). Similarly, Skiba, & Tobacman (2008) found that 54% of borrowers at a Texas payday lender defaulted within a year.

PAYDAY LENDING IN NORTH DAKOTA

North Dakota is one of 30 states that authorizes payday lending at triple-digit APRs without any meaningful restrictions.⁶ The state has 56 payday loan stores, and borrowers pay \$34.8 million in fees annually (Montezemolo, 2013).

North Dakota lenders typically charge the maximum allowed by law—\$20 per \$100 borrowed, plus a small database fee—which corresponds to an APR of over 500% for a two-week loan.⁷

Borrowers are allowed to formally renew each loan once, after which a three-day waiting period goes into effect. This waiting period, however, is ineffective at stopping the debt trap, as borrowers can pay off the loan on their payday, float their expenses for three days, and then take out another loan. Indeed, many do; one CFPB study found that 80% of payday loan volume is due to loans that are taken out within two weeks of having paid off another payday loan (CFPB, 2014a). Similarly, CRL found that 76% of total loan volume is due to this loan "churn" (CRL, 2008).

For more information on how the default rate in North Dakota compares with the default rate in other states, see Appendix 1.

We are interested in delving deeper into the default rate to examine what happens after a default. Do borrowers who default ultimately have their loans written off (taken off the books) for failure to pay? Or do borrowers eventually repay the loans, possibly even re-borrowing at a future date? Of borrowers who default, do they do so early or late in the lending cycle? The answers to these questions will help determine the extent to which the current limited underwriting of payday loans is inadequate and leads to the provision of unaffordable, expensive credit.

To better understand the visible default rate, we acquired data from North Dakota's Veritec database, which tracks payday lending activity across lenders. We tracked for two years 1,065 people who took out their first payday loan between October and December of 2011. Because North Dakota allows renewals, we treated renewals as new loans for the analysis.

Key Visible Default Findings

Data from North Dakota show that a large proportion of borrowers ultimately default after taking out their first payday loan: 39% did so within one year of their first loan, and 46% did so within two years. For most borrowers, default did not signal the end of the cycle of debt: Two-thirds of defaulters ultimately paid back the debt in full, and 39% of defaulters re-borrowed at a later date. Of defaulters, one-third experienced a subsequent default. Nineteen percent of borrowers and 39% of defaulters had a loan charged off, i.e., taken off the books for being more than 60 days past due.

⁶ Twenty-one states, including the District of Columbia, eliminate or substantially reduce the debt trap through meaningful laws, such as rate caps that apply to small-dollar loans. These states are: Arizona, Arkansas, Colorado, Connecticut, Delaware, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Washington, Vermont, Virginia, and West Virginia.

⁷ A review of national lenders in North Dakota shows that they all charge the maximum allowed by law of \$20/\$100 borrowed (plus a small database fee). For example, Check-n-Go offers a \$300 two-week loan with \$60.58 in fees at 526% APR (see <https://www.checkngo.com/resources/state-center/nd.rates>). Speedy Cash offers a similar product: a \$300, 14-day loan for \$60 in fees at 521% APR (see <https://www.speedycash.com/rates-and-terms/north-dakota/>). Cash Central (from Community Choice Financial) offers the same loan: a two-week \$300 loan with fees of \$60 and an APR of 521%. Cash Net USA charges a \$60 fee for a \$300 loan, or 521% APR for a 14-day loan (see <https://www.cashnetusa.com/rates-and-terms.html>).

Finding 1: Nearly half of all payday borrowers defaulted within two years of their first loan

Figure 1: Percentage of borrowers defaulting over time

Time since taking out first payday loan	Borrower default rate
6 months	33%
12 months	39%
18 months	44%
24 months	46%

Figure 1 shows a high visible default rate, with fully one-third of borrowers defaulting within six months of having taken out their first payday loan. This percentage grows over time, with nearly half—46%—defaulting within two years of the date they took out their first payday loan. This seems especially high considering that payday loans are due on a borrower’s payday, when he or she should have the most money during the pay period.

Finding 2: Of borrowers who defaulted, nearly half did so within the first two payday loans.

Figure 2 shows that most defaulters did so early in their borrowing, with 48% defaulting within the first two loans, and over one in five—22%—doing so on their very first payday loan. That defaulters tend to miss a payment so early in their borrowing is another clear sign of borrower distress, suggesting that any minimal underwriting performed does not adequately consider a borrower’s ability to afford the loan or intent to repay the loan.⁸

Figure 2: Among defaulters, loan number on which default occurred

Loan #	1	2	3	4	5	6	7+ loans
Of defaulters, percent defaulting	22%	26%	7%	9%	4%	6%	27%

⁸ According to Rick Hackett, a payday loan researcher and former Assistant Director of Installment and Liquidity Lending at the Consumer Financial Protection Bureau, some payday loan applications contain some element of fraud, whether false identity, synthetic identity, or another problem.

Finding 3: Default does not necessarily signal the end of payday borrowing, with many defaulters going on to repay their loan and even borrow (and possibly default) again at a later date.

Sixty-six percent of borrowers who defaulted ultimately paid the debt back in full.⁹ This statistic highlights that even though borrowers experience financial distress with default (including having to pay additional fees to the payday lender and their financial institution), default does not pose nearly as much risk for the lender. In fact, CFPB took an enforcement action against ACE Cash Express, one of the largest payday lenders in the United States. CFPB found that the payday lender “used illegal debt collection tactics—including harassment and false threats of lawsuits or criminal prosecution—to pressure overdue borrowers into taking out additional loans they could not afford” (CFPB, 2014b).¹⁰

Moreover, of those with a default, nearly two in five (39%) re-borrowed at a later date, while fully one-third experienced more than one return event.

Finding 4: Nearly one in five borrowers had a loan charged off by the lender.

Figure 3 shows that of all borrowers, nearly one in five (19%) had a loan a charged off.¹¹ Charge-offs indicate that the borrower has been in default long enough that he or she is unlikely to ever pay it back; borrowers with loans charged off can still face aggressive third-party debt collection tactics.¹²

Figure 3: Percentage of borrowers with loan charged off over time*

Time since taking out first payday loan	Borrower charge-off rate (loans at least 60 days past due)
6 months	12%
12 months	16%
18 months	18%
24 months	19%

* Loans more than 60 days past due assumed to be charged off

Not surprisingly, the charge-off rates for defaulters are higher than those in figure 3; for example, among defaulters, nearly two in five (39%) had a loan charged off within 24 months of their first payday loan.

9 The remaining one-third of defaulters may have paid it back in part, but the Veritec database does not track partial payments.

10 ACE does not do business in North Dakota, although it offers payday loans in most states where they are legal.

11 We consider loans more than 60 days past due to be charge-offs, as that is the point at which many loans are taken off the books. For example, the 2005 Payday Lending Guidelines from the Federal Deposit Insurance Corporation (FDIC) state: “Furthermore, payday loans that have been outstanding for extended periods of time evidence a high risk of loss. While such loans may have some recovery value, it is not practical or desirable to defer writing off these essentially worthless assets. Payday loans that are outstanding for greater than 60 days from origination generally meet the definition of Loss.”

12 For example: “A person familiar with the industry describes the arrangement this way: ‘If you’re an online payday lender, 30 percent of the people you loan money to will immediately default. That’s just incorporated into the business model. At first, the lender will do a soft collect: sending e-mails, etc., trying to get the consumer to pay up. They’ll do that for about four weeks, and then they bundle up all the bad loans and send them to a company like [National Credit Adjusters], which is trained in federal collections laws and specializes in getting that money collected’” (Hudnall, 2014). National Credit Adjusters has been the subject of enforcement actions by regulators in New York City and Arkansas for debt-collection abuses.

INVISIBLE DEFAULTS

Borrowers experience visible default on payday loans when they fail to make their scheduled payments. However, in exchange for an overdraft fee (typically \$35), many financial institutions process payments even when the accountholder lacks sufficient funds. Thus, the “visible default” rate should be seen as conservative. That is, to the extent that banks are allowing payments to payday lenders to go through when borrowers do not have enough money in their account, the “visible default” rate understates the degree to which the borrower experiences difficulty repaying the loan and masks the resulting consequences (an overdraft fee from the payday loan transaction and potentially overdraft and/or non-sufficient funds fees on other transactions).

In this section, we examine what we term the “invisible default” rate, i.e., payments to payday lenders that would have defaulted if the bank had not covered the payment through an overdraft loan. These defaults are invisible to the payday lender because the lender receives the payment on time. In order to determine the invisible default rate, we examined the detailed transaction records for 2011 and 2012 from a representative sample of U.S. checking account holders to identify people who had taken out loans from payday lenders.¹³ To measure invisible defaults, we searched for days when both a payday loan payment and an overdraft occurred.¹⁴ Note that for this analysis, we did not include payday loans where the bank itself is the lender (sometimes called deposit advance products).

In most cases, the overdrafts we identified included the specific transaction that caused the overdraft and the date on which overdraft occurred. We also included overdrafts that occurred on the same day as a payment to a payday lender, even if the overdraft could not be tied specifically to the payday lending payment. We did so for two reasons: First, some overdraft descriptions included a date but did not note which transaction on that date caused the overdraft; and second, the common bank practices of reordering and batch processing transactions mean that the actual order of the transactions is somewhat arbitrary. That is, any overdraft on the day a payday loan payment is processed, regardless of the time that it occurs, indicates that the accountholder does not have sufficient funds for the day’s payments.¹⁵

Finding 5: One-third of payday borrowers experienced at least one invisible default in which their account was overdrawn on the same day that they made a payment to a payday lender.

Figure 4 highlights that one-third of payday borrowers had an overdraft on the same day as a payday loan payment, *showing that the visible default rate masks clear signs of borrower distress*. These findings are consistent with Pew (2013), whose survey found that 27% of payday borrowers said that payday loans “directly cause checking account overdrafts.”

13 As further described in Appendix 4, the account holders in the data set were not always in the data set for both years; some were in the data set for a substantially shorter period of time.

14 As further described in Appendix 4, we identified the date that the overdraft occurred, not the date the overdraft fee was assessed. In many cases the overdraft fee was assessed one or more days after the overdraft occurred.

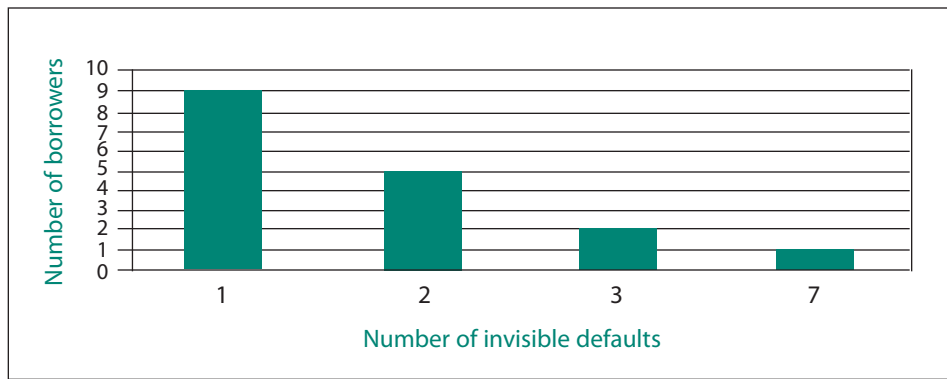
15 For more information on how we identified payday transactions, overdraft transactions, and dates, please see Appendix 4.

Figure 4: Invisible Default Summary Statistics

Number of payday borrowers ¹⁶	52
Number of these borrowers with overdrafts on same day as payday loan payment	17
% of borrowers with same-day events (17/52)	33%
Median number of same-day events per borrower	1
Mean number of same-day events per borrower	1.9

Figure 5 shows that although most borrowers only had one invisible default, some had more than one. In addition to masking borrower distress, invisible defaults result in bank overdraft fees that average \$35 per overdraft (Borné & Smith, 2013).

Figure 5: Invisible defaults per borrower



The list of transactions shown in Figure 6 illustrates invisible default for one payday borrower in the data set. On October 3rd, this borrower:

- (a) received her income of her monthly Social Security deposit of \$831 (item 7);
- (b) made payments on deposit advance loans from her bank (items 1, 2, 3)¹⁷ and took out a new deposit advance loan (item 4);¹⁸
- (c) made purchases at a gas station and two grocery stores (items 5, 8, 13); and
- (d) repaid two payday loans (items 11, 14).

On October 4th, she was assessed a \$35 overdraft fee (item 15) directly tied to the previous day’s \$288 payday loan payment (item 14). This overdraft fee signals that the payday loan payment from the prior day was an invisible default.

16 Although our full dataset contained 125 payday borrowers, only 52 of the 125 payday accountholders had enough data to assess invisible defaults. For more information, see Appendix 4.

17 Generally, we excluded “deposit advance” loans—payday loans made by banks—from our analysis; i.e., borrowers who only received deposit advance loans were not considered payday borrowers for the purpose of the analysis. There were, however, borrowers who received both payday loans and deposit advance loans, as is the case with the borrower in this example, which is why both deposit advance loans and payday loans appear in the transaction list.

18 CRL usually refers to deposit advance loans as “bank payday loans,” as they are short-term loans repaid on the customer’s next direct deposit. Note, however, that we do not include deposit advance loans in our invisible defaults quantitative analysis, as the FDIC and OCC put in place strong supervisory guidance in 2013 that established meaningful underwriting standards for the loans. (For more information, see FDIC, 2013.)

Figure 6: Example of one borrower's invisible default

Item #	Date posted	Amount debited	Amount credited	Transaction description
1	10/03	(\$19.50)		Deposit advance payment for loan taken out on 09/09
2	10/03	(\$16.50)		Deposit advance payment for loan taken out on 09/08
3	10/03	(\$220.00)		Deposit advance payment for loan taken out on 09/08
4	10/03		\$500.00	Deposit advance loan proceeds deposited 10/01
5	10/03	(\$4.72)		Gas purchase 10/01
6	10/03	(\$55.00)		Check card purchase 10/01
7	10/03		\$831.00	Social Security paycheck
8	10/03	(\$125.69)		Grocery store purchase 10/03
9	10/03	(\$32.50)		Bank payday loan payment for loan taken out on 09/02
10	10/03	(\$260.00)		Bank payday loan payment for loan taken out on 09/09
11	10/03	(\$293.75)		Payday loan payment
12	10/03	(\$6.95)		Fee for bill pay on 10/01
13	10/03	(\$34.67)		Grocery store purchase 10/01
14	10/03	(\$288.75)		Payday loan payment
15	10/04	(\$35.00)		Overdraft fee for \$288.75 10/03 Payday Loan Payment

Other measures of financial instability

Invisible defaults described above are limited to overdrafts that occur on the same day as a payday loan payment. This is generally the date when the borrower should have the most money available, given that payday loans are due on a borrower's payday. But what if a borrower is assessed an overdraft or NSF fee shortly thereafter—say, on the day after a payday loan payment is due? This would still indicate financial instability, even though it would not be considered an invisible default. Therefore, in addition to invisible defaults, we examined the timing of payday transactions and overdrafts or bounced transactions to determine how these may interact for borrowers.¹⁹

¹⁹ Bounced transactions are not counted as invisible defaults because they should be captured by visible default data. For the analysis in finding 6, however, we included bounced transactions, as we wanted to capture the types of transactions that would indicate a visible or invisible default on the day of a payday loan payment.

Prior research has indicated that payday loan use and bank account overdrafts more generally go hand-in-hand. For example, CFPB (2013) found that the majority of payday loan customers paid overdraft fees. We similarly find that payday loan borrowers are more likely to be assessed overdraft and NSF fees.

Finding 6: For payday borrowers, overdrafts and bounced transactions frequently occurred close in time to the use of payday loans. Nearly half of payday borrowers incurred an overdraft or NSF fee in the two weeks after a payday loan transaction, and 64% paid overdraft or NSF fees at some point.

Figure 7 shows that nearly half (44%) of the identified payday borrowers incurred an overdraft or NSF fee in the two weeks following the payday transaction.²⁰ Many of these overdrafts occurred within a week or a few days of the payday transaction.

Figure 7: Percentage of payday borrowers assessed payday and NSF fees up to two weeks after a payday transaction

Days since payday transaction	Percentage
14 days	44%
7 days	38%
3 days	34%

In addition, nearly two-thirds (64%) of identified payday borrowers also paid at least one overdraft or NSF fee, which is more than twice the rate at which non-payday panelists paid overdraft or NSF fees (25%).

²⁰ We assumed 14 days to be the typical length of a payday loan.

CONCLUSION & POLICY RECOMMENDATIONS

This paper has examined a key indicator of borrower ability to repay payday loans: defaults—both those that are visible and invisible to the lender. Because payday loan payments are due when a borrower should have the most money in a pay cycle—on his or her payday—a high default rate is a key indicator that a borrower is facing significant financial difficulty and may even be approaching insolvency. Defaults are also expensive for payday loan borrowers, potentially more than doubling the cost of a loan through high NSF and/or overdraft fees (typically \$35 each). Thus, default provides a key indicator that payday loans cause financial harm to borrowers.

This paper finds significant levels of both visible and invisible defaults. On the visible side, we find that a large proportion of borrowers—nearly two in five—defaulted within one year of taking out their first payday loan, and almost half did so within two years. Most defaulters did so early in their borrowing, with nearly half defaulting on the first or second loan. For most borrowers, default did not signal the end of the cycle of debt: Two-thirds ultimately paid their debt back in full, and nearly two in five went on to re-borrow at a later date. Of defaulters, nearly two in five had a loan charged off.

On the invisible side, one-third of borrowers experienced at least one invisible default. Many borrowers showed additional financial instability, with nearly half of payday borrowers being assessed an overdraft or NSF fee within two weeks of a payday transaction. Payday borrowers were also more than twice as likely as non-borrowers to be assessed an overdraft fee. This high invisible default rate underscores that the high visible default rate should be considered a conservative measure of borrower distress.

Our findings thus provide evidence that payday loans cause financial harm. As a result, we make the following policy recommendations:

- Congress should enact a 36% APR limit applicable to all borrowers, similar to what it enacted for active-duty military and their families in the Military Lending Act.
- CFPB should promulgate regulations that:
 - require payday lenders to determine the borrower's ability to repay the loan without re-borrowing, including consideration of income and expenses;
 - do not provide a safe harbor for loans that are poorly, or not at all, underwritten;
 - do not sanction any series of repeat loans or rollovers; and
 - establish an outer limit on length of indebtedness that is no longer than FDIC's 2005 guidelines—90 days in a 12-month period.
- Federal regulators—including the Department of Justice, FTC, prudential regulators, and CFPB—should use their enforcement authority against payday lenders to address violations of law.
- States should continue to put in place 36% APR limits applicable to payday loans.
- States should vigorously enforce their laws against unlicensed lenders and should work in partnership with federal regulators to address attempts at subterfuge.
- In addition to implementing substantive protections, CFPB and states should continue to collect and make public detailed data on payday loan use.

It is important to note that the concerns about lack of affordability, as highlighted through visible or invisible defaults, exist regardless of whether loans are structured with lump-sum single-payment or longer-term installment loans. Although the data from North Dakota allow us to examine visible defaults of loans under 60 days, data from other states reflect high visible defaults for loans structured as installment. For example, in Colorado—where payday loans have a minimum loan term of six months—regulator data show that one in five payday loans defaulted in 2013 (Staff of the Administrator of the Colorado Consumer Credit Code, 2014a). With borrowers taking out multiple loans on average per year, the per-borrower default rate was likely higher.²¹ And Texas data show that the default rate on payday installment loans is 53%²² (Texas Office of the Consumer Credit Commissioner, 2014).

Likewise, high levels of repeat refinancing serve to mask defaults or borrower distress in making payments on unaffordable loans. Again in Colorado, 37% of all loans were taken out on the same day that the borrower paid off a prior loan from the same lender, with loans over \$400 having an even higher “same-day-as-payoff” rate of nearly 50% (Staff of the Administrator of the Colorado Consumer Credit Unit, 2014b). In Texas in 2013, more than one-quarter (26%) of all payday installment loans were direct refinances, and this rate does not include loans taken out on the same day that the borrower paid off another payday loan (Texas Office of the Consumer Credit Commissioner, 2014).²³

21 The latest demographic and statistical report shows that borrowers typically took out 2.9 loans from a single lender over the prior 12 months (Staff of the Administrator of the Colorado Consumer Credit Unit, 2014b).

22 The default rate is the same per borrower and per loan for Texas installment loans.

23 There is evidence that consumer installment loans, like payday loans, have high refinance rates. For example, according to its 10-K filing with the Securities and Exchange Commission, consumer installment loan lender World Acceptance Corporation wrote, “In fiscal 2014, approximately 83.9% of the Company’s loans were generated through refinancings of outstanding loans and the origination of new loans to previous customers. A refinancing represents a new loan transaction with a present customer in which a portion of the new loan proceeds is used to repay the balance of an existing loan and the remaining portion is advanced to the customer. The Company actively markets the opportunity for qualifying customers to refinance existing loans prior to maturity. In many cases the existing customer’s past performance and established creditworthiness with the Company qualifies that customer for a larger loan. This, in turn, may increase the fees and other income realized for a particular customer” (World Acceptance Corporation, 2014). Consumer installment lenders, like payday lenders, also appear to offer “default-masking” same-day transactions in which a new loan is taken out on the same day that a prior loan is paid back. Sixty percent of OneMain financial’s loans, e.g., are renewals (Corkery, 2014).

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APPENDIX 1: VISIBLE DEFAULT DATA: 2013 CALENDAR YEAR SNAPSHOT

In addition to the data that we highlight in the paper, in which borrowers were tracked for two years after they took out their first payday loan, we acquired data providing a one-year snapshot of borrowing activity for January–December 2013. We did so in order to be able to compare defaults in North Dakota with the default rates typically reported by state regulators, which usually cover a calendar year. This Appendix reports the results of the one-year snapshot and compares it with similar data from other states.

It is important to note that the borrower default rates reported in this Appendix are here for the purpose of comparison with other states and are not comparable with the numbers reported in the main paper. The calendar year borrower default rate may understate defaults because some borrowers take out their first loan toward the end of the year and thus are not tracked for enough time to show default. For example, borrowers who took out their first payday loan in mid-December 2013 and who defaulted in early January 2014 would appear “successful” in the 2013 data. Conversely, if those borrowers were tracked for one year after taking out their first payday loan, they would be considered defaulters.

The data from Figure A-1 show that North Dakota has similar one-year default rates as other states. This finding is not surprising, as the payday lending business model is generally consistent across states that authorize the product. The table below shows various state default rates on a per-loan and a per-borrower basis, where available. North Dakota’s per-loan default rate is also similar to that in QC Holding’s 2013 10-K filing with the Securities and Exchange Commission, which cites a per-loan default rate (called the “loan loss rate”) of 6.4% (QC Holdings, 2014).

Figure A-1: Payday loan default rate, by state

State	Time Period	Default rate per loan	Default rate per borrower
North Dakota	Jan.–Dec. 2013	6.4%	29.2%
Oklahoma	Jan.–Dec. 2007	4.9%	24.6%
Florida	Sept. 2006–Aug. 2007	4.8%	26.0%
California	Jan.–Dec. 2013	5.8%	Not reported
Louisiana	Jan.–Dec. 2013	4.9%	Not reported
Missouri	Jan.–Dec. 2012	5.2%	Not reported

APPENDIX 2: LOAN CLUSTER ANALYSIS

We received borrower-level data and what we term “loan cluster” data. We defined a loan cluster as a string of one or more loans in which any subsequent loan was taken out within 30 days of having paid off a prior loan. A break of more than 30 days between paying off one loan and taking out another would signify the start of a new loan cluster.²⁴

The loan cluster data highlight similar trends as the borrower-level data. Of the 2,186 loan clusters in our data set, 569 (26%) included at least one default. Six percent included more than one default, and ten percent included a loan that we assumed to have been charged off (i.e., the loan was more than 60 days past due).

Of the 569 loan clusters with at least one default, 23% comprised just one loan and 25% comprised just two loans, highlighting that default tends to occur early in borrowing.

²⁴ This is similar to the “loan sequence” definition used in the CFPB’s 2014 “data point” on payday lending, though the CFPB used 14 days to denote a break in lending rather than 30 days. Although the 14-day definition is more conservative than the 30-day definition, some people may be able to float longer than 30 days between loans by strategically timing bill payments, so the 30-day definition should also be seen as conservative in defining what constitutes a break in lending.

APPENDIX 3: NORTH DAKOTA VERITEC DATA

General Notes:

- Renewals were treated as new loans for the analysis.
- We requested data on charge-offs and received two types of data. 1) Loans that were 60 days past due and 2) loans that were closed with a payment of “bad debt.” As discussed previously, we assumed loans that were more than 60 days past due to be charge-offs, in accordance with industry practices and regulator assumptions (FDIC, 2005). However, we include the numbers for loans closed as “bad debt” in the spirit of sharing all the information we received from our open records request.
- A return event, which we consider a default, is defined as an event where a check or ACH was returned due to insufficient funds.
- Because of the dynamic nature of the database, the information is subject to change.

A. General information on defaults

Note: We did not use these calendar-year data in the paper, but rather used it in Appendix 1 to compare North Dakota with other states, which report data in calendar year format.

One-year snapshot of data for calendar year 2013

- Total number of loans: 102,159
- Total unique borrowers: 15,722
- Loans with a return event: 6,497 loans (6% of all loans)
- Loans more than 60 days past due: 2,523 (3% of all loans)
- Loans closed as “bad debt”: 290 (0.3% of all loans)
- Borrowers with a return event: 4,583 (29% of all borrowers)
- Borrowers with more than one return event: 1,293 borrowers (8% of all borrowers)
- Borrowers with a loan that was more than 60 days past due: 2,171 (14% of all borrowers)
- Borrowers with loans closed as “bad debt”: 288 (2% of all borrowers)
- Loans to borrowers with a return event: 26,626 (26% of all loans)
- Loans to borrowers with loan more than 60 days past due: 9,956 (10% of all loans)
- Loans to borrowers with loan closed as “bad debt”: 1,058 loans (1% of all loans)

B. Tracking borrower defaults over time

Note: These are the data we use throughout the paper.

This section tracks borrowers who opened their first loan in October, November, or December of 2011 and tracks each borrower for two years.

- Total loans over rolling two years: 9,201
- Total unique borrowers who took first loan Oct.–Dec. 2011: 1,065

Of all of these borrowers (n=1,065):

- Total loans to borrowers with a return event: 4,370 loans (48% of loans)
- Total loans to borrowers with a loan more than 60 days past due: 1,519 (17% of loans)
- Total loans to borrowers with a loan closed as “bad debt”: 254 (3% of loans)
- Borrowers experiencing a return event in the following timeframe:
 - 6 months from their first loan: 349 (33% of borrowers)
 - 12 months from their first loan: 418 (39% of borrowers)
 - 18 months from their first loan: 466 (44% of borrowers)
 - 24 months from their first loan: 492 (46% of borrowers)
- Borrowers with a loan more than 60 days past due in the following timeframe:
 - 6 months: 123 (12%)
 - 12 months: 166 (16%)
 - 18 months: 188 (18%)
 - 24 months: 205 (19%)
- Borrowers with a loan closed as “bad debt” in the following timeframe:
 - 6 months: 31 (3%)
 - 12 months: 47 (4%)
 - 18 months: 50 (5%)
 - 24 months: 56 (5%)

Of the borrowers who experienced a return event (n=492):

- Borrowers with more than one return event: 162 (33% of those with a return event)
- Mean and median number of loans borrower taken out prior to the return event (including the transaction on which the return event occurred):
 - Mean: 6
 - Median: 3

- Borrowers with a return event occurring on the:
 - 1st loan: 109 (22% of those with a return event)
 - 2nd loan: 126 (26% of those with a return event)
 - 3rd loan: 35 (7% of those with a return event)
 - 4th loan: 42 (9% of those with a return event)
 - 5th loan: 22 (4% of those with a return event)
 - 6th loan: 30 (6% of those with a return event)
 - 7th loan: 15 (3% of those with a return event)
 - 8th loan: 17 (3% of those with a return event)
 - 9th loan: 13 (3% of those with a return event)
 - 10th loan: 8 (2% of those with a return event)
 - 11th loan: 5 (1% of those with a return event)
 - 12th or later loan: 73 (15% of those with a return event)

Note: although these data only include loans with agreement dates within two years of the borrower's first loan, some of the loans had return events that occurred more than two years after the first loan.

- Borrowers with a return event who fully cured the loan (paid it back in full): 327 borrowers (66% of those with a return event)

Note that the database does not track partial repayments, so we did not receive any such information.

- Borrowers with a return event who had that particular loan 60 days or more past due: 193 (39% of borrowers with a return event)
- Borrowers with a return event who had that particular loan closed as “bad debt”: 53 (11% of borrowers with a return event)
- Of those with a return event, mean and median amounts owed at the time of the return event:
 - Mean: \$336.02
 - Median: \$305.00
- Of those with a return event, mean and median amounts of the first loan taken out:
 - Mean: \$307.76
 - Median: \$300.00
- Mean and median difference between the amount owed at the time of the return event and the principal amount of the first loan:
 - Mean: \$38.73
 - Median: \$0.00

- Borrowers with a return event who re-borrowed at a later date: 192 (39% of borrowers with a return event)
- Of borrowers with a return event who re-borrowed at a later date, mean and median number of days between the return event and the next loan:
 - Mean: 105 days
 - Median: 45 days

Of borrowers who had a loan more than 60 days past due (n=205):

- Mean and median principal amount of loans more than 60 days past due:
 - Mean: \$300.78
 - Median: \$300.00
- Mean and median principal amount of first loan:
 - Mean: \$269.57
 - Median: \$250.00
- Mean and median difference between the amount more than 60 days past due and the principal amount of the first loan:
 - Mean: \$45.23
 - Median: \$0.00
- Borrowers with a loan more than 60 days past due who re-borrowed at a later date: 21 (10% of borrowers with a loan more than 60 days past due)
- Of borrowers with a loan more than 60 days past due who re-borrowed at a later date, mean and median number of days after a loan being more than 60 days past due and the next loan:
 - Mean: 238
 - Median: 219

Of borrowers who had a loan closed as “bad debt” (n=56):

- Mean and median principal amount of loans closed as “bad debt”
 - Mean: \$353.05
 - Median: \$400.00
- Mean and median principal amount of first loan:
 - Mean: \$335.86
 - Median: \$330.00
- Mean and median difference between the amount closed as “bad debt” and the principal amount of the first loan:
 - Mean: \$21.86
 - Median: \$0.00

- Borrowers with a loan closed as “bad debt” who re-borrowed at a later date: 5 (9% of borrowers with a loan closed as “bad debt”)
- Of borrowers with a loan closed as “bad debt” who re-borrowed at a later date, mean and median number of days after a loan was closed as “bad debt” and the next loan:
 - Mean: 138
 - Median: 43

C. Tracking “loan cluster” data over time

Note: These data are used only in Appendix 2, not in the main paper. In Appendix 2, we define a loan cluster as a string of one or more loans in which any subsequent loan is taken out within 30 days of having paid off a prior loan. Thus, a break in borrowing of at least 30 days signifies the end a loan cluster. Analysis in this section uses the same data as in section B (“tracking borrower defaults over time”), with data broken out by loan cluster rather than by borrower.

Of all loan clusters (n=2,186):

- Total loan clusters: 2,186
- Loan clusters with at least one return event: 569 (26% of all loan clusters)
- Loan clusters with more than one return event: 121 (6% of all loan clusters)
- Loan clusters with a loan at least 60 days past due: 220 (10% of all loan clusters)
- Loan clusters with a loan closed as “bad debt”: 58 (3% of all loan clusters)

Of loan clusters with at least one return event (n=569):

- Of loan clusters with a return event, number/share comprising:
 - 1 loan: 132 (23% of loan clusters with a return event)
 - 2 loans: 144 (25% of loan clusters with a return event)
 - 3 loans: 44 (8% of loan clusters with a return event)
 - 4 loans: 48 (8% of loan clusters with a return event)
 - 5 loans: 30 (5% of loan clusters with a return event)
 - 6 loans: 30 (5% of loan clusters with a return event)
 - 7 loans: 14 (3% of loan clusters with a return event)
 - 8 loans: 20 (4% of loan clusters with a return event)
 - 9 loans: 9 (2% of loan clusters with a return event)
 - 10 loans: 12 (2% of loan clusters with a return event)
 - 11 loans: 11 (2% of loan clusters with a return event)
 - 12 or more loans: 75 (13% of loan clusters with a return event)

- Of loan clusters with a return event, mean and median number of days after the start of the loan cluster that the return event occurs:
 - Mean: 93
 - Median: 54
- Of loan clusters with a return event comprising more than one loan, mean and median number of days after the start of the loan cluster that the return event occurs:
 - Mean: 112
 - Median: 66
- Of loan clusters with a return event, mean and median amount of the first loan in the loan cluster:
 - Mean: \$323.94
 - Median: \$300.00
- Loan clusters with a return event that fully cured the loan (paid it back completely): 322 (57% of loan clusters with a return event)

APPENDIX 4: INVISIBLE DEFAULTS METHODOLOGY

For our analysis of invisible defaults, we examined the transactional data of 2,721 consumers with checking accounts from a nationwide sample of U.S. credit card holders. The data, which we purchased from Lightspeed Research Inc. (Lightspeed), are generally representative of the U.S. banked population in terms of geography, household income, and credit scores.²⁵

Participants provided Lightspeed with access to all of their account activity during their period of participation, including deposits, paper checks, electronic bill payments, debit card purchases, fees, and miscellaneous charges or credits that are posted to the account. The data used for this analysis covered January 2011–December 2012, although not all account holders provided data for the entire time period. The data include the posting date, transaction amount, and a free-form text field that we parsed to identify payday transactions and overdraft/NSF activity.

Identifying transactions of interest

To identify payday loan transactions, we searched the text of each transaction description for 532 key words that identified payday lending companies. For the purposes of this analysis, we did not include deposit advance products—payday loans made by the banks themselves. In other words, panelists who only had bank payday loan transactions were not included in the analysis, although many borrowers had loans from both third-party payday lenders and banks. We separately identified payday credits (deposits, i.e., loan proceeds credited to a bank account) and payday debits (withdrawals, i.e., loan repayments debited from an account). Using this method, we identified 125 payday borrowers, i.e., account holders with at least one payday credit or debit. Similarly, we used a set of 209 keywords to identify and tag overdraft transactions and a set of 117 keywords to identify and tag NSF transactions. A list of all search terms is available on request.

Determining the date of the event that caused the overdraft

Overdraft transactions are often assessed one or more days after the event that caused the overdraft. For example, if a borrower overdraws her account on a Friday, the overdraft transaction fee may not be posted to the account until the following Monday. The lag time varies by bank and the day of the week on which the overdraft occurs. As a result, we could not use the posting date of the overdraft fee to establish that a payday loan transaction and an overdraft occurred on the same day. Fortunately, some of the banks in the dataset provided enough information in the transaction description field to determine the date of the event that caused the overdraft. For the banks where this information was included, we examined the text in the transaction description field to isolate the date that the overdraft occurred and used it to analyze same-day events.

This process reduced the sample size of payday borrowers for which we could investigate invisible defaults, because not all banks provided sufficient information to determine the date on which the overdraft actually occurred. We identified dates for 57% of overdraft transactions at four of the 17 institutions where payday borrowers banked. We excluded one bank because only seven percent of the overdraft transactions had identifiable dates. This resulted in a subset of 62 payday borrowers with accounts at three banks for whom we could determine the date of an overdraft and thus analyze invisible defaults.

²⁵ Lightspeed requires that participants have Internet access, which may lead to selection bias. A survey conducted by the Pew Internet & American Life Project from November 14–December 8, 2012, reveals higher Internet usage among younger Americans versus older Americans and among higher income Americans versus lower income Americans (Pew, 2012).

Assessing invisible defaults

We analyzed invisible defaults only for the subset of borrowers and overdraft transactions where we could identify the date of the overdrawing transaction as described above. We further reduced the dataset to include only those borrowers with transaction history of more than 40 days following their first payday transaction. This was to ensure that the data included at least one payday loan repayment period (typically 14 to 30 days). We also excluded overdraft charges that indicated that the payment did not go through (e.g., excluding “returned item fees” or “NSF fees”), as this would indicate that the loan was a visible default.

For our ultimate subset of 52 payday borrowers, we identified cases of invisible defaults by comparing the date of a payday loan payment (debit) with the date of an overdraft. We identified an invisible default when the dates were the same. Seventeen of the 52 payday borrower account holders had at least one instance of an invisible default.

Assessing the timing of overdrafts/NSF transactions and payday borrowing

We also looked more generally at when payday borrowers incurred overdraft or NSF fees. For this analysis we simply compared the posting dates of all payday transactions (credits and debits) with the posting dates of all overdraft or NSF transactions for payday borrowers. We examined how many payday borrowers incurred such fees within different ranges of time following a payday transaction (within three, seven, and 14 days after the payday transaction). We assumed 14 days to be the length of a typical payday loan. We performed this analysis for all 125 payday borrowers in the dataset.

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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