



## **Phantom Demand:**

**Short-term due date generates need for repeat  
payday loans, accounting for 76% of total volume**

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Revised December 7, 2009

(Table 9 is revised from an earlier version to correct household expenditure data which previously over-counted utility payments.)

## EXECUTIVE SUMMARY

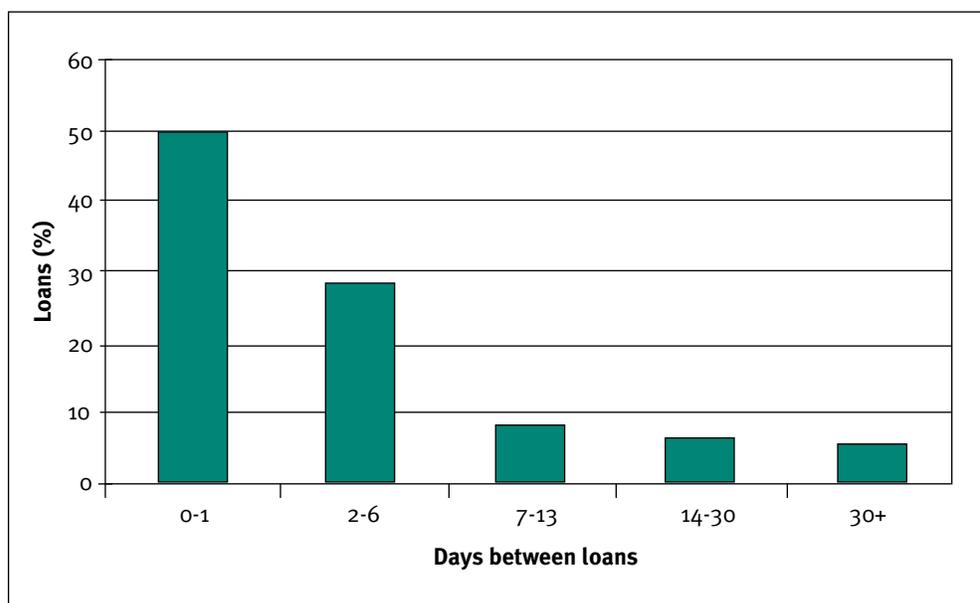
Since its inception in the 1990s, the payday lending industry has established over 22,000 locations which originate an estimated \$27 billion in annual loan volume. The amount of payday lending, while small relative to other unsecured loan products like credit cards, is often said to reflect a strong demand for the payday loan product. Further analysis, however, reveals that a sizeable majority of payday lending volume is generated by payday debt itself—borrowers need to open a new loan shortly after repaying a previous loan because repayment left them with inadequate funds for other needs.

*The data show that half of new loans are taken out at the borrower's first opportunity upon paying a previous loan back.*

The payday loan product, which routinely comes with a 400 percent annual percentage rate (APR) sticker, requires a short-term balloon payment that can account for 25-50 percent of a borrower's entire take-home income. Devoting this substantial share of a paycheck to repaying a payday loan, it appears, leaves most borrowers inadequate funds for their other obligations, compelling them to take a new payday loan almost immediately. In fact, the most common period of time between payday loans—one day or less—is consistent with the explanation that payday borrowers, unable to both repay their payday loan and meet other expenses, are effectively locked in a cycle of debt.

Using tabulations of loan-level data obtained through public records requests, this report examines the loan activity of the more than 80 percent of borrowers who take out more than one payday loan a year. These borrowers generally open new loans in rapid succession, with 87 percent of all new loans to these borrowers occurring during the very next pay period. In fact, the data show that half of new loans are taken out at the borrower's first opportunity upon paying a previous loan back.

**Figure 1: Days between payday loan transactions for borrowers with multiple payday lending transactions**



Note: Over 80 percent of borrowers have more than one payday lending transaction per year.

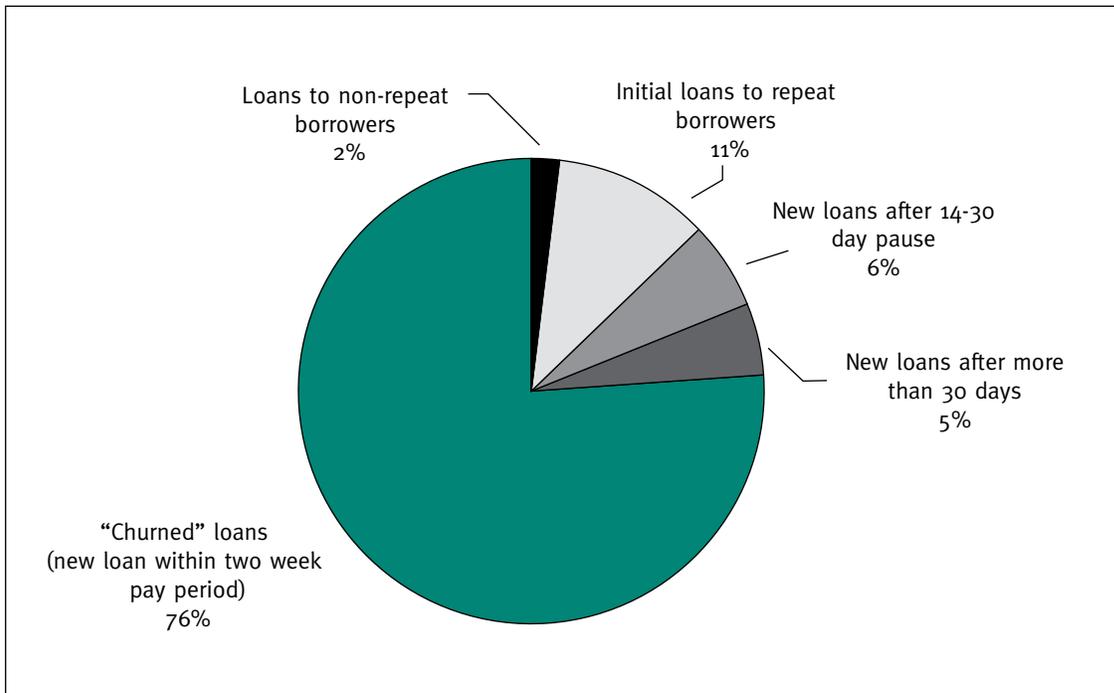
This “churning” of existing borrowers’ loans every two weeks accounts for three-fourths of all payday loan volume. Nearly 59 million loans totaling more than \$20 billion are a product of this churning. In contrast, loans to non-repeat borrowers account for just two percent of loan volume, and subsequent loans to repeat borrowers originated a month or longer after a previous loan was closed account for five percent of all loans.

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**Nearly 59 million loans totaling more than \$20 billion are a product of this churning.**

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**Figure 2: Share of total loan volume attributable to churning**



Churned loans result in \$3.5 billion in fees each year. The importance of generating these fees by churning borrowers is clearly recognized by payday lenders who frequently offer first loans for free or at highly discounted rates in order to attract new customers and convert them into long-term borrowers.

The unique structure of a payday loan with a short term balloon payment due in two weeks inherently sets borrowers up to need a new loan to fill the financial gap which results by paying off the first in its entirety. While some households may need an occasional small loan, offering loans with such a short repayment term causes financial harm for most payday borrowers.

**Policymakers can curtail small loan abuses that trap borrowers in debt by enacting a 36 percent APR cap.** A loan’s APR reflects both the cost of the loan and the time in which a borrower has to repay this debt. So, a loan carrying a high APR (such as a payday loan) is more difficult to repay because of a high cost, a short term, or both. As the experiences in 15 states and the District of Columbia show, a 36 percent APR rate cap protects families from short-term balloon payment loans, encouraging installment products where a borrower can repay their debt at a more manageable pace.

In addition to this rate cap, regulators and policymakers should also consider (1) establishing a standard similar to that endorsed by the FDIC which would limit the amount of time each year a borrower could be indebted to a payday lender; (2) expanding access to affordable small loan products and emergency savings; and (3) discouraging other abusive loan products such as fee-based overdraft loans that weaken financial security.

### **Summary Findings:**

**Finding 1:** The great majority of payday loans are originated shortly after a previous loan is paid back, with half of new loans opened at the borrower's first opportunity, and 87 percent opened within two weeks.

**Finding 2:** Borrower churn inflates payday loan volume by over \$20 billion each year, with three of every four loans generated by the debt trap.

**Finding 3:** This churning of loans to borrowers each pay period costs these households \$3.5 billion in extra fees each year.

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## INTRODUCTION

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Payday loans are marketed as short-term cash advances to meet an emergency expense between paychecks. Typically less than \$400, the cost of these loans is frequently expressed as a fee per \$100 borrowed, averaging around \$15-20 per \$100 depending on applicable state law. For the average two-week payday loan, these fees amount to an annual percentage rate (APR) ranging from 391 to 521 percent.

The borrower needs only a source of income—usually from a job or government benefits such as Social Security—and a checking account to qualify. No credit check is performed, nor greater assessment of ability to repay, such as a review of the borrower’s other obligations. To take out a loan, the borrower gives the lender a personal check written for the amount they want to borrow, plus the fee. If the borrower does not return to repay the loan in full on their next payday, the lender can deposit the borrower’s check to recoup the funds.

### The Payday Lending Debt Trap

The payday lending industry reports that 90 percent or more of loans are repaid. However, after repaying their loan, many borrowers find they cannot meet their other expenses with the remainder of their income. Faced with this shortfall, borrowers take out a new loan soon after they pay back the old one, trying to fill the hole in their family budget that was created by repaying the previous loan. This begins a debt trap in which borrowers are compelled to take out a new loan each pay period.

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***In contrast, borrowers taking out a single loan per year account for only two percent of total business.<sup>3</sup>***

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In previous research, CRL has found that the average borrower takes out nine payday loans per year.<sup>1</sup> The industry depends on this repeat borrowing dynamic to keep its business model viable—90 percent of business is generated by borrowers with five or more loans per year, and over 60 percent of business is generated by borrowers with 12 or more loans per year.<sup>2</sup> In contrast, borrowers taking out a single loan per year account for only two percent of total business.<sup>3</sup>

State policymakers have attempted to address the debt trap by narrowly focusing on loan renewals. Loan renewal (or “roll-over”) is the practice of extending a loan another two weeks and charging the borrower another fee. Seeking to curtail this practice through renewal bans and related restrictions has not been effective because these policies have only resulted in lenders closing out a borrower’s loan and opening a new loan either immediately or a few days later.<sup>4</sup>

### Growth of the Payday Lending Industry

State legislatures authorized short-term payday loans at triple-digit rates in the 1990s and early 2000s.<sup>5</sup> In many cases, authorization was granted by exempting payday lenders from existing interest rate caps that apply to other loan products that the state regulates. This was done routinely based on payday industry arguments that these loans were intended only for the rare financial emergency, and that because of the occasional and short-term nature of the loans, conventional caps to annual interest should not apply. Since the start of this authorization, the payday lending industry has grown tremendously, from around 500 locations in 1990 to over 22,000 locations across 35 states today, in

addition to firms which originate payday loans online. Nationally, there are more than two payday lending storefronts for every Starbucks location; in 29 of the 35 states with payday lending, payday storefronts outnumber McDonald's restaurants.<sup>6</sup>

Given these tallies, many who are concerned with the negative effects of payday lending are nevertheless worried that it might be a “necessary evil” that—if no longer available—would leave a large gap in options for families facing a financial shortfall. In this paper, we seek to determine whether the large growth in the payday lending industry is a result of the strong demand of households for this type of product or if it is an indication of how frequently and consistently borrowers, trapped by an initial loan, must take out a new loan.

The following section describes our research questions and the methodology used to determine the share of payday loan volume resulting from the payday lending debt trap in more detail. The remainder of the paper outlines our findings, discusses their implications, and concludes with policy recommendations.

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## RESEARCH DESIGN AND METHODS

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The purpose of this analysis is to determine what share of total payday loan volume is a result of borrowers being unable to repay one loan without taking a new loan during a two-week period, a proxy for the same pay period. The question is, with the typical borrower taking out nine loans a year, are each of these loans taken sporadically for separate occasions where the borrower falls short of cash? Or, was the first loan for a financial need and the subsequent eight loans taken one after the other because the borrower had trouble retiring their payday loan debt? Put another way, are eight out of this borrower's nine loans a consequence of the payday loan debt trap, or are they a genuine reflection of a need for multiple small loans? We hypothesize that a large share of payday loan volume essentially reflects instances of this “churning” of loans, with lenders extracting, new fees though no substantively new credit is available to the borrower.

### Time between successive loans

To evaluate our hypothesis, we obtained data on the number of days between successive loans made to the same borrower from two states, Florida and Oklahoma. These states have databases in which each payday loan transaction is entered, so we can examine the usage patterns among all payday borrowers over a 12-month period. We use this data to determine the length of time between payday lending transactions among borrowers with two or more transactions over the course of a year.

We supplement the detailed data available from Florida and Oklahoma with data on average loan terms collected by regulators in other states. Since payday loans are due on the borrower's next payday, we would expect to observe a preponderance of very short loan terms (for example, of less than seven days), consistent with the explanation that the borrower ran out of money a few days before their next paycheck because they faced an unexpected financial shortfall.

In contrast, if we observe that most loans are made for longer terms (for example, about 14 days), this would suggest that the borrowers run out of money almost immediately after being paid. If borrowers typically have loan terms that are roughly equivalent to the length of time between paychecks, this is further evidence that loans are originated immediately or soon after a previous loan is repaid on payday.

## Calculating loan churn and resulting fees

Our next step is to determine what share of total payday loan volume represents “churn”—which we define as any loan made within the same two-week period in which a previous loan is paid off. This two week period serves as an indirect method for determining whether subsequent loans were likely taken out in the same pay period. The table below illustrates the practical differences between “churned” and “non-churned” loans. Finally, we determine the financial impact of this loan churning to borrowers by estimating the fees paid to service these loans.

**Table 1: Examples of churned and non-churned loans**

<b>Churned loans</b>
A borrower takes out a payday loan, repays it on their next payday, and then takes out a new loan before leaving the store.
A borrower takes out a payday loan and repays it on their next payday. Before they receive their next paycheck, they run out of money again and open a new payday loan.
<b>Non-churned loans</b>
A borrower takes out a first payday loan, pays it back, and does not visit a payday lender for the rest of the year.
A borrower takes out a total of four loans separated by a month or more: one loan in January, another in March, one in August, and another in December.

Our resulting findings are likely conservative for two reasons. First, because we assume a 14-day pay period, we do not fully account for the churning of borrowers paid monthly by their employers or receiving monthly benefits such as Social Security.<sup>7</sup> Second, the states we use to draw our conclusions—Florida and Oklahoma—are states where most, if not all, of the payday lenders’ trade association “best practices” have been codified. For example, both of these states employ renewal bans, cooling-off periods, and extended repayment plans, and are among the states with the lowest fees per \$100 borrowed where payday loans are offered.<sup>8</sup>

For more details on calculations and data, see Appendices I-III.

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## FINDINGS

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### **Finding 1: The great majority of payday loans are originated shortly after a previous loan is paid back, with half of new loans opened at the borrower’s first opportunity, and 87 percent opened within two weeks.**

Most payday borrowers have multiple payday loans a year, with new loans typically opened quickly after a previous loan is repaid. In these instances, borrowers have not managed to climb out of payday lending debt for a typical pay period. While most states bar lenders from simply extending a borrower’s loan out another two weeks in exchange for paying an additional fee, lenders can circumvent these renewal or rollover bans by simply having the borrower repay their loan in full and then open a new loan in its place immediately or soon after. While these “back-to-back” transactions are not considered a renewal from a legal standpoint, they function the same way for borrowers by keeping them in nearly continuous payday lending debt.<sup>9</sup>

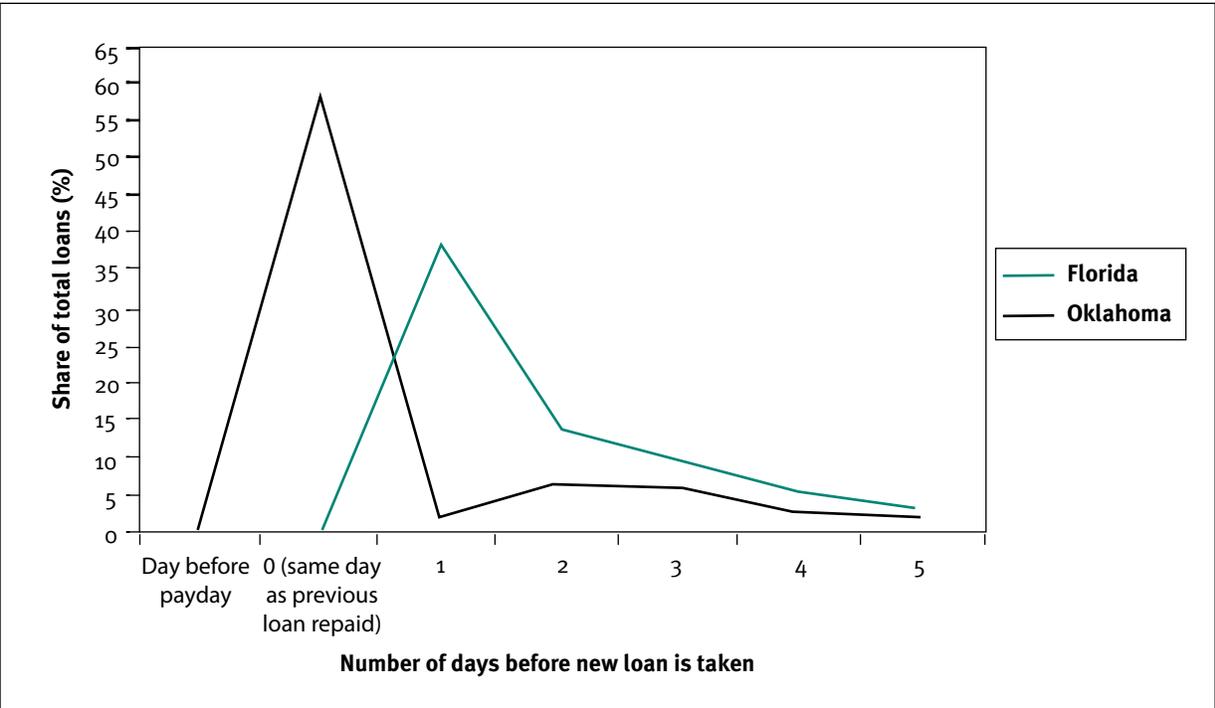
### Time between successive loans

As discussed in the previous section, we first analyze the time between successive loans in Florida and Oklahoma. Over 80 percent of borrowers in these states conduct multiple payday loans each year.<sup>10</sup> If we look at data specific to these “repeat borrowers,” we see that most loans are taken within two weeks of a previous loan, and nearly all are originated within the same month.

In Florida, borrowers cannot get a loan until 24 hours after paying a previous loan back. Thirty-nine percent of new loans are taken the day after this cooling-off period expires. Oklahoma allows borrowers, in most cases, to take out a new loan immediately after paying a previous loan back.<sup>11</sup> In that state, 59 percent of new loans are taken the same day the previous loan is repaid. For repeat borrowers, then, about half of new loans are taken at the borrower’s first opportunity.

The figure below illustrates this finding that the overwhelming share of subsequent loans is taken right after a previous loan is repaid. For example, we see a spike in loan originations on Day 0 for Oklahoma, which is the borrower’s payday and the day they return to the lender to pay back a previous loan. In Florida, we see a similar spike on Day 1, when the 24 hour cooling-off period expires.

**Figure 3: Demand for new loans greatest right after previous loan repaid**



Borrowers that do not return to the payday lender at their first opportunity nevertheless *do* return before their next payday with a total of 86 percent of new loans taken within the same two-week pay period in Florida and 88 percent of new loans taken with the same two-week pay period in Oklahoma.

It is interesting to note that, among repeat borrowers, almost every loan (94 percent) is taken within a month of another. The majority of a household’s expenses and obligations come due on a monthly basis and, accordingly, families begin to save for larger expenses like housing, utilities and

car payments well before the typical monthly due date. One could posit that a borrower should be able to clear an entire billing-cycle, rather than just a pay-cycle, without re-borrowing in order to evaluate whether the payday loan acted as a bridge to financial security or a shovel to deeper debt. That only about six percent of repeat loans are taken with a gap of longer than a month is more indication of the serial usage of these loans among borrowers.

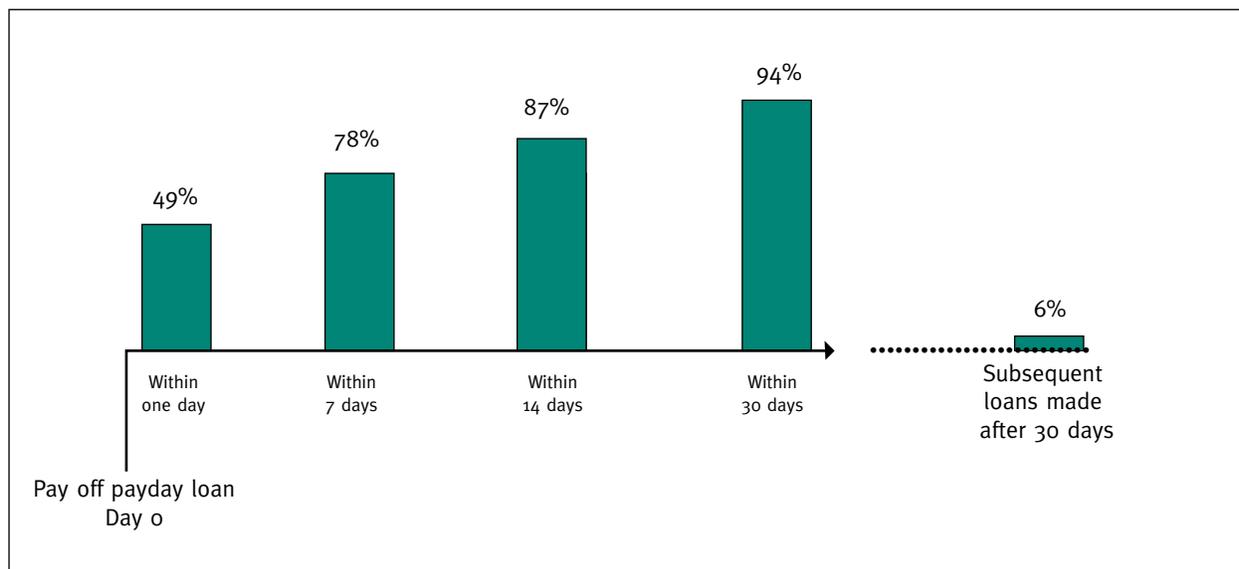
***A borrower should be able to clear an entire billing-cycle, rather than just a pay-cycle, without re-borrowing in order to evaluate whether the payday loan acted as a bridge to financial security or a shovel to deeper debt.***

**Table 2: Time between loans for repeat borrowers**

	Florida borrowers	Oklahoma borrowers	Overall average
Subsequent loan taken at borrower's first opportunity <sup>12</sup>	39%	59%	49%
Subsequent loan taken within a week	75%	81%	78%
Subsequent loan taken within a two-week pay period	86%	88%	87%
Subsequent loan taken within a month	93%	94%	94%

Figure 4 below illustrates how the vast majority of subsequent loans are taken within a month of a borrower's previous loan, with only six percent falling outside this window.

**Figure 4: Elapsed time between loans, repeat borrowers**



While this analysis focuses on the churning of loans during a two-week pay period in two states, less detailed data from Colorado shows similar indications of large shares of payday lending activity being generated by churning borrowers. The Colorado regulator tracks borrowers who either directly renew an existing loan or immediately take out a new loan on the same day the previous loan is repaid. The share of borrowers in this category has risen steadily over the years since payday lending was authorized in Colorado, with about two-thirds (65.4 percent) of all loans either directly renewed or taken out on the same day as a previous loan was repaid by a borrower.<sup>13</sup>

While limited to three states, we find these results persuasive because of the relatively monolithic nature of payday lending, as we have previously found little or no variance of repeat lending patterns among the states that authorize the basic payday loan product. Moreover, the nation’s largest payday lender, Advance America, has noted in an SEC filing that nearly half (47 percent) of its loans are renewed either directly or by having the borrower close one loan and open another on the same day.<sup>14</sup>

### Typical payday loan term

Next, we examine additional evidence from other states to see if it corroborates our findings from Florida and Oklahoma. If payday loans are truly used as bridge loans from a financial emergency to the borrower’s next payday, then we should observe very short average loan terms in practice, that is, loans of a few days. Most households living paycheck-to-paycheck run out of money shortly before their next payday, not on the day they are paid or quickly thereafter. To test this hypothesis, we review average loan durations from states which collect this data. We exclude those states that establish any statutory minimum loan term, which would skew the results of the data:

**Table 3: Average (Mean) Loan Duration**

California <sup>15</sup>	16 days
Colorado <sup>16</sup>	19 days
New Mexico <sup>17</sup>	18 days
Washington State <sup>18</sup>	19 days

Note: while the average (mean) term in Colorado is 19 days, the state regulator also reports that the typical loan (the mode) is exactly 14 days.<sup>19</sup>

Loans made to borrowers paid on a monthly basis ostensibly skew these findings, but borrowers paid monthly should also have short loan terms, if they are using payday loans to cover a shortfall right before their payday. Thus, even including those borrowers, we should still observe loans of very short durations. Instead, we find that loans that are most likely to be used as bridge loans to cover a temporary shortfall—which we define as loan terms of seven days or less—are much more the exception than the rule.

**Table 4: Loan terms of seven days or less (as a percentage of all loans)**

North Carolina (as reported during the state’s brief legalization period) <sup>20</sup>	8.7%
Washington State <sup>21</sup>	8.9%

This additional evidence is consistent with patterns in Florida and Oklahoma, leading us to conclude that, once a borrower is caught in the debt trap, the balloon payment of the payday loan is the typical borrower’s most common financial emergency.

**Finding 2: Borrower churn inflates payday loan volume by over \$20 billion each year, with three of every four loans generated by the debt trap.**

We estimate that the payday lending industry originates over \$27 billion in loan volume annually at more than 22,000 locations across 35 states. As shown in Table 5, this is a slight decrease from our 2005 estimate of industry size. That decrease is most likely attributable to the departure of the industry from several states in which interest rate caps were enacted or affirmed, as well as federal legislation barring lenders from charging triple-digit rates to members of the military (see Appendix IV for a list of states with interest rate caps). While storefronts and loan volume have decreased somewhat, the average loan size has risen from \$325 to \$350.

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**Table 5: Comparison of previous and current CRL estimates of payday lending industry**

	2005 CRL Estimate <sup>22</sup>	Current CRL Estimate
States with industry presence	41 states and DC	35 states
Locations	24,803	22,868
Average loan size	\$325	\$350
Total loan volume	\$28.2 billion	\$27.2 billion

As shown in Table 6 below, we estimate that 76 percent of this \$27 billion in loans is generated by the churning of loans to repeat borrowers who cannot afford to pay off their payday loan and meet expenses, rather than representing credit extended to help with a financial shortfall. We arrive at this estimate by excluding the following categories of loans from the payday lending totals shown above:

- Loans made to borrowers who take out a single loan per year
- Initial loans made to “repeat” borrowers (borrowers with more than one loan per year)<sup>23</sup>
- Subsequent loans made to repeat borrowers that are not opened during the same pay period in which the previous loan was repaid

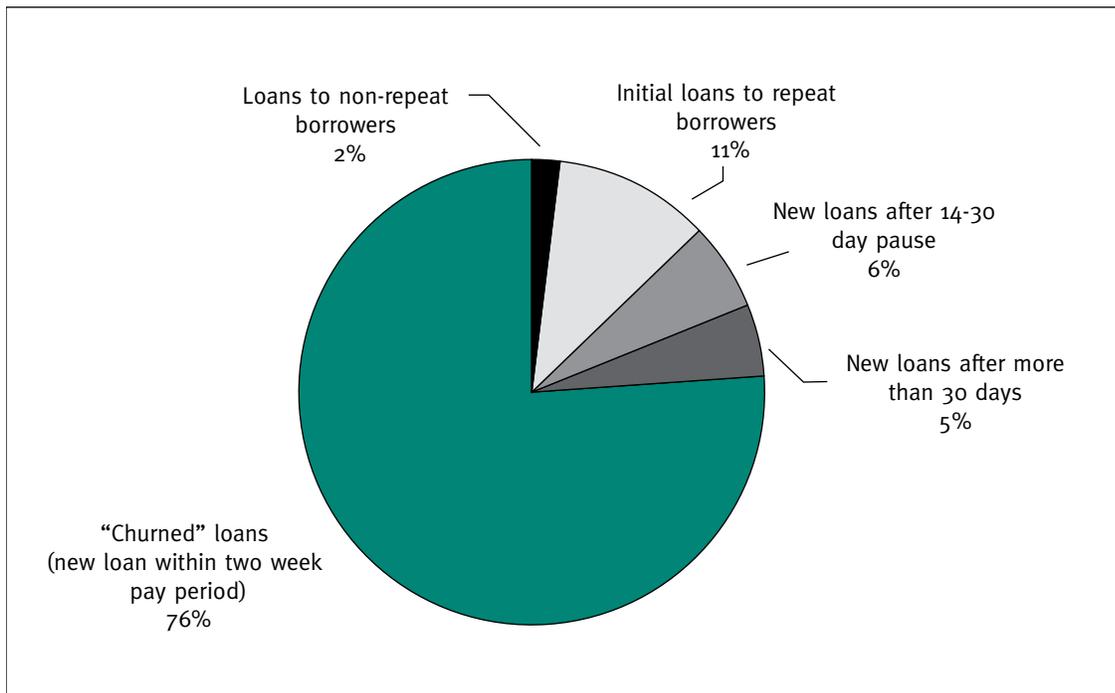
A summary of this calculation is provided in Table 6 on the following page.

**Table 6: Loans and loan volume generated by borrower churn**

Activity source	Number of Loans (in millions)	Loan Volume (in billions)
(A) Total	77.8	\$27.2
(B) Borrowers taking a single loan	1.6	\$0.5
(C) Initial loan from repeat borrowers	8.5	\$2.9
(D) Subsequent loans made after two-week or longer pause in borrowing	8.8	\$3.1
(E) Borrower churn comprised of subsequent loans made within two weeks of closing a previous loan	58.9	\$20.6
Share of totals	76%	76%

In effect, the credit actually demanded by payday borrowers is much smaller than the total loan volume generated by the industry would suggest. The vast majority of business is generated by the borrowers' inability to repay a payday loan without taking on more payday loan debt, leaving only a small fraction— \$6.6 billion—not directly attributable to churning. Figure 5 breaks down the shares attributable to churning below:

**Figure 5: Three-quarters of loan activity attributable to “churn”**



To put the amount of credit extended by the payday lending industry into perspective, we can consider close substitutes offered by other financial institutions. For example, the actual amount of credit made available by payday lenders totals just three percent of the \$212 billion loan volume of credit card cash advances alone made by banks and credit unions nationally in 2008.<sup>24</sup>

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As noted previously, this estimate of the total share of payday loans attributable to borrower churn is conservative—taking into account only those loans made within 14 days of a previous loan being repaid. Alternatively, we could take a more comprehensive approach and look at this effect on a monthly basis, since most expenses, such as rent, utilities, and payments on longer-term loans, such as auto loans and credit cards are incurred on this type of cycle. **If we re-define borrower churn to include all loans made within a month of paying a previous loan off, we find that 82 percent of all payday loans are simply churned from one month to the next.** This is equivalent to \$22 billion of the total \$27 billion in loan volume generated by the industry.

**Table 7: Share of total payday loans generated by churn, defined as pause of one month or less**

	Churn defined as loans made with two week or less pause in borrowing	Churn defined as loans made with one month or less pause in borrowing
Churn rate (share of loan volume attributable to borrower church)	76%	82%
Payday activity generated by churned loans	\$20.6 billion	\$22.3 billion

**Finding 3: This churning of loans to borrowers each pay period costs these households \$3.5 billion in extra fees each year.**

Our analysis finds that 59 million payday loans are opened, not due to a financial emergency, but primarily because the borrower could not repay a previous payday loan and afford their regular expenses without it. A review of the pricing of loans in each state shows that the average \$350 loan costs the borrower approximately \$59.15 in fees. The result of these 59 million unnecessary loans is that borrowers pay about \$3.5 billion in fees to avoid having to permanently part ways with the principal borrowed in one fell swoop.

**Table 8: Excess fees caused by borrower churn**

Loans/Loan volume generated by borrower churn	58.9 million loans/\$20.6 billion
Average loan size	\$350
Average fee per \$350 loan (16.9% of loan amount)	\$59.15
Total excess fees	\$3.5 billion

This common experience, where repeat borrowers pay fees every two weeks because they cannot retire their payday loan debt, is illustrated by focus group participants in California and North Carolina who discussed their experiences with payday lending:

*“I was just going to take the one, but when the loan was due, I needed another one because I was still short.”*

*“I just took the one for the amount I needed, but when I went back, I ended up getting another one and for more this time.”*

—Comments from focus group of California payday borrowers<sup>25</sup>

*“When it’s due, when you have to repay it...then you take out another.”*

*“I started calculating. I’ll never get out of it. If you’re already struggling, you’ll never come out of it.”*

—Comments from focus group of North Carolina payday borrowers<sup>26</sup>

## DISCUSSION

### The structure of a payday loan creates churning that accounts for most payday lending volume

Our findings show that becoming trapped in debt is the rule rather than the exception with payday loans. We largely attribute this pattern to the way the product is structured. This point is illustrated by looking at the impact of repaying the average \$350 payday loan on a family's budget over a two-week pay period.

Regardless of whether the payday loan is offered for free (many initial loans are offered for free or at a substantial discount), or for \$15-20 per \$100 borrowed, a typical household would struggle to meet their basic obligations and repay their payday loan debt in a two week period. The table below shows the result for a payday borrower earning \$35,000 a year. Within one pay period, they have enough money to either repay their payday loan or meet very basic obligations with the proceeds of their paycheck, but do not have adequate funds to do both. Many families will likely have other expenses not captured here, such as a car loan, childcare—the typical borrower is single and has minor children—clothing, and other debt obligations, making the repayment of their payday loan on one paycheck even more insurmountable. Thus, to make ends meet after paying back their first payday loan, they would need to take out a new loan during the same pay period.

**Table 9: Two-week loan term results in a debt trap**

Income and Expenses for Payday Borrower Earning \$35,000 per year	Cost of Two-Week Payday Loan		
	\$0 per \$100 (free loan)	\$15 per \$100 (391% APR)	\$20 per \$100 (521% APR)
<b>Income and Taxes</b>			
Income per half-month pay period	1346.15	1346.15	1346.15
Taxes	16.42	16.42	16.42
Social Security	88.92	88.92	88.92
Income after tax	1240.81	1240.81	1240.81
Payday loan payment due on \$350 payday loan	350.00	402.50	420.00
Paycheck remaining after paying back payday loan	890.81	838.31	820.81
<b>Household Expenditures per 2 week period</b>			
Food	178.65	178.65	178.65
Housing	476.50	476.50	476.50
Transportation (insurance, gas, maintenance, etc.)	144.38	144.38	144.38
Healthcare	95.88	95.88	95.88
Total Essential Expenditures	895.42	895.42	895.42
Money from paycheck remaining (deficit)	(4.61)	(57.11)	(74.61)

\*The median payday loan size in the United States is currently \$350.

Source: Two-week estimates for taxes, Social Security, and household expenditures derived from annual estimates from the 2007 Consumer Expenditure Survey, Bureau of Labor Statistics, households earning \$30,000-39,999 annually. Annual income and expenses are divided by 26 to obtain a two-week cash flow estimate.

## Loan churning causes borrowers substantial financial harm

The \$3.5 billion in excess fees to service these churned loans is a substantial loss of critical household funds, and can set off further negative financial consequences for these families and their communities. For example, these resources could be otherwise used to buy needed goods and services or put towards paying down other debts and increasing their emergency savings to deal with any future financial shortfalls.

Research has shown that payday borrowers are more likely to become delinquent on their credit cards and file for bankruptcy than similarly-situated people who do not use payday loans.<sup>27</sup> In addition, households with access to payday loans are more likely to pay other bills late, delay medical care and prescription drug purchases, and lose their bank accounts due to excessive overdrafts.<sup>28</sup> These impacts can push families on the fringes of the middle class down into poverty.

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## POLICY RECOMMENDATIONS

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State and federal policymakers can curtail abuses in the small loan marketplace that trap borrowers in debt by enacting the following policy recommendations:

**Key Recommendation: Protect consumers from high-cost debt through a 36 percent APR rate cap.** Historically, households were protected from high-cost credit schemes through usury caps that formed the basis for consumer protections in the small loan marketplace, and these limits on allowable interest charged still garner overwhelming public support.<sup>29</sup> These usury caps were expressed as limits on annual interest rates. Expressing limitations in the form of annual interest is important because a loan's APR reflects both the cost of a loan and the time in which a borrower has to repay this debt. So, a loan carrying a higher APR will be more difficult to repay because of a higher cost, a shorter term, or both.

Most states still have interest rate caps in the range of 36 percent APR on small loan products that they regulate. Fifteen states and the District of Columbia have interest rate caps in place, and do not allow payday loans to be exempted from these caps. In addition, Congress passed a law to cap rates for active-duty members of the military and their families at 36 percent APR. Our prior research strongly suggests that measures intended to address the debt trap without a rate cap have largely failed.<sup>30</sup>

Rate caps in this range protect families from short-term balloon payment loans, encouraging instead installment products where a borrower can repay their debt at a more manageable pace. For example, a payday lender could continue to charge \$15 per \$100 for a loan, but would have to allow the

borrower five months to repay their debt under a 36 percent APR rate cap. This would result in the borrower paying \$34.50 each of their next ten pay periods, rather than owing \$345 from a single paycheck.

While interest in reining in high-cost lending continues in states, efforts to enact a comprehensive federal interest rate cap that applies to all types of lenders and all loan products are also being considered.<sup>31</sup>

In addition to enacting new rate caps, the National Credit Union Administration (NCUA) should enforce federal credit unions' *existing* 18 percent annual interest rate cap. Some credit unions charge minimal “interest” on payday loans but charge large “application” or “participation” fees arguing that they are excluded from the 18 percent rate cap. Typically, these charges are on condition and part of the extension of credit and should clearly be included in the credit union rate cap.<sup>32</sup> The NCUA should prohibit such practices.

## Other policy recommendations

In addition to capping interest rates on small loans, state and federal policymakers should take other actions that could prove helpful to protect borrowers against payday lending abuses, increase the market for responsible loan products, and help families save.

**Recommendation: Establish a “suitability” standard for payday loans.** Payday lenders have repeatedly acknowledged that payday loans are harmful if used long-term.<sup>33</sup> Unfortunately, long-term use is the norm for many borrowers and the industry relies heavily on this activity. In addition to the comprehensive policy of re-establishing small loan rate caps, state and federal policymakers could consider prohibiting payday lenders from making loans to anyone who has been indebted to a payday lender for more than 90 days in any 12-month period.<sup>34</sup> In effect this would limit the number of loans any borrower can have to no more than six a year (from any one lender or multiple lenders combined). This provision is based upon FDIC rules for payday lending by banks or for banks working with third party payday lenders.<sup>35</sup> Enacting a yearly loan limit will stop the debt trap but still allow loans to the occasional users for whom the industry contends these loans are designed. For state policymakers, particularly, this would “level the playing field” between payday lenders and state-chartered banks, to which the FDIC rules already apply.

Other federal banking regulators should, at a minimum, apply the FDIC’s payday lending guidelines to their banks and thrifts, if they allow them to offer payday loans at all. Finally, the Federal Trade Commission (FTC), the primary federal regulator of non-bank financial products, has the authority to extend the FDIC loan cap to all market players.

**Recommendation: Expand access to small loans and emergency savings.** Consumers largely do not need access to *short-term* credit—in fact, our research demonstrates that the very short-term nature of a payday loan which requires a lump sum payment is a large part of the debt trap problem.

While borrowers may certainly benefit from the ability to borrow \$300 on occasion, few “need” to pay that loan back, in its entirety, on the next payday. Advocates of the payday lending industry claim that households living from pay period-to-pay period need access to short-term loans for occasional use. But if a borrower cannot pay their regular bills and living expenses with no interest charged, it stands to reason that they cannot pay them at 400 percent APR.

Clearly, many American families suffer from inadequate income, cash reserves or resources to support them through financial crises. What these households really need are broader opportunities to save for financial emergencies, effective strategies to bridge financial gaps, and access to small loans that allow them to retire their debt gradually over a series of pay periods.<sup>36</sup>

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***What these households really need is broader opportunities to save for financial emergencies, effective strategies to bridge financial gaps, and access to small loans that allow them to retire their debt gradually over a series of pay periods.***<sup>36</sup>

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Federal banking regulators should extend the FDIC's Affordable Small Loan Guidelines to all federally regulated lenders. The guidelines provide for a minimum loan term of at least 90 days and regular installment payments. As part of the guidelines, the FDIC suggests that banks should structure their small loans to include a savings component. For example, a portion of the borrower's regular installment payments or a portion of the initial loan proceeds could be automatically deposited into a savings account to encourage borrowers to rely upon savings instead of new debt to meet financial emergencies. The FDIC also strongly encourages these loans to be at 36 percent APR or less.<sup>37</sup>

It should be stressed that many banks and credit unions already offer comparable products, including "clean" credit cards (especially with new protections which will be enacted as a result of recent federal credit card legislation), overdraft lines of credit, signature loans and other types of small loan products. This means that banks and credit unions already make small loans, typically at a fraction of the cost of payday lending, and should be encouraged via the Community Reinvestment Act (CRA) or other means to more affirmatively market and tailor these existing products to low- and moderate-income borrowers' needs.<sup>38</sup>

Consumer Federation of America researchers found that households with no savings earning \$25,000 or less annually were eight times more likely to use a payday loan than similarly situated households with just \$500 in emergency savings.<sup>39</sup> Accordingly, federal regulators should encourage financial institutions to adopt so-called "lifeline" savings accounts that can act as an important mechanism to establish emergency savings accounts. In addition, policymakers and regulators could encourage and facilitate policies and programs that help low- and moderate-income families save, such as matched savings programs and regular automatic contributions to savings accounts through employer payroll systems.<sup>40</sup>

**Recommendation: Discourage abusive loan products that weaken financial security** At the same time new responsible loan products and emergency savings are promoted, federal regulators should *discourage* abusive products that weaken already vulnerable households such as payday-like products and certain overdraft practices. Fee-based overdraft loan programs—as opposed to overdraft lines of credit—act as tremendous disincentives for both banks and credit unions to offer more suitable products and for low-income households to join the traditional banking system. Moreover, despite claims to the contrary, much of the available data suggests that payday lending and overdraft programs do not act as substitutes for each other. Because payday loans are secured by a borrower's personal check or automatic electronic access to a borrower's bank, payday lending can actually spur overdraft fees and ultimately lead to the loss of one's bank account.<sup>41</sup>

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## **CONCLUSION**

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While the \$27 billion size of the payday loan industry would seem to signal a large need among vulnerable households for this product, most of these loans have been shown to reflect a churning sequence in which borrowers repay and open new loans in rapid succession. We conservatively estimate that this churning of loans to repeat borrowers accounts for over \$20 billion, or three-quarters, of total loan volume.

Being trapped in payday loan debt can have dire consequences for the financial health of families and their communities. Excess fees of \$3.5 billion per year are drained from trapped borrowers who vainly attempt to retire their payday loan debt. As a result, bank account closures, credit card delinquencies, delayed bill payment and medical care, and bankruptcies are more common among payday borrowers and in communities with access to payday lending and other high-cost forms of credit.

State and federal policymakers should encourage responsible lending by capping interest rates on small loans at or around 36 percent APR, supporting policies that give families access to the resources they need and facilitating emergency savings, to help vulnerable households secure better financial futures.

## APPENDIX I:

### Payday Loan Volume and Storefronts by State

	Number of Licensees	Loan Volume	Source	Year
Alabama	1163	\$1,482,752,237	Estimate	2007
Alaska	31	\$21,600,000	Regulator	2006
Arizona	669	\$852,933,144	Estimate	2007
California	2,403	\$2,969,905,917	Regulator	2007
Colorado	618	\$639,506,705	Regulator	2007
Delaware	102	\$130,043,618	Estimate	2008
Florida	1,370	\$2,270,000,000	Regulator	mid 2007-mid 2008
Hawaii	15	\$19,124,062	Estimate	2008
Idaho	232	\$295,785,485	Estimate	mid 2007-mid 2008
Illinois	772	\$116,343,559	Regulator	2008
Indiana	456	\$517,728,000	Regulator*	mid 2007-mid 2008
Iowa	274	\$321,803,051	Regulator	2007
Kansas	413	\$428,153,233	Regulator	2008
Kentucky	781	\$995,726,137	Estimate	2008
Louisiana	2,059	\$2,625,096,178	Estimate	2008
Michigan	781	\$935,772,819	Regulator	mid 2006-mid 2007
Minnesota	58	\$25,216,140	Regulator	2008
Mississippi	1,082	\$1,379,482,305	Estimate	2007
Missouri	1,275	\$821,520,700	Regulator	2008
Montana	119	\$47,271,444	Regulator	2007
Nebraska	218	\$277,936,361	Estimate	2007
Nevada	414	\$527,824,098	Estimate	2008
New Mexico	144	\$41,896,028	Regulator	2008
North Dakota	82	\$34,022,564	Regulator	mid 2007-mid 2008
Oklahoma	409	\$406,700,000	Regulator	mid 2007-mid 2008
Rhode Island	13	\$16,574,187	Estimate	2008
South Carolina	1,051	\$1,038,755,200	Regulator	mid 2006-mid 2007
South Dakota	118	\$150,442,617	Estimate	2008
Tennessee	1,481	\$1,091,761,680	Regulator	2007
Texas	1,800	\$2,652,087,101	Estimate	2008
Utah	353	\$450,052,915	Estimate	2007
Virginia	769	\$1,324,944,357	Regulator	2008
Washington	729	\$1,492,948,183	Regulator	2007
Wisconsin	524	\$733,173,765	Regulator	2007
Wyoming	90	\$79,425,350	Regulator	2008
TOTAL	22,868	\$ 27,214,309,138		

\*estimate based on average loan volume per month, as reported by regulator

State regulator data calculating loan volume is available for 21 of the 35 states where the payday lending industry has a presence. This data is for the most current year, per state regulator, largely from 2007 or 2008.

For 13 other states where data is not collected or is not publicly available, loan volume is estimated based on the following equation (see below for Texas specific calculations):

Loan Volume = Payday lending storefronts \* median loan size \* average number of transactions per store

We determine the number of payday lending storefronts, average loan size, and the average number of transactions per store as described below.

### Payday lending storefronts

We use the total number of payday lending storefronts reported by the state regulator in states where this data is available. For the remaining states, we use the annual estimates of payday storefronts from Stephens Inc., an investment banking firm which conducts periodic analyses of the payday lending industry.

### Median loan size

Regulators in 21 states either directly reported average loan size or had data for which the median national loan size could be calculated. The median loan amount among these 21 states, \$350, is assumed to be the average loan size in the remaining states where regulator data is not available.

Median Loan Size	
Alaska	\$382.00
California	\$266.00
Colorado	\$362.10
Florida	\$386.72
Illinois	\$369.88
Indiana	\$314.92
Iowa	\$328.46
Kansas	\$366.59
Michigan	\$402.15
Minnesota	\$282.76
Missouri	\$290.29
Montana	\$260.00
New Mexico	\$425.80
North Dakota	\$292.72
Oklahoma	\$377.79
South Carolina	\$240.88
Tennessee	\$232.88
Utah	\$350.00
Virginia	\$340.00
Washington	\$428.44
Wisconsin	\$420.85
Median	\$350.00

## Average number of transactions per store

Based on data in 18 states where the number of transactions per store can be calculated, we found that the average payday lending storefront conducted 3,643 transactions per year. This national estimate of the typical payday lending store's activity was calculated by taking a weighted average of each of the 18 states' data to normalize for varying numbers of payday stores across states. This allows us to take into account the activity of each storefront equally, rather than giving equal weight to each state regardless of its relative concentration of payday lenders.

	Number of Loans	Number of Stores	Number of Loans per store
Alaska	56,545	31	1,824
California	11,152,466	2,403	4,641
Colorado	1,766,120	618	2,858
Florida	5,800,000	1,370	4,234
Indiana	1,644,000	456	3,605
Iowa	979,740	274	3,576
Kansas	1,167,924	413	2,828
Michigan	2,326,906	781	2,979
Minnesota	87,009	58	1,500
Missouri	2,830,000	1,275	2,220
Montana	181,896	119	1,529
North Dakota	116,230	82	1,417
Oklahoma	1,076,612	409	2,632
South Carolina	4,312,257	1,051	4,103
Tennessee	4,688,093	1,481	3,165
Virginia	3,370,396	769	4,383
Washington	3,484,603	729	4,780
Wisconsin	1,742,122	524	3,325
Total	46,782,919	12,843	
Weighted Average			3,643

## Estimating payday loan volume for Texas

Payday lenders operate under a unique business model in Texas in which lenders do not abide by the state's payday lending regulations, but instead operate as entities called "credit services organizations," or CSOs. The payday lender CSOs then partner with independent third-party lenders which provide the loan's funding. Because these loans are not subject to state limitations on payday lending, payday loans in Texas tend to be for larger amounts, have higher fees, and do not feature restrictions such as renewal bans common in other states. Because the payday lending industry operates differently in Texas, we do not estimate the state's loan volume based on national averages. Instead, we look at data from the two publicly-traded lenders with large numbers of stores in Texas which separate out their CSO-specific payday lending activity.

	Cash America	EZ Corp.	Combined average
(A) Number of Texas storefronts	249	334	
(B) Total CSO loans	457,293	920,000	
(C) Total CSO loan volume	\$231,514,000	\$515,200,000	
(D) Estimated transactions per store (D=B/A)	1,837	2,754	2,296
(E) Average CSO loan size (E=C/B)	\$506	\$560	\$533

We apply the average loan size and the average loans per store to the 1,800 total storefronts Stephens, Inc. estimates are present in Texas. In addition, we also add Cash America's reported internet loan volume generated through the CSO model (the vast majority of which is from Texas), since Cash America's online lending activity is believed to be counted towards total loan volume in other states where they follow identical licensing and reporting standards as storefront lenders. We include this as a separate line item, rather than including it in as part of the Cash America's loan volume in the previous table, since online loan volume does not impact the number of transactions per store.

(A) Total number of storefronts	1,800
(B) Estimated average loan size	\$533
(C) Estimated transactions per store	2,296
(D) Estimated storefront loan volume (D=A*B*C)	\$2,202,866,101
(E) Online loan volume (Cash America)	\$449,221,000
(F) Total estimated loan volume (F=D+E)	\$2,652,087,101

Our estimate is similar to an earlier estimate of \$2.5 billion in payday loans made in Texas annually.<sup>42</sup>

## APPENDIX II:

### Estimating churn

As a result of public records requests, we obtained the following data on the days between transactions conducted by the same payday borrower in Oklahoma and Florida with more than one transaction within a 12 month period.<sup>43</sup>

Days	Florida		Oklahoma	
	% of transactions	Cumulative %	% of transactions	Cumulative %
0-1	0.0	0.0*	58.6	58.6
1-2	39.0	39.0	2.3	60.9
2-3	13.9	52.9	6.5	67.4
3-4	10.3	63.2	6.3	73.7
4-5	5.6	68.8	3.1	76.8
5-6	3.5	72.3	2.2	79.0
6-7	2.7	75.0	1.8	80.8
7-8	2.8	77.8	1.9	82.7
8-9	2.2	80.0	1.2	83.9
9-10	1.3	81.3	0.7	84.6
10-11	1.5	82.8	1.0	85.6
11-12	1.2	84.0	0.8	86.4
12-13	0.9	84.9	0.6	87.0
13-14	0.8	85.7	0.6	87.6
14-15	1.1	86.8	0.8	88.4
15-16	0.8	87.6	0.5	88.9
16-17	0.6	88.2	0.5	89.4
17-18	0.7	88.9	0.6	90.0
18-19	0.6	89.5	0.5	90.5
19-20	0.5	90.0	0.4	90.9
20-21	0.5	90.5	0.4	91.3
21-22	0.6	91.1	0.5	91.8
22-23	0.5	91.6	0.3	92.1
23-24	0.3	91.9	0.2	92.3
24-25	0.3	92.2	0.3	92.6
25-26	0.3	92.5	0.2	92.8
26-27	0.2	92.7	0.2	93.0
27-28	0.2	92.9	0.2	93.2
28-29	0.3	93.2	0.2	93.4
29-30	0.2	93.4	0.2	93.6
30+	6.6	100.0	6.3	100.0

Note: 17 percent of Florida borrowers and 13 percent of Oklahoma borrowers had only one transaction during a 12 month period.

\*Because of the 24 hour cooling off period between loans in Florida, borrowers cannot start a new transaction until a full day after their prior loan is repaid.

The table above shows that 85.7 percent of Florida transactions and 87.6 percent of Oklahoma transactions to repeat borrowers occur during the same two-week pay period as the previous loan was repaid.

### Calculating the loan volume generated by borrower churn

To determine the loan volume that is generated by the churn of loans opened within the same two week pay period as a previous loan was repaid, we must separate out these transactions from those: (1) going to borrowers who conduct only one transaction per year (“non-repeat borrowers”); (2) initial loans to borrowers with multiple loans per year (“repeat borrowers”); (3) and loans to repeat borrowers which are taken after the two-week pay period in which the previous loan is repaid.

Loan volume generated by debt trap = Total loan volume minus:

- loans to non-repeat borrowers
- initial loans to repeat borrowers
- loans to repeat borrowers taken after the pay period where the previous loan is repaid

We estimate that the payday lending industry makes \$27.2 billion in loans each year. Since the average loan is \$350, and the average borrower conducts nine transactions per year, we estimate that 78 million loans are made annually.

(A) Total loan volume	27,214,309,138
(B) Average loan size	\$350
(C) Average transactions per borrower	9
(D) Total loans made per year (D=A/B)	77,755,169

#### (1) Loans to non-repeat borrowers

From regulator reports from Florida and Oklahoma, we know that approximately two percent of loans are made to borrowers who conduct just a single transaction a year, or about 1.6 million loans.

(A) Total loans made per year	77,755,169
(B) Percent of loans going to borrowers with a single transaction per year	2%
(C) Loans made to non-repeat borrowers (C=A*B)	1,555,103

Loans remaining after subtracting transactions to non-repeat borrowers: 76,200,066.

## (2) Initial loans to repeat borrowers

Next, we need to deduct the initial loans taken by repeat borrowers. Since the average borrower has nine transactions a year, we separate out one of these nine transactions from the loans remaining.

(A) Total loans remaining	76,200,066
(B) Average transactions per year	9
(C) Initial loans to repeat borrowers (C=A/B)	8,466,674

Loans remaining after subtracting initial loans to repeat borrowers: 67,733,392.

## (3) Loans to repeat borrowers taken after the two-week pay period in which previous loan is repaid

Finally, if borrowers repay a loan and then do not open the next one until after they are paid again two weeks later, we do not count these transactions as churn loans. We know that, among repeat borrowers, 87 percent of subsequent loans are taken within two-weeks of a previous loan being repaid, which leaves 13 percent outside this two-week window.

(A) Total loans remaining	67,733,392
(B) Percent of subsequent loans made after two-week pay period	13%
(C) Subsequent loans to repeat borrowers taken after two-week pay period (C=A*B)	8,805,341

Ultimately, when we add together the loans made to non-repeat borrowers (1,555,103), the initial loans made to repeat borrowers (8,466,674), and the subsequent loans to repeat borrowers after two weeks (8,805,341), we find that this represents a total of only 18,827,118 loans and \$6,589,491,386 of loan volume.

This means that the remainder is generated by the churning of loans every pay period to borrowers trapped in debt. This churning of loans to trapped borrowers is the cause of about three-quarters (76%) of all loans and loan volume, or 58,928,051 loans totaling \$20,624,817,752.

### Results if counting subsequent loans made within a typical 30-day billing cycle as churn

Alternatively, we could count loans made to repeat borrowers within 30 days (rather than just two weeks) as churned loans. From the data from regulators in Oklahoma and Florida, we know that 94 percent of subsequent loans are taken within 30 days of a previous loan’s repayment, leaving just six percent as non-churned loans under this definition. This would result in the following finding:

(A) Total loans remaining	67,733,392
(B) Percent of subsequent loans made after two-week pay period	6%
(C) Subsequent loans to repeat borrowers taken after two-week pay period (C=A*B)	4,064,003

We would then add these four million loans together with loans made to non-repeat borrowers and the initial loans to repeat borrowers with a result of 14,085,781 loans and \$4,930,023,291 and of loan volume. This means that loan churning accounts for 82 percent of all loans and loan volume, or 63,669,388 loans totaling \$22,284,285,847.

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## **APPENDIX III:**

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### **Excessive fees resulted from borrower churn**

From previous calculations, we know that the average loan size nationally is \$350, and that 58,928,051 payday loans are the result of borrower churn. To estimate the fees generated by these loans, we need to determine an average fee charged. To do this, we take a weighted average of the allowable fees charged per state for a \$350 loan. This weighting takes into account the varying number of storefronts per state in our sample. As shown in the table below, we find an average fee of 16.9 percent of the loan amount, within the range of \$15 to \$20 per \$100 borrowed that is commonly charged for a payday loan.

A fee of 16.9 percent of \$350 equates to \$59.15. If we multiply this fee by the total number of churned loans (58,928,051), we find that total \$3.5 billion in excess fees are charged as a result of borrower churn.

State	Allowable fee for \$350 loan	Fee as percent of total loan	Share of Total Licensees in Sample**
Alabama	\$61.25	17.5%	6.0%
Alaska	\$57.50	16.4%	0.2%
Arizona	\$61.78	17.7%	3.5%
Colorado	\$63.75	18.2%	3.2%
Delaware*	\$78.75	22.5%	0.5%
Florida	\$40.00	11.4%	7.1%
Hawaii	\$61.78	17.7%	0.1%
Idaho*	\$75.85	21.7%	1.2%
Illinois	\$54.25	15.5%	4.0%
Indiana	\$45.50	13.0%	2.4%
Iowa	\$40.00	11.4%	1.4%
Kansas	\$52.50	15.0%	2.1%
Kentucky	\$61.78	17.7%	4.0%
Louisiana	\$45.00	12.9%	10.7%
Michigan	\$48.00	13.7%	4.0%
Minnesota	\$26.00	7.4%	0.3%
Mississippi	\$77.00	22.0%	5.6%
Missouri	\$87.50	25.0%	6.6%
Nebraska	\$61.78	17.7%	1.1%
Nevada*	\$74.10	21.2%	2.1%
New Mexico	\$56.00	16.0%	0.7%
North Dakota	\$70.00	20.0%	0.4%
Oklahoma	\$35.00	10.0%	2.1%
Rhode Island	\$52.50	15.0%	0.1%
South Dakota*	\$77.00	22.0%	0.6%
Tennessee	\$30.00	8.6%	7.7%
Texas*	\$76.79	21.9%	9.3%
Utah*	\$81.66	23.3%	1.8%
Virginia	\$75.00	21.4%	4.0%
Washington	\$52.50	15.0%	3.8%
Wisconsin*	\$80.50	23.0%	2.7%
Wyoming	\$30.00	8.6%	0.5%
Weighted Average		16.9%	

\*These states do not set a maximum allowable fee charged on a payday loan, so we instead report an average of the fees charged by three of the largest payday lenders (Advance America, Check 'N Go, and QC Holdings) in these states from fee schedules available on company websites and SEC disclosures.

\*\*This sample includes all states with payday lending storefronts except California, Montana, and South Carolina where a \$340 loan exceeds the maximum loan amount allowed.

## APPENDIX IV:

### States with interest rate caps that prevent high-cost payday lending

	Rate Cap (annual interest)	Recent legislative/regulatory activity
Arkansas	17%	Attorney General ruled that payday loans subject to state 17% annual interest usury limit in 2008
Arizona	Reduction to 36% APR expected in July 2010	Exemption to 36% rate cap set to expire in July 2010, ballot initiative to extend payday lending authorization defeated in 2008
Connecticut	30%	Payday lending never authorized
District of Columbia	24%	Interest rate cap enacted in 2007
Georgia	60%	Payday lending never authorized <sup>44</sup>
Maine	30%	Payday lending never authorized
Maryland	33%	Payday lending never authorized
Massachusetts	23%	Payday lending never authorized
New Hampshire	36%	Interest rate cap enacted in 2008
New Jersey	30%	Payday lending never authorized
New York	25%	Payday lending never authorized
North Carolina	36%	Legislature allowed payday lending authorization to sunset in 2001
Ohio	28%	Interest rate cap enacted in 2008, affirmed by voters through a ballot initiative
Oregon	36%	Interest rate cap enacted in 2007
Pennsylvania	24%	Payday lending never authorized <sup>45</sup>
Vermont	18%	Payday lending never authorized
West Virginia	31%	Payday lending never authorized
Federal	36%	Cap on payday, car title, and refund anticipation loans made to active duty members of the military and their dependents.

Source: Interest rate cap information by state is available at [www.paydayloaninfo.org](http://www.paydayloaninfo.org), maintained by the Consumer Federation of America.

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## NOTES

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1 Uriah King & Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform*, Center for Responsible Lending, (December 2007), available at [www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf).

2 See Uriah King & Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform*, Center for Responsible Lending, (December 2007), available at [www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf). Other researchers have also noted that payday lenders depend upon repeat borrowing. See Mark Flannery & Katherine Smolyk, *Payday Lending: Do the Costs Justify the Price?*, FDIC Center for Financial Research, (June 2005), available at [www.fdic.gov/bank/analytical/cfr/2005/wp2005/cfrwp\\_2005-09\\_flannery\\_samolyk.pdf](http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/cfrwp_2005-09_flannery_samolyk.pdf) and Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, *Economic Development Quarterly*, 17(1) (February 2003), available at [www.kenan-flagler.unc.edu/assets/documents/CC\\_Payday\\_lending.pdf](http://www.kenan-flagler.unc.edu/assets/documents/CC_Payday_lending.pdf).

3 Uriah King & Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform*, Center for Responsible Lending, (December, 2007), available at [www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf).

4 For further discussion of the distinction between renewals and back-to-back transactions, see *Rollover Bans Don't Stop Payday Trap*, Center for Responsible Lending, (April 9, 2009), available at [www.responsiblelending.org/media-center/press-releases/archives/rollover-bans-don-t-stop-payday-trap.html](http://www.responsiblelending.org/media-center/press-releases/archives/rollover-bans-don-t-stop-payday-trap.html).

5 For a history of payday lending Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, *South Carolina Law Review*, 11(589) (2000) and Christopher L. Peterson, *Usury Law, Payday Loans and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, *Minnesota Law Review*, 92(4) (April 2008).

6 Dr. Steven Graves, a Geography professor at California State University at Northridge tracks the number of McDonalds and Starbucks locations, in relation to the number of payday lending storefronts. His findings are available at [www.csun.edu/~sg4002/research/mcdonalds\\_by\\_state.htm](http://www.csun.edu/~sg4002/research/mcdonalds_by_state.htm) and [www.csun.edu/~sg4002/research/starbucks\\_pdlenders.xls](http://www.csun.edu/~sg4002/research/starbucks_pdlenders.xls).

7 One study of the customers of a large Texas-based payday lender found that 70 percent are paid every two-weeks (or semi-monthly), while 17 percent have are paid on a monthly basis. See Table 1 in Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008), available at <http://bpp.wharton.upenn.edu/tobacman/papers/rd.pdf>.

8 For more information on how Florida and Oklahoma regulate payday lending, see [www.paydayloaninfo.org/state\\_detail.cfm?id=FL](http://www.paydayloaninfo.org/state_detail.cfm?id=FL) and [www.paydayloaninfo.org/state\\_detail.cfm?id=OK](http://www.paydayloaninfo.org/state_detail.cfm?id=OK).

9 *Rollover Bans Don't Stop Payday Trap*, Center for Responsible Lending, (April 9, 2009), available at [www.responsiblelending.org/media-center/press-releases/archives/rollover-bans-don-t-stop-payday-trap.html](http://www.responsiblelending.org/media-center/press-releases/archives/rollover-bans-don-t-stop-payday-trap.html).

10 In Florida, 83 percent of borrowers take out multiple loans each year and in Oklahoma, 87 percent of borrowers take out multiple loans each year. Florida data includes all transactions conducted in that state between September 2006 through August 2007. Oklahoma data includes all transactions conducted in 2006. Analysis performed by Veritec Solutions, LLC, which manages the payday lending database for Florida and Oklahoma regulators, on file with authors.

11 Oklahoma requires a two-day cooling-off period between every five successive loans.

12 Florida has a legally required cooling-off period of 24 hours between every loan. We have accounted for this artificial pause between successive loans by comparing the Florida repeat loan numbers for the first day after the cooling-off period and those loans made on same day another loan is paid off in Oklahoma.

13 *Payday Lending Demographic and Statistical Information: July 2000 through December 2007*. Administrator of the Colorado Uniform Consumer Credit Code (February 4, 2008). Flannery and Smolyk have noted that repeat borrowing increases as stores mature, with stores at least three years old disproportionately accounting for gross profits. See Mark Flannery & Katherine Smolyk, *Payday Lending: Do the Costs Justify the Price?*, FDIC Center for Financial Research, (June 2005), available at [www.fdic.gov/bank/analytical/cfr/2005/wp2005/cfrwp\\_2005-09\\_flannery\\_samolyk.pdf](http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/cfrwp_2005-09_flannery_samolyk.pdf) for more details.

14 Advance America Prospectus, December 17, 2004, pg 37-38. 42.3 percent of transactions were consecutive transactions defined as loans entered into on the same day as a previous payday loan was paid and 4.2 percent were direct renewals, defined as simple extensions of an outstanding payday loan by paying only the applicable finance charge.

15 *California Deferred Deposit Transaction Law Consolidated Annual Reports: Calendar Years 2005, 2006, and 2007*, California Department of Corporation, (December 3, 2008).

16 *Payday Lending Demographic and Statistical Information: July 2000 through December 2007*. Administrator of the Colorado Uniform Consumer Credit Code (February 4, 2008).

17 As reported by the state regulator for 2008, email on file with authors.

18 *2007 Payday Lending Report*, Washington State Department of Financial Institutions (2008).

19 *Payday Lending Demographic and Statistical Information: July 2000 through December 2007*. Administrator of the Colorado Uniform Consumer Credit Code (February 4, 2008).

20 *2000 Annual Report of Check Cashing Businesses Licensed Under Article 22 of Chapter 53 of the North Carolina General Statutes*, North Carolina Commissioner of Banks (2001).

21 *Payday Lending Report: Statistics and Trends 2004*, Washington State Department of Financial Institutions (2005).

22 Uriah King, Leslie Parrish, & Ozlem Tanik, *Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year*, Center for Responsible Lending, (November 30, 2006), available at [www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial\\_Quicksand-1106.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf).

23 There are somewhat subtle but important differences between our prior research on the “debt trap” and this paper’s analysis of payday loan churning. For example, many payday borrowers are “trapped” on the very first loan meaning the borrower cannot pay back the initial loan without taking another loans. For this paper, we are looking what share of payday volume is attributed to a demand for a small loan product vs. the share of payday loan volume that is generated by a borrower taking an additional loan because they could not afford to repay a prior loan while meeting their regular expenses. While the initial loan may be captured in the definition of loans made to borrowers in a debt trap, it should be excluded for the purposes of measuring churned loans.

24 As reported by CardWeb.com, there was \$212 billion in Mastercard and Visa credit card cash advances in 2008.

25 *2007 Department of Corporations Payday Loan Study*, Applied Management and Consulting Group for the California Department of Corporations, (December, 2007).

26 *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*, Center for Community Capital, University of North Carolina at Chapel Hill, (November 2007), available at [www.nccob.org/NR/rdonlyres/4BB13853-F3B0-48E2-9A2B-1A59177018CF/0/NC\\_After\\_Payday.pdf](http://www.nccob.org/NR/rdonlyres/4BB13853-F3B0-48E2-9A2B-1A59177018CF/0/NC_After_Payday.pdf).

27 Using a database on payday borrowers of a large Texas-based payday lender, researchers find those approved for a payday loan were 88 percent more likely to file for Chapter 13 bankruptcy within two years than the rest of the Texas population. They were also 14 percent more likely to file for Chapter 13 bankruptcy than their peers who had applied—and then been denied—a payday loan. See Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008), available at <http://bpp.wharton.upenn.edu/tobacman/papers/rd.pdf>. Using this same database of borrowers, the authors find that taking out a payday loan makes a borrower 92 percent more likely to become seriously delinquent on their

credit card (ie; 90 days or more late) during the year. See Sumit Agarwal, Paige Marta Skiba, & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?*, Federal Reserve Bank of Chicago, Vanderbilt University Law School, and University of Pennsylvania, (January 13, 2009), available at <http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf>.

28 An increase in payday lending locations in a particular county is associated with an 11 percent increase in involuntary bank account closures (generally due to the account being excessively overdrawn), even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. For more information, see Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School, (December 3, 2008). In addition, another researcher finds that access to payday loans increases the chances a family will face a hardship, have difficulty of paying bills, or have to delay medical care, dental care, and prescription drug purchases. See Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, Kellogg School of Management, Northwestern University, (January 3, 2009), available at [www.kellogg.northwestern.edu/faculty/melzer/realcosts\\_melzer\\_01\\_03\\_09.pdf](http://www.kellogg.northwestern.edu/faculty/melzer/realcosts_melzer_01_03_09.pdf).

29 A history of usury laws is available at Christopher L. Peterson, *Usury Law, Payday Loans and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, *Minnesota Law Review*, 92(4) (April 2008). A national, representative telephone survey conducted for CRL in March 2009 found that 75 percent of respondents favored Congress setting an interest rate cap, and that over 70 percent of respondents wanted this cap set at no higher than 36 percent annually. See *Congress Should Cap Interest Rates: Survey Confirms Public Support for Cracking Down on High-Cost Lending*, Center for Responsible Lending (March 2009), available at [www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf).

30 See Uriah King & Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform*, Center for Responsible Lending, (December, 2007), available at [www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf) for a discussion of why reforms of the payday lending industry other than an interest rate cap have not prevented borrowers from becoming trapped in debt.

31 Federal rate cap legislation, titled “Protecting Consumers from Unreasonable Credit Rates Act of 2009” has been proposed in the 111th Congress by Rep. Speier as HR 1608 and Sen. Durbin as S. 500. In addition, President Obama proposed extending the 36 percent interest rate cap protecting members of the military to all Americans during his presidential campaign. See “Barack Obama’s Plan to Reclaim the American Dream.”

32 For more information, see a letter from the National Consumer Law Center to the National Credit Union Administration outlining concerns about some payday loan alternative products offered by federal and state-chartered credit unions, available at [www.consumerlaw.org/issues/payday\\_loans/content/NCUA-payday-letter0109.pdf](http://www.consumerlaw.org/issues/payday_loans/content/NCUA-payday-letter0109.pdf).

33 For example, the payday lenders’ trade association website provides the following advice to consumers: “... payday advances are inappropriate when used as a long-term credit solution for ongoing budget management” and “Inappropriate use of a payday advance can create serious financial hardship.” See [www.cfsa.net/when\\_is\\_payday\\_inappropriate.html](http://www.cfsa.net/when_is_payday_inappropriate.html).

34 The Washington State legislature recently passed a law (ESHB 1709) that will take effect January 1, 2010 limiting borrowers to 8 payday loans per year. For more information about this new law, see [www.dfi.wa.gov/about/2009-legislature.htm](http://www.dfi.wa.gov/about/2009-legislature.htm).

35 In Financial Institution Letter FIL-14-2005, the FDIC notes that banks entering relationships with payday lenders should “ensure that payday loans are not provided to customers who had payday loans outstanding at any lender for a total of three months during the previous 12 months. When calculating the three-month period, institutions should consider the customers’ total use of payday loans at all lenders.” See [www.fdic.gov/news/news/financial/2005/fil1405a.html](http://www.fdic.gov/news/news/financial/2005/fil1405a.html).

36 Depending on their financial situation and household circumstances, there are a variety of credit and non-credit strategies available for payday borrowers. See Section 5 of *Payday Lending Isn’t a Legitimate Alternative: It’s a Debt Trap*, Center for Responsible Lending, (June 4, 2009) for a discussion of how households can use these strategies to address a financial shortfall without taking a payday loan.

37 See the FDIC's Financial Institution Letter FIL-50-2007, available at [www.fdic.gov/news/news/financial/2007/fil07050a.html](http://www.fdic.gov/news/news/financial/2007/fil07050a.html) for a discussion of affordable small loan guidelines.

38 In addition, consumer finance companies also offer small loan products. In North Carolina, the number of small installment loans made by consumer finance companies at or below 36% APR increased once payday lenders left the state. For a more detailed discussion of the variety of credit products and strategies low- and moderate-income households in North Carolina used to meet financial shortfalls after payday loans were no longer available, see *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*, Center for Community Capital, University of North Carolina at Chapel Hill, (November 2007), available at [www.nccob.org/NR/rdonlyres/4BB13853-F3B0-48E2-9A2B-1A59177018CF/0/NC\\_After\\_Payday.pdf](http://www.nccob.org/NR/rdonlyres/4BB13853-F3B0-48E2-9A2B-1A59177018CF/0/NC_After_Payday.pdf).

39 Testimony of Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America before the Subcommittee on Domestic Policy of the House Committee on Oversight and Domestic Reform (March 21, 2007).

40 For more information on how policymakers and regulators could encourage households to save, see Alejandra Lopez-Fernandini, Reid Cramer, & Rourke O'Brien, *The Assets Agenda: Policy Options to Promote Savings and Asset Ownership by Low- and Moderate-Income Americans*, New America Foundation, (September, 2008), available at [www.newamerica.net/files/Assets%20Agenda%202008%20Final.pdf](http://www.newamerica.net/files/Assets%20Agenda%202008%20Final.pdf).

41 For a more detailed discussion of the negative interaction between payday lending and bounce overdraft protection see *Payday Loans Put Families in the Red: Research Refutes Industry Claim That Payday Loans Prevent Overdraft Fees*, Center for Responsible Lending, (February, 2009), available at [www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf](http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf).

42 See Don Baylor, "The Hidden Costs of Payday Lending," *Texas Business Review* (April 2008). This estimate for Texas was based on data from Matt Fellowes & Mia Mabanta, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential*, Brookings Institution (January 2008).

43 Data on successive transactions in Florida includes all transactions conducted in that state between September 2006 through August 2007. Oklahoma data includes all transactions conducted in 2006. Analysis performed by Veritec Solutions, LLC, which manages the payday lending database for Florida and Oklahoma regulators. Data on file with authors. Veritec notes that 17 percent of Florida borrowers are excluded from this analysis because they had only one transaction during the study period. While this information is not directly disclosed for Oklahoma, data from other regulator reports for this state shows that 13 percent of borrowers in a 12 month period have only one transaction during this time period. For example, see *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions, LLC (May 2007).

44 While Georgia never authorized payday lending at triple-digit rates, payday lending storefronts did operate in Georgia for several years through partnerships with out of state banks until enforcement of payday lending guidance issued by the FDIC caused banks to end these business arrangements. See Harnick, Ellen, *Georgia's Payday Loan Law: A Model for Preventing Predatory Payday Lending*, Center for Responsible Lending, (June 2006), available at [www.responsiblelending.org/payday-lending/policy-legislation/states/pa-GeorgiaPayday-0606.pdf](http://www.responsiblelending.org/payday-lending/policy-legislation/states/pa-GeorgiaPayday-0606.pdf).

45 Similar to Georgia, Pennsylvania payday lenders operated by partnering with out-of-state banks to evade the state's interest rate cap. Payday lenders left the state after the FDIC issued guidelines which ended these bank partnerships and the state legislature failed to authorize the product.

### ***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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