Financial Quicksand:

Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year

Executive Summary

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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.

Visit our website at **www.responsiblelending.org.**

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EXECUTIVE SUMMARY

America's working families pay billions of dollars in excessive fees every year, as payday lenders across the nation routinely flip small cash advances into long-term, high-cost loans with annual interest rates in the range of 400 percent.

Despite attempts to reform payday lending, now an industry exceeding $28 billion a year, lenders still collect 90 percent of their revenue from borrowers who cannot pay off their loans when due, rather than from one-time users dealing with short-term financial emergencies.

Based on data collected by state regulators, financial records released by payday lenders, and assessments by third-party analysts, CRL has updated our 2003 quantification of the cost of predatory payday lending to American families. Breaking down the impact by state, we have also calculated the savings to families in states that have banned payday lending.

In our report, *Financial Quicksand,* we find that:

- **Ninety percent (90%) of payday lending revenues are based on fees stripped from trapped borrowers, virtually unchanged from our 2003 findings. The typical payday borrower pays back $793 for a $325 loan.**
- **Predatory payday lending now costs American families $4.2 billion per year in excessive fees.**
- **States that ban payday lending save their citizens an estimated $1.4 billion in predatory payday lending fees every year.**

Ninety percent (90%) of payday lending revenues are based on fees stripped from trapped borrowers.

New information from data provided by state regulators, payday lenders' public filings, and assessments of third-party industry analysts confirms that the payday lending industry's continued reliance on loan flipping.

	Loans to borrowers with 5 or more transactions per year	Loans to borrowers with 12 or more transactions per year
CRL 2003 findings	91%	62%
Washington State	90%	58%
Florida	89%	57%
Oklahoma	91%	66%
Colorado	Not Available	65%
2005 Average	90%	62%

The typical payday borrower pays back $793 for a $325 loan.

Taking the interest on the average payday loan principal as reported by state regulators, and multiplying it by the average number of loan flips per year, we find that the typical borrower ends up paying back $793 for a $325 loan.

Average principal (from state regulator data):	$325
Typical fee for $325 loan:	$52
Average transactions per year:	9
Total interest for original loan + 8 flips	$468
Total principal plus interest paid:	$793

Predatory payday lending now costs American families $4.2 billion per year in excessive fees.

Counting the fees paid by borrowers who have five or more payday loans per year, which indicates they are caught in a cycle of debt, we calculate the 2005 costs of predatory payday lending in each state, for a national total of $4.2 billion per year.

State	2005 Cost of Predatory Payday Lending	State	2005 Cost of Predatory Payday Lending
Alabama	$225 million	Nebraska	$20 million
Alaska	$4 million	Nevada	$108 million
Arizona	$139 million	New Hampshire	$5 million
Arkansas	$25 million	New Mexico	$27 million
California	$365 million	North Carolina	$74 million
Colorado	$76 million	North Dakota	$6 million
DC	$3 million	Ohio	$209 million
Delaware	$23 million	Oklahoma	$38 million
Florida	$156 million	Oregon	$51 million
Hawaii	$3 million	Pennsylvania	$29 million
Idaho	$26 million	Rhode Island	$3 million
Illinois	$219 million	South Carolina	$186 million
Indiana	$51 million	South Dakota	$87 million
Iowa	$40 million	Tennessee	$133 million
Kansas	$30 million	Texas	$259 million
Kentucky	$131 million	Utah	$69 million
Louisiana	$311 million	Virginia	$160 million
Michigan	$120 million	Washington	$155 million
Minnesota	$4 million	Wisconsin	$124 million
Mississippi	$135 million	Wyoming	$10 million
Missouri	$317 million		
Montana	$8 million	Total	$4.2 billion

States that ban payday lending save their citizens an estimated $1.4 billion in predatory payday lending fees every year.

Despite the spread of payday lending nationwide, a number of states have no known costs associated with the practice. We project the 2006 savings for states that ban payday lending at $1.4 billion, quite a significant level considering that these total savings are realized by fewer than a dozen states.

State	2006 Savings
Connecticut	$64 million
Georgia	$149 million
Maine	$26 million
Maryland	$98 million
Massachusetts	$121 million
New Jersey	$152 million
New York	$349 million
North Carolina	$155 million
Pennsylvania	$236 million
Vermont	$12 million
West Virginia	$36 million
Total	$1.4 billion

CONCLUSION AND RECOMMENDATIONS

Solving the payday lending problem has been a huge challenge for most states. The industry has successfully lobbied legislatures across the country to exempt payday lending from state consumer loan laws. In addition to legalizing the practice of holding a live check as collateral, these exemptions typically authorize interest rates at ten times the interest rate cap provided for in the state's consumer loan laws.

But there are signs that the tide is turning. The wave of payday authorization has clearly slowed, with states increasingly wary of this loan product. Several states have either refused to exempt payday lending from their laws or have closed existing loopholes.

Since the FDIC recognized the abusive nature of payday lending and tightened the reins on the banks they insure, the practice of national payday companies partnering with out-of-state banks (rent-a-bank) has all but disappeared. This places the responsibility for preventing predatory payday lending squarely in the hands of state legislators in the states where it is currently legal.

Some states have tried to reform payday lending by requiring databases, cooling-off periods, repayment plans or limits to the number of outstanding loans. The payday lending industry generally endorses these reforms, though we have found in the analysis provided in this paper that they have little impact on the debt trap payday lenders depend on for their revenues. Additional data is available from the states that have tried these reforms, which will provide the basis for a forthcoming CRL state-level analysis.

To solve the problem of high-cost payday lending effectively, state policymakers are increasingly applying their consumer loan laws to all lenders, including Internet lenders.

Most states have an existing interest rate cap in their consumer loan laws in the double digits; about a dozen are set at 36 percent. To prevent predatory payday lending, some states have refused to authorize special exemptions from these limits for payday lenders, whose business model requires them to charge triple-digit interest and repeatedly flip the loans.

Congress recently adopted, and the President signed into law, a 36-percent annual interest rate cap for consumer loans made to military families, protecting them from predatory payday loans as well as many other high cost loan products. The legislation outlawed taking a security interest in a live check, therefore prohibiting payday lending. The Pentagon reported that payday lenders are targeting their troops, and that servicemen and women are frequently losing security clearance because of their resulting debt problems.

Policymakers interested in preventing predatory payday loan flipping in their states should consider capping annual interest rates on small consumer loans at an all-inclusive 36 percent. This change would continue to allow responsible credit to flow, while saving Americans the billions of dollars now lost to predatory payday lenders.

To see the full report, go to www.responsiblelending.org.