CENTER FOR RESPONSIBLE LENDING

Written Statement of

THE CENTER FOR RESPONSIBLE LENDING

PREDATORY LENDING AND ITS IMPACT ON THE MILITARY AND LOCAL COMMUNITIES

Kansas City Armory
March 29, 2005

Congressman Graves, thank you for asking the Center for Responsible Lending (CRL) to testify here today on an issue of great concern to us, and one which should be of concern to all Americans who rely upon each and every member of our military.

CRL is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. It is affiliated with Self-Help, one of the nation's largest community development financial institutions. Our work in promoting fair and responsible lending has expanded beyond mortgage lending as we noted that the earnings of working families were being systematically stripped from them through other predatory practices, like payday lending.

We are based in North Carolina, home to seven military bases and the nearly 109,000 men and women on active duty in those bases. More than 10,000 soldiers from Fort Bragg in North Carolina are serving in Iraq or Afghanistan. One in five soldiers fighting in Iraq are from North Carolina bases.

The financial stresses caused by payday lending to our military neighbors led us to set up a special Military Outreach project last year. The staff involved in that project is visiting bases literally from coast to coast, talking with military counselors, JAG and Legal Assistance officers, and most importantly, military personnel themselves. We have participated in fora on payday lending at Fort Bragg and we continue to work with the Pentagon's Financial Readiness Campaign on this issue. We are pleased to share with you some of what we've learned about the industry, and about the special problems it presents to our service men and women.

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Our written statement expands on our oral statement addressing the three issues we've been asked to discuss.

I Quantify the cost of payday lending to the military: We will discuss three tiers of cost data – to customers nationwide, to military customers in the aggregate, and to the individual borrower.

II. Solutions to the problems raised by use of payday loans by military personnel.

III. Alternatives to the payday product for military personnel.

I. QUANTIFYING THE COST OF PAYDAY LENDING

A. *The excess cost to American families nationally is over $3.4 billion yearly.*

In a study published early last year, we conservatively estimated the cost of predatory payday lending at $3.4 billion in excess fees nationwide.[1] **Given the substantial growth in the industry since our study,[2] we now believe the cost exceeds $5 billion.** As you know, the business model for payday lending is a small dollar, two-week balloon loan, with APR price tags typically over **400%** nationally. (The APRs vary by loan amount, while the fees tend to be fixed amounts, rather than set as a percentage of the loan amount.[3]) In North Carolina, the average loan size is $325, and the average fee per loan is $52, for a two-week APR of 417%.

The loans are justified as a source for cash-strapped borrowers to meet the occasional emergency. However, as we show below, that is not the way it works for millions. Indeed, the industry depends on the repeat borrower. The loans are designed to trap borrowers, so that they become repeat customers against their better judgment, really against their will. Advance America, the largest payday company in the nation, has publicly disclosed that its average number of loans per borrower was nine per year in

[1] Keith Ernst, John Farris & Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending* (December 18, 2003, rev'd Feb. 24, 2004), available at www.responsiblelending.org

[2] The payday loan market has grown 60% to $40 billion since our previous analysis. Dennis Telzrow & David Burtzlaff, Industry Report: Payday Loan Industry, 4 Stephens, Inc., (May 24, 2004).

[3] Industry often claims that the APR is a misleading figure because these are short-term loans, typically written as two-week balloons. There are two flaws with that claim. First, as the data shows, the expense of these loans puts the borrower on a treadmill of continued rollovers, when they can't pay the balloon on such a short time line. They become long-term loans because of the treadmill (See Section I-C, below.) Second, the APR appropriately factors in the difference in the short term vs. long term loan. Consider this ad: "*Looking for a Place to Sleep? Here it is – only $400.*" Whether that is affordable for a weary ad reader depends a lot on whether that $400 buys one night of rest at an expensive hotel, or one month of living in a modestly-priced apartment. The APR is a shorthand way of helping a prospective borrower weigh that time factor along with the dollar cost.

2003. Study after study confirms that the repeat borrower is the lifeblood of the industry.[4]

Borrowers nearly always find they cannot pay back the loan in the two weeks it is due. We have found that the average payday borrower pays $1105 to borrow $325, and is in a payday loan for 7 1/2 months of the year. Because payday lenders have the signed personal check of the borrower, when the borrower cannot pay off the loan in full, they must pay the interest fees over and over again to avoid defaulting, so the lender won't bounce their check. These fees come before rent, utilities, and often groceries. An annual interest above 400% APR is outrageous, but it is the debt trap that is the bigger problem.

B. The Cost to Military

1. Military personnel are targeted

Military families are the ideal targets for this practice. The typical private first class makes less than $17,000 per year. Nearly three-quarters of active-duty military personnel top out at around $30,000 per year.[5] Many are young, typically without a lot of experience in managing finances, and without a cushion of savings to help them through emergencies. It is easy to see how soldiers would find a need for quick cash in these circumstances. What is less obvious, but even more compelling, is the difficulty of escaping the debt cycle, once the soldier is in it. (See B-3, below.)

In addition to those economic and demographic factors, other factors make the military an ideal target. Military pay is regular and secure. Those borrowers are not likely to be downsized, outsourced, or quit. Also, the military culture emphasizes financial responsibility**.** The consequences for not repaying debt can be confinement, court martial, loss of security clearance, and discharge. Against that backdrop, threats to contact the base commander can be a very effective collection tool. According to the NCLC report, one lender specializing in military loans even includes the following clause:

> If I fail to provide these funds, I understand that this will be a violation of [the Uniform Code of Military Justice], punishable by up to 6 months confinement, forfeiture of all pay and allowances, and a bad conduct discharge…I authorize the [lender] to contact my military superiors in these matters.[6]

[4] See eg, *Ernst*, footnote 1; Michael Stegman and Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 8 Economic Development Quarterly, Vol. 17, No. 1 at 18 (February 2003); *Payday Lending Report: Statistics and Trends for 2003*, Washington State Department of Financial Institutions (2005), at http://www.dfi.wa.gov/news/DFI_PaydayReport.pdf

[5] National Consumer Law Center, *In Harm's Way – At Home: Consumer Scams and the Direct Targeting of American's Military and Veteran*, p 8 (May 2003), www.nclc.org)

[6] *Id*., at 13. Major Carrisa Gregg, U.S. Army, recently made the same points on a panel entitled "Consumer Abuses Against Military Personnel" at the Consumer Federation of America's 2005 Consumer Assembly (Washington, D.C., March 10, 2005).

Finally, geographic concentration is another factor making it easy and economical to target the military. Active-duty military are physically concentrated in and around bases, and physical locations of facilities can be – and are – targeted to those areas of concentration.

Ft. Bragg, North Carolina is home to some 42,000 active-duty military. Nearby Pope Air Force base has another 4,800 service men and women. If you drove by Fort Bragg in eastern North Carolina, you would see for yourself what we can show you with a simple map. [See Appendix A.] Payday lenders set up shop in proximity to this base and the communities where the soldiers live. This map shows that thirty-one of thirty three payday loan shops in a roughly 1000-square mile area are within approximately 5 miles of the base and the census tracts with high concentration of military personnel. Another study looking at payday lending stores in 20 states with military bases confirms this kind of clustering. It is scheduled for release March 28 or 29. We urge you, Mr. Graves, to hold your record open so that it may be added. It is the most comprehensive study done on this topic, and should be definitive.[7]

We believe that the mapping data (which confirms the evidence of our own eyes around the bases) establishes beyond a reasonable doubt that the military is targeted. Even the names of the lenders show that they are geared to garner the attention of military personnel, such as Military Financial Network. An analysis by the New York Times reveals that at last one fourth of military households have been caught up in payday lending,[8] and officials at the Army Emergency Relief office in Fort Bliss, Texas estimate that 10 percent of the 10,000 active-duty military stationed there have needed financial counseling because of payday loans and other debt problems. In response to publicity with figures like these, the industry commissioned a telephone poll, and concluded that less than 4% of the military have used payday loans.[9] While they cite that figure as evidence that they do not target the military, a closer look leads to a different conclusion.

2. The overall cost to the military households

[7] Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, (March, 2005). The study should be available soon at http://www.law.ufl.edu/faculty/peterson/

[8] Diana B. Henriques, "Seeking quick Loans, Soldiers Race Into High-Interest Traps", p. 1 (New York Times, December 7, 2004).

[9] See "Less that 4 Percent of Military Have Taken a Payday Advance Loan, Says New Survey: Even So Trade Association Adopts Special Protections," http://sev.prnewswire.com/banking-financial-services/20050203/FLTH03303022005-1.html

However, the survey methodology is very weak for a number of reasons. Perhaps most fundamentally, we've already learned from industry's surveys of borrowers from its own customer base, payday loan borrowers do not admit to strangers that they borrow from payday lenders. Given the military culture concerning debt and potential consequences of financial troubles, it is not surprising that any soldier in trouble with payday loans would be reluctant to admit to the problem.

Prior to 9/11, our calculations show that active-duty military personnel were three times more like to have taken out a payday loan than the general population. In 2001, the Credit Research Center, an industry-funded research group, conducted a national survey of payday loan borrowers.[10] While not reported in the survey results, we believe from industry statements[11] and statements of the report's authors,[12] conclude that between 2 and 4% of payday loans at that time were loans to active duty military.

Given the industry size of $10 billion in 2000,[13] an average loan size of $300,[14] and an average number of loans per borrower of 11,[15] we believe there were approximately three million payday loan customers at this time. Therefore, between 60,000 and 120,000 active duty military personnel had payday loans. Taking the most conservative end of this spectrum -- assuming only 2% of payday loans were to military borrowers (60,000) -- we find that 4.3% of all active duty military had payday loans at that time.[16]

At the same time, only about 1.4% of the non-military US general adult population were payday loan borrowers.[17] **Therefore, using conservative estimates, we find that, pre-9/11, active duty military personnel were three times more likely to be payday loan borrowers than the general population.[18]**

Since 9/11, many active duty military personnel are on duty overseas, thus, it is difficult to determine what the current disparities are between lending to active duty military and the general population. Given the evidence that payday loan stores locate near military bases, the numerous statements by military personnel, and our analysis of the industry's own data regarding lending to military personnel, we believe that military personnel continue to bear a disproportionate burden of this abusive loan product.

We have begun research to determine the full economic cost of predatory payday lending on military families, but we are unable to provide you with a final analysis today.

[10] Elliehausen, G., & Lawrence, E. C. "Payday advance credit in America: An analysis of consumer demand" (Monograph. 35) Georgetown University, McDonough School of Business, Credit Research Center (2001). Question E4b asks if the borrower is on active military duty. Elliehausen at p.82.
[11] *See, e.g*., "Payday Advance and the Military," Factsheet by Consumer Financial Services of America (stating that "In the 2001 national survey conducted by the Credit Research Center at Georgetown University, only 2% of payday advance customers were members of active duty military."). On file with CRL.
[12] Diana B. Henriques, "Seeking quick Loans, Soldiers Race Into High-Interest Traps", p. 1 (New York Times, December 7, 2004)
[13] Stephens Inc., "Payday Advance – The Final Innings: Standardizing the Approach" at p5 (September 22, 2000).
[14] Keith Ernst, John Farris & Uriah King, *Quantifying the Economic Costs of Predatory Payday Lending*, Center for Responsible Lending (2003) at p.9(Table 4), at http://www.responsiblelending.org/pdfs/CRLPaydayLendingStudy121803.pdf.
[15] Id.
[16] According to the US Department of Defense, there were 1.4 million active duty military personnel in fiscal year 2000. See http://www.dod.mil/prhome/poprep2000/html/summary/summary.htm
[17] According to the US Census, the non-military adult population was 209 million in 2000.
[18] 4.3% divided by 1.4%

However, to give you an indication of the size of the economic cost, we performed a calculation to allocate the cost of predatory payday lending[19] to the segment of payday loan customers that are military personnel. Instead of using the 2% to 4% range described above, we were more conservative and assumed that 2% to 3% of payday customers are active duty military, since that is what the payday loan industry's own statements conclude.[20] **Assuming that military borrowers are no more nor no less likely to get ensnared in the payday loan debt trap, predatory payday lending likely costs military personnel between $68 million[21] and $165 million[22] annually**. That is a significant burden to impose on those who bear the burden of protecting us all.

3. The Cost to the Individual Military Borrower

Earlier we mentioned that the salary levels of the lower ranks of active duty military – the majority of active duty military -- was one factor making the military an attractive target. At the $17,000 to $30,000 income range, that puts the military payday loan borrower slightly below the $25,000 - $35,000 range typically cited in non-industry studies for the general payday loan customer.[23]

Just do the math. "An E-3 (one of the lower ranks), married with one child, after base pay and other allowances has no money left at the end of the month. Zero," explains the head of a branch of the Navy-Marine Corps Relief Society.[24]

At $17,000 income per year, bi-weekly net pay is approximately $600. If regular expenses for food, utilities, healthcare, etc. are $500 (a conservative estimate), then that leaves $100 in disposable income per paycheck. If a soldier has a payday loan of $300, he will never be able to afford to pay it off in its entirety, and will be stuck in the debt trap, paying the interest fee of $50 or so every payday without every paying down the principal. Any unforeseen expense will get him even deeper into the hole. Many borrowers take out a second payday loan at this point, desperate to keep up with the fees on the first.

We've appended to this testimony a chart showing why the industry is able to count so heavily on the repeat borrower for its business. Attachment B is a chart which

[19] The range of predatory payday lending is $3.4 billion (2003) to $5.5 billion today. See Section I.A. infra.
[20] Diana B. Henriques, "Seeking quick Loans, Soldiers Race Into High-Interest Traps", p. 1 (New York Times, December 7, 2004) (Steven Schlein of Community Financial Services Association stating that 2-3% of payday loan customers are military consumers).
[21] $3.4 billion in predatory payday lending multiplied by 2% of payday loan borrowers being active duty military personnel.
[22] $5.5 billion in predatory payday lending multiplied by 3% of payday loan borrowers being active duty military personnel.
[23] See, e.g. Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Markektplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 So. Car. L. Rev. 589, 626-6377 (2000).
[24] Capt. Bill Kennedy, quoted in National Consumer Law Center, *In Harm's Way, supra* n. 5, at pp. 10-11.

shows why the debt treadmill is such an integral feature of the business, prepared using data from your neighboring state of Iowa. Substitute the military $600 bi-weekly paycheck, and the result is obvious. The payday loan is quicksand, not a bridge to better economic stability.

II. Solutions

Our recommendation is simple, though it has proven to be very difficult to fight the lobbying efforts of the industry to get these borrower protections enforced.

- No rollovers: Payday lenders should not be allowed to repeatedly flip their borrowers, collecting interest again and again for no new money. Limits on rollovers should take into account the pressure on borrowers to go to second and third lenders to pay off the first.

- Longer repayment terms: Emergency loans should have 90-day loan terms, and should be paid back in installments.

- Lenders must consider the ability to pay: Payday lenders should have to consider the borrower's ability to repay the loan.

- Prohibit the use of checks as the promissory note/security for loans: The lender can use the personal check as a cold club to collect usurious fees. Notwithstanding industry "best practices," threats of prosecution for writing "bad checks" can pressure borrowers to pay excess fees before attending to their basic survival needs. Further, depositing checks brings additional revenues in the form of NSF fees. (Indeed, some business plans even tout the profitability of the NSF fees and late charges.[25])

- No mandatory arbitration clauses that keep borrowers from suing when lenders use unlawful practices.

- Finally, the FDIC should be encouraged to enforce the guidelines they have presented to the banks they insure, to keep them from engaging in this predatory practice. Payday lending is illegal in 13 states, but the national chains operate in those states under cover of FDIC policy, which overlooks the illegitimate relationship between the payday lenders and out-of-state banks. If the FDIC enforces their new guidelines, national payday lenders will not be allowed to trap our North Carolina soldiers in endless debt.

[25] *"The threat of a $200 advance eventually costing them in excess of $1,000 and destroying their credit will yield a compliant customer...This [agreement] allows you to collect a multitude of late fees and NSF charges."* See http://www.responsiblelending.org/payday/factfiction.cfm#four, business plan on file with the Center for Responsible Lending.

III. Alternatives

Any of these alternatives would be better than a payday loan:

- Military credit union loans, such as those offered by the Pentagon Federal Credit Union and the Fort Bragg Federal Credit Union. Pentagon Federal Credit Union Foundation has developed the Asset Recovery Kit (ARK) program in order provide short term emergency loans to counter "the abuses associated with military payday lending."[26] The ARK program provides up to a $500 loan that costs $6 per pay period (or 32% APR). In addition to an interest rate that is 10-15 times lower than a typical payday loan, the ARK program provides credit counseling services in order to help the military family to get their finances back in order.
- State & Local Employees Credit Union loans, which may offer a salary advance loan at 1/30th the cost of a payday loan.
- Other credit union loans. (Small loans range from prime to 18%, 1/30th cost)
- Military Relief Societies – These should be a first resource, not the last resort; they offer low interest rate loans to retired and active duty military and their eligible family members.
- Casual pay – pay advance approved from unit commander—no fees, no interest.
- Credit Card Advances – even the highest priced credit card advances are 1/10th the cost of a payday loan.
- Small consumer loans with state usury limits of 36% are 1/10th the cost of payday loans.
- "Good" overdraft protection – those that are tied to savings accounts or credit cards are excellent alternatives to payday, though military personnel should avoid bounce protection programs than can end up costing 1000% APR and trapping them in a debt cycle similar to that of payday.
- Late fees are much cheaper than paying repeated fees on payday loans.
- Working out payment arrangements with creditors.

We are no longer a nation of savers, and there is not a lot of room in a paycheck of $710 twice a month (based on a starting salary of $17,000 annually). But if a military family did save $26 per pay period for 6 months, they would have the $325 in reserve – the average amount borrowed. That's an interest cost of $0, compared to $1105 that the typical borrower ends up paying for a payday loan of that amount (over 7 ½ months), without retiring the debt.

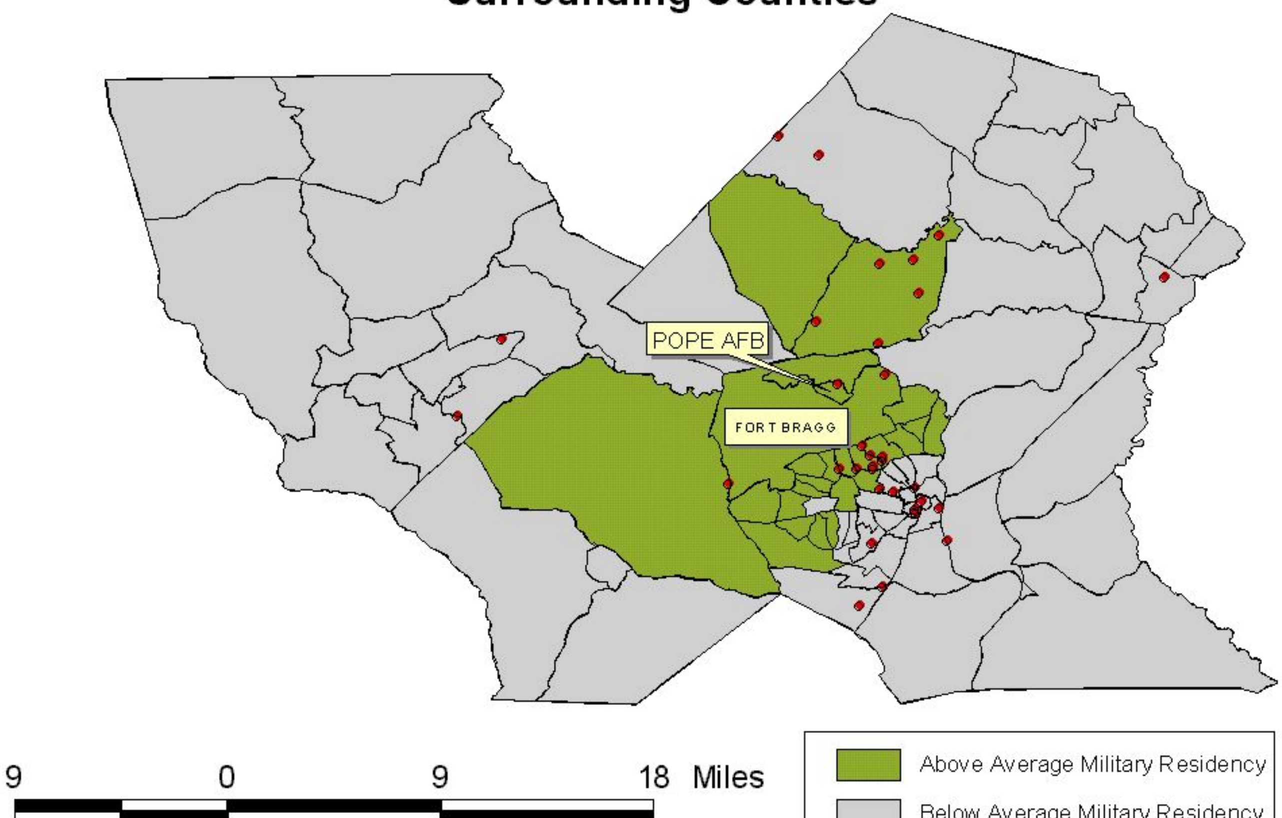
Payday loans should not be authorized on the grounds that they are the best alternative. They are the worst. Payday loans trap borrowers in debt – by design. The members of the military are our protectors. In return, they deserve protection from financial predators, for themselves and their families.

[26] See http://www.pentagonfoundation.org/programs/ark.html.

Thank you for inviting us. We appreciate the opportunity to talk with you about this challenge facing the men and women who serve our country.

APPENDIX A

Payday Shop Concentrations
Fort Bragg & Pope Air Force Base
Surrounding Counties



SOURCES: 2000 U.S. Census; 2004 Online address directories
NOTE: Counties included in this map have a combined 10% military residency

APPENDIX B

THE DEBT TREADMILL:
THE HOUSEHOLD BUDGET IMPERATIVE BEHIND THE ROLL-OVERS AND THE "BORROW FROM PETER TO PAY PAUL" FACTORS[27]

Annual Household Income	***$25,000***	***$35,000***
Two-week net paycheck (less taxes and retirement)	$847	$1,138
Necessary expenditures (food, housing, utilities, transportation and healthcare only)	$875	$1,004
Net paycheck minus necessary expenditures	- $28	$134
Average Iowa payday loan due at end of pay period (2003)	$304.39	$304.39
Pay period deficit if payday loan is paid in full on time	**-$332.39**	**-$170.39**

This shows why the treadmill is inherent in this industry. It also brings into focus the fallacy in looking at loan volume either as a reflection of "demand" or as a reflection of "choice," when much of the volume is actually churning prior debt.

[27] Source: Adapted from data collected for the *Forum on Short-Term High-Interest Paycheck Advances,* convened by Sen. Joseph Lieberman, ranking minority member, U.S. Senate Comm. On Governmental Affairs (Dec. 15, 1999). Income and expense data were derived by Committee staff from Bureau of Labor Statistics Consumer Expenditure Survey. This adapts the Committee chart to reflect the average payday loan amount (principal plus fee) in Iowa in 2003.