PAYDAY LENDING ABUSES AND PREDATORY PRACTICES

The State of Lending in America & its Impact on U.S. Households

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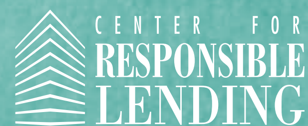
September 2013



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PAYDAY LENDING ABUSES AND PREDATORY PRACTICES

Payday loans—high-cost small loans averaging $350 that usually must be repaid in a single payment after two weeks—are designed to create a long-term debt trap. Whether they receive the loans online, in storefronts, or through banks,[1] the vast majority of borrowers cannot both repay the loan and cover all their basic living expenses until their next payday. As a result, they typically take out multiple loans within a short timeframe, paying repeated fees to do so. Payday loans create a debt treadmill that makes struggling families worse off than they were before they received a payday loan.

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The following five payday lending practices contribute to the creation of a debt treadmill for borrowers:

- Lack of underwriting for affordability. The payday lending business model depends on borrowers' *inability* to afford their loan and their subsequent need to borrow—paying more fees—multiple times.
- High fees. Payday lenders typically charge the maximum possible rate allowed in a state. As a result, the annual percentage rate (APR) on payday loans is often 400% or higher.
- Short-term due date. Most borrowers cannot repay their payday loan principal within a two-week period—let alone the principal plus a fee. In fact, some payday lenders offer a "free" first payday loan with no fee,[2] knowing that borrowers who cannot afford to repay the principal in two weeks will incur many repeat borrowings and fees in subsequent pay periods.
- Single balloon payment. The entire payday loan balance typically is due in one lump sum; combined with the short-term due date, this single-payment feature makes payday loans especially difficult to repay.
- Collateral in the form of a post-dated check or access to a bank account. The consequence of not repaying a payday loan is that the check used as collateral will be deposited or ACH transaction debited, which puts lenders "first in line" to be paid (rather than being "just another bill").[3] Because the payday loan is tied to the borrower's payday, the lender can be reasonably sure the check will clear. Most borrowers will simply run out of money to cover their expenses before the end of the month, often taking out more payday loans (and paying more fees) to pay for the expenses.

Any of these five factors alone creates problems for borrowers. Together, they create a high likelihood of repeat borrowing and a long-term cycle of debt.

1 For more information on bank payday lending, see the accompanying bank payday chapter of *State of Lending*.

2 For example, http://www.checkntitle.com/ advertises several times on its website "First loan FREE!" for new customers. Website visited 7/9/13.

3 Melzer (2012) provides support for the notion that households prioritize paying off payday loans before their regular expenses. Melzer compared the likelihood of using food stamps and paying child support of low- and moderate-income households (earning between $15,000 and $50,000 annually) in states with and without payday lending storefronts. He found that those with payday loan access are 20% more likely to use food stamps and 10% less likely to make child support payments. He concludes, "these findings suggest that as borrowers accommodate interest and principal payments on payday loan debt, they prioritize loan payments over other liabilities like child support payments and they turn to transfer programs like food stamps to supplement the household's resources."

The high level of payday loan "churn"—when borrowers either directly renew loans or pay back a loan but take out another shortly thereafter—underscores the existence of a long-term debt trap. The Center for Responsible Lending (CRL) published "Phantom Demand" (Parrish & King, 2009), which quantified the level of loan churn by examining the length of time between successive payday loans. The paper found that most successive loans are originated shortly after a previous loan is paid back. Half of repeat loans were opened at the borrower's first opportunity,[4] 87% within two weeks, and 94% within one month of the previous loan.

As "Phantom Demand" concluded, this rapid re-borrowing indicates that very few borrowers can clear a monthly borrowing cycle without borrowing again. Using a one-month definition of loan churn—appropriate for households paid on a monthly basis (such as public benefit recipients) and those managing major expenses and obligations on a monthly basis[5] —82% of overall payday loan volume is due to loan churn.[6] If loan churn is defined more narrowly as taking out a subsequent loan within two weeks of the previous loan—consistent with the most common pay period length for most payday borrowers—76% of total payday loan volume is still due to loan churn.[7]

IMPACT ON U.S. HOUSEHOLDS

Cost of Loan Churn

Loan churning dramatically increases payday lending fees without providing borrowers with access to new credit. We estimate that loan churn in states with no restrictions on payday lending costs borrowers at least $2.6 billion in excess fees annually.[8] This number is lower than that in "Phantom Demand," which found that loan churn causes borrowers to pay an extra $3.5 billion in fees annually.[9]

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This lower level of fees attributable to loan churn is the result of consumer-friendly changes in state laws since the publication of "Phantom Demand." Several states have enacted laws eliminating high-cost payday lending. For example, Arizona voters upheld the planned sunset on the law that allowed payday lenders to charge 400% annual interest rates, and as a result the state's 36% APR limit for unsecured consumer loans went back in effect in 2010. Similarly, in 2010, Montana voters approved a 36% APR limit for payday loans, which previously had been offered at 400% APR.[10] In addition, this

4 We say "first opportunity" because some states have mandatory cooling-off periods in which borrowers may not take out a new loan immediately after having paid off a previous loan. For example, Florida has a 24-hour cooling-off period.

5 CFPB (2013) analyzed payday borrower pay frequency. Although most borrowers (55%) were paid biweekly or twice a month, one-third (33%) were paid monthly. The remainder (12%) were paid weekly.

6 This 82% figure represents the percent of *all* payday loans that were originated within a month of paying off a previous loan. In contrast, when looking only at payday loans to repeat borrowers, 94% were originated within a month of paying off a previous loan.

7 This 76% figure represents the percent of *all* payday loans that were originated within two weeks of paying off a previous loan. In contrast, when looking only at payday loans to repeat borrowers, 87% were originated within two weeks of paying off a previous loan.

8 If loan churn is defined as taking out a payday loan within one month of having paid back a prior loan, borrowers pay an excess of $2.8 billion in annual fees. If it is defined as taking out a loan within two weeks of having paid back a prior loan, borrowers pay an excess of $2.6 billion in fees each year. Note that this loan churn number, consistent with "Phantom Demand," does not include data from banks or unlicensed lenders. For more information, see Appendix 1.

9 The "Phantom Demand" estimate used the narrow two-week definition of churn.

10 Montana's 36% APR rate cap also applies to car-title and consumer installment loans.

loan churn estimate is conservative because it excludes several states where statutory changes have allowed for payday lending to continue in some form but have limited the debt trap, for example by limiting the number of loans in a 12-month period[11] or by coupling extended minimum loan terms with limits on fees and refinancing incentives.[12]

Impact of Loan Churn on Individual Borrowers

"Phantom Demand" found that loans are most often taken out in rapid succession (within two weeks of closing a prior loan), and thus the actual impact of repeat transactions is simply repaying fees to float the same debt rather than being extended new credit each time. The Consumer Financial Protection Bureau (CFPB) recently published a white paper with data from 15 million payday loan transactions from 1.5 million borrowers and covering one year of activity. This is the most comprehensive data set on payday lending ever compiled and analyzed.

The CFPB white paper confirms the findings from "Phantom Demand": "Two-thirds of payday borrowers in our sample had 7 or more loans in a year. Most of the transactions conducted by consumers with 7 or more loans were taken within 14 days of a previous loan being paid back—frequently, the same day as a previous loan was repaid" (CFPB, 2013). The median borrower in the CFPB sample took out ten payday loans from a single lender during the year, paying $458 in fees alone for $350 in non-churn principal (CFPB, 2013). These numbers are most likely conservative, as they did not examine borrower experiences across lenders.

Other analyses using less extensive data sets confirm the CFPB findings. For example, Appendix 2 highlights data from state regulator databases showing that borrowers on average take out nine loans per year, paying back $504 in fees alone for $346 in non-churn principal. A report on payday lending from the Pew Safe Small-Dollar Loans Research Project similarly finds that borrowers take out an average of eight 18-day loans during the year and are indebted 144 days (40%) each year, paying on average $520 in fees alone for an initial loan of $375 (Pew, 2012). A study from the Center for Financial Services Innovation (CFSI) (Levy & Sledge, 2012) estimates that payday borrowers take out 11 loans annually and are in payday loan debt 150 days (41%) each year. Even payday lender data confirm heavy borrowing: Advance America, the nation's largest payday lending company, consistently reports that its customers take out an average of eight loans per year (Dougherty 2013).

Figure 1 highlights why this debt trap is so pernicious for families: simply put, a payday borrower earning $35,000 per year[13] cannot afford to repay even a "free" payday loan (for which no fee is charged) while covering their two-week essential expenditures:

11 For example, Delaware and Washington State have limited the number of loans a borrower may take out over the course of a year to five and eight loans, respectively. There is evidence that national payday lenders are evading Delaware's law by migrating to the state's installment lending statute in order to continue to offer unrestricted triple-digit-APR debt trap loans. Washington State, however, has strong underlying small loan laws that prevent similar evasion, and thus the state has been able to enforce and monitor its law.

12 For example, Virginia has a minimum two-pay-period loan term, which translates into about a one-month minimum loan term for those paid biweekly. Oregon has a minimum 31-day loan term, along with a fee limit of 36% annual interest plus the lesser of $30 or 10% of the principal borrowed. Colorado has an extended minimum loan term of six months; limitations on fees, including making the origination fee proportionately refundable (thus decreasing the incentive to churn loans); and a prohibition on the sale of ancillary products. Because "Phantom Demand" based its churn calculations on a two-week product, which is churned more frequently than longer-term loan products, we excluded these states in the loan churn calculations in *State of Lending.*

13 The Consumer Financial Protection Bureau, in its recent white paper on payday lending, found a median *net* borrower income of $22,476 and a mean of $26,167 (CFPB, 2013). Although most states do not provide income information about payday borrowers, Illinois reports an average payday borrower gross income of $33,157 (Veritec, 2013). In Colorado, the average gross annual income of payday borrowers is $29,724 (Colorado AG, 2012).

Figure 1: A Two-Week Payday Loan Results in a Debt Trap, Even with No Fee

Cost of a Two-Week Payday Loan for a Borrower Earning $35,000/Year in Gross Income			
	$0 per $100 ("free" loan, 0% APR)	$15 per $100 (391% APR)	$20 per 100 (521% APR)
	Two-Week Income		
Before-tax income	$1,346	$1,346	$1,346
Income taxes paid	$1	$1	$1
After-tax income	$1,345	$1,345	$1,345
Social Security & pensions payments	$84	$84	$84
Net two-week income	$1,261	$1,261	$1,261
	Payday Loan Cost		
Payday loan fee	$0	$53	$70
Payment due on $350 (average-sized) payday loan	$350	$403	$420
Amount remaining to cover all expenses	$911	$859	$841
	Two-Week Essential Expenditures		
Food	$205	$205	$205
Housing	$516	$516	$516
Transportation (incl. insurance, gas, maintenance)	$246	$246	$246
Heath care	$106	$106	$106
Total essential two-week expenditures	$1,073	$1,073	$1,073
Money remaining in paycheck after paying payday loan (deficit)	($162)	($215)	($232)

Source: 2011 Consumer Expenditure Survey, Bureau of Labor Statistics, for households earning $30,000-$39,999 annually.

Regardless of whether a payday loan is offered for "free" (as many initial loans are) or for a fee of $15-$20 per $100 borrowed, a typical borrower will be unable to meet his or her most basic obligations and repay the payday loan debt in a two-week period. Within one pay period, borrowers may have enough money to either repay their payday loan or meet very basic expenses, but not both. The situation is even worse for the many families who have other expenses not captured here, such as child care, clothing, and other debt obligations.

Another CRL study, "Payday Loans, Inc.," (King & Parrish, 2011) tracked payday borrowers for two years after having taking out their first payday loan. Those findings illustrated the negative impact of a debt trap that worsens over time, including:

- Payday loans for repeat borrowers increased in size and frequency over time. Active borrowers (those taking out at least one loan in each six-month period of the second year) took out an average of nine loans in the first year and 12 loans in the second year.
- Overall, borrowers were indebted an average of 212 days (58%) of the first year and continued to be indebted over half of the second year. Leaving out the 15% of borrowers who took out only one loan in the two-year period, the remaining borrowers were indebted 345 days (63%)

of their first 18 months and 432 days (59%) of the full two-year period. This is similar to the CFPB's white paper, which found that the average payday borrower was in debt 199 days (55%) of the year.

- A significant share of borrowers became late or defaulted on their payday loan, triggering more fees and placing their bank account at risk. Thirty-seven percent of the payday borrowers experienced default in the first year of borrowing; within the first two years, 44% did. This finding is consistent with Skiba & Tobacman (2008b), who examined data from a large Texas-based payday lender and found a 54% default rate. High levels of loan churn mean that even borrowers who default often pay substantial fees, often paying the payday loan fee multiple times before ultimately defaulting.

Other Studies Demonstrating Further Negative Consequences

Other studies have found other important negative consequences of taking out payday loans, including the following:

- Losing bank accounts. Research has shown that access to payday loans is linked to increased rates of involuntary bank account closures, which makes routine financial transactions more expensive and risky (Campbell, Jerez, & Tufano, 2008).
- Becoming delinquent on other debts. Agarwal, Skiba, & Tobacman (2009) found that once credit card users began borrowing from payday lenders, they were 92% more likely to become delinquent on their credit card payments. In addition, Melzer (2011) compared low- and middle-income households[14] living in areas with and without storefront payday lenders. He found that people with access to the loans were 25% more likely to have difficulty paying bills and 25% more likely to delay needed medical care. Melzer states,

  > I find no evidence that payday loans alleviate economic hardship. To the contrary, loan access leads to increased difficulty paying mortgage, rent and utilities bills. . . . Counter to the view that improving credit access facilitates important expenditures, the results suggest that for some low-income households the debt service burden imposed by borrowing inhibits their ability to pay important bills.

- Filing for bankruptcy. One study (Skiba & Tobacman, 2008a) found that payday borrowers nearly doubled their chances of filing for bankruptcy compared with households of similar financial status who were denied a payday loan.

Borrowers who ultimately default on a payday loan face a litany of other negative consequences:

- Additional financial stress, with both the payday lender charging non-sufficient-funds (NSF) fees and the borrower's bank assessing NSF and/or overdraft fees, both of which average about $30-35.
- Legal ramifications, such as wage garnishment and potential court action.
- Having their debt sold to a collection agency, which can negatively affect credit reports and scores and also can lead to repeated solicitations for payment or even illegal harassment and debt collection scams.[15]

14 Melzer limits his analysis to those earning between $15,000 and $50,000 annually.

15 For an example of an illegal payday debt collection scam, see FBI (2010).

Characteristics of Payday Loan Borrowers

According to the Pew Safe Small-Dollar Loans Research Project (2012), 12 million American adults (5.1%) used a payday loan in 2010, and 5.5% of American adults used payday loans in the prior five years.[16] As detailed below, these borrowers tend to be low-income, young, and female. In addition, although most payday borrowers are white, people of color are more likely to receive payday loans, and payday lending storefronts are more likely to locate in neighborhoods of color. Historically, storefront payday lenders have targeted members of the military, setting up shop right outside military bases, but this has changed since passage of the Military Lending Act in 2006.

- Income. CFPB (2013) included some information on payday borrowers in its analysis of payday lending data from a number of lenders. It found a median borrower net income of $22,476.[17] In addition, it analyzed the sources of income, finding that although most (75%) receive their income through employment, nearly one in five (18%) receive income through public assistance and benefits. The remainder (7%) do so through retirement or another source.

- Demographic information. Pew (2012) included information on the demographic makeup of payday loan borrowers obtained through a nationally-representative telephone survey. Pew's report noted,

  > Most borrowers are white, female, and are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: those without a four-year college degree; home renters; African Americans; those earning below $40,000 annually; and those who are separated or divorced.

  That African Americans and Latinos are more likely to receive payday loans is not surprising, since payday lenders disproportionately locate in neighborhoods of color. A 2009 CRL study of the location of payday loan shops in California found that payday lenders are eight times more likely to be located in African American and Latino neighborhoods than in white neighborhoods. Even after controlling for other factors like income, the study found that payday lenders were 2.4 times more concentrated in neighborhoods of color (Li, Parrish, Ernst, & Davis, 2009).

- Military targeting. Historically, payday lenders also have targeted members of the military, setting up shop just outside military bases. In response to Department of Defense (DoD) appeals to protect service members and their families from abusive loans, Congress enacted the Military Lending Act of 2006 (MLA), which set a 36% APR limit on payday loans to members of the military and their families. The MLA also prohibited lenders from holding a post-dated check or using electronic access to a borrower's bank account as collateral.

  DoD (2008) concluded that the MLA "has established a balanced approach in using the regulation to curb products with demonstrated high costs and balloon payments, while working with Federal and state governments to protect Service members and their families." Military financial counselors and legal assistance officers report limited use of payday and car-title loans, and the

16 The 2010 number is derived from analysis of administrative data, whereas the five-year usage figure is derived from a survey in which borrowers self-reported their usage of payday loans. Generally, administrative data are more reliable.

17 CFPB remains the most comprehensive source for income data, since it examined 15 million payday loans to 1.5 million borrowers in 33 states. Only a few state regulators provide income information. In Colorado, the average gross annual income of a payday borrower is $29,724 (Colorado AG, 2012). In Illinois, the average payday borrower's gross annual income is $33,157 (Veritec, 2013). Note that total household income for a payday borrower could be higher than these numbers, for example if another household member brings in an income.

Navy Marine Corps Relief Society reports a savings in relief funds from no longer having to rescue as many "active duty personnel entrapped by the predatory loan industry" (DoD, 2008).[18]

However, some problems remain. Fox (2012) demonstrates that some lenders have exploited definitional loopholes in the law to offer high-cost, abusive products using open-ended or installment credit to active-duty service members and their families. Jowers (2010) highlights that banks offering open-ended payday loans are able to circumvent the MLA.

Borrower Use of Payday Loans

The evidence shows that the majority of payday borrowers are trying to address budget gaps caused by recurring, everyday expenses; they are not trying to address the occasional emergencies payday lenders claim are the key reasons borrowers to take out loans. For example, Pew (2012) found that despite payday lender claims to the contrary, 69% of payday loans are taken out for recurring expenses, with only 16% for unexpected emergencies, 8% for "something special," and 2% for "other." Similarly, Bhutta, Skiba, & Tobacman (2012) state that payday loans do not go to people who are managing temporary short-term income shocks, but rather to people with "extremely persistent weakness in credit record attributes" over the long term. Levy & Sledge (2012) similarly found that payday loans primarily cover recurring expenses.

That payday loans are for everyday, recurring expenses suggests a structural budget problem where expenses exceed income, which helps explain why it is so difficult to pay off even a "free" payday loan, especially one with a two-week balloon payment. High-priced, short-term debt is inherently unsuitable for borrowers coming up short on regular expenses. Each loan leaves them with significantly less income to meet the next round of expenses, which leads them to continue to pay payday loan fees in a cycle of debt.

High-priced, short-term debt is inherently unsuitable for borrowers coming up short on regular expenses.

Pew (2012) also asked borrowers what they would do if they did not have access to payday loans. Eighty-one percent said they would cut back on expenses, and many would delay paying some bills, borrow from friends and family, or sell or pawn personal possessions. These survey findings are consistent with the results of a focus group Pew conducted of former payday borrowers in New Hampshire, which has eliminated high-cost payday lending from the state. In these focus groups, borrowers said that they would turn to lowering overall expenses and re-budgeting, borrowing from friends and family, using payment plans for bills, and the like. Interestingly, these are the same options that payday borrowers who do not default ultimately take advantage of in order to retire their payday debt. The difference is that borrowers who do not have access to payday loans do not pay the high fee multiple times first.

These findings are consistent with a study from the University of North Carolina's Center for Community Capital (2007). The study examined the impact of the state's 36% APR limit, which eliminated high-cost payday lending there. Researchers concluded that the absence of storefront payday lending had no significant impact on the availability of credit for North Carolina households. Those who faced a financial shortfall in the absence of payday lending chose to delay paying a bill, tap into savings, borrow from friends and family, visit a pawnshop, or take advantage of other

18 After implementation of the MLA, the Navy Relief Society reported that it spent significantly less each month to help members entrapped in predatory loans (from $100,000 per month before implementation to $40,000 per month after) (DoD, 2008).

available options. In addition, more than twice as many former payday borrowers reported that the absence of payday lending had had a positive rather than a negative effect on them; nearly 90% of households thought that the loans were bad for their finances.

MARKET AND INDUSTRY OVERVIEW

The payday lending industry includes both bank and non-bank lenders.[19] Non-bank lenders offer payday loans via two primary channels: through storefronts (with typical APRs of over 400%) and over the internet (with typical APRs often exceeding 600%). No matter how these loans are offered, they are structured to create a long-term cycle of debt for borrowers.

Lending Activity and Major Players

According to Stephens Inc., a privately-held investment firm that also issues investment analysis on payday and related lending institutions, the storefront payday lending industry has slumped from an estimated high of just over 23,500 stores in 2007 (Stephens Inc., 2008) to under 19,000 by 2010 (Stephens Inc., 2011). Stephens estimated storefront loan volume shrank from $43 billion in 2007 (Stephens Inc., 2008) to slightly less than $30 billion in 2010 (Stephens Inc., 2011). However, in that same period, internet payday loan volume more than doubled from an estimated $6.7 billion in 2007 (Stephens Inc., 2008) to approximately $14.3 billion in 2010 (Stephens Inc., 2011).

Our analysis shows that 16,341 payday stores are located in states without substantive restrictions on payday lending, with total loan dollar volume (including churn) of $19.9 billion and total fees collected of $3.4 billion.[20]

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Although the industry has always had a number of locally owned "mom-and-pop" shops, nine major operators run almost 50% of the estimated number of stores. Five of these lenders (listed alphabetically) are publicly traded, stock-owned companies. (The names in parentheses are the primary names for their payday stores):

- Texas-based Cash America started out 30 years ago as a pawn shop operator but moved into payday lending in 2000. It operates more than 660 locations that offer payday-like products; Texas is its largest storefront state. Additionally, its CashNetUSA subsidiary appears to be the largest online lender in the country. Combining its international business with U.S. operations, Cash America appears to derive more revenues from payday lending than any other firm.
- Pennsylvania-based DFC Global (Money Mart) has seen its number of storefronts decline gradually to slightly more than 300, with the bulk of those operating in California and Florida. The company has expanded aggressively outside the U.S., building storefronts and online operations across Europe and in Canada.

19 For more information on bank lenders, see the accompanying Bank Payday Lending chapter of *State of Lending.*

20 See Appendix 3 for more information.

- EZCORP (EZ Money) is another Texas-based pawn store operator that has diversified into payday products, offering them at more than 450 U.S. stores, with more than half of them located in Texas. It recently purchased an online lending outfit and stated in an investor call that it intends to more than double its online lending volume within the next year.

- Texas-based First Cash Financial Services (First Cash Advance and Cash and Go) is a pawn shop operator that also engages in payday lending. Despite having previously made payday loans in its stores in multiple states as recently as 2011, it has reduced its domestic payday footprint primarily only to Texas.

- Kansas-based QC Holdings (Quik Cash) focuses on storefront payday lending, with a heavy concentration in Missouri and California. Its store count has shrunk from almost 600 in 2006 to fewer than 450 in 2013.

The other four major players in the industry are privately held or subsidiaries of larger entities. As a result, there is limited public information available on their operations:

- Begun in the 1990s, South Carolina-based Advance America is the largest storefront lender in the country, operating an estimated 2,500 stores, down from more than 2,800 stores in 2007. It operates almost exclusively as a storefront business, although it offers online loans through a partnership with Cash America's CashNetUSA. In Spring 2012, Mexico-based Grupo Elektra, a major supplier of both consumer electronics and financial services in Mexico, acquired Advance America and has since operated the stores as a U.S. subsidiary.

- Texas-based Ace Cash Express diversified into payday lending as a sideline to its primary business of providing check-cashing services. More than 1,300 of its estimated 1,700 retail locations offer payday loans. The company also is emphasizing car-title lending and prepaid debit cards, and it makes online loans in Canada through Zippy Cash.

- Tennessee-based Check Into Cash bills itself as the "father" of the payday industry, claiming that founder Allan Jones first developed the concept in the early 1990s. The company has more than 1,100 stores spread across the U.S. and recently bought a UK-based payday operator.

- Ohio-based CNG Financial (Check 'n Go) primarily operates as a payday lender, though it has also engaged in car-title lending, check cashing, and other operations. It has scaled back its store count from more than 1,350 in 2007 to a reported 1,025. It has also established an online operation.

Other national storefront operators include Allied Cash Advance, Amscot, Approved Cash Advance, Community Choice Financial (doing business as Checksmart), Moneytree, and PLS Loan Store. Many of these national storefront lenders also make loans over the internet.

The online industry is far harder to track; other than Cash America, few lenders report in detail on their operations. In recent years, some payday lenders have associated with Native American tribes to set up online lending operations that they claim are exempt from compliance with state consumer standards, as discussed in more detail below.

Industry Business Model

Two-Week Payday Loans

The payday lending industry is heavily reliant on repeat borrowers for its revenue. The leading payday industry trade association—the Community Financial Services Association (CFSA)—states in a recent letter to the CFPB, "[i]n any large, mature payday loan portfolio, loans to repeat borrowers generally constitute between 70 and 90% of the portfolio, and for some lenders, even more" (Miller, 2013).

Stephens Inc. (2011) also underscores this reliance: "In a state with a $15 per $100 rate, an operator . . . will need a new customer to take out 4 to 5 loans before that customer becomes profitable." Indeed, Dan Feehan, CEO of Cash America, remarked at a Jeffries Financial Services Conference in 2007, ". . . [T]he theory in the business is [that] you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is." Lender marketing materials offer incentives to promote frequent loan usage, such as discounts to promote repeat borrowing.

In addition, data from state payday lending databases highlight that repeat borrowing continues to fuel the payday lending business model. Figure 2 highlights the percentage of loans made to borrowers who receive five or more and 12 or more loans per year, both of which we also reported in CRL's 2006 report "Financial Quicksand" (King & Parrish 2006). State regulator data from 2010 and 2011 indicate that, on average 91% of loans go to borrowers with five or more loans in a year, compared with 90% in our 2006 analysis. Similarly, on average, 65% of loans go to borrowers with 12 or more loans in a year, compared with 62% in 2006. This provides evidence that the payday lending industry's debt trap business model has not changed over time.

In 2005, the Federal Deposit Insurance Corporation (FDIC) issued payday lending guidelines, highlighting the significant risks that these loans pose for borrowers, as well as safety and soundness risks for financial institutions that offer them or partner with institutions that do so.[21]

Although these guidelines only apply to FDIC-supervised banks, they provide an important reference point for what constitutes a debt trap. The guidelines state in part that covered banks should "ensure that payday loans are not provided to customers who had payday loans outstanding at **any lender** [emphasis in the original] 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" (FDIC, 2005). This guidance would allow approximately six two-week loans or three 30-day loans.

Our analysis using the latest data available from state regulators demonstrates that 85% of loans go to borrowers with seven or more loans in a year, more than the maximum level of indebtedness recommended by the FDIC. CFPB (2013) similarly found: "Three-quarters of all loan fees generated by consumers in our sample come from those with more than 10 transactions during this [one-year] period."

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21 These guidelines effectively ended the "rent-a-bank" scheme, in which storefront payday lenders partnered with national banks to evade state laws.

Figure 2: Repeat Borrowing Continues to Fuel Payday Lending

State	Time Period	% of loans to borrowers with 5+ loans/year	% of loans to borrowers with 7+ loans/year	% of loans to borrowers with 12+ loans/year
Florida	June 2010-May 2011	92%	85%	63%
Kentucky	Jan. 2011-Dec. 2011	93%	88%	70%
Oklahoma	Nov. 2010-Oct. 2011	91%	84%	61%
South Carolina	Jan. 2011-Dec. 2011	90%	82%	53%
Average		**91%**	**85%**	**62%**
Average from "Financial Quicksand" (published in 2006)		90%	not available	62%

Source: State regulator reports of annual payday loan activity reported by state-regulated databases.

It is important to note that all of the states that report data on loan frequency—Florida, Kentucky, Oklahoma, and South Carolina—have codified industry-touted "best practices"—such as extended payment plans, rollover bans, and cooling-off periods that are typically only one or two days long—that purportedly ensure that borrowers are not caught in a debt trap. In reality, though, the data make clear that these payday industry-designed provisions do not prevent the cycle of debt. In Florida, for example, borrowers are limited to one outstanding loan at a time, may not roll over a loan, must wait 24 hours after paying off a loan before taking out another loan, and may enter a repayment plan at any point before they default for no charge. Despite these provisions, 63% of Florida loans go to borrowers with 12 or more loans per year, and 85% go to borrowers with seven or more loans per year.

Installment Payday Loans

The market for non-bank payday loans has become more complex in recent years, with many lenders also providing high-cost installment payday loans in which borrowers make multiple payments, rather than the traditional single balloon payment."[22] In some states—including Colorado, Illinois, New Mexico, and South Carolina—the installment product dominates the payday lending market. In many cases, these installment loans are so costly that they are the equivalent of a payday loan with multiple renewals effectively incorporated into the product.

In Illinois and Colorado, the move toward installment loans was precipitated by new state laws that regulated both the structure and pricing of payday loans. Despite legislative limits on the cost of these loans, payday installment loans in Illinois and Colorado are still very expensive, featuring triple-digit APRs. In other states—such as New Mexico, South Carolina, Missouri, Delaware, and Texas—payday lenders offer installment products as a way to evade even minimal regulatory requirements for single-payment payday loans, allowing them to operate in an environment with few or no regulatory restrictions.[23] For example, in Texas, although single- payment loans make up the majority of the payday loan volume in the state, some payday lenders also offer payday loans structured with installment

22 For more information on Illinois and Colorado, see Appendix 4.

23 For example, the New Mexico payday lending law applies only to loans of between 14 and 35 days that are secured by a post-dated check or ACH access. Martin (2010) wrote, "In the end, this narrow definition of payday lending defanged the legislation. The industry quickly switched to loan products that fell outside the statute, namely longer loans or those not involving a post-dated check; these loans are not regulated at all."

payments. EZCorp (EZMoney) advertises a payday installment loan with a 126-day term, carrying a 560% APR, resulting in $960 in charges for a $700 payday loan (EZ Money, 2013). Similarly, in Missouri, Advance America offers online payday loans payable in installments with a 182-day minimum loan term, carrying a 297% APR, resulting in $1,586 in charges for a $1,500 loan (Advance America, 2013).

Whether payday installment loans are explicitly authorized or made through subterfuge, their costs can be as excessive as single-payment payday loans. In Illinois in 2011, for example, borrowers paid more in interest than they received in principal for payday installment loans: $232.5 million in interest paid vs. $223.1 million in principal received. Indeed, Martin (2010) conducted interviews with New Mexico payday installment borrowers, which revealed that their experience differed little, if at all, from the single-payment payday borrowers. Despite their installment terms, these loans share the same troublesome characteristics as other payday loans: a lack of underwriting, requiring access to a borrower's bank account as security, and charging excessive fees that result in patterns of repeat borrowing.

LEGISLATION AND REGULATION

Historically, states had usury limits in place that prevented payday and other high-cost loans from being made. The storefront payday loan industry rapidly expanded when many states exempted payday lenders from these usury caps in the 1990s (Drysdale & Keest, 2000). Since then, the states and the federal government have ramped up their regulation of these products.

State Approaches to Regulation

The trend at the state level over the past decade has been toward greater scrutiny of payday lending products. Numerous states have ended the authorization of payday loans or put in place new limits; state voters have consistently supported ballot initiatives aimed at eliminating high-cost payday lending. For example, voters in Arizona and Montana voted to bring payday lenders under a 36% APR limit in 2008 and 2010, respectively. Similarly, in 2008, voters in Ohio defeated a ballot initiative that would have overturned the state's 28% APR payday loan rate cap.[24] In addition, since 2005, no state has authorized payday lending.

Numerous states have ended the authorization of payday loans or put in place new limits; voters have consistently supported ballot initiatives aimed at eliminating high-cost payday lending from states.

Appendix 5 lists the legal status of payday lending by state, divided into two categories:

- 29 states with no substantive restrictions on payday lending.
- 22 states, including the District of Columbia (DC), with significant payday lending reforms that either eliminate or limit the debt trap. Of these states, 16 states (including DC), which represent 34% of the U.S. adult population, have put in place rate caps that eliminate the payday lending debt trap. Six other states, representing 8% of the U.S. adult population, have enacted reforms that limit but do not completely eliminate the debt trap.

24 Despite this rate limit, payday lenders in Ohio are illegally offering very high cost payday loans by exploiting loopholes in the law. These illegal payday loans are under court scrutiny, with two courts having ruled that the loans are being made illegally and the Ohio Supreme Court set to weigh in. For more information on subterfuge in Ohio, see Rothstein (2009).

The Strongest Approach: Setting Maximum APRs to Eliminate the Debt Trap

Sixteen states, including DC, have ended or never allowed the payday debt trap by enforcing historic usury limits. Generally, these are around 36% APR. For example, New York subjects small-dollar loans to a 25% APR ceiling. Similarly, New Jersey has set a 30% ceiling and Arkansas a 17% ceiling. Pew (2012) concluded that in these most restrictive states without high-cost storefront payday lending, "95 of 100 would-be borrowers elected not to use payday loans at all—just five borrow online or elsewhere," such as through banks.[25] Importantly, in recent years, payday lenders have attempted to replace these rate limits with laws allowing 300% APR or higher but have been unsuccessful because of broad opposition from policymakers and their constituents in those states.

Laws that Decrease the Payday Lending Debt Trap

Several other states have sought to limit the payday lending debt trap through policies such as limiting the number of loans a borrower may take out in a year or extending the minimum loan term to up to six months. In Delaware and Washington State, for example, borrowers are limited to five and eight payday loans per year, respectively, which regulators enforce through the use of a statewide payday loan database.

Delaware's law went into effect in 2013, so no data are yet available. However, there is evidence that some national payday lenders have migrated to the state's installment lending statute in order to continue to offer unrestricted triple-digit-APR debt trap loans. If payday loans were the quick, emergency fix that they are marketed to be, then payday lenders should have been unaffected by the new law, which sought to curb the debt trap. That lenders are evading the law provides further evidence that long-term, repeat re-borrowing is at the core of the payday lending business model, as data from other states have consistently found.

Washington State, however, has strong underlying small loan laws that prevent similar evasion, and thus the state has been able to enforce and monitor its payday loan law. Figure 3 analyzes the Washington State data before and after the new law went into effect. The law appears to have been successful in greatly lowering the level of payday lending debt trap and associated fees in the state, along with the number of borrowers: Between 2009 (before the law went into effect) and 2011 (the most recent year of data after the law took effect), the number of payday borrowers decreased by 43%. In addition, the annual loan dollar volume decreased by 76% or over $1 billion; the number of annual loans decreased by 74% or 2.4 million; and the number of payday stores decreased from 603 to 256. As a result, borrowers paid $136 million or 75% less in annual payday loan fees.

Despite the limitation on the number of loans allowed per borrower and an increase in the allowable loan size to $700, the average loan size decreased by $30 (from $412 to $382). The average fee stayed

25 To determine this statistic, Pew (2012) asked borrowers in "permissive" states (that do not restrict payday lending) and "restrictive" states (that prohibit payday lending) whether they had used storefront or other types of payday loans (such as online or bank) in the previous five years. Permissive states averaged 522 storefront borrowers per 10,000 people over the five-year period, whereas restrictive states averaged 129 storefront borrowers per 10,000 people. (Restrictive state borrowers might have received a storefront loan before a change in the state law, moved between states over the five-year period, or crossed the border to a neighboring state with storefronts.) Researchers concluded that restrictive state laws led to 393 fewer storefront payday borrowers per 10,000 people (522-129). These are "would-be" payday borrowers. In addition, permissive states averaged 137 online/other payday borrowers per 10,000 people, whereas restrictive states averaged 158 per 10,000 people. This led to the conclusion that in restrictive states there are an additional 21 online borrowers per 10,000 people (158-137). By dividing the additional online borrowers (21) by the reduced storefront borrowers (393), researchers concluded that 95% of would-be borrowers do not use payday loans at all; only 5% take out loans through the internet and banks.

approximately equal, but the average APR decreased from 256% in 2009 to 182% in 2011, largely because the average loan term increased by nine days (from 19.6 days in 2009 to 28.7 days in 2011).

On average, borrowers took out substantially fewer loans in the wake of the new law. Whereas borrowers took out an average of 7.9 loans per year in 2009, in 2011 they took out an average of just 3.7 loans, a decrease of 54%. As a result, the average number of total days of payday borrower indebtedness decreased by 32%, from 155 days in 2009 to 105 days in 2011. This is a longer period of indebtedness than the three-month maximum level recommended in the 2005 FDIC guidelines, but it is substantially lower than before the law was implemented.

The vast majority of borrowers did not reach the eight-loan limit after the new loan went into effect; in 2011, 24% of customers reached the eight-loan limit, up from 16% in 2010. Customers reaching the eight-loan limit in 2011 were indebted on average 230 days of the year, well above the FDIC guideline recommendation.

Figure 3: Analysis of Washington State Data

	2009 (before new law)	2010 (after new law)	2011 (latest data under new law)	2011 vs. 2009
Total Loan Volume	$1,336,028,845	$434,111,743	$326,673,119	$1.0 billion (76%) lower
Total # Loans	3,244,024	1,093,776	855,829	2.4 million (74%) fewer
Total # Borrowers[1]	410,041	280,587	233,835	176,206 (43%) fewer
Avg # loans per borrower	7.9	3.9	3.7	4.3 (54%) fewer
Total Fees	$183.4 million	$61.3 million	$46.6 million	$136.8 million (75%) lower
Average Loan Term (in days)[2]	19.6	28.6	28.7	9.1 days longer
Average Total # Days of Indebtedness	155	111	105	50 days (32%) fewer
Average Loan Amount	$412	$397	$382	$30 lower
Average Fee Amount	$57	$56	$55	$2 lower
Average fee/$100 borrowed	$13.73	$14.12	$14.29	$0.56 higher
Average APR	256%	180%	182%	74 points lower
% of customers reaching 8-loan limit (approximately 230 days of indebtedness)[3]	N/A	16%	24%	N/A
# stores	603	424	256	347 (58%) fewer
Installment plan usage[4]	N/A	13%	10%	N/A

Source: Washington State Department of Financial Institutions Payday Lending reports for 2009, 2010, and 2011

1 The 2010 and 2011 figures are from the state's Department of Financial Institutions (DFI) report and represent data collected from a statewide database, including loans to a single customer from multiple lenders. The state did not have a database in place in 2009, and the DFI figure reported comes from reports to DFI from lenders covering 90% of the market.

2 This metric reported not from database but rather from reports filed by individual companies covering 90% of the market in 2009 and 96% of the market in 2010 and 2011.

3 As of Jan. 1, 2010, borrowers could take out a maximum of eight loans per year.

4 As of Jan. 1, 2010, all borrowers are entitled to an installment plan at any time prior to default.

Some states have codified extended loan terms under the theory that the balloon two-week payment is a key factor in creating the debt trap. For example, as highlighted in Appendix 4, Colorado effectively eliminated the traditional single-payment two-week payday lending model and moved borrowers to a high-cost installment product through enactment of a package of reforms in 2010. These reforms limited interest and fees,[26] made the origination fee proportionately refundable (thus lessening the incentive to churn loans), extended the minimum loan term to six months, and prohibited the sale of ancillary products.

Despite the six-month minimum loan term, in 2011—the first full calendar year in which the law was in effect—loans were repaid after an average of 104 days, or 3.5 months. However, borrowers took out an average of 2.3 loans from a single lender during the year and were in debt an average of two-thirds (240 days) of the year. This marks a substantial increase in total days of indebtedness over 2009 (the last full year that the balloon payment model was in effect), when borrowers took out 7.5 two-week loans from a single lender and were in debt 40% (147 days) of that year. Indeed, even with the provisions in the Colorado law in place to decrease the incentive to churn loans—such as proportionately refundable origination fees—lenders still have an incentive to flip loans in order to keep customers in debt over a longer period of time.

Total fees paid decreased from $95 million in 2009 to $54 million in 2011, a decrease of over $41 million (43%), in large part owing to the significant price restrictions in the new Colorado law. On average, in 2011, borrowers paid $282 in interest on an average initial loan of $380; in 2009, they paid $476 in fees annually on an average initial loan of $368. The number of Colorado payday borrowers appears to have decreased only slightly from 2009 (279,570) to 2011 (247,441).[27]

In addition to six-month payday loans, Colorado authorizes consumer installment loans of up to $1,000, but lenders may not hold a post-dated check with these loans. Consumer installment loans carry an average fee of $80, principal of $380, and loan term of 82 days, which equates to a 93% APR. Repeat refinancing is persistent in this market as well; for example, the Colorado Attorney General brought an enforcement action in 2010 against one national consumer installment company for refinancing loans in order to maximize fees (Gillentine, 2010).

Two other states have extended loan terms as part of their reform efforts. Virginia increased the minimum payday loan term to twice the length of a borrower's pay period and put in place a 45-day cooling-off period in which a borrower may not take out another payday loan after his or her fifth loan. However, Virginia also simultaneously increased the allowable fees, resulting in payday loans that carry the same or higher APRs as before the extended loan terms went into effect. Oregon has a 31-day minimum loan term, along with restricted fees (to 36% annual interest plus an origination fee of the lesser of $10 per $100 borrowed or $30). Less is known about the impact of these laws because data in the state regulators' annual reports are limited.

26 The 2010 law, which allows payday loans of up to $500 in principal, limits fees to 45% annual interest; plus a one-time finance charge of 20% of the loan amount up to $300 and 7.5% over $300; plus a monthly maintenance fee of $7.50 per $100 borrowed, up to $30, after the first month. Colo. Rev. Stat 5-3.1-105. These fees combine to cost 191% APR on the average contracted loan and are, importantly, refundable *pro rata* upon prepayment. They mark a significant reduction from the preceding law, which resulted in an average APR of 319%.

27 These figures likely overstate the number of borrowers because Colorado does not have a database to track borrowers across payday lenders; instead, when one borrower takes out payday loans from multiple lenders, he or she is counted as multiple borrowers.

The False Promise of Industry "Best Practices"

Many states that allow payday lending have codified industry-promoted "best practices" that supposedly offer strong consumer protections, such as renewal bans, one- or two-day cooling-off periods, and payment plans that give borrowers more time to pay off a loan. The data clearly show, however, that such laws do nothing to end the long-term debt trap for borrowers.

For example, payday lenders routinely circumvent renewal bans by having borrowers pay off their loan and immediately take out another or, if there is a short cooling-off period in place (generally 24-48 hours), taking out a new loan at the end of the cooling-off period. In "Springing the Debt Trap" (King & Parrish, 2006), CRL researchers found that in Florida and Oklahoma, which have codified these industry "best practices," about half of subsequent loans were opened at the borrower's first opportunity, and nearly 90% were made in the same pay period as the previous loan was paid off.

Some states have enacted laws codifying the industry best practice of allowing borrowers the option to request an extended payment plan. Though these plans seem to offer a way for borrowers to get out of payday loan debt, they rarely achieve this goal. Payday lenders often ensure that the terms of a plan are more expensive in the short term for borrowers, who would typically have to pay more to enter into a payment plan agreement than to simply renew their loan and pay a new fee.[28] In addition, although payday lenders are generally required to furnish borrowers with information about the availability of payment plans, they have little incentive to advertise these plans aggressively or cast them in a positive light.

Even in states with relatively consumer-friendly repayment plans, usage is infrequent. For example, Washington State allows anyone to enter an extended payment pan at any time prior to default for free. Under the extended payment plan, borrowers have between 90 and 180 days to repay the loan, depending on the original loan amount. Despite these seemingly consumer-friendly loan terms, in 2011, only 9.5% of loans were converted to installment loans under this option.

Finally, although a key feature of payday lending is that anyone with a checking account and a source of income can qualify for a loan, a few states have enacted limited "ability to repay" measures that purport to prevent borrowers from getting more money than they can afford to pay back. Requiring a real evaluation of the affordability of a payday loan is essential; unfortunately, however, key elements in determining a borrower's true ability to repay are absent in state laws. In general, these laws limit the total amount of payday loan debt to 20-25 percent of the borrower's gross (pre-tax) monthly income. However, the typical borrower takes out a payday loan for two weeks, rather than a month. This means that a person can qualify to take out a loan for 40-50 percent his or her gross income over a two-week period. Compounding this problem is that these provisions only consider pre-tax income.

Figure 1 shown previously highlights that a borrower earning $35,000 per year would not be able to afford a $350 loan even with no fee, yet the typical state ability-to-repay standard would allow that borrower to take out a payday loan for almost twice that amount ($673). Finally, existing ability-to-repay provisions fail to take into account a borrower's other legal obligations, such as a mortgage or rental payment, car loan, or minimum credit card payment, much less other recurring expenses. Without knowing these, it is impossible for a payday lender to accurately assess a borrower's ability to both repay the loan and meet other existing obligations.

28 For example, a borrower taking out a $325 loan pays just $52 to extend the loan (either through a direct renewal or by taking out a loan shortly after paying back the previous loan) compared with $94 to pay the first installment of a typical amortizing payment plan (King & Parrish, 2006).

EVASION ATTEMPTS

Payday lenders have attempted to evade consumer protections or offer loans in states where high interest rates are illegal. State and federal regulators have been generally successful at enforcing laws against these attempts. Examples include the following:

Rent-a-Bank: In the early 2000s, some large payday lending chains attempted to evade state anti-payday lending laws by partnering with small banks that may not be subject to state payday regulation. Federal banking regulators intervened to stop this practice in 2000 and 2005 by prohibiting rent-a-bank arrangements, and—in the case of the FDIC—establishing a 90-day borrower indebtedness limit in a 12-month period.[29]

Tribal lending: Tribal sovereign immunity generally bars states from enforcing their laws against Native American tribes, though federal laws and regulations still apply. Some payday lenders have sought to partner with Native American tribes for the specific purpose of offering loans otherwise not permitted by state or tribal law.

29 For more information, see the "Federal Approaches to Regulation" section to the right.

Federal Approaches to Regulation

Until the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) created the CFPB and gave it the power to regulate payday lenders, federal regulation of payday lending was limited. Nevertheless, the trend at the federal level, like that at the state level, has been to take steps to curb the payday lending debt trap, including through the following legislative and regulatory actions:

- In 2000, the Office of the Comptroller of the Currency (OCC) issued an advisory letter that put an end to the rent-a-bank scheme among its regulated banks, stating that "payday lending can pose a variety of safety and soundness, compliance, consumer protection, and other risks to banks." Noting that some payday lenders were partnering with banks, the advisory letter continued, "Payday lenders entering into such arrangements with national banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them" (OCC, 2000).

- In 2005, the FDIC issued payday lending guidelines that ended the "rent-a-bank" scheme in which payday lenders partnered with small banks in order to evade state law. Among other provisions, these guidelines advised against making a payday loan to a customer who had already been in payday loan debt for three months during a twelve-month period. In addition, in 2007, the FDIC issued affordable small-dollar loan guidelines "to encourage financial institutions to offer small-dollar credit products that are affordable, yet safe and sound, and consistent with all applicable federal and state laws" (FDIC, 2007). The 2007 guidelines advise that loans be reasonably priced, with a maximum APR of 36% and minimal or no fees, and repayable in affordable installments.

EVASION ATTEMPTS

Choice of law: While some internet lenders comply with the laws in the states in which they operate, others erroneously claim that "choice of law" allows them to comply only with the laws in the states in which they are headquartered (generally those with minimal or no payday loan regulations). State regulators have had some success in enforcing their own state laws, such as interest rate caps, against internet lenders when the borrower resides in their state. However, Fox (2011) highlighted that even when internet lenders technically comply with state laws, they sometimes still take loan applications for borrowers in these states and serve as lead generators, selling the information to other internet companies that are willing to make the loan in violation of the state's law.

Credit Service Organizations (CSOs): Under this scheme, lenders position themselves as credit services organization (CSOs) and broker loans on behalf of borrowers. This allows payday lenders to charge the maximum interest rate allowed on the underlying loan plus an additional brokerage fee. For example, a third-party lender might finance a $300 loan at the legal interest rate of 36% APR, receiving $4.14 in interest. The payday lender, posing as a CSO, would receive an additional $60 fee to serve as the broker—essentially to arrange for the loan and collect and guarantee the fee to the third-party lender. The borrower

- In 2006, Congress passed the Military Lending Act (MLA), which put in place for active-duty military and their families a 36% APR rate cap and prohibited the holding of a post-dated check as security for any credit product covered under the law. The law charged DoD with determining which credit products would be covered, and the 2007 DoD regulations included closed-end, but not open-end, payday loans. DoD has concluded that the law has worked to curb abusive lending practices, and military relief societies as well as financial counselors have reported limited use of these products. However, the narrow definition of covered credit under the regulations means that high-cost payday-like installment loans and open-end lines of credit remain legal.

  A recent amendment to the MLA has given the CFPB and the Federal Trade Commission enforcement authority over the law. The Conference Report accompanying the amendment also called for DoD to review the regulations to address continuing predatory lending and to report back to Congress within one year (U.S. House of Representatives, 2012). DoD recently solicited public comment as part of that review, seeking input in particular on the scope of credit that should be covered under the regulations. A diverse range of constituencies and state and federal policymakers urged a broad definition of covered credit to address current abuses and prevent circumvention of the law's intent.

- The Federal Trade Commission (FTC) has brought several enforcement actions against illegal online lending practices.[30] For example, in 2011, the FTC brought enforcement action against Payday Financial, also known as Western Sky Financial (doing business as Lakota Cash and Big Sky Cash), and its owner, Martin Webb. The FTC alleged that the defendants charged undisclosed and inflated fees and collected on loans by illegally threatening borrowers with arrests and lawsuits (FTC, 2011).

30 The Consumer Federation of America has compiled a list of FTC actions against payday lenders as of February 2012. This can be viewed at http://bit.ly/17jnlSO.

EVASION ATTEMPTS

would pay $64.14 in total fees for a two-week, $300 loan, resulting in an APR of over 550%.

This type of subterfuge has been shut down in nearly every state in which the payday lenders have attempted it (including California, Maryland, Florida, and Michigan). In the two remaining states (Texas and Ohio),[31] it is currently under scrutiny—by the legislature in Texas and by the courts in Ohio.

Despite these attempts at evasion, states with interest rate caps that prohibit high-cost payday loans have been very successful in enforcing those laws. In fact, Pew (2012) found that only 1.29% of adults in the most restrictive payday states report having borrowed from a payday storefront over the prior five years, and only 1.58% of residents in those states had borrowed online or from another source (such as a bank).

31 For more information on subterfuge in Ohio, see Rothstein (2009).

In 2012, the FTC brought enforcement action against several defendants, including AMG Services, Inc. (doing business as 500FastCASh and USFastCash) and one of its owners, Scott Tucker. According to the FTC, the defendants violated a wide range of federal consumer protection laws—including the Federal Trade Commission Act, the Truth in Lending Act, and the Electronic Fund Transfer Act—when they claimed they would charge borrowers a one-time finance fee and instead "made multiple withdrawals from borrowers' bank accounts and assessed a new finance fee each time, without disclosing the true costs of the loan. The defendants also falsely threatened that consumers could be arrested, prosecuted, or imprisoned for failing to pay and that the defendants would sue them if they did not pay" (FTC, 2012).

Currently, the CFPB has the power to supervise, bring enforcement actions, and regulate all payday lenders, regardless of size or type. This means that for the first time, payday lenders receive supervisory scrutiny even when they are located in states with little or no regulation. The Bureau also has the authority to use its Unfair, Deceptive or Abusive Acts and Practices (UDAAP) authority to bring an end to the debt trap.

POLICY RECOMMENDATIONS

The following policy provisions would address the payday lending cycle of debt:

- Congress should enact a 36% APR limit applicable to all borrowers, similar to what it enacted for active-duty military and their families in the Military Lending Act.
- The CFPB should promulgate regulations that require payday lenders to:
  - determine borrowers' ability to repay the loan and afford their regular expenses without taking out another payday loan.
  - limit the length of time payday lenders can keep borrowers in debt, consistent with the FDIC's 2005 payday loan guidelines, which limit payday loan indebtedness to a maximum of 90 days over a twelve-month period, the equivalent of six two-week loans or three 30-day loans.
  - prohibit lenders from requiring a post-dated check or electronic access to the borrower's checking account as a condition of extending credit.
- Federal regulators—including the Department of Justice, FTC, and CFPB—should use their enforcement authority against payday lenders to address violations of law.
- States should continue to put in place 36% APR limits applicable to payday loans.
- States should vigorously enforce their laws against unlicensed lenders and should work in partnership with federal regulators to address attempts at subterfuge.
- In addition to implementing substantive protections, the CFPB should continue to collect and make public detailed data on payday loan use, and states that do not collect or make public such data should do so.

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Appendix 1: Cost of Payday Loan Churn in States without Meaningful Regulation of Payday Lending

State	Total Cost of Churn with One Month Definition (82% multiplier)	Total cost of Churn With Two-Week Definition (76% multiplier)
Alabama	$190,295,996	$176,371,899
Alaska	$4,648,090	$4,307,986
California	$474,226,587	$439,527,081
Florida	$256,373,927	$237,614,860
Hawaii	$2,690,567	$2,493,696
Idaho	$26,961,607	$24,988,807
Illinois	$5,759,916	$5,338,459
Indiana	$57,856,740	$53,623,320
Iowa	$30,559,714	$28,323,637
Kansas	$53,658,898	$49,732,637
Kentucky	$92,496,000	$85,728,000
Louisiana	$148,679,862	$137,800,848
Michigan	$89,135,094	$82,613,014
Minnesota	$7,419,962	$6,877,038
Mississippi	$213,795,260	$198,151,704
Missouri	$102,425,544	$94,930,992
Nebraska	$26,373,448	$24,443,684
Nevada	$63,735,185	$59,071,635
New Mexico	$3,854,000	$3,572,000
North Dakota	$5,658,000	$5,244,000
Oklahoma	$44,526,000	$41,268,000
Rhode Island	$5,785,099	$5,361,799
South Carolina	$51,250,000	$47,500,000
South Dakota	$28,170,921	$26,109,634
Tennessee	$162,777,305	$150,866,771
Texas	$559,839,898	$518,876,003
Utah	$21,559,843	$19,982,294
Wisconsin	$18,416,597	$17,069,041
Wyoming	$8,841,523	$8,194,582
Total	**$2,757,771,584**	**$2,555,983,419**

We use the most recent data available from each state's payday lending regulator and provide estimates in states with limited or no data. The data exclude loans from banks and unlicensed lenders.

Appendix 2: Average Number of Loans Per Borrower Per Year

Average Number of Loans Per Borrower Per Year in States without Meaningful Regulation of Payday Lending

State	Average # loans per borrower	Total # loans in state	Total # borrowers
Florida	8.8	7,338,912	833,967
Kentucky	10.0	2,079,822	207,982
New Mexico	6.4	83,022	12,934
Oklahoma	8.8	1,026,417	116,638
South Carolina	7.9	1,063,945	135,155
TOTAL		11,592,118	1,306,677
Weighted avg	**8.9**		

These statistics imply that a borrower on average receives one non-churn loan and eight flips, based on findings from CRL's "Phantom Demand "(Parrish & King, 2009). This translates into a borrower paying back $504 in fees alone for $346 in non-churn principal, given a median loan size from state regulator data of $346 and median fee of $56. This compares with CFPB (2013), which found that the typical borrower takes out ten loans from a single lender during the year, paying $458 in fees alone for $350 in non-churn principal.

Average Number of Loans per Borrower in States that Limit the Payday Lending Debt Trap

State	Average # loans per borrower	Total # loans in state	Total # borrowers
Colorado[1]	2.3	444,333	247,441
Oregon[2]	3.9	131,757	33,833
Virginia[3]	3.2	470,062	147,162
Washington[4]	3.7	855,829	233,835
Weighted avg	**3.5**		

1 Colorado has a six-month minimum loan term, coupled with a fee limitation and restrictions on repeat refinancing. For more information on Colorado, see Appendix 4.

2 The minimum loan term in Oregon is 31 days, and fees are limited to 36% APR plus 10% of the principal borrowed, up to $30.

3 The minimum loan term in Virginia is two pay periods, and there is a mandatory 45-day cooling-off period after the fifth payday loan in six months, enforceable through a database.

4 Washington State limits the number of payday loans to eight per year, enforceable through a database.

These data highlight that states that have enacted significant reforms short of an APR have had some success in lowering the rate of loan churn. Whereas in low-regulation payday states, the average loans/borrower is nearly 8, in these states with some structural changes to limit the debt trap, it is less than half that (3.5). However, the number of loans is not always indicative of the number of days of indebtedness; for example, in Colorado—where the average annual number of loans is 2.3—the average annual days of indebtedness is 240.

Appendix 3: Payday Lending Statistics by State

Payday Lending Statistics for States without Meaningful Regulation of Payday Lending

State	# of Stores	Source[1]	Avg. # loans/ store[2]	Payday Loan Dollar Volume (Including Churn)[3]	Source	Total Payday Fees[4]	Source	Avg. Loan Amt.[5]	Source
Alabama	1,070	Regulator	3,541	$1,326,104,500	Estimated	$232,068,288	Estimated	$350	Assumed
Alaska	34	Regulator	2,550	$34,900,146	Regulator	$5,668,403	Estimated	$403	Regulator
California	2,119	Regulator	5,797	$3,276,629,497	Regulator	$578,325,106	Estimated	$263	Regulator
Florida	1,275	Regulator	5,756	$2,906,456,786	Regulator	$312,651,131	Regulator	$396	Regulator
Hawaii	15	Stephens	3,541	$18,590,250	Estimated	$3,281,179	Estimated	$350	Assumed
Idaho	213	Regulator	2,170	$165,060,286	Regulator	$32,880,009	Imputed	$357	Imputed
Illinois	522	Regulator	265	$46,020,498	Imputed	$7,024,288	Imputed	$333	Regulator
Indiana	376	Regulator	4,220	$502,850,000	Regulator	$70,557,000	Regulator	$317	Regulator
Iowa	218	Regulator	3,904	$294,098,537	Regulator	$37,267,944	Imputed	$346	Regulator
Kansas	352	Regulator	3,541	$436,251,200	Estimated	$65,437,680	Estimated	$350	Assumed
Kentucky	578	Regulator	3,598	$677,500,000	Regulator	$112,800,000	Regulator	$326	Regulator
Louisiana	931	Regulator	3,541	$1,153,834,850	Estimated	$181,316,905	Estimated	$350	Assumed
Michigan	646	Regulator	3,541	$800,620,100	Estimated	$108,701,335	Estimated	$350	Assumed
Minnesota	74	Regulator	4,572	$127,043,568	Regulator	$9,048,734	Regulator	$376	Imputed
Mississippi	1,036	Regulator	3,541	$1,283,966,600	Estimated	$260,725,926	Estimated	$350	Assumed
Missouri	934	Regulator	2,505	$716,320,800	Imputed	$124,909,200	Imputed	$306	Regulator
Nebraska	180	Regulator	3,527	$182,225,167	Imputed	$32,162,742	Regulator	$350	Assumed
Nevada	339	Stephens	3,541	$420,139,650	Estimated	$77,725,835	Estimated	$350	Assumed
New Mexico	121	Regulator	686	$31,200,000	Regulator	$4,700,000	Regulator	$375	Regulator
North Dakota	56	Regulator	1,940	$34,800,000	Regulator	$6,900,000	Regulator	$320	Regulator
Oklahoma	358	Regulator	2,867	$404,600,000	Regulator	$54,300,000	Regulator	$394	Regulator
Rhode Island	29	Regulator	6,327	$70,549,986	Regulator	$7,054,999	Estimated	$385	Imputed
South Carolina	367	Regulator	2,899	$416,200,000	Regulator	$62,500,000	Regulator	$391	Imputed
South Dakota	126	Stephens	3,541	$156,158,100	Estimated	$34,354,782	Estimated	$350	Assumed
Tennessee	1,208	Regulator	3,791	$1,124,696,366	Regulator	$198,508,909	Estimated	$221	Regulator
Texas	2,617	Regulator	2,240	$3,061,174,112	Imputed	$682,731,583	Imputed	$522	Regulator
Utah	116	Regulator	3,541	$142,121,576	Estimated	$26,292,492	Estimated	$346	Regulator
Wisconsin	423	Regulator	603	$76,652,781	Regulator	$22,459,265	Imputed	$300	Regulator
Wyoming	87	Regulator	3,541	$107,823,450	Estimated	$10,782,345	Estimated	$350	Assumed
Total	**16,420**			**$19,994,588,807**		**$3,363,136,078**			

Notes: The data exclude loans from banks and unlicensed lenders. We use the most recent data available from each state as of the writing of this report. In general, "regulator" indicates a metric directly reported by the state regulator. "Imputed" refers to a metric that is imputed from other data directly reported from a regulator. For example, an average fee could be imputed by dividing total fees by the number of loans. "Estimated" means a metric that we estimated using assumptions that we outline below.

1 When regulator data were unavailable, we used the figures from the 2011 Stephens, Inc. annual report (based on 2010 payday loans).

2 We estimated the average number of loans per store for states that do not provide these data by calculating the weighted mean from the states that do so. This weighted mean is 3,541.

3 For states that did not report payday loan volume, we estimated it by multiplying the number of payday stores in the state times the average number of loans per store (3,541) times the median loan size from CFPB (2013) ($350).

4 For states that did not report total fees, we estimated it by using the statutory maximum rate, since the evidence shows that payday lenders charge the maximum allowable amount. For states with no statutory maximum, we used the median rate charged by storefront lenders that publish their rates.

5 For states that did not report average loan amount, we assumed the $350 median from CFPB (2013).

Appendix 3: Payday Lending Statistics by State (Continued)

Payday Lending Statistics for States that Impose Some Significant Restrictions on Payday Lending

State	Payday Loan Dollar Volume	Source	Total Payday Fees	Source	Avg. Loan Amt.	Source
Colorado[6]	$167,042,409	Regulator	$54,054,658	Regulator	$379	Regulator
Maine[7]	The Maine regulator does not collect overall loan dollar volume or fee figures. However, in an email on file with the author, the Principal Credit Examiner noted that there were only seven payday lending storefronts in the state. The email stated, "Of the licensed payday lenders in Maine, the bigger companies, such as Republicash, did more business in Maine. The total [dollar] volume of loans reported by some of the larger companies ranged from about 1 million to about 4 million per year. Some of the smaller, Maine-based companies reported much less in volume with a range of approximately a few thousand dollars up to $50,000 per year. This trend has not changed in the last few years."					
Oregon[8]	$66,174,976	Regulator	$7,279,247	Regulator	$266	Regulator
Washington[9]	$326,673,119	Regulator	$46,666,858	Regulator	$382	Regulator
Virginia[10]	$185,679,381	Regulator	$42,047,046	Estimated	$395	Regulator

6 Colorado has a six-month minimum term, coupled with a fee limitation and restrictions on repeat refinancing. For more information on Colorado, see Appendix 4.

7 Maine prohibits the advance of money on a post-dated check except for "supervised lenders" and limits fees to $5 for loans up to $75, $15 for loans from $75.01-$250, and $25 for loans over $250.

8 The minimum loan term in Oregon is 31 days, and fees are limited to 36% APR plus 10% of the principal borrowed, up to $30.

9 Washington State limits the number of payday loans to eight per year, enforceable through a database.

10 The minimum loan term in Virginia is two pay periods, and there is a mandatory 45-day cooling-off period after the fifth payday loan in six months, enforceable through a database.

Appendix 4: Analysis of Colorado and Illinois Payday Installment Lending Data

COLORADO ANALYSIS

Colorado 2011 Installment Data (First Full Year of Installment Loan Data)

Total Loan Volume	Total # Loans	Total # of Borrowers[1]	Total contracted fees	Total actual fees	Avg. contracted loan size	Avg. contracted fee	Avg contracted loan term (days)
$167,042,409	444,333	279,570	$105,439,820	$54,054,658	$375.45	$236.99	188

Avg. contracted APR	Avg. actual loan	Avg actual fee	Avg. actual loan term (days)	Avg. actual APR	Avg # loans per borrower[2]	Avg total # days of indebtedness
191%	$379.39	$122.77	104	131%	2.3	240

		% of Borrowers
Total # loans paid in full in 2011	297,985	
Paid in full within one month of origination	40,367	14%
between 1-2 months	41,797	14%
between 2-3 months	38,705	13%
between 3-4 months	41,110	14%
between 4-5 months	43,439	15%
more than 5 months	92,567	31%

Source: Regulator report.

1 This figure may overstate the number of borrowers because Colorado does not have a database in place to track borrowers across lenders; instead, when one borrower takes out payday loans from multiple lenders, he or she is counted as multiple borrowers.

2 This figure comes from Colorado regulator examination results published in the state's 2012 publication "Payday Lending Demographic and Statistical Information."

Appendix 4: Analysis of Colorado and Illinois Data (Continued)

COLORADO ANALYSIS

Colorado 2009 Payday Data (last full year before new law implemented)

$576,242,827	Total payday loan dollar volume
1,565,481	Total # of loans
279,570	Total # borrowers[3]
$95,087,316	Total Fees
$368.09	Avg. Loan Size
$60.74	Avg. Fee
319%	Avg. APR
18.9	Avg. loan term (days)
7.8	Avg. # loans per borrower[4]
148	Avg. total # days of indebtedness

Source: Regulator report.

3 This figure may overstate the number of borrowers because Colorado does not have a database in place to track borrowers across lenders; instead, when one borrower takes out payday loans from multiple lenders, he or she is counted as multiple borrowers.

4 This figure comes from Colorado regulator examination results published in the state's 2010 publication "Payday Lending Demographic and Statistical Information."

Difference, 2009 vs. 2011 (Before and After New Law)

Change in loan volume	($409,200,418)	(71%)
Change in total fees (using actual 2011 fees)	($41,032,658)	(43%)
Change in avg. total # of days of indebtedness	92	62%
Change in # of borrowers	(32,159)	(12%)

Appendix 4: Analysis of Colorado and Illinois Data (Continued)

ILLINOIS ANALYSIS

Illinois Installment Payday Loans

Month	# Transactions	Total principal	Total fees
July 2011	9,038	$5,211,518	$5,751,358
August 2011	40,266	$23,157,656	$24,710,181
September 2011	32,889	$18,543,177	$19,888,700
October 2011	33,444	$19,104,433	$20,572,643
November 2011	34,638	$20,526,126	$21,577,037
December 2011	46,336	$28,181,000	$29,131,885
January 2012	30,612	$17,687,605	$18,148,319
February 2012	19,504	$11,517,621	$11,695,991
March 2012	27,082	$16,087,086	$16,415,875
April 2012	34,025	$20,444,034	$20,971,113
May 2012	39,626	$24,080,864	$24,267,715
Total	347,460	$204,541,120	$213,130,816
Monthly Average	31,587	$18,594,647.25	$19,375,529
Year estimate	379,047	$223,135,767	$232,506,345
		Average loan amount	Average fee amount
		$588.68	$613.34

Appendix 4: Analysis of Colorado and Illinois Data (Continued)

ILLINOIS ANALYSIS

Illinois Balloon Payday Loans

Date	Transaction volume	Advance Amount	Fees
July 2011	2,476	$868,598	$129,153
August 2011	12,980	$4,401,897	$670,326
September 2011	12,509	$4,137,631	$630,337
October 2011	13,079	$4,302,481	$656,815
November 2011	13,036	$4,276,771	$653,910
December 2011	15,126	$5,087,072	$775,759
January 2012	13,222	$4,400,352	$673,079
February 2012	9,510	$3,217,219	$492,062
March 2012	10,814	$3,550,186	$543,618
April 2012	11,914	$3,932,698	$601,685
May 2012	12,948	$4,305,554	$657,213
Total	127,614	$42,480,460	$6,483,958
Monthly Average	10,635	$3,540,038	$540,330
Year Estimate	138,249	$46,020,498	$7,024,288
		Average loan amount	Average fee amount
		$332.88	$50.81
Total Loan Volume (installment & balloon)	$269,156,265		
% of loan volume installment	83%		
% of loan volume balloon	17%		
Total fees (installment & balloon)	$239,530,632		
% of fees installment	97%		

Appendix 5: Legal Status of Payday Loans By State

States with No Meaningful Regulation of Payday Lending (29 total)
Alabama
Alaska
California
Florida
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
Michigan
Minnesota
Mississippi
Missouri
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Rhode Island
South Carolina
South Dakota
Tennessee
Texas
Utah
Wisconsin
Wyoming

Appendix 5: Legal Status of Payday Loans By State

States that Eliminate or Limit the Payday Debt Trap (22 Total)

States and DC that Eliminate the Payday Debt Trap Through APR Limits (16 total)	States with Reforms that Limit but Do Not Eliminate the Payday Lending Debt Trap (6 total)
Arizona	Colorado[2]
Arkansas	Delaware[3]
Connecticut	Maine[4]
District of Columbia	Oregon[5]
Georgia	Washington[6]
Maryland	Virginia[7]
Massachusetts	
Montana	
New Hampshire	
New Jersey	
New York	
North Carolina	
Ohio[1]	
Pennsylvania	
Vermont	
West Virginia	

1 Ohio law—which voters elected not to overturn in a 2008 referendum—limits payday loans to 28% APR, with a 31-day minimum loan term and a maximum of four loans per borrower per year. Nevertheless, payday lenders are illegally exploiting loopholes and continuing to make triple-digit two-week loans. The payday lender evasion of the law is currently under court scrutiny. For more information, see Rothstein (2009).

2 Colorado has a six-month minimum loan term, coupled with a fee limitation and restrictions on repeat refinancing. For more information on Colorado, see Appendix 4.

3 Delaware limits borrowers to five loans per year, enforceable through a database, although there is evidence that national lenders are evading Delaware's law by migrating to the state's installment lending statute in order to continue unfettered triple-digit-APR debt trap loans.

4 Maine prohibits the advance of money on a post-dated check except for "supervised lenders" and limits fees to $5 for loans up to $75, $15 for loans from $75.01-$250, and $25 for loans over $250.

5 The minimum loan term in Oregon is 31 days, and fees are limited to 36% APR plus 10% of the principal borrowed, up to $30.

6 Washington State limits borrowers to eight loans per year, enforceable through a database.

7 The minimum loan term in Virginia is two pay periods, and there is a mandatory 45-day cooling-off period after the fifth payday loan in six months, enforceable through a database.