CENTER FOR RESPONSIBLE LENDING

Payday Loan Quick Facts: Debt Trap by Design

Diane Standaert, 919-313-8550, dianes@responsiblelending.org *July 2014*

QUICK FACTS

- Payday loans cost, on average, over 300% APR.
- According to the U.S. Department of Defense, "*The debt trap is the rule not the exception.*"
- Payday loans drain over $3.4 billion annually in excessive fees.
- Over 75% of all fees to payday lenders are generated by borrowers with more than 10 loans a year.
- Payday borrowers are more likely to experience bankruptcy, delinquencies on other bills, and delayed medical care.
- Nearly 1 in 4 payday borrowers report some form of public assistance or other benefits or retirement funds as an income source.

Payday lenders market their loans as a quick financial fix, but in reality they create a long-term cycle of debt and even worse problems, such as delayed medical care and bankruptcy. Payday loans are typically $350 and come with these features:

-An annual percentage rate (APR) of 391%
-No underwriting to determine affordability
-Direct access to the borrower's account (a post- dated check or electronic authorization)
-Single-balloon payment with a quick due date

These features combine to create a loan designed to trap borrowers. But all of these elements need not be present for loans to create a debt trap. Some payday loans are structured to have multi-payments, but these are the effective equivalent of a series of short-term, single-payment payday loans. Payday lenders know that borrowers typically cannot repay the loan *and* cover their basic living expenses. Once the loan is paid back, payday lenders quickly lend them another. Payday lenders repeat this cycle over and over and over again. This is the payday loan debt trap.

Payday Lenders Depend on the Debt Trap

According to a U.S. Department of Defense report, "*The debt trap is the rule not the exception.*"[1] In the words of the CEO of Cash America, one of the nation's largest payday lenders: *"The theory in the business is 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."*[2] Payday loans drain over $3.4 billion annually from borrowers,[3] with the large majority paid by borrowers caught in the trap. The Consumer Financial Protection Bureau found that over 75% of payday loan fees were generated by borrowers with more than 10 loans a year. [4]

The Payday Loan Debt Trap Harms Borrowers

According to the Center for Responsible Lending, 76% of all payday loans are taken out within two weeks of a previous payday loan.[5] The cycle of debt means borrowers are paying new fees every two weeks to float the same payday loan – the typical payday borrower will pay over $450 in fees for a $350 loan. Payday loans lead to a cascade of financial consequences such as bankruptcy, delinquencies on other bills, delayed medical care, overdraft fees and the loss of bank accounts.[6]

Public Policy is Trending Against Payday Lending

Today, 21 states—home to over 40% of Americans—prohibit or significantly restrict the payday loan debt trap. Since 2007, seven states (including the District of Columbia) have established meaningful reform to address payday lending —while no state without payday lending has authorized it since 2005. After the U.S. Department of Defense released a report on the harms of payday loans and other high-cost products, Congress enacted a 36% rate cap and other protections on payday loans made to active-duty military families. In states without payday loan storefronts, there is no evidence of increased online payday loan borrowing.[7] Without the payday loan debt trap, individuals fare better, as they no longer face the burden of a 300% APR payday loan every two weeks.[8]

Policy Recommendations

- Congress and the states should enact the strongest protection possible against payday lending: An interest rate limit of about 36% annually has been the most effective way to ensure loans are structured affordably.

- The CFPB should issue regulations that require lenders to determine the borrower's ability to repay the loan and afford their regular expenses without taking out another loan, and that limit the length of time lenders can keep borrowers in debt.

- Policymakers should ensure that borrowers' checking accounts— especially income, like Social Security benefits, that is used to pay for necessities—are protected from the effective wage assignment that payday lending creates. Lenders should be prohibited from requiring, or effectively requiring, access to borrowers' checking accounts as a condition of making a loan.

---

[1] U.S. Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (2006), http://bit.ly/DoDPaydayReport

[2] Dan Feehan, CEO of Cash America, at a Jeffries Financial Services Conference in 2007

[3] Center for Responsible Lending, *State of Lending in America: Payday Lending* (2013), http://bit.ly/CRLStateofLending

[4] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings,* April 24, 2013, http://bit.ly/CFPBPaydayPaper

[5] L. Parrish & U. King, Center for Responsible Lending, *Phantom Demand* (2009), http://bit.ly/CRLPhantom; See also, *CFPB Data Point: Payday Lending*, March 25, 2014 (finding that 82% of all loans are renewed within 14 days of a prior loan).

[6] See, e.g., P.M. Skiba & J. Tobacman, *Do Payday Loans Cause Bankruptcy?* (2008); B. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market* (2011); D. Campbell, A.S. Jerez, & P. *Tufano*, *Bouncing Out of the Banking System* (2011)

[7] Pew Charitable Trust, "Payday Lending in America," July 2012, http://bit.ly/pewpaydayreport

[8] See, e.g. N.C. Commission on Banks, "NC Consumers After Payday Lending," (2007): http://bit.ly/NCafterpayday