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 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." 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.” Payday loans drain over $3.4 billion annually from borrowers, 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.

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. 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.
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.

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\(^2\) Dan Feehan, CEO of Cash America, at a Jeffries Financial Services Conference in 2007


