Statement of Uriah King on release of
“Springing the Debt Trap”
December 13, 2007

Good afternoon. I am Uriah King, policy associate with the Center for Responsible Lending and co-author of today’s new report, “Springing the Debt Trap.” I would like to thank Representative William Batchelder of Ohio and Delegate Harvey Morgan of Virginia, for sharing their insights on today’s call and especially for their outstanding work to help secure the financial well-being of families in the great state of Ohio and commonwealth of Virginia. I would also like to express my personal appreciation to Carol Hammerstein for her invaluable editing and Leslie Parrish, co-author of “Springing the Debt Trap,” and senior researcher at the Center for Responsible Lending.

For this report, which analyzed millions of payday loan transactions across a number of states, we found the following:

First: the debt trap of payday lending – the long-term, high-cost lending imposed on what were originally short-term borrowers – continues to persist.

Second: this debt trap continues even in states that have tried to address repeat borrowing through measures such as renewal bans and payment plans, while still allowing lenders to charge triple-digit rates.

And finally: a dozen states, and now the District of Columbia, which have taken a different approach by including payday lending under their small loan rate caps of around 36% are saving their citizens billions of dollars while preserving responsible credit options.

Payday loans are marketed to borrowers as a fast, convenient way to meet an emergency financial need, such as a car breakdown. And the typical payday loan is two weeks or less with all the principal and interest coming due on borrower’s next payday. The loan is collateralized with access to the borrower’s bank account, most often by a post-dated personal check.

However, the problem with payday loans is that the high cost of about 400% in interest, coupled with the fact that the entire amount is due in two short weeks, traps borrowers hoping for a quick solution into long-term, high-cost debt they cannot afford to pay off.

In today’s paper, we show how in a dozen states, and now the District of Columbia – one of every four people in America – are now saving their citizens $1.5 billion every year in abusive fees by including payday lending under their small loan rate caps – typically set at or around 36 percent. Moreover, this savings means more money is available for housing, food and utilities than is available to comparable families in states with payday lending.

Not only does a 36 percent rate cap weed out abusive lending, it preserves and encourages a more responsible small loan market. Recent research from the University of North Carolina (www.unc.ccc.edu) on behalf of the North Carolina Commissioner of Banks, drew conclusions from direct interviews with past payday borrowers. The researchers found that low- and middle-income survey respondents do not miss payday lending and that borrowers found a number of cheaper options in addressing financial emergencies. For example, our paper today documents a 37 percent increase in consumer finance loans since 2002. One credit union alone saved their members over $30 million in excessive fees while generating nearly $10 million in new savings for these same borrowers.

But today's report also talks about what doesn't work.

Some states have allowed payday lenders to operate with virtually no restrictions. Others have solved their payday lending problem with the interest rate cap. And a third group has tried to create a middle ground by passing measures that put restrictions on payday loans while exempting them from interest rate caps. Unfortunately, this middle ground is still quicksand for borrowers.

In these states that have tried to place certain restrictions on payday lending, without including a reasonable rate cap, the debt trap persists. The industry often supports these measures, because they already know they will not stop the repeat borrowing they need to survive. None of the measures have worked:

We find that renewal bans and cooling-off periods do not work.

Limits on the number of loans outstanding do not work.

Payment plans do not work.

Capping the loan amount based on a borrower's income does not work.

Databases which only enforce already ineffective provisions do not work

In this report, we find that 90 percent of payday lending business is still generated by trapped borrowers, even in states that have attempted reform. We also find that 60 percent of payday loans go to borrowers with 12 or more transactions per year—that's at least one every month. And 24 percent—nearly one quarter of payday lenders' total revenues—comes from borrowers with 21 or more transactions per year.

Data from the state of Colorado shows that one in seven borrowers have been in payday debt <u>every day</u> of the past six months. And another telling figure in our report: nearly 90 percent of repeat payday loans are made shortly after a previous loan was paid off. This is evidence that borrowers are going right back into the same payday debt, rather than paying their loan off for good.

The simple truth is that borrowers who do not have cash for an emergency in between paydays will not have the money to pay off a 400 percent balloon payment plus all their other bills. So what happens? Overwhelmingly, we find that borrowers must take out loan, after loan, after loan, before truly paying off their debts to the payday store.

Not only is this how payday loans work. It is intended to work this way. Like earlier research, we find that the payday loan business model is dependent upon taking borrowers who want a short-term loan and pushing them into long-term, 400 percent interest rate debt. Even the industry acknowledges how important repetitive borrowers are to their profitability.

This is in stark contrast to the talking points policymakers hear from payday lenders, who say that their high rates are not a big deal, because their loans are short-term. It doesn't make economic sense to go cross country in a taxi, they say, but it might across town from the airport. The difference between the cab company and the payday lender is that the payday lender depends on long-term use. It's the families that need support the most who bear the costs of this deception.

Payday loans are designed to keep borrowers in debt they cannot afford to pay off. The only proven way for state policymakers to stop this abuse is to enforce a comprehensive small loan law with an interest rate cap at or around 36 percent.

We will now hear from a state legislator who learned the hard way, and another who is determined to end the debt trap in his state.

Thank you.