

PREDATORY PAYDAY LENDING TRAPS BORROWERS



Many working families live from paycheck-to-paycheck. When these families experience an unforeseen expense, some products marketed as emergency loans seem to offer a solution. But they almost invariably lead these families further into financial crisis.

Research shows that payday lending, also known as cash advance or deferred deposit, fails to help families solve their financial crises. There are many more payday borrowers trapped in loans than there are occasional users—ninety-nine percent (99%) of payday loans go to repeat borrowers. Instead of benefiting borrowers, payday loans trap them in high-cost debt.

PAYDAY LOANS CREATE A DEBT TRAP FOR BORROWERS

To qualify for a payday loan, borrowers need only a bank account and a steady income. They write a post-dated

personal check and exchange it for cash from the lender. But payday lenders typically allow borrowers just two weeks to repay, and borrowers frequently find that they cannot come up with the cash to pay back their loan so quickly.

Without adequate funds in their bank account, the lender's possession of a signed check becomes a major problem for the borrower. If the lender deposits the check, the borrower will be assessed bounced check fees from the lender and from their own bank. The borrower may even fear going to jail for "writing a bad check."

So to avoid default, the borrower agrees to renew the loan and pay the interest fee again. The lender either keeps the same loan outstanding, or reopens it in a back-to-back transaction. Payday borrowers get trapped in this cycle of debt, forced to pay the interest every two weeks to avoid default, often for months or

years. On a loan of \$325 (with a typical APR of over 400%), that interest is typically \$52 every two weeks, or \$104 every month.

Fees from these trapped borrowers are the lifeblood of the payday lending industry. A 2003 CRL study found that borrowers with five or more loans per year account for 91 percent of payday lenders' business. A University of North Carolina study likewise found that the financial success of payday lenders depends on their ability to cultivate repeat borrowers who take out at least one loan per month.

An August 2004 statement issued by Advance America, the largest payday lender in the nation, placed the average number of loans to its borrowers at 9 per year. Many borrowers take loans from second and third lenders as they try to manage a worsening crisis, making the number of loans per year even higher.

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FAST FACTS

Ninety-nine percent (99%) of payday loans go to repeat borrowers.

The average payday borrower is flipped 8 times by a single lender.

African-American neighborhoods have 3 times as many payday stores per capita as white neighborhoods in North Carolina, even when income is taken into account.

Proximity to military bases is a powerful predictor of a high number of payday loan shops, according to two university researchers.

The average payday borrower pays \$800 to borrow \$325.

We have previously estimated that predatory payday lending costs American families \$3.4 billion annually. That cost is increasing rapidly, as the size of the market explodes.

CRL MISSION

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions. Please visit our website at www.responsiblelending.org.



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PREDATORY PAYDAY LENDING Continued

WORKING FAMILIES AT RISK

The 22,000 payday loan shops operating nationwide are disproportionately located near military bases and in African-American neighborhoods. These shops are generating excessive interest fees from up to 15 million working families per year.

Says NAACP chairman Julian Bond, "The NAACP is dedicated to eliminating payday lending, because wealth-building and saving for the future are vital to the economic success of communities of color."

The Department of Defense lists payday lending as one of the top ten key issues impacting the quality of life of U.S.

soldiers. A December 2004 analysis by the *New York Times* reveals that at least one fourth of military households (26%) have been caught up in payday lending. And Admiral J.L.

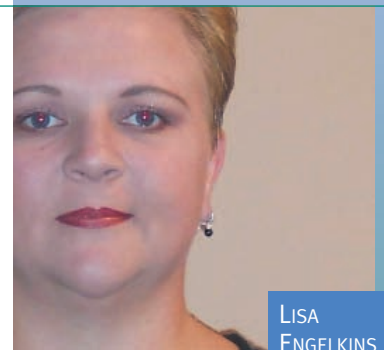
Johnson, a former member of the Joint Chiefs of Staff, stated in a Consumers Union report, "There can be no question that military families are among the 'targeted group.'"

THE RENT-A-BANK PROBLEM

Payday lending is illegal in fourteen states, but in many of those states national chains use partnerships with out-of-state banks to get around the law. They also use this arrangement, known as the rent-a-bank model, to avoid limits on interest rates and other provisions in states that do authorize payday lending. For example, payday lending

is legal in Texas, but the state has the highest number of rent-a-bank shops in the country, collecting fees in excess of the triple-digit interest rate limit in Texas.

Three of four federal regulators (the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve Board) have acted to prevent the financial institutions they regulate from partnering with payday lenders. However, the Federal Deposit Insurance Corporation (FDIC) still tolerates the rent-a-bank subterfuge by its member institutions.



LISA
ENGELKINS

BEHIND THE NUMBERS: *Personal Tragedies*

Lisa Engelkins was making just above minimum wage when she was flipped 35 times, paying \$1,254 in interest to extend a \$255 payday loan.

Mary Hamilton (name changed), a 62-year-old Fayetteville, NC woman pays 40 percent of her monthly income of \$1000 in interest to keep from defaulting on her payday loans.

Arthur Jackson (name changed), a 69-year-old warehouse worker, renewed his Advance America payday loan every payday for over five years. He was flipped over a hundred times, paying over \$5,000 in interest for a loan of less than \$300, causing him to fall behind on his mortgage payments.

POLICY RECOMMENDATIONS

- Strong state legislative action is needed to protect citizens from predatory payday lenders. CRL recommends emergency loan products with these features:
 - A minimum loan term of 90 days to enable borrowers to recover from financial emergencies;
 - Repayment in installments (with no prepayment penalty) to enable borrowers to get back on their feet incrementally;
 - Full consideration of borrowers' ability to repay the loan;
 - No use of personal check (or electronic equivalent) as loan collateral to stop punitive civil collection actions and accumulation of bounced-check fees, and to remove fear of criminal prosecution;
 - Meaningful limits on rollovers, extensions, and back-to-back transactions to stop loan flipping; and
 - No mandatory arbitration clause.
- We recommend that states follow the examples of Georgia, Maryland and other states that are strengthening enforcement provisions to protect their citizens from the attempts of out-of-state lenders to avoid state regulations through rent-a-bank.
- Finally, CRL opposes the tolerance of rent-a-bank activity by the FDIC, which should bar, rather than encourage, this evasion of state consumer protection law.

SCOPE OF WORK

CRL's staff includes attorneys, researchers, and policy analysts in North Carolina and Washington, DC who study and report on predatory lending matters and monitor legislative and regulatory activity in state capitols and in the US Congress. CRL's work has five main components:

Policy and Technical Assistance: sharing market and legal knowledge with advocates and policymakers across the country interested in reforming lending practices.

Research: conducting and publishing research on predatory lending to inform policymakers, advocates, and others on its extent and impact on borrowers and communities.

Coalition-Building: supporting national and state organizations concerned about predatory lending.

Litigation: partnering with other advocates to advance predatory lending litigation and submitting legal briefs on important issues of law.

Communications: promoting public awareness of predatory lending issues and providing a web-based archive of information for local legislators and advocates.

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