Predatory Payday Lending by Banks on the Rise

Short-term loan carries 365%-plus APR

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Contact: Rebecca Borné, (202) 349-1868

- **At least four large banks are making payday loans directly to their customers, and more plan to do so.**
- **Bank payday loans trap borrowers in debt, like the street corner payday loans that strip $4.5 billion per year from Americans. Bank payday loans often send borrowers into financial devastation.**
- **Bank payday lending circumvents state consumer protections; undermines the Pentagon's protection of military personnel; and harm economically vulnerable communities and families.**

How Bank Payday Loans Work. Banks make payday loans by depositing money into a customer's checking account. The bank then automatically repays itself in full by deducting the loan amount, plus fees, from the account when the customer's next direct deposit paycheck or other benefits income comes into the account. ***The average annual percentage rate (APR) based on a typical loan term of 10 days is 365% APR***.[i]

> *"I was* ***stuck in payday loan hell*** *when I banked with Wells Fargo."*
>
> User of Wells Fargo payday loan, commenting in an online forum

The Payday Lending Debt Trap. These electronic payday loans have the same structure as street corner payday loans—and the same problems. The balloon repayment and short term combine to stack the deck against already cash-strapped customers. Because customers must use such a large share of their incoming paycheck to repay the loan, they will often run out of money again before their next payday, forcing them to take out another loan and starting a cycle of borrowing at high rates every pay period. The banks permit customers to remain trapped in these 300%-plus APR loans month after month, even while they claim that "installment options" or "cooling-off periods" make this high-cost product acceptable.[ii] These so-called "protections" are not effective: In reality, CRL's recent research of actual checking account activity found that ***bank payday borrowers are in debt for 175 days per year*** (twice as long as the *maximum* length of time the FDIC has advised is appropriate).[iii]

> *"Many [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken."*
>
> Wells Fargo insider quoted in "120% rate for Wells' Advances," by David Lazarus, San Francisco Chronicle, Oct. 6, 2004.

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Undermining State Law. Payday loans are banned or significantly restricted in 18 states and the District of Columbia, as several states have re-instituted interest rate caps in recent years, and others never allowed these loans to be part of their small loan marketplace.[iv] But banks claim a right to disregard these state laws—a claim that has so far enjoyed cover from the banks' federal regulators. As a result, millions of borrowers who would otherwise be protected are made vulnerable to this abusive high-cost debt.

Impact on Communities of Color. Payday lending has a disparate impact on communities of color.[v] By making payday loans, banks hurt these communities financially rather than fulfill their obligations under the Community Reinvestment Act to provide the communities they serve with appropriate financial services. Banks may also risk violation of the Equal Credit Opportunity Act and other fair lending laws.[vi]

> *"A drive through minority neighborhoods clearly indicates that people of color regardless of income are a target market for legalized extortion. Payday lending is an economic drain that threatens the livelihoods of hardworking families and strips wealth from entire communities."*
>
> Julian Bond, Former Chairman, NAACP

Threat of Closed Bank Accounts. A Harvard Business School study found that payday lending increases the odds that households will repeatedly overdraft and ultimately lose their checking accounts.[vii] In their payday loan disclosures, banks warn of overdraft fees, negative credit reporting, and closed bank accounts should a customer's direct deposit not come in as scheduled.[viii]

Evading Federal Protections for the Military; Harming our Troops. In 2006, Congress capped interest rates on payday loans to active-duty members of the military and their families at 36% APR. This law grew out of concern from the Department of Defense and base commanders that troops were being trapped in high levels of payday loan debt. This debt not only burdened military families, it also threatened security clearances—and by extension military readiness. Banks' attempts to structure their payday loans to evade the federal law once again puts our troops at risk.

> *"This problem with... payday lending is the most serious single financial problem that we have encountered in [one] hundred years."*
>
> Admiral Charles Abbot, USN (Ret.), president, Navy-Marine Corps Relief Society, testifying before U.S. Senate Banking Committee, Sept. 14, 2006

A Big Bank Drag on Economic Recovery. U.S. taxpayers have been supporting our nation's banks by providing bailouts and access to credit at interest rates as low as 1%. This makes bank payday lending at 360% APR especially unconscionable. Payday lending makes it difficult for working families to stay afloat and, as a consequence, drags down economic recovery.

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[i] Center for Responsible Lending Research Brief, *Big Bank Payday Loans*, July 2011, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf. This cost, 360% APR, assumes a fee of $10 per $100 borrowed, the cost at most banks offering payday loans, for a 10-day loan term. One bank, Wells Fargo, charges $7.50 per $100 borrowed, which results in a 270% APR for a 10-day loan term.

[ii] According to Wells Fargo's Direct Deposit Advance Service Agreement and Product Guide Addendum effective 2/19/2011, after a customer uses this product for 6 consecutive statement periods, the credit line available to the customer decreases by $100 a month until either the credit limit reaches $0 or the customer does not request an advance for an entire statement period. This allows a customer to remain in debt for 330 days per year.

[iii] *Big Bank Payday Loans, supra.*

[iv] High-cost single-payment payday loans are not authorized by law in the following states/jurisdictions: Arkansas, Arizona, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Jersey, New Hampshire, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. Although interest rate caps vary by state, most are about 36 percent APR. In a few instances, payday lenders attempt to circumvent state protections by structuring their loans to operate under other loan laws not intended for very short-term, single payment loans.

[v] In California, payday lenders are 2.4 times more concentrated in communities of color, even after controlling for income and a variety of other factors. State surveys have found that African Americans comprise a far larger percentage of the payday borrower population than they do the population as a whole. Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis, *Predatory Profiling The Role of Race and Ethnicity in the Location of Payday Lenders in California*, Center for Responsible Lending (March 26, 2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf

[vi]The OCC's 2000 guidance on payday lending cautions that the product "may foster abusive pricing or discriminatory steering of borrowers to high cost payday loans" and therefore lead to violation of the Equal Credit Opportunity Act (ECOA). The guidance further cautions that failure to comply with ECOA and other fair lending laws may lead to "various administrative actions, including enforcement actions to address violations and to ensure appropriate corrective action; lawsuits; and civil penalties." *OCC Advisory Letter on Payday Lending, AL 2000-10* (Nov. 27, 2000).

[vii] An increase in the number of payday lending locations in a particular county is associated with an 11 percent increase of involuntary bank account closures, even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*. June 6, 2008.

[viii] If a customer does not receive a direct deposit within 35 days, the bank automatically repays itself from the customer's account anyway, even if the withdrawal makes the customer's account balance negative. Wells Fargo' account agreement includes the following disclosure: "If there are insufficient funds in your Linked Consumer Checking Account at the time of the Automatic Repayment, your account will become overdrawn when the outstanding advance is repaid and any other transactions posting to your account that day would be subject to overdraft or insufficient funds fees. If you cannot repay your overdrawn balance and fees, you risk closure of your Linked Consumer Checking Account and negative information may be reported to consumer reporting agencies. This may impact your future ability to open a deposit account or qualify for credit." Wells Fargo, Direct Deposit Advance Service Agreement and Product Guide, effective April 2011, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

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