The Payment Plan Smokescreen

Guidelines Fail to Address the Debt Trap

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PAYDAY INDUSTRY HIDES BEHIND INEFFECTIVE BEST PRACTICES

- The payday industry's "new" guidelines are already proven failures. Any reliance on them for legislative reforms will also fail.
- In states that have legislated these guidelines, the debt trap persists. Nearly two of every three loans still go to borrowers with twelve or more loans per year and less than one percent of transactions use the "mandatory" payment plan.
- The only proven solution to stop the payday debt trap is to enforce a state's two-digit usury cap.

No Financial Incentives for Payday Lenders to Stop the Debt Trap

Payday loans are short-term cash advances on a borrower's next paycheck, secured by a post-dated check. To qualify for a payday loan, borrowers need only a checking account and a steady income. The borrower gives the payday lender a personal check and receives cash, minus the lender's fee, which is generally $15 for every $100 borrowed—the equivalent of about 400 percent APR. Despite the payday association's marketing of payday loans for short-term use only, only one loan in a hundred goes to the one-time borrower and over 90 percent of loans go to borrowers trapped in a cycle of debt. Rather than helping people bridge a financial gap, these loans have led to financial ruin.

Because payday lenders earn the vast majority of their revenue from these trapped borrowers, industry representatives will not support proposals that effectively stop payday loan flipping. In fact, experience shows that policymakers should <u>expect</u> circumvention and illusory concessions from the industry; payday lenders have the strongest of incentives – any rule that seriously addresses the cycle of debt means a drastic, if not fatal, reduction of revenues to predatory payday lenders.

Facing increasing scrutiny of the problems caused by payday lending, the industry trade group recently announced a new public relations campaign that claims to address the problem

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership 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.

For additional information, please visit our website at **www.responsiblelending.org**.

of loan flipping by requiring its lenders to offer borrowers an extended payment plan. However, this plan will not give borrowers a viable option for escaping the debt trap, and a description of the guidelines suggests lenders will offer the plan to borrowers in trouble only once per year despite the fact that the typical borrower has nine loans per year.

All Smoke, No Fire for Renewal Bans

Community Financial Services Association (CFSA) has publicized their list of best practices over the years, but while they may sound helpful at first glance, they have not reduced the problem of loan flipping.

For example, CFSA has long claimed to limit payday loan "renewals" for their members. But the renewal ban has been a failure, as lenders merely change the way they "flip" borrowers from rollovers to back-to-back transactions. So instead of having the borrower keep the same $300 loan outstanding by paying another $45 fee, the lender has the borrower pay off their initial loan and then immediately take out a new $300 loan for a $45 fee. Trapped borrowers also take additional loans at other payday stores or use another borrower's name from a joint checking account to originate a "new" loan.

These types of transactions keep the borrower trapped just as simple renewals do.

Payment Plans Have No Impact on the Debt Trap

Variations of the payment plans have already been incorporated into law in several states and have had extremely low take-up rates, even though the vast majority of borrowers cannot pay off their payday loans and instead must flip them every two weeks.

Payment plan use is low because they are often <u>unaffordable</u> for the trapped borrower. Most borrowers have to pay more to enter into the payment plan than they would to simply flip their loan (which can be accomplished through a back-to-back transaction if rollovers are prohibited). For example, a borrower that took out a $300 payday loan carrying an interest rate of 390 percent would have to come up with $45 to renew the loan in full or pay their first installment of a payment plan of $86. This $40 difference could have a large impact on a family cash-strapped enough to take out a payday loan, so the structure of payment plans leads them to fail.

Many payday borrowers "borrow from Peter to pay Paul," taking out multiple payday loans from multiple payday companies. When borrowers don't have the funds to repay the original payday lender, they walk down the block and get a second payday loan to pay back the first and so on. For these borrowers, payment plans are particularly inaccessible. For example, if a borrower has three payday loans outstanding, they would need to come up with $258 ($86 x 3) to enter into the repayment plan with all these lenders at once. If they start the repayment plan with only one shop, they don't have the money to repay the other lenders. This means that borrowers without considerable front-end cash (i.e. those most likely to take a payday loan to begin with) simply cannot afford to enter into a payment plan.

As the following examples illustrate, in the states where a payment plan is already in place, the debt trap continues for borrowers. While Oklahoma and Washington State have formal payment plan options, Florida employs a 60-day grace period, where borrowers can take additional time to pay back their loans without additional fees and interest, which functions in a similar way.

	Average Loans per Borrower per Year	% of Loans Employing Payment Plan or Grace Period	% of Loans to Borrowers with 5 or More Loans/Yr.	% of Loans to Borrowers with 12 or More Loans/Yr.
Florida	8	0.5%	89%	57%
Oklahoma	9	0.4%	91%	66%
Washington	8	0.8%	90%	58%
National Average	9		90%	62%

Usury rate caps offer effective payday lending reform

Because the payday lending business model depends on repeat borrowing by trapped consumers, any reform or consumer protection proposed by the payday lending industry must guarantee that borrowers continue to flip their loans every payday, month after month. As demonstrated by the states that already incorporate payment plans into their payday lending regulations, this type of "protection" is no exception.

Across the country, the only states that successfully prevent the predatory aspects of payday lending are those that enforce a usury rate cap that applies to all small loan lenders. In these 11 states, households in need of short-term credit turn to responsible credit options rather than triple-digit interest rate payday loans, saving a collective $1.4 billion in predatory fees each year.[*]

Congress has followed suit, passing a law to prevent military families from being charged more than 36 percent on payday loans. The FDIC is also concerned with this type of high-cost credit, and is actively encouraging banks under its purview to craft and market small loan products at 36 percent or less.

Policymakers in states with payday lending should look to these models when addressing payday lending abuses and be wary of industry-supported concessions that are purported to end the payday lending debt trap.

[*] For more information, see CRL's report, *Financial Quicksand*, available at www.responsiblelending.org