Center for Responsible Lending | Since 2002

36% Cap on Annual Interest Rate Stops Payday Lending Debt Cycle

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Payday loans, high-cost small loans averaging $350 that usually must be repaid in a single payment after two weeks, are designed to create a long-term debt trap. A 36% annual interest rate cap on payday loans (inclusive of fees) most effectively stops the cycle of debt.

Currently 18 states and the District of Columbia have enacted rate caps of 36% or less. Since 2005, no new state has authorized high-cost payday lenders. States can and must continue to enact strong protections, such as a rate cap of 36% annual interest or less, to stop the payday debt trap.

What's the Problem with Payday Lending?

Triple-Digit Interest Rate + Debt-Trap Design

= Devastating Financial Damage

What's the Solution?

A Rate Cap on Annual Interest of

36% or Less

Is the Most Effective Reform

Triple-Digit Interest Payday Loans Trap Borrowers in Long-Term Debt

In states without reasonable caps on the annual percentage rate of interest (APR) for payday loans, the annual interest rate is in the triple-digits, **averaging about 400% and rising as high as 664%.**

One Borrower's Story

Arthur, a 69-year-old warehouse worker and grandfather of seven, started with a loan of $200 from Advance America. He eventually increased the loan amount to $300. Every payday, rather than defaulting or coming up short on bill money, Arthur went into the Advance America store and paid a fee of $52.50 so Advance America would not deposit his check. Advance America flipped the loan over a hundred times, until his total interest paid was an estimated $5,000.

(Source: loan documents on file with CRL).

While lenders attempt to justify these absurdly high rates based on the two-week terms of most payday loans, these loans cost many times more than most alternatives, and these lenders obscure the fact that the terms are designed to turn two-week loans into months- or years-long debt traps. (See APR Matters for a breakdown of these arguments.)

Research from the Consumer Financial Protection Bureau shows that the repeat cycle is the business model of payday lenders. Lenders collect **75% of their fees from borrowers with 10 or more** loans per year. Payday lenders succeed by making sure their customers fail.

The practice **drains billions of dollars per year** from local economies and from families who can least afford it. It is associated with a cascade of financial harms, including the inability to keep up with other household expenses,

including groceries and bills, and repeat overdraft or insufficient funds fees, which in turn lead to involuntary bank account closures. Borrowers even file for bankruptcy at higher rates than similarly situated consumers.

Disproportionate Impact on Communities of Color

Research has repeatedly found that payday lenders concentrate in communities of color. In other words, payday lenders engage in a type of reverse redlining, locating primarily in communities that have been historically and systematically deprived of mainstream financial services in order to extract fees on the false promise of access to credit.

Greater concentrations of payday lending stores in majority Black, Latino and Native American communities, even after controlling for income, have been documented across the country. These disproportionate impacts have been found in studies undertaken in California, Rhode Island, Florida, Louisiana, Arizona, Texas and North Carolina.

> "A drive through any low-income neighborhood clearly indicates people of color are a target market for legalized extortion…Visits to payday stores…are threatening the livelihoods of hardworking families and stripping equity from entire communities."
>
> *The late Julian Bond,*
> *former national chairman of the NAACP*

Widespread, Bipartisan Support for Rate Caps, Before and After Passage

Support for capping payday loans at rates of 36% annually or less remains strong across the country and in multiple states where citizen polls have been conducted. A national poll released December 2022 found that 76% of likely voters favored lowering interest rates on payday and other high-cost loans to 36%, with strong support across all party lines. Those states that have passed 36% caps by ballot measure have seen margins leaning heavily toward approval, including Nebraska, where a citizen's initiative passed by 83% in 2020.

Thousands of groups and individuals across the country have endorsed the cap, including faith groups, financial counselors, housing advocates, advocates for working families, military groups and civil rights groups. In Illinois, the rate cap passed in 2021 was a legislative priority of the Illinois Legislative Black Caucus. The Michigan Governor's Black Leadership Advisory Council has also called for a 36% rate cap in their 2022 report.

In states that have passed caps, former borrowers express relief that they are gone and report a range of resources for covering a cash shortfall that do not have the harms of payday lending. Polls in South Dakota and Illinois after passage of caps show strong support among voters and no interest in a return of triple-digit interest rates to their states.

Map of U.S. Payday Interest Rates | Center for Responsible Lending.

What about larger loans?

Recently, larger loans with longer terms have taken a greater share of the market. These loans can also carry triple-digit interest rates, and create a larger, longer debt trap.

For loans larger than small payday loans (which typically range from $300-$500), a 36% annual interest rate is too high and a lower rate cap should apply. The larger the loan balance, the lower the interest rate should be.