APR Matters

Allows True Comparison; Reveals Astronomical Cost of Payday Loans

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Payday lenders often describe the cost of their loans in terms of fees or simple interest rates. Responsible lenders readily disclose the APR on their loans, aligned with the Truth in Lending Act (TILA)[i]. They are not afraid to let their customers compare the costs of their loans to other loans in the market. Tellingly, payday lenders often object to having to disclose the APR of their loans.

Simple Interest versus APR

When you pay to borrow money, it matters how long you carry the loan. If you carry it for one year, a 15% simple interest rate equals a 15% Annual Percentage Rate (APR). If you carry it for six months, that's a 30% APR, because you have half the time to pay it back.

Unlike simple interest, APR includes fees. Payday lenders frequently try to hide the true cost of their loans by describing the cost in fees, or adding fees outside the interest rate.

APR functions similarly to Miles Per Hour (MPH) in expressing speed, taking account of both distance and time. For example, if the speed limit is 60 MPH, that applies whether you're driving 2 miles, 60 miles, or 100 miles.

APR is so fundamental to responsible lending, that federal law has long required lenders to reveal the APR on loan documents, through the Truth in Lending Act (TILA).

Why APR Matters

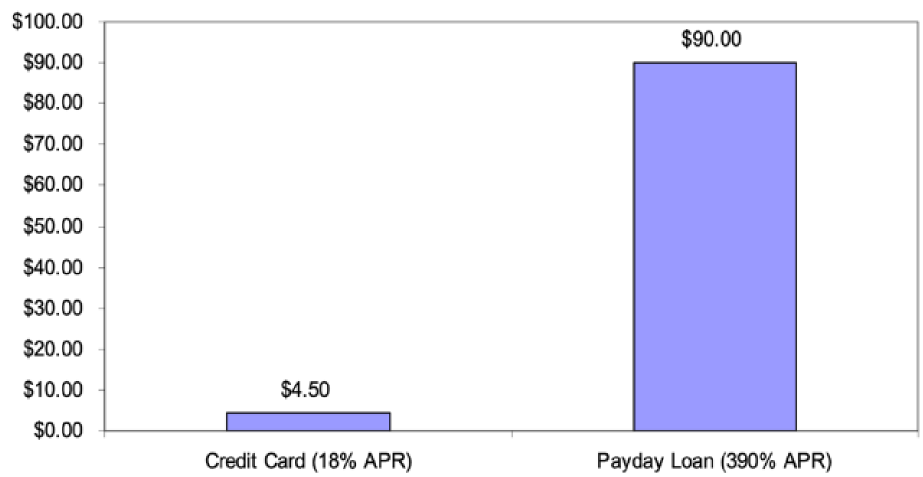
Payday lenders do not like disclosing APR for two reasons. **One, it allows a true comparison of the cost with other forms of credit**, even those that are short-term like a credit card advance. The real cost of payday loans is so expensive that distracting borrowers away from the way the cost compared with other loans makes it easier to lure borrowers in.

Two, although traditional payday loans are marketed as being for short-term use, **research shows many of these loans are refinanced and extended for months or years.** By their design, payday loans create a cycle of long-term debt for borrowers, so the APR reveals the high cost of the loans over the duration of the cycle.

Reason One: Apples-to-Apples Cost Comparison

Consumers have a variety of options available to meet short-term cash flow needs, as described in this CRL report, [Shark Free Waters: States are Better Off without Payday Lending](). Not all are forms of credit, but if we take just one example, that of a typical credit card cash advance, we can easily see the high cost of a payday loan in comparison, based on APR.

Figure 1: Cost of borrowing $300 over 30 days, in dollars



The APR is a shorthand way of comparing true cost

Figure 1 illustrates why it's important to have all lenders adhere to the same rules of the road, when disclosing costs. If borrowers compare the payday loan's 15% simple interest rate to the 18% APR for a credit card, the payday loan seems cheaper. However, a $300 credit card charge with an 18% APR carried over 30 days would cost the borrower **$4.50**, while a two-week payday loan, carried for one month (two terms at $45 per term) would cost the borrower **$90**.[ii]

Reason Two: APR Reveals Astronomical Cost of the Long-Term Debt Trap

The repeat cycle of debt is the norm for payday lending, not the exception. The terms are designed to ensare borrowers in a debt trap, and the lender has access to the borrower's bank account. The typical borrower ends up reborrowing multiple times in order to pay back their prior loans, and 75% of payday lending revenue comes from borrowers with ten ***or more*** loans per year.[iii]

At triple-digit APRs, this cycle of debt has devastating consequences for borrowers, including increased difficulty paying bills, delayed medical spending, involuntary bank account closure, higher likelihood of filing for bankruptcy, and decreased job performance.[iv]

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. The clerks knew him by name and often had his paperwork ready for him when he came in.

(Source: loan documents on file with CRL).

Recommendations

Eighteen states and the District of Columbia have capped payday loans at around 36% annual interest, protecting their citizens from the significant harms of payday lending. There is significant bipartisan support[v] for 36% rate caps, and several states have passed 36% rate cap ballot measures by wide margins, including Nebraska, where 83% of voters supported a 36% rate cap.

- State legislatures should pass rate cap laws that limit APR/annual interest to no more than 36% for payday loans, including all fees.

- Congress should pass a federal cap of 36% APR to protect those families who live in states without sufficient protections.

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[i] CFPB Laws and Regulations TILA. (April 2015). 201503_cfpb_truth-in-lending-act.pdf (consumerfinance.gov)

[ii] The cost of a credit card cash advance, which gives consumers direct access to cash, includes additional fees, typically 3-5% of the loan amount. In that case, a $300 cash advance on the same credit card with an 18% APR plus a 5% cash advance fee carried over 30 days would cost $19.50 ($15.00 in fees + $4.50 in interest), still substantially less than a payday loan.

[iii] Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings (April 2013). 201304_cfpb_payday-dap-whitepaper.pdf (consumerfinance.gov)

[iv] Howarth, Robin, Delvin Davis and Sarah Wolff. Shark Free Waters: States are Better Off without Payday Lending. (Updated September 2017). Microsoft Word - crl_shark_free_waters_aug2016.doc (responsiblelending.org)

[V] Morning Consult, commissioned by the Center for Responsible Lending. (January 2020). New Morning Consult Poll Shows Broad, Bipartisan Support among Voters for 36% Interest Rate Cap on Payday and Installment Loans. January 2020.