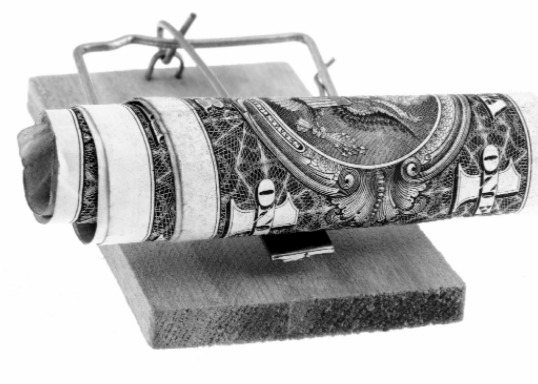

Springing the Debt Trap:

Rate caps are only proven payday lending reform

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CENTER FOR RESPONSIBLE LENDING

www.responsiblelending.org

Payday lenders in public:

"Since a payday advance is a short-term solution to an immediate need, it is not intended for repeated use in carrying an individual from payday to payday. When an immediate need arises, we're here to help. But a payday advance is not a long-term solution for ongoing budget management. Repeated or frequent use can create serious financial hardships."
- Community Financial Services Association, *the FACTS about payday advance services* information brochure, 2005.

Payday lenders in private:

"And the theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is."
- Dan Feehan, CEO of Cash America, remarks made at the Jefferies Financial Services Conference (6.20.07)[1]

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EXECUTIVE SUMMARY

Payday lenders argue that charging 400 percent annual interest is the only way their business model can be profitable. Some states have responded by exempting payday lenders from the interest rate caps imposed on small loans in general. Perhaps this special treatment would be justified if payday loans provided a strong public benefit, but the experience of borrowers shows the reverse. The vast majority of families taking out payday loans are ensnared in long-term debt, making them worse off than they would be without high-cost payday lending.

A payday loan typically ranges from $300 to $500 and is secured by a personal check. It is marketed as a short-term advance on the borrower's next paycheck, but the high price and the fact that it must be paid off in one lump sum two short weeks later virtually ensures that cash-strapped borrowers will be unable to pay off their loan with a single paycheck and still meet their basic expenses.

Payday lenders justify payday loans and their high costs because they are short-term loans that get borrowers past an immediate shortfall. To give payday lenders the benefit of the doubt in our definition of the debt trap, we assume that a borrower may have one of these shortfalls every quarter—this reasoning would justify four loans per year. When borrowers receive greater than this number, we can assume that the difficulty in repaying the short-term balloon debt has forced the borrower to convert that short-term loan into long-term, high-cost debt. The borrower is therefore caught in a debt trap—a cycle of debt they cannot afford to pay off for good.

States approach payday lending in one of three ways. Some allow payday lenders to operate with virtually no legal restrictions. Others enforce an interest rate cap at or around 36 percent on small loans, inclusive of payday lending. And a third group attempts to create a middle ground where payday lenders can charge triple-digit interest rates with certain restrictions intended to make sure that payday loans don't create a debt trap for borrowers.

In this paper, we evaluate the efficacy of this third approach. We find:

- The debt trap of payday lending persists even in states that have attempted to reform the practice. In these states, 90 percent of payday lending business is generated by trapped borrowers with five or more loans per year.

  More evidence that the debt trap persists:

  - Over 60 percent of loans go to borrowers with 12 or more transactions per year;
  - 24 percent of loans go to borrowers with 21 or more transactions per year;
  - One of every seven Colorado borrowers have been in payday debt every day of the past six months; and
  - Nearly 90 percent of repeat payday loans are made shortly after a previous loan was paid off.

- As implemented in any state, none of these restrictions have stopped payday lending from trapping borrowers in long-term debt:
    - Renewal bans/cooling-off periods
    - Limits on number of loans outstanding at any one time
    - Payment plans
    - Loan amount caps based on a borrower's income
    - Databases which enforce ineffective provisions
    - Regulations that narrowly target payday loans

- Those states which enforce a comprehensive interest rate cap at or around 36 percent for small loans have solved their debt trap problem; realizing a savings of $1.5 billion for their citizens while preserving a more responsible small loan market.

In sum, the only proven way for state policymakers to protect their citizens from predatory small loans is to enforce a comprehensive small loan law with an interest rate cap at or around 36 percent.

BACKGROUND

Payday loans are secured by access to the borrower's checking account, most commonly through a post-dated check or an automated clearinghouse (ACH) authorization. Marketed to low- and moderate-income consumers as a quick and easy solution to an unexpected expense, these loans are generally due in about two weeks—on the borrower's next payday. Costs vary state-by-state but lenders typically charge the maximum rate permitted by state law, with the average being $16 per $100 borrowed.[2] For the average $325 loan, this would equate to a fee of $52 for two weeks or an annual percentage rate (APR) of about 400 percent.

Payday lenders argue that the APR is not a valid measure of the cost of a payday loan. They claim their product is short term, when in fact most borrowers' experience with payday loans is one of long-term debt. Consideration of APR is important because it allows consumers to compare the cost of credit across products of varying terms. For example, it allows borrowers to compare a two-week payday loan, a six-month credit union signature loan, and an open-ended credit card cash advance. Indeed, the Federal Reserve notes that APR and other protections provided under the Truth in Lending Act allow for "uniformity in creditors' disclosures [which are] intended to assist consumers in comparison shopping."[3]

How Payday Loans Work

A customer seeking a payday loan needs only identification, a checking account, and proof of income from a job or government benefits. Payday lenders do not require the borrower to disclose debts or other obligations that would allow the lender to fully assess the borrower's ability to repay the loan, nor is the borrower's credit history taken into account. The borrower provides the lender with a personal check for the amount of cash they are receiving that day plus the fee. For the average $325 loan, a check might be written for $377 (the $325 principal plus a $52 fee). The lender promises not to cash the check until the loan comes due, usually on their next payday.

The day the loan comes due, the borrower has several options. If the borrower has the funds to pay back the loan, the borrower can return to pay it off or simply allow the lender to cash the check. If the borrower cannot pay back his or her payday loan and get by until the next paycheck, which is frequently the case, the borrower must renew the loan, paying an additional $52 fee to extend the loan another two weeks. In states where renewals are not allowed, borrowers pay off the loan in full and then take out another payday loan either immediately or within a few days, commonly called a back-to-back transaction. Either way, the cost to the borrower is the same.

History of the Payday Lending Industry

While payday lending in its current form has a relatively short history, it is rooted in the long-illegal practice of "wage buying" from the late nineteenth and early twentieth century. Lenders, often called "wage buyers" or "salary lenders," would make a loan to borrower in exchange for the borrower relinquishing their right to collect a certain portion of their future wages. A typical borrower might receive $5 on a Monday in return for promising to pay the lender back $6 on Friday.[4] This 20 percent fee on a one week loan translated to triple digit annual interest rates well in excess of interest rate caps.

Wage buyers argued that they were not subject to these caps because they were purchasing future wages at a discount in return for the immediate "sale" of the borrower's next paycheck—in other words, charging a fee for service as opposed to originating a loan. Some wage buyers, in addition to the contractual transaction outlined above, would require a check, arguing that this was necessary as "collateral" for the loan. Similar to today's payday borrowers, workers assigning their future wages often could not pay back the entire loan amount when due, and instead had to roll over their debt repeatedly.[5]

States responded to these abusive lending practices in the early and mid 1900s by enacting strong regulations for small consumer loans with interest rate caps ranging from 24 to 42 percent. These interest rate caps largely remain in place for consumer lending, with a median rate of 36 percent among all states. Additionally, many of these small loan laws prohibited wage assignments, comprehensively defined interest and required installments, effectively banning balloon payments.[6]

The modern version of payday lending first appeared in Kansas City in the late 1980s, and gradually grew into a full-fledged industry over the next decade. Payday lenders require that borrowers submit a personal check that can be cashed on the borrower's next payday. Like their predecessors a century ago, payday lenders argue against applying state interest rate caps to their loan product and have successfully received special exemptions that allow them to charge an average of 390 percent APR.

> ***"When used frequently or for long periods, the costs [of a payday loan] can rapidly exceed the amount borrowed and can create a serious hardship for the borrower. The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending."***
>
> FDIC press release, 2005

In addition, even states that did not grant a special exemption of their interest rates for payday loans or did not authorize the practice in any form were still at risk of having payday lenders charge their residents triple-digit rates. Payday lenders attempted to circumvent unfavorable state laws through partnerships with federally-insured banks, allowing exportation of more favorable lending laws from the bank's home state. Bank regulators shut down the payday lending "rent-a-bank" model over the course of several years, with the final regulator, the FDIC, effectively putting an end to the practice in 2005.[7]

After several months of enforcement activity, the last payday lenders left states with two-digit rate caps such as North Carolina in mid 2006. The FDIC ended these relationships based, in part, on the legal and reputational risks payday lending posed to their member banks, commenting: "When used frequently or for long periods, the costs [of a payday loan] can rapidly exceed the amount borrowed and can create a serious financial hardship for the borrower. The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending."[8]

Further, a Georgia statue passed in May 2004 specifically prohibited payday lenders from forming subterfuge relationships with out of state banks to evade their small loan law. The statute also successfully addressed a number of other schemes that payday lenders have attempted to use to avoid state law. The Georgia law was repeatedly upheld over the payday lending industry's objections and legal actions were dismissed completely in 2006.[9] These rulings show that states can clearly enforce interest rate caps or outright bans on payday lending if they so choose.

Payday Lending Today

CRL's November 2006 *Financial Quicksand* report estimated that there are nearly 25,000 payday lending storefronts across the country. In 2005, payday lenders made over $28 billion in loans and collected approximately $4.6 billion in fees from borrowers. Ninety percent of fees (or $4.2 billion) were collected from borrowers trapped in debt—those borrowers who flip their initial loan at least four times per year.

Payday loans are widely available in 37 states.[10] In the 12 other states in which interest rate caps (averaging 36 percent) apply to all small loans, lenders have chosen not to offer payday loans. In addition, payday lenders are expected to stop offering payday loans in the District of Columbia once a 24 percent cap takes effect there in early 2008. And, a recent federal law protects all active-duty military families, prohibiting interest rates above 36 percent on payday loans.[11]

The Problem with Payday Lending

"I needed the cash to get through the week. It didn't cross my mind that I was borrowing back my own money." - Former payday borrower, "Arthur Jackson"

Arthur Jackson,[12] a warehouse worker and grandfather of seven, went to the same Advance America payday shop for over five years. His total interest paid is estimated at about $5,000—for a loan that started at $200 and eventually increased to a principal of $300. Advance America flipped the loan for Arthur over a hundred times, collecting interest of up to $52.50 for each transaction, while extending him no new money. His annual interest rate was in the triple digits. Arthur fell behind on his mortgage and filed for bankruptcy.

In payday lending, short-term loans become long-term debt at triple-digit interest rates, creating a debt trap the borrower cannot afford to pay off.

Payday loans are sold as a quick solution to address an unanticipated expense. In some very limited circumstances, the borrower pays $16 per $100 borrowed to cover an expense, and is free of debt as soon as their paycheck arrives. Payday lenders make it seem as if their customers deal with their financial predicament, pay back the loan in two weeks or less, and then stay away from payday lending for awhile.

Unfortunately, payday lending only works this way about two percent of the time. State regulator data demonstrates that only one to two percent of transactions are made to borrowers who take out one loan, pay it off on time, and do not need to borrow again that year.[13] The high price of a payday loan and the fact that it must be paid off in one lump sum two short weeks later, virtually ensures cash-strapped borrowers will be unable to meet their basic expenses and pay off their loan with a single paycheck. Consequently, they are forced to flip the loan over and over.

The high price of a payday loan and the fact that it must be paid off in one lump sum two short weeks later virtually ensures cash-strapped borrowers will be unable to meet their basic expenses and pay off their loan with a single paycheck.

As the table below illustrates, a person earning $35,000 a year would be hard-pressed to pay back a typical payday loan and still meet basic expenses during one two-week pay period.

Table 1. The Typical Borrower Cannot Afford to Pay off a Payday Loan after Two Weeks

Income and Taxes	
Income before tax	$35,000
Income per 2 week period	$1,346
Taxes	$25
Social Security/Pension	$95
Net Paycheck	$1,227
Household Essential Expenditures per 2 week period	
Food	$175
Housing (including utilities)	$459
Transportation	$238
Healthcare	$91
Total Essential Expenditures	$962
Amount Remaining after Essential Expenditures ($1227-$962)	$265
Amount Due to Repay a $325 Payday Loan with $52 fee	$377
Pay period deficit if payday loan paid on time ($265-$377)	-$112

Source: Expenditure data from the Bureau of Labor Statistics, 2005 Consumer Expenditure Survey

The inability to repay their payday loans and meet basic needs drives consumers to continue to take out loans over the course of multiple pay periods. In fact, regulator data collected in several states shows that the average payday borrower has more than eight transactions per year.

Table 2. Average payday loans per year by state

	Average Annual Loans per Borrower
California[14]	7.0
Colorado[15]	9.4
Florida[16]	7.9
Iowa[17]	12.0
Michigan[18]	7.7
Oklahoma[19]	9.1
Virginia[20]	8.3
Washington State[21]	8.2
Average[22]	8.7

With the exception of Florida, Michigan, Oklahoma, and Washington state these statistics likely underestimate the number of loans per borrower, as these states assume that each borrower uses only one payday lender. In fact, an industry-sponsored survey found that the average borrower visits 1.7 payday stores.[23]

DISCUSSION OF FINDINGS

Finding #1: The debt trap of payday lending persists even in states that have attempted to reform the practice. In these states, 90 percent of payday lending business is generated by trapped borrowers with five or more loans per year.

More evidence that the debt trap persists:

- Over 60 percent of loans go to borrowers with 12 or more transactions per year;
- 24 percent of loans go to borrowers with 21 or more transactions per year;
- One of every seven Colorado borrowers have been in payday debt every day of the past six months; and
- Nearly 90 percent of repeat payday loans are made shortly after a previous loan was paid off.

Repeat borrowing is rooted in the pricing and structure of payday loans. As noted previously, the full payment on these loans is due in two short weeks. This, coupled with a triple-digit interest rate, makes it much harder for a borrower to successfully pay off a payday loan than it is to pay off small loans that allow payments to be made in installments over time—which typically carry a far lower cost.

The payday lending business model depends on trapping borrowers in loans. Regulators report that 90 percent of loans go to borrowers with five or more transactions per year, even in states that have attempted to reform the practice, as shown in Table 3. This state data also shows that over 60 percent of loans go to borrowers with 12 or more transactions per year. In other words, over half of payday lenders' revenues are derived from borrowers taking out at least one loan every month. Further, 24 percent comes from borrowers taking out 21 or more each year.

Therefore, the vast majority of payday lenders' revenues generated are from trapped borrowers. If these borrowers only took out an occasional payday loan, lenders would be faced with sharp reductions in revenue that would threaten the viability of their business model.

Table 3. Loans to trapped borrowers generate most payday lending revenue

	Loans to borrowers with five or more transactions per yearper year	Loans to borrowers with 12 or more transactions per year	Loans to borrowers with 21 or more transactions per year
Colorado[24]	N/A	65%	28%
Florida[25]	89%	58%	20%
Michigan[26]*	94%	77%	52%
Oklahoma[27]	91%	64%	27%
Washington State[28]	89%	56%	20%
Average	90%	61%	24%

*Michigan figures are for a 13-month period and are not included in the average

Additional data from state regulators confirm that many borrowers are trapped in payday loans for significant periods of time. For example, in Colorado, one in seven payday borrowers were indebted to the same payday loan company every day for at least six months in 2006.[29]

Table 4. Colorado: Borrowers Indebted for 6 months

	In Debt for Past Six Months
2001	8%
2002	8%
2003	11%
2004	12%
2005	14%
2006	14%

Source: Administrator of the Colorado Uniform Consumer Credit Code

Already troubling, this does not capture borrowers' indebtedness to other payday loan companies nor borrowers who had a "lapse" of being payday loan debt free for a day or two in any six-month period. Notably, the percentage of Colorado borrowers continuously indebted for at least six months has steadily increased since 2001. This is consistent with research conducted by the FDIC's Center for Financial Research which finds that as payday lending stores become more established, repeat use increases.[30]

In Virginia, state regulator data shows that borrowers with 13 or more loans per year comprise more than one out of five borrowers (22 percent) and like Colorado, this percentage has steadily increased every year.

Table 5. Virginia: Borrowers with 13 or more loans annually

	2003	2004	2005	2006
Borrowers with 13+ loans per year	50,928	76,068	90,859	96,831
Total Borrowers	285,798	387,686	445,891	433,537
% of borrowers with 13+ loans	17.8%	19.6%	20.4%	22.3%

Source: Virginia Bureau of Financial Institutions, 2006 Annual Report of Payday Lending Licensees

Finally, an examination of payday borrower activity in Michigan over a 13-month period reveals that borrowers taking out five or more loans—borrowers we consider to be stuck in the payday debt trap—generated 94 percent of the Michigan payday industry's loan business during the study period.[31] In fact, while 8 percent of Michigan's payday customers took out 30 loans or more, they generated 27 percent of the industry's total loans for the 13-month period.[32]

State regulator data also shows that the vast majority of payday loans are made shortly after a previous loan was paid off.

Nearly half (45 percent) of repeat payday transactions in Florida happen as soon as the 24-hour cooling-off period expires, and 88 percent of these are originated before the typical borrower receives their next paycheck.[33] Data from Oklahoma reveals a similar trend with 87 percent of loans taken out during the pay period in which the previous loan is paid off.[34] So, while a brief pause in lending does occur, the borrower is still flipped into another loan and continues to be in long-term debt. This is despite the renewal ban and a cooling-off period established in these states to attempt to end the debt trap, as discussed in the next section.

Table 6. Majority of repeat loans taken out within a few days of previous loan

	Florida[35]	Oklahoma[36]
Within one day	45%	59%
Within one week	79%	79%
Within the same two-week pay period	88%	87%
Within thirty days (typical billing cycle and monthly pay period)	96%	94%

The data from Florida and Oklahoma is consistent with data from Advance America that shows 46.5 percent of their transactions were originated on the same date as a previous loan was paid off.[37]

Industry participants and researchers acknowledge the importance of loan flipping

Consistent with our analysis of state regulator data for this report, payday lending industry representatives, researchers, and analysts have made the point on numerous occasions that repeat borrowers are extremely important to them. Consider the following comments from payday lenders, industry analysts, and observers:

"A note about rollovers. We are convinced the business just doesn't work without them." - Roth Capital Partners, First Cash Financial Services, Inc. Company Update, July 16, 2007

"The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers." - Michael Stegman, "Payday Lending: A Business Model that Encourages Chronic Borrowing," Economic Development Quarterly[38]

"This industry could not survive if the goal was for the customer to be 'one and done'. Their survival is based on the ability to create the need to return, and the only way to do that is to take the choice of leaving away. That is what I did." - Stephen Winslow, former payday lending store manager, Harrisonburg, VA

"We find that high-frequency borrowers account for a disproportionate share of a payday loan store's loan and profits… the business relies heavily on maximizing the number of loans made from each store…" - Mark Flannery and Katherine Samolyk, Payday Lending: Do the Costs Justify the Price? FDIC Center for Financial Research[39]

"We saw most of our customers every month – a majority came in every month." - Rebecca Flippo, former payday lending store manager, Henrico County, VA

Finding #2: As implemented in any state, none of these restrictions have stopped payday lending from trapping borrowers in long-term debt:

- Renewal bans/cooling-off periods
- Limits on number of loans outstanding
- Payment plans
- Loan amount caps based on a borrower's income
- Databases which enforce ineffective provisions
- Regulations that narrowly target payday loans

Seeking to strike a compromise with state legislators who want to protect their constituents from the negative effects of payday loans, the payday lending industry has agreed to a variety of regulations that appear to rein in abuses. However, data from state regulator reports demonstrate that industry-supported protections do not stop the central problem of payday loans: the debt trap.

Since payday lenders are dependent on trapped borrowers for their business model to be profitable, it reasonably follows that any regulations that garner industry support would leave the debt trap intact. In fact, the industry actively supports many of these "reforms" since, as Florida payday lenders report, these laws "have increased recognition and legitimacy of this product."[40] Each of these regulations, and the results of their implementation in the states, is detailed below.

Renewal bans/cooling-off periods have not stopped the cycle of repeat borrowing

"Irrespective of whether the repeat transactions are cast as "renewals," "extensions," or "new loans," the result is a continuous flow of interest-only payments at very short intervals that never reduce the principal." - Michael Stegman, "Payday Lending: A Business Model that Encourages Chronic Borrowing," Economic Development Quarterly[41]

Almost every state allowing payday lending has some sort of restriction on the renewal of payday loans.[42] Twenty-two states ban all renewals and others allow only one to six renewals of the original loan. Only five states—Kansas, Nevada, Texas, Utah, and Wisconsin—allow unlimited renewals. Many policymakers enact renewal bans to address concerns that these ostensibly short-term loans are repeatedly rolled over into long-term debt. Payday lenders often support these measures, knowing they have already found effective ways around them.

For example, payday lenders routinely circumvent a renewal ban by having borrowers pay off their loan and immediately take out another; this process is termed a "back-to-back" transaction. Because these types of transactions technically do involve paying off the loan—if only for a moment before a new loan is originated—they are not considered renewals.

Some states have sought to enforce renewal ban provisions with a "cooling-off" period of a business day or two between loans.[43] In some states, this cooling-off period is enforced between each loan, but in others it is only activated once the borrower takes out a certain number of consecutive loans. While this superficially ends some rollovers, it merely delays the inevitable as borrowers must still take out another payday loan to make it through the pay period.

As discussed in the previous section, the percentage of payday loans made during the same pay period as the previous loan is paid off is quite high in Florida and Oklahoma, which both have cooling-off periods and renewal bans. About half of re-opened loans in these states were taken out at the borrower's first opportunity; and nearly 90 percent of new loans were made during the same pay period as the previous loan was paid off (see Table 6).

Limits on Number of Loans Outstanding have not stopped the cycle of repeat borrowing

Several states restrict the number of payday loans a borrower can have outstanding or employ limits on the total indebtedness a borrower can have at any given time. Loopholes in these types of provisions are rampant, with many states merely requiring that the borrower sign a statement that they have no other loans outstanding. In other cases, since this limitation is applied to an individual borrower, another member of the household can simply visit the payday lender to take out an additional payday loan for the family.

While some states have implemented a database to enforce these provisions, these state laws still allow the typical borrower to take out 24 loans per year—remaining indebted to a payday lender the entire time. A more meaningful cap on the number of loans that can be taken out each year—for example, only allowing a household one loan per quarter—meets strong opposition from the payday lending industry.[44]

Table 7. Three state laws limiting number of loans at any one time

	Limit on Loans Outstanding	% of Year Borrower Can Be Indebted to Payday Lender
Florida[45]	One loan at a time, 24 hour cooling-off period between loans	92%
Michigan[46]	One loan per licensee and no more than two outstanding loans overall	100%
Oklahoma[47]	Two loans at a time, cooling-off period until 2nd business day after five consecutive loans	98%

Payment plans have not stopped the cycle of repeat borrowing

Some state laws provide payday borrowers with an option to request an extended payment plan.[48] These payment plan provisions generally require the borrower to be in debt to a payday lender for a certain period of time or to be in default to be eligible. Often, there is a fee associated with entering into the plan and the borrower is barred from taking additional loans while the payment plan is in effect. There may also be a cooling-off period once the payday loan debt is fully repaid. In some states, borrowers must formally request the payment plan in advance of the loan's due date.

Though these plans seem to offer a way for borrowers to get out of payday loan debt, they are seldom utilized for several reasons. While payday lenders are generally required to furnish borrowers with information about the availability of payment plans, they have little incentive to cast these plans in a positive light. In at least one state with a payment plan provision, lenders have tweaked their business model slightly to ensure that trapped borrowers do not trigger the eligibility requirements for payment plans.[49]

In addition, payday lenders often ensure that the terms of a plan are more expensive in the short-term for the borrower since they typically have to pay more to enter into a payment plan agreement than to simply flip their loan. For example, a borrower taking out a $325 loan has to come up with $52 to renew their loan (either through a direct renewal or back-to-back transaction) or with $94 to pay their first installment of a typical payment plan.[50] These are likely explanations for the extremely low usage of payment plans as detailed in the table below.

Table 8. Take-up rates for payment plans very low for eligible borrowers

	% of Eligible Transactions Employing Payment Plan/Grace Period	Payment Plans as % of Total Transactions
Florida[51]	0.42%	0.42%
Michigan[52]	2.42%	1.33%
Oklahoma[53]	1.84%	1.14%
Washington State[54]	N/A	1.20%

Washington State Case Study: Pre and Post Enactment of Statutory Payment Plan

The 2003 passage of industry-supported Senate Bill 5452 in Washington State allows for a unique case study.[55] Prior to 2003, payday lending had been legal for eight years in Washington State. The law gives consumers a right to a payment plan after four successive loans. In addition to the payment plan provision, the law also increases the maximum amount of a small loan from $500 to $700, extends the loan term to a maximum of 45 days, adds a right of rescission and prohibits certain collection practices.

While the latter provisions became effective January 1, 2004, the payment plan did not become effective until October 31, 2004. Because Washington State borrowers are not eligible for the payment plan until they take out four successive loans, few, if any, of these borrowers could use a payment plan until at least the beginning of 2005.[56] As the following table shows, the introduction of a payment plan did not meaningfully reduce repeat borrowing.[57]

Table 9. Washington State Payment Plan Experience[58]

	Without Payment Plan (2003–2004)	With Payment Plan (2005)
Average Loans/Borrower	9.0	8.5
Loans to Borrowers with 5 or more transactions a year	91%	90%

In addition to these state-specific payment plans, the industry's trade association, the Community Financial Services Association (CFSA), recently responded to public pressure and introduced an extended payment plan to be offered by all of its members. CFSA members must give borrowers who are unable to pay off their loans the option of paying them off over the next four pay periods at no additional cost. However, CFSA members are only required to offer the plan on **one** of the borrower's loans each year. This initiative is essentially the same as the payment plans that have shown not to reduce repeat borrowing in other states. Accordingly, there is no reasonable basis to expect this "new" trade association practice to be effective in reducing the number of trapped payday borrowers.

The industry, in fact, is counting on the likelihood that borrowers will not use this payment plan option. Correspondence from a payday lending representative to California Assemblyman Ted Lieu argues that if a significant number of borrowers actually take advantage of the payment plan option, payday lenders will lose money. The basis for this analysis is his comparison of the average borrower taking eight two-week payday loans to a borrower who takes one loan and then the payment plan (with both borrowers indebted for a total of 120 days). The letter notes that the repeat borrower generates $360 in interest versus $45 for the payment plan borrower—a revenue reduction of 87.5 percent.[59]

And when a CFSA representative was asked about making a payment plan option available on a frequent basis (perhaps by changing their business model to a loan with a similar term), he explained "We lose money on [payment plans]. There's no doubt about it…we cannot offer this product…for $16 per $100...for 90 days."[60]

These are clear acknowledgements from the industry that widespread use of a payment plan is not financially viable for them. This likely explains why the industry routinely opposes any proposal that automatically activates payment plans after a set period of indebtedness, and it explains the low usage of the payment plans in the states where they have already been tried.

"We lose money on [payment plans]. There's no doubt about it... we cannot offer this product...for $16 per $100... for 90 days."

– CFSA representative

Loan amount caps based on a borrower's income have not stopped the cycle of repeat borrowing

Although the key feature of payday lending is that anyone with a checking account and a source of income can qualify for a loan, a few states have enacted limited "ability to repay" measures that aim to prevent borrowers from getting more money than they can afford to pay back. In these states, however, key elements in determining a borrower's true ability to repay are absent. These state provisions fail to take into account the borrower's other obligations, such as a mortgage or rental payment, car loan, or minimum credit card payments. Without knowing the extent of a borrower's other expenses, it is impossible to truly assess the borrower's ability to repay the loan.

The practical impact of these regulations is to generally limit the total amount of payday loan debt to 20-25 percent of the borrower's gross (pre-tax) monthly income. States with this provision include Illinois, Indiana, Montana, New Mexico, and Nevada. The income requirement fails to help borrowers avoid being in trapped in debt for additional reasons. First, the average payday loan borrower takes out a payday loan for two weeks, rather than a month. This means that only half of their monthly income is available to pay back the loan. And these provisions only consider pre-tax income.

The chart below illustrates how a typical borrower earning $25,000 or $35,000 a year would not be protected by current ability-to-repay provisions limiting the amount of payday loan debt to 20-25 percent of gross monthly income. For example, a person making $25,000 a year in a state that limits loans to 20 percent of a borrower's monthly income would be allowed to borrow up to $417. However, this person would only have $58 left over to pay back their payday loan after meeting basic expenses for food, housing, transportation, and health care. Therefore, the borrower cannot afford to pay back the entire loan balance even with this type of ability to repay standard in place.

Table 10 A. Income requirement fails to protect borrowers, 20%

20% Ability to Repay Provision (Loan Limited to 20% of Borrower's Monthly Income)		
Income and Taxes		
Income before tax	$25,000	$35,000
Income per 2 week period	$962	$1,346
Taxes	$12	$25
Pension/Social Security	$53	$95
Net Paycheck	$897	$1,226
Household Essential Expenditures per 2 week period		
Food	$152	$175
Housing (including utilities)	$383	$459
Transportation	$217	$238
Healthcare	$87	$91
Total Essential Expenditures	$839	$963
Amount Remaining after Essential Expenditures	$58	$263
Maximum Loan Size Allowed (20% of Gross Monthly Income)	$417	$729
Pay Period Deficit	-$359	-$466

Table 10 B. Income requirement fails to protect borrowers, 25%

25% Ability to Repay Provision (Loan Limited to 25% of Borrower's Monthly Income)		
Income and Taxes		
Income before tax	$25,000	$35,000
Income per 2 week period	$962	$1,346
Taxes	$12	$25
Pension/Social Security	$53	$95
Net Paycheck	$897	$1,226
Household Essential Expenditures per 2 week period		
Food	$152	$175
Housing (including utilities)	$383	$459
Transportation	$217	$238
Healthcare	$87	$91
Total Essential Expenditures	$839	$963
Amount Remaining after Essential Expenditures	$58	$263
Maximum Loan Size Allowed (25% of Gross Monthly Income)	$521	$729
Pay Period Deficit	-$463	-$466

Source: Expenditure data from the Bureau of Labor Statistics, 2005 Consumer Expenditure Survey

Databases which enforce ineffective provisions have not stopped the cycle of repeat borrowing

A handful of states with the regulations outlined above enforce these provisions through a live database that tracks every payday transaction conducted in the state. States such as Florida and Oklahoma have had a centralized database tracking system for several years, with Michigan, Illinois, and North Dakota implementing systems more recently.[61] While these centralized, real-time database systems are necessary to enforce certain regulations, they do not reduce the risks of payday loans for borrowers. This is because—as shown above—they merely enforce ineffective provisions. Analysis of the data from state regulators shows that borrowers in states with various combinations of these provisions remained trapped in payday loans at high rates.

Regulations that narrowly target payday loans have not stopped the debt trap

"[P]ut a cap on the interest rate of 36% maximum … Coming to any agreement on any other level will just allow them to get around a loophole, by making their loan open end, or installment, or doing back-to-back transactions when you outlaw rollovers. Whatever you can think of they will get around, except the maximum interest rate." - Hank Klein, CEO of Arkansas Federal Credit Union (retired)[62]

Some states have tried to regulate payday loans, only to find that payday lenders change the terms of their loans to avoid the new law. For example, payday loan regulations enacted in Illinois in 2005 only cover loans with over 36 percent APR and terms of less than 120 days. To avoid complying with these provisions—which essentially trim the cost of a payday loan from 573 percent to 351 percent APR—payday lenders changed their product to a longer-term "payday installment loan" of at least 121 days.[63]

The APR for these re-structured payday loans is approximately 550 percent, in the range that Illinois payday lenders originally charged on regular payday loans before the 2005 regulations went into effect.[64] Payday lenders are now planning to roll out alternative payday loans in several other states where similar regulatory constraints motivate them to modify their product in order to continue charging triple-digit interest.

To avoid this type of evasion, policymakers must take a comprehensive approach to regulating not only payday lending, but also small loans in general. For example, Oregon recently incorporated an interest cap that covers all loans under $50,000—whether made by a payday lender, consumer finance company, car title lender, or other entity.[65]

Finding #3: Those states which enforce a comprehensive interest rate cap at or around 36 percent for consumer loans have solved their debt trap problem, realizing a savings of $1.5 billion for their citizens while preserving a more responsible small loan market.

In states that have regulated aspects of payday lending while allowing triple-digit interest rates, regulator data shows that borrowers continue to be trapped in debt. States that have specifically addressed payday lending but fail to put protections in place covering all small loans find that new predatory products take their place. The only effective way to ensure consumers have access to more affordable credit without abusive features is to enforce a comprehensive rate cap on all small loans.

Previous CRL research found that the absence of triple-digit payday lending in eleven states saved their citizens an estimated $1.4 billion per year.[66] With new restrictions on high-cost lending in Oregon and the District of Columbia enacted in 2007, this savings will grow by an estimated $77 million.

Table 11. Savings achieved by states that enforce interest rate caps

	Savings
Connecticut	$64 million
District of Columbia (new cap)	$12 million
Georgia	$147 million
Maine	$25 million
Maryland	$97 million
Massachusetts	$119 million
New Jersey	$150 million
New York	$345 million
North Carolina	$153 million
Oregon (new cap)	$65 million
Pennsylvania	$234 million
Vermont	$12 million
West Virginia	$36 million
Total	$1.5 billion

Momentum has gathered at the federal level to rein in abusive small loans as well. In 2006, Congress passed a law to prevent active-duty military families across the country from being charged more than 36 percent on small loans. The FDIC quickly followed suit, actively encouraging banks under its purview to craft and market small loan products at 36 percent or less to the general population.

The North Carolina example

"Offering low-cost alternatives to high-cost payday loans can be done profitably." - FDIC Chair Sheila C. Bair[67]

The North Carolina experience shows the positive impact of effectively enforcing a reasonable interest rate cap on all small lenders. North Carolina once authorized payday lending by exempting payday lenders from its 36 percent interest rate cap. The law included a four-year sunset provision to allow lawmakers to examine the impact of the industry before reauthorizing the practice. After seeing the documented effects of payday lending on residents, legislators declined reauthorization.

In its place, small loans from consumer finance companies, credit unions, and other financial institutions have flourished while charging rates at or below the rate cap. From 2002-2006, the number of consumer finance loans made for $600 or less increased by 37 percent.[68]

Table 12. Growing availability of small consumer loans in North Carolina at or below the 36% cap

	Number of Loans, $600 or Less
2002	23,768
2003	23,667
2004	24,412
2005	29,400
2006	32,586
Percent Change (2002-2006)	37%

Source: North Carolina Commissioner of Banks

In addition, the largest credit union in the state—the North Carolina State Employees Credit Union (NCSECU)—created an alternative payday loan product at 12 percent APR with no additional fees. The Salary Advance Loan also includes a savings feature where borrowers must put five percent of the loan amount into a savings account to help them weather financial emergencies in the future without needing additional credit. Not only has this product saved borrowers $33.6 million annually in excessive interest charges, between 2003 and June 30, 2006, the savings component generated $9.7 million in new savings for its estimated 53,000 salary advance borrowers.[69]

"Three-quarters of low- and middle-income people were unaffected by the ban on payday lending...of those that were affected...more than twice as many reported that the absence of payday lenders had a positive impact on their lives."

– Report by the NC Commissioner of Banks

While payday lenders predict doomsday scenarios for their borrowers if they are no longer allowed to charge triple-digit interest rates, former payday borrowers who no longer have access to payday loans tell a much different story. A recent study from the North Carolina Commissioner of Banks found that "three-quarters of low- and middle-income people were unaffected by the ban on payday lending…of those that were affected by the end of storefront payday lending, more than twice as many reported that the absence of payday lenders had a positive impact on their lives."[70] The report also shows that North Carolina families have a myriad of credit and other options for dealing with financial crises.

This is consistent with the industry's own survey findings that less than 10 percent of payday borrowers took out a payday loan because they had no other credit alternatives.[71] In addition, payday borrowers and the general public also overwhelmingly support an interest rate cap, even if it results in less credit.[72]

- Only 6.4% of payday borrowers had no other alternative to payday loan
- 72% of payday borrowers want the government to limit interest rates, even if it results in fewer consumers having access to credit
  -2001 Payday Borrower Survey, Credit Research Center

- Only 9% of payday borrowers chose payday loans because they had no other alternative
- 69% of payday borrowers believe that the government should limit the fees payday lenders can charge
  -2004 Payday Borrower Survey, Cypress Research Group

- 63% of all Virginians support an interest rate cap of 36 percent.
- 73% believe that payday lenders take advantage of borrowers as opposed to offering a service
  -2007 Survey USA News Poll of Virginia residents

- 72% of Ohio swing voters are more likely to support candidates that would cap payday loan rates at 36 percent.
  -2007 Benenson Strategy Group Poll of Ohio swing voters

POLICY RECOMMENDATIONS

"I have always been a vocal supporter of free enterprise, and have opposed needless and burdensome regulation. However, these abusive practices are a threat to the free markets which are so critical to our state's prosperity. The bad faith of these lenders and the desperation of the borrowers will, if unchecked, ultimately combine to bring disrepute on the financial sector and cries for draconian and excessive regulation. Adam Smith, the great prophet of free enterprise, believed there had to be limitations on interest in order to preserve a free market. What Smith would think of an APR of 300%, I cannot imagine." - The Honorable William G. Batchelder, State Representative (R-OH), former Speaker Pro-Tempore and Presiding District Court Judge[73]

Enact a comprehensive small loan cap at or around 36 percent.
The only meaningful way to address the debt trap is through a comprehensive small loan law with a meaningful interest cap. The 12 states and the District of Columbia with reasonable rate caps on small loans can and should serve as a model to states that currently authorize payday lending in any form. In these states and in the District of Columbia, citizens in need of credit to help them through an unexpected expense still can access affordable alternatives without sinking into high-cost, long-term debt.

Other Recommendations

In addition to capping interest rates on small loans, state and federal policymakers have taken other actions that could prove helpful in protecting borrowers against payday lending abuses, to increase the market for responsible loan products, and to help families save:

Cap the number of loans a borrower can receive annually. The payday lending industry asserts that its product is intended for occasional, short-term use. Therefore, capping the number of loans a borrower can receive each year would be consistent with the industry's definition of responsible use. To be effective, a loan cap would need to extend to all members of a household, and be tracked through a statewide database, such as those in place in Florida, Michigan, and Oklahoma.

Precedence for a loan limit comes from FDIC guidelines for banks that may directly engage in payday lending. The guidelines call for banks to ensure that payday loans would not be made to customers in payday loan debt—from any payday lender—for over three months of any twelve-month period.[74] The FDIC rule recognized that payday loans were not being used as short-term debt.

Ban the use of the bank account access as collateral. Policymakers should follow the lead of the federal law protecting military families and prohibit the practice of holding a check or requiring electronic access to the borrower's bank account as security for a loan. From the borrower's perspective, this creates a super lien on their income, because the payday lender is holding a live check to be deposited on the date the borrower is paid. This forces borrowers to address the payday loan first before all other debts and essential obligations.

Further, borrowers unable to repay the debt are often forced to make uneconomical decisions because the live check prevents borrowers from prioritizing essentials over certain debts or less essential expenses—a fact of life for struggling families. Default on payday loans means triggering bounced check fees from both the payday lender and the borrower's financial institution. Not only does this expose vulnerable households to coercive collection tactics from lenders threatening civil or criminal action for unpaid checks, it puts their bank account and ability to write checks at risk.

The payday industry touts itself as a viable alternative to bouncing a check and overdraft fees; what often is not mentioned is that one tool of the payday loan business—the use of a check as collateral for the payday loan—uses NSF and overdraft fees as a means to collect from payday lending borrowers.

The Federal Trade Commission (FTC) has declared a number of standard provisions in consumer loan contracts to be unfair and therefore illegal, including wage assignments, confessions of judgment, and the taking of security interests for certain transactions. Because check holding by payday lenders is the modern day equivalent of wage assignment, it should be banned by state and federal policymakers.

Increase incentives for small loans and emergency savings. Policymakers can provide incentives to banks and credit unions crafting small loan products. For example, in partnership with the State Treasurer, credit unions in Pennsylvania have begun to offer responsible small loans. In just the first year, over 50 credit unions are participating in this initiative, and have made over 1,600 loans.[75] A legislative proposal in Ohio calls for the state to deposit funds in financial institutions that agree to make small installment loans at no more than 36 percent APR.[76] In addition, banks following the FDIC's small loan recommendations will have this loan activity considered as part of their Community Reinvestment Act (CRA) exam.

Policymakers and financial institutions can also look at ways to encourage saving among low- and moderate-income families so that they can weather financial emergencies without taking on additional debt. Consumer Federation of America researchers found that families earning $25,000 per year with no emergency savings were eight times as likely to use payday loans as families in the same income bracket who had more than $500 in emergency savings.[77] Small loan products that are combined with a savings component can also help families build savings for future unexpected expenses while making loan payments. Products such as those offered by NCSECU and Pennsylvania Credit Unions described above can serve as models for other financial institutions wanting to include a savings component into a small loan product.

Appendix 1: The Effects of Payday Lending Regulations in Florida, Michigan, Oklahoma, and Washington

	Regulations	Results
Florida[78]	• $500 maximum loan amount • No more than one outstanding loan at a time • $10 per $100 (plus verification fee) maximum fee • 24 hour cooling off period after each loan • 60 day grace period available, upon declaration of inability to repay • Rollovers prohibited • Database	• 89% of business generated by borrowers with five or more transactions per year • 58% of business generated by borrowers with 12 or more transactions per year • Average of 8 loans per borrower • Less than one percent of transactions take advantage of the 60 day grace period • 45% of new loans taken out day after previous loan paid off; 88% of new loans taken out in the same two week pay period that previous loan is paid off
Michigan[79]	• $600 maximum loan amount • No more than two loans outstanding at a time (can only have one loan outstanding per lender) • Maximum fee of 15% for 1st $100 borrowed; 14% for 2nd $100; 13% for 3rd $100; 12% for 4th $100; and 11% for 5th and 6th $100 • Payment plan option • Rollovers prohibited • Database	• 94% of business generated by borrowers with five or more transactions* • 77% of business generated by borrowers with 12 or more transactions* • Average of 8 loans per borrower • 2% of eligible transactions employ payment plan *13 month time period as reported by regulator
Oklahoma[80]	• $500 maximum loan amount • No more than two outstanding loans at a time • $15 per $100 maximum fee on loans up to $300; $10 per $100 maximum fee on loans of $301-500 • Two business day cooling off period after 5th consecutive loan • Payment plan option available after 3rd consecutive loan • Rollovers prohibited • Database	• 91% of business generated by borrowers with five or more transactions per year • 64% of business generated by borrowers with 12 or more transactions per year • Average of 9 loans per borrower • Less than 2% of eligible transactions employ payment plan • 59% of new loans made within a day after previous loan paid off; 87% of new loans taken out in the same two week pay period that previous loan is paid off

Appendix 1: The Effects of Payday Lending Regulations in Florida, Michigan, Oklahoma, and Washington (Continued)

	Regulations	Results
Washington[81]	• Cannot borrow more than $700 from a single lender at one time • $15 per $100 maximum fee on loans up to $500, then $10 per $100 on remaining portion of loan up to $700 • Payment plan option available after 4th consecutive loan with same company • Rollovers prohibited	• 89% of business generated by borrowers with five or more transactions per year • 56% of business generated by borrowers with 12 or more transactions per year • Average of 8 loans per borrower • 1.2% of all transactions employ the payment plan option

Appendix 2: Savings in States Without Payday Lending at Triple-Digit Interest Rates

States without triple-digit payday lending	2000 Population	Households	Projected Payday Stores	Projected Total State Loan Volume	Fee %	Projected Payday Loan Fees	Projected Predatory Payday Costs per State
			HHs/3500	(Payday Stores * 1,188,525)		(State Loan Volume * Fee %)	(Payday Loan Fees * 90%)
Connecticut	3,405,565	1,301,670	372	442,019,239	16%	70,723,078	63,650,770
District of Columbia	572,059	248,338	71	84,330,263	16%	13,492,842	12,143,558
Georgia	8,186,453	3,006,369	859	1,020,898,490	16%	163,343,758	147,009,383
Maine	1,274,923	518,200	148	175,969,616	16%	28,155,139	25,339,625
Maryland	5,296,486	1,980,859	566	672,657,269	16%	107,625,163	96,862,647
Massachusetts	6,349,097	2,443,580	698	829,787,406	16%	132,765,985	119,489,386
New Jersey	8,414,350	3,064,645	876	1,040,687,771	16%	166,510,043	149,859,039
New York	18,976,457	7,056,860	2016	2,396,358,438	16%	383,417,350	345,075,615
North Carolina	8,049,313	3,132,013	895	1,063,564,500	16%	170,170,320	153,153,288
Oregon	3,421,399	1,333,723	381	452,903,751	16%	72,464,600	65,218,140
Pennsylvania	12,281,054	4,777,003	1365	1,622,167,854	16%	259,546,857	233,592,171
Vermont	608,827	240,634	69	81,714,150	16%	13,074,264	11,766,838
West Virginia	1,808,344	736,481	210	250,093,166	16%	40,014,907	36,013,416
Totals	78,644,327	29,840,375	8526	$10,133,151,913		$1,621,304,306	$ 1,459,173,876

Sources: U.S. Census Bureau: 2000 Census, American Community Survey 2003; Morgan Stanley's assumption of 3,500 households per branch as a saturation point, Advance America report from January 25, 2005, page 25.

This table updates a calculation in our *Financial Quicksand* report which projected the savings of citizens from states without payday lending for 2006. Since this report's publication, Oregon imposed a rate cap on all small loans and payday lenders chose to leave the state. In addition, the District of Columbia passed a 36 percent rate cap that is expected to take effect in early 2008. Like other states with a similar rate cap, payday lenders are expected to cease operation in the District. Therefore, Oregon and the District of Columbia have been added.

To estimate the savings in states which enforce reasonable rate caps averaging 36 percent, we first must predict the number of stores that would open in the state if payday lenders were granted an exemption from the cap, or other means of payday lending authorization.

Using Morgan Stanley's assumption of 3,500 households per payday loan store for average state saturation,[82] we divide household figures in each state by 3,500. For example, Connecticut has 1,301,670 households, so we predict that after authorization it would have 372 stores. For all states without payday lending combined, we project 8,526 new stores.

We calculated the potential loan volume in each state by multiplying our estimate of the number of stores by annual loan originations per store and median loan size (see *Financial Quicksand*). Connecticut's 372 stores would generate $442 million and all states without payday lending would generate a little over $10 billion in loan volume annually.

Next, we multiplied the loan volume in each state by the fee a typical payday lender would charge (in this case, the average 16% fee charged by Advance America), to get the total projected payday loan fees ($1.6 billion). Our *Financial Quicksand* paper determined that 90 percent of loans go to borrowers with five or more transactions a year; we consider these borrowers trapped in a cycle of abusive lending. Therefore, we find that 90 percent of payday loan fees, or $1.5 billion are paid on transactions to borrowers trapped in debt.

NOTES

1 Link to Cash America's presentation at the Jefferies Financial Services Conference available at http://www.cashamerica.com/invest.html. Transcript on file with authors.

2 Average loan size and fees for a payday loan were estimated for a November 2006 CRL report, *Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year.* Available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

3 Federal Register Volume 65, Number 63, Truth in Lending Final Rule, March 31, 2000.

4 Christopher Peterson, *Taming the Sharks: Towards a Cure for the High Cost Credit Market.* University of Akron Press (2004).

5 For a comprehensive discussion on the history of usury laws in the United States and their impact on small loans, see Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, Minnesota Law Review (forthcoming Winter 2008) and Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society* (2000).

6 Ibid.

7 Federal Deposit Insurance Corporation, *Payday Lending Programs Revised Examination Guidance*, (March 1, 2005). Available at http://www.fdic.gov/news/news /financial/2005/fil1405a.html. See Uriah King, et al, *Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina*. March 22, 2005, pages 4-6 for additional information on the federal regulators' response to the rent-a-bank model.

8 *Press Release: FDIC Revises Payday Lending Guidance* (March 2, 2005).

9 See http://www.responsiblelending.org/policy/state/georgia/page.jsp?itemID=28010186 for discussion of the Georgia statute and subsequent litigation.

10 Payday loans with triple-digit interest rates are not offered in Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Vermont, and West Virginia. Additionally, the District of Columbia City Council passed a bill in September 2007 to impose a 24% rate cap which is expected to take effect in late 2007. In many states, payday lenders have been granted an exemption from existing small interest rate caps. In others—including Delaware, Illinois, New Hampshire, New Mexico, Wisconsin, and Utah—there is not an interest rate cap on small loans.

11 The Military Lending Act, which caps interest rates on small loans of 91 days or less to active duty military and their dependents, part of the John Warner National Defense Authorization Act for Fiscal Year 2007, signed into law in October 2006. The interest rate cap took effect October 1, 2007.

12 Name changed to respect victim's privacy.

13 In the four states that report this data—Florida, Michigan, Oklahoma, and Washington state—the percent of loans going to borrowers with one transaction a year ranges between 1.1 to 2.1 percent. Regulator data from Washington State assumes that borrowers only take loans from a single lender. CRL has applied a multiplier to account for this; for methodology see Appendix 1 of *Financial Quicksand,* available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

14 *2006 Annual Report, Operation of Deferred Deposit Originators under the California Deferred Deposit Transaction Law,* California Department of Corporations (September 7, 2007). Available at http://www.corp.ca.gov/pdf/CDDTL2006AR.pdf.

15 *Payday Lending Demographic and Statistical Information, July 2000 through December 2006,* Administrator of the Colorado Uniform Consumer Credit Code. (March 8, 2007). Available at http://www.ago.state.co.us/UCCC/PDF/ddlasummary2006.pdf.

16 *Florida Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Florida Department of Banking and Finance. (August 2007). Available at http://www.veritecs.com/FL_trends_aug_2007.pdf.

17 Iowa Division of Banking Survey Results for 2005. Rob Reed, Finance Bureau Chief. The survey was conducted at 109 deferred deposit services branches, and at each branch the examiner reviewed a 12-month history of the last 20 borrowers. See Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles,* Isenberg School of Management, University of Massachusetts, at pg 8 (June 2005). Available at http://www.aecf.org/upload/PublicationFiles/FEs3622H334.pdf.

18 Michigan Trends in Deferred Presentment, Prepared by Veritec Solutions LLC for the Michigan Office of Financial and Insurance Services (July 31, 2007). Available at http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf. The report notes that the average borrower took out 8.3 loans during a 13 month period. This equates to 0.64 loans per month, or 7.7 loans per year.

19 Oklahoma Trends in Deferred Deposit Lending, Prepared by Veritec Solutions LLC for the Oklahoma Department of Consumer Credit. (May 2007). Available at http://www.veritecs.com/OK_Trends_05_2007.pdf.

20 *The 2006 Annual Report of the Bureau of Financial Institutions: Payday Lender Licensees Check Cashers Operating in Virginia at the Close of Business December 31, 2006,* Virginia Bureau of Financial Institutions, State Corporation Commission (2007). Available at http://www.scc.virginia.gov/division/banking/forms/ar04-06.pdf.

21 Data is based on reporting from 92% of the industry. See *2006 Payday Lending Report.* Washington State Department of Financial Institutions (2007). Available at http://www.dfi.wa.gov/cs/pdf/2006_payday_report.pdf. Regulator data from Washington state assumes that borrowers only take loans from a single lender. CRL has applied a multiplier to account for this; for methodology see Appendix 1 of Financial Quicksand, available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

22 The mean number of loans per borrower is 8.7 per year, with a standard deviation of 1.5. This means that most borrowers receive between 7 to 10 loans a year.

23 G. Elliehausen & E.C. Lawrence, *Payday Advance Credit in America: An Analysis of Consumer Demand,* (Monograph 25), Georgetown University, McDonough School of Business, Credit Research Center (2001) at pg. 49.

24 *Payday Lending Demographic and Statistical Information, July 2000 through December 2006,* Administrator of the Colorado Uniform Consumer Credit Code. (March 8, 2007). Available at http://www.ago.state.co.us/UCCC/PDF/ddlasummary2006.pdf.

25 *Florida Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Florida Department of Banking and Finance. (August 2007). Available at http://www.veritecs.com/FL_trends_aug_2007.pdf.

26 *Michigan Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Michigan Office of Financial and Insurance Services (July 31, 2007). Available at http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf.

27 *Oklahoma Trends in Deferred Deposit Lending,* Prepared by Veritec Solutions LLC for the Oklahoma Department of Consumer Credit. (May 2007). Available at http://www.veritecs.com/OK_Trends_05_2007.pdf.

28 Data is based on reporting from 92% of the industry. See *2006 Payday Lending Report.* Washington State Department of Financial Institutions (2007). Available at http://www.dfi.wa.gov/cs/pdf/2006_payday_report.pdf. Regulator data from Washington State assumes that borrowers only take loans from a single lender. CRL has applied a multiplier to account for this; for methodology see Appendix 1 of *Financial Quicksand,* available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

29 *Payday Lending Demographic and Statistical Information, July 2000 through December 2006,* Administrator of the Colorado Uniform Consumer Credit Code. (March 8, 2007). Available at http://www.ago.state.co.us/UCCC/PDF/ddlasummary2006.pdf.

30 Mark Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005). Available at http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf.

31 *Michigan Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Michigan Office of Financial and Insurance Services (July 31, 2007). Available at http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf.

32 Ibid.

33 Response to public records request of Florida data collected by Veritec, provided by the Florida Office of Financial Institutions and Securities Regulation on June 16, 2003, on file with authors.

34 Response to public records request of Oklahoma data collected by Veritec, provided by the Oklahoma Department of Consumer Credit on August 29, 2007, on file with authors.

35 Response to public records request, of Florida data collected by Veritec, provided by the Florida Office of Financial Institutions and Securities Regulation on June 16, 2003, on file with authors.

36 Response to public records request of Oklahoma data collected by Veritec, provided by the Oklahoma Department of Consumer Credit on August 29, 2007, on file with authors.

37 Advance America Prospectus. December 17, 2004, pg 37-38. 42.3 percent of transactions were consecutive transactions defined as loans entered into on the same day as a previous payday loan was paid and 4.2 percent were direct renewals, defined as simple extensions of an outstanding payday loan by paying only the applicable finance charge.

38 Michael Stegman and Robert Faris. Payday Lending: A Business Model that Encourages Chronic Borrowing, *Economic Development Quarterly,* Vol. 17, No. 1 (February 2003).

39 Mark Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005). Available at http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf.

40 Veritec Solutions LLC, *The Florida Deferred Presentment Program Myths & Facts*. (September 2002). Available at http://www.veritecs.com/MythsFacts.pdf

41 Michael Stegman and Robert Faris. Payday Lending: A Business Model that Encourages Chronic Borrowing, *Economic Development Quarterly,* Vol. 17, No. 1 (February 2003).

42 States' renewal policies are as follows:
Renewal ban: Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Montana, Nebraska, New Hampshire, New Mexico, Ohio, Oklahoma, South Carolina, Tennessee, Virginia, Washington, and Wyoming
One renewal allowed: Alabama, Colorado, North Dakota, and Rhode Island
Two renewals allowed: Alaska
Three renewals allowed: Arizona, Idaho
Four renewals allowed: Delaware, South Dakota
Six renewals allowed: Missouri
Kansas, Nevada, Texas, Utah, and Wisconsin do not have limits on renewals. In Texas, payday lenders do not follow the statutes which apply to payday lending, but rather operate under the Credit Services Organization (CSO) model, which does not have limitations on renewals.

43 States with cooling off provisions include Alabama, Florida, Illinois, Indiana, North Dakota, Ohio, and Oklahoma.

44 Interview with Bill Faith, Executive Director of COHHIO. December 5, 2007. Mr. Faith quoted a payday lender lobbyist as saying "The only thing I hate more than a rate cap is a loan cap." The loan cap is a reference to Ohio HB 333's codification of the FDIC Revised Payday Lending Guidelines' limitation on long-term indebtedness to payday lenders.

45 Because Florida payday borrowers must wait 24 hours between loans, they could take out 24 two-week (14 day) loans, with a one day cooling-off period in between, each year. This equates to being in payday lending debt for 92 percent of the year.

46 Because Michigan payday borrowers can take out a new payday loan the same day the previous payday loan is paid off and no cooling off period exists, they can be indebted to a payday lender every day of the year.

47 Oklahoma borrowers have a two day cooling off period after their fifth consecutive loan. Therefore, payday borrowers with two-week loans would have to wait two days between loans every ten weeks. With four two-day cooling off periods a year, the borrower could be in debt for 357 days, or 98% of the year.

48 States with payment plan provisions include Alabama, Alaska, Colorado, Florida, Illinois, Indiana, Michigan, Nevada, New Mexico, Oklahoma, and Washington State.

49 For example, borrowers are eligible for Colorado's payment plan after taking out four consecutive loans (defined as loans taken within five days after a previous loan is repaid). The state regulator office reports that lenders have made their borrowers ineligible for payment plans in the following ways: (1) requiring at least a six day cooling off period after the third consecutive loan, (2) offering an interest free loan after the third consecutive loan (loans without finance charges do not count towards payment plan eligibility under the law), and (3) refusing origination of a 4th consecutive loan, which would presumably drive borrowers to another payday lender. Correspondence via email with Laura Udis, Colorado Consumer Uniform Credit Code Administrator, on file with authors.

50 A borrower owes $377 assuming a $325 payday loan with a $52 fee. If this borrower is given a payment plan to pay the loan back over four pay periods, the fee of each installment would be $94.25 ($377/4 payments).

51 *Florida Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Florida Department of Banking and Finance. (August 2007). Available at http://www.veritecs.com/FL_trends_aug_2007.pdf. Payday borrowers in Florida may request a 60 day grace period the day before their loan is due and must make an appointment with a credit counselor within 7 days.

52 *Michigan Trends in Deferred Presentment*, Prepared by Veritec Solutions LLC for the Michigan Office of Financial and Insurance Services (July 31, 2007). Available at http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf. Payday borrowers are eligible for a payment plan in Michigan after eight transactions over a 12 month period. The lender may charge a $15 set up fee. The borrower can then pay back their debt over three installments.

53 Oklahoma Trends in Deferred Deposit Lending, Prepared by Veritec Solutions LLC for the Oklahoma Department of Consumer Credit. (May 2007). Available at http://www.veritecs.com/OK_Trends_05_2007.pdf. Payday borrowers may request a payment plan in Oklahoma prior to the due date of their 3rd, 4th, or 5th consecutive loans. The lender may charge a fee of 10% or $15, whichever is less. The borrower then pays back their debt over the next four paydays in equal installments and must wait 15 days after paying the loan off before taking out a new payday loan.

54 Data is based on reporting from 92% of the industry. See *2006 Payday Lending Report*. Washington State Department of Financial Institutions (2007). Available at http://www.dfi.wa.gov/cs/pdf/2006_payday_report.pdf. Payday borrowers in Washington State are eligible for a payment plan after taking out four successive loans and before the default of the last loan. Lenders may charge a one-time fee of up to 15 percent of the first $500 of principal owed and 10% of the remaining principal balance. Borrowers are given at least 60 days to pay back their debt in three or more installment payments.

55 "The local payday lending industry supported this year's amendments to the original law, in SB 5452. "It's good legislation," said Dennis Bassford, president of Money Tree Inc. and of the local payday trade group, Financial Service Centers of Washington." http://www.bizjournals.com/seattle/stories/2003/06/02/story6.html.

56 For example, if a borrower took out their first payday loan on October 31, 2004 (the first day the payment plan provision went into effect), they would not be eligible for a payment plan until their fourth consecutive loan which would be due on December 26, 2004 at the earliest. Therefore, it is unlikely that few, if any, borrowers could take advantage of the payment plan until 2005.

57 For 2006, the Washington State regulator expanded the scope of its reporting requirements to capture over 90 percent of payday shops in the state. In previous reports, only the five largest payday lenders reported. Accordingly, for the purposes of the payment plan case study, we limit our analysis to the data provided under the same reporting regime in effect during the period before the payment plan was enacted.

58 Data from Washington state regulator on file with authors. Regulator data from Washington State assumes that borrowers only take loans from a single lender. CRL has applied a multiplier to account for this; for methodology see Appendix 1 of *Financial Quicksand,* available at
http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

59 Letter from Chuck Cole, California Financial Service Providers, to Assemblyman Ted Lieu, dated July 21, 2006. On file with authors.

60 Willie Green, Community Financial Services Association, in response to a question by District of Columbia Councilmember Cheh at a District of Columbia Committee on Public Services and Consumer Affairs hearing, June 21, 2007.

61 Note that other states—such as Alabama and Indiana—have multiple databases, which do not talk to each other, and New Mexico's new law calls for a database but it has not yet been implemented.

62 Quote included in email correspondence from Victor Elias to the Coalition Against Abusive Lending, December 7, 2007.

63 See 10-K SEC filings for Fiscal Year 2006 submitted March 2007 by Advance America and QC Holdings. Advance America reports launching an installment loan product in Illinois in October 2006; QC Holdings began offering installment loans in Illinois in the second quarter of 2006. For a more detailed discussion of how payday lenders in Illinois evade the state's payday lending law, see Hunting Down the Payday Loan Customer: The Debt Collection Practices of Two Payday Loan Companies, The Woodstock Institute (September 28, 2006). Available at
http://www.woodstockinst.org/component/option,com_docman/Itemid,41/task,doc_download/gid,639/.

64 See Advance America schedule of fees for the Illinois installment loan product at
http://www.advanceamerica.net//files/fees/il_fees.pdf.

65 See Oregon Revised Statute 725.

66 Uriah King, Leslie Parrish, and Ozlem Tanik, F*inancial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year* (November 2006). Available at
http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

67 *Press Release: FDIC Launches Study to Identify Alternatives to Payday Loans* (October 30, 2007). Available at
http://www.fdic.gov/news/news/press/2007/pr07088.html.

68 Data provided via correspondence with Mark Pearce, Deputy Commissioner, North Carolina Office of the Commissioner of Banks, on file with authors.

69 For savings to borrowers due to the Salary Advance Loan product's low interest rate see
http://www.ncsecu.org/PDF/Press/022206_SalaryAdvance.pdf. For the total deposits by borrowers into share accounts through the savings component of the Salary Advance Loan, see *State Employees Credit Union 2006 Annual Report*, available at http://www.ncsecu.org/Resources/Publications/PDF/Annual/2006.pdf.

70 *News Release: N.C. Commissioner of Banks and UNC Study Finds Working Families Do Not Miss Payday Lending* (November 13, 2007). Available at http://www.nccob.org/NR/rdonlyres/1D3C8641-B108-4AB9-B9DB-F470B97BCCF5/0/NCCOBpaydaypr.pdf. The entire study, *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options,* is available at
http://www.nccob.org/NR/rdonlyres/4BB13853-F3B0-48E2-9A2B-1A59177018CF/0/NC_After_Payday.pdf.

71 G. Elliehausen & E.C. Lawrence, *Payday Advance Credit in America: An Analysis of Consumer Demand,* (Monograph 25), Georgetown University, McDonough School of Business, Credit Research Center (2001) and *Payday Advance Customer Satisfaction Survey,* Cypress Research Group (May 2004). Available at http://www.cfsa.net/downloads/customer_satisfaction_study.pdf.

72 See Elliehausen and Lawrence (2001) and Cypress Research Group (2004) for findings that payday borrowers support capping interest rates. The general public showed support for capping interest rates in a January 2007 SurveyUSA poll of Virginia residents (available at www.wdbj7.com/Global/story.asp?S=5989382&nav=menu368_2_6) and a 2007 Benenson Strategy Group poll of Ohio swing voters, on file with authors.

73 http://www.batchelderforohio.com/blog.cfm?ID=133

74 Federal Deposit Insurance Corporation, *Payday Lending Programs Revised Examination Guidance,* (March 1, 2005). Available at http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

75 Moed, Joyce. CUs Save Pennsylvanians More the $600K with Alternatives to Payday Loan Program, *The Credit Union Journal.* September 10, 2007.

76 House Bill 333, introduced in the 127th Session of the Ohio General Assembly, October 2007. Bill text available at http://www.legislature.state.oh.us/bills.cfm?ID=127_HB_333.

77 Testimony of Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America before the Subcommittee on Domestic Policy of the House Committee on Oversight and Domestic Reform (March 21, 2007).

78 *Florida Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Florida Department of Banking and Finance. (August 2007). Available at http://www.veritecs.com/FL_trends_aug_2007.pdf. Data on the percent of new loans taken out within the same pay period is from a public records request of Florida data collected by Veritec, provided by the Florida Office of Financial Institutions and Securities Regulation on June 16, 2003, on file with authors.

79 *Michigan Trends in Deferred Presentment,* Prepared by Veritec Solutions LLC for the Michigan Office of Financial and Insurance Services (July 31, 2007). Available at http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf. The report notes that the average borrower took out 8.3 loans during a 13 month period. This equates to 0.64 loans per month, or 7.7 loans per year.

80 *Oklahoma Trends in Deferred Deposit Lending,* Prepared by Veritec Solutions LLC for the Oklahoma Department of Consumer Credit. (May 2007). Available at http://www.veritecs.com/OK_Trends_05_2007.pdf. Data on the percent of new loans taken out within the same pay period is from a public records request of Oklahoma data collected by Veritec, provided by the Oklahoma Department of Consumer Credit on August 29, 2007, on file with authors.

81 Data is based on reporting from 92% of the industry. See *2006 Payday Lending Report.* Washington State Department of Financial Institutions (2007). Available at http://www.dfi.wa.gov/cs/pdf/2006_payday_report.pdf. Regulator data from Washington state assumes that borrowers only take loans from a single lender. CRL has applied a multiplier to account for this. For methodology see Appendix 1 of Financial Quicksand, available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

82 Morgan Stanley Report, *Advance America: Initiating with an Underweight-V Rating,* January 25, 2005 at pg. 25.

About the Center for Responsible Lending

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.

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