Payday Loans, Inc.:
Short on Credit, Long on Debt

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CENTER FOR RESPONSIBLE LENDING

www.responsiblelending.org

Overview

While payday loans are advertised as a quick solution to the occasional financial shortfall, new data analyzing the use of payday loans by borrowers over two years after their first payday loan show that borrowers are typically indebted to payday lenders for much of the year, with those who remain active borrowers taking on more debt over time. This study tracks the transactions of the 11,000 borrowers in Oklahoma who took out their first loans in either March, June, or September of 2006 for the following 24 months.

Specifically, this report finds:

- **The typical payday borrower remains in payday loan debt for much of the year, and many borrowers remain indebted in payday loans for extended periods of time.** While the Federal Deposit Insurance Corporation (FDIC) has ruled that it is inappropriate for payday borrowers to remain indebted for more than 90 days in any 12 month period, we find that borrowers are indebted for more than double this limit on average. For example, in their first year of payday loan use, borrowers are indebted an average of 212 days. Over the full two-year period, borrowers are indebted a total of 372 days on average.

- **Payday borrowers' loans increase in size and frequency as they continue to borrow.** Those payday borrowers who continue to take out loans over a two year period have 12 payday transactions in their second year of borrowing, up from 9 transactions in the first year. In addition, evidence suggests that borrowers' loan sizes increase after their initial loan. While borrowers' initial loans averaged under $300, the average Oklahoma borrower owes $466 on payday loans.

- **A significant share of borrowers become late or default on their payday loan, triggering more fees and placing their bank account at risk.** Over the first two years of payday loan use, 44 percent of borrowers will experience a "return event" or default in which they are cannot service their payday loan debt in a timely manner. These defaults place additional financial stress on borrowers by triggering bounced check fees from the lender and the borrrower's bank.

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, the nation's largest community development financial institution.

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

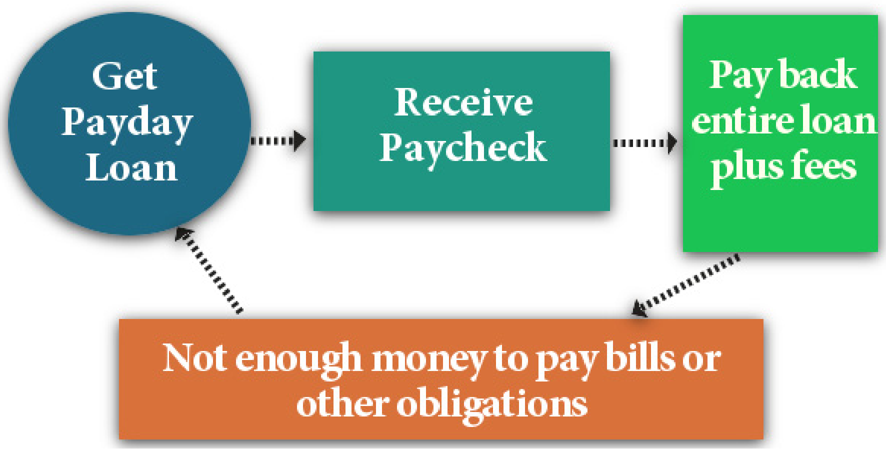
Data collected by regulators of the payday lending industry in many states have demonstrated that the payday lending business model relies on borrowers taking out multiple loans in a year, often on a back-to-back basis. This report supports this finding by showing that very few new borrowers begin borrowing from a payday lender at any given point, but those who do begin borrowing are likely to continue for long stretches of time. This repeated borrowing is a result of the structure of the payday loan product itself—requiring that the borrower repay the entire amount due with a single paycheck virtually ensures that they will not have enough money left over to get through the rest of their pay period without quickly taking out another loan. Borrowers are misled by the promise of a short-term credit product to take a loan that is designed to keep them indebted for extended periods. Payday lenders themselves acknowledge that their product is harmful if used on a continuing basis even though the bulk of payday revenue comes from borrowers stuck in repeated payday loans.

To ensure that available small loans help borrowers cover a financial shortfall without trapping them in long-term debt, states should end special exemptions for payday lenders that authorize triple-digit annual interest rates and restore traditional interest rate limits which are commonly set at or around 36 percent APR. While the new Consumer Financial Protection Bureau (CFPB) at the federal level cannot limit interest rates on payday loans as states can, both the new Bureau and states can take other steps to ensure that payday borrowers' short-term loans do not turn into long-term debt, such as (1) limiting the amount of time a borrower can remain indebted in high-cost payday loan debt; (2) setting sustainable loan terms which provide the borrower adequate time to repay and prohibit the taking of a borrower's personal check or an ACH authorization as security for the loan; (3) responsible underwriting standards that take the borrower's income and other obligations fully into account; and (4) facilitating efforts to help households save.

I. BACKGROUND AND METHODS

Payday loans—small, short-term loans due on a borrower's next payday—are marketed as a quick solution to a financial shortfall. Despite the contention that these loans are intended to be used only on an occasional basis, research from CRL and others confirms that the typical payday borrower has multiple payday loans per year, usually taking one after the other and paying a new fee each time.[1] This "debt treadmill" on which borrowers commonly find themselves is created by the nature of the loan itself—the loan must be repaid in full from a single paycheck, a tall order for a household already living close to the edge. Borrowers routinely find themselves short of cash soon after paying one loan back, and then must take out another to meet their ongoing financial obligations. Chart 1 illustrates this cycle of having to take out one payday loan after another.

Chart 1: Payday Lending Debt Treadmill



In a proposed rule on providing responsible small loans, the National Credit Union Administration (NCUA) found that a dependence on payday loans "often reflects or exacerbates other financial difficulties payday loan borrowers are experiencing."[2] This is consistent with studies which have found that payday lending is associated with higher rates of bankruptcy filings and credit card delinquency, trouble paying bills and medical expenses, and a greater risk of losing a bank account due to excessive overdrafts.[3]

The fees allowed on payday loans vary by state, but are generally between $15-20 per $100 borrowed, the equivalent of an annual percentage rate (APR) of around 400 percent or more on a two-week loan. In most states in which payday lenders operate, they are allowed to charge these triple-digit rates because of special exemptions from the state's traditional interest rate caps, which apply to consumer finance loans and other small loan products. Payday lenders do not operate in 17 states and the District of Columbia either because these jurisdictions do not authorize the product, or because they will not allow lenders to charge triple-digit rates.[4] Payday lenders also do not make loans to active duty military personnel and their families in any state, because these families are protected from payday loans by a federal 36 percent APR limit.[5]

Many of CRL's previous studies of payday borrowing activity have been derived from annual reports from regulators in the states in which payday lenders operate. While these reports provide valuable summary statistics, they do not tell the full story of the experience of borrowers over time. For example, the average number of loans per borrower in a given year is reported, but how many years a consumer remains in payday lending, or whether their borrowing patterns change over time, has not been documented.

This report fills part of this gap by tracking borrowers for 24 months from the date of their first payday loan. It documents the size of their initial loan, how many transactions they conduct, how long they remain indebted, and how many of them default. We analyze the transactions of Oklahoma borrowers whose first payday loan was logged into the state's payday lending database in one of three months—March, June, or September of 2006 (the public records request and response is shown in the Appendix). This database collects data from all lenders in the state, so it reliably captures a borrower's total use of payday loans, even if they borrow from multiple lenders.

We look at consumers who start borrowing from payday lenders in three different quarters to account for cash flow needs that may differ depending on the time of year. As discussed in more detail later, relative to the overall number of borrowers taking out a loan each month, there are few new borrowers entering the payday lending system at any given point in time. For example, during the three months in 2006 in which the borrowers in our analysis (totaling around 11,000 people) take their first loan, there are at least 50,000 total consumers conducting transactions with Oklahoma payday lenders every month.[6]

Table 1: Observation periods of borrowing activity for first-time borrowers

Cohort	Observation Period
1	March 2006-February 2008
2	June 2006-May 2008
3	September 2006-August 2008

In addition to allowing us to track all activity of a given borrower across multiple lenders, the database ensures compliance with Oklahoma's payday lending regulations which allow borrowers to be indebted a maximum of $1,000 across two loans outstanding at any given time. The table below summarizes the main provisions of Oklahoma's payday lending law:

Figure 1: Provisions of Oklahoma's payday lending law:

- Maximum principal outstanding at one time: $1,000 (each loan can be for no more than $500)
- Maximum number of loans outstanding at one time: 2
- Loan term: 12-45 days
- Maximum fees allowed: $15 fee per $100 on portion of loan up to $300, $10 fee per $100 on portion of loan above $300
- No direct rollovers permitted
- Cooling-off period—after 5 consecutive loans, 6th loan cannot be made until the 2nd business day after previous loan repaid
- Extended repayment plan option—eligible for plan on 3rd consecutive loan, subject to an additional processing fee and 15 day cooling off period once repaid

Source: Okla. Stat. Tit. 59 3101 et seq.

In the 11 states including Oklahoma that have a consolidated database tracking system, we can be more confident that lenders are following the laws as it relates to the number of loans a borrower is given.[7] Therefore, it is reasonable to assume our findings on borrowing activity in Oklahoma are conservative relative to what occurs in other states with fewer limitations on payday lending. It should also be noted that because this analysis took place before the worst impacts of the financial crisis hit households across the country, our findings are not affected by more recent financial and employment conditions.

As discussed throughout this paper, we compared the findings from this analysis with other available information and studies, including regulator data from Colorado and Florida, as well as findings from borrower interviews conducted in New Mexico and California, and an analysis of transactions from a large Texas-based payday lender.[8] These supplement and confirm our findings.

II. FINDINGS

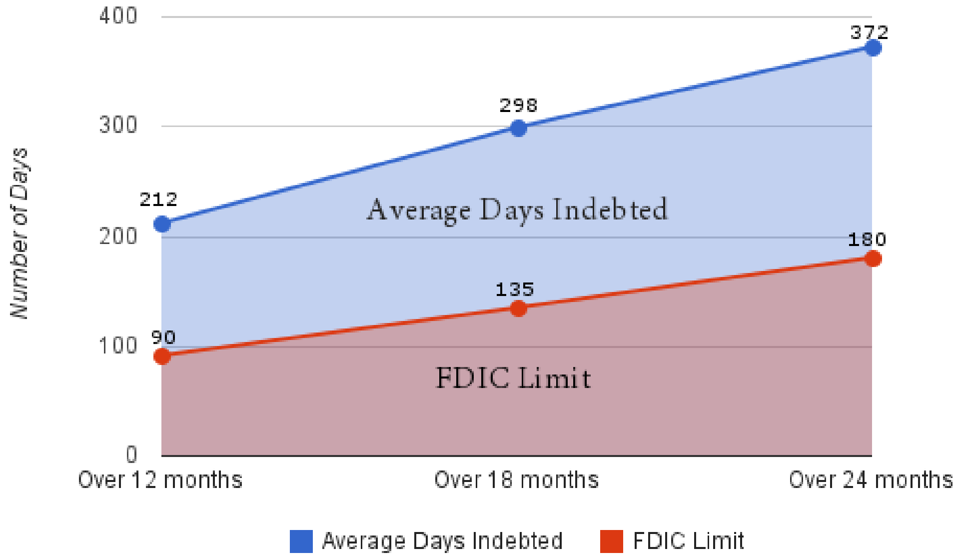
Finding 1: The typical payday borrower remains in payday loan debt for much of the year, and many borrowers remain indebted in payday loans for extended periods of time.
Payday lenders were granted exemptions to existing state interest rate caps that apply to other small loan products in part because of their assertion that borrowers would use these loans only sparingly for financial emergencies. The industry's trade group, the Community Financial Services Association (CFSA), acknowledges in its consumer guide that payday loans are "…not a long-term solution" and that "[r]epeated or frequent use of payday advances can cause serious financial hardship."[9]

Federal banking regulators agree with this assessment that long-term use of payday loans is harmful. In a warning to national banks considering partnering with payday lenders, the Office of the Comptroller of the Currency (OCC) stated that repeatedly renewing a payday loan, which can be done either by extending a loan or through a series of back-to-back transactions, is an exceedingly expensive and unsuitable way to borrow over the long term.[10] The Federal Deposit Insurance Corporation (FDIC) has concluded that extensive use of payday loans is harmful. In guidance to banks that sought to partner with payday lenders, the regulator found that keeping borrowers in payday loan debt for longer than 90 days in any twelve-month period (the equivalent of 6 two-week loans) was inappropriate.[11]

We find that, on average, borrowers stay indebted to payday lenders for far longer than the 90 days that the FDIC considers the maximum acceptable period. The borrowers in our study are indebted an average of 212 days in the first year they borrow (or 58 percent of the year), and continue to be indebted over half the time in their second year as well. This average includes the small number of borrowers (15 percent) who managed to borrow only once and then not return during the remainder of this two-year period, so the depth of indebtedness of the other 85 percent is understated. For example, if we leave out these one-time borrowers, we estimate that the remaining 85 percent of borrowers are indebted for 345 days (63 percent of the total time period) in their first 18 months and 432 days (59 percent of the total time period) on average over the course of two years.[12]

These numbers demonstrate that a substantial number of borrowers are trapped in payday lending debt for over twice what the FDIC has deemed the maximum appropriate length of payday loan indebtedness.

Chart 2: Average number of days indebted in payday loans



A previous report from CRL shows that borrowers in Oklahoma and other states tend to take loans on a consecutive basis—essentially staying in continuous debt for significant stretches of time.[13] Among the 87 percent of Oklahoma borrowers who had multiple payday loan transactions in 2006, a new loan was opened the same day as a previous loan was repaid over half (59 percent) of the time. Other borrowers did not take out a new loan on the same day, but nevertheless had to return before their next payday two weeks later—our definition of being trapped in the payday lending debt treadmill. Nearly 90 percent of time, these repeat borrowers had to return to the payday lender for another loan within the same pay period of paying off the previous loan. Knowing that borrowers' loans tend to be taken consecutively rather than spaced out more sporadically, it is likely that not only are the payday borrowers in this analysis indebted for many days of the year, but that this signifies extended periods of generally uninterrupted high-cost indebtedness.

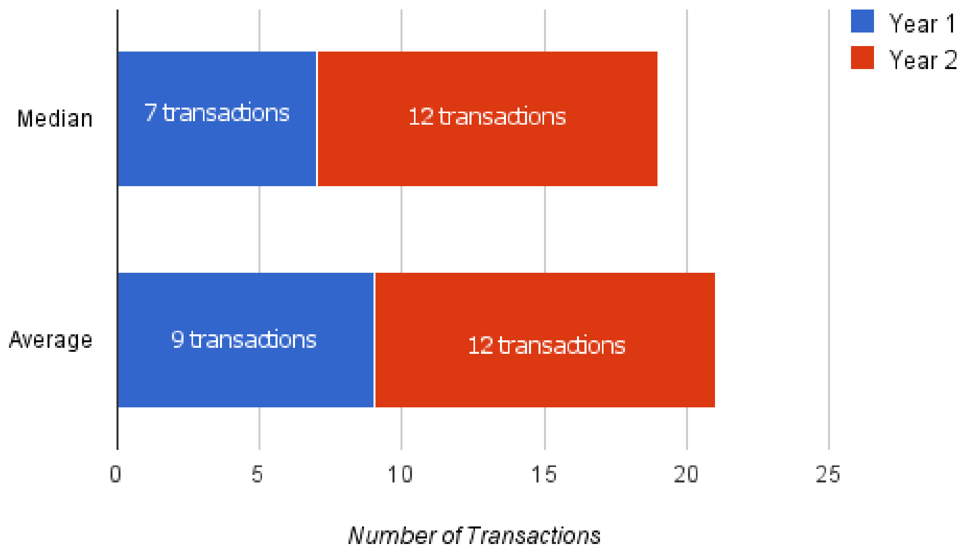
A law professor at the University of New Mexico conducting interviews of payday borrowers in that state similarly found that most payday borrowers had been in payday loan debt on a continuous basis for more than a year. In an article outlining her findings, she concludes that "[t]o call this industry the 'short-term loan' industry is a misnomer."[14]

Finding 2: Payday borrowers' loans increase in size and frequency as they continue to borrow.

In addition to staying indebted for long stretches of time, our data demonstrate that borrowers tend to become more heavily indebted—taking out loans more frequently and for larger amounts—as they continue to borrow from payday lenders.

First, we examine borrowers who remain "active" throughout the 24-month time period (defined as borrowers with at least one loan in months 13-18 and one loan in months 19-24).[15] In their first year of payday usage, these borrowers had an average of 9 transactions (7 median). The frequency of borrowing among those who remained active increases during the second year, where our data suggest that active borrowers take out a total of 12 loans—six loans during the first half of the year, and an additional 6 loans during the second half. Put another way, those using payday loans consistently throughout this two-year time period are taking out the equivalent of one loan every month by the second year.

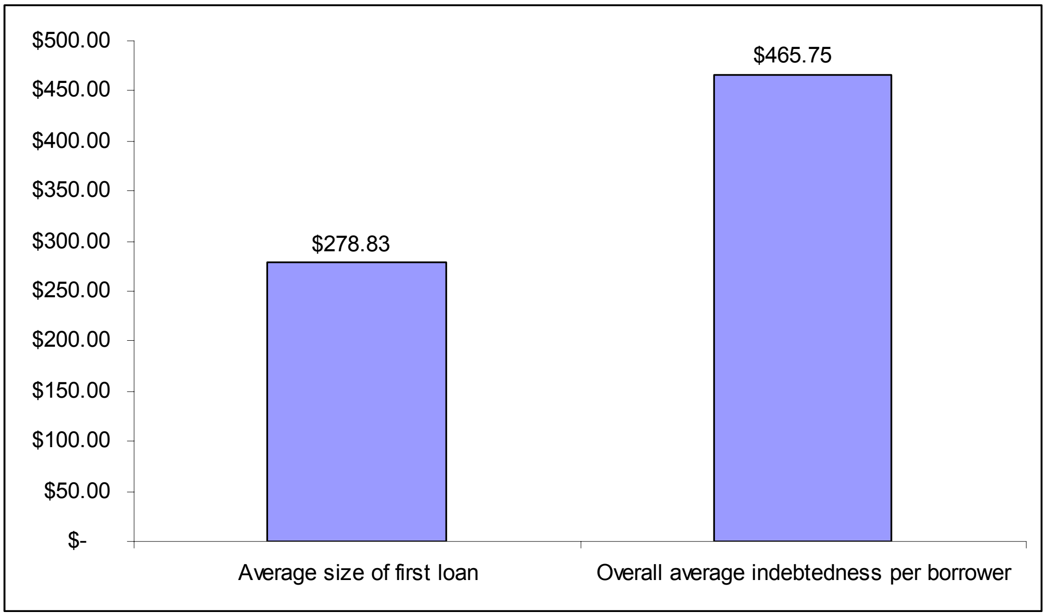
Chart 3: Increased frequency of payday borrowing, among active borrowers



These findings of borrowers engaging in multiple transactions over time are consistent with borrower comments in a focus group conducted in California for the state regulator. In this group of 16 payday borrowers, only one took just a single loan over an 18 month time period. For the remaining borrowers, six had 20 or more loans (or had so many loans they could not remember the exact number), and an additional six had 15 to 20 loans during 18 months' time.[16]

In addition to borrowing more frequently, our data suggest that the amount borrowed also increases over time. The first loans taken by borrowers in our study were for relatively small amounts. For example, the average (mean) size of an initial loan was $279. Oklahoma allows consumers to borrow up to $1,000, through two loans which individually cannot exceed $500. During this 2006-2008 time period, the average amount by which all borrowers in Oklahoma were indebted by about $466 to a payday lender—a 67 percent increase over the amount of a payday borrower's first loan.[17]

Chart 4: Increasing payday loan indebtedness



Taking out larger loans puts borrowers at greater risk of not being able to retire their payday loan debt and, as a result, needing to take out a new loan each pay period. For example, the regulator in Colorado has found that larger loans are more likely to be "refinanced" (defined in that state as either directly renewing the loan or taking out a new loan the same day a previous loan is repaid).[18]

The root of this problem of borrowers increasing the frequency and size of their payday indebtedness is the balloon payment structure of the payday loan product, which requires the loan to be repaid in full over a very short period of time. The financial burden of only having two weeks to repay can be insurmountable. Allowing a minimum of 90 days to repay over the course of installments—as the FDIC recommended for its own small loan pilot program—creates a more sustainable loan for borrowers. Table 2 shows that even a $300 loan—which is far lower the average amount by which an Oklahoma borrower is indebted ($466)—eats up all remaining funds after the borrower has paid for just their most basic expenses. In contrast, the same loan and fee paid off over a longer period of time becomes more manageable.[19]

Table 2: Amount repaid out of each paycheck, $300 loan with 15% fee

	Payment (including principal and fee)	Payment as share of residual income (defined as income remaining after basic expenses for a pay period) *
$300 loan and $45 fee, 14 day loan term, one balloon payment	$345.00	100%
$300 loan and $45 fee, 90 day loan term, 6 installment payments	$57.50	17%

*A borrower earning $35,000 a year would bring home a paycheck after taxes every two weeks of about $1240.81 and need to spend $895.42 during that period on basic expenses such as food, housing, transportation, and healthcare. This leaves the borrower with just over $345 for their payday loan, other loan payments, and other potential expenses such as childcare. See household budget calculations derived from the Bureau of Labor Statistics Consumer Expenditure Survey on page 15 of CRL's Phantom Demand, available at http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

Finding 3: A significant share of borrowers become late or default on their payday loan, triggering more fees and placing their bank account at risk.

Payday lenders say that over 90 percent of the time, borrowers successfully repay their loan.[20] This is consistent with the default rates of around five percent reported by state regulators in Oklahoma and elsewhere, which is similar to that of a credit card.[21] However, while payday lenders have very little risk of not getting repaid on any given loan, the typical borrower taking out loan after loan every year has a much higher chance of not only experiencing an eventual default on one of their payday loans, but also other financial distress as they attempt to pay for their other obligations.

The payday lending industry contends that the small share of loans going into default is proof that their borrowers are demonstrating their ability to repay—or effectively handle—their payday loan debt. However, a low default rate on a per loan basis should be expected due to two critical factors: (1) the payday loan is timed to be due on the borrower's payday, when the borrower has an infusion of cash that can be used to repay the loan and (2) lenders can repay themselves, since they are holding the borrower's personal check for the amount due, or have authorization to withdraw funds from a bank account. In effect, the payday lender guarantees that he will have the first claim on the borrower's funds, potentially causing the borrower to come up short on his or her other obligations. Research finding that those with access to payday lending have trouble paying other bills and that payday borrowers are more likely to become delinquent on their credit card payments illustrates this dynamic of financial distress showing up in other areas of the borrower's balance sheet while they service their payday loan debt on time.[22]

Eventually though, this financial distress can cause a default on payday loans as well. In his seminal book on the history of the payday lending industry, Robert Mayer notes that the typical payday lending company must set aside just over three percent of loan volume for losses, anticipating one out of every thirty loans will go unpaid. However, because lenders, such as Advance America, report that their borrowers take out about 8 loans on average in a given year, one in four borrowers will incur a default. Mayer concludes that "[t]hese debtors will flounder and drown, but in most cases not before they have generated more in fee income than must be written off in principal."[23]

In our sample of Oklahoma borrowers, we find that 37 percent—or almost two out of every five borrowers—experience a "return event" within their first year of payday borrowing. This return event, or default, occurs when the borrower has failed to return to the lender to repay their loan on its due date or their check bounces when the lender attempts to collect on the debt at the borrower's bank. Within the first two years of borrowing, nearly half (44 percent) of borrowers we tracked had experienced such a default.

A study of a large Texas-based payday lender finds an even higher default risk for borrowers. Tracking payday borrowers' activity from 2000-2004, the authors find that over half (54 percent) of payday borrowers who took out loans on a bi-weekly basis defaulted. Over half of the defaulting borrowers could not pay on the loan further after the initial default, resulting in the debt being written off.[24]

These defaults place additional financial stress on borrowers, with both the lender and the borrower's bank assessing NSF fees, which average over $30 per incident. Those that fail to make good on the loan and late fee may be taken to court or have their debt sold to a collection agency. The borrower's bank account is also placed at risk, since the leading cause of a bank closing a customer's account is excessive overdrafts. In fact, research has shown that access to payday loans is linked with increased rates of involuntary bank account closures.[25]

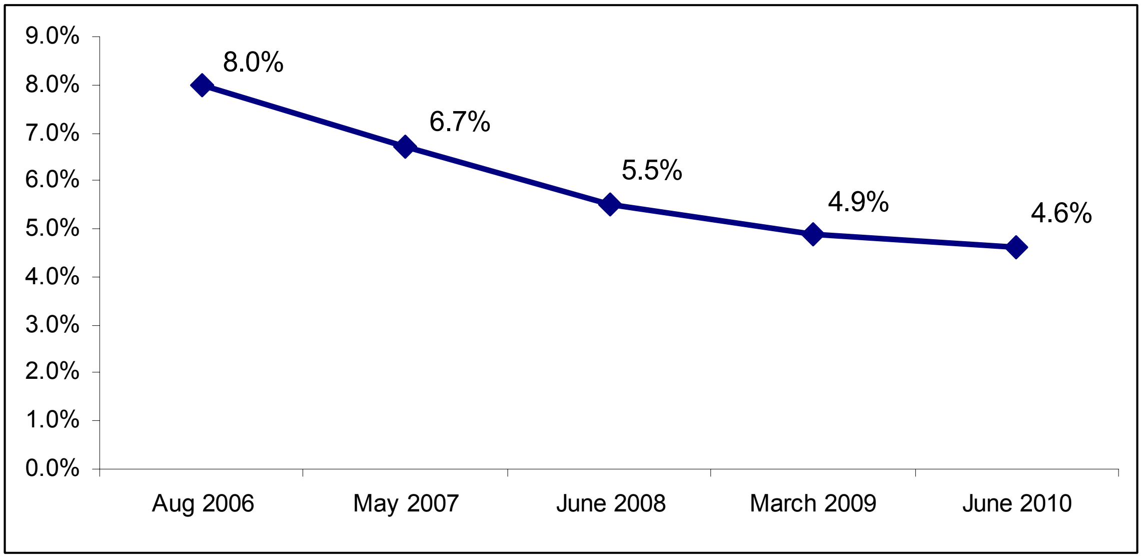
III. DISCUSSION

Tracking Oklahoma payday borrowers for 24 months from their initial loans reveals that many consumers end up indebted to payday lenders for a substantial period of time. This repeated borrowing is not an aberration; our previous research has found that the payday lending business model is dependent on keeping customers borrowing frequently over long periods of time—more than 60 percent of payday lending business is generated by borrowers who have 12 or more transactions per year. While the data clearly show a dependence on frequent borrowers, payday lenders also admit that long-term use of their product is harmful.

Keeping existing customers in extended periods of debt is important to the payday lending business model, since only a small base of new customers take out payday loans every year. The regulators in Florida and Oklahoma issue reports on payday lending activity over 12 month periods at somewhat regular intervals. These reports include what share of borrowers with transactions in the state are new to payday lending—meaning they have never taken a payday loan from a lender licensed in their state before.

As the graph below demonstrates, new borrowers make up a small share of total borrowers, and this percentage has declined to less than five percent of total customers in recent years.[26] For example, the August 2006 Oklahoma report found that 8 percent of borrowers were new over the year preceding that report; by its June 2010 report, this figure had dropped to 4.6 percent. Perhaps most interestingly, there was no discernable increase in new borrowers brought on by the financial crisis and subsequent tightening of the credit markets.[27]

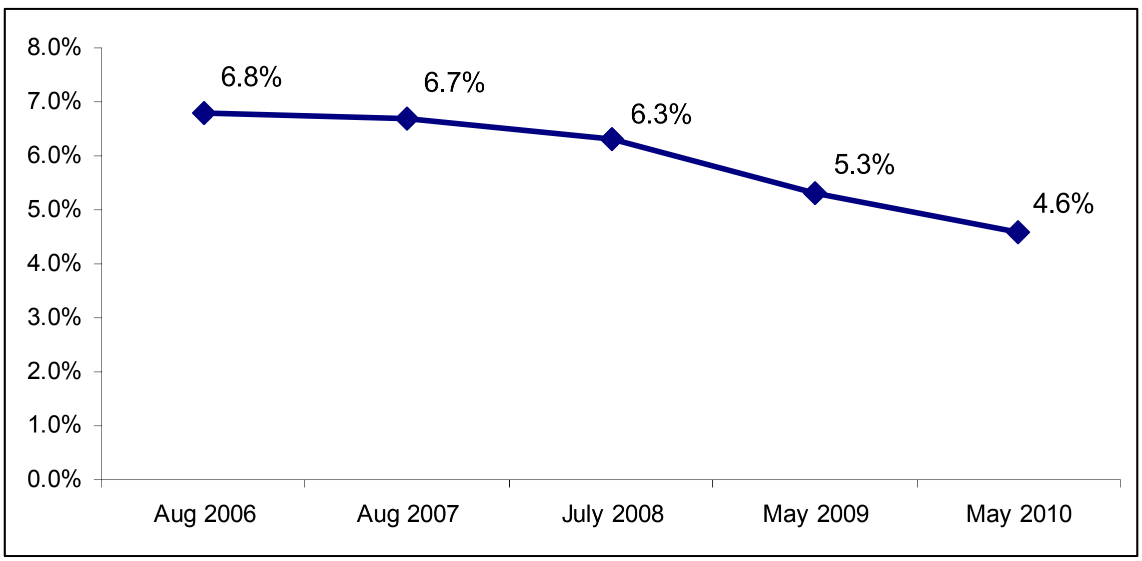
Chart 5: Share of borrowers who are "new" to payday lending in Oklahoma



Note: The dates in the chart above refer to the publication date of the report in which the share of new borrowers is reported for the preceding year.

We see a similar pattern when looking at regulator reports from Florida over roughly the same time period.

Chart 6: Share of borrowers who are "new" to payday lending in Florida



Note: The dates in the chart above refer to the publication date of the report in which the share of new borrowers is reported for the preceding year.

Put another way, well over 90 percent of payday borrowers conducting transactions in a given year are existing customers who remain payday borrowers for long stretches of time rather than new customers taking out their first loan. Because there are relatively few new borrowers entering the payday loan market, lenders have a strong incentive to keep existing customers borrowing on a regular, ongoing basis

This reality that underlies the payday lending business model is apparent in industry advertisements. These ads aim to get borrowers in the door the first time to try out a payday loan and then encourage them to keep borrowing. A survey of company websites and direct mail advertisements of the 15 largest payday lending companies from 2008-2010 showed that nine of these companies offered a free or discounted first loan and six offered a discount on loans for returning customers.[28] Offering a free first loan gives some suggestion of the industry's confidence that most borrowers will need to return often for new loans once the payday lending cycle begins and will make up for that initial "discount" many times over.

IV. CONCLUSION AND POLICY RECOMMENDATIONS

First-time payday borrowers take out a loan expecting a quick fix to a financial shortfall. However, our analysis demonstrates that these short-term loans often lead to long-term indebtedness. While the industry contends that the vast majority of its borrowers use the product responsibly—defined as using these loans only on an occasional basis for an unexpected financial emergency—our findings show otherwise. Even in a state such as Oklahoma that has a variety of protections in place, borrowers still remain in debt for a significant portion of the year. Among those borrowers who take loans regularly throughout this time period, the frequency and size of borrowing increases over time. In addition, on average, borrowers are indebted to payday lenders over twice as long as the FDIC found is appropriate for the product. The financial toll of this long-term high-cost debt results in more than one-third of those in our sample experiencing a default within their first year of payday loan usage, and close to half defaulting by the end of the second year.

The fundamental flaws of a payday loan are the product's design and weak underwriting. Payday lenders provide loans without giving consideration to a borrower's other obligations and therefore cannot gauge the borrower's ability to repay. They also require that the loan and fees be paid back in full from a single paycheck. To ensure households seeking to cover a financial shortfall with a small loan can do so without ending up in long-term debt and less financially secure, we recommend the following:

1. End special exemptions for payday lenders and other providers of high-cost credit that authorize triple-digit annual interest rates. Many states that are home to payday lenders and other providers of high-cost credit, such as car title lenders, have authorized this practice by creating a special exemption to the state's cap on interest rates that apply to all other small loan providers. Often, these exemptions were granted based on the payday lending industry's argument that its loans were to be used only occasionally for financial emergencies. Data from this and other analyses, however, clearly show that the industry does not function this way; instead, the average borrower stays indebted in payday loans for over half of the year.

Many states have rolled back their exemptions to existing double-digit interest rate caps for payday lenders in recent years.[29] Other states that did not have any interest rate caps on small loans have decided to subject all small loan lenders to an interest rate cap, including those making payday loans.[30] While these rate caps vary by state, they tend to be in the range of 36 percent annual interest, the historical median limit which protected citizens of many states from predatory lending throughout much of the 20th Century.[31] As noted previously, 17 states and the

District of Columbia have rate caps that preclude triple-digit payday loans. Moreover, after considering how payday and other high-cost loans were harming the military, Congress enacted a 36 percent rate cap in 2006 to protect active-duty servicemembers and their families from payday loans nationwide. A study in North Carolina found that residents were overwhelmingly pleased to no longer have these loans offered in their state, and found other ways to deal with financial shortfalls.[32]

2. Limit the amount of time a borrower can remain indebted in high-cost payday loans. While a rate cap deals with the problem of predatory small loans comprehensively, regulators and policymakers at either the state or federal level, such as the Consumer Financial Protection Bureau, could—at a minimum—ensure that payday borrowers' short-term loans do not turn into long-term debt by limiting the number of days in any 12-month period a borrower could be indebted to a payday lender. This could be done by following the FDIC's guidance of no more than 90 days a year indebtedness—the equivalent of about six two-week loans. A measure such as this would help to ensure that lenders are providing these loans only as advertised—on no more than an *occasional* basis.

3. Ensure that small loans do not lead to debt traps by requiring sustainable loan terms and meaningful underwriting. The FDIC and the NCUA have both laid out guidelines for what constitutes a responsible small loan with some similar features.[33] Both recognize that cash-strapped borrowers will need more than one pay cycle to repay their loan, and that payments should be in regularly amortizing installments. In an evaluation of its small loan pilot program, the FDIC concluded that "a longer loan term is key…because it provides more time for consumers to recover from a financial emergency than the single pay cycle for payday loans" and that "a 90-day loan term emerged as the minimum time needed to repay a small-dollar loan."[34]

Lenders should be required to assess a borrower's ability to repay a loan in full without the need to refinance or immediately re-borrow by considering the borrower's income and other obligations, rather than using access to a borrower's bank account—either through taking a personal check or an ACH authorization—as security for the loan. Some states that have experimented with ability to repay standards for payday loans have only required lenders to limit loan sizes to a share of the borrower's monthly income. This fails to take into account that most borrowers only have two weeks of income (rather than a month) available to repay a given loan. In addition, there is no accounting for the borrower's other obligations and, therefore, the actual amount of money they have to repay the loan.[35]

Facilitate efforts to help low- and moderate-income households save. All families, and especially those living paycheck-to-paycheck, would benefit from having savings that they could use as an alternative to taking on debt when an unexpected expense occurs. The Consumer Federation of America 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 with more than $500 in emergency savings.[36] Emergency savings can be encouraged and facilitated through a variety of means including small loan products with savings features, matched savings programs, and reforms to designs of government assistance programs, with asset limits that may discourage saving.[37]

[1] For a more detailed discussion of how payday borrowers take out multiple consecutive loans, see Leslie Parrish and Uriah King, *Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume*, Center for Responsible Lending (July 9, 2009), available at http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf. Other research showing evidence that many borrowers take out multiple loans in a year include Marianne Bertrand and Adair Morse, *Information Disclosure, Cognitive Biases, and Payday Borrowing,* University of Chicago School of Business (March 2009) and Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?,* Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008).

[2] See 75 Fed. Reg. 24497 (May 5, 2010).

[3] See Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?,* Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008); Sumit Agarwal, Paige Marta Skiba, & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?,* Federal Reserve Bank of Chicago, Vanderbilt University Law School, and University of Pennsylvania, (January 13, 2009); Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market,* Kellogg School of Management, Northwestern University, (January 3, 2009); and Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School, (December 3, 2008).

[4] In addition to the District of Columbia, 17 states—including Arkansas, Arizona, Connecticut, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia do not grant exemptions to interest rate caps that authorize triple-digit rate payday lending.

[5] 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, was signed into law in October 2006. The interest rate cap took effect October 1, 2007.

[6] Oklahoma regulator reports show that about 50,000-55,000 payday borrowers took out loans in the months of March, June, and September 2006. See *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions LLC (August 2006) and *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions LLC (May 2007).

[7] States which currently operate a single database of all payday lending transactions to ensure compliance with regulations include Florida, Illinois, Kentucky, Michigan, New Mexico, North Dakota, Oklahoma, South Carolina, Virginia, Washington state, and Wisconsin.

[8] See the results from focus groups conducted in California described in *2007 Department of Corporations Payday Loan Study*, Applied Management and Planning Group (December 2007) and a series of interviews with payday borrowers discussed in Nathalie Martin, *1,000% Interest—Good while supplies last: A study of payday loan practices and solutions*, Arizona Law Review Vol. 52 (2010). In addition, Paige Marta Skiba of Vanderbilt University and Jeremy Tobacman of the University of Pennsylvania have authored a series of studies documenting their findings of borrower outcomes using a database of 145,000 payday loan applicants from 2000-2004 from a large Texas-based payday and pawn lender.

[9] *Your Guide to Responsible Payday Advances*, Community Financial Services Association of America. Available at http://www.cfsa.net/downloads/Your_Guide_to_Responsible_Use_of_Payday_Advances_English.pdf.

[10] *OCC Advisory Letter on Payday Lending*, AL 2000-10 (Nov. 27, 2000).

[11] *Guidelines for Payday Lending*, FDIC Financial Institutions Letter FIL-14-2005 (February 25, 2005), available at http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[12] Since 15 percent of borrowers have just a single loan in year 1, we can assume they are indebted for zero days in year 2. Given that, we can estimate what number of days the remaining 85 percent of borrowers would be indebted to arrive at the overall average days reported by the Oklahoma regulator.

[13] Leslie Parrish and Uriah King, *Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume*, Center for Responsible Lending (July 9, 2009)

[14] Nathalie Martin, *1,000% Interest—Good while supplies last: A study of payday loan practices and solutions*, Arizona Law Review Vol. 52 (2010).

[15] For purposes of our analysis, we assume that those borrowers active in the first half of year 2 are the same as those borrowers active in the second half of year 2. However, even if this assumption does not hold in all cases, the data still show an average of six loans in each six month timeframe, or one transaction a month for the average consumer that is using payday loans.

[16] *2007 Department of Corporations Payday Loan Study*, Applied Management and Planning Group (December 2007).

[17] During the 2006-2008 time period, three payday lending reports were issued by the Oklahoma regulator citing the average amount borrowers were indebted over the preceding 12 months. These averages were $460.26, $469.05, and $467.94 for the August 2006, May 2007, and June 2008 reports, respectively, or an overall average of $465.75. The reported amount of indebtedness for a single borrower takes into account that this borrower may have up to two loans outstanding at any given time. However, even if we only compare a borrower's initial loan to an average loan taken in Oklahoma during this time period (ranging from $354 to $378 per loan depending on the year), we find that the initial loan is for a significantly smaller amount. See *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions LLC (August 2006), *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions LLC (May 2007), and *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions LLC (June 2008).
[18] *Payday Lending Demographic and Statistical Information: July 2000 through December 2009*, Administrator of the Colorado Uniform Consumer Credit Code (March 2, 2010), available at http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/DDLASummary2009corr.pdf
[19] Some states require lenders to offer extended payment plans to borrowers who struggle with payday lending debt. However, many payday lenders are effective in dissuading borrowers from using this option. See page 15 in Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate Caps are the Only Proven Payday Lending Reform*, Center for Responsible Lending (December 13, 2007).
[20] For example, the Community Financial Services Association's *Myth vs. Fact* notes that "More than 90 percent of payday loans are repaid when due…" available at http://www.cfsa.net/myth_vs_reality.html.
[21] See historical credit card delinquency rates at http://www.federalreserve.gov/releases/chargeoff/delallsa.htm .
[22] A study of payday borrowers with credit cards found that once the user began borrowing from a payday lender, they were 92 percent more likely to become delinquent on their credit card payment. See Sumit Agarwal, Paige Marta Skiba, & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?,* Federal Reserve Bank of Chicago, Vanderbilt University Law School, and University of Pennsylvania, (January 13, 2009). A study comparing low- and middle-income households in states with and without access to payday lending found that those who could access payday loans had increased chances of having difficulty of paying bills, or having to delay medical care, dental care, and prescription drug purchases. See Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market,* Kellogg School of Management, Northwestern University, (January 3, 2009)
[23] Robert Mayer, *Quick Cash: The Story of the Loan Shark*, Northern Illinois University Press (2010), p 152-153.
[24] Paige Marta Skiba (Vanderbilt) and Jeremy Tobacman (U. Pennsylvania). *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default*, Vanderbilt University Law School and Unversity of Pennsylvania (August 21, 2008). Available at: http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=1636.
[25] Incurring NSF fees as a result of payday loan defaults may ultimately cause a borrower to lose their banking account privileges—the leading cause of involuntary bank account closures is the customer becoming excessively overdrawn, and households with access to payday loans experience higher involuntary bank account closure rates than those with no access to these loans. See Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School, (December 3, 2008).
[26] The decreasing share of new borrowers over time is likely attributable to the fact that as more borrowers are entered into the database system over several years, the base naturally grows. Thus, new borrowers will make up a declining share of total borrowers in the database. It is possible, however, that the actual number of new borrowers entering the system is also declining over time.
[27] While rising unemployment could temper demand for payday loans, some payday lenders have recently begun allowing unemployment benefits to be used as proof of an income stream. In addition, we find no evidence that the higher levels of underemployment, which might cause more financial shortfalls, have translated into a rise in payday loan users.
[28] A more detailed analysis will be provided in a forthcoming paper from CRL showing how payday lenders do not compete with each other based on differences in pricing or product offerings.
[29] For example, an existing payday loan authorization was allowed to expire in Arizona in July 2010, and recent laws in Ohio, Oregon and the District of Columbia curtailed payday lenders' ability to offer loans at triple-digit rates.
[30] In Montana and New Hampshire, laws were passed by ballot initiative and the legislature respectively to establish interest rate caps on a range on small loan products which are regulated at the state level.

[31] 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 (Winter 2008) and Lynn Drysdale and 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).
[32] Kim Manturuk and Roberto Quercia, North Carolina Consumers after Payday Lending: Attitudes and Experiences with Credit Options, UNC Center for Community Capital (November 2007), available at http://www.ccc.unc.edu/abstracts/1107_NorthCarolina.php
[33] See the FDIC's Financial Institution Letter FIL-50-2007, available at www.fdic.gov/news/news/financial/2007/fil07050a.html and the NCUA's announcement of its payday loan alternative product at http://www.ncua.gov/news/press_releases/2010/MA10-0916MatzPaydayLoan.pdf for a discussion of affordable small loan guidelines. Most notably, each program encourages loans with longer terms which are repayable in installments.
[34] "A Template for Success: The FDIC's Small-Dollar Loan Pilot Program," *FDIC Quarterly*, 2010, Vol. 2 No. 2, available at http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf
[35] A few states have ability to repay standards which limit payday loan indebtedness to 20-25% of total gross monthly income. However, because these loans are typically due in two weeks, the borrower only has available half of this monthly income to repay, and likely has other obligations that will consume much of a paycheck that are not considered in current ability to repay provisions.
[36] 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).
[37] For more information on how policymakers and regulators could encourage households to save and reform policies that discourage saving among low-income households, see Cramer et al. *The Assets Agenda 2011: Policy Options to Promote Savings and Asset Development*, New America Foundation (September 2010), available at http://assets.newamerica.net/sites/newamerica.net/files/policydocs/Assets_Agenda_2011.pdf. In addition to these broader policy ideas, several financial institutions have created small loan programs that can serve as alternatives to payday loans that incorporate savings features. The goal of these programs is to help borrowers build savings so that eventually they can tap into their own reserves if they have a financial short-fall. Some examples of these initiatives include the state-wide Pennsylvania Better Choice program (http://www.patreasury.org/betterChoice.html) and the Salary Advance loan offered by one of the country's largest credit unions, the North Carolina State Employees Credit Union (https://www.ncsecu.org/Loans/SalaryAdvance.html).

APPENDIX: PUBLIC RECORDS REQUEST QUESTIONS AND ANSWERS

Study parameters: An analysis of Oklahoma borrowers entered into the database in March, June, and September 2006 (the "study cohort")

Initial loan data:

1. Total number of new borrowers which comprise the study cohort

11,062

2. For these borrowers' first transactions: the average (median) loan size, average (median) loan term, average (mean and median) fee charged

Mean loan size: $278.83
Median loan size: $250.00

Mean loan term: 30.70 days
Median loan term: 17 days

Mean fee charged: $36.70
Median fee charged: $37.50

Repeat/consecutive borrowing:

1. Number/percent of study cohort borrowers who continued to use the product over the course of 12 months, over the course of 18 months, over the course of 24 months.

Continued use within months 0-12: 9,421 (85.2%)
Continued use within months 13-18: 4,413 (39.9%)
Continued use within months 19-24: 3,661 (33.1%)

(note: "continued use" for each time period is defined as follows: (1) for months 0-12, borrowers with more than one transaction during this time period; (2) for months 13-18, borrowers with at least one transaction during this time period; (3) for months 19-24, borrowers with at least one loan during this time period.)

2. Average (median and mean) number of transactions per borrower over the first 12 months; over the first 18 months; over the first 24 months *(note: we would want this reported two ways—(1) for all study cohort, even if they are no longer active borrowers after the first year and (2) only for "active" borrowers who are continuing to use the product during these time periods, ex: to measure the average number of transactions over 18 months, we would only look at borrowers with at least one transaction between months 12-18; to measure the average number of transactions*

over 24 months, we would only look at borrowers with at least one transaction between months 18-24)

(1) For all study cohort, even if no longer active:

Mean number of transactions per borrower 0-12 months: 9.31
Median number of transactions per borrower 0-12 months: 7

Mean number of transactions per borrower 13-18 months: 2.52
Median number of transactions per borrower 13-18 months: 0

Mean number of transactions per borrower 19-24 months: 2.10
Median number of transactions per borrower 19-24 months: 0

(2) Only for "active" borrowers (at least one loan during period in question)

Mean number of transactions per borrower 0-12 months: 9.31
Median number of transactions per borrower 0-12 months: 7

Mean number of transactions per borrower 13-18 months: 6.32
Median number of transactions per borrower 13-18 months: 6

Mean number of transactions per borrower 19-24 months: 6.36
Median number of transactions per borrower 19-24 months: 6

3. On average (mean and median), how many days are cohort borrowers indebted within a 12 month period? 18 month period? 24 month period?

Over 12 month period, mean days indebted: 211.87
Over 12 month period, median days indebted: 228

Over 18 month period, mean days indebted: 298.39
Over 18 month period, median days indebted: 313

Over 24 month period, mean days indebted: 372.45
Over 24 month period, median days indebted: 375.5

Return events:

1. Percent of cohort borrowers that have experienced a "return event" over the first 12 months, over the first 18 months, over the first 24 months. How many transactions on average (mean and median) has the study cohort borrower opened before this return event occurs?

Returns in first 12 months: 4,089 (37%)

Mean number of loans before return: 5.86
Median number of loans before return: 4.50

Returns in first 18 months: 4,506 (40.7%)
Mean number of loans before return: 7.34
Median number of loans before return: 5.00

Returns in first 24 months: 4,810 (43.5%)
Mean number of loans before return: 8.58
Median number of loans before return: 5.00

(note: the number of return events is cumulative)