IN THE UNITED STATES DISTRICT COURT
FOR THE STATE OF DELAWARE

ROSALYN JOHNSON, on behalf of herself and all others similarly situated,	)	
Plaintiffs,	)	C.A. No. 1:13-v-01186-LPS
v.	)	
ACE CASH EXPRESS, INC.	)	CLASS ACTION
Defendant.	)	

SECOND AMENDED CLASS ACTION COMPLAINT[1]

Plaintiff ROSALYN JOHNSON, on behalf of herself and all others similarly situated, alleges as follows:

Nature of Action

1. This is an action seeking permanent injunctive relief, recovery of compensatory, consequential, and punitive damages, reasonable attorneys' fees and costs, and other relief arising from defendants' wrongful and unconscionable conduct, including breaches of the duty of good faith and fair dealing, and violations of 6 Del. C. § 2513 (the "Delaware Consumer Fraud Act") by ACE CASH EXPRESS, INC. (the "Defendant").

2. Plaintiff is a borrower who took a loan from Defendant under unconscionable terms and conditions. Defendant advertises and markets these loans as "fast, secure and easy" that is "convenient." At the same time, Defendant further and expressly advises that its product is for "short-term financial needs only, and not as a long-term solution." In reality, however, Defendant preys on poor and unsophisticated borrowers, who do not understand the financial or legal implications of these loans. Further, Defendant never

[1] A blackline comparing the amended complaint to this second amended complaint is attached hereto as Exhibit J.

has the intention of making a short-term loan. Rather than providing a quick "solution," Defendant intends to burden borrowers with expensive, long-term debt, enforced by unconscionable terms and conditions, which they know borrowers will have little or no ability to understand or repay. As a result, Plaintiff, and thousands of similarly situated borrowers, suffers injury, harm, loss and damage.

3. As an example, Plaintiff borrowed $450.00 from Defendant. The yearly interest rate or cost of this loan: 387.85% or $200.38, assuming the loan could be paid off in full; within two months. Late payments are subject to a delinquency charge of 5% of the unpaid amount. Additionally, Defendant forced Plaintiff to grant them a secured lien on her bank account, and authorization for Defendant to make automatic withdraws, and release important rights of due process, including the right to a jury trial, or judicially monitored discovery.

4. This loan threatens Plaintiff's ability to pay rent, purchase food, and otherwise cover basic living expenses.

The Parties

5. Plaintiff ROSALYN JOHNSON is a natural person residing at 102 W. 23RD Street, Wilmington, Delaware 19802. She incurred a loan from ACE CASH EXPRESS, INC., on or about June 16, 2013.

6. Defendant ACE CASH EXPRESS, INC. is a foreign corporation registered to do business in Delaware, which may be served with process at the offices of its registered agent for service of process in Delaware, The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801. ACE CASH EXPRESS, INC. does business in Delaware at 1901 West 4th Street, Wilmington, DE 19805, 14 Marrows Road, Suite B,

Newark, DE 19713, 2504 Kirkwood Highway, Wilmington, DE 19805, 38223 DuPont Boulevard, Unit 7, Selbyville, DE 19975, 22978 Sussex Highway, Seaford, DE 19973, 3209 Miller Road, Unit H, Wilmington, DE 19802, and 833 North Market Street, Wilmington, DE 19801.

Jurisdiction and Venue

7. This Court has exclusive jurisdiction over this civil action pursuant to 28 U.S.C. § 1332(d)(2) because the controversy exceeds the sum of $5,000,000, exclusive of interest and costs, and the Plaintiff is a citizen of a State different than one of the defendants, and Plaintiff believes there are more than a 100 class members.

8. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391(b)(2) as a substantial part of the events giving rise to Plaintiff's claims occurred in this judicial district.

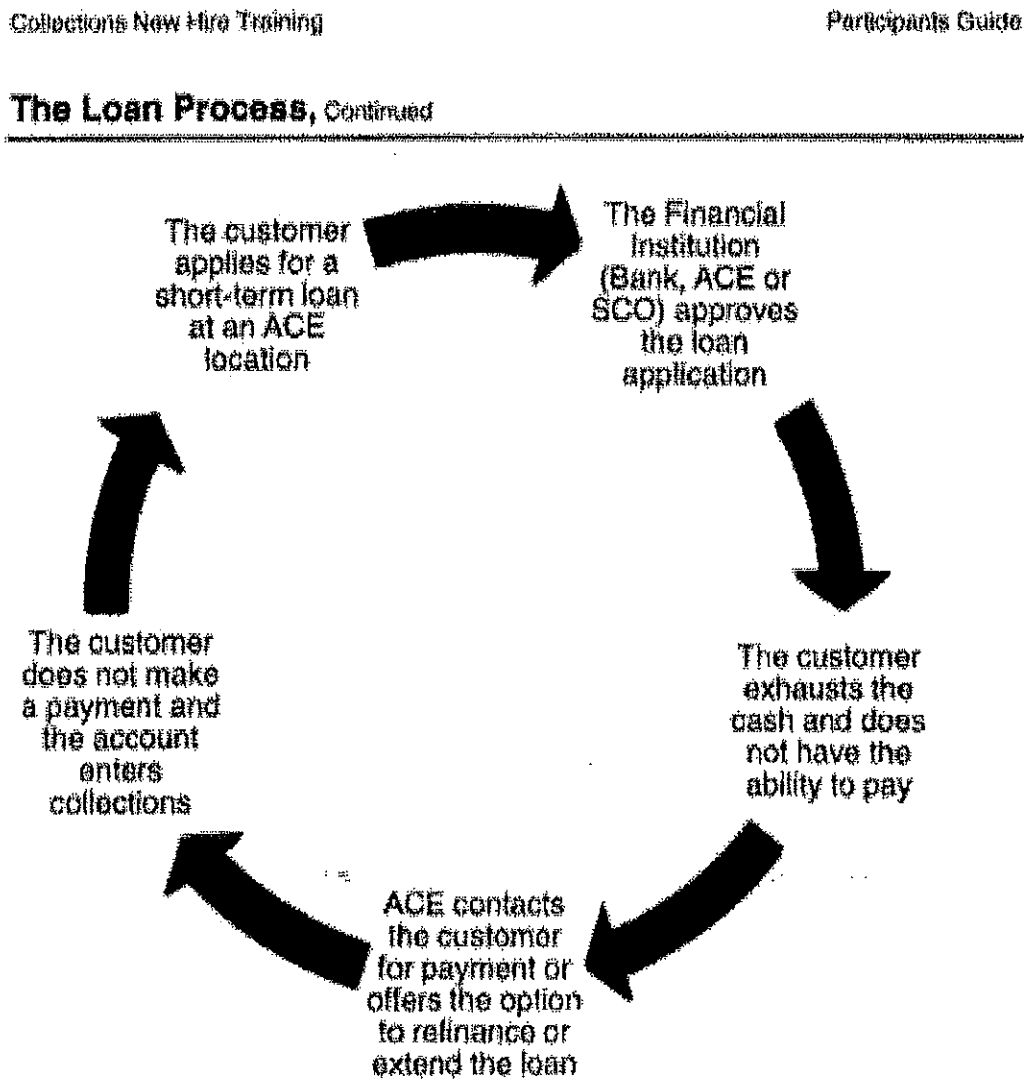
Background

9. Defendant is engaged in the business of marketing, advertising, and making short term loans, including payday and installment loans. Defendant regularly advertizes, markets and makes these loans within the State of Delaware.

10. Plaintiff borrowed $450 from Defendant in June 2013. As was the case with Plaintiff, Defendant's loans are secured by a lien on, and electronic access to, the borrower's bank account.

11. In entering the installment loan with Plaintiff, the Defendant expressly stated that it was intended to be used for "short-term financial needs only, and not as a long-term solution." Secretly, however, Defendant knows this is not a "short-term solution" and their business model is based on pushing customers into a cycle of debt. Defendant's

own internal manual indicates that Defendant relies on trapping its customers in a cycle of "short-term" loans:



Copy attached as Exhibit A.

12. These "installment loans" issued by Defendant are simply an end-run on attempts by the General Assembly to regulate the payday loan industry. However, the effect of these "installment loans," on consumers is really no different from a "payday loan." The only difference is that by morphing these loans into "installment loans,"

Defendant avoids the very regulations designed to protect consumers. See Exhibit B at p. 585-591.

13. Prominent organizations such as the Pew Charitable Trusts and the Insight Center for Community Economic Development have studied the effects of payday lending, and published findings concluding that the practice has a harmful effect not only on borrowers' finances and credit, but on the broader economy. An in-depth study published by the Pew Charitable Trusts in 2012 discussed the payday loan industry and the effects of such loans on borrowers and society. The study found that, while payday loan companies market their products as "payday," or short-term loans, the average initial loan is rolled over again and again, and remains open for five months of the year. Researchers found that payday lenders build their business models on the premise that borrowers cannot repay the loans in a two-week period, and that the loans become extremely profitable (to the lender) when it becomes a long-term debt. Researchers at the Federal Reserve Bank of Kansas City concluded that, "the profitability of payday lenders depends on repeat borrowing." A copy of the Pew Charitable Trusts report is attached hereto as Exhibit C. A second report was issued in February 2013. A copy is attached as Exhibit D. A third report was issued in October 2013. A copy is attached as Exhibit E.

14. Costly debt terms drain borrowers' limited cash needed to cover basic living expenses such as rent and food. Costly debt also impairs a borrower's ability to save, invest or otherwise spend on worthwhile consumer goods. Onerous debt terms also increase the chances that a borrower will file for personal bankruptcy. Indeed, at least fifteen states have banned payday lending, and Congress has prohibited payday lenders from targeting members of the military.

Defendant's Practices

15. For years, Defendant has marketed, advertised and made short-term loans to residents of Delaware, including Plaintiff.

16. Defendant aggressively markets and advertises these loans as short-term credit solutions, quick access ("Easy Application" "Quick Money") to cash. (See Exhibit F hereto.)

17. For years, Defendant has derived substantial revenues and profits from short-term loans in Delaware. Payday loans are only profitable to the lender when the short-term loan becomes a long-term obligation. As shown in Exhibit A, there is direct evidence that while Defendant markets and advertises the loans as short-term credit, its actual business model and intent is to induce the borrower to extend the initial loan into a long-term, and unduly expensive loan. As a result of the policies and practices of Defendant, borrowers are routinely trapped in products that cause harm, including financial loss, hardship, and damage to personal credit.

18. Defendant intends to induce borrowers to enter into short-term loans, knowing that borrowers will be unable to pay off the loan in a short period of time, and extends the terms of the loans. As noted in the February 2013 Pew report, lenders such as Defendant "rely on borrowers to use the loans for an extended period of time . . . in order to be profitable. . . ." (Exhibit D at 19.)

19. Defendant's representations and statements about the easy and quick access, instant approval, and the short-term nature of the loans are intended to induce borrowers, including Plaintiff, to enter into a loan agreement with Defendant.

20. Instead of disclosing that borrowers, including Plaintiff, would likely need extended terms to make her repayment obligations, Defendant remained silent, and induced borrowers, including Plaintiff, to borrow under expensive, onerous, and unconscionable terms.

21. Defendant conceals its true business models from borrowers, deceptively marketing its loans as short-term solutions even though defendant makes such loans with the expectation that borrowers will become saddled with a longer-term debt, structured in such as way as to make repayment all but impossible.

22. Defendant hides the fact that Defendant intends, and expects borrowers, including Plaintiff, to repay the loan on extended payment terms and pay interest rates exceeding 300% of the principal amount of the loan.

23. There is no limit to the amount that a borrower will pay unless and until the borrower repays the loan in full, including interest and any and all other fees pursuant to the terms of the loan document. Initial short-term obligations stretch into never ending cycle of inescapable debt.

24. Defendant never discloses that the overwhelming majority of their borrowers will never be able to repay the loan, and are forced, at substantial, undue and unconscionable cost, to extend the terms of the loan or take a new loan. Defendant is silent on these known facts, which are material to any borrower making a decision to take a loan from Defendant.

25. Defendant entered into an agreement with Plaintiff knowing that the overwhelming majority of Defendant's borrowers are unable to pay loans within the initial terms, at substantial and undue cost to borrowers.

26. Defendant entered into an agreement with Plaintiff remaining silent on its expectation that Plaintiff would repay the loan together with onerous, expensive and unconscionable interest.

27. Defendant preys on borrowers who can be induced, like Plaintiff, to enter into an unconscionable loan, knowing that the borrowers are at a significant disadvantage to negotiate fair terms.

28. Defendant knowingly uses its significant leverage to induce borrowers, including Plaintiff, to enter into loans with excessive, onerous and unconscionable terms. Indeed, the interest and penalties of borrowers' loans, including Plaintiff's loan, dwarf the principal amount of the loans.

29. Additionally, on a "take-it-or-leave-it basis," Defendant uses its significant leverage to cause borrowers, including Plaintiff, to accept onerous, outrageous and unconscionable boilerplate terms, including terms that significantly, if not wholly, impaired Plaintiff's rights to due process under law. For instance, buried in the Plaintiff's loan document with Defendant are references to Plaintiff's purported waiver of a right to jury trial, waiver of a right to a public, civil proceeding in a court of competent jurisdiction, and waiver of a right to judicially-monitored discovery, and an opt-out deadlines and rescission rights. The meaning of these terms, and the implication of agreeing to these terms are incomprehensible to a layperson, and particularly borrowers who typically use such loans. Plaintiff never understood the implication of these terms.

30. Defendant knowingly exploits its sophistication and its counterparty's equal lack of sophistication, lack of understanding and lack of bargaining ability, to impose unconscionable loan terms and unconscionable purported waivers of due process rights.

Defendants' Contract is Unconscionable

31. Plaintiff's loan documents evidence on their face a gross imbalance in the parties' respective rights and obligations, and an exploitation of an underprivileged, unsophisticated borrower.

32. The Delaware Chancery Court, in the context of reviewing a contract under the uniform commercial code, has considered ten factors as an aid to determine whether a contract is unconscionable and unenforceable:

> 1. The use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide standards offered on a take it or leave it basis to the party in a weaker economic position.
>
> 2. A significant cost-price disparity or excessive price.
>
> 3. A denial of basic rights and remedies to a buyer of consumer goods.
>
> 4. The inclusion of penalty clauses.
>
> 5. The circumstances surrounding the execution of the contract, including its commercial setting, its purpose and actual effect.
>
> 6. The hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract.
>
> 7. Phrasing clauses in language that is incomprehensible to a layman or that divert his attention from the problems raised by them or the rights given up through them.
>
> 8. An overall imbalance in the obligations and rights imposed by the bargain.
>
> 9. Exploitation of the underprivileged, unsophisticated, uneducated and the illiterate.
>
> 10. Inequality of bargaining or economic power.
>
> Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448 at * 4-5 (Del. Ch. 1990)

33. The Delaware Supreme Court has held that a contract is unconscionable if it is "such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other" or "whether the provision amounts to taking of an unfair advantage by one party over the other." See Tulowitzki v. Atlantic Richfield Co., 396 A.2d 956, 960 (Del. 1978); see also, Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448, *4-5 (Del. Ch. 1990).

34. While not all of the factors are necessary to find unconscionability, all of the above factors are present with respect to the payday loans at issue in this case.

Allegations Specific To
Plaintiff ROSALYN JONES

35. Plaintiff incorporates by reference the foregoing paragraphs as if fully set forth herein.

36. Plaintiff ROSALYN JONES entered into loan agreement with Defendant ACE CASH EXPRESS, INC. on or about June 16, 2013. A true and correct copy of the loan agreement is attached hereto as Exhibit G.

37. Plaintiff borrowed $450 to cover a cash flow problem. At the time she borrowed the principal, she did not understand fully the financial or legal terms of her loan document, contained in a 17-page, single-spaced document written in what appears to be 10-point font. She did not understand that she had a right of rescission, or a right to decline ACH authorization. She did not understand that she was committing to mandatory arbitration unless she opted out. She did not understand how to opt out of the arbitration clause. She had no knowledge of her legal rights, or the statutory obligations of the Defendants.

38. Plaintiff is locked in a long-term obligation with exorbitant interest rates, penalties and terms.

Class Certification Allegations

39. This action is brought and may properly be maintained as a class action pursuant to Fed. Civ. P. R. 23. Plaintiff is typical of members of the Class (hereinafter, the "Class"), Plaintiff brings this action on behalf of herself and all others similarly situated, as representative of a proposed Class, because the proposed Class is so numerous that the individual joinder of all its members is impracticable, common questions of law and fact exist as to all members of the proposed Class, and Plaintiff's claims are typical of the claims of the members of the proposed Class.[2]

COUNT I
Breach of the Duty of Good Faith and Fair Dealing

40. Plaintiff incorporates by reference the averments set forth above as if fully set forth herein.

41. Defendant has failed and refused to deal fairly with Plaintiff, and with all others similarly situated, in connection with Defendant's business practices and imposing the unconscionable terms of the loan agreements.

42. In applying for a loan, the Defendant required Ms. Johnson (and all other customers) to submit an application. However, while the ability to repay is a fundamental principle of sound lending, Defendant performs no underwriting before issuing loans. Thus, while Defendant advertises that these loans are for short-term solutions, the effect of making loans where there is no demonstration of an ability to

[2] Plaintiff's allegations for class certification do not constitute a motion for class certification, and Plaintiffs reserve the right to file a motion for class certification at the appropriate time.

repay causes injury to Plaintiff and other consumers by forcing them into a cycle of debt. See Exhibit H at p. 7, Exhibit I at p. 3, 5, 10-11 and Exhibit A.

43. Defendant implies that it is reviewing an application and performing underwriting. In failing to do so, Defendant violates the covenant of good faith and fair dealing.

44. As a direct result of Defendant's breaches of their duty of good faith and fair dealing, Plaintiff, and the Class, have suffered and will suffer injury as heretofore alleged.

COUNT II
Violation of the Delaware Consumer Fraud Act

45. Plaintiff incorporates by reference the averments set forth above as if fully set forth herein.

46. Defendant advertises its installment loan product as a short-term solution and not intended as a long-term solution.

47. Nevertheless, Defendant's secret business model is to trap consumers, including Plaintiff, in a cycle of debt.

48. Defendant suggests that it is reviewing a loan application and implied in that is that it is confirming a borrower's ability to repay the loan.

49. In fact, Defendant performs no underwriting to determine if the borrower will be able to repay the loan, because to do so would undermine the business model.

50. Defendant's conduct, as alleged herein, is in violation of 6 Del. C. § 2513.

51. Specifically, as set forth herein, Defendant has engaged in deception, fraud, false pretense, false promise, misrepresentation, concealment, suppression or omission of

material facts with its customers, with the intent that their customers rely on such conduct in connection with the sale or advertisement of its products.

52. As a direct result of Defendant's violations of 6 Del. C. § 2513, Plaintiff, and the Class, have suffered and will suffer injury as heretofore alleged.

WHEREFORE, Plaintiff, on behalf of herself, and the Class, respectfully requests that this Court enter judgment as follows:

a. Entering an Order certifying the plaintiff Class, appointing Plaintiff as representative of that Class, and appointing undersigned counsel to represent that Class, all pursuant to Fed. R. Civ. P. 23;

b. Granting a permanent injunction barring Defendant from taking funds from Plaintiff and the Class's bank account, and from charging Plaintiff and the Class interest and penalties and enjoining Defendant from continuing to market and sell these loans;

c. Awarding to Plaintiff, and all others similarly situated, damages, including compensatory damages, consequential and incidental damages, for Defendant's violation of the duty of good faith and fair dealing, and Defendants' violation of 6 Del. C. § 2513;

d. Voiding Plaintiff's loan and the loans of all others similarly situated, and awarding Plaintiff and all others similarly situated all amounts borrowed from, and paid to, Defendants pursuant to their loan agreements with Defendant;

e. Awarding to Plaintiff, and the Class, punitive damages for Defendant's willful bad faith conduct;

f. Awarding to Plaintiff, and the Class, pre- and post-judgment interest;

g. Awarding to Plaintiff, and the Class, all costs of this action;

h. Awarding such other and further relief as this Court deems just and appropriate.

Dated: August 21, 2014
Wilmington, Delaware

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Exhibit A

The Loan Process, Continued

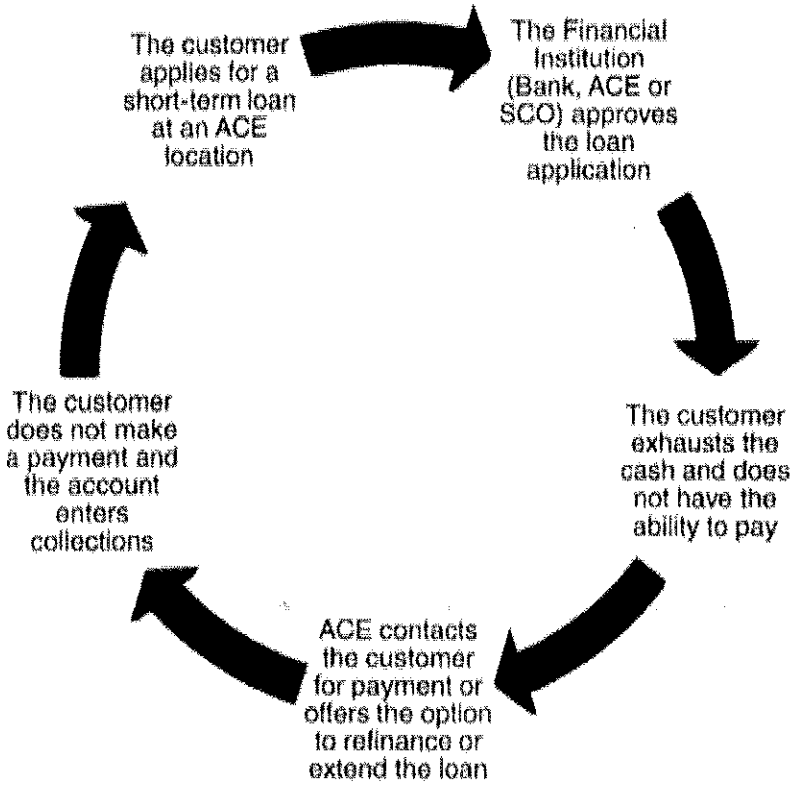


Exhibit B

1,000% INTEREST—GOOD WHILE SUPPLIES LAST: A STUDY OF PAYDAY LOAN PRACTICES AND SOLUTIONS

By Nathalie Martin*

Would you pay $1000 in fees to borrow $100 for a period of twenty weeks? Is it possible that such a loan is even legal? Welcome to the world of payday lending—one of the fastest growing segments of the consumer-credit industry. This Article describes the practices of payday loan companies and then discusses some states' failed attempts to institute regulation. These legislative efforts frequently fail because crafty lenders quickly adapt to new legislation by finding loopholes that undermine any consumer protection provided by the new regulatory laws. This Article also reports on an empirical study of borrower conduct and understanding of payday lending terms. This study is one of the first to gather information about these loans directly from customers at the point of sale. These study data uncover critical facts, including a deep misunderstanding by most borrowers of the true cost of the loans. These data also reveal an apparent inability of many consumers to "do the math" necessary to conceptualize the structure of the loans. This lack of understanding leaves many consumers unable to make important comparisons with other forms of credit which may have been available to them. This study reveals the need for effective regulation through legislation, and suggests that a federal usury cap may be the only real solution.

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* Keleher and McLeod Professor of Law, University of New Mexico School of Law. The Author thanks the National Conference of Bankruptcy Judges and the University of New Mexico School of Law for their financial support, and Margarita Araiza, Erin Croke, Maggie Murray, and Adam Robson for their assistance in the field. The Author also thanks Stormy Ralston for her fine research assistance, Karl Kalm for his data analysis, and Aaron Martin and Karen Summers for their editorial assistance. The Author also thanks Ted Occhialino, Robert Lawless, Stewart Paley, and Sam Brownstein for comments on earlier drafts. The Author also thanks Elizabeth Warren, Jay Westbrook, Kathryn Porter, and the Joint Texas–Harvard Commercial Realities Conference for providing feedback on the questions in the survey described here. Finally, the Author thanks Erik Gerding and Deborah Thorne for their assistance in writing and revising the questions.

INTRODUCTION

A payday loan is a small, short-term, triple-digit interest rate loan, typically in the range of $200 to $500 dollars, secured by the consumer's post-dated check or debit authorization. These loans were originally designed to tide a consumer over until payday, and then be paid back in one lump sum when the consumer received her paycheck. A typical[1] short-term loan product in today's market allows a customer to borrow $400, for fourteen days or less, for a $100 fee.[2] The loan is usually designed as an interest-only loan, with the interest payment—here $100—due every two weeks. Because this is an interest only loan, the principal essentially stays out forever, while the lender recoups the money he has loaned in only four weeks.

As of March 2010, more than 19 million U.S. households had taken out payday loans worth more than $35 billion.[3] Payday and other short-term loan outlets nearly tripled in number between 1999 and 2006.[4] As of 2006, there were over 22,000 storefronts nationwide.[5] The Center for Responsible Lending (CRL) reported that, in Ohio, payday loan centers outnumber Burger King, Wendy's and McDonald's locations combined.[6] There are 11,000 Starbucks locations in America, compared to 22,000 payday locations,[7] and in twenty-nine of the thirty-five states where payday lending is legal, there are 12,400 McDonald's.[8] If this trend continues, payday loans could prove to be the fastest growing segment of the consumer-credit industry, and if the economy continues to falter, more and more middle-income people may use this form of credit.

Payday lending and other forms of high-cost, short-term loans are among the most controversial credit products in the marketplace. These loans vary in design. In one form loan common in New Mexico, the customer borrows $100, to be repaid in twenty-six bi-weekly installments of $40.16 each, plus a final

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1. This Article analyzes data gathered through interviews with payday loan customers. The loans on which we gathered data ranged in interest rates from 100% per annum to 1100% per annum. For additional explanation of the interview and data-gathering process, see *infra* notes 17–19 and accompanying text.

2. This is a 650% interest rate. Moreover, kept out for one year, this loan would earn interest of $2600, and the borrower would still owe the $400.

3. *Newshour: Payday Lenders Face Increasing Scrutiny* (PBS television broadcast Mar. 16, 2010), *available at* http://www.pbs.org/newshour/bb/business/jan-june10/payday_03-16.html.

4. Patrick M. Aul, Note, *Federal Usury Law for Service Members: The Talent-Nelson Amendment*, 12 N.C. BANKING INST. 163, 165 (2008). *See also* Interview with Study Participant SB11, who noted that a shop with one employee in 2003 has now grown to have six employees.

5. Aul, *supra* note 4, at 165 n.15.

6. Gigi Stone, *Strapped Homeowners Turn to Bad Loans* (ABC television broadcast Apr. 12, 2008), *available at* http://abcnews.go.com/WNT/story?id=4641165.

7. *10 Shocking Facts About Payday Loans*, PAYDAYLOANS.ORG., http://www.paydayloans.org/10-shocking-facts-about-payday-loans (last visited June 5, 2010) (stating that there are two payday locations for every Starbucks).

8. *Payday Lenders vs. McDonald's*, http://www.csun.edu/~sg4002/research/mcdonalds_by_state.htm (last visited June 5, 2010).

installment of $55.34.[9] In total, this borrower would pay $100 in principal and $999.71 in interest, for an annual percentage rate (APR) of 1147%.[10] In addition to charging high interest rates, payday lenders have been criticized for questionable collection tactics and for targeting minorities.[11] The ubiquitous presence of payday loan and other short-term loan outlets makes them a far easier method of accessing quick cash than other financing alternatives.

Given both the popularity and the high cost of these loans, they have attracted the attention of scholars from many disciplines, including economics,[12]

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9. Felix Salmon, *Loan Sharking Datapoints of the Day*, REUTERS (Jan. 6, 2010, 7:37 PM), http://blogs.reuters.com/felix-salmon/2010/01/07/loan-sharking-datapoints-of-the-day/.

10. This assumes the lender is unable to convince the borrower to reborrow the principal before the loan is paid back. *See infra* Part I.C.

11. *See* ARACELY PANAMEÑO & KEITH CORBETT, CTR. FOR RESPONSIBLE LENDING, WEALTH-STRIPPING PAYDAY LOANS TROUBLE COMMUNITIES OF COLOR 7 (2008), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/wealth-stripping-payday-loans-trouble-communities-of-color.html ("Prominent civil rights groups such as the NAACP have condemned the practice of payday lending. . . .The NAACP refuses to accept money from payday lenders for any of its programs."). The article quotes African American leader Julian Bond: "A drive through any low income neighborhood clearly indicates people of color are a target market for legalized extortion . . . . Visits to payday stores . . . are threatening the livelihoods of hardworking families and stripping equity from entire communities." *Id.* (quoting Dave Anderton, *Payday Lending Fees Add Up: $3.4 Billion*, DESERET NEWS, Dec. 19, 2003, http://findarticles.com/p/articles/mi_qn4188/is_2003 1219/ai_n11418408).

The Mexican American Legal Defense and Educational Fund (MALDEF) is also quoted in the CRL Article:

> Even if you have a bank account, you can get into trouble if you use payday lenders as a quick solution rather than building a solid relationship with a bank or credit union that you can rely on in times of trouble. These merchants prey upon those who are short of money, but don't feel comfortable asking a bank for a loan.

Id. (quoting MALDEF, MAKING THE MOST OF YOUR MONEY: A GUIDE TO FAMILY FINANCES FOR LATINOS LIVING IN THE UNITED STATES 10 (2007), *available at* http://maldef.org/assets/pdf/MALDEF%20Making%20the%20Most%20of%20Your%20Money%20Handbook.pdf).

As an example of such questionable collection practices, in *Valued Services of Kentucky v. Watkins*, a customer was trapped in a payday lender's store by a store employee for failure to pay his loan. 309 S.W.3d 256, 258 (Ky. Ct. App. 2009). He informed the store manager that he could not repay his loan that day, but that he would be able to do so three days later. *Id.* The manager insisted that Watkins had to repay the entire amount that day and stated that he was not leaving the premises until he had paid in full. *Id.* She pushed a button to lock the office door and would not allow Watkins to leave even though he repeatedly asked to do so. *Id.* She also telephoned her regional manager, and told her that "I have a black guy over here that refuses to pay his bill and he's not going to leave until he does." *Id.* Watkins later sued for false imprisonment. *Id.* at 259.

12. TOM LEHMAN, PAYDAY LENDING AND PUBLIC POLICY: WHAT ELECTED OFFICIALS SHOULD KNOW 1 (2006), *available at* http://www.fisca.org/Content/NavigationMenu/Resources/FortheIndustry/ResearchPublications/WhatElectedOfficialsShouldKnow.pdf.

business,[13] finance, law, sociology, and public policy,[14] among others. Even geographers have written about payday lending,[15] yet some of the most basic questions about these loans remain unanswered.[16] Scholars have examined the profitability of payday lenders, the demographic served, the need for the product, the benefits and detriments of the product, whether the loans create a debt trap for consumers, whether regulation works and, if so, what kind of regulation is most effective.

However, no one really knows what is going through a payday lending customer's mind when she enters a payday loan center. What other options do borrowers have, and what is their understanding of the cost of the credit? This Article attempts to answer these and other questions by reporting on one of the only empirical studies to date gathering data at the point of sale. This study explores the following questions, among others: What draws customers to payday lenders in general and to a particular payday store? What are the loans most

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13. *See* Edward C. Lawrence & Gregory Elliehausen, *A Comparative Analysis of Payday Lending Customers*, 26 CONTEMP. ECON. POL'Y 299 (2008); Adair Morse, Payday Lenders: Heroes or Villains? (Feb. 2007), http://ssrn.com/abstract=999408.

14. *See, e.g.*, Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121 (2004); Lisa Blaylock Moss, Commentary, *Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 ALA. L. REV. 1725 (2000); Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994, 997 (2006); Charles A. Bruch, Comment, *Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257 (2001); Carmen M. Butler & Niloufar A. Park, *Mayday Payday: Can Corporate Social Responsibility Save Payday Lenders?*, 3 RUTGERS J.L. & URB. POL'Y 119 (2005); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002); Ronald Mann & James Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2007); Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385 (1997); Michael A. Stegman, *Payday Lending*, J. ECON. PERSP., Winter 2007, at 169; Michael A. Stegman & Robert Ferris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8 (2003); Therese Wilson, *The Inadequacy of the Current Regulatory Response to Payday Lending*, 32 AUSTL. BUS. L. REV. 193, 198–206 (2004); Michael Bertics, Note, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 133 (2005); Diane Hellwig, Note, *Exposing the Loan Sharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567 (2005).

15. *See, e.g.*, Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location Analysis of Payday Lenders and Banks*, 55 PROF. GEOGRAPHER 303 (2003). The geographic data are among the most interesting. For instance, data show that Minnesotans with lower income levels had a higher probability of living near a payday lending outlet: $15,000: 88%; $30,000: 73%, $45,000: 50%; $60,000: 27%; $75,000: 12%; $90,000: 5%; $125,000: less than 1%. *See* H.J. Cummins, *Legislators Seek to Curtail Payday Lending Practices: The Industry Argues that the Proposed Legislation to Limit Interest Rates Would Effectively Put it Out of Business*, STAR TRIB. (Minneapolis), Feb. 24, 2008, at D1 (citing data from the Minnesota Department of Commerce, analyzed by the Legal Services Advocacy Project).

16. *See* GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, CREDIT RESEARCH CTR., PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CONSUMER DEMAND 47 (2001), *available at* http://www.cfsa.net/downloads/analysis_customer_demand.pdf.

commonly used for? Do people understand the repayment terms? Can they estimate how much they will pay for a loan in total dollars over time? Do they understand the meaning of APR? Does disclosure of the APR help them shop around for loans? Do people actually compare different payday loans? Do borrowers have realistic expectations about whether they will be able to pay the loans back? What alternatives do they have?

In addition to the information gleaned through the curbside interviews, this Article offers insight for states considering implementing legislation, or that have already passed payday loan consumer-protection laws. Because these curbside data were collected in a state that had just changed its laws to allegedly protect consumers, the study also captured the creative methods used by the short-term loan industry to get around states' efforts to legislate the industry. Most of the efforts by states to regulate this industry have failed miserably, and this Article details the reasons for regulatory failure.

Effective regulation could save states both time and money, and prevent collateral damage caused by legislation that does not achieve its goals. Ineffective legislation can be more harmful than no legislation at all because it causes the public to believe that the issue has been satisfactorily dealt with, even when there is no appreciable effect on the payday-lending industry in the state. Thus, while the legislative process was not originally a focus of the empirical study described in this Article, our methodology provides insights into the types of industry changes that occur after legislation passes, as well as the legislative process in general.

This study gathers these data in three ways, first through a series of cold calls to lenders to request information about what terms they offer on short-term loans. Lenders were identified through the most recent Yellow Pages as well as web-based directories. The second data set was gathered outside payday loan stores from customers themselves. We interviewed 109 payday or installment loan customers using the survey attached as the Appendix.[17] These customer interviews form the primary data for this study. Additionally, because the study was conducted in a state with a new payday lending statute, the data also revealed industry changes in response to the new law. As a result of these changes, we were able to see how the industry operated both before and after institution of the new law. The final data set consists of twenty qualitative interviews conducted in the Author's office.[18] These interviews were done in order to clarify various questions raised by the initial study data and to gain additional background information about customers' understanding of these loans. In the interviews, respondents were

17. Curbside interviews were conducted June 2009 to December 2009 in Albuquerque, New Mexico and surrounding areas. The interviewees are referred to in this Article as "CS" followed by a number. The Author retains all information in her files.

18. Office interviews were conducted September 2009 to February 2010, by the Author in the Author's office in Albuquerque, New Mexico. The interviewees are referred to in this Article as "SB" followed by a number. The Author retains the interview notes in her files.

asked the survey questions and allowed to expound on their answers, ask further questions, and make any comments they wished.[19]

Industry data were generated through borrower interviews and by calling payday lenders to determine what terms they were offering borrowers. We first called the lenders in March 2009. We called a random sample of lenders at this time, some from chains and some from stand-alone lenders. This initial contact was meant to determine whether lenders were in general compliance with the new law, at least by their own self-disclosures. The phone interviews revealed a general shift in the New Mexico small-loan marketplace from payday loans to a new product called the "installment loan." Curbside interviews of both payday and installment borrowers were conducted next. In June 2009, all short-term or payday lenders listed in the 2009 Yellow Pages were contacted to determine whether they offered payday or installment loans, or both. These data on marketplace shifts provide information highly useful to the legislative process, perhaps more useful than the results of the curbside interviews themselves.

Part I of this Article provides the background needed to understand the short-term loan industry. This Part describes the industry's self-articulated goals and its business and marketing plans. Part II describes the legislative process in one representative state, New Mexico. Part II also explains the recent amendments to the New Mexico Short Term Loan Act, which was adopted in 2007 and now purports to regulate payday loans in the state.[20] Moreover, this Part describes how the payday loan industry in New Mexico changed in response to the new law. Finally, it discusses the relevance of these changes—as well as of the industry's business and marketing plans—to future legislative efforts, providing useful information for other states intending to legislate short-term lending.

Part III describes the methodology of the curbside empirical study, as well as the qualitative and quantitative results. It also contains some data from the more in-depth office interviews. These data confirm some claims upon which both the industry and scholars agree. Specifically, these data confirm that customers take out loans near home or work out of convenience, rather than shopping around for price, and that customers do not understand the significance of the APR.

The data also show that many consumers cannot easily compare the cost of this form of credit to other forms of credit, and that many customers are unable to accurately describe how much they will ultimately pay for the small sums they borrow. Further, data show: customers generally feel they will pay back the loans in a short time, despite national statistics to the contrary; most payday borrowers

19. The study questionnaire naively asked about what "the" loan was being used for, how the customer could calculate cost of "the" loan, etc., assuming that customers would have just one or at most two loans at a time. It also naively assumed that customers had to pay back their loans and could not roll them over, causing customers to call a loan "one loan" even if it had been out for years. We learned curbside that we had been vastly underestimating both the numbers of loans people had at a time, as well as the duration of those loans, and decided to use a different interview format in the second data collection process in order to learn more. Most of the data from this second set of interviews will be discussed in a subsequent article.

20. N.M. STAT. ANN. §§ 58-15-1 to -39 (2009).

are repeat customers; and payday lending is far more convenient, less intimidating, and less embarrassing than getting a loan from another source. The data further show that while a few payday lending customers use the loans for one-time emergencies, the vast majority use them for regular, recurring monthly expenses.[21]

The data also reveal the ineffectiveness of statutes that define payday loans as those between fourteen and thirty-five days in duration and then: (1) cap fees per pay period; (2) create a database; and (3) prohibit rollovers but contain no cooling-off period. This type of statute was recently enacted in New Mexico and the short-term loan industry tried to get it passed in Arizona as well. However, if a state intends to protect consumers by regulating these products, laws like New Mexico's are ineffective and inadvisable because they do not change lending practices. In fact, they have little effect of any kind.[22]

Part IV provides justification for regulating the short-term loan industry in light of the empirical data. The analysis starts from the perspective that many consumer products need not be regulated, but that several unique conditions make payday lending different. These conditions include: (1) market failure;[23] (2) largely innumerate consumers who lack the time, knowledge, or resources to fully comprehend the dollar costs of the loans;[24] and (3) failure of consumers to shop around for loans on the basis of price. Information asymmetry between lenders and consumers is another compelling reason for regulation of this industry.

Part V concludes that, while there is still a great deal we do not know about payday lending, we now know that legislation is necessary. This Part concludes that the question of how best to regulate payday loans is an important topic that justifies further inquiry. Ultimately, this Article suggests that an absolute interest-rate cap is one possible solution to the short-term loan problem, particularly in light of the failure of New Mexico-style regulation to have any meaningful effect on the short-term loan practices.

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21. Our data also show that payday customers are not, for the most part, middle class, a topic that will be explored in more detail in a subsequent article.

22. The industry may initially fight legislation like this, but will not fight for long because the industry knows that: (1) it will still have plenty of customers under this model; and (2) it can quickly change its products to skirt this form of legislation and perhaps make even more money.

23. *See infra* Part IV.A. *But see* SHEILA BAIR, ANNIE E. CASEY FOUND., LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 29, 33 (2005), http://www.aecf.org/upload/publicationfiles/fes3622h334.pdf. Sheila Bair contends that:

> There is no evidence of price collusion or monopolistic concentrations in the payday loan market. This may suggest that payday loans are efficiently priced as compared to the relatively high operational costs associated with the product. *Alternatively, it may suggest that the customers who use the product are sufficiently desperate for cash that the immediacy of the product is more important than the price paid.*

Id. (emphasis added). While the Author agrees with Bair's latter alternative as a partial explanation, she does not agree with the premise that there is no collusion.

24. *See generally* Ann M. Olazábal & Howard Marmorstein, *Structured Products for the Retail Market: The Regulatory Implications of Investor Innumeracy and Consumer Information Processing*, 52 ARIZ. L. REV. 631 (2010).

I. THE SHORT-TERM LOAN BUSINESS PLAN

This Part describes the short-term loan industry in general, with a focus on payday lending. It describes the industry's self-articulated goals and the publicly available information about the industry's business and marketing plans.[25]

A. Sky-High Profits

Payday lending is a tremendously profitable business. One need only review a typical industry website to understand the strong profit motivations of such lenders:

> The payday loan industry may be the fastest growing financial segment - bar none! Not only can you find a payday loan store seeminly [sic] everywhere but additionally there are payday loan web sites as well. As a matter of fact, the payday loan internet component offers even greater rewards than the payday loan brick-n-mortar!
>
> So, why is this so? Why is the payday loan industry growing at such a rapid rate? And why are a few of the most saavy [sic] financial minds entering this "loan shark" business segment? The answer, of course, is the TREMENDOUS PROFITS AVAILABLE! Depending on the state or province, payday loan consumers are paying $10 to $35 per $100 borrowed for a term averaging 8 days. These cash advance fees are equivalent to 480% to 1200% APR's (Annual Percentage Rate). These returns are simply PHENOMINAL [sic]!
>
> [C]onsumers throughout the world have an insatiable demand for the payday loan product! Small loans ranging from a few hundred dollars to $1500 or more are in huge demand by cash strapped consumers everywhere on this planet. . . .
>
> Payday loans, just in the USA, are estimated to be a $40 billion to $50 billion dollar industry and still growing 20% to 30% annually! . . . A typical 8 day paycheck advance extended to your client will yield an annual percentage rate on your money of 805%![26]

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25. This information was gathered from existing literature, as well as the websites of both industry and consumer groups. *See, e.g.*, CTR. FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/ (last visited Aug. 5, 2009); *Resources for Policymakers*, COMMUNITY FIN. SERVS. ASS'N OF AM., http://www.cfsa.net/policymakers_resources.html (last visited Aug. 5, 2009); Trihouse Enterprises, Inc., *How to Start a Payday Loan Business, Start a Cash Advance Company*, http://www.paydayloanindustry.com/payday-loan-internet.html (last visited Aug. 5, 2009). We attempted to spend equal time at sites written by consumers and the industry in order to get the full picture of what each side of the debate was saying.

26. *How to Start a Cash Advance Business*, CASHADVANCEPROFITS.COM, http://www.cashadvanceprofits.com (last visited July 22, 2010); *see also Payday Pundit: The Latest News and Information About the Payday lending Industry*, PAYDAY PUNDIT (Jan. 5, 2010), http://paydaypundit.org/2010/01/05/. The numbers in these websites are at odds

Dan Feehan, CEO of payday lender Cash America, has said that "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 profit is."[27] While some scholars have questioned the profitability of the industry[28] and the industry sometimes denies that its returns are excessive, the mere existence of such a large number of lenders belies the conclusion that these loans are not highly profitable.

B. The History of Payday Lending and the Current Lending Practice

According to some, the payday lending industry initially grew from the salary-buying business of the early twentieth century. Salary buyers advanced cash at steep fees on the security of a wage assignment.[29] If the loan was not repaid or renewed on time, the salary buyer would threaten to present the wage assignment to the borrower's employer, who might then terminate the employee.[30]

Other people in the industry claim that payday lending grew out of the check-cashing business. Professors Ronald Mann and James Hawkins talked to an executive in the check-cashing industry who described the emergence of post-dated check cashing:

> Payday loans grew out of that business in the early 1990's. We would cash a personal check on the weekend for 10% of the check, but most payroll checks or government checks we would cash for 3%. So people would come to us on Thursday and ask if we would cash it then and hold it until Monday. For a while we said no we wouldn't do that, then we started trying it out, found there was a demand for cashing post-dated checks, and slowly gravitated into that, charging an extra 5% or so for the extra risk and service. People loved it. Their options, when they are in a bind, are that they can write a check that will go on insufficient funds, but they'll get a charge of $35/check. So if they write three checks for $100 they will

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with other information promulgated by the payday loan industry that claims it is not that profitable, but these web sites are surely not entirely without basis.

27. *Payday Lending: Research and Analysis*, CTR. FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/media-center/press-releases/archives/payday-loan-reform-act-must-be-strengthened.html (last visited July 20, 2010).

28. *See, e.g.*, Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 FORDHAM J. CORP. & FIN. L. 203, 203 (2007).

29. Robert Mayer, *One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County 2* (undated) (working paper), *available at* http://lwvmilwaukee.org/mayer21.pdf (last visited Aug. 6, 2009).

30. *Id.* at 2–3.

> Today a post-dated check has replaced the wage assignment as the security for a payday loan. [Lenders] require an open checking account and a steady income source (usually a paycheck, but pension or W-2 income is also accepted) to get a short-term cash advance. The process is quick and convenient, with many chains using the TeleTrack system to assess the risk for this subprime segment of the credit market.

Id.

> get $105 in fees, which is a pretty bad alternative. Or they can accept the late-rent penalty. Or they can put off fixing their car and lose two or three days of work.[31]

In any case, payday lending first emerged in the South in the late 1980s and grew rapidly during the following decade.[32] Payday lenders typically assess a borrower's creditworthiness using the industry-wide TeleTrack credit reporting system and then offer a loan through a retail store location.[33] The industry depends heavily on retail store locations because customers usually travel only to the store that is nearest their place of employment.[34] The industry is aware that convenience is a main draw of payday lending and accordingly does its best to provide optimal accessibility.[35]

Payday lending locations are normally small, with outstanding loan portfolios of less than $100,000 and annual revenues of about $350,000.[36] As stores age, their profitability increases. For instance, a typical new store will make fewer than 1000 loans per year, while a mature store will make more than 8500 loans per year.[37] Because a store's costs are fixed, the costs per loan from the mature stores are much lower than the costs per loan from the newer stores.[38]

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31. Mann & Hawkins, *supra* note 14, at 862 (footnote omitted).

32. Mayer, *supra* note 29, at 3.

33. Mann & Hawkins, *supra* note 14, at 863–64. Mann and Hawkins found, through industry information and interviews, that lenders typically look at a borrower's identification, evidence of income, and a current bank statement. *Id.* at 862–63. They also evaluate past borrowing history and the other criteria using a software program functionally parallel to the credit scoring that credit card issuers use to evaluate their customers. *Id.* at 863. They also claim that some lenders use TeleTrack to access information about a borrower's prior-payment history with payday lenders. *Id.* This information is consistent with what payday lenders told customers (and our researchers) was needed to qualify for a payday loan. *See id.* at 863 n.19.

34. *Id.* at 863.

35. When describing a new survey of payday lending customer habits in Alberta, Canada, an industry webpage states that "[a] number of other studies of our industry have consistently pointed out the same thing; IT'S ABOUT CONVENIENCE!" *New Payday Loan Industry Survey Results Available*, PAYDAY LOAN INDUSTRY BLOG (June 6, 2009), http://paydayloanindustryblog.com/new-payday-loan-industry-survey-results-available.

36. Mann & Hawkins, *supra* note 14, at 864.

37. *See* Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 9 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf. In the Federal Deposit Insurance Corporation (FDIC) study, a mature store was one more than four years old. *Id.* at 8–9.

38. *See* ERNST & YOUNG TAX POL'Y SERVS. GROUP, THE COST OF PROVIDING PAYDAY LOANS IN CANADA 39–43 (2004), *available at* http://www.cpla-acps.ca/english/reports/EYPaydayLoanReport.pdf. Chris Robinson at York University has made this same point: large operations have lower costs than small operations, allowing larger lenders to make a profit with stricter rate caps. CHRIS ROBINSON, REGULATION OF PAYDAY LENDING IN CANADA (2006); *see also* James Daw, *Consumer Protection in the Wind on Payday Loans*, TORONTO STAR, May 30, 2006, at D6 (discussing the Robinson report).

C. The Importance of Repeat Customers

Both industry experts and small-loan foes acknowledge that repeat customers are important to the payday lending business model.[39] Some lenders even offer loyalty programs and rewards cards, like those offered by bakeries and pizza shops. These programs encourage borrowers to become repeat customers with offers such as: if you "pay your interest five times in a row on time, you get your sixth interest payment at half price."[40]

Multiple empirical studies have reported that repeat customers comprise the vast majority of all payday lending customers. For example, a study by the CRL, using data from North Carolina regulators, reports that 91% of loans are made to borrowers with five or more loans per year.[41] Another CRL study found that 76% of payday lending business comes from repeat customers.[42] Similarly, a study of Colorado borrowers found that about 65% of loan volume in that state comes from customers who borrow more than twelve times per year.[43] Some borrowers avoid renewal limits by alternating between lenders, using the funds from each lender to pay off the other in turn.[44] Professors Mark Flannery and Katherine Samolyk report in their 2005 Federal Deposit Insurance Corporation (FDIC) study that about 46% of all loans are either renewals of existing loans or new loans that follow immediately upon the payment of an existing loan ("rollovers").[45]

The costs of serving high-frequency borrowers are less than the costs of serving low-frequency borrowers, both because the loss ratios are significantly lower for high-frequency borrowers and because the operating costs are lower.[46] As sources in the industry explained to Mann and Hawkins, a loan to a first-time borrower will probably require verification of a telephone number and a bank account, as well as some investigation of the identity of the borrower.[47] Those steps, which are costly in the context of a loan with a fee of only $30, are

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39. *See* Mann & Hawkins, *supra* note 14, at 864.

40. Interview with Study Participant SB01 (discussing interest-only loans with Ace Cash Express). One downside is that if customers want to use their loyalty points toward their next interest payment, they cannot pay down any amount toward principal. *Id.*

41. KEITH ERNST ET AL., CTR. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 2, 7 (2004), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/CRLpaydaylendingstudy121803.pdf.

42. LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76% OF TOTAL VOLUME 11 (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

43. *See* Paul Chessin, *Borrowing From Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387, 411 (2005).

44. *Id.* at 415.

45. Flannery & Samolyk, *supra* note 37, at 12, 13 fig.2.

46. *Id.* at 16–17.

47. Mann & Hawkins, *supra* note 14, at 865.

unnecessary for repeat customers. Also, unlike new customers, repeat borrowers have demonstrated a propensity to repay.[48]

Lenders use time-tested methods to attract new borrowers into their portfolio, including offering a free payday loan to first-time borrowers[49] and offering money to existing customers for referring new ones.[50] Since loans to repeat customers are cheaper to administer, lenders do what they can to encourage repeat borrowing, including calling customers as soon as a loan is paid back and offering them even more money.[51] Study data show that people generally return to the original lender unless they have had a bad experience with a particular lender or, as the saying goes, need to "borrow from Peter to pay Paul."[52] And, as with credit cards and other forms of consumer financing, lenders discourage paying off the loans by making it difficult or impossible to pay part of the principal on interest-only loans designed to rollover automatically,[53] and by encouraging additional borrowing as installment loans get paid off.[54]

Borrowers also frequently take simultaneous payday loans from multiple lenders. A Wisconsin study of bankruptcy data showed that many payday loan customers take out loans from more than one lender, frequently in amounts that exceed their paychecks. Professor Robert Mayer explained that such multiple loans make rollovers inevitable and collectively function like a long-term, high-rate, interest-only cash advance.[55]

Mayer examined a sample of 500 bankruptcy petitions filed by residents of Milwaukee County during the summer of 2004, looking for petitions that listed

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48. Mann & Hawkins, *supra* note 14, at 865.

49. PARRISH & KING, *supra* note 42, at 3; *see also* study data *infra* Part III.B. Our calls to payday lenders, as well as the signs outside many of their stores, confirm that a significant portion of the remaining payday lending market is now offering the first loan free.

50. Interview with Study Participant CS05 (discussing lender offering $20 to refer a new customer, compared to the $10 they could get doing our study interview).

51. Interview with Study Participant SB12 (discussing that she was called less than a week after paying off her first loan in full and offered "a raise," meaning a loan in twice the amount she originally qualified for).

52. Interview with Study Participant CS61, who stated she had four loans at one time totaling about $1000. She got one loan, then got the others to pay back the first one. She eventually declared bankruptcy.

53. *See* Interview with Study Participant SB01.

54. *See, e.g.*, Interviews with Study Participants SB01, CS21, CS27, CS34, and CS44.

55. Mayer, *supra* note 29, at 2–3. Mayer notes that:

> [P]ayday advance creditors in Milwaukee County repeatedly make loans to debtors in financial crisis who already have one or more payday loans. Together these loans frequently exceed the amount of the borrower's next paycheck, making roll-overs inevitable. The debtor has one payday but many payday loans, and when combined in this way these loans function like a large, long-term, very expensive, interest-only cash advance.

Id. at 2.

more than one payday loan.[56] If his sample is representative of the entire population filing for bankruptcy in Milwaukee County, then roughly 825 households went bankrupt in the county in 2003 while owing more than one payday loan (10.6% of all petitioners).[57] Some petitions listed as many as nine of these loans, and the median debtor claiming one or more of these debts owed the entire amount of her next paycheck to payday lenders. Most of the debtors had been rolling over the principal for many months.[58] In fact, 70% of the people who listed a payday loan on their petition had more than one. Almost 30% had four or more.[59]

Installment loans are one of the preferred replacement products for payday loans in New Mexico.[60] As with payday loans, lenders rely heavily on repeat customers. Lenders encourage employees to get customers to take out as many new loans as possible, and there are no explicit laws precluding these practices. As one former employee explained:

> [W]e were trained to encourage customers the day they paid a loan off to make another loan as early as the next day. We tried to get customers to keep getting loans and borrow up to their maximum approval amount whether they wanted it or not.[61]

This former clerk went on to explain that store employees were instructed to pressure installment-loan customers to borrow more when they came in to make a payment.[62] She explained that this would allow the lender to reissue the loan and reset the whole payment plan.[63] She said she would be reprimanded by her manager if she did not pressure people into rewriting their loans in a way that would essentially wipe out all the payments previously made on the loans.[64] She

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56. *Id.*

57. *Id.* at 2–3.

58. *Id.*

59. *Id.* at 5.

60. As discussed in further detail in Part II.B.1, *infra*, when the New Mexico payday lending statute passed, lenders quickly began offering a replacement product, called an installment loan, that fell outside the new law. It is entirely unregulated and thus can be rolled over indefinitely. There are neither caps on fees nor other rules, so lenders can offer whatever terms they like. The other replacement product is the interest-only payday-style loan for which no post-dated check is required.

61. CTR. FOR RESPONSIBLE LENDING, FACT V. FICTION: THE TRUTH ABOUT PAYDAY LENDING INDUSTRY CLAIMS (2001), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/fact-v-fiction-the-truth-about-payday-lending-industry-claims.html; *see also* Interview with Study Participant CS44.

62. *See* Interview with Study Participant CS44. Another participant, who had both payday loans and title loans, described a title loan on which he had defaulted. The car was repossessed within a short time, but the default did not discourage the lender, who promptly starting calling back and offering another loan in an even greater amount. *See* Interview with Study Participant SB20.

63. The language of this person's interview suggests that she also did not understand how the loans worked, even though she was an employee. *See* Interview with Study Participant CS44.

64. *Id.*

was told to do this every time someone came in to make a payment, in order to increase the lender's interest and fees. It was very clear to this employee that rewriting or resetting, rather than initiating loans, was the bread and butter of the business.[65]

In our survey process, we had an opportunity to look at several installment loan receipts, the documents customers receive when they make a payment. In all cases, the receipt was a half-page statement of what the customer had paid that day and what was still outstanding, as well as this statement: "[y]ou are entitled to borrow $85.00 more today!" This was the only item in bold on the entire page. The former employee said that clerks were instructed to point this statement out to customers whenever they came in to make a payment.[66]

D. The Importance of Late Fees

Industry websites enthusiastically acknowledge that lenders make more money when customers pay late. For example, one site explains why internet lending is so lucrative, along with the importance of late fees:

> Think about it! A typical payday loan customer who applies for and receives 3 payday loans per year for ten years is worth a minimum of $2400. (Conservatively, a payday loan customer gets 3ea $400 payday loans at 20/$100 loaned = $80 in fees per loan X 3 times/yr = $240/yr X 10 years = $2400 life time value. Add on late fees, their family and friend referrals, etc. and each customer is worth $3000 or more!)[67]

In fact, industry experts suggest dividing payday loans into three or more smaller loans to maximize late fee assessments. They even recommend telling customers their checks have been deposited when they have not, so that the customers will be scared into believing they will bounce checks as a result.[68]

E. Service with a Smile

Finally, these study data suggest that payday lenders are aware that many lower-income people are intimidated by banks.[69] Thus, the lenders try to create an environment that is as welcoming and friendly as possible. Curbside interviews

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65. *Id.*

66. *Id.*

67. PAYDAY LOAN INDUSTRY BLOG, http://paydayloanindustryblog.com/index.php?s=%22each+customer+is+worth+%243000%22 (last visited Aug 9, 2010).

68. *See* Michaelsmom, Post to *Answers*, DEBT CONSOLIDATION CARE (Aug. 13, 2006, 7:37 AM), http://www.debtconsolidationcare.com/getting-loan/payday-industry.html. The post claims that "in 2002, Affordable Payday Loan Consultants, now called Trihouse Enterprises Inc., produced a business plan it sold to people wanting to get started in the payday industry." *Id.* One tip from the Trihouse website states that "late fees are a very lucrative profit center. You do not need to actually present a client's check(s) to the bank to have them stamp (non-sufficient funds). Purchase your own stamp! They owe the NSF fee even if you did not take it to the bank. You simply say, 'My bank verifies funds before accepting my deposit. Unfortunately, (your check was no good). The fee is $15 per check.'" *Id.*; *see also* CTR. FOR RESPONSIBLE LENDING, *supra* note 61.

69. *See* Interviews with Study Participants SB01 and CS46.

confirmed that some customers wanted to protect their "friends" at the lenders and not get them in trouble.[70] While not addressed directly in the survey, respondents frequently volunteered that the service at payday lenders was good.[71]

F. The Debt Trap

The payday lending industry claims it helps people make ends meet.[72] Given the demographics of the payday loan customers in this study and the typical expenses of people within this demographic, coupled with the loan design, very few customers can afford to pay back the loans. Rather, as discussed above, most customers find it necessary to continue to pay $1000 to borrow $500 for twenty weeks, or to pay $100 in interest every two weeks—for the rest of time—on an original loan of $400.[73]

Thus, while people can disagree about the precise definition of a debt trap—and whether these loans create one—given the cost of this credit and the industry's own business plan and articulated profit margins, it is hard to fathom that anyone actually believes these loans *do not* create a debt trap. It is likely that the industry's own very detailed TeleTrack data, which comes from the industry's credit checking system, show precisely that. Short-term loan products like payday loans create a debt trap by design.[74] In fact, the debt trap *is* the business plan.

In sum, the business plan of short-term lenders appears to include setting up convenient and ubiquitous storefronts, hiring extremely friendly clerks, building a base of loyal customers, maximizing the frequency and amount of lending while maintaining repayment at the minimum amount required by law, and encouraging late payments to maximize fees. With this information as a backdrop, it is worthwhile to consider the legislative process in New Mexico, and attendant industry changes. The New Mexico legislation is increasingly relevant because several other states are currently considering implementing identical laws.

II. CHANGES IN LAW AND SHORT-TERM LOAN PRACTICE IN NEW MEXICO

This Part describes the legislative process in New Mexico as well as the law enacted by the state in 2007. It also describes the changes in the industry in New Mexico following enactment of the 2007 law. Finally, it discusses the

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70. *See* Interviews with Study Participants CS23 and CS57.

71. *See* Interviews with Study Participants CS23, CS33, and CS45.

72. *See* Carl Chancellor, *What the Mob Can Learn from Payday Lenders*, CHANGE.ORG (Mar. 1, 2010), http://uspoverty.change.org/blog/view/what_the_mob_can_learn_from_payday_lenders.

> According to the CRL, U.S. borrowers who rely upon high-interest payday lending for quick cash are caught in a "*debt trap*" that costs them $3.4 billion each year. . . . [t]here is no arguing the fact that it's a very lucrative arrangement for payday lenders to follow a *business plan designed to keep a borrower in debt.*

Id.

73. The $25 per $100 every two weeks amounts to 650% per annum.

74. *See* Chancellor *supra*, note 72.

relevance of these changes on future legislative efforts in light of the industry's apparent sidestep of the law. This information should be useful to other states that choose to regulate short-term lending.

A. Changes in the Law

Payday lenders began appearing in New Mexico after the state repealed its General Usury statute (former NMSA 1978 § 56-8-11-1) in 1991. Prior to the summer of 2007, New Mexico was one of only two states[75] that had no regulation of payday lending. For five very long and frustrating years, the New Mexico legislature debated various payday lending statutes. Finally, during the legislative session of 2007, the New Mexico state legislature adopted a set of changes to the New Mexico Small Loan Act of 1955 intended to address payday lending.[76] These regulations went into effect in July 2007. The New Mexico law is similar to those of several other states in that the regulations rely on a computer database enforcement mechanism for consumer qualification and reporting.[77] In fact, thirty-three states have laws that bear some similarity to the New Mexico Act. [78] This is

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75. CTR. FOR RESPONSIBLE LENDING, TESTIMONY OF URIAH KING BEFORE OHIO SENATE FINANCE AND FINANCIAL INSTITUTIONS COMMITTEE 10 n.2 & 3 (May 7, 2008), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/states/king-ohio-payday-testimony-05072008.pdf.

76. N.M. STAT ANN. §§ 58-15-1 to -39 (2010).

77. Other states that have enacted similar statutes and use the same database enforcement mechanisms. *See* FLA. STAT. ANN. § 560.103–.144, .402–.408 (West 2002); 815 ILL. COMP. STAT. ANN. 122/1-1 to 99-99 (West Supp. 2008); IND. CODE ANN. §§ 24-4.5-7-101 to -414 (West 2006 & Supp. 2008); MICH. COMP. LAWS ANN. § 487.2121–.2173 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); N.D. CENT. CODE ANN. §§ 13-08-01 to -15 (West 2004 & Supp. 2007); OKLA. STAT. ANN. tit. 59, §§ 3101–3119 (West, Westlaw through Chap. 170, 2010 2d Sess., 52d Leg.).

78. ALA. CODE §§ 5-18-1 to -23 (LexisNexis 1996 & Supp. 2008); ALASKA STAT. ANN. §§ 06.50.010–.900 (2008); CAL. FIN. CODE §§ 23000–23106 (West 2008); COLO. REV. STAT. ANN. §§ 5-3.1-101 to -123 (West 2002 & Supp. 2008); DEL. CODE ANN. tit. 5, §§ 2201–2213A, 2227–2243 (2001 & Supp. 2006); D.C. CODE § 26-301 to -323 (LexisNexis 2005); FLA. STAT. ANN. § 560.103–.144, .402–.408 (West 2002); HAW. REV. STAT. §§ 480F-1 to -7 (LexisNexis 2005 & Supp. 2008); IDAHO CODE ANN. §§ 28-46-401 to -413 (2005 & Supp. 2008); 815 ILL. COMP. STAT. ANN. 122/1-1 to 99-99 (West Supp. 2008); IND. CODE ANN. §§ 24-4.5-7-101 to -414 (West 2006 & Supp. 2008); IOWA CODE ANN. §§ 533D.1–.16 (West 2001 & Supp. 2008); KAN. STAT. ANN. § 16a-2-404 (2001); KY. REV. STAT. ANN. §§ 286.9-010 to -.991 (LexisNexis 2007 & Supp. 2008); LA. REV. STAT. ANN. §§ 9:3578.1–8 (West, Westlaw through 2009 Sess.); MICH. COMP. LAWS ANN. § 487.2121–.2173 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); MINN. STAT. § 47.60 (West, Westlaw through 2010 sess., Chap. 180–200, 202–214); MISS. CODE ANN. § 75-67-501 to -539 (West 2000 & Supp. 2007); MO. ANN. STAT. § 408.500–.510 (West, Westlaw through Jul. 7, 2010 of 2010 Sess., 95th Leg.); MONT. CODE ANN. §§ 31-1-701 to 729 (West, Westlaw through 2009 Leg.); NEB. REV. STAT. ANN. §§ 45-901 to -929 (LexisNexis 2005 & Supp. 2008); NEV. REV. STAT. ANN. §§ 604A.010–.940 (West, Westlaw through 2009 Sess., 75th Leg.); N.D. CENT. CODE ANN. §§ 13-08-01 to -15 (West 2004 & Supp. 2007); OKLA. STAT. ANN. tit. 59, §§ 3101-3119 (West, Westlaw through Chap. 170, 2010 2d Sess., 52d Leg.); R.I. GEN. LAWS ANN. §§ 19-14.4-1 to -10 (West, Westlaw through Chap. 392 of Jan. 2009 Sess.); S.C. CODE ANN. §§ 34-39-110 to -290 (West, Westlaw through 2009 Sess.); S.D. CODIFIED LAWS §§ 54-4-36 to -69 (West,

remarkable when one considers that none are effective in curbing payday loan abuses.

The stated purpose of the recent New Mexico law is to ensure "more rigid public regulation and supervision" of lenders and to "facilitate the elimination of abuse of borrowers."[79] The Act further states that its intention is to "establish a system which will more adequately provide honest and efficient small loan service and stimulate competitive reduction in charges."[80]

The Act, with a few exceptions,[81] applies to lenders engaged in the business of lending amounts of $2,500 or less.[82] A payday loan is defined in the Act as a loan with a duration of fourteen to thirty-five days, for which the consumer gives the lender a check or debit authorization for the amount of the loan plus interest and fees.[83] In exchange, the lender agrees to defer presentment of that instrument until the consumer's next payday, or another date agreed upon by the lender and the consumer.[84] The lender then pays the amount represented by the check or debit authorization, minus interest and fees, to the consumer.[85] In the end, this narrow definition of payday lending defanged the legislation. The industry quickly switched to loan products that fell outside the statute, namely longer loans or those not involving a post-dated check; these loans are not regulated at all.

1. Fee Cap

The Act limits administrative fees and interest on payday loans to $15.50 per $100 borrowed[86] plus an additional $0.50 per loan for fees charged by the consumer-information database provider.[87] While this appears to be a great improvement over the unregulated rates charged in New Mexico prior to

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Westlaw through 2010 Sess.); TENN. CODE ANN. §§ 45-17-101 to -117 (West, Westlaw through 2010 1st Ex. Sess. & Apr. 14, 2010 Sess.) and TENN. COMP. R. & REGS. 0180-28-.01 (West, Westlaw through Mar. 31, 2010); 7 TEX. ADMIN. CODE § 83.604 (Vernon 2006 & Supp. 2008) and TEX. FIN. CODE ANN. §§ 342.251–.259 (Vernon 2006 & Supp. 2008); UTAH CODE ANN. §§ 7-23-01 to -504 (West 2006 & Supp. 2008); VA. CODE ANN. §§ 6.1-444 to -471 (West, Westlaw through 2010 Sess.) and 10 VA. ADMIN. CODE § 5-200-10 to -130 (West, Westlaw through 26:18 VA.R. May 10, 2010); WASH. REV. CODE ANN. § 31.45.010–200 (West 2008) and WASH. ADMIN. CODE § 208-630-120 to -270 (West, Westlaw through May 19, 2010); WYO. STAT. ANN. §§ 40-14-362 to -364 (West, Westlaw through 2010 Sess.). Fourteen other states have usury caps on all small loans: Arkansas, Arizona, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia.

79. N.M. STAT. ANN. § 58-15-1(D) (2010).

80. *Id.*

81. § 58-15-3(B), (C) (exempting certain individuals and banking institutions from the provisions of the New Mexico Small Loans Act of 1955).

82. § 58-15-3(A). These lenders are required to obtain a license from the New Mexico Financial Institutions Division (FID) and to comply with all aspects of the Act.

83. *See* § 58-15-2(H).

84. *Id.*

85. *See id.* The Act includes in the definition of a payday loan product a payday loan that has been converted to a payment plan pursuant to § 58-15-2(I).

86. § 58-15-33(B).

87. § 58-15-33(C).

implementation of the Act, which sometimes resulted in loans at 2500% per annum, this fee structure still results in an APR of at least 417%, assuming the longest possible repayment period of fourteen days.[88]

2. The Allegedly Free Installment Plan

The Act also provides that a lender must offer every consumer the "opportunity to enter into an unsecured payment plan for any unpaid administrative fees and principal balance [owed on] the payday loan."[89] The Act specifies that the payment plan must permit payment of the unpaid balance of the loan, in relatively equal installments, over a period of a minimum of 130 days, with no interest or fees added.[90] While the payment-plan option appears to protect consumers, the Act contains several disincentives for consumers to convert these loans to free payment plans. First, the Act does not require a "cooling-off period," or waiting period between loans, for a regular payday loan.[91] The statute does, however, require a ten-day cooling-off period after the repayment of a loan that has been converted to a payment plan.[92] Additionally, the cooling-off period does

88. This is still at the high end of rates permitted in other states that have implemented laws similar to the Act. For example, the following is a sampling of the transaction fees charged by other states per $100 borrowed:

Florida:	$10
Oklahoma:	$15 on first $300, then $10
Indiana:	$15 on first $250, $13 on next $150, $10 on next $150
Illinois:	$15
Michigan:	Stepped from $15 to $11, depending on amount borrowed
North Dakota:	$20

See FLA. ADMIN. CODE. ANN. r 69 V-560.905 (West, Westlaw through Chap 279, 2010 Sess., 21st Leg.); OKLA. ST. ANN. tit. 59 § 3108 (West, Westlaw through Chap. 170, 2d Sess., 52d Leg.); IND. CODE § 24-4.5-7-201 (West, Westlaw through 2010 2d Sess.); 815 ILL. COMP. STAT. ANN. 122/2-5 (West, Westlaw through P.A. 96-1015, excluding 96-1000, 1002, 1004, 1008, 1012, 2010 Sess.) ($15.50 per $100); MICH. COMP. LAWS ANN. § 487.2153 (West, Westlaw through P.A. 2010, No. 109, 2010 Sess., 95th Leg.); N.D. CENT. CODE ANN. § 13-08-12(2) (West, Westlaw through 2009 Sess.).

89. N.M. STAT. ANN. § 58-15-35(A).

90. § 58-15-35(B), (C).

91. A cooling-off period is a period after the repayment of a loan during which the consumer may not take out another payday loan from any payday lender regardless of whether the consumer would otherwise be qualified for such a loan under the Act. Cooling-off periods generally range from one to seven days and are often limited to the lender with whom the paid-off loan was originated. For example, Florida has a twenty-four hour cooling-off period, North Dakota has a three-day waiting period with the same lender, and Indiana has a seven-day waiting period with the same lender. *See* FLA. STAT. § 560.404(19) (West, Westlaw through Chap. 279, 2010 2nd Sess., 21st Leg.); N.D. CENT. CODE § 13-08-12(4) (West, Westlaw through 2009 Sess.); IND. CODE § 24-4.5-7-401(2) (West, Westlaw through 2010 2d Sess.). Indiana's cooling-off period takes effect only after the consumer has borrowed five loans. IND. CODE § 24-4.5-7-401(2).

92. N.M. STAT. ANN. § 58-15-36.

not start until the consumer has paid off all other outstanding payday loans.[93] Various parts of the law discourage use of the free payment plan.[94]

In March 2009, when at least some lenders were attempting to operate under the new law, very few clerks offered information about this free installment loan to researchers who called to inquire about how to get a loan. After significant prodding ("But isn't there some requirement that I be allowed to pay over time?"), some clerks attempted to explain the free installment payment plan. The clerks, who were overall exceedingly friendly, sometimes tried to make the caller feel guilty about entering the payment plan. They explained that the customer could pay back the loan over five months (sometimes described as twenty weeks). One clerk explained that "the payment plan is bad for everybody, bad for us, bad for you." What was so bad for the customer? To start, one cannot enter into another payday loan "for a long time," as one claimed, or "during the entire time the installment plan is out," explained another. Also, the *database* reflects that the person went into the payment plan. This seemed to imply that other lenders would be discouraged from lending to someone who had used a payment plan.[95]

3. Rollovers, Cooling-Off Periods, and Touch-and-Go Loans

The Act ostensibly prohibits what are known in the industry as "rollovers," but does not actually do so.[96] A rollover is a transaction in which the lender allows the consumer to delay payment of the loan principal for another pay period by paying only the interest due on the transaction. Consumer groups consider rollovers a particularly insidious problem because they trap a consumer into potentially paying the interest on a loan indefinitely without ever reducing the principal balance. The Act refers to rollovers as "renewed payday loans," and purports to preclude them.[97] The definition of a renewed payday loan includes using the proceeds from one loan to pay off another loan with the same lender.

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93. *Id.* Cooling-off periods are considered beneficial by consumer groups because they help prevent "touch-and-go" rollovers which allow a consumer to repay a payday loan and immediately take out another loan for the same amount. The New Mexico Act does not prevent such abuses. No cooling-off period is required for standard payday loans, only for people who enter into free installment plans.

94. Consumers need not discover this disincentive on their own. Customers in our study reported that lenders openly dissuaded them from using the free installment plan—if they disclosed the free installment plan requirement at all. Thus, this provision may make it easier for lenders to steer consumers away from the payment plan option into more expensive and risky alternatives, such as another payday loan or their new progeny, the non-free installment loan. For a consumer who makes frequent use of payday loans, the requirements for a cooling-off period and payment of all other payday loans may effectively rule out the payment-plan option. This is unfortunate because regular users of payday loans are one of the groups of consumers who might benefit from payment-plan loans as a way to break the cycle of borrowing and debt.

95. Eventually, in the late summer and fall of 2009, discussions with clerks or customers about free payment plans became obsolete, because lenders were offering almost exclusively products outside the statute and thus were under no legal obligation to offer the payment plan.

96. *See* § 58-15-34(A).

97. *Id.*

The Act nominally prevents rollovers by prohibiting lenders from entering into an agreement for a renewed payday loan, or otherwise refinancing or extending the term of a payday loan,[98] and by prohibiting lenders from requiring consumers to "enter into a new payday loan [in order] to pay [off] an existing payday loan . . . when the existing loan is eligible for a payment plan."[99] These provisions do not, however, prevent "touch-and-go" rollovers or "back-to-back" loans—transactions where the consumer repays a loan in full and then immediately takes out another loan for the same amount.[100] While the Act appears on its face to prohibit the lender from loaning the consumer the funds to repay an existing loan, because there is no cooling-off period between standard payday loans, the consumer can repay one payday loan and take out another for the same amount, or more, in essentially a single transaction. [101] As discussed above, because of the possible perception of penalties associated with converting standard payday loans to payment plan loans, consumers may choose touch-and-go rollovers as an alternative.[102] The payday loan without the post-dated check, one of the popular products in New Mexico today, is an interest-only loan for the life of the loan. Thus, the loan is designed for a lifetime of rollovers.

4. Loans are Limited to 25% of a Person's Gross Income

Another protection included in the Act limits the total amount a consumer can accumulate in payday loans at any given time to 25% of the consumer's gross monthly income.[103] Because the database used to enforce this provision is not used

98. *Id.*

99. § 58-15-34(E).

100. Remar Sutton, *Avoiding "Loan" Schemes and other "Services" Risky to your Financial Well-Being*, DIGITAL FEDERAL CREDIT UNION STREETWISE (Nov. 2008), http://www.dcu.org/streetwise/november2008.html.

101. *Id.*

102. A number of other states have prohibited rollovers by imposing cooling-off periods between loans, either from the same lender or other payday lenders. *See supra* note 91. Additionally, the FDIC, in its *Guidelines for Payday Lending*, recommends that lending institutions under its purview be required to establish "cooling-off" periods between paying off of a payday loan and granting another application as "prudent risk management" for the lending institution. FEDERAL DEPOSIT INSURANCE CORPORATION, FIL-14-2005, GUIDELINES FOR PAYDAY LENDING (2005), *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html; *see also* Veritec Solutions, *White Paper Analysis of the Center for Responsible Lending Report: Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform* (2007), VERITECS.COM, http://www.veritecs.com/2008_01_CRL_Whitepaper_Analysis.pdf.

103. Interestingly, the industry's own best practices do not suggest a cooling-off period. According to the CRL, income-limit requirements do not necessarily help consumers avoid becoming trapped in debt. CTR. FOR RESPONSIBLE LENDING, SPRINGING THE DEBT TRAP: RATE CAPS ARE ONLY PROVEN PAYDAY LENDING REFORM (2007), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf. Because the restriction is based on the consumer's gross income, and thus on a dollar figure that the consumer does not actually have available, it does not relate directly to the consumer's ability to repay the loan. Additionally, the income figure is for an entire month, but in most cases the term of the loan is only two weeks, meaning that the consumer only has half of the stated income with which to attempt to repay the loan.

in the case of loans that fall outside the law, these loans do not go into the database. Thus, the database serves no purpose.[104]

5. No Limit on Total Payday Loans per Customer

The Act does not limit the number of payday loans a consumer may have over a given span of time (e.g., one year). This means consumers could have up to 25% of their gross monthly income continuously tied up in debt to payday lenders, even as the law is written.[105]

6. Right of Rescission

Additionally, the Act gives the consumer the right to rescind the contract by returning all funds advanced by the lender before 5 p.m. on the business day following the day on which the loan was obtained.[106] The lender may not charge a fee for the rescinded transaction.[107] Of course, this protection does not apply to loans outside the statute.

7. The Database

One of the most seemingly significant provisions of the Act requires lenders to use a commercially reasonable method to verify that a consumer's income qualifies her for a payday loan.[108] Lenders were required to begin using this method no later than November 30, 2007,[109] and the New Mexico Financial Institutions Division (FID) certified Veritec, Inc. for this purpose.[110] Without this system, a lender could not check whether an individual was currently participating in a payment plan or had payday loans totaling more than 25% of the individual's

104. One customer had five loans on which she paid $100 a month, and she made only $685 from disability benefit payments. The loans did not involve a post-dated check, however, so none made it into the database. *See* Interview with Study Participant SB12.

105. The Act limits the various penalties and fees that lenders may charge. Lenders are prohibited from charging penalties for early repayment of a loan. The Act also prohibits charging fees for late repayment. N.M. STAT. ANN. § 58-15-33(E) (2010). This section limits the fee that a lender may charge for insufficient funds in the consumer's account on the date the loan is due to a single $15 charge. The section also allows the lender to present a given check or debit authorization to the consumer's financial institution only once. However, the Act permits the consumer to waive this protection and permits the lender to present the instrument one additional time. The waiver must be in writing. *Id.*

106. § 58-15-32(C).

107. As set out above, the Act requires clerks to tell customers that they had the right to cancel the loan at no charge any time before 5 p.m. the next day. Of the customers in our study who reportedly took out payday loans, 78% reported that they were not informed about the right to cancel the loan by 5 p.m. the next business day. These data are questionable, however, because we are not sure customers were able to tell if they were getting a payday loan or an installment loan.

108. *See* §§ 58-15-32(A) to -37(A).

109. § 58-15-37(C).

110. *See* Veritec Solutions, *State of New Mexico Payday Loan Transaction System*, https://www.nmpdl.com/AboutUs.aspx (last visited July 18, 2010).

gross salary.[111] Since 2001, Veritec has provided similar services for regulation of payday lending institutions in several other states, including Florida, Oklahoma, Michigan, Illinois, North Dakota, and Indiana.[112]

8. The Results

New Mexico spent several years attempting to regulate payday lending, the results of which are detailed above. Compared with the lack of regulation in New Mexico before the legislation, the Act appeared to offer substantial mechanisms for regulating the industry and for collecting information that could give state officials the ability to continue to evaluate and improve these laws. One of the most significant of these mechanisms appeared to be the Veritec database system, which seemed to have the potential, over time, to show real statistics on the average number of: (1) loans per borrower per year; (2) back-to-back or touch-and-go loans issued;[113] (3) loans converted to payment plans; and (4) uncollectible loans.[114] The database, however, is not capturing the lion's share of the short-term loan data in New Mexico.

Real data in these areas could have been very helpful in understanding both the problems and the solutions associated with payday lending, yet none of this potential will be realized in New Mexico, or in any other state that adopts a similar regime to regulate payday lending. State legislators and consumer groups all over the country still advocate using the Veritec database as a solution to short-term loan abuses, but this is no solution if the industry can change its lending model to avoid implicating the database. The database is little more than a costly chimera if it will not capture the information it is designed to collect.

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111. According to its website, "Veritec was established in 1988 to provide program management services to State agencies, and Veritec Solutions, LLC was established in 2001 to partner with the State of Florida Department of Banking and Finance to develop and implement the Florida Deferred Presentment Program as a state regulatory solution for the payday loan industry." Veritec Solutions, *About Veritec Solutions*, VERITECS.COM, http://www.veritecs.com/About.aspx (last visited Feb. 9, 2010); *see also* Veritec Solutions, *New Mexico Payday Loan Transaction System Welcome Package*, N.M. REGULATION AND LICENSING DEP'T, http://rld.state.nm.us/FID/PDFs/Veritec_Welcome_Package.pdf (last visited June 1, 2008). The database is a self-funding project. The sole source of revenue for the database is a $0.50 charge on each payday loan that is entered into the system. There is no charge for customer eligibility checks, Social Security number validation checks, use of the Veritec help desk, transaction updates, or report generation. In order to register and use the database, lenders must be licensed by the New Mexico Financial Institutions Division to provide payday loans in New Mexico, they must have registered their operators with Veritec, and those operators must complete the Veritec training program and be certified by Veritec to use the system. Finally, as noted above, the lenders must complete the upload of their historical data. *Id.*

112. *See* http://www.veritecs.com/PaydaySolution.aspx (Florida); https://www.okddl.com/ (Oklahoma); http://www.midpp.com/ (Michigan); http://www.veritecs.com/Docs/IL_3_Year_PLRA_Report.pdf (Illinois); https://www.nddpp.com (North Dakota); https://www.indpp.com/about.asp (Indiana).

113. Back-to-back or touch-and-go transactions allow a consumer to repay a payday loan and immediately take out another loan for the same amount.

114. N. M. REGULATION & LICENSING DEP'T., FINANCIAL INSTITUTIONS DIVISION REPORT (2009) (on file with Author).

The New Mexico law, like many others around the country, capped interest rates at a generous 417%, yet payday lenders regarded this as an insufficient return. In order to reclaim the "tremendous profits"[115] to which it had become accustomed, the industry invented new products such as the payday loan without the post-dated check and the installment loan described in the next Section, which earn higher lender fees. One conclusion resonates strongly from this game of legislative cat-and-mouse, namely that these types of legislative efforts do not reduce short-term lending, interest rates, or fees for such loans.

While the payday lending industry itself claims that payday legislation *can* effectively protect consumers,[116] the industry's actions tell a different story. The new products offered by short-term lenders suggest what the industry denies—namely that the only type of regulation that really ends the abusive practice of charging 500% or more in interest over long periods of time is an absolute interest rate cap. Any other solution is subject to further end runs.

B. Changes in the Short-Term Loan Industry

To say that the short-term loan industry is resilient, creative, and resistant to piecemeal legislation is a tremendous understatement.[117] The amount of legislative time and effort the industry's shifting business plans have spawned is nothing short of remarkable. The resulting maze of state and federal statutes is complex, ineffective, and inefficient. While some scholars describe the payday lending industry as one of the most highly-regulated industries in consumer credit,[118] it is strangely unaffected by the most intrusive legislation, such as that recently passed in New Mexico. Such regulatory regimes are costly because they are time-consuming to pass and require implementation of databases. Moreover, they accomplish nothing.

1. The End Run Around New Mexico's Small Loan Act and Similar Laws in Other States

A look at the substitute products being offered by New Mexico's payday lenders quickly reveals the legislative deficiencies. While some lenders in New Mexico in the summer of 2009 were still offering payday loans *with* post-dated checks, most were not. Many had stopped offering payday loans completely, and were instead offering a product called an "installment loan." These loans are outside the New Mexico payday lending statute because they are written for more than the thirty-five days prescribed by the Small Loan Act. Many are written for twenty weeks or five months, though it is unclear why this particular length was

115. *See* HOW TO START PAYDAY LOAN BUS., http://www.paydayloanindustry.com (last visited July 30, 2009).

116. *See, e.g.*, Brief of Amicus Curiae Community Financial Services Ass'n of America in Support of Petitioner, Buckeye Check Cashing v. Cardegna, 546 U.S. 440 (2006) (No. 04-1264), 2005 WL 1941281, at *1.

117. *See* Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 962 (2008).

118. LEHMAN, *supra* note 12.

chosen. These loans are completely unregulated, so lenders have carte blanche in structuring them.

According to several of the customers interviewed curbside, some of the lenders converted existing payday loans into installment loans without their knowledge once the law changed.[119] Others continued to carry the old payday loans since they were not affected by the new legislation.[120] Overall, this study suggests that a very large portion of the market shifted to installment loans by August 2009.[121] Another product also popped up in place of the payday loan: the payday loan without the post-dated check.[122]

In June 2009, all listed payday and short-term lenders in Albuquerque were contacted and informally surveyed to estimate what market share installment loans had captured. Later in the fall, results were validated by random calls to one-third of the lenders originally contacted. More lenders offered payday loans in March than in June, and by September, only one lender we contacted offered only payday loans. While some lenders were offering both payday loans and installment loans, most were pushing installment loans.[123]

So how does an installment loan work? As one lender explained to a customer, these installment loans have to be written for at least 120 days, but can be "paid off early so they can behave like a payday loan." While the terms vary somewhat, the following example demonstrates the general structure:

> You borrow, for example, $500, and over the twenty week period, you pay back this plus $585, for a total of $1,085. For another

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119. *See, e.g.*, Interview with Study Participant CS66.

120. One gentleman reported paying over $2000 over two years for a $300 loan. This loan is still unpaid, and he does not understand why he still owes the original $300. *See* Interview with Study Participant CS27.

121. *See* data from calls to lenders, gathered March, June, and November 2009. The New Mexico payday lending industry is still in business, but it is unclear whether it is complying with the new law. In order to be in compliance with the new law, the charge for a payday loan should be $15.50 per $100 borrowed, with a one-time $0.50 service fee. Examples of loan amounts we obtained from clerks over the phone or from survey participants include: (1) loans of $500 for $78, with $578 due by payday (1st Payday), whether payday is tomorrow or two weeks from now; (2) $300 for $67.50 (Allied Cash and FastBucks); and (3) $500 for $7 a day from now until payday (FastBucks), which appears to compute to over 500% per annum. These examples suggest most lenders were in compliance with the fee caps, but some were not.

122. For example, Allied Cash Express appeared to be offering this product in New Mexico during the summer of 2009.

123. We found that by the summer of 2009, the new installment loans made up well over half of the market that was previously known as the payday lending market in the Albuquerque Metro area. This conclusion comes from calling lenders, not from information gathered from customers. We also asked survey respondents whether they were offered a payday loan or an installment loan and they reported that they were offered: 53.75%, just installment; 25.37%, both; 17.91%, only payday; 2.99%, unsure. Unfortunately these data turned out to be questionable when we looked at the actual terms of individual loans. When the data were analyzed more closely, it was clear that consumers simply could not reliably tell the difference between the two, and thus it was ineffective to ask them which type of loan they took out, a payday or an installment loan.

> example, you borrow $400 and you pay back that plus $468.20, for a total of $868.20. The clerks are honest with people about the fact that fees are higher with the installment (typically expressed as $25 per $100 versus $15.00 per $100). They also tell customers that the customers have a better chance of paying back this type of loan.[124]

Once a customer has repaid part of the principal on an installment loan, she is encouraged to reborrow the loan as quickly as possible.[125]

Clerks explain to customers that if they choose an installment loan rather than a payday loan, the customers can protect their identity because their names and other data will not be placed in the statewide database. Several clerks mentioned the ability to avoid the database, and characterized this as a good thing to protect one's identity and also to get more loans. One or two clerks explicitly stated that if there was no database reporting, there was no limit on the number of loans a customer could have. One store prominently posted a huge sign outside stating:

> **ATTENTION:** Come in and Get Your Money Today: If You Have a Loan in Good Standing with Our Competitors, Verifiable Employment and Residence – You Are Guaranteed a Loan with World Finance.[126]

This sign suggests that at least for some lenders, multiple loans are part of the solution rather than part of the problem.

The industry shift away from payday loans toward installment loans also is causing confusion among customers. One woman reported that her family and friends had bad experiences with payday and title loans, so she took out an installment loan.[127] Other customers described their loan as either a payday loan or an installment loan, but when they told the interviewers when the loan was due and how it would be paid back, it clearly was the other type of loan.[128] One man said he thought he would get a payday loan but instead chose the installment loan.[129] His description of the terms indicated that he had a payday loan, suggesting that these labels mean very little to the consumer.[130]

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124. *See* Interviews with Study Participants CS44 and CS68.

125. *Id.*

126. The sign displayed at World Finance, located at 965 W Highway 550, Bernalillo, New Mexico 87004-5924.

127. *See* Interview with Study Participant CS02.

128. *See, e.g.*, Interviews with Study Participants CS13, CS54, CS60, and CS68. A study participant who was paying interest only on a payday loan without a post-dated check said he did not choose the installment loan because he did not want to be in debt, apparently not realizing that he was failing to pay down any of the principal on his loan. *See* Interview with Study Participant CS37; *see also* Interview with Study Participant CS19 (explaining that installment loans seem to cost more over time, but not understanding that he was not paying anything on the principal on the payday loans).

129. *See* Interview with Study Participant CS09.

130. *Id.*

a. The Payday Loan without the Post-Dated Check

Since the New Mexico Act defines a payday loan as one involving a post-dated check or a debit authorization, loans that exclude these elements but are otherwise identical to a payday loan are currently unregulated in New Mexico. As a result, a lender can make the same loan it made before and just not require the post-dated check. Then it can charge whatever fees it wants because the transaction is completely outside the statute. These are interest-only loans and many prohibit prepayment of partial principal—meaning that if the loan amount is high enough, it virtually precludes paying off the loan without a family or friend bailout. People using payday loans without post-dated checks are not entered in the state database, making the database of very limited utility at this point.[131]

While payday loans without post-dated checks did not seem to be the industry loan product of choice in the summer of 2009, by the fall and winter, these seemed to be more popular than the installment loans. Thus, interest-only loans are again commonplace.

b. Some Customers Know about the Law and Know it Doesn't Work

While not every payday loan customer had heard about the modifications to the law in New Mexico, a few offered information about the changes without being asked or prompted. One customer articulately stated that "the new laws are not working. They try not to call it a payday loan but it is. The interest rates are just as high. They have found a way to circumvent the law."[132] Another said, "Nothing changed with the new legislation."[133]

2. Similar End Runs in Other States

The new loan products described above are a complete end run around New Mexico's payday lending statute and should be a wake-up call for other states trying to curb abuses in this industry. Laws of this kind accomplish nothing, yet are passed in various states around the country. For example, Professor Mayer reports on similar Illinois legislation:

> Regulators in Illinois imposed rules in 2001 that were designed to [curb the number of simultaneous payday loans and rollovers]. Customers were allowed to borrow no more than $400; only two renewals were permitted, with some of the principal paid down each time; and a cooling-off period was mandated to prevent borrowers from using the proceeds of a new loan to pay off the old one. The state . . . promised to establish a database to track loan activity and enforce the rules.[134]

131. N.M. STAT. ANN. § 58-15-2(E) (2010).
132. *See* Interview with Study Participant CS09; *see also* Interview with Study Participant CS67.
133. *See* Interviews with Study Participants CS08 and CS10.
134. Mayer, *supra* note 29, at 8.

Unfortunately, the Illinois case is a lesson in failed reform. The database was never established,[135] and the payday lenders devised a new product to evade the rules.[136] The reforms applied to cash advances with a term of less than thirty-one days, so the industry created a thirty-one day loan not covered by the rules. As a result, the old abuses persist: a 2003 Illinois Department of Finance report acknowledges that it remains "quite common for borrowers to have multiple payday loans outstanding with several different payday loan companies."[137]

States other than New Mexico, such as Florida and Oklahoma, have similarly tried to curb perpetual borrowing and lending practices by banning loan renewals.[138] Proposed federal legislation, H.R. 1214, also attempts to address this problem.[139] But payday lenders quickly evade this restriction by closing out the current loan and replacing it with a new, identical loan.[140] This system results in no reduction in the average number of loans per borrower or interest paid.[141]

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135. Ironically, based upon New Mexico's experience, Illinois may have saved itself some time and money by not setting up the database.

136. Mayer, *supra* note 29, at 8 (quoting Tom Feltner & Marva Williams, *New Terms for Payday Loans: High Cost Lenders Change Loan Terms to Evade Illinois Consumer Protections*, REINVESTMENT ALERT (Woodstock Inst.), Apr. 2004, at 3, *available at* http://woodstockinst.org/document/alert_25.pdf).

137. *Id.*

138. *See* Veritec Solutions, *Congressional Hearings Confirms That States Are Doing A Good Job At Regulating Short Term Lending*, PR NEWSWIRE (Apr. 4, 2009), http://news.prnewswire.com/DisplayReleaseContent.aspx?ACCT=104&STORY=/www/story/04-08-2009/0005002727&EDATE=lending ("'Several states, including Florida and Oklahoma, are effectively protecting consumers,' said Thomas Reinheimer, CEO of Veritec Solutions of Jacksonville, Florida. 'Veritec is at the forefront of implementing effective regulatory enforcement solutions for strong consumer protections required by state law. We see first-hand the impact of good regulation in enabling access to short-term credit while protecting consumers from getting trapped in a downward debt-cycle.'").

139. Payday Loan Reform Act of 2009, H.R. 1214, 111th Cong. (1st Sess. 2009); Michael Calhoun, *Payday Loan Reform Act Must be Strengthened*, CTR. FOR RESPONSIBLE LENDING (Apr. 2, 2009), http://www.responsiblelending.org/media-center/press-releases/archives/payday-loan-reform-act-must-be-strengthened.html.

140. Veritec Solutions, *supra* note 138.

141. Veritec has published detailed white papers and reports about effective regulation of the payday loan industry, which illustrate the following facts: borrowers and lenders are unable to rollover payday loans in Florida and Oklahoma; over 75% of borrowers pay off their loans within two days after the due date; grace periods and repayment plans are available under state law to any eligible borrower who cannot pay off their loans on time; and over 25% of borrowers no longer use the product more than one year and a majority of borrowers no longer use the product after three years.

Could it be that Veritec does not read the industry's own weblogs? "We are concerned that states considering regulation and enforcement of consumer protections may be swayed by misinformation from CRL. Veritec supports effective regulation of short-term lending that provides borrower access to short-term credit products with enforcement of consumer protections. State bans on short-term credit products often have an unintentional consequence of helping eliminate a consumer's option to choose a regulated product," said Mr. Reinheimer. "To better illustrate this, all anyone has to do is to search the Internet for loans available in rate cap states and see that unregulated, unlicensed activity is alive and well." Veritec Solutions LLC is a regulatory services company that manages statewide

States such as Florida, Illinois, and Michigan[142] have tried to impose interest-free payment plans like those proposed in New Mexico. These laws have produced no meaningful reduction in the number of trapped borrowers, because the requirement that borrowers have only one loan at a time has no effect on the revolving 400+% interest-only loans.[143]

Perhaps most critically, payday lenders can evade attempted reforms by slightly modifying their products. For example, in Virginia, payday lenders have marketed open-end loans to avoid new regulations.[144] In Illinois, as in New Mexico, payday lenders changed their product to high-cost installment loans to sidestep state laws targeted at the industry.[145] Ultimately, whenever payday

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lender compliance programs in eight states with statewide databases and related limits included in their respective payday lending (aka deferred presentment, deferred deposit) statutes. Veritec helps state agencies regulate lenders through the management of these programs. Veritec's primary customers are state regulatory agencies; the firm does not supply any goods or services to the payday lending industry. *Id.*

142. Florida's loan interest rates and fee caps actually amount to very large annual percentage rates. The APR for a $100 fourteen-day loan is 390%. Illinois' payday law caps the fee that can be charged at $15.50 per each $100. This amounts to a very high effective APR. The APR for a fourteen-day $100 loan is 403%. Michigan's legislation, the Deferred Presentment Service Transactions Act, limits loan amounts to $600 in a thirty-one-day period and allows lenders to charge up to 15% depending on the size of the loan. *See State-by-State Payday Loan Summary*, CREDIT.COM, http://www.credit.com/credit_information/credit_law/PaydayLoanLaws.jsp (last visited Aug. 17, 2010).

143. *Id.*

144. *SCC Plugs Payday Loan Loophole*, RESPONSIBLELENDING.ORG (Mar. 19, 2010), http://www.responsiblelending.org/tools-resources/headlines/Momentum-for-Payday-Loan-Reform-Growing.html (citing Jeff E. Schapiro, *SCC Plugs Payday Loan Loophole*, RICHMOND TIMES-DISPATCH, Jan. 1, 2010, http://www2.timesdispatch.com/news/2010/jan/01/b-pday01_20091231-204806-ar-23927/). Shapiro reports that:

> Payday lenders started offering open-ended loans, which are treated much like bank lines of credit, after Virginia lawmakers placed restrictions on the industry. Legislators responded by passing a law requiring payday businesses to choose one product or the other: payday loans or open-ended loans, but not both. However, that law included language that enabled payday lenders to also offer car title loans and to continue hawking both products. Consumer advocates say the SCC's corrective actions could help safeguard consumers from being bogged down in debt.

Id.

145. *Momentum for Payday Loan Reform Growing*, RESPONSIBLELENDING.ORG (Mar. 19, 2010), http://www.responsiblelending.org/tools-resources/headlines/Momentum-for-Payday-Loan-Reform-Growing.html (citing Adam Doster, *Momentum for Payday Loan Reform Growing*, PROGRESSILLINOIS.COM (May 19, 2010 2:09 PM), http://progressillinois.com/posts/content/2010/03/19/momentum-payday-loan-reform-growing).

> Illinois state Sen. Kim Lightford and 11 co-sponsors have introduced SB 655, which would regulate small consumer installment loans (CILA) in the state. It comes in an attempt to close a loophole in payday legislation passed by the General Assembly in 2005. That law defined a payday loan to have a term of 120 days or fewer, so the payday lending industry skirted the stipulation by turning to installment loans with slightly longer repayment terms. Lightford's bill would limit interest rates on

lending legislation passes, the industry finds a way to charge even more for loans than it did prior to the legislation.

The new installment loans in New Mexico are not legislated at all, and in practice lenders seem able to start the whole loan over and over again, despite the name "installment loan." Numerous customers reported they were never able to pay off any of the principal.[146] The data show that customers do not understand the loan in these terms, but imagine if they did. Imagine how popular these products would be if they were described as a loan for $400 that would require a $62 payment every month for the rest of the borrower's life, after which the borrower would still owe the original $400.[147] Surely those who could find alternatives would do so.

3. Ways Around the 29% Absolute Cap: The Ohio Story

In 2008, the Ohio state legislature voted to rescind the twelve-year-old law that exempted payday lenders from the state's usury laws—a vote Ohioans supported two to one.[148] The Short Term Loan Act purports to cap interest on all short-term loans at 28%, and also gives customers at least one month to pay off the loans.[149] In response, some payday loan operators chose to close their stores and leave the state.[150] Those that remained resorted to other innovative approaches. As one industry website explains, these lenders are now prospering because there is less competition, and creative tactics allow them to remain in business. They have simply switched their licenses so they can offer payday "clones" under two parallel lending statutes, the Small Loan Act or the Mortgage Lending Act.[151] Ohio

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> installment loans at 99 percent APR, index loans based on a borrower's ability to pay, and require equal monthly installment payment plans. A similar effort was defeated by House Democrats last session.

Id.

146. *See, e.g.*, Interviews with Study Participants SB01, CS23, CS27, CS35, and CS44.

147. This is the cost under New Mexico's new payday lending law. N.M. STAT. ANN. §§ 58-15-32 to -38 (2010).

148. Substitute H.B. 545, 127th Gen. Assemb., Reg. Sess. (Ohio 2007); *see also* Creola Johnson, Dear President Obama: You Protected the Troops; Now Fulfill Your Promise to Protect All Americans from Payday Loans 12–14 (2010), *available at* http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context =creola_johnson.

149. OHIO REV. CODE ANN. § 1321.39–.40 (West 2008).

150. Mary Rice, *Ohio HB 486: Limiting payday lending fees*, PERSONALMONEYSTORE.COM (May 11, 2010), http://personalmoneystore.com/moneyblog/2010/05/11/ohio-hb-486-payday-lending-fees/ ("After the first round of regulation was passed, more than 700 Ohio payday loan stores closed.").

151. *Ohio Payday Loans Laws & Legislation*, OHIO PAYDAY LOAN LAWS, http://paydayloanlegislation.com/ohio.html (last visited July 19, 2010). Making the change is quite simple. As one industry website instructs:

> By adjusting the loan amount to just above $500, payday loan lenders double the loan origination fees from $15 to $30. The Small Loan and Mortgage Lending acts allow the fees on top of the 28 percent interest, something the new payday lending law doesn't permit.
>
> Under the new HB545 licensing scheme with the check cashing fees added, customers pay the same $575 to walk out the door with $500

Attorney General, Rich Cordray, said his office has found payday clones with APRs ranging from 128% to 700%. As the same industry website explains, "[T]here is a lot of confusion in Ohio as a result of the attempt by fools to legislate away a product that millions need, want, use and demand!"[152]

4. Credit Service Organizations and Payday Loans: The Next Face of Hydra

Professor Mary Spector characterizes payday loans as the mythical beast hydra, a nine-headed monster from Greek mythology that grew a new head every time one was cut off.[153] The industry's newest incarnation makes the analogy particularly apropos. Many states have statutes that govern entities called Credit Service Organizations (CSOs).[154] CSO statutes were originally established to

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> in cash. Prior to HB545, Lenders typically charged $15 for every $100 borrowed . . . . A First American payday loan customer indicated he previously paid $75 for a $500 loan, First American charged him a total of $90 to borrow the same amount after the law changed. More than one Ohio payday loan company has structured their check cashing and loan operations as two separate entities to justify the fees.

Id.

As another industry webpage explains:

> With news of the passage of Issue 5 in Ohio on Nov. 4, Check Into Cash began restructuring its loan product offerings throughout the Buckeye state to comply with the new law. On Nov. 5, the company ceased to offer payday loans and began offering a new product, micro loans, which are short-term loans from $50 to $600 and permitted under Ohio's Small Loan Act.

Check Into Cash Committed to Serving Ohio Customers – Repost, PAYDAYFACTS.ORG (Nov. 21, 2008, 10:19 AM), http://www.paydayfacts.org.

152. *Payday Loans: Ohio Still Going Strong*, PAYDAY LOAN INDUSTRY BLOG (Feb. 21, 2009), http://paydayloanindustryblog.com/payday-loans-ohio-still-going-strong.

153. Spector, *supra* note 117, at 962, 964.

154. Congress and numerous states have enacted CSO legislation to crack down on abuses by companies claiming they could help individuals repair their credit. Most of the credit-repair agencies turned out to be scams, with some even offering to rent other people's credit scores to borrowers for fees of $2000 or more. To curb these abuses, states began enacting laws prohibiting agencies from charging fees for these types of services. Congress soon followed suit with the Credit Repair Organizations Act. *See* Credit Repair Organizations Act, 15 U.S.C. §§ 1679–1679j (West 2000 & Supp. 2005). Many states have also passed Credit Repair Organization legislation. *See, e.g.*, CAL. CIV. CODE § 1789.11(b) (West 2007). For additional state statutes, see ARIZ. REV. STAT. ANN. §§ 44-1701 to -1712 (West 2007); ARK. CODE ANN. §§ 4-9-101 to -109 (West 2008); COLO. REV. STAT. ANN. §§ 12-14.5-101 to -113 (West 2007); CONN. GEN. STAT. § 36a-700 (2007); DEL. CODE ANN. tit. 6, §§ 2401–2414 (2007); D.C. CODE §§ 28-4601 to -4608 (2008); FLA. STAT. §§ 817.7001, .7005 (2008); GA. CODE ANN. § 16-9-59 (2007); 815 ILL. COMP. STAT. 605/1–605/4 (2007); IND. CODE §§ 24-5-15-1 to -11 (2007); IOWA CODE §§ 538A.1–.14 (2008); KAN. STAT. ANN. §§ 50-1116 to -1135 (2006); LA. REV. STAT. ANN. §§ 9:3573.1–.17 (2007); ME. REV. STAT. tit. 9-A, §§ 10-101 to -401 (2007); MD. CODE ANN., COM. LAW §§ 14-1901 to -1916 (West 2008); MASS. GEN. LAWS ch. 93, §§ 68A–68E (2008); MICH. COMP. LAWS §§ 445.1821–.1826 (2008); MINN. STAT. §§ 332.52–.60 (2007); MO. REV. STAT. §§ 407.635–.644 (2007); MONT. CODE ANN. §§ 30-14-2001 to -2015 (2007); NEB.

control credit-repair businesses, but in the past few years, short-term lenders have been operating as CSOs under a statutory loophole that allows them to obtain "an extension of consumer credit" for borrowers. The CSOs charge large fees in exchange for purportedly helping consumers repair poor credit histories and gain access to more credit.[155] Most statutes define a CSO as:

> [A] person who, with respect to the extension of credit by others, sells, provides, or performs, or represents that he or she can or will sell, provide or perform, any of the following services, in return for the payment of money or other valuable consideration:
>
> (1) Improving a buyer's credit record, history, or rating.
>
> (2) Obtaining a loan or other extension of credit for a buyer.
>
> (3) Providing advice or assistance to a buyer with regard to either paragraph (1) or (2).[156]

The definition is extremely broad, opening the door for payday lenders to redefine themselves as CSOs.[157] Although CSO authorizing statutes provide regulations for disclosure, registration, and operation of CSOs, they do not cap

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REV. STAT. §§ 45-801 to -815 (2007); NEV. REV. STAT. ANN. §§ 598.741–.787 (2007); N.H. REV. STAT. ANN. §§ 359-D:1–11 (2008); N.Y. GEN. BUS. LAW §§ 458-a to -k (McKinney 2008); N.C. GEN. STAT. §§ 66-220 to -226 (2007); OHIO REV. CODE ANN. §§ 4712.01–.99 (West 2008); OKLA. STAT. tit. 24, §§ 131–148 (2007); OR. REV. STAT. §§ 646.380–.398 (2006); 73 PA. CONS. STAT. ANN. §§ 2181–2192 (West 2007); S.C. CODE ANN. §§ 37-7-101 to -122 (2007); TENN. CODE ANN. §§ 47-18-1001 to -1011 (2007); TEX. FIN. CODE ANN. §§ 393.001–.505 (West 2007); UTAH CODE ANN. §§ 13-21-1 to -9 (West 2007); VA. CODE ANN. §§ 59.1-335.1–.12 (2008); WASH. REV. CODE §§ 19.134.010–.900 (2008); W. VA. CODE §§ 46A-6C-1 to -12 (2007); WIS. STAT. §§ 422.501–.506 (2007). These states do not appear to have CSO statutes: Hawaii, Idaho, Kentucky, New Mexico, South Dakota, Tennessee, Vermont, and Wyoming.

155. Spector, *supra* note 117, at 988–89. *See also* Arkansans Against Abusive Payday Lending, *Payday Lenders in Arkansas: Attorney General Cracks Down on PaydayLenders – Most Comply, Some Defy*, PAYDAYLOANINFO.ORG, 7 (July 2008), http://www.paydayloaninfo.org/elements/www.paydayloaninfo.org/File/08_07_attorney_general.pdf.

156. CAL. CIV. CODE ANN. § 1789.12(a)(1)–(3) (West 2008).

157. *See* Spector, *supra* note 117, at 987. California's statute, which is similar to statutes in Texas and other states, exempts several categories of businesses, including licensed lenders, federally-insured banks, most attorneys, and most tax-exempt nonprofit organizations. Nevertheless, the breadth of the definition is apparent on first reading and, in some states, unless specifically exempted, entities such as mortgage brokers are included within its terms. Increasingly, the line is difficult to draw. For example, an Ohio court held that a company that advertised "personal loans up to $50,000" for consumers with credit problems must comply with the Act, but an Illinois court using the same definition held that a car dealership and a home remodeling company, both of which arranged loans with third-party lenders, fell outside the Act's scope. *Id.* at 987–88 (citing Ohio *ex rel.* Petro v. Berks Fin., No. 03-CV-8373, 2004 WL 3736495, at *2 (Ohio Ct. Com. Pl. Aug. 4, 2004)); Cannon v. William Chevrolet/Geo, Inc., 794 N.E.2d 843, 851–52 (Ill. App. Ct. 2003) (stating car dealership is not within the scope of the Act); Midstate Siding & Window Co. v. Rogers, 789 N.E.2d 1248, 1253–55 (Ill. 2003) (stating remodeling company is not within the scope of the Act).

interest rates or fees, leaving the door wide open for payday lenders to slip into the definition of a CSO and return to business as usual.[158]

Not surprisingly, the payday-lending industry has done just that, as this industry website regarding the CSO loophole demonstrates:

> If you're not familiar with the CSO payday loan model it essentially consists of a "servicer" that markets the product, services the product, and accepts the risks associated with the product by issuing a "letter of credit" on behalf of the "borrower" to a "lender". A Credit Services Organization typically charges the consumer $20–$30 per $100 loaned for 7 to 31 days. The CSO Credit Services Organization is "registered" with the state rather than "licensed" by the state. The state does not "regulate" the CSO.
>
> . . . .
>
> The CSO Credit Services Organization model yields much better returns than the typical payday loan-cash advance-deferred deposit statutes existing in various states (Texas, Florida, Oregon...) and provinces without all the licensing and regulation. It's no wonder the use of the CSO Credit Services Organization model is on the rise throughout the country.[159]

Since at least thirty-eight states have CSO statutes, payday lenders in any of these states may try this approach.[160] CSOs are incredibly prolific in Texas, following its recent regulation of payday loans. In 2005, there were fewer than 100 CSOs in Texas, but now there are more than 2000 CSO storefronts offering high-cost small loans across the state.[161] Unlike other short-term or small-dollar lenders, CSOs in Texas are not subject to any limitation on fees they can charge.[162] CSOs also sidestep licensing and enforcement by the state's Office of Consumer Credit Commissioner, which holds other Texas consumer lenders accountable.[163] Texans now take out an estimated $2.5 billion in loans through CSO payday lenders each year and pay $500–600 million in annual fees.[164]

Ironically, CSO legislation was originally enacted to protect consumers from credit overextension and to help them make informed decisions about credit.[165] Now CSOs are used to allow payday lending in states that have prohibited it. The states that currently prohibit payday lending—Arkansas, New York, New Jersey, Georgia, Maine, Maryland, Massachusetts, New Jersey, New

158. Spector, *supra* note 117, at 988.

159. *Florida Payday Loan Credit Services Organization Issues*, PAYDAY LOAN INDUSTRY BLOG (June 17, 2008), http://paydayloanindustryblog.com/florida-payday-loan-credit-services-organization-issues.

160. *See supra* note 154 and accompanying text.

161. Rebecca Lightsey, *High Cost Lenders Profit from Desperate Times*, TEXAS LONE STAR FORUM (Mar. 12, 2009, 1:06 PM), http://amforumbacklog.blogspot.com/2009/03/high-cost-lenders-profit-from-desperate.html.

162. TEX. FIN. CODE ANN. §§ 393.001–.505 (West 2007).

163. Lightsey, *supra* note 161.

164. *Id.*

165. CTR. FOR RESPONSIBLE LENDING, *supra* note 75, at 1.

York, North Carolina, Pennsylvania, Vermont, West Virginia, and most recently New Hampshire—should keep their eye on CSO legislation. Such legislation already exists in thirty-four states, including Arizona, Arkansas, New York, New Hampshire, North Carolina, Georgia, Maine, and West Virginia.[166] If these states wish to continue their prohibitions on payday lending, they should repeal these CSO statutes. Other states interested in curbing payday lending should follow suit.

5. State Law and Politics

One might wonder why so many legislative efforts to curb payday lending fail, or more specifically, why none of the specific payday lending laws actually change industry practices. The answer lies partially in the political process itself.[167] The $42 billion-a-year payday lending industry spent $6.1 million lobbying Washington last year alone.[168] It has spent many more millions lobbying in battlefield states like Wisconsin, Ohio, and Arizona.[169] With this kind of money to spend, it is no wonder these forms of credit are difficult to regulate effectively.[170]

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166. *See supra* note 154 and accompanying text.

167. *See* Keith Epstein, *Profiting from Recession: Payday Lender Spend Big to Fight Regulation*, HUFFINGTON POST, Mar. 2, 2010, http://www.huffingtonpost.com/2010/03/02/profiting-from-recession_n_482297.html.

168. *Id.* (noting that the industry paid campaign contributions in the amount of at least $1,315,841 and incurred lobbying expenditures of at least $6,110,000 in 2009–2010).

169. Trade groups have financed studies to underscore the small profit margin on each loan. These groups have also created a database of more than half a million customers who can be quickly mobilized to persuade particular politicians. The persuasion often takes the form of personal, handwritten accounts from constituents about how quick cash helped them during times of financial need. *Id.* Forms of these letters are left on the counter for customers to pick up. *See* Interview with Study Participant SB19. The industry spent more than twice as much lobbying in 2009 as it did in 2008. The Community Financial Services Association, one of many trade organizations of high-interest lenders, increased its spending by 74%, to $2.56 million. *Id.*

Industry representatives claim to be tracking 178 different pieces of legislation around the country—101 of which they oppose. In thirty-four states and Washington D.C., the payday loan industry and its companies have forty of their own in-house lobbyists, while paying another seventy-five outside lobbyists. An analysis of federal elections records shows political contributions linked to payday lending are streaming into the campaigns of members of Congress. At the current rate—$1.3 million since the start of 2010—the amount of money spent before the 2010 midterm elections could easily surpass the industry's spending during the 2007–2008 presidential campaign season. *Id.* Wright Andrews, whose lobbying shop Butera & Andrews earned $4 million in fees for coordinating the subprime industry's lobbying between 2002 and 2006, now represents the payday industry. Records show his firm earned $240,000 from the Community Financial Services Association in 2009. *Id.*

170. Payday lenders also contribute millions to candidates in state elections, making them among the dozen or so top donors when figures for state and federal campaign contributions are combined. That puts them in the same influential ballpark, for instance, as unions, the gaming industry, and real estate interests. *Id.* In Wisconsin alone, efforts to establish an interest rate ceiling of 36% mobilized at least twenty-seven registered lobbyists against it. On February 16, 2010, Wisconsin lawmakers adopted a bill that could lead to

III. RESULTS OF CURBSIDE AND OFFICE INTERVIEWS

Part III describes the methodology of our empirical study, as well as the qualitative and quantitative results. All of the quantitative data described in this Section are derived from the curbside interviews. The footnotes at times elaborate on these quantitative data with comments made in the qualitative office interviews, but the office interviews were not included in the percentage data analysis set out below.

The curbside data demonstrate that customers do not shop around for payday or other short-term loans, customers tend to take out loans near home or work out of convenience rather than pricing, customers do not understand the significance of APR, most payday customers are repeat customers, payday lending is far more convenient and less embarrassing than getting a loan from another source, and the staff at many payday lending sites are friendly and welcoming. The data also demonstrate that, while some payday lending customers use the loans for the occasional emergency, most use them for regular, recurring expenses or to pay off other payday loans.

The data also indicate that most customers cannot easily compare the cost of this form of credit to other forms of credit; that most customers are unable to accurately describe how much they will ultimately pay for the small sums they borrow; that most customers generally feel they will be able to pay back the loans they borrow in a short time, despite the fact that few ultimately can; and that once a person has taken out one of these loans, it is harder to meet future ordinary expenses.

A. Description of Empirical Study: Curbside Interviews

Beginning in spring 2009, after receiving funding from the National Conference of Bankruptcy Judges and obtaining Institutional Review Board (IRB) approval of the methodology, the IRB and the Author trained four University of New Mexico students to conduct curbside interviews of payday lending customers pursuant to the script set out in the Appendix.[171] While a much longer interview was contemplated initially, the study methodology called for a cash payment of $10 in exchange for each study participant's time. Given the small size of these payments, a much shorter interview protocol was designed for the purpose of this initial study. All participants were offered an opportunity to make general open-

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regulation of payday lenders for the first time, but not before rejecting the interest-rate limit. *Id.* In Arizona and Ohio, the industry spent $30 million in 2008 campaigning for ballot initiatives that favor payday lenders; by contrast, reform groups reported spending only $475,000. *Id.*

171. Thereafter, one student was trained to enter study data and code such data. The questions were initially written by the Author and colleague Erik Gerding, and fine-tuned by a sociologist, Dr. Deborah Thorne. They were tested in the field before the actual study began, and were reviewed and finalized at an empirical conference sponsored by Harvard Law School and the University of Texas School of Law.

ended comments of any kind at the end of the interview, and many chose to do so. Thus, these curbside interviews gleaned both quantitative and qualitative data.[172]

Students interviewed customers in groups of two, usually during the lunch hour, from 4 to 7 p.m., and all day on Fridays. These were found to be the busiest times of the week. The students stood outside payday lenders or sat in their cars in the parking lot. They asked each customer who exited a store if she had just obtained or was paying on a loan she took out within the past month. If the answer was yes, the students asked the customer if she would like to take a ten minute survey in exchange for a $10 gift card or $10 in cash. During the summer, the students also offered cold water to respondents. The response rate was 27.8%, with 109 people who qualified accepting interviews out of 391 asked. Most of the questions were open-ended to avoid suggesting an answer and to get as truthful a response as possible from each study participant.

Though the original design contemplated interviews only with payday lending customers who were getting their loan that day, it changed because there were an insufficient number of subjects within that category. The vast majority of the customers were paying on an existing loan, rather than taking out a new one, consistent with the industry's business model.[173] Among those who were taking out loans, many more (at least during the summer months) were getting installment loans than payday loans. After attempting for several weeks with little success to restrict survey data to customers obtaining a loan that day, the study was expanded to include interviews of installment loan customers as well, and eventually all customers who were either taking out or paying on a recent loan that day.

To generate better data, interviews were limited to the point of sale rather than phone interviews after the fact. This approach was adopted to avoid recall bias,[174] which causes people to forget events that occurred a long time ago.

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172. The interviewing process itself started with a zip code and geographical analysis, pursuant to which each lender's zip code was recorded and mapped. Students were then given the zip code maps and asked to randomly visit payday stores within a particular zip code until they had collectively visited all lenders within the zip code. Students were instructed to sit outside each store for a stated period until they saw a customer to interview. Students were not required to sit outside stores with no customers for more than thirty minutes. At times customers were few and far between, particularly in relation to the number of loan outlets. When more than one lender was visible from a particular parking lot, the most fruitful approach was to park within viewing distance of several stores and approach each customer when she left the store.

173. In the beginning, when the students were only interviewing people who were taking out new loans, they could go several days without identifying a customer who was taking out a new loan.

174. Recall bias is likely to have entered into the interviews conducted by Elliehausen and Lawrence, in which the investigators called the customers of several large payday lenders to discuss loans taken out over the past year. ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 60. Studies suffering from recall bias create less reliable data. Eman Hassan, *Recall Bias Can be a Threat to Retrospective and Prospective Research Designs*, INTERNET J. EPIDEMIOLOGY (Feb. 13, 2009), http://www.ispub.com/ostia/index.php?xmlFilePath=journals/ije/vol3n2/bias.xml; Francis W. Horvath, *Forgotten Unemployment: Recall Bias in Retrospective Data*, MONTHLY LAB. REV., Mar. 1982, at 40–43.

B. Statistical Data

Some of the more interesting conclusions from the data are described below.

1. Borrowers Are Neither Infrequent nor Occasional and the Loans Are Far From Short-Term

To call this industry the "short-term loan" industry is a misnomer. While the industry repeatedly claims that most borrowers use short-term loans infrequently, the data suggest otherwise.[175] In addition to the curbside interviews, the Author conducted twenty one-hour, in-depth interviews. Most of the random payday borrowers interviewed had been in continuous "short-term" debt for over a year, many with more than one loan. Some of this debt was structured as interest-only debt that did not permit the borrower to make even partial payments on the principal.[176] The never-ending, interest-only nature of the debt is evident in the loyalty programs offered by some payday lenders: after a certain number of timely interest payments, customers can get a discount on the next interest payment.[177] However, none of these payments pay off any of the principal.[178]

Nor do customers use these loans only occasionally. A significant number of subjects had used multiple payday loans or direct-deposit advances from multiple lenders for a period of years, including some from traditional banks like Wells Fargo and US Bank.[179] These banks offer payday advances that can be rolled over for about a year and then must be paid off for about a month before the customer can resume using them for another year.[180] When it became apparent that

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175. Since the frequency of these products has already been well documented, this was not a focus of our study. Nevertheless, customers were allowed to make any comments they liked at the end of the interview, and some commented on having used the same lender for years. *See, e.g.*, Interview with Study Participant CS45.

176. Interviews with Study Participants CB34, SB01, SB12, and SB13.

177. Interview with Study Participant SB01.

178. *See* Allied Cash Advance loyalty card for interest-only loan (on file with the Author).

179. *See* Interview with Study Participant SB01.

180. As the Wells Fargo website explains:

> You may take advances (in $20 increments) as often as you like—up to your available credit limit. This Service is designed to provide access to cash on a short-term basis when you may need it most. If you use the Service for more than 12 consecutive statement periods, your credit limit will be gradually reduced by $100 in future statement periods until your credit limit is zero or you do not use the Service for one statement period. (A statement period is approximately a month—your exact statement cycle dates can be found on your monthly statement.) For example, assume your calculated advance limit is $500 and you have used the *Direct Deposit Advance* service in each of the last 12 consecutive statement periods. In the 13th statement period, your advance limit will be $400 ($500 less $100). If you continue to use the service your advance limit in the 14th statement period will be $300. If you continue to use the service thereafter, your advance limit will continue to decrease by $100 each consecutive statement period until it

interviewees were just rolling these direct-deposit-advance loans indefinitely, the Author asked one customer what she did if she could not use one of these loans in a given month. That, she explained, "is when you go to one of these other loan companies."[181]

If states wish to regulate payday lending, and the industry claims use of such loans is infrequent, states should consider requesting evidence to support these claims. The short-term loan industry has access to data showing how frequently customers use these loans. Such data, available through Veritec, TeleTrack, or other credit-checking methods used by the industry, could be very useful to states, if the industry made it available.

2. Many Customers Do Not Understand How the Interest-Only Loans Work

There is a marked lack of transparency, not to mention understanding, about how the interest-only loans work. Several customers explained that the clerks did not tell them that the minimum fees do not pay down the principal amount of the loan before they took out the loan.[182] Many customers ultimately figure out that the loan is interest-only, but some do not. Another customer reported hearing an elderly woman in one payday lending store arguing vehemently that there was no way the math could possibly work out the way the clerk said—it was just not right. The customer being interviewed knew what the confusion was because she had also misunderstood the way the loans were structured, at least at first.[183] Another customer said he chose a payday loan instead of an installment loan because he did not want to be in debt, yet he was not paying down the loan.[184] As another customer explained, "The lender never explained that I could pay down the loan by paying more than the minimum. Unless you pay more than the minimum, the loan amount never goes down."[185] Yet another said that the clerks did not inform him of the terms of the loan until he took it out.[186] One reported that the "paperwork is usually handed to the customer in a sealed envelope, so you won't read it."[187]

> equals $0 for one statement period. You can avoid this reduction in your standard credit limit if you do not take a new advance for 1 complete statement period at any time. Your current advance limit appears in the *Direct Deposit Advance* section of your monthly checking account statement.

Direct Deposit Advance Service Questions, WELLS FARGO, https://www.wellsfargo.com/help/faqs/dda_faqs (last visited Oct. 15, 2009).

181. *See* Interview with Study Participant SB01.

182. *See* Interview with Study Participant CS32; *see also* Interview with Study Participant CS23 (stating that "they did not tell me I could pay down the debt by paying more than the minimum, and unless you do that, the whole payment goes to fees").

183. *See* Interview with Study Participant SB01.

184. *See* Interview with Study Participant CB37.

185. *See* Interview with Study Participant CS28.

186. *See* Interview with Study Participant CS32.

187. *See* Interview with Study Participant SB12.

Some customers still did not understand the terms of their loan, even after paying on it for some time. One man had paid more than $2000 on a $300 loan and did not know why he had not made a "dent in the loan."[188] The loan amount, he explained, never went down. This person came in with two other family members. One of them, his daughter, commented that the interest was too high and that the loan principal would not decrease with the payments.[189] The third family member in the group said that "the way they apply the payments, it just doesn't add up."[190] A failure to understand the interest-only nature of the loans showed up in other areas as well, including the common misunderstanding about how payday loans differ from installment loans.

3. Most Borrowers Are Unable to Describe the APR on Loans and Cannot Predict the Total Dollar Cost of the Loans to Them

a. Complete APR Disconnect

Few of the respondents said they could confidently state the APR on their own loans without looking at the top right corner of their loan documents. Almost 60% of those asked said they did not know what the APR was and that they were not willing to wager a guess of what the APR might be. Of those that said they knew or would guess, the rates described varied widely. They ranged from 0.05% per annum to 586% per annum. Of those who were willing to attempt to state the APR, 39% thought the APR was in the double-digit range of 18% to 96%, despite the fact that the actual annual percentage interest rates on almost all loans was between 417% and 587% per annum.[191]

Interviewees were almost universally unable to specifically state the APR, even in general terms, unless they were holding the loan paperwork in their hands, as shown in Figure 1. Moreover, the acronym itself meant nothing to them. Many people seemed generally unaware of what APR represented. Even when interviewers told the interviewees that the term meant annual percentage rate, or interest rate, many interviewees could not articulate what the rate represented.[192]

188. *See* Interview with Study Participant CS27.

189. *See* Interview with Study Participant CS25.

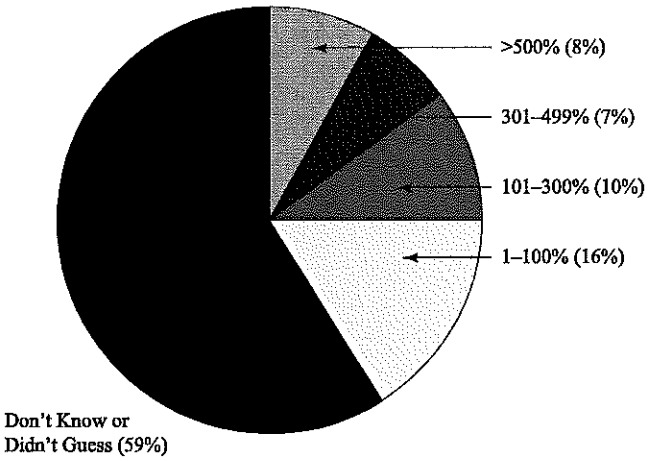
190. *See* Interview with Study Participant CS26. This same person reported that payday loans are cheaper than credit cards, an issue taken up in Part III.B.4, *infra*.

191. A few lenders in this market, typically local rather than national lenders, did give loans at around 100%. We were familiar with these lenders and considered 100% a correct answer when customers borrowed from them.

192. This is, of course, not unique to payday customers, as many other people also cannot articulate what an APR means.

Figure 1
APR Guesses

Guess	Occurrence
> 500%	8%
301-499%	7%
101-300%	10%
1-100%	16%
Don't Know or Didn't Guess	59%



The industry has long argued that requiring the loan to be stated in terms of APR is a waste of time because people do not borrow the money for a full year. Many times, however, people do borrow the money for a year or more. Nevertheless, disclosing APR is of little value to most consumers, though it does help legislators understand the cost compared to other credit. So why is the industry opposed to disclosing the cost of their short-term loans in terms of APR? Because the APR makes the loans appear very expensive when in reality, claims the industry, the loans are short-term and infrequently used by particular consumers.[193] Moreover, paying $15 to borrow a much-needed $100 once in a great while is well worth it, according to the industry.

193. *See* Arkansans Against Abusive Payday Lending, *How to Calculate the Interest Rate on Payday Loans*, PAYDAYLOANINFO.ORG, http://www.stoppaydaypredators.org/pdfs2/aaapl_howtocal.pdf (last visited Aug. 18, 2010).

If only this were reality. Numerous studies have shown that a large number of payday loan customers rollover the principal again and again.[194] Customers pay numerous fees for a single cash advance, which means that many of the loans are not truly "short-term." The Indiana Department of Financial Institutions revealed in 1999 that "91% of customers in the state rolled over their loans; the average number of renewals was ten."[195] Even the industry-funded Elliehausen and Lawrence study found that 75% of a national sample renewed the loans at least once and more than 39% rolled over the loans five or more times.[196] According to a 2001 report of the Wisconsin Department of Financial Institutions, more than half of the loans it reviewed were rolled over; 38% of customers renewed their loans more than three times.[197] "Other studies show that the bulk of revenue and profits for payday loan outlets is derived from 'churning' or back-to-back loans."[198] More than one study found that at least one-third of payday loan customers reported using the proceeds of one loan to pay off another loan at a different outlet.[199] Study data reported in this Article suggest that this figure is a gross underestimate.

b. Difficulty Understanding the Total Dollar Cost of the Loans

A number of our study questions sought and obtained information about customers' understanding of the dollar costs of their loans.[200] Respondents were

194. Mayer, *supra* note 29, at 3.

195. *Id.*

196. *See* ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 39.

197. WIS. DEP'T OF FIN. INSTS., REVIEW OF PAYDAY LENDING IN WISCONSIN 10 (2001).

198. Mayer, *supra* note 29, at 3.

199. Stegman & Ferris, *supra*, note 14, at 20. Other studies offer anecdotal evidence about debtors borrowing multiple times against the same paycheck. The state OFI reports note that the average payday-advance customer takes out a dozen loans a year, and not all of these loans are sequential. A team of researchers in Ohio went on a spree to see whether they could borrow from several different stores in a few days. One individual was granted nine loans in three days, even though the creditors used the TeleTrack system. Johnson, *supra* note 14, at 63. Other horror stories have been reported in the media, such as debtors carrying more than a dozen loans at once—but there has been no attempt thus far to determine how common that practice is. As we shall see below, the practice is in fact quite common. Every weekday in Milwaukee County, an average of three or four residents file for bankruptcy owing debts to several different payday lenders. Bankruptcy court is a good place to look for payday loan customers because they are four times more likely to have filed for bankruptcy in the past than the average adult. *See* ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 46.

200. These questions are:

L1—How much cash did you take away/borrow (in dollars)?

L2—How many days before you are expected to pay it back?

L3—Do you know how much you can expect to pay in fees and/or interest?

L4—Do you expect to be able to pay it back within this time frame?

L5—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a month? For example, do you know the total amount you would be charged in fees and extra charges?

first asked to describe in detail how much they borrowed and when and how they were expected to pay the money back. Thereafter, they were asked to describe their understanding of the total amount they would pay in interest and fees in addition to the principal.

The first data set described here contains each customer's understanding of the fundamental terms of her loan—meaning how much each borrowed, when the loan was to be paid back, and at what total dollar cost. Of the participants, 19% declined to attempt to describe the dollar costs of their loan. That is, rather than describe the total interest and fees for the loan in dollar terms they replied with "not sure," "not sure, it's high," "at least the amount of the loan," "not real clear, a lot," "tricky, not sure," or "not sure, they tell you but it seems like a lot more." This was surprising because it appeared likely to us that, while people might not be able to articulate the APR, they probably *would* understand the short-term cost of the loan and perhaps even the long-term cost of the loan.

Because we knew that most businesses interviewed charged between $15 and $25 per $100 to borrow a payday loan, any time a person said they were paying a fee in that range (to be paid back in a period of fourteen days or less), we counted that person as one who described dollar costs that seemed facially consistent with the terms of the loan. Likewise, because we knew that a typical twenty-week installment loan costs just over double the loan amount, we counted, as facially consistent with the terms of the loan, borrowers who described a loan to be paid over time and as anything at or over the loan amount. Thus, if a person described an installment loan's total fees as anything at or over the loan amount, we counted that person as one who described dollar costs that seemed facially consistent with the terms of the loan.

Of those who attempted to describe the short-term dollar cost of their loan, 59% (or fifty-two people) described short-term dollar costs that were facially consistent with the terms of the loan described by the customer or the in-hand paperwork and/or what we knew about the terms from our own inquiries to the stores.[201] This left 41% (or thirty-six people) that described fundamental loan terms that were inconsistent with the price being charged, based on what we knew about the lender from calling, from in-hand paperwork, and/or from other customers exiting the same store. Overall, that means that just over half of the

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L6—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a year? For example, do you know the total amount you would be charged in fees and extra costs?

L7—Have you heard the term "annual percentage rate"?

L8—Many people don't know the answer to the next question, but if you do, would you tell me what the annual percentage rate for this loan is?

201. For example, someone borrowed $100 for seven days and said the fees were $25 at a place that we understood to be charging $25 to borrow $100 between now and payday. *See* Interview with Study Participant CS07. Someone else in this family of establishments was borrowing $200 for two weeks for $50 in fees. *See* Interview with Study Participant CS22. Another described the fees and costs as $20 to borrow $100 until payday, which we considered close enough to constitute a decent understanding of the initial costs of the loan. *See* Interview with Study Participant CS01.

respondents seemed to understand the fundamental terms or overall cost of their loan even in the short term.

Question L5 asks, "Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a month? For example, do you know the total amount you would be charged in fees and extra charges? If so, how much?" Participants were asked to give a dollar figure as the extra monthly cost. Forty-nine of 109 (44.9%) declined to give a dollar figure, simply answering "no" or "I don't know." Another five gave nonresponsive answers such as "pay off and re-borrow," "22–26%," "an extra 10–15%," "renew loan," and "same interest rate." Two said they did not believe they could not keep the loan out an extra month because "it would go to collections," or that that they did not think they could because "they automatically debit my account after a five-day grace period." The remaining sixty respondents attempted to do the math.

Answering this question required study participants to calculate the monthly interest payments by doubling the two-week fee for a payday-style loan or by dividing the total fees by the number of months over which an installment loan was to be paid. To analyze the answers to this question, we simply assumed for this question only that whatever terms the customer described as their loan arrangements were accurate and used the question to measure math capabilities. For payday loans, the exercise was not too difficult, as it simply involved doubling the two-week fee. For installment loans, the math was harder to calculate, but not impossible.[202] We attempted to give the benefit of the doubt to a customer whose answer made a reasonable degree of math sense.[203]

Of the sixty who attempted the math, twenty-nine answered in ways that were inconsistent with the numbers they described in the prior question. That left thirty-one that answered in a way that came close to what the actual cost of that extra month of credit might be.[204] That meant that at most, thirty-one out of 109 interviewees (or 28.4% of those interviewed) were able to calculate the added cost of keeping this credit out for an additional month. Put another way, less than one-third of those interviewed knew the monthly cost of the credit.

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202. Again, to answer this question correctly, the customer would need to divide the total fee for the loan by the number of months over which the loan was to be paid.

203. For example, if a customer said they were borrowing $250 for fourteen weeks for total fees of $275, then the actual additional cost of keeping the loan out for one month extra would likely be about $78. If the customer said this would cost about $100, this was considered a rational answer. However, if a customer said that a $100 loan was due back in two weeks and that the fees on that loan would be $20, we would expect the extra month to cost $40. If the person said $20 for the month, this was counted as a calculation that showed a lack of math aptitude. *See* Interview with Study Participant CS01. In the case of Study Participant CS17, the customer had a two-week loan that cost $37, but said that a one-month loan was $64. We counted this customer as having reasonable math aptitude, even though there was a $10 math error. It seemed the person knew what she was doing but just made a mistake. The same mistake was made in the reverse by Study Participant CS22.

204. Interestingly, a number of the borrowers described the loan as costing $20 to borrow $100. Stated in those terms, these loans sound reasonable even though this amounts to 730% per annum.

Previous studies show that most payday borrowers do not pay back their payday or installment loans after one loan cycle, but rather borrow the money again and again, paying mostly fees and no principal for over a year or longer. For that reason, we also sought to determine if payday and installment loan customers knew the cost of keeping the loans out for this longer period of time. Thus, question L6 asked, "Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a year? For example, do you know the total amount you would be charged in fees and extra costs? How much?"

At this point, only twenty-four of 109 (or 22%) were willing to even try to quantify the dollar cost of keeping the loan out for a full year. Of the twenty-four, ten gave figures that were consistent with the other answers given on the total costs of the loan. The other fourteen gave answers that were implausible based upon the other information we gleaned. This means that less than 10% of the customers we interviewed could estimate the cost of this credit over a year period, even though many probably kept their loans out for a year or more.

This lack of ability to understand should not necessarily be blamed on the customers. In many cases, the paperwork could hardly be more confusing.[205] Lenders are no doubt aware that customers do not, and perhaps cannot, do this math. As one customer explained, "I don't like math, and I don't want to try to calculate [these things]." Another rather unsurprising reason why customers are unable to calculate the cost of this credit is that many are hopelessly optimistic regarding when they expect to be able to repay the loan, particularly at the beginning of the relationship. One customer explained that she did not realize that it would be so hard to pay her loan back. She had become a hair stylist and needed money to establish clientele while still meeting her other bills and obligations. She quickly found, however, that the payday loan made it harder to fulfill those obligations.[206] Many others reported thinking they would be able to pay back the loans much more quickly than they actually could.[207]

4. Hear No Evil, See No Evil: Customers Cannot Compare the Cost of Alternative Credit Sources and Do Not Understand the Cost of Credit Cards versus Payday Loans

Survey data reveal that some consumers misperceive the cost of credit cards in comparison to payday loans. Thirty-three of 109 customers (or 30%) reported having credit cards. Of the thirty-three, seventeen reported that their credit cards were maxed out.[208] Of those surveyed with credit cards, 15% said they

205. For example, for one loan the interview team was unable to find any APR disclosure on any of the in-hand paperwork. Confusingly, the cover page disclosed the original loan amount as $3612.07, even though the customer took away just $1000. The second page of the paperwork analyzed the payments in virtually incomprehensible terms, but essentially showed payments of $3612.07 to borrow $1000 for seven months.

206. *See* Interview with Study Participant CS43.

207. *See* Interviews with Study Participants CS59, CS60, CS69, and CS78. Study Participant CS69 was celebrating the day we interviewed her. She had taken the loan out months ago and was making her last payment. *See* Interview with Study Participant CS69.

208. *See* Interviews with Study Participants CS11, CS21, CS35, CS55, CS59,

would not use the credit card at this time because credit cards are for emergencies only.[209] This seems to contradict the notion that payday loans are *also* for emergencies only. Another customer said credit cards should be used only when one is trying to build a credit history.[210] Yet another said he did not want to get into the habit of using credit cards.[211]

The idea that credit cards should be used more sparingly than payday or installment loans also suggests that people think it is somehow less expensive or safer to use a payday loan than a credit card. Many of the comments above suggest that people do not know that credit card interest is typically at least five to twenty times less expensive than payday loan fees.[212] More to the point, in addition to those mentioned above, at least five of the sixteen respondents with credit cards stated outright that the interest paid on a credit card is higher or more expensive than the fees for a payday loan.[213] As one man explained, "Credit cards are worse [than payday loans]. You could lose your job. $1000 becomes $5000 overnight."[214] Another explicitly stated that "interest is cheaper at the payday lender than it is on the credit card."[215] All totaled, it appears that more than half of the customers surveyed who had credit cards thought credit cards were more expensive to use than payday loans.[216] Even some customers who did not have credit cards reported without prompting that credit cards were more dangerous because they grant more freedom to spend without limits.[217] Yet payday loans did not cause similar alarm to these customers. As one said in response to the question about why she took out a payday loan instead of a using a credit card, "no reason, impulse."[218]

As described above, the majority of people also thought APR for a payday loan was a single- or double-digit number, suggesting that when consumers

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CS62, CS71, CS81, CS82, CS85, CS92, CS93, CS98, CS99, CS102, and CS105. Another customer said she needed cash but did not know she could get a cash advance from a credit card. *See* Interview with Study Participant CS18.

209. For example, people made statement such as, "credit cards are strictly for emergencies;" "[my credit card] is in a safe deposit box locked away so I cannot use it;" "I need my credit card for emergencies;" and "I had credit card problems when I was younger, so now I use [it] only for emergencies." *See* Interviews with Study Participants CS05, CS34, CS36, CS49, CS53, and CS66.

210. *See* Interview with Study Participant CS39.

211. *See* Interview with Study Participant CS64. Again, typical APRs in this market were 100% (two lenders that we know of and visited) to 586% (many of the installment loan establishments).

212. *See* Interviews with Study Participants CS06 (stating that she had no credit cards because she was "afraid of accumulating debt"), CS25 (same), CS45 (stating that "credit cards cost more than payday loans"), CS26 (stating that credit cards cost two times the interest of payday loans), CS93 (credit cards are "too expensive"), and CS98 (interest rates are "too high to take out cash on a credit card").

213. *See* Interviews with Study Participants CS33, CS74, CS85, CS93, and CS98.

214. *See* Interview with Study Participant CS36.

215. *See* Interview with Study Participant CS33.

216. *See, e.g.*, Interview with Study Participant CS98. This is no secret to the payday-lending industry. *See* ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 37.

217. *See* Interview with Study Participant CS15 (stating that "credit cards are worse because they grant more freedom to spend without realizing").

218. *See* Interview with Study Participant CS40.

hear that they are being lent money at $15 or $20 per $100, even over a two-week period or less, they may equate this with 15% or 20% per annum. This may appear cheaper than the average 25% many credit-challenged people pay on their credit card balances.[219]

According to Professor Christopher Petersen, American states traditionally had single-digit usury limits, which ultimately inched up into the double-digits, until usury laws were largely abandoned following the 1978 Supreme Court decision in *Marquette*.[220] Professor Peterson explains that consumers have grown used to seeing certain numbers affiliated with the cost of credit and are likely to make certain assumptions about what those numbers mean. More specifically, consumers are accustomed to double-digit interest rates and cannot rationally imagine a rate that is in the triple digits. As Professor Petersen explains:

> Salience distortion is defined as the absolute value of the difference between the annual percentage rate of a usury statute's most expensive permissible loan and the most prominent, or salient, number written in the statutory language limiting the price of the loan . . . . Because currency is numerical, in any statute that caps the price of a loan, the legislature must at some point pick a number or numbers. While this is true of every usury law, the specific number a legislature chooses only has meaning in relation to other variables associated with the law in question.[221]

As Professor Petersen explains, one legislature might adopt a usury limit of 8% per year while another might adopt a cap of 8% per month, and while both would have chosen to feature the same number in the language of the statute, the latter cap would be twelve times higher than the former because there are twelve months per year. A legislature could even adopt an interest rate cap of 8% per century—which would create a price cap much lower than either the monthly or annual cap. To continue the point, "a legislature could adopt a cap of 8% per second, which would generate an extremely high price limit."[222] In other words, if it chose to do so, any legislature could pick a small number and create a relatively high price limit or, instead, pick a large number and create a relatively low price limit. Legislatures can feature whatever number they want in a usury law.[223]

This might explain why consumers think that a 417% payday loan, described as costing $15 per $100 borrowed sounds less expensive than an APR of 25% on a credit card. People in this study actually seemed scared of credit card debt, and one woman claimed that at least with a payday loan she knew what she

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219. *See CreditCards.com's Weekly Rate Report*, CREDITCARDS.COM, http://www.creditcards.com/credit-card-news/interest-rate-report-aprs-record-highs-1276.php (last visited Aug. 16, 2010).

220. Marquette Nat. Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1117–22 (2008).

221. Peterson, *supra* note 220, at 1136.

222. *Id.*

223. *Id.*

would be paying. With credit cards, she explained that "you have no idea what it'll ultimately cost, and there is no one to talk to."[224] Student interviewers wondered if the media also frightens people away from credit cards with constant television ads for specialists offering to help debtors out of credit card messes. No one working on this project could ever remember anyone on television talking about how to get out from under a rash of payday loans.

5. Loans Are Used Primarily for Recurring Expenses, Not for Unexpected Emergencies

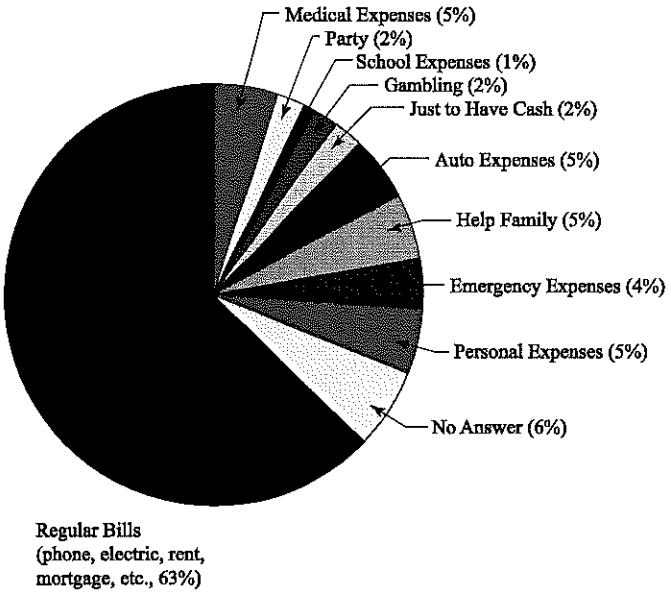
The majority of participants—indeed, 63%— reported using payday loans for regular, recurring monthly bills and expenses, as shown in Figure 2. Initially, these respondents stated that the money was to cover "bills," but later elaborated that they meant rent, utilities, gas bills, cell phone bills, and so on. This category of usage consists of ongoing expenses, nothing out of the ordinary like a broken car or medical emergency. These data are inconsistent with the 2001 industry-sponsored Elliehausen and Lawrence study, which concluded that nearly half (47.2%) of most recent loans were used to pay an unexpected expense, a third for discretionary uses, and just 12% for regular expenses."[225]

224. Interview with Study Participant CS45.

225. *See* ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 47. Similar to the industry study, another study conducted by Environics Research Group on behalf of the Canadian Association of Community Financial Service Providers reports that 92% of payday customers used their loans for an immediate cash-flow crisis and 4% for immediate consumption. *See* ENVIRONICS RESEARCH GROUP, UNDERSTANDING CONSUMERS OF CANADA'S PAYDAY LOANS INDUSTRY 18 (2005), *available at* http://www.cpla-acps.ca/english/reports/PaydayLoansReportPresentationJune9.ppt.

Figure 2
Study Participant's Responses
When Asked What They Wanted Loan For

Responses	Percent Responding
Regular bills (phone, electric, mortgage, rent)	63%
No Answer	6%
Personal Expenses	5%
Auto Expenses	5%
Help Family	5%
Medical Expenses	5%
Emergency Expenses	4%
Just to Have Cash	2%
Party	2%
Gambling	2%
School Expenses	1%



6. Borrowers Choose This Form of Credit Over Cheaper Forms Because It Is Convenient and Available Anywhere, Anytime

As other studies have found, convenience drew consumers in our study (see Figure 3) to a particular payday lender.[226] Unlike qualifying for other forms of credit, qualifying for money is easy and fast—just as the advertisements say—without the stigma of admitting to friends, family, or a financial institution that the customer is broke.[227] Moreover, many payday loan consumers do not trust mainstream financial institutions.[228] Our participants also noted the friendliness of the clerks in payday lending stores as a reason why they opted for that form of credit.[229] Frankly, we noticed the same thing ourselves when calling around about rates and plans. The lenders train their employees to be friendly to customers.[230] The extended hours of payday lenders were also a big draw in our study.[231] And—as expected—location, location, location, is an important factor.[232]

226. Michael Kenneth, *Payday Lending: Can "Reputable" Banks End Cycles of Debt?*, 42 U.S.F. L. REV. 659, 669 (2008).

227. *Id.*

228. *Id.*

229. *See* Interview with Study Participant CS28.

230. Kenneth, *supra* note 226, at 669. Professor Kenneth reports on a focus group study in California of low-income and ethnic consumers, which identified five ways in which fringe banks, like check-cashers, are superior to mainstream banks: (1) easier access to cash; (2) accessible locations; (3) better treatment of customers; (4) greater trustworthiness; and (5) better service because of the many useful products in one location, better hours, and more Spanish-speaking employees. *Id.*

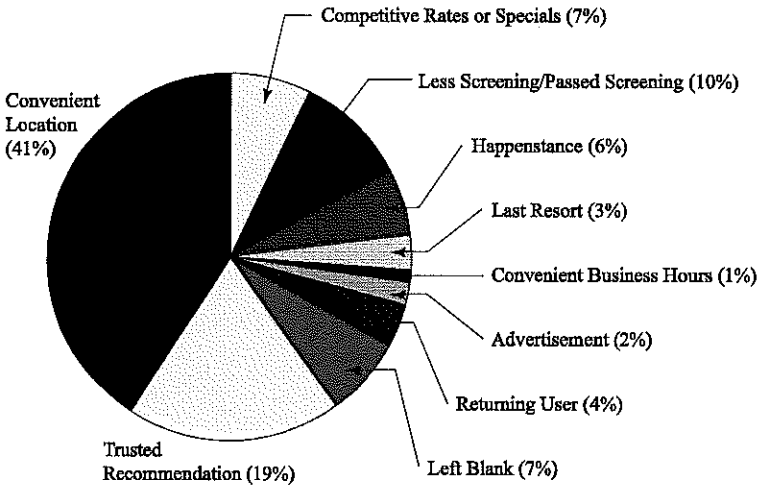
231. *Id.*

232. ELLIEHAUSEN & LAWRENCE, *supra* note 16, at 52.

Figure 3

Why Customers Choose Payday Storefronts Over Lower Cost Credit Options

Answers	Percent Responding
Convenient Location	41%
Trusted Recommendation	19%
Less Screening/Passed Screening	10%
Left Blank	7%
Competitive Rates or Specials	7%
Happenstance	6%
Returning User	4%
Last Resort	3%
Advertisement	2%
Convenient Business Hours	1%



7. Customers Do Not Pursue Lower-Cost Credit Because These Loan Outlets Are Ubiquitous and Convenient

One of the common criticisms of payday and similar loan establishments is that they are *too* available for consumers, and thus cause customers to choose payday loans instead of cheaper or no-cost alternatives. As these outlets have become more ubiquitous and convenient, consumers frequently make payday lenders their first choice of finance. One study participant tells a particularly

perilous story. She was pleased with herself for not taking out any student loans, yet she was at a payday lender, borrowing money.[233] She was accompanied by her mother who had given her the advice to avoid student loans, even though student loans can be obtained for between 0% and 8.5% APR.[234]

This is not an isolated example of people choosing high-cost credit over low-cost credit. Another example is the use of payday loans rather than credit cards discussed previously in Part III.B.4. A large percentage of study participants could have either chosen cheaper credit or foregone the payday loan entirely. Participants were asked what they would have done if they had not been able to get a payday loan. Nearly 43% said they would have asked a friend or family member for the money, a classic no-cost option.[235] A few said they would use a bank, which would clearly be cheaper, and two said they would go to a pawn shop.[236] One gentleman got a loan from a bank once and then later returned to the payday lender.[237] Another initially wanted to avoid borrowing from family, but now had to borrow from a family member just to make "this installment."[238]

Another 13.4% of interviewees said they would use another low- or no-cost alternative such as waiting until payday,[239] not having the party they were planning,[240] not going to the casino that day,[241] not getting dental work done now,[242] working overtime,[243] walking for a week until they could afford a car repair or gas,[244] going to a credit bureau and entering into a repayment plan,[245] calling the utility company to delay payment of their bill,[246] or working out a deal with the cell phone company.[247] This means more than half of the people asked could have refrained from taking out a payday loan, suffered little or no negative consequence, and saved themselves money.

Of course, some of these alternative sources of cash may be unpalatable for other reasons. For example, loans from family members might be accompanied by an unwelcome inquiry as to how the money is to be used or a lecture on

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233 *See* Interview with Study Participant CS63.

234. *See* Interview with Study Participant CS62.

235. *See* Interviews with Study Participants CS61, CS62, CS65, CS72, CS109, and many others.

236. *See* Interviews with Study Participants CS9, CS36, CS7, CS26, and CS67.

237. *See* Interview with Study Participant CS90.

238. *See* Interview with Study Participant CS109; *see also* Interview with Study Participant CS58 (stating that she "had to borrow from family to pay off payday loans. Sounds too good to be true and it is.").

239. *See* Interviews with Study Participants CS15 and CS79.

240. *See* Interview with Study Participant CS29.

241. *See* Interview with Study Participant CS40.

242. *See* Interview with Study Participant CS20.

243. *See* Interview with Study Participant CS42.

244. *See* Interview with Study Participant CS66.

245. *See* Interview with Study Participant CS45. Two of the worst stories I heard during the office interviews were about a credit repair organization that took $4000 to negotiate bills, ultimately used $1400 to pay bills, and took $2600 in fees. *See* Interviews with Study Participants SB02 and SB03.

246. *See* Interviews with Study Participants CS16, CS52, and CS70.

247. *See* Interview with Study Participant CS64.

financial prudence.[248] Nevertheless, as set out above, most customers do not seem to understand the cost of this high-cost, short-term debt, in dollar terms or otherwise. Thus, they are generally unable to compare the personal cost[249] of the lecture or invasion of privacy by the relative or friend to the dollar cost of the loan. If they *were* able to calculate these dollar costs, they might well decide that avoiding the loan was worth the lecture. Moreover, if payday and installment loans were less ubiquitous, people might be forced to exhaust low-cost options before turning to these businesses for cash.

As for the other half of respondents who had no other alternatives for obtaining cash, one might wonder how badly they could be hurt by the lack of available credit. In many cases, however, the results were not dire. Many people said they would default on their bills or incur overdraft charges. These responses, totaling 16% of those surveyed, ranged from one individual who said she would miss a car payment to another who said his electricity would be cut off.[250] No other specifics were provided about the consequences of defaulting on these obligations. In fact, one person who was borrowing money to keep from defaulting on his bills acknowledged that if he could not get the loan, "the bill collectors would have to wait."[251] This demonstrates one theme we found among many payday borrowers: many are averse to paying any bill late. Payday lenders provide a highly expensive solution to a potentially cost-free problem: paying some bills late, including some utilities, results in no extra charge at all.

8. Customers Do Not Shop Around

When asked if they considered getting a loan from another payday lender, 78.64% of respondents said they had not. If they said they shopped around, they were prompted to explain. Once prompted, only one person said that he called around to check rates.[252] It appears that the vast majority of customers do not shop around for short-term loans; instead, they choose their lender based upon convenience, location, and other factors such as recommendations from friends. Some people reported that because they were using the loans to pay for other short-term loans, the primary goal was to find a new lender from which to borrow to pay the old lender. Some respondents had numerous loans outstanding for years at a time with many different lenders.

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248. Some people said they were embarrassed to ask a family member for money. *See* Interviews with Study Participants CS10, CS38, CS60, CS71, CS81, and CS85. Two said borrowing from friends could ruin the friendship. *See* Interviews with Study Participants CS23 and CS84. One said she did not want to ask at work because she did not want to "be personal at work or in debt at work." *See* Interview with Study Participant CS39. Many said getting a payday or installment loan was easier, faster, and more convenient. *See, e.g.*, Interviews with Study Participants CS6, CS38, CS72, and CS78.

249. These are admittedly noneconomic concerns, making the cost even more complex to calculate.

250. *See* Interviews with Study Participants CS52 and CS148.

251. *See* Interview with Study Participant CS03; *see also* Interviews with Study Participants CS13, CS14, CS16, CS18, CS19, CS21, CS28, and CS47 (all indicating that if they could not get the loan, they would have to default on regular bills or just pay late).

252. *See* Interview with Study Participant CS48.

IV. REGULATION: SHOULD WE REGULATE PAYDAY LENDING, AND IF SO, HOW?

Ineffective regulation is extremely costly to society and should be avoided. Situations involving failed markets, information asymmetry, and innumeracy—all of which are problems in the payday and other short-term lending industries—are ripe for regulation. The results of New Mexico-style legislation serve as a contraindication to their implementation, leaving open the question of what might actually work.

A. Classic Failed Market

Perfect markets are competitive.[253] In the perfect market, many sellers offer substantially identical products, so it is easy to shop around and compare costs.[254] There are also many buyers.[255] All actors in the perfect market act to maximize their own financial well-being.[256] There are no barriers to entry into the market by new sellers, and both buyers and sellers are well-informed.[257] In a perfect market, supply and demand for products will level out and the price of goods will stabilize.[258] The absence of any of these attributes is known as market failure.[259]

An imperfect market does not adjust in response to competition.[260] Sometimes, this is because there is no meaningful competition.[261] This can occur when sellers create a monopoly or price-fix such that the market can no longer respond to normal supply and demand. Certain conditions create fertile ground for market failure. For example, collusion among sellers may create more profits than competition among sellers, creating temptation to collude rather than compete.[262] This temptation is stronger in young industries with few competitors, where buyers have difficulty shopping around on the basis of price.[263] This is particularly true in industries where the primary choice of one seller over another is based on something other than price.[264]

The payday lending and other short-term lending industries are classic failed markets. The industry is young, having developed primarily in the 1990s. Thus, price competition is not yet necessary to create a strong market share. Rather, most lenders charge similar amounts for the same loan, typically the largest amount permitted by law. In addition, payday customers are not necessarily

253. Bertics, *supra* note 14, at 141.
254. *Id.*
255. *Id.*
256. *Id.*
257. *Id.*
258. *Id.*
259. *Id.* at 142.
260. Pearl Chin, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 740–42.
261. *See* Bertics, *supra* note 14, at 142.
262. *See id.*
263. *Id.*
264. Chin, *supra* note 260, at 742; Bertics, *supra* note 14, at 142.

sophisticated and, as Part III demonstrates, they typically do not understand the cost of these loans. Moreover, they do not shop around.[265] Finally, a factor other than price—convenience—drives most borrower choices in this industry. Lenders are therefore able to charge more than they could if the customer shopped around, had perfect information, and understood the cost of this credit.

When market forces are functioning properly, economists disdain intervention in and regulation of markets.[266] Even the staunchest libertarian would agree, however, that failed markets create a need for regulation. The current payday lending situation warrants legislation. Ohio State Representative William Batchelder, a conservative proponent of payday lending reform, describes the dilemma as follows:

> 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. 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.[267]

As Representative Batchelder acknowledged, the market has not driven down prices, nor is it likely to do so as the industry ages, since price does not enter into the calculus of most borrowers. The market failure is exacerbated by information asymmetry between the lender and the borrower, and the innumeracy of borrowers.[268]

B. Information Asymmetry and Innumeracy: 200% of Nothing

Part III of this Article demonstrated that payday and installment loan customers have difficulty understanding the meaning of the annual percentage rate disclosure and the total dollar cost of their loans. There are several reasons for this. First, lenders have far more information about how the loans work than customers do. They control the terms, so they can change the product and even the terms of existing loans. Whether this is designed to confuse customers or not, the result is the same: customers are at a considerable disadvantage. Second, the loans are

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265. *See* Chin, *supra* note 260, at 742.

266. Benjamin D. Faller, *Payday Loan Solutions: Slaying the Hydra (and Keeping it Dead)*, 59 CASE W. RES. L. REV. 125, 139 (2008).

267. *Id.*; *see also* PARRISH & KING, *supra* note 42, at 22 (suggesting that the lack of state regulation in Texas is responsible for higher payday loan fees).

268. *See* Faller, *supra* note 266, at 139–40. As Benjamin Faller explains:

> Lenders then take advantage of a borrower's financial predicament to trap them in a loan they cannot pay off. This inequality of power is yet another reason why market failure has occurred. It is also a key reason why well-off individuals and people in stable financial situations are not flocking to payday lenders in the same numbers as their less-advantaged counterparts. Consequently, we cannot rely on typical market forces to solve the problems associated with payday loans and must resort to regulatory solutions to accomplish the ends that the market cannot.

Id.

described in terms of a certain amount of fees per $100 borrowed, which causes many consumers to believe the number—say $15 or $20 per $100 borrowed—represents the annual percentage rate, not the rate for two weeks. Lenders know the truth. Most borrowers do not.

Information asymmetry is not the only problem customers encounter with these loans, however. Americans as a whole suffer from general financial illiteracy.[269] This is especially true when the financial information at issue involves long disclosures full of unfamiliar vocabulary. In fact, the disclosures given in connection with consumer-finance transactions in general are of questionable utility.[270] Consumers are overwhelmed by too much information in many legally required disclosures, and thus the disclosures do little if anything to educate them about the risk of credit products.[271] Additionally, consumers do not always read these disclosures.[272]

These data suggest that regulating the short-term loan industry through disclosure does not work. These disclosures may even be harmful to consumers. The fact that APR and other terms must be disclosed has led some lawmakers to think they have effectively regulated payday lending, when the reality is quite the opposite.

Math illiteracy, or innumeracy, is widespread.[273] High school math skills in the United States are among the worst in the developed world. The United States also has the most complex, developed, and arguably unregulated, consumer credit market in the world.[274] This perfect storm renders the average consumer a lamb to the slaughter for unscrupulous creditors. In his book *200% of Nothing*,

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269. *See* Susan Block-Lieb, *Mandatory Protections as Veiled Threats*, 69 BROOK. L. REV. 425, 431 (2004) ("[I]f a significant portion of the U.S. population struggles to read and write in English on topics of general interest, then most certainly it will fail to comprehend descriptions of financial transactions that necessarily involve more complex concepts and vocabulary."); *see also* A.K. DEWDNEY, 200% OF NOTHING: AN EYE-OPENING TOUR THROUGH THE TWISTS AND TURNS OF MATH ABUSE AND INNUMERACY, v, 1 (Steve Ross & Emily Louse eds., 1993).

270. Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 261–62 (2002) (relying on recent data on illiteracy to argue that commonly used contract and disclosure forms are incomprehensible to most American consumers).

271. Elizabeth J. Keeler, *The Truth in Lending Simplification and Reform Act of 1980: Is "Simplification" Better for Both Consumer and Creditor*, 8 NOVA. L. REV. 175, 184-85 (1983) (discussing how consumers overwhelmed with information will fail to digest any of the disclosures); Jason Ross Penzer, Note, *Grading the Report Card: Lessons from Cognitive Psychology, Marketing, and the Law of Information Disclosure for Quality Assessment in Health Care*, 12 YALE J. ON REG. 207, 250 (1995) ("Critics of the original Truth In Lending Act charged that Truth in Lending disclosures overwhelmed consumers with too much complicated information and ultimately discouraged them from credit shopping.").

272. Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* (Univ. Chi. Booth Sch. Bus., Working Paper No. 10-01, 2009), *available at* http://ssrn.com/abstract=1532213.

273. DEWDNEY, *supra* note 269, at 2.

274. *Id.*

A.K. Dewdney notes that, as a general matter, we are beset more than ever by abuses stemming from innumeracy.[275] We become prey to "commercial chicanery, financial foolery, medical quackery, and even numerical terrorism."[276]

While innumeracy plays a large role in the short-term loan crisis, the problem is not unique to the world of payday or other short-term loans. Credit cards and debit cards are other examples of products that consumers do not understand,[277] as are mortgages.[278] One study showed that less than one-third of Americans could explain or understand how the fees and interest are calculated on credit cards.[279]

Another study of adult innumeracy showed that while many individuals can perform simple arithmetic operations when both the numbers and operations are made explicit, they are unable to do so when these same operations are performed on numbers that must be located and extracted from different types of documents that contain similar but irrelevant information, or when these operations must be inferred from printed directions.[280] Moreover, while innumeracy is rampant throughout American society, people who are less financially literate tend to pay higher interest on borrowed money.[281]

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275. *Id.* Dewdney states:

> Literacy, after all, concerns a translation skill—learning to move easily between written and spoken speech. Numeracy concerns thought itself. You might exploit people's innumeracy through an advertisement, for example, making a claim that seems to be valid but isn't. But how would you exploit their illiteracy through an ad they can't even read?

Id.

276. *Id.*

277. RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS (Andrew Brasher & Nick Bunch eds., 2006).

278. New rules require lenders to give borrowers a standard statement clearly showing all details, helping homebuyers avoid financial land mines and other nasty traps. James R. Hagerty, *Rules to Clarify Cost of Mortgages*, WALL ST. J., Dec. 31, 2009, at A2.

279. Annamaria Lusardi & Peter Tufano, *Debt Literacy, Financial Experiences, and Overindebtedness* 1, (Nat'l Bureau of Econ. Research, Working Paper No. w14808, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1366208.

280. Block-Lieb, *supra* note 269, at 438; IRWIN KIRSCH ET AL., NAT'L CTR. FOR EDUC. STATISTICS, TECHNICAL REPORT AND DATA FILE USER'S MANUAL FOR THE 1992 NATIONAL ADULT LITERACY SURVEY (2001), *available at* http://www.nces.ed.gov/pubs2001/2001457.pdf. Professor Block-Lieb analyzes this study in her article. The study, commissioned by the National Adult Literacy Survey found little difference among prose, document, and quantitative literacy. ("The three literacy scales—prose, document, and quantitative literacy—are relatively highly related . . . ."). This is not to applaud the quantitative literacy of the respondents, however. Indeed, 22% of the respondents performed at Level One: "able to add numbers on a bank deposit slip, or to perform other simple arithmetic operations using numbers presented to them." Another 25% of the respondents demonstrated Level Two quantitative literacy skills. "Individuals in Level 2 on the quantitative scale were likely to give correct responses to a task involving a single arithmetic operation using numbers that can easily be located in printed material." Block-Lieb, *supra* note 269, at 438.

281. Block-Lieb, *supra* note 269, at 438–39.

The adult innumeracy study referenced above, and others like it, may explain why consumers have difficulty understanding the true cost of payday loans and other short-term debt.[282] Only 4% of the consumers in the adult innumeracy study were able to calculate the payments on a home equity loan.[283] The cost of payday loan transactions may be even more complex than those of the home mortgage loans asked about in the adult innumeracy study. Based upon the study described in this Article, the actual cost of payday loans over time is not easily translated into an annual percentage rate, making it difficult for consumers to compare the cost of credit.

CONCLUSION

Our curbside empirical study of payday lending customers was designed to discover what brings customers into payday lenders, how customers choose their lenders, and how well customers understand the terms of the loans they request. Before we could actually interview customers and ask them about the terms of their loans, we needed to find out what terms lenders were actually offering. When we investigated the terms offered by the lenders, we learned that few of the lenders seemed to be complying with a new law passed in the state where the study took place. This information led us to a series of loopholes discovered by lenders in order to circumvent the new law. These loopholes became the story within the story, and now create a clear roadmap for states wishing to avoid meaningless payday loan legislation. As a result, this Article provides a detailed description of what not to do.

The findings in the curbside interviews, augmented by the office interviews, however, provide a strong case for why more meaningful legislation is desperately needed. A large percentage of payday customers seem to use payday or installment loans not for occasional emergencies, as the industry would have us believe, but to pay regular bills. At high rates of interest, these loans make it more difficult to make ends meet because the loan (or loans) actually increase the

282. *Id.* Concrete examples of the sorts of quantitative tasks pertaining to the various literacy levels measured by the above referenced adult innumeracy study illuminate the difficulties American consumers must experience when engaging in household commercial transactions. *Id.* at 439. For example, "one task required the reader to locate the appropriate shipping charges in a table before entering the correct amount on an order form and calculating the total price for ordering office supplies." *Id.* The tasks were given a level number, indicating their difficulty. This task was assigned a scale value of 270, or Level Two. "A score of 312, or Level 3, was assigned to a table of money rates that asked the reader to determine how much more interest would be earned in money market accounts provided by mutual funds than in those provided by savings and loan associations." *Id.* "One of the most difficult quantitative tasks the survey asked readers to perform involved reading a newspaper advertisement for a home equity loan and explaining how they would calculate the total amount of interest charges to be paid." *Id.* It asked respondents to imagine they needed to borrow $10,000, and asked them to find the advertisement for a home equity loan in a provided newspaper. It then asked participants to explain to an interviewer how she would compute the total amount of interest charges due under this loan plan, where the terms offered were a 14.25% fixed-rate mortgage under various payment options. Only 4% of the study respondents were able to successfully complete this task. *Id.*

283. *Id.*

borrower's ongoing expenses. The data show that many customers have low-cost or no-cost options but use payday loans instead because they are more convenient and less embarrassing than some of the alternatives. These data suggest that having an unlimited supply of payday loans available hurts rather than helps customers in the long run.

The data further suggest that payday and installment loan customers generally do not shop around for price when taking out a loan, but rather pick their lender based upon location or the recommendation of a friend or family member. This creates a classic market failure, and thus a need for effective regulation.

Finally, the data show that customers have a difficulty understanding the dollar costs of these loans, stating the annual percentage rate, or comparing the cost of this credit to other forms of available credit. Some even believe that these loans are cheaper than credit cards or even student loans. Innumeracy—or the inability to do math—is partially responsible for these mistaken beliefs, and is not unique to payday lending customers.[284] Most of us suffer from innumeracy to some degree, and the evidence of innumeracy here supports the need to regulate these loans, despite the contention that doing so is deeply paternalistic.

One thing this Article does not do is describe the legislation that might be meaningful in this context. A federal interest rate cap is one possible solution to the short-term loan problem, particularly in light of the failure of New Mexico-style regulation to meaningfully effect short-term loan practices in the state. The industry's ability to evade more detailed and invasive laws, as well as states' inability to efficiently regulate all products at once, may make rate caps that apply to all loans one of the few truly effective methods of regulation.[285] This question of what solution will ultimately work is worthy of further scholarly discussion.

284. For example, the Author recently had a very hard time convincing a newspaper reporter that $15 per $100 for fourteen days was *not* 15% per annum.

285. *See* Johnson, *supra* note 148, at 43.

APPENDIX

We interviewed 109 payday or installment loan customers using the following survey:

DATE:

Lender Zip Code:

Respondent ID #:

Lender ID:

Greetings! I am a law student at UNM and am working on a study of payday lending. We are offering $10 or a $10 gift card in exchange for a ten minute interview. Would you like to participate?

The interviews are anonymous and all you need to do to qualify is to have gotten a payday loan or installment loan here in the last month.

Introduction

Did you get a payday loan or Installment loan? (Y/N)

Which type? (Plus approx. date of loan.)

First, I'm going to ask a couple background questions

D1—What is your zip code at your home address?

D2—What is your work zip code?

Q1—What brought you to this payday lender *when you got the loan*? Write it down verbatim. (If they just say "needed money" or "bills," ask for what.)

Q2—If you had been unable to get a payday/installment loan today, what would you have done instead. In other words, what would have been your next best alternative?

A4—Did you consider getting this money from another source besides a payday lender? Which? (Maybe ask bank, family member, credit card, pawn shop, *employer for an advance on pay*?)

A4.5—Why did you decide to take out a payday loan instead?

Next, I have a few questions about the loan that you got

L1—How much cash did you take away/borrow (in dollars)?

L2—How many days before you are expected to pay it back?

L3—Do you know how much you can expect to pay in fees and/or interest?

L4—Do you expect to be able to pay it back within this time frame? How much?

The next couple questions are going to involve a little bit of math

L5—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for a *month*? For example, do you know the total amount you would be charged in fees and extra charges? How much?

L6—Do you know about how much the loan would cost if you needed to keep it out (not pay back what you borrowed) for about a *year*? For example, do you know the total amount you would be charged in fees and extra costs? How much?

L7—Have you heard the term "annual percentage rate?"

L8—Many people don't know the answer to the next question, but if you do, would you tell me what the annual percentage rate for this loan is?

A few questions about your past experience with payday loans

P1—Payday loans are becoming more and more common. Can you recall how many payday loans, total, you have taken out, say in the past *two years*?

P2—Including the loan that you took out this time, what is the total dollar amount of all payday loans you currently have outstanding now?

Principal owed:

Interest/fees owed:

A few questions about how you chose this lender and this type of loan

A1—Have you used this lender before?

A2—How did you hear about this lender?

A3—Do you remember why you decided to borrow from this particular lender?

L6—Before taking out this loan, did you look into borrowing money from another payday lender instead? If not, why not?

A5—Do you have a credit card? If answered NO to A5, SKIP to E1.

A6—Do you know what the interest rate is on your credit card or cards? How much?

A7—Are your credit cards maxed out?

A8—If no, could you tell me about how much credit you still have available on your cards? For example, how much more could you charge on them without going over the limit?

A9—Why did you choose to take out a payday loan rather than charge (item) to your credit card or get a cash advance?

Exhibit C



THE PEW CHARITABLE TRUSTS

PAYDAY LENDING IN AMERICA:

Who Borrows, Where They Borrow, and Why

This report series, *Payday Lending in America*, presents original research findings from the Pew Safe Small-Dollar Loans Research Project on how to create a safe and transparent marketplace for those who borrow small sums of money.

www.pewtrusts.org/small-loans

JULY 2012

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

The Safe Small-Dollar Loans Research Project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

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For additional information, visit www.pewtrusts.org/small-loans

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Contents

Executive Summary 2

Key Findings. 4

Introduction 6

1. Who Uses Payday Loans?. 8
Exhibit 1: Payday Loan Usage by Demographic 10
Exhibit 2: Payday Loan Borrowing More Common in Cities 12
Exhibit 3: Payday Loan Usage by Geographic Grouping. 12

2. Why Do Borrowers Use Payday Loans? 13
Exhibit 4: Most Borrowers Use Payday Loans for Recurring Expenses 14

3. What Would Borrowers Do Without Payday Loans? 16
Exhibit 5: Alternatives if Payday Loans Were Unavailable 16

4. Does Payday Lending Regulation Affect Usage?. 19
Exhibit 6: How States Regulate Payday Lending 21
Exhibit 7: In Restrictive States, 95 of 100 Choose Not to Borrow 22
Exhibit 8: Number of Borrowers per 10,000 Population 23
Exhibit 9: Method of Acquiring Payday Loans by State Law Type 23
Exhibit 10: Payday Loan Storefronts. 24
Exhibit 11: State Laws Are Not Driving Payday Loan Complaints 25
Exhibit 12: How People Obtain Payday Loans. 27
Exhibit 13: Method of Acquiring Payday Loans by Borrower Demographic Group . 28

Conclusion 29

Methodology: Opinion Research. 31

Appendix A 35
Exhibit 14: Payday Loan Borrower Demographic Snapshot. 35

Appendix B. 36
Exhibit 15: Logistic Regression Analysis of Likelihood of Payday Loan Usage by Select Demographics. 37

Endnotes 38

Executive Summary

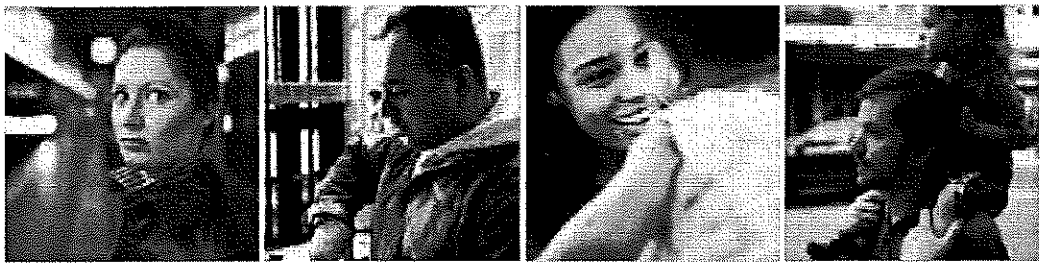
Payday loan borrowers spend approximately $7.4 billion[1] annually at 20,000 storefronts and hundreds of websites, plus additional sums at a growing number of banks. The loans are a highly controversial form of credit, as borrowers find fast relief but often struggle for months to repay obligations marketed as lasting only weeks.[2] While proponents argue that payday lending is a vital way to help underserved people solve temporary cash-flow problems, opponents claim that the practice preys on overburdened people with expensive debt that is usually impossible to retire on the borrower's next payday.

Many state officials have acted to curb payday lending. However, there has been little opportunity for federal policy on payday lending until now. Resolving the debate over the ways in which payday loans and lender practices may help or harm borrowers will fall to the Consumer Financial Protection Bureau (CFPB), which Congress recently created and charged with regulating payday lending. Other federal agencies, such as the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Federal Trade Commission (FTC), also will have important roles to play as banks and online providers continue to enter the payday loan field.[3]

Existing data show that, in at least two significant respects, the payday lending market does not function as advertised. First, payday loans are sold as two-week credit products that provide fast cash, but borrowers actually are indebted for an average of five months per year. Second, despite its promise of "short-term" credit, the conventional payday loan business model requires heavy usage to be profitable—often, renewals by borrowers who are unable to repay upon their next payday. These discrepancies raise serious concerns about the current market's ability to provide clear information that enables consumers to make informed decisions.

This report, *Who Borrows, Where They Borrow, and Why*, is the first in Pew's *Payday Lending in America* series. The findings provide policy makers with research to address concerns about small-dollar loans and to promote a safe and

transparent marketplace. In addition to discussing Pew's focus groups, the report presents selected results from a first-ever nationally representative telephone survey of payday borrowers. The report answers six major questions: Who are borrowers, demographically? How many people are borrowing? How much do they spend? Why do they use payday loans? What other options do they have? And do state regulations reduce payday borrowing or simply drive borrowers online instead?



Key Findings

1 Who Uses Payday Loans? Twelve million American adults use payday loans annually. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

Pew's survey found 5.5 percent of adults nationwide have used a payday loan in the past five years, with three-quarters of borrowers using storefront lenders and almost one-quarter borrowing online. State regulatory data show that borrowers take out eight payday loans a year, spending about $520 on interest with an average loan size of $375. Overall, 12 million Americans used a storefront or online payday loan in 2010, the most recent year for which substantial data are available.

Most payday loan borrowers are white, female, and are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: those without a four-year college degree; home renters; African Americans; those earning below $40,000 annually; and those who are separated or divorced. It is notable that, while lower income is associated with a higher likelihood of payday loan usage, other factors can be more predictive of payday borrowing than income. For example, low-income homeowners are less prone to usage than higher-income renters: 8 percent of renters earning $40,000 to $100,000 have used payday loans, compared with 6 percent of homeowners earning $15,000 up to $40,000.

2 Why Do Borrowers Use Payday Loans? Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

Payday loans are often characterized as short-term solutions for unexpected expenses, like a car repair or emergency medical need. However, an average borrower uses eight loans lasting 18 days each, and thus has a payday loan out for five months of the year. Moreover, survey respondents from across the demographic

spectrum clearly indicate that they are using the loans to deal with regular, ongoing living expenses. The first time people took out a payday loan:

- 69 percent used it to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food;
- 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.

3 What Would Borrowers Do Without Payday Loans? If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

When presented with a hypothetical situation in which payday loans were unavailable, storefront borrowers would utilize a variety of other options. Eighty-one percent of those who have used a storefront payday loan would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions. The options selected the most often are those that do not involve a financial institution. Forty-four percent report they would take a loan from a bank or credit union, and even fewer would use a credit card (37 percent) or borrow from an employer (17 percent).

4 Does Payday Lending Regulation Affect Usage? In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources.

In states with the most stringent regulations, 2.9 percent of adults report payday loan usage in the past five years (including storefronts, online, or other sources). By comparison, overall payday loan usage is 6.3 percent in more moderately regulated states and 6.6 percent in states with the least regulation. Further, payday borrowing from online lenders and other sources varies only slightly among states that have payday lending stores and those that have none. In states where there are no stores, just five out of every 100 would-be borrowers choose to borrow payday loans online or from alternative sources such as employers or banks, while 95 choose not to use them.

Introduction

Deborah is a young mother who works full time as a teacher and is studying for a graduate degree. She has struggled to make ends meet. "It just seems like one thing after another," she said; "I can't seem to catch up." A few years ago, Deborah needed money when she could not afford both her monthly bills and her daughter's routine vaccinations. Deborah said that she has used student loans, bank loans, and credit cards when she was short on money. When she needed more, she thought she could get help from family or friends, but "I didn't want to ask somebody for it." Instead, Deborah borrowed a couple hundred dollars from a payday lender. "I was scared when I went in there, but I needed the money, and I knew it was a fast fix," she said. Deborah's loan was due in full on her next payday, but she could not come up with enough extra cash to pay the lump sum and meet her other expenses. So she renewed the loan, paying fees to push the due date to her next payday but receiving no reduction in the principal owed. It took nearly six months of renewals before she had enough money for a payment large enough to eliminate her payday loan debt. "Once my taxes came in, I just paid it off and walked away," said Deborah. "I was like 'I'm done.'"[4]

Like Deborah, a former payday loan borrower in one of Pew's focus groups, millions have turned to payday lenders when finances are tight, finding fast relief but struggling for months to repay loans that, according to marketing, are supposed to last only weeks. Payday loans are small-dollar credit products that typically range from $100 to $500, though may be larger depending on state law; the average loan is about $375.[5] Lenders usually charge about $15 per $100 borrowed per two weeks (391 percent Annual Percentage Rate or APR).[6] The loans are secured by a claim to the borrower's bank account with a post-dated check or electronic debit authorization.

Payday loans are due in full on the borrower's next payday; yet if the borrower cannot pay off the full loan plus interest, she pays a fee to extend the due date, or pays back the loan but quickly takes out a new one to cover other expenses. The loans do not amortize, so this payment does

not reduce the loan principal owed. For example, a person who borrows $400 for a $60 fee for two weeks would have paid approximately $480 in fees after renewing the loan for four months, but would still owe the original $400. Most payday loans come from storefront providers with specialized state lending licenses, but similar types of small-dollar loan products are available elsewhere, including from online lenders and banks that offer "deposit advance" loans.[7]

Existing data show there are two clear problems in this market. First, payday loans are sold as two-week credit products that provide fast cash for emergencies in exchange for a fee. But the lump-sum repayment model appears to make it difficult for borrowers to avoid renewal. Pew's analysis of state and industry data indicates that borrowers are indebted for an average of about five months of the year.[8] According to one study, 76 percent of these loans, including renewals, are borrowed within two weeks following an existing payday loan's due date, meaning the borrower could not pay back the loan and make it to the next payday without another loan.[9] In addition, Pew's analysis of data from Oklahoma finds that more borrowers use at least 17 loans in a year than use just one.[10]

Second, the conventional[11] payday loan business model depends upon heavy usage—often, renewals by borrowers who are unable to repay upon their next payday—for its profitability.[12] Researchers at the Federal Reserve Bank of Kansas City concluded that, "the profitability of payday lenders depends on repeat borrowing."[13] According to industry analysts, "In a state with a $15 per $100 rate, an operator ... will need a new customer to take out 4 to 5 loans before that customer becomes profitable."[14] For example, an analysis of North Carolina data found that 73 percent of lender revenue came from borrowers using seven or more loans per year.[15] Despite these realities, payday loans continue to be packaged as short-term or temporary products.

Pew's research seeks to explore these discrepancies between packaging and reality, and to demonstrate borrower experiences and outcomes. The survey discussed in this report is a first-ever nationally representative telephone poll of payday loan borrowers about their usage, conducted in two parts. Demographic data derive from 33,576 responses, representative of all adult Americans, while information about why borrowers used payday loans and what alternatives they have come from 451 interviews representative of all storefront payday loan borrowers.



PROFILE

Borrower A: Female, white, married, non-parent, disabled, homeowner, high school, age 39, $28,000

A slight majority of payday loan borrowers are female, and a slight majority of borrowers are also white. Those who are unable to work because of a disability have used a payday loan at higher rates than those who are employed, unemployed, homemakers, students, or retired.

1 Who Uses Payday Loans?

Twelve million American adults use payday loans annually. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

The Pew survey found that 5.5 percent[16] of American adults report having used a payday loan in the past five years.[17] In addition, using the most recent available data,[18] we calculate approximately 12 million[19] Americans used a storefront or online payday loan in 2010, a figure that is consistent with the 5.5 percent finding.

Although Pew's survey reveals that borrowing is concentrated among younger, low-to-moderate-income individuals, people of most ages and incomes use payday loans. Importantly, while these findings indicate which individuals are most likely to borrow, they do not imply that a given characteristic *causes* people to use payday loans.

Pew's survey found that borrowers are 52 percent women and 55 percent white; 58 percent rent their homes; 85 percent do not have a four-year college degree; 72 percent have a household income of less than $40,000; and 52 percent fall in the 25 to 44 age category. (See Appendix A for a complete demographic breakdown of payday loan borrowers.) However, these figures do not necessarily reflect the likelihood of payday loan usage among different demographic groups. For example, while slightly more women use payday loans than men, gender is not a significant predictor of payday loan usage. Similarly, like the general population, most payday loan borrowers are white, but white respondents are less likely to have used a payday loan than people of other races or ethnicities. The results presented in this section are largely consistent with prior research.[20]

WHAT DO BORROWERS SPEND?

Lenders sell payday loans as a temporary bridge to the next payday, though in reality most borrowers are indebted for much longer than one pay cycle. Payday loan consumers take out an average of eight payday loans a year,[21] often renewing an existing loan or taking out a new loan within days of repaying the previous one. Data from Florida indicate that borrowers who take at least 12 loans in a year use 63 percent of all payday loans.[22] The average loan is about $375.[23] Three-quarters of payday loans come from storefronts, with an average fee of $55 per loan, and roughly one-quarter originate online, with an average fee of $95. Using these figures, we calculate that the average borrower spends about $520 on interest each year.[24]

How much borrowers spend on loans depends heavily on the fees permitted by their state. The same $500 storefront loan would generally cost about $55 in Florida, $75 in Nebraska, $87.50 in Alabama, and $100 in Texas, even if it were provided by the same national company in all of those states. Previous research has found that lenders tend to charge the maximum permitted in a state.[25]

For an analysis of how borrowers in each demographic group obtain their loans (i.e., from storefronts versus online), see Exhibit 13 on page 28. For more information on the findings regarding these groups, see our website at www.pewtrusts.org/small-loans.

Which demographic traits best predict loan usage, after controlling for other factors?

Pew researchers developed a logistic regression model to evaluate how certain characteristics relate to usage, while controlling for other factors. Among these characteristics, the odds of payday loan usage are:

57 percent higher for renters than for homeowners;

62 percent higher for those earning less than $40,000 annually than for those earning more;

82 percent higher for those with some college education or less than for those with a four-year degree or more;

103 percent higher for those who are separated or divorced than for those of all other marital statuses (single, living with a partner, married, or widowed); and

105 percent higher for African Americans than for other races/ethnicities.

For more on the model and the characteristics tested, see Appendix B.

EXHIBIT 1:

PAYDAY LOAN USAGE BY DEMOGRAPHIC

Percentage of Each Subgroup Reporting Payday Loan Usage

Certain demographic groups are more likely than others to have used a payday loan in the past five years.

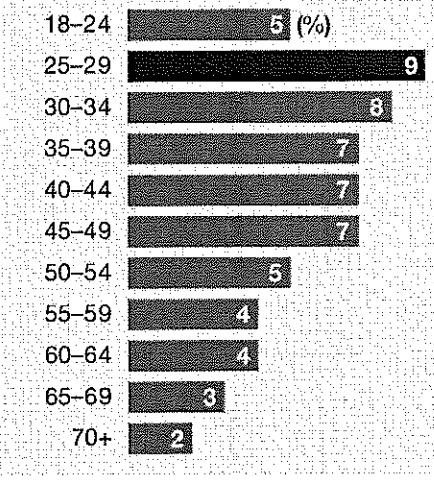
OVERALL

5.5 percent of all adult Americans have used a payday loan.



AGE

9 percent of adults aged 25-29 have used a payday loan.



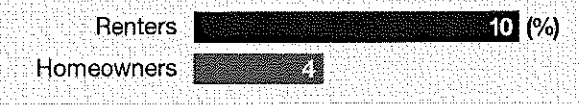
People ages 25 to 49 have used payday loans at a higher rate than the general population. By contrast, loan use is below average among 18-to-24-year-olds and those age 50 or older. There is relatively little usage by senior citizens, with just 2 percent of those 70 and older having used payday loans.

NOTE: Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

RENTERS VS. HOMEOWNERS

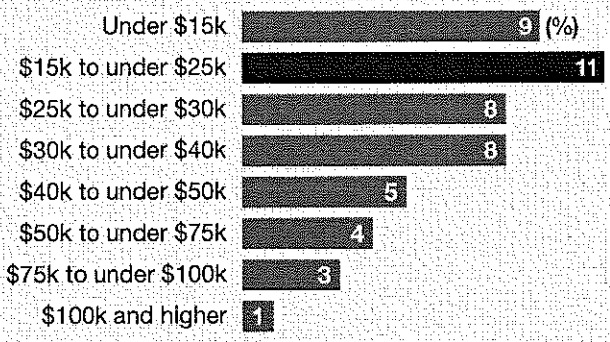
10 percent of renters have used a payday loan.



Renters have used payday loans at more than double the rate of homeowners. This sharp difference in usage between homeowners and renters persists in every age cohort. While payday loan usage is largely concentrated among those ages 25 to 49, among 50-to-69-year-old renters, fully one in 10 has used a payday loan, more than triple the rate for 50-to-69-year-old homeowners. Furthermore, renters' usage of payday loans is far higher than that of homeowners across the income distribution. For example, 8 percent of renters earning $40,000 to $100,000 have used payday loans, compared with 6 percent of homeowners earning $15,000 up to $40,000.

INCOME

11 percent of those earning $15,000 up to $25,000 have used a payday loan.



Respondents with household incomes less than $40,000 are almost three times as likely to have used payday loans as respondents with household incomes of $50,000 or more. Respondents from every income group report using payday loans, with loan usage the highest (11 percent) for those earning $15,000 up to 25,000 and lowest (1 percent) for those earning over $100,000. Except for those earning under $15,000, the relationship between income and payday loan usage is an inverse one, with borrowing decreasing as income increases.

EXHIBIT 1:

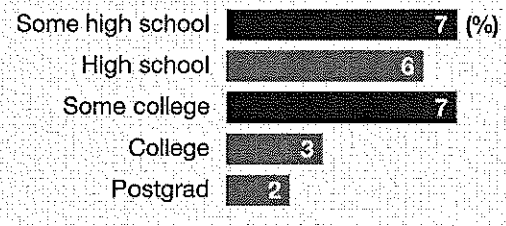
PAYDAY LOAN USAGE BY DEMOGRAPHIC

Percentage of Each Subgroup Reporting Payday Loan Usage

(CONTINUED)

EDUCATION STATUS

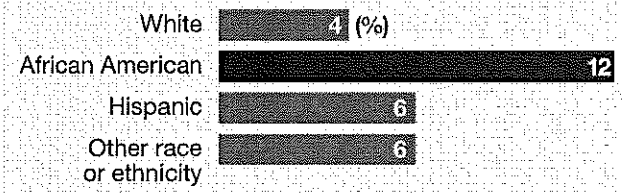
7 percent of those with some high school or some college have used a payday loan.



Those without a four-year college degree are much more likely to have used payday loans than those who have a degree. But among those without a four-year degree, further differences in education level do not correspond with significant differences in payday loan usage.

RACE AND ETHNICITY

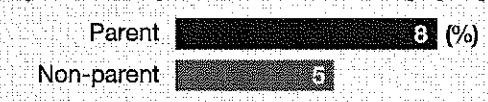
12 percent of African Americans have used a payday loan.



African American respondents are more than twice as likely as others to have used a payday loan but make up less than a quarter of all payday borrowers, as compared with whites who comprise 55 percent of all borrowers.

PARENTAL STATUS

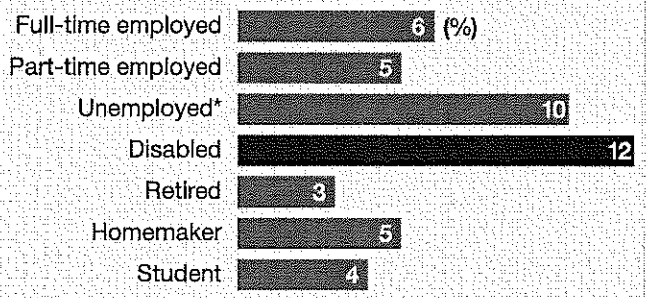
8 percent of parents have used a payday loan.



Parents are more likely to have used payday loans than those who are not parents, especially among those earning less than $50,000. Twelve percent of parents earning less than $50,000 have used a payday loan, compared with just 4 percent of parents earning $50,000 or more.

EMPLOYMENT STATUS

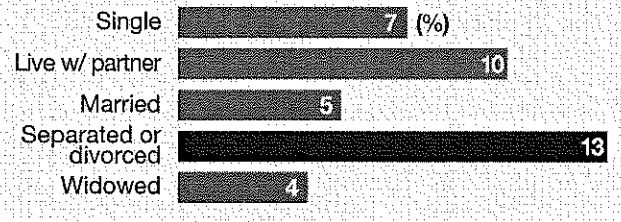
12 percent of those who are disabled have used a payday loan.



Those who are currently disabled or unemployed have used payday loans at the highest rates in the past five years, although it is possible that they were employed at the time they borrowed. However, those who are employed make up a majority of all payday borrowers, and an income stream is a requirement for obtaining a payday loan.

MARITAL STATUS

13 percent of those who are separated or divorced have used a payday loan.



Those who are separated or divorced are most likely to have borrowed. Thirteen percent of separated or divorced individuals report payday loan usage, a rate twice that of all other respondents.

*Payday lenders generally will lend only to someone with an income stream. It is possible that unemployed people were employed at the time of their last payday loan, or they are receiving a loan based on some other form of income, such as a benefits check.

NOTE: Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

PAYDAY LOAN USAGE BY GEOGRAPHY

Pew's survey revealed that payday loan usage is highest in parts of the South and Midwest Census regions (e.g., 13 percent of adults have borrowed in Oklahoma and 11 percent in Missouri, two of the leading payday loan states) and is significantly higher in urban areas as compared with the suburbs. A major factor causing the significant variation in payday loan usage by Census region and division is the difference in how states regulate payday loans, detailed on page 20.

EXHIBIT 2:

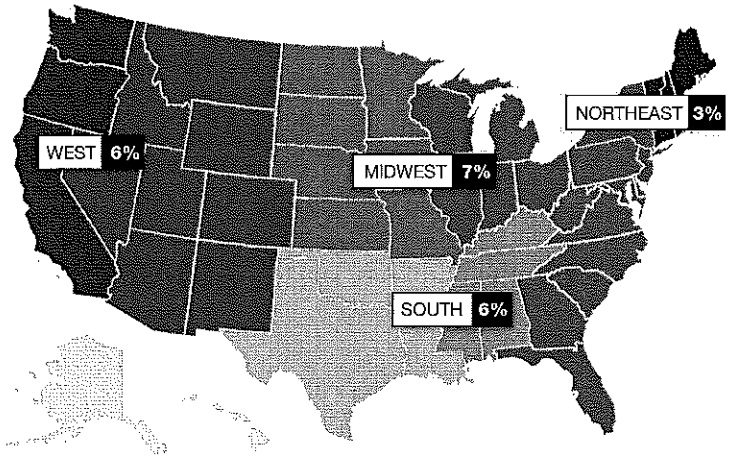
PAYDAY LOAN BORROWING MORE COMMON IN CITIES

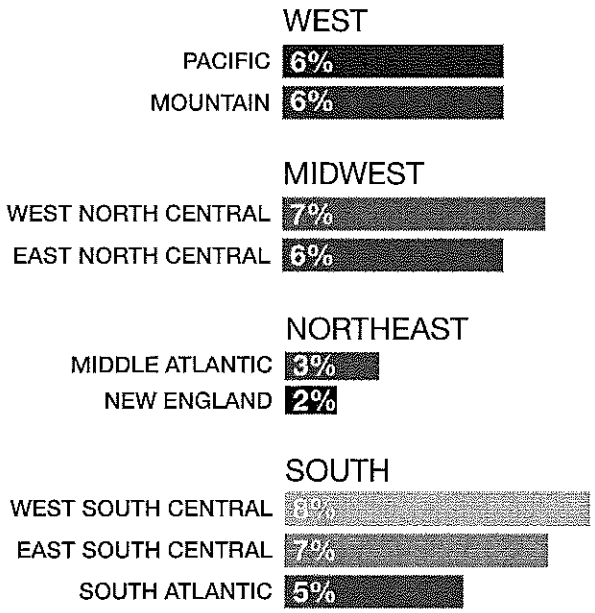
7 percent of those living in cities have used a payday loan.



EXHIBIT 3:

PAYDAY LOAN USAGE BY GEOGRAPHIC GROUPING





NOTES: Exhibit 2: **Exurban** (Inside a Suburban County of the MSA); **Small town** (In an MSA that has no Center City); **Rural** (Not in an MSA), **Urban** (In the Center City of an MSA), **Suburban** (Outside the Center City of an MSA, but inside the county containing the Center City). The Office of Management and Budget classifies geographic areas into Metropolitan and Micropolitan Statistical Areas (MSA), and these groupings are used by the U.S. Census Bureau. The higher usage in cities is consistent with previous research demonstrating that, historically, payday lending has been tied to relatively densely populated areas, as described in Robert Mayer's *Quick Cash*. This rate is significantly higher than the 3 percent of suburban-area residents who report having used payday loans. Data represent payday loan usage by geographic area in the contiguous United States.

Exhibit 3: Regions and divisions are those used by the U.S. Census Bureau. Data represent payday loan usage by geographic area in the contiguous United States. For state-level data, see www.pewtrusts.org/small-loans.

No surveys were conducted in AK and HI.

Results from Exhibits 3 and 4 are based on 33,576 interviews conducted from August to December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

2 Why Do Borrowers Use Payday Loans?

Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

Pew's survey asked borrowers why they first took out a payday loan. As illustrated in Exhibit 4, borrowers' initial reasons stem from an ongoing need for income, rather than a short-term need to cover an unexpected expense.[26] Four times more storefront borrowers used their first payday loans for a recurring expense (69 percent) than for an unexpected expense (16 percent).

These findings provide a sharp contrast with the conventional image of payday loans, which are advertised as short-term, small-dollar credit intended for emergency or special use. Industry, advocates, and regulators all suggest that using payday loans for recurring expenses is not an effective use of high-cost credit and that, rather, such credit should be used to cover unexpected expenses for a short period of time.[27] Yet, previous research, as well as discussions with industry leaders, and state-level reports, all make clear that a typical borrower uses payday loans many times per year,[28] and much of this borrowing comes in relatively quick succession once someone begins using payday loans.[29] Pew's analysis of existing data found that an average borrower is in payday loan debt for five months per year, using eight loans that last 18 days each.[30]



PROFILE

Borrower B: Male, Hispanic, divorced, non-parent, full-time employed, renter, associate's degree, age 44, $17,000

Divorced or separated men are more likely to have used a payday loan than their female counterparts. Renters are three times more likely to have used a payday loan than homeowners, while those earning $15,000-$25,000 are the most likely to have used a payday loan.

■ Regular, Ongoing Expenses

Female borrower, Chicago:
"I was behind on my mortgage and cable bill."

Male borrower, Chicago:
"Just need to get to the next paycheck. And I need, you know, either pay the bill to keep the lights on, or need some food, or whatever it is."

Female borrower, San Francisco:
"If I have bills to pay, or say I need food on the table, I am going."

Male borrower, San Francisco:
"Well, I was a little short and was thinking I could use some more money and I was at the ATM actually, and it was there, offering me a direct deposit advance. So, I thought I would try it."

■ Unexpected Emergency/Expense

Male borrower, New York:
"I got mine because my son got in a car accident."

Male borrower, New York:
"I had to get money for my car to get fixed."

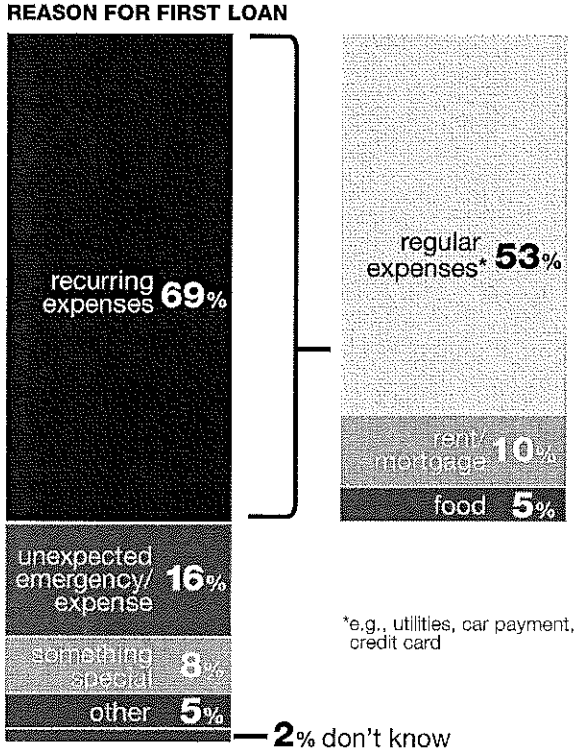
■ Something Special

Female borrower, San Francisco:
"It was the holidays and I just needed some extra cash to get gifts and help out with Christmas dinner and do my part."

Male borrower, San Francisco:
"It was a frivolous expense. Some friends wanted us to accompany them on an out-of-town trip... and I thought, 'why not?'"

EXHIBIT 4:

MOST BORROWERS USE PAYDAY LOANS FOR RECURRING EXPENSES



NOTES: Data represent percentage of borrowers who reported the reason for using their first payday loan based on 451 interviews. December 2011 - March 2012. Sampling error for the full-length survey of storefront payday loan borrowers is +/- 4.6 percentage points.

Survey participants were asked: Thinking back now to (that FIRST/the) time you took out a (online payday loan/payday loan/auto title loan), which of the following best describes what specifically you needed the money for?

1 To pay rent or a mortgage
2 To pay for food and groceries
3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs
4 To pay an unexpected expense, such as a car repair or emergency medical expense
5 To pay for something special, such as a vacation, entertainment, or gifts
6 (Do not read) Other (specify)

The combined results for "Recurring Expenses" include Regular Expense (53 percent), Rent or Mortgage (10 percent), and Food (5 percent) and add to 69 rather than the expected 68 because of rounding decimals. The response options were randomized in this and other survey questions, so the order in which the respondent heard them varied to eliminate order bias.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

PAYDAY LOAN MARKETING VS. PRACTICE

Payday loans are frequently described as short-term credit for unexpected expenses, and marketing materials sometimes inform borrowers that payday loans are not intended for long-term use.[31] The industry advertises this small-dollar form of credit as a product that offers borrowers "access to a financial option intended to cover small, often unexpected, expenses," but states that a payday loan "is not meant to be a long-term solution."[32] A large payday lender warns in its direct mail advertisements: "Short-term loans are not intended to be long-term financial solutions."[33] Another warns: "Payday advances should be used for short-term financial needs only, not as a long-term financial solution."[34]

Despite these warnings, repeat borrowing is the norm. Prior research indicates that borrowers are indebted for an average of five to seven months of the year.[35] As a report by the Federal Reserve Bank of Kansas City Economic Research Department concluded, "The profitability of payday lenders depends on repeat borrowing."[36]

The dependence on repeat borrowing is illustrated by the reaction of payday lenders to a recent Washington State law limiting borrowers to eight loans per year. The largest storefront lender in the United States "decided to close an additional 30 centers in the State of Washington where changes in the law there have greatly affected our ability to operate profitably in that state."[37] Similarly, according to industry analysts, "In a state with a $15 per $100 rate, an operator ... will need a new customer to take out 4 to 5 loans before that customer becomes profitable."[38]

The industry's stated best practices include limiting rollovers to four per person (or the state maximum) and providing extended repayment plans to borrowers who are unable to repay their loan within the original term.[39] Despite the promotion of these standards, marketing practices differ greatly. One key area of inconsistency is the practice among lenders of offering incentives to encourage habitual loan usage, such as discounts for repeat borrowing and referral bonuses.[40] As an example, one of the largest online payday lenders, which is affiliated with the largest storefront lender, offers a "Preferred Member Bonus" (Silver Status after five payday loans, Gold Status after 10 payday loans, and Platinum Status after 15 payday loans).[41]



PROFILE

Borrower C: **Female, African American, married, parent, part-time employed, renter, some college, age 28, $32,000**

African Americans are more likely than people of other races to have used a payday loan. People ages 25-29 are more likely to have used payday loans than those in any other age group. Parents are much more likely than non-parents to have used a payday loan, regardless of marital status.

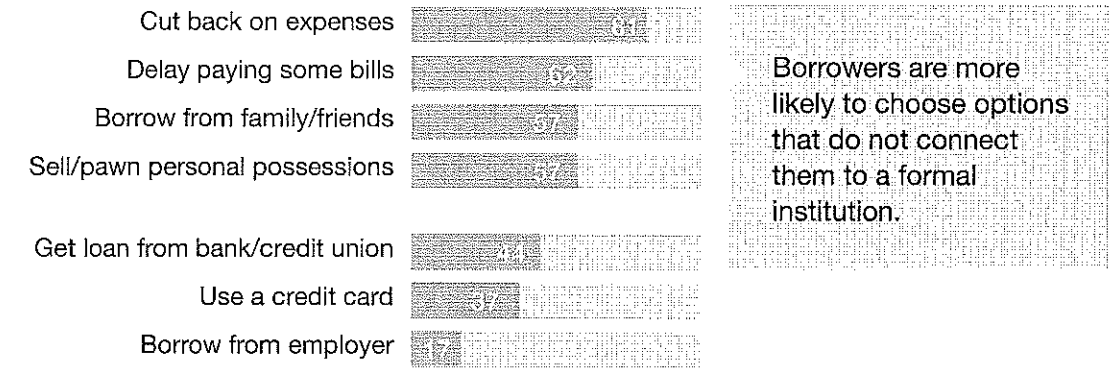
3 What Would Borrowers Do Without Payday Loans?

If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

Even though most borrowers use payday loans for recurring expenses, rather than for emergencies, survey respondents indicated they would use a variety of options to deal with those needs if payday loans were no longer available. In general, borrowers are more likely to choose options—such as adjusting their budgets, delaying bills, selling or pawning personal items, or borrowing from family or friends—that do not connect them to a formal institution. Eighty-one percent of payday borrowers say they would cut back on expenses if payday loans were unavailable.

EXHIBIT 5:

ALTERNATIVES IF PAYDAY LOANS WERE UNAVAILABLE



NOTES: Data represent percentage of borrowers who would use each of these strategies if payday loans were unavailable, based on 451 interviews, December 2011 to March 2012.

Survey participants were asked: "I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash and short-term loans of any kind no longer existed. How about (method)? Would you use this option or not?" The "borrow from employer" item was only asked of employed respondents.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

These survey findings are consistent with tactics described by former payday loan borrowers in a focus group Pew conducted in late 2011 near Manchester, New Hampshire, to find out what residents are doing now that there are no longer storefront payday lenders there. In that group, payday loan borrowers discussed various strategies they use in place of payday loans, such as re-budgeting, prioritizing bills, pawning or selling belongings, borrowing from family members, or, as one borrower stated, working out "payment plans with utility companies." Another borrower discussed prioritizing money: "I budget. I do my best, but the main thing that has to get paid is that mortgage . . . I pay that mortgage, I pay my car, I pay my insurance, and whatever is left over, that's what everything else gets paid with."

While a majority of surveyed borrowers said they would not take out a loan from a bank or credit union, many focus group participants throughout the country expressed that they would rather borrow from a bank or a credit union than from a payday lender if that option were available to them. The fact that a majority of survey respondents failed to list banks or credit unions as options may reflect an expectation, demonstrated among many focus group members, that they would not be approved for a loan.

Similarly, the fact that most survey respondents would not use credit cards may reflect a sentiment that those products are not available to them. Most, though not all, focus group participants nationwide indicated that they had maxed out their credit cards or believed they would not qualify. The reluctance to view credit cards as an alternative also may stem from confusion among some borrowers about whether the interest rate on a credit card is higher or lower than the interest rate on a payday loan. On several occasions, borrowers in focus groups equated the simple interest rate (e.g., 15 percent for a loan with a $15 per $100 fee for two weeks) with the Annual Percentage Rate disclosed for a credit card (which might be 15 percent on an annual basis). For example, a borrower from Alabama stated: "Because the interest on . . . some credit cards [is] 23.99 percent. So if you go charge $300, and then you don't pay that $300 off at the end of the month . . . they're going to tack that 23.99 percent on to it, so you're going to still be paying more than you would if you had to [get a payday loan]."

Previous surveys have found similar results to Pew's findings about payday loan alternatives. A study of former storefront payday loan borrowers in North Carolina found households have other ways to cope with cash shortfalls. For example, borrowers who experienced a shortfall within the previous three years chose instead to delay expenses (52 percent), use savings (44 percent), or borrow from family or friends (42 percent).[42] A study of

California payday loan borrowers found that of those who decided not to take out a payday loan explicitly because of the interest rate or fee, 47 percent chose to borrow from family or friends and 26 percent elected to wait until payday. In addition, for borrowers who were unable to obtain the full amount they needed from a payday lender, most chose to borrow the additional amount from family or friends.[43] Another survey of low- to moderate-income people in parts of Texas revealed that while 23 percent had used a payday loan, far more (60 percent) had borrowed from family or friends. Among payday loan borrowers in that study, 45 percent indicated they also borrowed from family or friends.[44]



PROFILE

Borrower D: **Male, white, separated, parent, full-time employed, renter, associate's degree, age 32, $41,000**

Separated people are far more likely to have used a payday loan than those of any other marital status. People who do not have a four-year college degree are much more likely to have used a payday loan than college graduates.

4 Does Payday Lending Regulation Affect Usage?

In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources.

Modern payday loans owe their existence to efforts, mostly in the 1990s, to create custom exemptions to state laws that otherwise would prohibit such small-dollar loans or apply usury interest rate caps. Since then, the wisdom of allowing payday lending has been a hotly contested issue among state policy makers and stakeholders. States have deployed a variety of strategies designed to prohibit, control, or enable this form of small-dollar credit.

EXAMPLES OF STATE LAW TYPES

MISSOURI (PERMISSIVE)

Missouri permits single-repayment payday loans with finance charges and interest not to exceed 75 percent of the borrowed principal. The 2011 payday lending report from Missouri's Division of Finance cites a fee of $52.45 for a 14-day loan of $307.56 (444.61 percent APR).[45] Payday loans are available for up to $500.
Incidence: 9.7 percent storefront, 1.5 percent online

FLORIDA (HYBRID)

Florida permits single-repayment payday loans with fees of 10 percent of the borrowed principal, along with a $5 fee for borrower verification with a state database of payday loan users. Payday loans are available for up to $500 and each borrower may have out only one payday loan at any given time.
Incidence: 6.6 percent storefront, 0.6 percent online

GEORGIA (RESTRICTIVE)

Georgia state statute prohibits payday lending in most forms. As in other jurisdictions, many banks and credit unions are exempt from the restriction on payday lending in the state.
Incidence: 1.9 percent storefront, 0.5 percent online

In the past decade, some states—most recently including Arizona, Arkansas, Montana, and New Hampshire—have revived consumer protections and rolled back laws that authorized payday loans. These states have reimposed usury interest rate caps or discontinued payday lenders' exemptions from these usury limits. Other states have limited the number of high-cost loans or renewals that a lender may offer to an individual, in an attempt to enhance borrowers' ability to repay debts in a timely fashion.[46]

Following a thorough review, Pew identified three categories of state payday loan regulation. (See Exhibit 6 for a complete breakdown of the states. See www.pewtrusts.org/small-loans for a compilation of relevant laws by state and a short history of payday lending law.)

■ **Permissive states are the least regulated and allow initial fees of 15 percent of the borrowed principal or higher.** Most of these states have some regulations, but allow for payday loans due in full on a borrower's next payday with Annual Percentage Rates (APRs) usually in the range of 391 to 521 percent ($15 to $20 per $100 borrowed per two weeks). Payday loan storefronts are readily available to borrowers located in these states.[47] Most Americans—55 percent—live in the 28 Permissive states.

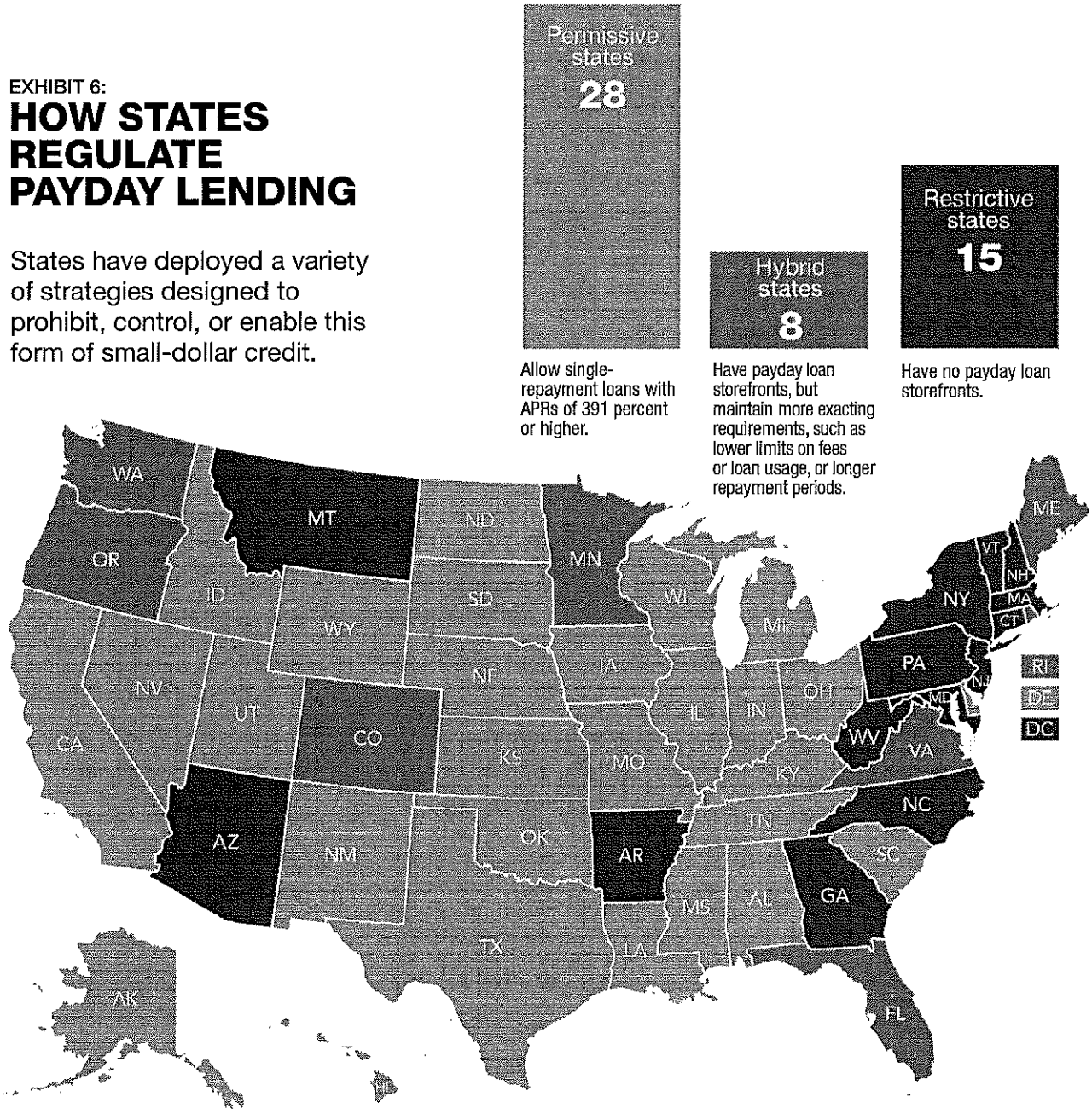
■ **Hybrid states have relatively more exacting requirements than Permissive states,** with at least one of the following three forms of regulation: (1) rate caps, usually around 10 percent of the borrowed principal, which are lower than most states but still permit loans to be issued with triple-digit APRs; (2) restrictions on the number of loans per borrower, such as a maximum of eight loans per borrower per year; or (3) allowing borrowers multiple pay periods to repay loans. Storefronts that offer payday loans exist in substantial numbers in these states,[48] though the market may be more consolidated and per-store loan volume may be higher here than in less restrictive states.[49] Sixteen percent of Americans live in the eight Hybrid states.

■ **Restrictive states either do not permit payday lending or have price caps low enough to eliminate payday lending in the state.** This rate cap often is 36 percent APR. Generally, payday loan storefronts are not found in these states. This category includes states where deferred presentment transactions (post-dated checks) are not authorized, are not specifically exempted from general state laws on usury, or are explicitly prohibited by state statute. Twenty-nine percent of Americans live in the 14 states and the District of Columbia that have a Restrictive payday loan regulatory structure.

EXHIBIT 6:

HOW STATES REGULATE PAYDAY LENDING

States have deployed a variety of strategies designed to prohibit, control, or enable this form of small-dollar credit.



SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Payday Lending Regulation Not Leading to Increased Online Borrowing

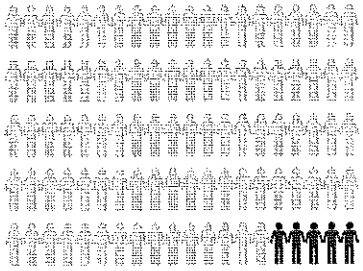
A key issue being discussed in state legislatures is whether restricting storefront payday lenders will lead borrowers to obtain loans from the Internet or other sources instead.[50] Consumer advocates[51] and some storefront lenders[52] have warned that other forms of lending, particularly online payday lending, could harm borrowers because they often occur outside the reach of state regulators. (Pew has seen evidence of fraud, abuse, and other problems with online payday lending, and will explore these later in this report series.)

However, Pew found that in Restrictive states, payday loan usage from all sources combined is far lower as compared with other states (see Exhibit 8).[53] Storefront payday loan usage is 75 percent lower in Restrictive than in Permissive states,[54] while online and other payday loan usage is only slightly higher (this difference is not statistically significant). Thus, the vast majority of would-be storefront borrowers in Restrictive states are not going online or to other providers to obtain payday loans instead.

Our data show that, in states that enact strong legal protections, the result is a large net decrease in payday loan usage (see page 23).

EXHIBIT 7:

In states that restrict storefront payday lending, 95 of 100 would-be borrowers elect not to use payday loans at all—just five borrow online or elsewhere.



SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

- Restrictive payday loan laws lead to 393 fewer storefront borrowers per 10,000 people;
- Of these, just 21 (5 percent) go online or elsewhere to get a payday loan; and
- The remaining 372 (95 percent) do not use payday loans.

In other words, in states that restrict storefront payday lending, 95 of 100 would-be borrowers elect not to use payday loans at all—just five borrow online or elsewhere.

PAYDAY BORROWING FAR LOWER IN RESTRICTIVE STATES THAN IN PERMISSIVE STATES

There is significantly less payday loan usage in states with strong legal protections because most people are not getting payday loans from the Internet or other sources instead. Although online payday lending and other sources may continue to experience substantial growth in coming years, these data give no indication that regulation of payday loan storefronts would fuel this growth. While online borrowing often is discussed as a problem in states without storefronts, it is nearly as prevalent in states with payday loan stores. In Permissive states, fully one-third of online borrowers also have borrowed from stores, choosing both methods rather than one or the other.

EXHIBIT 8:

NUMBER OF BORROWERS PER 10,000 POPULATION

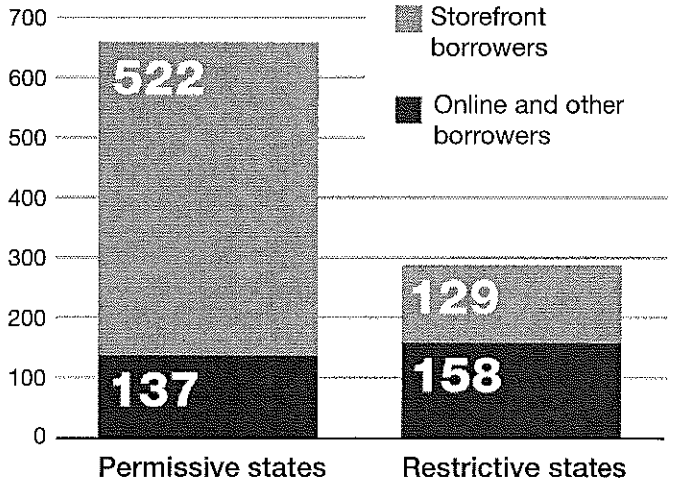


EXHIBIT 9:

METHOD OF ACQUIRING PAYDAY LOANS BY STATE LAW TYPE

Percentage of adults reporting payday loan usage in the past five years

	BORROW FROM STOREFRONT ONLY	BORROW FROM ONLINE OR OTHER*	NUMBER OF INTERVIEWS
National	4.01%	1.48%	33,576
Permissive states	5.22%	1.37%	17,881
Hybrid states	5.06%	1.28%	5,565
Restrictive states	1.29%	1.58%	10,130

NOTES: *Online or other represents all borrowers who have indicated online usage (including those who have borrowed both online *and* from a storefront), plus usage from other lenders that may include banks, credit unions, or employers, among others. Results are reported to two decimal places, but this reporting is not intended to imply such a detailed level of precision. Rather, two decimal places are used in order to avoid inaccurate calculations between groupings that could be caused by rounding. Because of sampling error, it is possible that the true level of usage in any of these groupings is slightly higher or lower.

Restrictive states are those that have no payday loan storefronts. Permissive states allow single-repayment loans with APRs of 391 percent or higher. Hybrid states have payday loan storefronts, but maintain more exacting requirements, such as lower limits on fees or loan usage, or longer repayment periods.

Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August 2011 through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

This analysis makes an evidence-based assumption backed by strong empirical data that inherent demand for payday loans is similar in Restrictive and Permissive states. Store counts from 2006 in the four states that have most recently adopted a Restrictive regulatory strategy after previously being Permissive—Arkansas, Arizona, Montana, and New Hampshire—show a similar number of stores per capita as in the other then-Permissive states: 5.5 percent fewer stores (0.64 fewer stores) per 100,000 residents in 2006 than their counterparts that remain Permissive (see Exhibit 10).[55] This fairly small difference in payday lenders per capita suggests there is not large variation between these two state groupings in demand for payday loans.[56] Other Restrictive states, such as North Carolina and Georgia, that were previously Permissive, also had heavy payday loan activity before changing their laws.[57]

EXHIBIT 10:

PAYDAY LOAN STOREFRONTS

STATE LAW TYPE	STOREFRONTS PER 100,000 RESIDENTS IN 2006
PERMISSIVE IN 2012 (WERE PERMISSIVE IN 2006)	11.57
RESTRICTIVE IN 2012 (WERE PERMISSIVE IN 2006)	10.93

NOTES: These figures are based on our analysis of state-by-state storefront data from Steven Graves and Christopher Peterson. Restrictive states are those that have no payday loan storefronts. Permissive states allow single-repayment loans with APRs of 391 percent or higher.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; Graves and Peterson (2008).

Pew also conducted a logistic regression analysis to examine the effect of state law type on the odds of payday borrowing, controlling for borrower demographic characteristics. The findings are that the odds of payday loan usage for people who live in a Permissive or Hybrid state are 169 percent higher than for those who live in a Restrictive state, meaning a person's state of residence is a highly significant factor in predicting payday loan usage, even after controlling for borrower demographics.

To examine whether these data were considerably impacted by changes in state laws during the period of inquiry in our survey, Pew compared incidence in states that changed their laws during the past five years and those that did not.[58] There was relatively little difference in incidence of payday loan usage between states that had Restrictive regulation prior to 2007 (2.93 percent) and those five states that implemented Restrictive regulation after January 2007 (2.46 percent). Usage rates are similarly close for states with Hybrid regulation prior to 2007 (6.14 percent) and the five states that implemented Hybrid regulation in 2007 or later (6.43 percent).

Prior research has found "no evidence that prohibitions and price caps on one AFS (Alternative Financial Services) product lead consumers to use other AFS products."[59] Our research builds on that finding, revealing that the vast majority of would-be borrowers do not even substitute a new method (using the Internet instead of a storefront) to obtain the same AFS product, which in this case is a payday loan.[60]

Payday Lending Regulation Not Driving Increase in Borrower Complaints

Another issue that state legislators and regulators have considered is whether payday lending restrictions could be driving an increase in borrower complaints.[61]

Consumer advocates also have been concerned that an increase in complaints may be driven by online lenders.[62] Given that online borrowing is nearly as prevalent in Permissive states (1.08 percent) as in Restrictive ones (1.21 percent), the rate of complaints increasing more in one type of state than another seems unlikely.

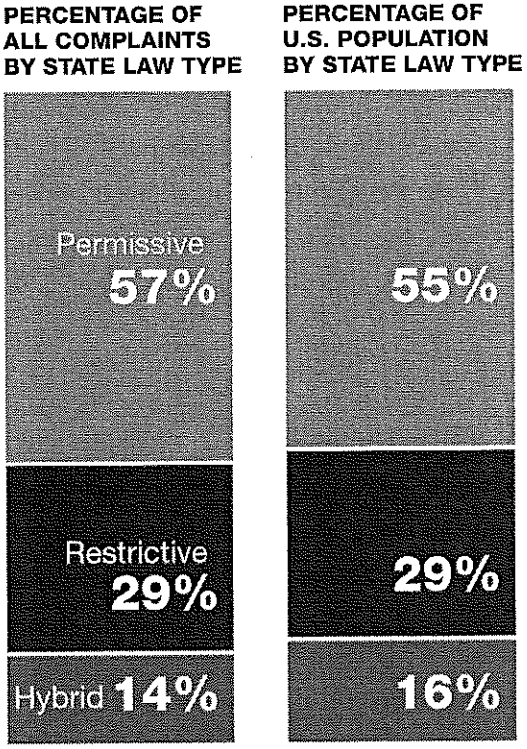
The Better Business Bureau reports that complaints against payday lenders are on the rise.[63] While online borrowing generally may indeed be driving this increase, there is no indication that the increase is attributable to efforts to regulate storefront payday lending. As shown in Exhibit 11, Pew's analysis of the complaints received by the Better Business Bureau in 2011 finds state regulations are not driving complaints against payday lenders. Twenty-nine percent of all complaints against payday lenders were filed by residents of Restrictive states, identical to the 29 percent of Americans who live in those states. Similarly, 55 percent of Americans live in Permissive states, and they filed 57 percent of complaints against payday lenders. Sixteen percent of the population lives in Hybrid states, and they filed 14 percent of payday lending complaints.

More evidence that complaints are not driven by consumer protections

EXHIBIT 11:

STATE LAWS ARE NOT DRIVING PAYDAY LOAN COMPLAINTS

The percentage of complaints against payday lenders received by the Better Business Bureau in each state law grouping closely mirrors the percentage of the population living in those states, suggesting that regulation is not driving complaints.



NOTE: Complaints are those received by the Better Business Bureau about payday lenders in 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; Better Business Bureau.

comes from Washington State, where complaints have been increasing, but the increase does not coincide with the recent change from a Permissive to a Hybrid regulatory model. Complaints increased 76 percent from 2008 to 2009, when there was no change in the law, and 50 percent from 2009 to 2010, when a change in the law took place.[64] Similarly, data Pew collected from state regulators show that from 2009 to 2011, Arkansas (Restrictive) had a 128 percent increase in complaints, Maine (Hybrid) had a 52 percent increase, and Missouri (Permissive) had a 107 percent increase.[65]

FORMER BORROWERS SPEAK ABOUT THE CHOICE BETWEEN STOREFRONT AND ONLINE

During a focus group in New Hampshire, former storefront payday loan borrowers dismissed the online option:

"I won't leave my information there."

"There's no face-to-face contact ... [I]f my identity was to be stolen, well who stole it?"

"It's too risky, in my opinion."

"With the identity theft the way it is ... who's going to see it?"

"I'm not going to put [my] information out there."

Another former borrower noted that she had used online payday loans in New Hampshire when storefronts were still present, in order to pay off her storefront payday loans:

"I had to come up with money [when] my husband was out of work, and I actually was up to $900 [in storefront payday loan debt] ... My entire check was gone the next two weeks, so that's when I went to the online ones ... And then after I did the online ones, and got in that loop, and got stuck in there, I went back to the store again, and, yeah, it got bad. And my [checking] account ended up pretty negative. I had to close it out totally."

NOTE: The focus group comprised only those people who had taken payday loans from storefronts before a recent New Hampshire law eliminated storefront payday lending.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

WHERE DO BORROWERS GET PAYDAY LOANS?

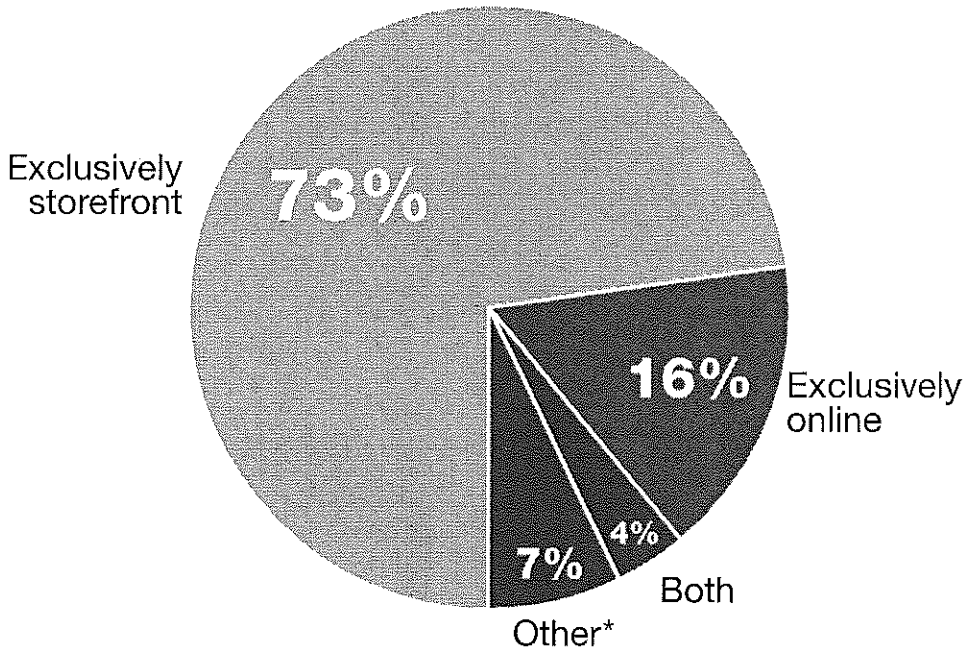
Pew's survey shows that retail storefronts are the exclusive source of payday loans for nearly three out of every four borrowers, while only one in six borrowers reports having used online providers exclusively (see Exhibit 12). About one in 10 borrowers has used both storefront and online providers or other types of providers, which may include banks or employers.[66]

While the overwhelming majority of borrowers use storefronts to get payday loans, certain groups are more likely than others to use online lenders (see Exhibit 13). Those who most often go online for loans tend to be younger, have incomes above $50,000, and have a college degree (for example, 41 percent of payday loan borrowers with a college degree used online lenders, and 66 percent used storefront lenders). These are the groups that use the Internet at higher rates generally throughout the population.[67]

The groups that are heavily skewed toward storefront borrowing are older, do not have a college degree, and have incomes below $50,000. White borrowers are especially likely to borrow from storefront lenders, as are disabled borrowers.

EXHIBIT 12:

HOW PEOPLE OBTAIN PAYDAY LOANS



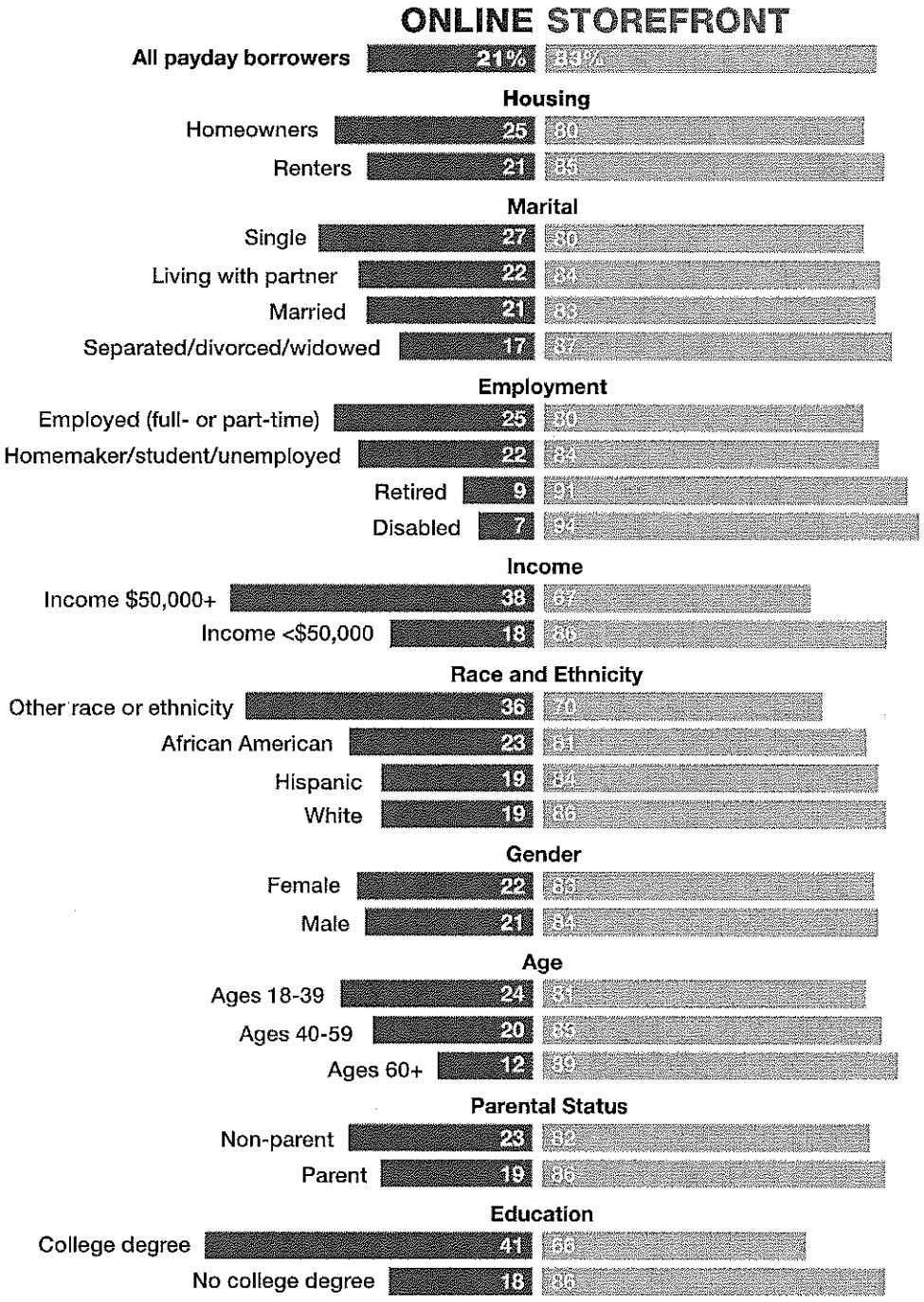
NOTES: In absolute terms, 4.0 percent of all survey respondents have used payday loans exclusively from storefronts, 0.9 percent have used payday loans exclusively from the Internet, 0.2 percent have used payday loans from both storefront locations and the Internet, and 0.4 percent of respondents have used payday loans that were neither storefront-based nor Internet-based. *Other sources may include banks, credit unions, or employers, among others.

Data represent percentage of payday borrowers who have used this type of provider in the past five years. Results are based on 33,576 interviews conducted from August 2011 through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

EXHIBIT 13:

METHOD OF ACQUIRING PAYDAY LOANS BY BORROWER DEMOGRAPHIC GROUP



NOTES: Numbers add to greater than 100 percent because of borrowers who have borrowed both from a storefront and online; they are counted in both columns and exist in greater numbers in some subgroups. The 7 percent of borrowers who have taken a payday loan from another source, such as a bank or employer, are excluded from this section, as are the 1 percent of borrowers who declined to state which method of borrowing they utilized. Results represent the percentage of payday loan borrowers in each category who report having used the specified type of payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Conclusion

Payday loans are marketed as short-term credit products intended for emergency use, and they usually are depicted as a fix for an unexpected expense. However, Pew's first-of-its-kind survey reveals that seven in 10 borrowers use payday loans to deal with recurring expenses, while only one in six uses the loans for unexpected emergencies. Pew's analysis shows that the vast majority of borrowers use the loans on a long-term basis, not a temporary one. Thus it seems that the payday loan industry is selling a product that few people use as designed and that imposes debt that is consistently more costly and longer lasting than advertised. This circumstance is especially troubling because the conventional payday loan business model fundamentally relies on repeat usage—often, renewals by borrowers who are unable to repay the full loan amount upon their next payday—for its profitability.

Pew's research shows that certain demographic groups are more likely to use payday loans, including those without a four-year college degree; African Americans; those who rent rather than own a home; people earning below $40,000 annually; and those who are separated or divorced. However, it also clearly demonstrates that the payday loan is a product that crosses lines of gender, race and ethnicity, income, and education, touching most segments of society.

These findings raise serious concerns about payday lending, including whether a two-week product with an APR typically around 400 percent is a viable solution for people dealing with a chronic cash shortage.

To date, payday loans have been regulated primarily at the state level. Pew's findings show that states that have chosen to implement statutory controls on these products have been successful in realizing policy makers' goal of curbing payday lending, with 95 out of 100 would-be borrowers electing not to use payday loans rather than going online or finding payday loans elsewhere. These findings are particularly important as policy makers discuss what happens to payday borrowers when storefront lenders are not present because of regulatory action.

Moving forward, the recently created Consumer Financial Protection Bureau has the authority to regulate the payday loan market at the federal level. With this ongoing series, *Payday Lending in America*, and other research, Pew will present in-depth findings to help identify the features of a safe and transparent marketplace for such consumer financial services, to inform efforts to protect consumers from harmful practices, and to promote safe and transparent small-dollar credit.

Methodology: Opinion Research

Findings in this report are based on a screening survey to measure incidence and identify payday loan borrowers, a full-length survey of people who answered that they had used a storefront payday loan in the past five years, and a series of 10 focus groups with small-loan borrowers, as described below.

Survey Methodology

Social Science Research Solutions (SSRS) Omnibus Survey

The Pew Safe Small-Dollar Loans Research Project contracted with SSRS to conduct the first-ever nationally representative in-depth telephone survey with payday loan borrowers about their loan usage. To identify and survey a low-incidence population such as payday loan borrowers, SSRS screened 1,000 to 2,000 adults per week on its regular omnibus survey, using random-digit-dialing (RDD) methodology, from August 2011 to April 2012. The term "omnibus" refers to a survey that includes questions on a variety of topics. This survey likely minimized payday loan borrowers' denying their usage of this product, because the omnibus survey included mostly non-financial questions purchased by other clients, and the payday loan questions were asked after other, less sensitive questions, giving interviewers a chance to establish a rapport with respondents.

If during the months of August through mid-December, respondents answered that they had used a payday loan, they were placed in a file to be recontacted later. Once the full-length survey was ready to field, in order to maximize participation, people who had used a payday loan were then given the full-length survey and paid an incentive of $20 for participating. Because of their relative scarcity, online payday loan borrowers were given an incentive of $35 for participating. Respondents were told about the compensation only after having indicated that they had used a payday loan. Further, online payday loan borrowers identified during the early months of screening were sent a letter with a five-dollar bill informing them that they would be recontacted to take the full-length survey. The second phase of the research involved recontacting all respondents who answered that they had used a payday loan, and immediately giving the full-length survey to anyone newly identified in the weekly omnibus survey as a payday loan borrower.

Sample and Interviewing

In the first phase of the survey, The Pew Safe Small-Dollar Loans Research Project purchased time on Social Science Research Solutions' omnibus survey, *EXCEL*, that covers the continental United States. Analysis of the incidence was conducted after 33,576 adults had been screened and answered a question about payday loan usage.

Sampling error for the omnibus survey of borrowers is +/- 0.24 percentage points. In the second phase, another 16,108 adults were screened in order to find a sufficient number of storefront payday loan, online payday loans, and auto title loan borrowers to complete a 20-minute survey about their usage and views. A total of 451 adults completed the full-length storefront payday loan survey, and two questions from that survey were included in this publication. Sampling error for the full-length survey of storefront payday loan borrowers is +/- 4.6 percentage points. In total, 49,684 adults were screened to complete the research.

EXCEL is a national weekly, dual-frame bilingual telephone survey. Each *EXCEL* survey consists of a minimum of 1,000 interviews, of which 300 interviews are completed with respondents on their cell phones and at least 30 are conducted in Spanish, ensuring unprecedented representation on an omnibus platform. Completes are representative of the U.S. population of adults 18 and older.

EXCEL uses a fully replicated, stratified, single-stage, RDD sample of telephone households, and randomly generated cell phones. Sample telephone numbers are computer-generated and loaded into online sample files accessed directly by the Computer-Assisted Telephone Interviewing (CATI) system. Within each sample household, a single respondent is randomly selected. Further details about *EXCEL* and its weighting are available at www.pewtrusts.org/small-loans.

Question Wording—Omnibus Survey

The data from the nationally representative omnibus survey of 33,576 adults are based on responses to the following questions. Wording for demographic and other questions is available at www.pewtrusts.org/small-loans.

Screening Phase (measuring incidence and compiling sample for callbacks):

- In the past five years, have you used payday loan or cash advance services, where you borrow money to be repaid out of your next paycheck?
- And was that physically through a store, or on the Internet?

Recontact Phase (calling back respondents who answered affirmatively, and identifying additional borrowers to take the full-length survey immediately):

- In the past five years, have you or has someone in your family used an in-person payday lending store or cash advance service?

Question Wording—Full-Length Survey of Storefront Payday Loan Borrowers

The data from the nationally representative, full-length survey of 451 storefront payday loan borrowers are based on responses to the following questions, which Pew designed with assistance from SSRS and Hart Research Associates. All other questions from this survey are being held for future release. The sample for this telephone survey was derived from the RDD omnibus survey.

Thinking back now to (that FIRST/ the) time you took out a (online payday loan/payday loan/auto title loan), which of the following best describes what specifically you needed the money for? (READ LIST. ACCEPT ONE RESPONSE.)

(IF MORE THAN ONE, ASK:) Well, if you had to choose just one, which best describes what specifically you needed the money for?

1 To pay rent or a mortgage

2 To pay for food and groceries

3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs

4 To pay an unexpected expense, such as a car repair or emergency medical expense

5 To pay for something special, such as a vacation, entertainment, or gifts

7 (DO NOT READ) Other (SPECIFY)_____

D (DO NOT READ) Don't know

R (DO NOT READ) Refused

I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash and short-term loans of any kind no longer existed. How about (INSERT)?

a. Borrow from family or friends

b. Borrow from your employer

c. Sell or pawn personal possessions

d. Delay paying some bills

e. Cut back on expenses such as food and clothing

f. Take out a loan from a bank or credit union

g. Use a credit card

Would you use this option or not?

1 Yes, would use

2 No, would not use

D (DO NOT READ) Don't know

R (DO NOT READ) Refused

Focus Group Methodology

On behalf of the Safe Small-Dollar Loans Research Project, Hart Research Associates and Public Opinion Strategies conducted eight two-hour focus groups, with two groups per location in New York City, New York; Chicago, Illinois; Birmingham, Alabama; and Manchester, New Hampshire. Those groups were conducted during weekday evenings from September 7, 2011 through September 19, 2011. The Safe Small-Dollar Loans Research Project conducted two additional groups in San Francisco, California, on November 16, 2011. All quotations come from these 10 focus groups.

EXHIBIT 14:

PAYDAY LOAN BORROWER DEMOGRAPHIC SNAPSHOT

Demographic	Percentage of All Payday Borrowers	Percentage of All American Adults
Renters	58	35
Homeowners	41	65
Single	24	31
Living with partner	14	N/A*
Married	33	50
Separated/divorced	25	13
Widowed	4	6
Full-time employed	49	59**
Part-time employed	13	
Unemployed	14	6
Disabled	8	N/A*
Retired	8	23
Homemaker	5	6
Student	3	5
Income <$15,000	25	13
Income $15,000 to under $25,000	24	11
Income $25,000 to under $30,000	11	
Income $30,000 to under $40,000	13	25**
Income $40,000 to under $50,000	8	
Income $50,000 to under $75,000	10	19
Income $75,000 to under $100,000	5	12
Income $100,000+	1	21
White (non-Hispanic)	55	64
African American (non-Hispanic)	23	12
Hispanic	14	16
Other race/ethnicity	6	8
Ages 18-24	12	13
Ages 25-29	16	9
Ages 30-34	12	9
Ages 35-39	11	9
Ages 40-44	13	9
Ages 45-49	11	10
Ages 50-54	10	10
Ages 55-59	5	8
Ages 60-64	5	7
Ages 65-69	3	5
Ages 70+	3	12
Parent	38	30
Non-parent	62	70
<High school	16	15
High school	38	29
Some college	31	30
College	11	16
Postgrad	3	9
Male	48	49
Female	52	51

This table describes the demographic characteristics of payday loan users overall, based on responses to Pew's survey. For example, 58 percent of all payday loan users rent (as opposed to own) their homes. For more on the survey, see the Methodology.

NOTES: All payday borrower data come from payday borrowers identified through 33,576 interviews conducted from August through December 2011 on behalf of Pew's Safe Small-Dollar Loans Research Project.

All comparative data except for employment status come from the Census Bureau's 2010 Decennial Census, the 2006–2010 American Community Survey 5-Year Estimates, and the 2008–2010 American Community Survey 3-Year Estimates. Employment status data come from a three-month average (March, April, and May 2012) of the NBC News/*Wall Street Journal* Survey, a nationally representative monthly telephone survey.

Data may not equal 100 percent due to rounding or because respondents declined to answer.

Marital status is based on residents 15 years of age and older. Educational attainment is based on adults 25 to 64 years of age. Other data, including Pew's survey data, represent adults 18 years of age and older.

*N/A Certain data were unavailable and/or are not comparable to Pew's survey.

**The Census uses slightly different income and employment categories in its survey.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; U.S. Census Bureau; NBC News/*Wall Street Journal* Survey.

Modeling the Likelihood of Borrowing by Demographics

To test the relationship between specific demographics and payday loan usage, Pew developed a statistical model to analyze the predictive strength of each demographic while holding all others constant. For example, the model tests whether there is a strong relationship between renting a home and borrowing a payday loan, regardless of a borrower's other characteristics such as income. The following eight demographics were examined and compared with those people who were not in the selected category (e.g., those who have annual household incomes below $40,000 are compared with those who have annual household incomes of $40,000 or higher).

- Ages 25 to 34
- Annual household income below $40,000
- Parents (with minor, financially dependent children)
- Some college education or less
- Renters
- African Americans
- Females
- Marital status is separated or divorced

It is important to reiterate that a limitation of our analysis is the time frame. While the survey recorded current demographics, payday loan borrowers were asked about loans they had taken out in the past five years. We are not implying any causality, and it would be incorrect to assume that certain characteristics are necessarily causing an increase in payday loan usage. Rather, the findings show strong relationships between certain characteristics and payday loan usage, many of which previous studies also have identified.[68]

In interpreting the logistic regression, the analysis focuses especially on the odds ratio, which shows the likelihood of payday loan usage based on the presence of a particular characteristic.

All relationships are significant at the 99 percent confidence level, with the exception of gender. This is not a surprising finding, as differences between males and females in Pew's initial analysis were slight and sometimes decreased when other variables were introduced. Thus, it is likely that the initial difference in usage by gender is being caused by other characteristics that correlate with gender, such as parental status or income.

Again, the baseline for payday loan usage is 5.5 percent across all adults. The figures resulting from this analysis describe only how much more likely it is that one type of person is to have used payday loans relative to another.

EXHIBIT 15:

LOGISTIC REGRESSION ANALYSIS OF LIKELIHOOD OF PAYDAY LOAN USAGE BY SELECT DEMOGRAPHICS

The percentages described in the body of the report as coming from a logistic regression model are derived from the Odds Ratio, and are calculated by subtracting 1 from the Odds Ratio. Thus, those who are Separated or Divorced, with an Odds Ratio of 2.034, are 103.4 percent more likely to have used a payday loan.

	Coefficient ß	S.E. ß	Wald's X^2	Odds Ratio
AfAm	0.717***	0.073	95.322	2.048
SepDiv	0.71***	0.072	96.729	2.034
NonCollege	0.6***	0.088	46.295	1.823
Income<$40k	0.479***	0.071	45.167	1.615
Rent	0.452***	0.066	47.118	1.572
Parent	0.352***	0.065	29.246	1.422
Age25to34	0.349***	0.071	23.786	1.417
Female	-0.122**	0.062	3.928	0.885
Constant	-3.94	0.093	1781.417	0.019

NOTE: * p<.10, ** p <.05, and *** p<.01.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Endnotes

1 David Burtzlaff and Brittny Groce. "Payday Loan Industry," (2011). Stephens Inc.

2 Marketers of payday loans routinely characterize the products as short-term solutions that are not meant to be used for long periods of time. For example, the Financial Service Centers of America (FiSCA), an industry trade group, describes a payday advance as a "short-term loan to cover expenses between paydays." "FiSCA Consumer Financial Services Factsheet," available at http://www.fisca.org/Content/NavigationMenu/ConsumerCenter/ConsumerFactSheet/CONSUMERCENTER-ConsumerFactSheet_Final_withlogo.pdf (accessed March 30, 2012).

3 Pew's research shows that the vast majority of borrowers report obtaining their loans from retail storefronts, which are non-bank, state-licensed entities that specialize in this form of lending. However, payday and similar types of loans are available online and from a growing number of banks. A small number of national and regional banks have developed small-dollar loan products that mimic or closely resemble conventional payday loans. These bank products are sometimes called "deposit advance" loans. The acting chairman of the Federal Deposit Insurance Corporation (FDIC) recently expressed "deep concern" about banks engaging in payday lending and announced an intention to investigate this trend. See FDIC letter at www.responsiblelending.org/payday-lending/policy-legislation/regulators/fdic-invests-bank-payday-lending.html.

4 In the fall of 2011, Pew contracted with research firms to hold focus groups of current and former payday loan borrowers. Participants told their stories and discussed a variety of questions related to their use of payday loans and other financial products. Deborah's story and her quotations are taken from one such focus group, which was conducted in New Hampshire (Deborah discussed experiences with storefront payday lenders that occurred prior to 2009, when New Hampshire enacted a 36 percent annual interest rate cap that effectively eliminated storefront payday lending in that state). "Deborah" is not the borrower's real name. We have used a pseudonym to protect the participant's privacy, but all other details are unaltered.

5 In 2011, the average payday loan at the nation's largest payday lender—Advance America—was $375, based on its annual report. Industry analyst Stephens Inc. uses Advance America as a proxy for the payday lending industry. Stephens Inc., "Payday Loan Industry," (2011).

6 Fees from online lenders often are higher, averaging $25 per $100 borrowed per two weeks, or 652 percent APR. Consumer Federation of America, "CFA Survey of Online Payday Loan Websites," (2011). See www.pewtrusts.org/small-loans for more information on state payday lending laws.

7 Although payday loans are not a new form of credit, the modern payday lending industry arose in the 1990s when a number of states modified their consumer lending laws, enacting special exceptions to interest rate caps and other laws that had traditionally regulated credit. See www.pewtrusts.org/small-loans for more information on the history of payday lending laws.

8 This calculation is based on a borrower using eight loans (the average number used annually according to state reports) for 18.2 days (the average duration of a payday loan, according to Advance America's annual (10-K) report). Multiplying these figures indicates an average of 146 days of indebtedness per year.

9 Leslie Parrish and Uriah King, "Phantom Demand," (Center for Responsible Lending, June 2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

10 Oklahoma probably is not an outlier, as the average number of loans used by borrowers in Oklahoma per year (8.7) is similar to the average from other states, based on state reports. Calculations use data in "Oklahoma Trends in Deferred Deposit Lending, 2010," www.ok.gov/okdocc/documents/2010_10_OK%20Trends_Final_Draft.pdf.

11 Payday and similar types of loans are available online and from a growing number of banks; however, Pew's research shows that the vast majority of borrowers report obtaining their loans from retail storefronts, which are non-bank, state-licensed entities that specialize in this form of lending.

12 A study funded by the payday lending industry found that 78 percent of borrowers take out five or more payday loans each year; Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," *Financial Services Research Program Monograph* No. 41, (George Washington University, 2009). Another study by consumer advocacy group Center for Responsible Lending found that Oklahoma borrowers who use payday loans take out an average of nine loans in their first year of borrowing; Uriah King and Leslie Parrish, "Payday Loans, Inc.: Short on Credit, Long on Debt," (Center for Responsible Lending, 2011). See also: "Report on the Business of Providing Deferred Presentment Service Transactions in Michigan," (2007), www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf; and "Florida Trends in Deferred Presentment," (2010), www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf.

13 Robert DeYoung and Ronnie J. Phillips. "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

14 Stephens Inc., "Payday Loan Industry," (2011).

15 Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly* (2003), www.ccc.unc.edu/abstracts/0203_Payday.php.

16 Our 5.5 percent payday loan usage number closely mirrors the 5 percent number found by the FINRA Foundation in their telephone survey conducted in 2009; Applied Research and Consulting, "Financial Capability in the United States," prepared for the FINRA Investor Education Foundation, (2009). It is somewhat higher than the 3.5 percent of households who reported ever having used payday loans in the 2009 FDIC supplement to the Current Population Survey; "Addendum to the 2009 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services," (2010), www.fdic.gov/householdsurvey/AFS_Addendum.pdf). The number also is higher than the 3.9 percent of households who reported having used a payday loan in the past year in the Federal Reserve Board's Survey of Consumer Finances, although that survey asked just about the past year, whereas our survey asked about the past five years; www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf. Earlier research has found and discussed evidence of known payday loan borrowers denying their usage of these loans in survey research: Gregory Elliehausen and Edward Lawrence, "Payday Advance Credit In America: An Analysis Of Customer Demand," (Monograph #35, 2001); Dean Karlan and Jonathan Zinman, "Lying About Borrowing," *Journal of the European Economic Association Papers and Proceedings* (2007); and Applied Management & Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008). To minimize underreporting in this survey, borrowers were asked about payday loan usage as part of an omnibus poll that covered mostly non-financial topics. In addition, the questions about payday loans were asked well into the survey, giving the interviewer a chance to establish a rapport with respondents before asking about this relatively sensitive issue.

17 The margin of error for payday loan usage in the omnibus survey is +/-0.2 percentage points. Margins of error for subgroups are included on our website at www.pewtrusts.org/small-loans.

18 We calculate the number of unique payday loan borrowers in 2010 using three different methods that all point toward roughly 12 million people having used payday loans that year. Based on our survey data, 18 percent of traditional payday loan borrowers (storefront or online, not other sources such as employers or banks) are borrowing exclusively online. All of these calculations refer to storefront data and then treat that population as 82 percent of the universe of payday loan borrowers, adding in the online-only borrowers afterwards. All of these calculations also utilize the Stephens estimate that there were 19,700 payday lending stores in the U.S. in 2010. Numbers have been rounded to avoid giving the impression that these calculations are precise, because they all involve reliance on data that are either incomplete or from a handful of states. Thus, each of these calculations is likely flawed because of data limitations, but the results cluster around, and average, 12 million borrowers.

Method 1: *Estimating transactions per store, multiplying by the number of stores, and dividing by the number of loans per borrower.*

We used the data from the 2010 published state payday loan reports that include number of transactions and number of storefronts: California, Florida, Oklahoma, and Washington. States that had reports from previous years but not reports based on 2010 data were reviewed but not included, such as Illinois, Michigan, North Dakota, and Virginia. Dividing the number of payday loan transactions by the number of payday loan stores yields 4,236 payday loans per store in 2010. Multiplying that figure by 19,700 yields 83.4 million loans. Dividing this figure by the eight loans per borrower figure, which is the average in the state reports, implies just over 10.4 million borrowers. Adding back in the 18 percent of borrowers who are borrowing only online adds to roughly 12.7 million.

Method 2: *Using the state reports to record or derive the number of unique borrowers in each state, and dividing by the number of stores in those states to create a borrowers per store ratio.* This calculation, based on the three states with published 2010 data on unique borrowers (Florida, Oklahoma, and Washington), yields a figure of approximately 486 unique borrowers per store. We then multiply that ratio by the number of stores in the country to reach roughly 9.6 million. Adding back in the 18 percent of borrowers who are borrowing only online adds to roughly 11.7 million.

Method 3: *Recording the number of unique borrowers in the reported states, dividing that figure by the adult population to determine a usage rate, and then multiplying that figure by the population in all of the states where payday loans are allowed.* Using this method gives us a usage rate of 4.8 percent in the states that publish detailed reports. Seventy-one percent of the population lives in states that have payday loan stores, while 29 percent do not. We multiply the 4.8 percent by the 163 million adults who live in states with stores, and then multiply the other 66 million adults by 1.2 percent, because our survey data show that storefront usage in restrictive states is one-fourth the level that it is in other states. This calculation suggests 8.7 million storefront borrowers, somewhat lower than the other methods. One reason for this disparity may be that most of the highest-usage states do not publish reports, so the 4.8 percent usage figure we derived may be slightly lower than the true usage figure in nonrestrictive states. Adding back in the 18 percent of borrowers who are only online would yield an estimate of 10.6 million borrowers per year.

19 This figure of 12 million borrowers is lower than some earlier estimates of payday loan usage, which may be partially explained by the fact that payday lenders have left some states because of regulations, and by high unemployment (given that a regular income stream is a prerequisite for obtaining a payday loan). Social insurance programs for individuals out of work also may provide an income stream on which a payday loan can be secured. Nonetheless, the high rate of unemployment in recent years and particularly the unprecedented rates of the unemployed who have been out of work for an extended period of time likely have a dampening effect on overall payday loan usage. The estimate of 12 million borrowers refers only to those using payday loans from storefronts or the Internet, not those using payday loans from banks, employers, or other sources.

20 Amanda Logan and Christian E. Weller, "Who Borrows from Payday Lenders?" (2009); Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," *Financial Services Research Program,* Monograph #41. (2009).

21 This figure is the average number of loans used based on the 2010 state reports from Florida, Oklahoma, and Washington. It also is consistent with data released by other states that either lack a database or did not publish a 2010 report, such as Michigan's 2007 data, Virginia's 2008 data, and California's data from 2006-2010.

22 "Florida Trends in Deferred Presentment," Program Status Report, (May 2010), www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf.

23 In 2011, the average payday loan at the nation's largest payday lender—Advance America—was $375, based on its annual (10-K) report. Industry analyst Stephens Inc., uses Advance America as a proxy for the payday lending industry. Stephens Inc. "Payday Loan Industry," (2011).

24 This figure is based on using the average loan size ($375 in Advance America's 2011 Annual Report), the average number of times (eight—based on data in state reports) in a year. Three quarters of these are storefront loans, charging an average of $55 per loan, based on the average fee disclosed in Advance America's 2011 Annual Report, and similar fees in the other publicly traded lenders' annual reports. Roughly one-quarter are online loans, charging an average of $95 for an equivalent loan, based on the rates cited by industry analyst Stephens Inc., in its 2011 report. Six fees of $55 and two fees of $95 yield our estimate of $520 spent by each borrower. If all eight loans came from a storefront, this figure would be $440, while if all eight loans were obtained online, the figure would rise to $760. These calculations assume the borrower does not incur any extra fees. The Center for Responsible Lending has made similar calculations in its publications, finding that a typical borrower pays back $793 on a $325 loan, spending $468 on interest. This calculation was based on storefront lending and was made before online lending had expanded to its present level with higher interest rates charged. See Uriah King, Leslie Parrish, and Ozlem Tanik. "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year," (November 2006), http://www.responsiblelending.org/payday-lending/research-analysis/financial-quicksand-payday-lending-sinks-borrowers-in-debt-with-4-2-billion-in-predatory-fees-every-year.html.

25 Robert DeYoung and Ronnie J. Phillips, "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

26 Previous surveys also have found that a substantial percentage of borrowers use payday loans to cover regular household expenses and other nonemergency needs. A 2007 study conducted for the California Department of Corporations reports that half of borrowers (50.2 percent) selected "pay other bills" as their reason for using a payday loan (an additional 22.3 percent selected "groceries/necessary household goods"). The "pay other bills" category is separate from groceries/necessary household goods, emergency situations, car repairs, and medical services. While categories differ slightly between each survey, both surveys separate regular expenses from food/groceries, emergencies, car repairs, and other, therefore providing a comparable benchmark for usage; Applied Management Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008), www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf. Also, the Federal Reserve's 2010 Survey of Consumer Finances (SCF), which asks about the most recent payday loan, found 42.4 percent of borrowers indicated it was for an emergency "and similar urgent needs or a lack of other options." The difference in overall incidence (3.9 percent payday usage in the 2010 survey) between Pew's results and results from the SCF may be explained by differences in time period queried (five-year versus one-year time span). The large difference in reason for usage in the "emergency" category is likely a result of survey wording, or including "a lack of other options" in the SCF question, which makes its emergency category far broader. Pew's survey question was seeking to capture something different than the SCF, to ascertain the purpose of the loan ("emergency"), without attempting to combine that with why the borrower chose a payday loan provider ("lack of other options"). A borrower may have both a regular

expense and a lack of other options, or an emergency expense but multiple options, so we did not seek to pair the reason for a loan with the reason for choosing a payday loan provider. SCF data are available at http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf.

27 The industry's largest trade association, Community Financial Services Association of America (CFSA), as well as many payday loan companies, note on their websites and in advertisements that payday loans are an expensive form of credit and intended for short-term or emergency use, and not as long-term solutions. For examples, see websites for CFSA (http://cfsaa.com), QC Holdings (www.QCholdings.com), and Cash America (www.cashamerica.com/loanoptions/cashadvances.aspx). See also: Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit in America: An Analysis of Customer Demand," (April 2001), 37, 40; and Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," (January 2009). "While payday loans might rarely if ever make sense for financing household investment directly, payday loans may provide rationed borrowers with a source of emergency funds that allows greater levels of debt-financed investment," as quoted from www.cfsaa.com/portals/0/RelatedContent/Attachments/GWUAnalysis_01-2009.pdf.

28 See endnote 12.

29 Parrish and King, "Phantom Demand," (2009).

30 The exact figure is 18.2 days, and comes from the 2011 Annual Report (10-K) filed with the Securities and Exchange Commission by the largest storefront payday lender, Advance America.

31 For example, the website of Check Into Cash, one of the largest payday lenders, notes that a payday loan "is not intended to be used as a long-term budget solution." Available at: http://checkintocash.com/faq/how-often-do-most-people-use-cash-advance-services/.

32 The industry's largest trade association, Community Financial Services Association of America (CFSA), provides a detailed overview of the industry and product on its website (http://cfsaa.com).

33 Quoted from Advance America direct mail piece "Your Line's Slowed. Your Bills Haven't," (2011).

34 Quoted from QC Holdings website, www.QCholdings.com.

35 These estimates vary somewhat based on the law, and especially the minimum loan term, in the state analyzed, but the most detailed analysis is the Center for Responsible Lending's finding of 212 days of indebtedness for Oklahoma borrowers in *Payday Loans, Inc.*

36 Robert DeYoung and Ronnie J. Phillips, "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

37 James A. Ovenden, "Quarterly Earnings Call, Advance America," Q2, (2011), http://seekingalpha.com/article/283283-advance-america-cash-advance-centers-ceo-discusses-q2-2011-results-earnings-call-transcript.

38 Stephens Inc., "Payday Loan Industry," (2011).

39 Community Financial Services Association of America (CFSA) Member Best Practices, http://cfsaa.com/cfsa-member-best-practices.aspx.

40 California Department of Corporations "Table 7: Amount of Referral Bonus Offered," www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf.

41 Information from CashNetUSA website, www.cashnetusa.com/rewards.html.

42 UNC Center for Community Capital, "North Carolina Consumers After Payday Lending," (2007), www.ccc.unc.edu/documents/NC_After_Payday.pdf.

43 Applied Management & Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008), www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf.

44 Texas Appleseed, "Short-term Cash, Long-term Debt: The Impact of Unregulated Lending in Texas," (2009), www.appleseednetwork.org/Portals/0/Documents/Publications/Center%20Pubs/TX%20Payday%20Lending.pdf.

45 Missouri Division of Finance. "Report to General Assembly on Survey of Payday Lenders," (2011), http://finance.mo.gov/consumercredit/documents/2011PaydayLenderSurvey.pdf.

46 Subsequent to passing legislation authorizing payday lending, Arizona, Arkansas, the District of Columbia, Georgia, Montana, North Carolina, and New Hampshire reimposed double-digit usury caps on deferred presentment transactions, allowed the authorizing legislation to expire, or prohibited the transaction. Colorado, Florida, Maine, Minnesota, Oregon, Rhode Island, Virginia, and Washington have lowered permissible loan fees while retaining triple-digit annual percentage rates, implemented structural requirements to permit borrowers multiple pay periods to repay their loans, or limited to the single digits the number of payday loans per borrower per year. Ohio passed legislation and also passed a ballot initiative restricting interest on payday loans to 28 percent APR, but payday lending has continued with effective loan terms and APRs that often are similar to those before the law change.

47 Stephens Inc., "Payday Loan Industry," (2011).

48 Steven Graves and Christopher Peterson, "Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation," *Catholic University Law Review*, Vol. 57, 2008: 637.

49 Robert B. Avery and Katherine A. Samolyk, "Payday Loans versus Pawn Shops: The Effects of Loan Fee Limits on Household Use," (preliminary draft, 2011).

50 For example, "House Mulls Reviving Payday Loans," *New Hampshire Business Review*, www.nhbr.com/businessnewsstatenews/935663-257/house-panel-mulls-reviving-payday-loans.html.

51 Consumer Federation of America, "CFA Survey of Online Payday Loan Websites," (2011).

52 "Analysis: U.S. Payday Lenders Point Fingers to Blunt Crackdown," *Reuters*, (January 20, 2012), www.reuters.com/article/2012/01/20/us-financial-regulation-payday-idUSTRE80I04R20120120.

53 This section includes results reported to two decimal places, but this reporting is not intended to suggest a greater level of precision. Rather, two decimal places are used in order to avoid inaccurate calculations between groupings that could be caused by rounding to one decimal place or the nearest integer. Even with these large sample sizes, there is a degree of sampling error. It is possible, therefore, that the actual number of would-be storefront borrowers who are going online is slightly lower or higher, because the results reported are based on survey research, and thus have a margin of error. These figures are fairly consistent with estimates from Stephens Inc., that roughly one-quarter of payday loan volume is online. Our survey data suggest just under one-quarter of traditional (storefront or online, but not "other") payday loan borrowers have borrowed online. Note that the 7 percent "other" finding may include products from banks or employers but should not be taken as a general estimate of bank payday or "deposit advance" lending.

54 This finding that storefront payday borrowing is lower in Restrictive states is consistent with prior research. Examples include: Applied Research & Consulting, "Financial Capability in the United States," (2009); and "Addendum to the 2009 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services," (2010), www.fdic.gov/householdsurvey/AFS_Addendum.pdf.

55 These figures are based on our analysis of state-by-state storefront data from Graves and Peterson, "Usury Law and the Christian Right," (2008). Peterson and Graves' data were used because of the level of detail, recording individual storefronts by ZIP code. The same calculations using Stephens' 2006 data yield similar results, with 10.71 storefronts per 100,000 residents in now-Restrictive states, and 11.50 storefronts per 100,000 residents in now-Permissive states, or 6.9 percent fewer. To calculate storefronts per capita, we obtained population estimates from the 2006 American Community Survey (available at www.factfinder2.census.gov). We selected 2006 because none of these states had begun to change their regulatory structure yet, and detailed data on storefronts by state were available. Restrictive states either cap payday loan interest rates at double-digit APRs or prohibit deferred presentment transactions. Permissive states either do not cap interest rates or tend to cap them at 391 percent APR or higher, and generally allow the entire loan to be due on a borrower's next payday. Alaska and Hawaii are included in this example and in all exercises that do not rely on the survey data.

56 Similarly, there is little difference in Internet access between Restrictive and Permissive states. Data from the U.S. Census Bureau's 2012 Statistical Abstract (Table 1156) show that at least 70 percent of people in every state report having Internet access. In both the average Permissive state and average Restrictive state, exactly 80 percent of residents report having Internet access either inside or outside the home. If this calculation is limited to in-home access, in the average Restrictive state 72 percent of residents have Internet access, compared with 71 percent in the average Permissive state. Data available at www.census.gov/compendia/statab/cats/information_communications/internet_publishing_and_broadcasting_and_internet_usage.html.

57 For example, the North Carolina Commissioner of Banks report using 1999 data notes more than 2.9 million payday loan transactions were made in the state, www.nccob.gov/Public/docs/News/Pub%20And%20Research/Check%20Cashers%20Report%20to%20Gen%20Assembly.pdf. Or for a discussion of payday lending in North Carolina and Georgia, including figures on stores in those states operated by major national lenders, see Donald P. Morgan and Michael R. Strain, "Payday Holiday: How Households Fare after Payday Credit Bans," (2007).

58 During the period of inquiry in our survey, the five years prior to the survey being administered, or roughly late 2006 to early 2012, 10 states implemented substantial changes to the laws regulating payday lending in their state. Five jurisdictions—Arizona, Arkansas, the District of Columbia, Montana, and New Hampshire—became newly Restrictive between January 2008 and January 2011. In Arizona, the legislation authorizing payday lending in the state expired; the other four jurisdictions implemented double-digit APR rate caps. Five additional states moved into the Hybrid category in recent years. Colorado and Virginia implemented longer minimum loan terms, among other regulations, and Rhode Island lowered the fees that may be charged for a payday loan. Washington State capped at eight the number of loans borrowers may take out each year. Oregon reduced allowable fees and now requires a 31-day minimum loan term.

59 Signe-Mary McKernan, Caroline Ratcliffe, and Daniel Kuehn. "Prohibitions, Price Caps, and Disclosures: A Look at State Policies and Alternative Financial Product Use" Urban Institute, (November 2010).

60 This publication does not present data related to the issue of whether borrowers could be substituting other forms of credit for storefront payday loans.

61 For example, "House Mulls Reviving Payday Loans," *New Hampshire Business Review*, www.nhbr.com/businessnewsstatenews/935663-257/house-panel-mulls-reviving-payday-loans.html.

62 For example, Alexandra Alper, "Complaints vs. Banks Drop, Payday Lenders Rise," *Reuters*, (March 1, 2012), www.reuters.com/article/2012/03/01/financialregulation-bbb-idUSL2E8E1FMB20120301.

63 The Better Business Bureau reports that complaints against payday lenders increased 159 percent from 2010 to 2011. Figure available at: http://tulsa.bbb.org/article/Complaints-Down-But-Huge-Jump-in-Inquiries-Means-Shoppers-Are-Doing-Their-Homework-33509.

64 "Washington State Department of Financial Institutions, 2010 Payday Lending Report," www.dfi.wa.gov/cs/pdf/2010-payday-lending-report.pdf.

65 Data obtained by Pew in telephone calls and e-mails with state regulators.

66 These figures are fairly consistent with estimates from Stephens Inc., that roughly one-quarter of payday loan volume is online. Our survey data suggest just under one-quarter of traditional (storefront or online, but not "other") payday loan borrowers have borrowed online. Note that the 7 percent "other" finding may include products from banks or employers but should not be taken as a general estimate of bank payday or "deposit advance" lending.

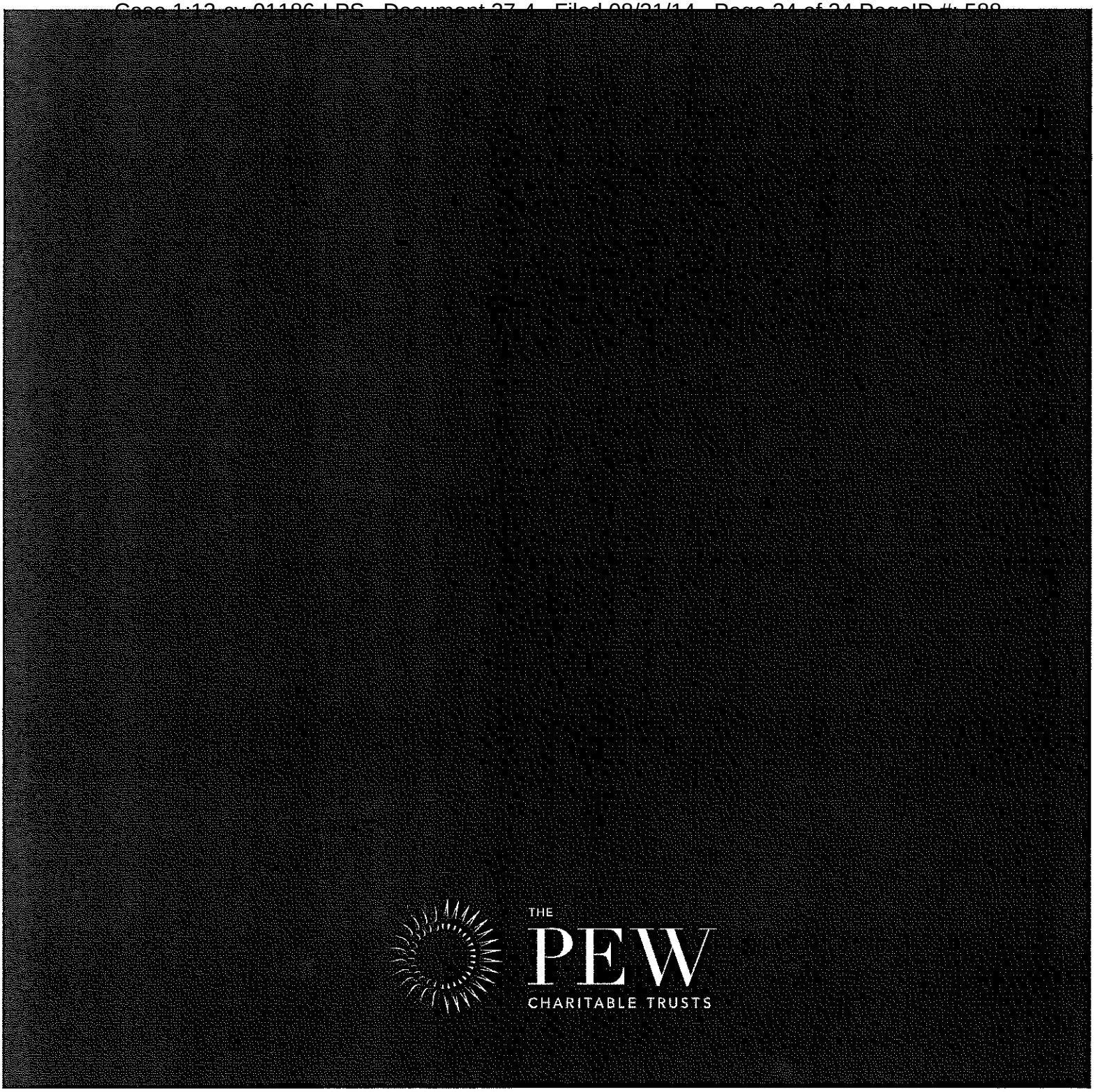
67 "Digital Differences," Pew Internet & American Life Project, (2012), www.pewinternet.org/~/media//Files/Reports/2012/PIP_Digital_differences_041312.pdf.

68 McKernan, Ratcliffe, and Kuehn. "Prohibitions, Price Caps, and Disclosures," (2010).

The Safe Small-Dollar Loans Research Project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

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Exhibit D



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PAYDAY LENDING IN AMERICA:
REPORT 2

How Borrowers Choose and Repay Payday Loans

February 2013

This is the second report in a series, *Payday Lending in America*, that presents original research findings from Pew's safe small-dollar loans research project on how to create a safe and transparent marketplace for those who borrow small sums of money.

www.pewtrusts.org/small-loans

FEBRUARY 2013

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

The safe small-dollar loans research project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

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For additional information, please visit www.pewtrusts.org/small-loans.

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Contents

Introduction 4

Key Findings of This Report 6

Summary of Findings from Report 1—Who Borrows, Where They Borrow, and Why (2012) 8

1. Payday Borrowers Routinely Struggle to Meet Expenses 9

2. Renewing Payday Loans Is Affordable, but Paying Them Off Is Not 13

3. Why People Borrow When They Can Afford Only to Renew, Not to Repay 19

4. Most Payday Borrowers Are Also Overdrafting Their Checking Accounts 32

5. Some Borrowers Use the Same Options to Repay Loans That They Could Have Used Instead of Borrowing 36

6. Borrowers Feel Relief, but They Also Feel That Payday Loans Take Advantage of Them 39

7. Payday Customers Want Changes and More Regulation but Expect to Borrow Again if Loans are Available to Them 47

Conclusion 52

Methodology 54

Endnotes 62

Introduction

Twelve million Americans take out payday loans each year when they are in difficult financial situations. As they weigh choices for addressing a cash shortfall, payday borrowers consider both formal credit and informal options, including cutting back on expenses, borrowing from family or friends, delaying bills, or selling or pawning items, as described in Pew's first payday lending report.[1] Borrowers mostly describe themselves as trying to keep up with their expenses, often by using noncredit alternatives rather than explicitly comparing credit options. They are very familiar with debt and are not eager to take on more.

In deciding whether to borrow from a payday lender, more than 3 in 4 borrowers rely on lenders to provide accurate information about the product, and lenders describe loans as "safe,"[2] "a sensible financial choice,"[3] and "the best alternative to meet their current needs"[4] for a "one-time fixed fee."[5] The product's stated two-week duration appeals to the borrower's desire for a quick cash infusion as well as the conflicting desire not to be in ongoing debt. In reality, both desires cannot be met. But a payday loan's unrealistically short repayment period suggests otherwise by enabling people in difficult situations to think that the loan can solve their problem at an affordable fixed cost so they can avoid asking for help, cutting back further, or creating another ongoing bill.

The ultimate cost and duration of the loans are highly unpredictable and bear little resemblance to their two-week packaging. Average borrowers end up indebted for five months, paying $520 in finance charges for loans averaging $375,[6] largely because they see their only choices as making a lump-sum repayment retiring their entire debt, which they cannot afford, or paying fees to continuously pay back and re-borrow the loan, which they can afford but which does not reduce what they owe. Once they have borrowed, neither choice is viable, leaving them indebted far beyond their next payday. This experience leaves borrowers torn—grateful to have received respectful customer service and credit when they sought it, but feeling taken advantage of by the loan's cost and frustrated by the difficulty of repayment.

This report, "How Borrowers Choose and Repay Payday Loans," the second in Pew's *Payday Lending in America* series, answers several important questions: If payday loans are unaffordable, why do people choose them? How can they eventually pay them back at all? And what are the consequences of using a loan that is so difficult to repay?

This report looks at individuals' decision processes to see why they borrow instead of cutting back expenses or choosing other options, and how they fare using the loans. The results indicate that the choice to use a payday loan often leaves borrowers needing to use these other alternatives to ultimately pay off the loan. Many payday borrowers find themselves overdrafting their checking accounts, indebted for the long term, or borrowing from family and friends anyway to repay their loan—options that were available to them instead of a payday loan in the first place.

The findings will demonstrate to policymakers and other readers the significant failures in the small-dollar loan marketplace, where millions of cash-strapped individuals are using payday loans that they cannot afford to repay in full by the nominal due date. Yet the loans continue to be marketed as a fixed-price, short-term solution. The Consumer Financial Protection Bureau has the authority to regulate payday lending at the federal level, along with prudential bank regulators such as the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. As these regulators are aware, some banks are also participating in the small-dollar lending market through their deposit advance loan products. At the state level, policymakers have several options. Some have chosen to eliminate payday lending stores, and these policies have been effective at reducing payday loan usage without driving an increase in online or other forms of payday lending. In other states, policymakers have sought to mitigate the potential harm of high-interest credit by capping rates below the industry average, limiting usage, or requiring that borrowers be allowed more than two weeks to repay the loan. But in a majority of states, none of these protections are in place.

Key Findings of this Report

1 Fifty-eight percent of payday loan borrowers have trouble meeting monthly expenses at least half the time. These borrowers are dealing with persistent cash shortfalls rather than temporary emergencies.

2 Only 14 percent of borrowers can afford enough out of their monthly budgets to repay an average payday loan. The average borrower can afford to pay $50 per two weeks to a payday lender—similar to the fee for renewing a typical payday or bank deposit advance loan—but only 14 percent can afford the more than $400 needed to pay off the full amount of these non-amortizing loans. These data help explain why most borrowers renew or re-borrow rather than repay their loans in full, and why administrative data show that 76 percent of loans are renewals or quick re-borrows while loan loss rates are only 3 percent.

3 The choice to use payday loans is largely driven by unrealistic expectations and by desperation. Borrowers perceive the loans to be a reasonable short-term choice but express surprise and frustration at how long it takes to pay them back. Seventy-eight percent of borrowers rely on lenders for accurate information, but the stated price tag for an average $375, two-week loan bears little resemblance to the actual cost of more than $500 over the five months of debt that the average user experiences. Desperation also influences the choice of 37 percent of borrowers who say they have been in such a difficult financial situation that they would take a payday loan on any terms offered.

4 Payday loans do not eliminate overdraft risk, and for 27 percent of borrowers, they directly cause checking account overdrafts. More than half of payday loan borrowers have overdrafted in the past year. In addition, more than a quarter report that overdrafts occurred as a result of a payday lender making a withdrawal from their account. Although payday loans are often presented as an alternative to overdrafts, most payday borrowers end up paying fees for both.

5 Forty-one percent of borrowers have needed a cash infusion to pay off a payday loan. Many of these borrowers ultimately turn to the same options they could have used instead of payday loans to finally pay off the loans, including getting help from friends or family, selling or pawning personal possessions, or taking out another type of loan. One in six has used a tax refund to eliminate payday loan debt.

6 A majority of borrowers say payday loans take advantage of them, and a majority also say they provide relief. The appreciation for urgently needed cash and friendly service conflicts with borrowers' feelings of dismay about high costs and frustration with lengthy indebtedness.

7 By almost a 3-to-1 margin, borrowers favor more regulation of payday loans. In addition, two out of three borrowers say there should be changes to how payday loans work. Despite these concerns, a majority would use the loans again. In a state where payday storefronts recently stopped operating, former borrowers are relieved that payday loans are gone and have not sought them elsewhere.

Summary of Report 1—Who Borrows, Where They Borrow, and Why (2012)

Although payday loans are characterized as a short-term solution for unexpected expenses, most borrowers use them for everyday bills. The average borrower is in debt for five months during the year, spending $520 on interest.

1 Who Uses Payday Loans? Twelve million American adults use payday loans annually. Pew's survey found that most payday loan borrowers are white, most are female, and most are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: home renters, those earning below $40,000 annually, those without a four-year college degree, those who are separated or divorced, and African Americans.

2 Why Do Borrowers Use Payday Loans? Sixty-nine percent of first-time payday borrowers used the loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food, while 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.

3 What Would Borrowers Do Without Payday Loans? If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions.

4 Does Payday Lending Regulation Affect Usage? In states that enact strong legal protections, the result is a large net decrease in payday loan usage (overall usage is 2.9 percent in the most stringently regulated states, compared with 6.6 percent in states with the least regulation). Borrowers are not driven to seek payday loans online or from other sources as a result of state regulation. In states with no stores, just 5 out of every 100 would-be borrowers choose to obtain payday loans online or from alternative sources, while 95 choose not to use them.

Report 1 findings were based largely on 33,576 interviews from an omnibus survey, 451 follow-up interviews with storefront payday loan borrowers, and state regulatory and industry data. For more information and a copy of Report 1, see www.pewtrusts.org/small-loans.

1 Payday Borrowers Routinely Struggle to Meet Expenses

"I'm like everybody else, living paycheck to paycheck, still not having enough to come through at the end."

—Online borrower, Manchester, NH

Most payday borrowers are dealing with persistent cash shortfalls. The Pew survey found that 58 percent of payday loan borrowers have trouble meeting their regular bills at least half the time, including more than one-third who say they have trouble meeting their bills most of the time. Just 1 in 7 never have trouble meeting their regular monthly bills and expenses.

These findings reinforce those of Pew's first paper in the *Payday Lending in America* series: Although payday loans are frequently described as intended for unexpected expenses, keeping up with regular bills is the primary reason that borrowers use payday loans.[7] That study found that 69 percent of storefront borrowers reported using their first payday loan to meet a recurring expense, and just 16 percent said it was for an unexpected expense. Pew's survey data specifically covering online borrowers show similar results, at 73 percent and 16 percent, respectively.

"For instance, like today is what, sixth, seventh? The rent is due on the first. I didn't pay it. I will in the next few days, but it seems like I'm always struggling to catch up in order to stay afloat."

—*Online borrower, New York*

"It seems like you never catch up, and it, it's just check-to-check, and something breaks down, and the house needs work, kids have school, just never catch up." [And how long have you felt that way?] "Twenty years."

—*Storefront borrower, Chicago*

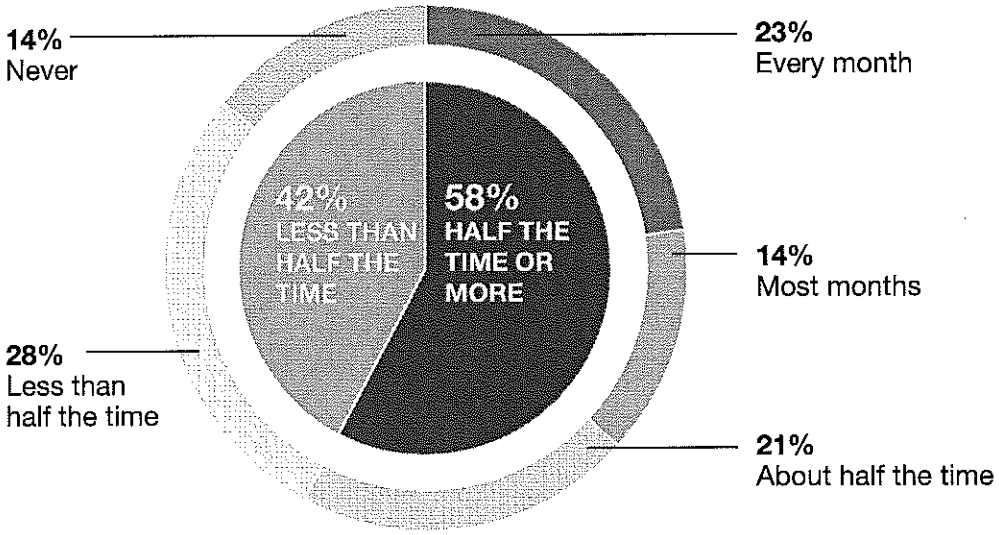
Borrowers Split on How They Rate Their Own Economic Situation

Half of payday borrowers describe their economic situation as "good," and half describe it as "bad," based largely on how often they can keep up with their bills. In focus groups, very few borrowers

EXHIBIT 1:

MAJORITY OF PAYDAY BORROWERS HAVE TROUBLE MEETING BILLS AT LEAST HALF THE TIME

FREQUENCY OF TROUBLE MEETING BILLS:



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "How often, if ever, do you have trouble meeting your regular monthly bills and expenses?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

described themselves as having savings or a financial cushion, and many felt that in their current economic situation, it was not possible to "catch up" or save for the future.

Among employed payday loan borrowers, 20 percent have multiple jobs, and in focus groups, several borrowers explained that a second job was critical to allow them to meet basic expenses. Others with one job were dependent on the income of another household member and said the loss of a second household income would leave them unable to pay regular bills. Previous research has found that 25 percent of small-dollar loan borrowers reported a loss of income, such as a job loss or reduction in hours, as a reason for a shortage of funds.[8]

"I work a couple jobs, and I have my teenagers that I put through Catholic high schools and colleges. ... And then the bills just keep coming, too, just constant bills."

—*Storefront borrower, Chicago*

"I don't want to look anybody in the eye and admit that I can't even break even."

—*Online borrower, Manchester, NH*

"My husband has been unemployed for the last two years, and it's been a struggle to make it. I hope that he gets a job any day so we don't have to be quite so tight on the budget. And my son is leaving to go into the Air Force."

—*Storefront borrower, Birmingham, AL*

"[I have a] full-time job at the sheriff's office [where] I'm taking a 20 percent pay cut, but I have a security job on the side."

—*Storefront borrower, Birmingham, AL*

"I've had a part-time job like for the last four years after my divorce, [but] the finances aren't like they were. ... I got a second job."

—*Storefront borrower, Birmingham, AL*

"[The] only light bulbs in my house are in the kitchen, the bathroom, and ... none in the bedroom. No bill in there is going to be over $100, no bill at all."

—*Storefront borrower, Chicago*

WHAT IS A BANK DEPOSIT ADVANCE LOAN?

A deposit advance loan is a payday loan for up to $500 that some banks offer to customers who have direct deposit. The structure mimics a conventional payday loan, with the entire loan plus interest due on the borrower's next payday. The cost—$7.50 to $10 per $100 per pay period, resulting in annual percentage rates (APRs) of 196 to 261 percent for a 14-day loan—is somewhat lower than that of a typical storefront loan ($10 to $20 per $100 per pay period, or 261 to 521 percent APR). The loans are secured by the customer's next direct deposit, and the bank repays itself immediately when that deposit is received. Depending on the bank, the loans may be advertised in branches, by direct mail, through email, at ATMs, or on a bank's website.

Previous research indicates that although bank deposit advances are advertised as two-week products, average customers end up indebted for nearly half the year, similar to the experience of payday loan customers borrowing from storefronts.[i] In Pew's focus groups, bank deposit advance borrowers explained that, once the bank has withdrawn the full amount plus interest, they frequently cannot meet their expenses and, like storefront and online payday borrowers, must re-borrow the loan amount.

EXHIBIT 2:

BANK DEPOSIT ADVANCE LOANS MIMIC PAYDAY LOAN MODEL

	CONVENTIONAL PAYDAY LOAN	BANK DEPOSIT ADVANCE LOAN
Advertised term	**One pay period with lump-sum repayment (about two weeks)**	**One pay period with lump-sum repayment (about two weeks)**
Amount loaned	**Usually up to $500**	**Usually up to $500**
Most common advertised price	**$15 per $100 per pay period**	**$10 per $100 per pay period**
Annualized interest rate on a 2-week loan (APR)	**391 percent**	**261 percent**
Security provided to lender	**Post-dated check or electronic debit authorization for borrower's account at third-party institution**	**Electronic debit authorization for borrower's account held by the lender**
Requirements to borrow	**Income stream, checking account**	**Income stream, checking account with direct deposit at this bank**
Borrower experience	**Average borrower indebted 5 months during year; ¾ of loans are quick re-borrows**	**Available evidence shows similar patterns as conventional payday loans**

SOURCES: "Payday Lending in America: Who Borrows, Where They Borrow, and Why." The Pew Charitable Trusts. (2012); "Big Bank Payday Loans." Center for Responsible Lending. (2011); Consumer Financial Protection Bureau."Examination Procedures: Short-Term, Small-Dollar Lending." January 19, 2012. Available at: http://files.consumerfinance.gov/f/2012/01/Short-Term-Small-Dollar-Lending-Examination-Manual.pdf; Fed. Reg. 76. 33409-33413. Guidance on Deposit-Related Consumer Credit Products. Notice by the Comptroller of the Currency, June 8, 2011; Bank-specific cost information comes from the websites of banks offering deposit advance loans. Pew's safe small-dollar loans research project, 2013.

i Center for Responsible Lending. "Big Bank Payday Loans." (2011). Available at: http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf

2 Renewing Payday Loans Is Affordable, but Paying Them Off Is Not

"If you can't pay that money back when you ... agreed to, they let you just pay the interest, and then it gets easier and easier for you to renew that loan, because you're saying, well, I need to do this with this money, and I can pay this $17.50 or $35 and go ahead on."

—Storefront borrower, Birmingham, AL

The vast majority of payday loan users are repeat borrowers who pay fees to renew or re-borrow the loans, accounting for nearly all of lender profitability.[9] Available data demonstrate the depth of this problem:

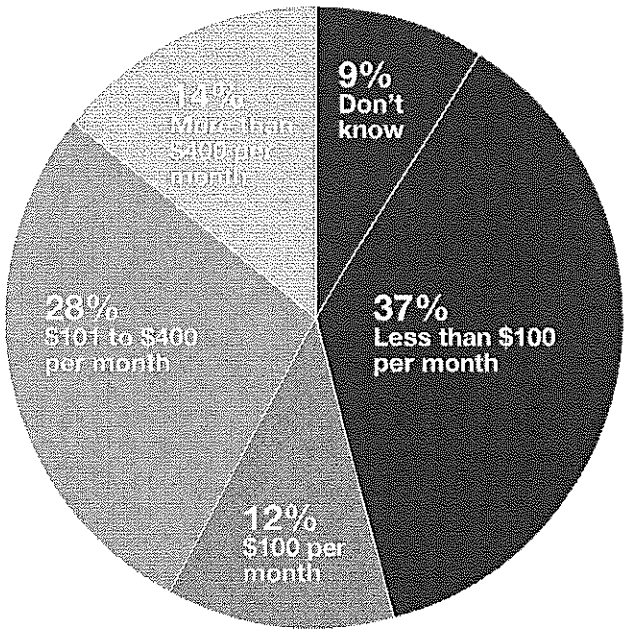
- The average payday borrower is indebted for five months during the year.[10]
- Four in five borrowers use three or more loans per year and account for 97 percent of all loans.[11]
- One in five borrowers use payday loans only once or twice per year, accounting for just 3 percent of all loans.[12] Notably, these borrowers are not profitable for lenders and are not the focus of the payday loan business model.[13]
- More than 60 percent of all loans go to people using 12 or more loans per year.[14]
- Seventy-six percent of loans are renewals or quick re-borrows.[15]

Lump-Sum Repayments Far Exceed Borrowers' Means

Pew's survey asked how much borrowers can afford to pay toward their payday loan debt and still afford their regular bills and expenses. As shown in Exhibit 3, the average borrower reported being able to pay $100 per month, or about $50 per two weeks. However, the typical borrower owes $430 ($375 plus a fee of $55) in two weeks for a storefront loan.[16] Only 14 percent of borrowers can afford enough out of their monthly budgets to pay off an

EXHIBIT 3:

AVERAGE PAYDAY BORROWER CAN AFFORD $100 PER MONTH



NOTE: Data represent percentage of payday borrowers who gave an answer that fell in this range. Respondents were asked: "How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?" All responses were volunteered and not read aloud as options to select. Results are based on 703 interviews conducted from December 2011 through April 2012.

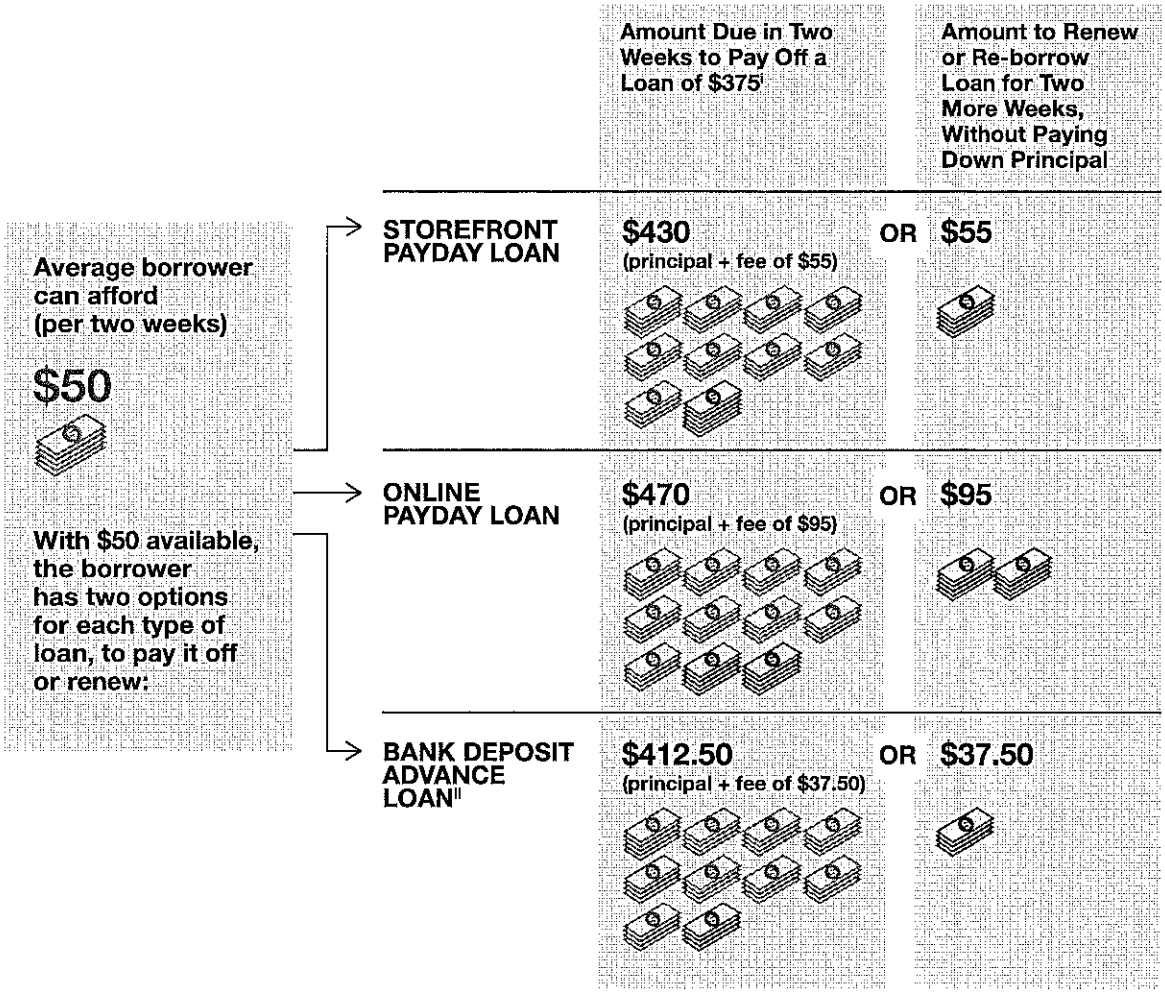
SOURCE: Pew's safe small-dollar loans research project, 2013.

average payday loan. As Exhibit 4 shows, the average borrower can barely afford just the $55 fee required to renew an average storefront loan for another two weeks.

Even among those who describe their financial situation as very or fairly good, only 15 percent can afford to pay more than $400 toward their payday loan debt in a month. Borrowers explained in focus groups that this incompatibility between the loans' required payment and their ability to pay caused them to renew or re-borrow the loans for months before they could pay them off. This finding about unaffordability helps explain why the average borrower ends up indebted for five months of the year.[17]

EXHIBIT 4:

RENEWALS ARE AFFORDABLE, REPAYMENT IS NOT



NOTE: Respondents were asked: "How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?" Results are based on 703 interviews conducted from December 2011 through April 2012.

[i] The average cost of storefront and online payday loans is discussed in Pew's first report in this series and comes from Stephens Inc. (2011).

[ii] "Big Bank Payday Loans." Center for Responsible Lending. (2011). Bank-specific cost information can also be found at https://www.usbank.com/checking/caa/index.html, https://www.wellsfargo.com/checking/direct-deposit-advance/, http://www.regions.com/personal_banking/ready_advance.rf, https://www.53.com/doc/pe/pe-eax-faq.pdf, http://www.guarantybanking.com/SiteContent/5871/final%20ea%20service%20agreement%20(gb)%207-31-10.pdf, and https://www.bankofoklahoma.com/sites/Bank-Of-Oklahoma/asset/en/theme/default/PDF/Bank%20of%20Oklahoma%20FastLoanSM%20Terms%20and%20Conditions.pdf.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It only costs me $45, but I can't live without that $255 at the same time. I've got to take out the loan again every paycheck. As much as I would just like to say, 'Here's the $300, I'm good. I don't want another loan,' I can't. Because if I do, that $255 that I don't have, what am I going to do? That's anything from like rent, other bills, food, cost of living stuff. It's difficult."

—Storefront borrower, San Francisco

"Paying $500 now, I mean, that's where the, kind of the vicious circle comes in. Now you almost have to at least get some of it back so you have enough to make it to the end of the month."

—Storefront borrower, Birmingham, AL

"I mean, to all of a sudden, 'Oh, you owe us $500. You got to pay now.' That's tough for anybody; you know what I mean? It's hard to come up with $500."

—Storefront borrower, Chicago

"Well, Friday came, you gave them your pay, what you owed them, which cleared off that loan, but now you have nothing, so you have to re-borrow to survive the week or two weeks."

—Former storefront borrower, Manchester, NH

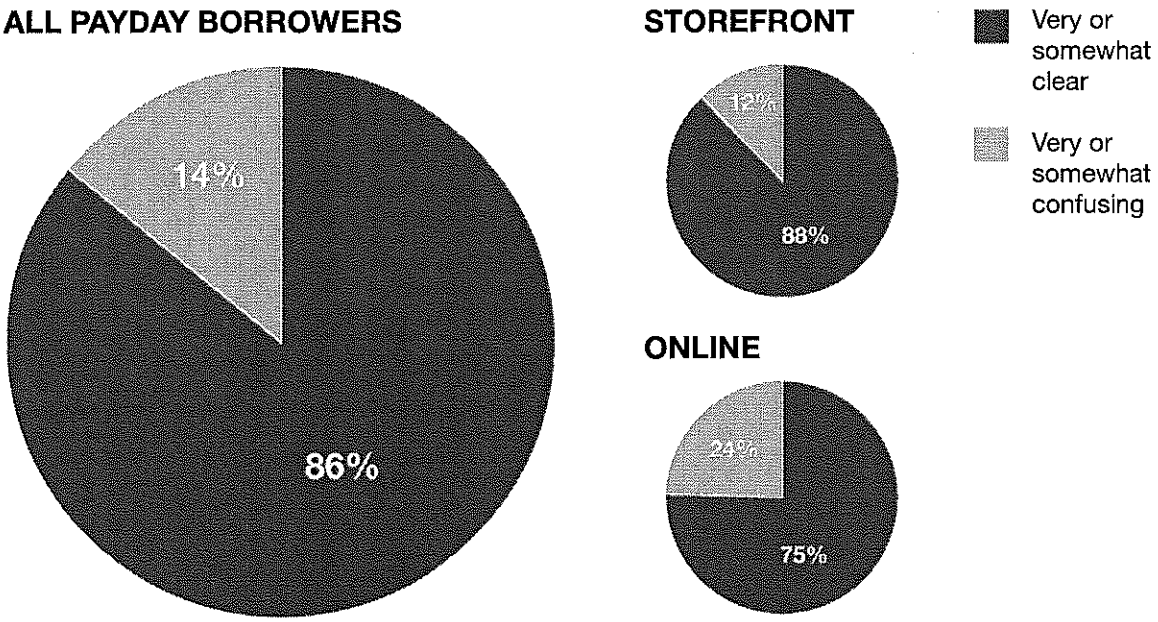
Most Borrowers Say Terms Are Clear but Still Struggle to Repay

Although most borrowers cannot afford to repay their payday loans, large numbers state that the terms and conditions were clear. Focus group participants often described the terms as unfair, usually meaning very expensive, but most said they understood what the fee was and when the loan was due, and in that way they thought the terms were clear. A significantly higher number of storefront borrowers than online borrowers thought the terms were clear.

The average storefront payday loan requires a $430 repayment in two weeks. Pew's survey found that even among those who said the loan terms were very clear, just 46 percent of borrowers could afford a repayment of more than $100 a month, and just 14 percent said they could pay more than $400 a month.

EXHIBIT 5:

SIX IN SEVEN BORROWERS SAY TERMS AND CONDITIONS ARE CLEAR



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "When you took out (that FIRST/the) (online payday loan/payday loan), would you say the terms and conditions of the loan were very clear, somewhat clear, somewhat confusing, or very confusing?" Data for online do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It's really basic. If you're taking out $300 and they're charging you $90, you pay $390. If you do not pay it back in two weeks, you're paying $90 out of your check every two weeks until you pay the full amount."

—*Online borrower, New York*

"I do agree [with other borrowers that loans take advantage of you], but you know up front what you're getting into."

—*Storefront borrower, Birmingham, AL*

"You know the interest rate is 17 percent. I mean, so you know before you get it what you're going to have to pay back."

—*Storefront borrower, Birmingham, AL*

"I think they're honest, but I don't think it's really fair. I mean, it's a really high interest rate."

—*Storefront borrower, Chicago*

PAYDAY LOAN LOSS RATES

Loss rates at the larger payday lenders are about 3 percent of funds ($2.98 per $100 lent), according to industry analyst calculations,[i] suggesting that 97 percent of payday loans (including extensions and renewals) are eventually repaid.[ii] No comparable data are available for deposit advance loans, but given that the loans are secured by the borrower's direct deposit to an account owned by the lender, it is likely that the loss rate is even lower.

In focus groups, borrowers stated they were eager to pay back loans, both to meet their obligations and to maintain future access to credit. These sentiments are consistent with relatively high rates of repayment and with prior research that found little evidence of strategic default.[iii]

i Stephens Inc. "Payday Loan Industry." (2011)

ii Using 2011's Annual (10-K) Report from Advance America, the largest storefront lender, as an example, we can calculate an approximate loss rate by dividing the "provision for doubtful accounts" by the "aggregate principal amount of cash advances originated." This calculation of $107,911,000 divided by $3,965,225,000 yields an estimated loss rate of 2.72 percent. Borrowers may renew or re-borrow a loan, or experience temporary defaults by bouncing checks and incurring nonsufficient funds fees while still paying back a loan eventually. Advance America has made a similar point, stating, "97 percent of our customers pay us back." http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf

iii Paige Marta Skiba and Jeremy Tobacman. "Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default." (2008). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319751

3 Why People Borrow When They Can Afford Only to Renew, Not to Repay

"You don't know that it's going to take you six months when you're going into it, to pay."

—Online borrower, New York

Payday borrowers renew or re-borrow loans because they cannot afford to repay them in full. But why do people choose to borrow unaffordable loans in the first place? The answer is not the same for every borrower, but our research reveals several contributing factors.

One clear reason is desperation. More than one-third of borrowers say they have been in such a difficult situation that they would take a payday loan on any terms offered. Another reason is that many borrowers struggle with the temptation of having cash readily available to them, describing payday loans as "too easy" to obtain.

Borrowers also hold unrealistic expectations about payday loans. In focus groups, people described struggling to accommodate two competing desires: to get fast cash and to avoid taking on more debt. They cited the "short-term" aspect of payday loans as a reason for their appeal and described how a payday loan appeared to be something that could provide needed cash, for a manageable fixed fee, without creating another ongoing obligation. However, this perception does not match reality: Borrowers typically experience prolonged periods of debt,[18] paying more than $500 in fees over five months.[19]

Lenders benefit from this misperception, because they rely on borrowers to use the loans for an extended period of time. Prior research shows that the payday loan business model requires repeat usage in order to be profitable,[20] with nearly all loans going to repeat users. (Ninety-seven percent of loans go to people using three or more loans per year, and 60 percent go to those using at least 12 loans per year.[21]) Yet lenders continue to structure their loans as a two-week fixed-fee product. They routinely promote the loans as a short-term solution that should not be used on a long-term basis,[22] even though the loans' unaffordability makes this

long-term use widespread. These efforts help shape the expectations of borrowers, who say they rely on lenders to give them accurate information by a nearly 4-to-1 margin. When asked to reflect on their experiences, borrowers expressed surprise over how long it actually took to pay off the loans, as well as frustration about how difficult that was to predict.

Taken together, these and other findings presented below help explain why people select an unaffordable loan.

Some Borrowers Have Been in Situations Where They Would Accept Any Terms Offered

Thirty-seven percent of payday borrowers have at some point felt that they would take a loan on any terms offered. This figure rises to 46 percent among those who rate their financial situation as fairly or very bad.

EXHIBIT 6:

SIX REASONS WHY PEOPLE USE PAYDAY LOANS THEY CANNOT AFFORD

1. **Desperation**
   More than one-third of borrowers say they have been in such a difficult situation that they would take a payday loan on any terms offered.
2. **Perception**
   Borrowers perceive that payday loans do not create ongoing debt, or are "not another bill," although the loans do in fact create high-cost, ongoing debt.
3. **Reliance**
   Borrowers rely on lenders for accurate information. Lenders sell payday loans that are packaged as a two-week product, although the borrower ends up indebted for five months on average.
4. **Focus on fee**
   Borrowers focus on being able to afford the finance fee, rather than on how the lump-sum repayment will affect their budget.
5. **Trust**
   Some bank deposit advance borrowers believe that bank payday loans are safer or more regulated than other payday loans.
6. **Temptation**
   Some borrowers consider the loans "too easy" to obtain, because they are readily available, and borrowers have a consistent cash shortfall.

SOURCE: Pew's safe small-dollar loans research project, 2013.

These borrowers accept an unaffordable loan for the simple reason that it allows them to stay solvent for two more weeks, regardless of cost. Previous research has also found that most customers do not comparison shop for small loans and instead focus on obtaining money quickly, demonstrating that when people are in an urgent situation, speed rather than affordability is paramount.[23]

EXHIBIT 7:

37%

of borrowers would have taken a payday loan on any terms offered

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Have you ever felt you were in such a difficult situation that you would take (an online payday loan/a payday loan) on pretty much any terms offered or have you never felt that way?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"If you're that desperate then you almost do any terms."

—*Storefront borrower, Manchester, NH*

"You don't think about the cost of funds in an emergency. That's basically it."

—*Storefront borrower, San Francisco*

"I mean you cannot choose—not as completely as you probably should. ... I am going to have to pay more later when I pay this off but we'll cross that bridge in two weeks. Right now I think it's just that whole immediacy moment."

—*Storefront borrower, San Francisco*

"Like the first time I did it, and maybe like the second time, getting the loan wasn't really going to help me out too long term, because I was spending more than I was bringing in. So I got into a real hard spot the first time I did it. And then the second time I did it, because I was desperate, where I ended up having to like extend it, because I needed that money to live on, and then extend it again. And I got in sort of over my head, where it's like now I owe all this money, and you're going to take basically my whole check."

—*Storefront borrower, Chicago*

"It hurts me to be in a situation where I have to go and accept those types of conditions."

—*Former storefront borrower, San Francisco*

Borrowers Perceive Payday Loans as 'Not Another Bill'

To some focus group respondents, a payday loan, as marketed, did not seem as if it would add to their recurring debt, because it was a short-term loan to provide quick cash rather than an additional obligation. They were already in debt and struggling with regular expenses, and a payday loan seemed like a way to get a cash infusion without creating an additional bill. Despite this appeal, the reality is that the average borrower ends up indebted to the payday lender for five months of the year.

It is highly unrealistic for borrowers to think that they will repay the loan on their next payday and not need to re-borrow the money (more people use 17-plus loans per year than use just one). But this optimism is consistent with previous research from the behavioral economics field.[24] Previous research has found that people across income levels express unrealistic optimism in assessing their financial prospects in areas such as investment returns, future earnings, or ability to repay loans quickly.[25]

"I thought, 'No I don't want to charge it,' at the time, because I had enough [other bills] to pay. I was already, you know, my limit was getting kind of there."

—Online borrower, New York

"I don't want to prolong it too much, and then it becomes another bill, because that's essentially what will happen. If I'm paying over six months, it's just another bill, like I have another extra cable bill or something."

—Online borrower, New York

"Because when I kept getting those statements and so forth, I made a decision to pay [the credit cards] off, and I'm not going to get another one ... because I don't want to keep paying all that interest."

—Storefront borrower, Birmingham, AL

"By my next paycheck, I should be done."

—Online borrower, New York, who has had a loan out for three months

"And I think, 'Oh, it'll just be fine next paycheck, just need to get to the next paycheck.' And I need, you know, either pay the bill to keep the lights on, or need some food, or whatever it is."

—Storefront borrower, Chicago

Other research in the field has found that people experience "confirmation bias," looking for information to confirm their already-held hope or belief.[26] A loan from a state-licensed lender or federally chartered bank that is marketed as a two-week product serves to confirm an overly optimistic perspective, signaling to borrowers that it is realistic for them to receive quick cash without creating ongoing debt.

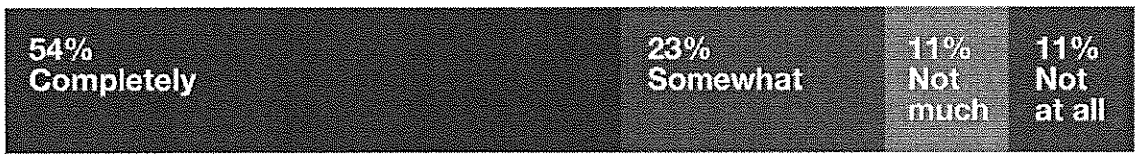
Borrowers Rely Heavily on Payday Lenders, Whose Loans Appear to Last for Just Two Weeks

More than three-quarters of borrowers in Pew's survey stated that they rely on the payday lender to provide accurate information, but information is provided only about a two-week product, even though borrowers end up indebted for an average of five months. Because the loans do not amortize, paying just the fee—the salient price that borrowers are instructed to pay if they cannot afford full repayment—does not reduce the amount owed, leaving them no closer to eliminating the debt. Therefore relying on the lender for accurate information makes the ultimate cost and duration of the debt extremely difficult to predict.

Lenders' advertising heavily promotes the concept of relying on and trusting them. One bank describes itself in a payday loan advertisement as "your trusted source"[27] and suggests you "work with a lender you trust."[28] A large storefront payday lender advertises itself as "the name millions trust"[29] and promises, "We're here for you."[30] Other lenders call themselves "a company you can trust"[31] or "someone you can rely on"[32] and explain that they are "here to help you,"[33] encouraging people to "stop by to borrow … money from your friends."[34]

EXHIBIT 8:

MAJORITY COMPLETELY RELY ON PAYDAY LENDERS FOR ACCURATE INFORMATION



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "How much do you rely on (online payday lenders/payday lenders) to give you accurate information?" Results are based on 703 interviews conducted from December 2011 through April 2012. Data do not add to 100 percent because "Don't know" and "Refused" were omitted from this chart.

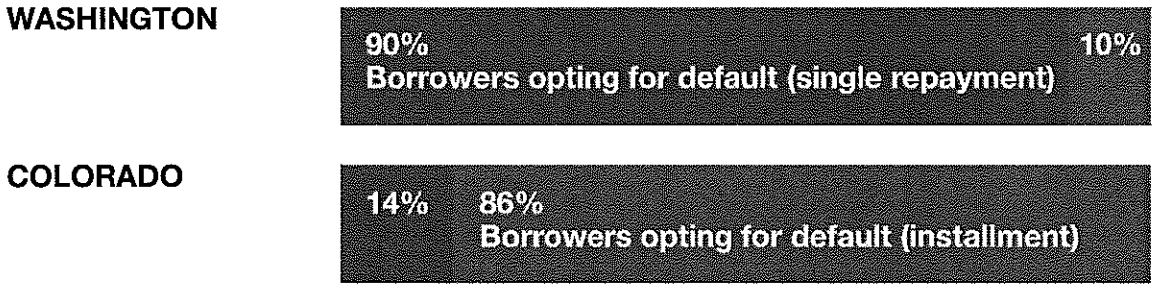
SOURCE: Pew's safe small-dollar loans research project, 2013.

The meaning and implications of this reliance are perhaps best illustrated by comparing how borrowers use payday loans in Washington and Colorado. In Washington, a payday loan's term is for two weeks with a lump-sum repayment, and, as in most states, the majority of payday users re-borrow the loans multiple times.[35] But unlike most states, Washington gives borrowers a no-cost option to convert the loan immediately into a far more affordable[36] 90- to 180-day loan, payable in installments.[37] In 9 of 10 instances, however, borrowers fail to do so, instead accepting the unaffordable default loan structure provided by the lender.[38] This striking data point demonstrates that even when a payday loan could become affordable for borrowers through conversion to an installment loan, the default structure provided by the lender is so influential that most borrowers do not alter that structure.

It would be possible to interpret this inaction as a borrower preference for single-repayment loans, were it not for the example of Colorado, where the default loan structure is for a 180-day term, but borrowers can pay back the loans (with no pre-payment penalty) in two weeks or any other amount of time. Only 1 in 7 pay the loans back in full within a month, with the majority instead accepting the default installment loan structure.[39] As has been found repeatedly in the behavioral economics literature,[40] people tend to accept financial products as they are offered, relying on the structure and choices the provider has established as the default. Payday borrowers are no exception, overwhelmingly accepting the default loan structure that the lender provides them and demonstrating a tremendous degree of reliance on the lender, even when they cannot afford the terms the lender is offering.

EXHIBIT 9:

BORROWERS RELY HEAVILY ON LENDER, ACCEPTING DEFAULT LOAN STRUCTURE



SOURCES: State of Colorado Department of Law; Washington State Department of Financial Institutions; Pew's safe small-dollar loans research project, 2013.

Previous research also found that borrowers do not know the annual percentage rates (APRs) on payday loans,[41] although they are posted in stores and on websites. Instead, borrowers generally know the fee charged per $100 borrowed per pay period. Not knowing a loan's APR makes it hard to compare products, leading to further reliance on lenders. Some in focus groups expressed difficulty in comparing the cost of a payday loan with that of other loan products, such as a credit card. Several borrowers mistook the two-week fee on a payday loan for an interest rate and erroneously compared that with the APR of a credit card.[42] (More information on payday borrowers' use of credit cards is featured on Page 30.)

"I honestly did not think about the fact that once I got paid again ... that it was going to take that money out that I owed them plus with the fee for it. So when that happened I was just like, 'Okay, so now what? I still have to pay [the bills]. ... What do I do?' That's when I had to do it again. I honestly just needed to get that done in that moment and did not think about the consequences too well."

—Bank deposit advance borrower, San Francisco

"They just say it in big terms. ... I get real confused when they start talking about the numbers, and I don't read it. I'll be honest, I don't read it. She just said initial here, initial here, initial here, initial here."

—Storefront borrower, Birmingham, AL

"Should I pay this whole loan back, or pay the little fee they told me to pay a month? I'm going to pay them a little money."

—Storefront borrower, Chicago

"And there's a lot of, there's a lot of nice talk going back and forth, but not a lot of like, you know, understand the steps that are here."

—Storefront borrower, Chicago

ALMOST ALL PAYDAY BORROWING IS FOR PERSONAL, NOT BUSINESS, EXPENSES

In developing countries, economists and academics have documented the widespread use of high-cost credit to finance investment in a small business.[i]

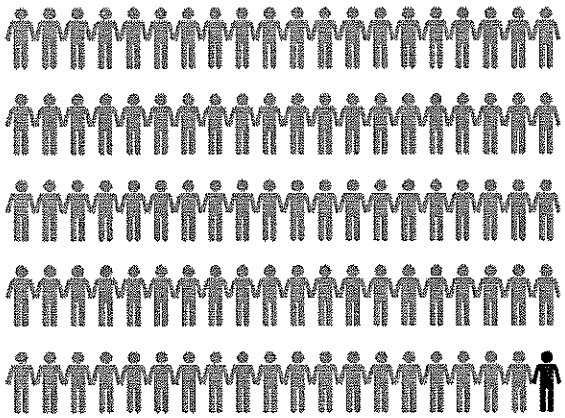
Domestically, some business and policy leaders have suggested that small businesses are using payday and other high-cost, very short-term loans to finance their operations.[ii] However, Pew's data show that borrowers almost universally use payday loans to cover personal or family—rather than business—expenses, even among the 6 percent of storefront payday loan borrowers who are self-employed.

i A great deal has been written about the self-employed poor borrowing from money lenders to finance their business operations in developing countries. For example, David Bornstein discusses this practice in "The Price of a Dream: The Story of the Grameen Bank" (2005), and Esther Duflo and Abhijit Banerjee discuss it in "Poor Economics" (2011).

ii The Hispanic Chamber of Commerce argued that small-business owners are using overdraft services and direct deposit advances as credit to finance business operations in a letter from the organization's president, Javier Palomarez, to the Office of the Comptroller of the Currency (OCC) on July 18, 2011. http://www.regulations.gov/#!documentDetail;D=OCC-2011-0012-0038. See also Jim Hawkins, "Credit on Wheels: The Law and Business of Auto Title Lending" (2011), which notes that those claiming that significant numbers of title loan borrowers are using the loans for business reasons have included industry leaders, elected officials, and academics.

EXHIBIT 10:

ALMOST ALL PAYDAY BORROWING IS FOR A PERSONAL OR FAMILY EXPENSE



Personal or family

Business

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "And was that primarily a personal or family expense, or was that primarily for a business that you own or operate?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

Borrowers Focus on the Fee, Rather Than the Whole Repayment

A number of focus group participants explained that when using payday loans, they concentrated just on the fee, which they could afford, rather than the entire repayment, which they usually could not afford without having to borrow again to meet their expenses. Some borrowers talked about the loan fee being affordable, but they had not realized that the full loan repayment would then make it impossible to meet their expenses.

"You can afford that little bit [the loan fee]. It doesn't hurt you."

—*Former storefront borrower, San Francisco*

"Once my paycheck came, it was like, 'Okay, we're taking this out.' I was like, 'Dang, I should have never done this.' And it was like it took me a while to pay it back. It took me ... six months. ... Because every two weeks it was something, their amount of money, then I had to pay this, and I had to pay bills."

—*Online borrower, New York*

"It's just playing with the money. I hand it to you, you hand it back. I hand it to you, you hand it back, you know, and it's only the interest. ... Just as long as you pay me $17 on every $100, we're good, you know."

—*Storefront borrower, Birmingham, AL*

"The first one I paid off in full. That's the thing. I paid it off. I said, 'Here's $400, whatever it was.' ... But then that month, okay, here's my paycheck, $400 gone, and now I have this much left, but I have all these bills. All of a sudden, you're already like, 'Hmmm, I got the short end of the straw.'"

—*Online borrower, New York*

"You need that money from the next paycheck that is coming, but they take it all, and then you're going to have to find another way to get the money from somewhere to cover that amount."

—*Former storefront borrower, San Francisco*

"I think [it's safe] because they are through the bank and the bank has FDIC insurance. I don't know. I am just assuming that. I would assume so."

—*Bank deposit advance borrower, San Francisco*

"Well they've got usury laws, don't they? I think probably the payday loans aren't subject to usury laws, but the banks, because they're chartered by federals, they've got a lot of pressure on them to stay within the usury laws."

—*Bank deposit advance borrower, San Francisco*

"For the banks, on the door it says FDIC, so you know it's governed."

—*Bank deposit advance borrower, San Francisco*

"I found out about it because when you do the online banking there is this thing. I hadn't heard about it, and it just says that I can do a direct deposit advance. And I clicked on it, like 'Oh! Really?' And then, well, it's very quick and easy."

—*Bank deposit advance borrower, San Francisco*

"Well, I was a little short and was thinking I could use some more money and I was at the ATM actually, and it was there, offering me a direct deposit advance. So, I thought I would try it. They did it for me. They put it right on the ATM where I was at, so I went for it."

—*Bank deposit advance borrower, San Francisco*

Some Borrowers Believe Bank Deposit Advances Are Safer or More Regulated

Several borrowers in focus groups believed that bank deposit advance products (see Page 12), which have the same lump-sum repayment structure as payday loans, were safer than other types of payday loans and were more inclined to use them. Some focused on the fact that the loan was offered by the bank where they already did business, making it both familiar and convenient. Others mistakenly believed that the products were covered by special federal regulatory protections and therefore were relatively safe to use compared with other payday loan options. In reality, nationally chartered banks that offer deposit advance loans may disregard state usury rate limits and other consumer protection laws, and so far there is relatively little federal regulation of payday and deposit advance lending.[43]

"It could be a little too easy."

—*Storefront borrower, Chicago*

"It [was] tempting when you were just in that dire need."

—*Former storefront borrower, Chicago*

"We press click, we press okay, we say submit, and you know, I agree. But I think it's, it makes it too convenient. It's too easy to do it."

—*Online borrower, Manchester NH*

"It's contradictory, but it's like I wouldn't fall into the trap if I didn't have the option."

—*Online borrower, New York*

"When I paid them off … they'd send me stuff in the mail, we'll give you this, we'll give you this, we'll give you this, you know, and they'd call me on the phone. … I knew what they were up to, you know, because it was so easy to fall right back into that."

—*Former storefront borrower, Manchester, NH*

"It was that quick fix that was too easy."

—*Former storefront borrower, Manchester, NH*

Some Borrowers Describe Getting Payday Loans as 'Too Easy'

In focus groups, borrowers appreciated how easy it is to obtain a payday loan, but in many instances, they described it as "too easy" and said they had difficulty resisting the temptation to borrow. Interestingly, both storefront and online borrowers expressed this sentiment, even though these two groups are different, and they think of storefront and online payday loans as two very different products.

CREDIT CARD USAGE AMONG PAYDAY BORROWERS

Credit cards can be an important source of liquidity for cash-strained households. Although a large portion of payday loan applicants have credit card accounts, many have exhausted their limits.[i] Pew's survey found that 2 in 5 payday borrowers used a credit card in the past year, and most had "maxed out" their credit at some point during the same period.

Among payday borrowers who do not have a credit card, nearly half do not want one, and almost as many have been turned down or expect they would be turned down. In focus groups, many borrowers reported having incurred substantial credit card debt in the past and said that is why they intentionally avoid them. Other borrowers discussed feeling overextended by debt already and said payday loans seemed like a different kind of choice compared with a credit card or longer-term loan, because they expected payday loans to last only a short time.

Still others were confused about the relative costs of credit cards compared with payday loans. For example, one participant mistakenly believed that a credit card's annual percentage rate (APR) of 23.99 would cost more per month than a payday loan (which in his state costs $17.50 per $100 borrowed, or 17.5 percent every two weeks), and others did not disagree.

"Because the interest on ... some credit cards [is] 23.99 percent. So if you go charge $300, and then you don't pay that $300 off at the end of the month ... they're going to tack that 23.99 percent on to it, so you're going to still be paying more than you would if you had to [get a payday loan]."

—Storefront borrower, Birmingham, AL

"I just never got one because I've seen what it did to my sister."

—Storefront borrower, Chicago

"Well, I got my first credit card when I, I think I was 18, and was probably working like a minimum wage job, and I've not had one since. ... I'm still paying it off."

—Storefront borrower, Chicago

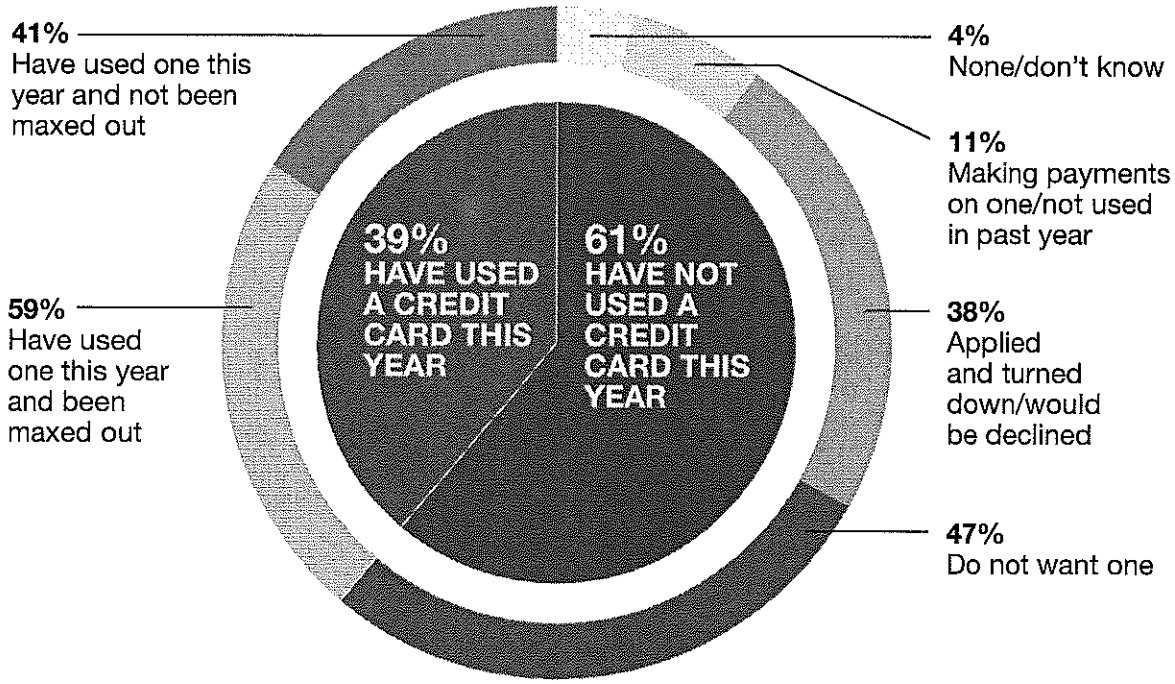
"I've had them, and ... I just can't deal with it, you know. It's a false money. You pay for it later and more than you plan to."

—Storefront borrower, Birmingham, AL

i Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman (forthcoming). "Payday Loan Choices and Consequences." This research finds that almost all payday applicants have a credit score, and a majority have credit cards but are mostly maxed out on their credit limits at the time they apply for a payday loan. Available at: http://assets.wharton.upenn.edu/~tobacman/papers/Payday%20Loan%20Choices%20and%20Consequences%2020121010.pdf. Overall, approximately 68 percent of all American adults utilize credit cards (2010 Survey of Consumer Finances. Federal Reserve Bulletin. 2012. http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf).

EXHIBIT 11:

CREDIT CARD SITUATION OF PAYDAY LOAN BORROWERS



NOTE: Data represent percentage of payday loan borrowers who gave the listed answer. Respondents were asked: "I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used a credit card in the past year?" (If "Yes") "In the past year, have you maxed out or been at the top of your credit limit on any of your credit cards?" (If "No") "Have you not used a credit card in the past year because you do not want one, because you think you would not be approved to get one, you are already making payments on one, or did you apply for one and were turned down?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

4 Most Payday Borrowers Are Also Overdrafting Their Checking Accounts

"And even if you tell them the money is not there, guess what? They're going to put that check through and it's going to bounce two times before they come back and say, 'well, can you send us another check?' So now you have two extra fees on your bank account."

—Storefront borrower, Chicago

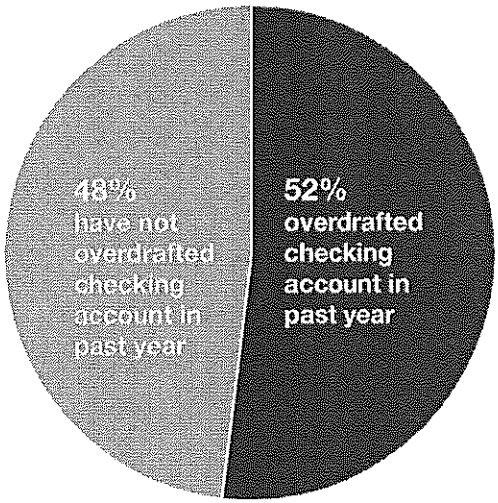
Payday loans are sometimes promoted as a cost-effective alternative to checking account overdrafts. (A major storefront and online payday lender encourages borrowers to "use payday loans to stop a bank overdraft or NSF fee,"[44] and a prominent online payday loan website states, "avoid costly overdraft fees and charges!"[45]) However, more than half of payday loan borrowers report having overdrafted their accounts in the past year,[46] and 27 percent report that a payday lender making a withdrawal from their bank account caused an overdraft. Moreover, Pew's prior research has shown that the vast majority of those who overdraw their accounts do so by mistake, not by intention. Although people choose payday loans in order to avoid overdrafts, many end up paying payday loan fees and overdraft fees as well.[47]

Payday Loans Not Eliminating Overdrafts

Although it is unclear how much payday borrowing may reduce or increase the likelihood of checking account overdrafts, Pew's research shows that payday loans do not eliminate overdraft risk. Prior research has found that some payday loan borrowers are explicitly choosing to use the loans to avoid overdrafts and bounced checks,[48] but Pew's survey research demonstrates that borrowers are incurring overdraft fees anyway.

EXHIBIT 12:

MAJORITY OF PAYDAY BORROWERS HAVE OVERDRAFTED IN THE PAST YEAR



NOTE: Data represent percentage of payday loan borrowers who gave the listed answer. Respondents were asked: "I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used overdrafting on your checking account in the past year?" Results are based on interviews with the 565 payday borrowers in the survey who still had a checking or savings account at the time they took the survey. Interviews were conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

There is less evidence about overdrafts related to bank deposit advance loans, but those loans' single-repayment structure makes it likely that they will be of limited help to customers trying to avoid overdrafts. Corroborating evidence comes from a large financial services consultant that developed a deposit advance loan program for banks and originally promoted the program as a new source of revenue that would result in little to no "overdraft revenue cannibalization."[49] Its analysis indicates that deposit advance loans provide little to no value in helping borrowers avoid overdrafts.

Previous research on the relationship between payday loan usage and overdrafts has yielded mixed results. One study looked at county-level data nationwide and found that access to payday loans was associated with increased levels of involuntary bank account closures, generally because of overdrafts.[50] Another

Twenty-seven percent of borrowers report that a payday lender making a withdrawal from their bank account *caused* an overdraft.

study found that when payday loans were no longer available in two states, bounced checks increased in one state but not the other.[51] A third study showed similar levels of nonsufficient funds (NSF) and overdraft fees paid per household in states that had payday loan stores and in states that did not.[52]

In focus groups, borrowers overwhelmingly agreed that they would not use overdrafts as an alternative to payday loans because, as a credit source, they would be too expensive. These sentiments are consistent with a national survey from Pew's Safe Checking in the Electronic Age Project, which found that 90 percent of those who overdrew their accounts did so by mistake rather than by choice.[53]

PAYDAY LOAN BORROWERS USE PREPAID CARDS AT THREE TIMES THE NATIONAL RATE

Thirty-eight percent of payday loan borrowers report having used a prepaid debit card[i] in the past year, triple the rate at which the general population uses these products.[ii] Prepaid cards are often advertised as a way to avoid checking account overdraft fees and credit card debt, perhaps explaining their appeal to payday loan users, who are eager to avoid both of these.[iii] Prepaid cards also can function much like a checking account for those who do not have one and can be used to budget and compartmentalize spending. For more on prepaid cards, please visit www.pewtrusts.org/prepaid.

i This data point refers to usage of general purpose reloadable (GPR) prepaid cards.

ii Javelin Strategy & Research found that 13 percent of American adults used a prepaid card in 2011. http://www.businessweek.com/news/2012-04-11/prepaid-card-use-up-18-percent-as-consumers-drop-debit-study

iii For example, one of the largest providers of prepaid debit cards, Green Dot, focuses its marketing on the fact that its cards do not have overdraft fees or lead to credit card debt: https://www.greendot.com/greendot

Payday Loans Causing Overdrafts

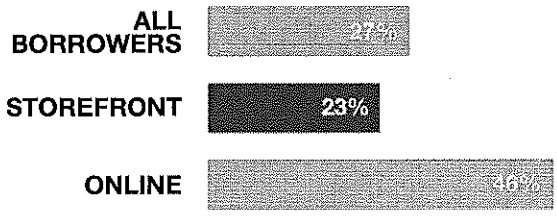
Among storefront borrowers, 23 percent report that a payday lender attempting to make a withdrawal from their account caused an overdraft. Among online borrowers, 46 percent had this experience.[54] This significant difference was reflected in Pew's focus groups: Online borrowers experienced many more problems as the result of payday lenders accessing their bank accounts.

> "When I was actually out of town, we had a family member that passed away, and then I missed the date to pay it back, and then I was gone longer than I expected, so I missed a payment. And then they, it was two weeks, and they went and they took it out of my account. And then the overdrafts killed me."
>
> —*Storefront borrower, Chicago*

These findings—that 52 percent of payday borrowers also report overdrafting their checking accounts, and that for 27 percent of borrowers, payday loans are actually causing overdrafts—reveal that payday loans frequently fail to help borrowers avoid overdrafts.

EXHIBIT 13:

PAYDAY LOANS CAUSING OVERDRAFTS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Storefront payday borrowers were asked: "For each one I read, please tell me whether it has happened to you. How about Had a payday lender attempt to make a withdrawal that overdrew your bank account?" Online payday loan borrowers were asked: "For each one I read, please tell me whether it has happened to you. How about Had an online payday lender make a withdrawal that overdrew your bank account?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

5 Some Borrowers Use the Same Options to Repay Loans That They Could Have Used Instead of Borrowing

"I finally paid those off, but I would probably still be doing it if it wasn't for my parents helping out with things."

—Online borrower, Manchester, NH

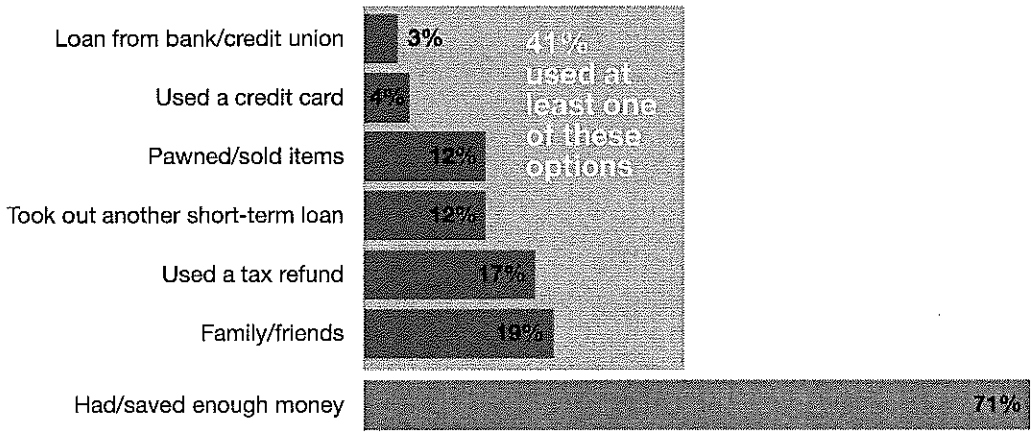
Access to credit is an important tool for people dealing with a cash shortfall, but it would be a mistake to think that people are choosing solely among credit options. Pew's first *Payday Lending in America* report identified a variety of informal or noncredit options that a majority of borrowers said they would employ if payday loans were unavailable: cutting back on expenses, borrowing from family or friends, delaying bills, and pawning or selling items.[55] As explained below, many ultimately turn to the same options they could have used instead of payday loans as a way to pay off the loans.

Pew's survey asked borrowers which methods they have used to pay back a payday loan. Seven in 10 payday borrowers have repaid loans from regular income or savings at least once. Although most borrowers have had or saved enough money to repay a loan at some point, 41 percent have used some other method—asking family or friends for help, waiting for a tax refund, or using another credit product—at least once. Three in 10 borrowers have never been able to repay with income or savings, relying exclusively on one or more alternative strategies.

Some borrowers repaid loans using strategies that they had available to cover their expenses before taking a payday loan in the first place. For example, 19 percent of borrowers received help from family or friends to pay back the loans, and almost all of them report that borrowing from family or friends is an option that would be available to them instead.[56] Similarly, some focus group participants said they chose a payday loan instead of other options but then turned to those same alternatives later to help them resolve their payday loan debt.

EXHIBIT 14:

TWO IN FIVE PAYDAY BORROWERS REPAY USING HELP, WINDFALL, OTHER LOANS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Survey participants were asked: "Please tell me whether you have or have not used each of the following methods to pay back (an online payday loan/a payday loan). How about (INSERT)? Have you used this method or not?" Data do not add to 100% because each item was asked separately. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

Also of note is the use of tax refunds. One in six borrowers have used a tax refund to pay off a payday loan, a finding that is consistent with prior research showing that outstanding payday debt decreases when tax refunds are issued.[57] The large windfall provided by a tax refund enables borrowers to repay loan principal that their regular paychecks are not sufficient to cover.[58] Both storefront and online borrowers have used these alternative methods of repayment, demonstrating that this problem applies to both types of loans, and several bank deposit advance users in Pew's focus groups reported the same experience.

Many borrowers ultimately turn to the same options they could have used instead of payday loans as a way to pay off the loans.

"Sometimes I would have good fortune and pay it off, you know, income tax time or whatever."

—*Storefront borrower, Birmingham, AL*

"I got a credit union loan to pay off all those [online payday loans]."

—*Online borrower, New York*

"I ended up having to call my parents to bail me out."

—*Online borrower, New York*

"I mean, we were taking out payday loans to pay payday loans [and that] doesn't make any sense."

—*Online borrower, Manchester, NH*

"[I paid off the payday loan by] asking some other person for the money, that I know I don't have to worry about this interest, you know, let me pay you back a few dollars at a time."

—*Storefront borrower, Chicago*

"Let me just do it until I get some kind of windfall to stop at the end."

—*Bank deposit advance borrower, San Francisco*

"I only did it because I didn't want to ask for any money, ask to borrow from ... a friend or anything. I kind of wish I did, you know, because I ended up paying more than I actually borrowed."

—*Online borrower, New York*

6 Borrowers Feel Relief, but They Also Feel That Payday Loans Take Advantage of Them

"It can be lifesaving, but, yes, it is a trap that's hard to get out of."

—Storefront borrower, Birmingham, AL

Payday borrowers' experiences—receiving credit to cover expenses but then ending up spending far more than suggested by the loan's two-week price tag—lead to complicated and conflicted feelings: gratitude that credit is available to them, appreciation for friendly service, dismay with the high cost, and frustration with lengthy indebtedness.

Borrowers See Loans as Taking Advantage of Them

A majority of borrowers say payday loans take advantage of them, and online borrowers and those who describe their financial situation as "bad" feel this most strongly. Sixty-four percent of this latter group said the loans take advantage, compared with 47 percent of borrowers who rated their financial situation as "good." In focus groups, borrowers who described payday loans as taking advantage focused on the high cost of the loans and the difficulty they have in paying them back.

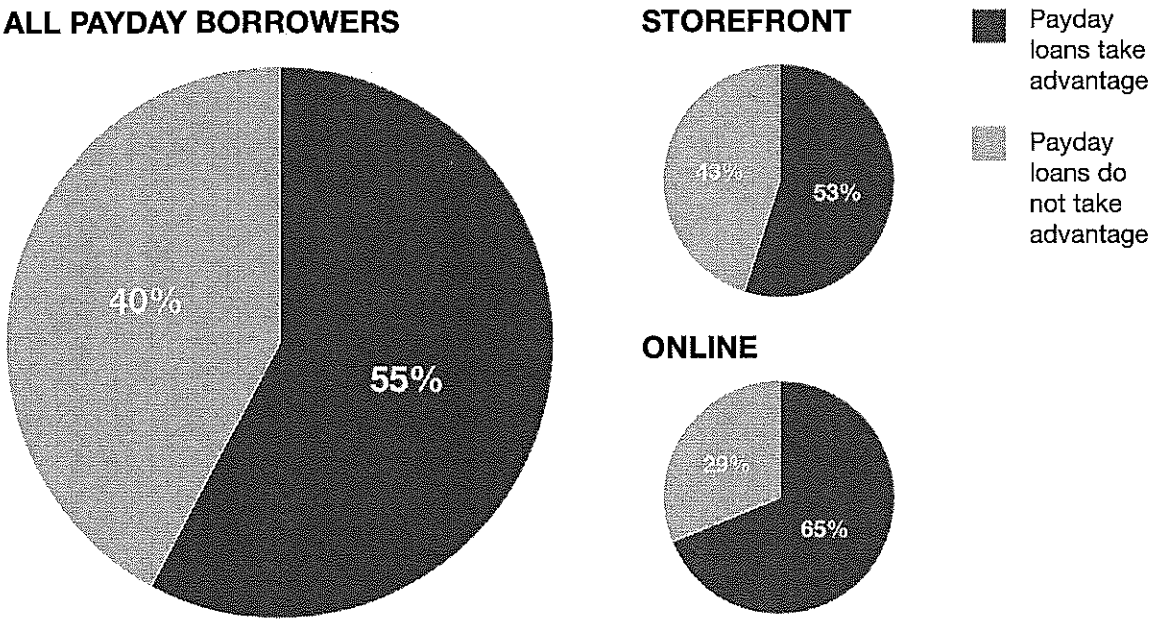
Similarly, 82 percent of those who found the loan terms and conditions "confusing" think the loans take advantage, compared with 51 percent of those who felt the terms and conditions were "clear."

However, 4 in 10 believe that the loans do not take advantage. In focus groups, borrowers who recounted more positive experiences often focused on the friendly relationships they have with individual employees at the payday loan stores they visit. Previous research has also found that storefront payday lenders win high marks for respectful and friendly customer service.[59]

The payday loan industry works hard to create a friendly and respectful atmosphere that customers appreciate. Many describe good relationships with those who work in the stores, even when the product leaves them indebted for an extended period of time.

EXHIBIT 15:

MAJORITY FEEL PAYDAY LOANS TAKE ADVANTAGE OF BORROWERS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Some people say (online payday loans/payday loans) take advantage of borrowers, while other people do not think (online payday loans/payday loans) take advantage of borrowers. What do you think, do (online payday loans/payday loans) take advantage of borrowers or not?" Data do not add to 100% because "Some of both/Neither," "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"So you feel like when, oh, when you go into a place like that, it's like Norm from 'Cheers.' ... You're back. I mean, they're happy to see you, because you're a regular."

—Storefront borrower, Birmingham, AL

"They always ... speak to you by first name and say, 'hello, how you doing' when you first come in the store, and are good with remembering your name and your face."

—Storefront borrower, Chicago

"But they're the same as you, the people that work there. ... They're the same as you, they're just, they're struggling, too."

—Storefront borrower, Chicago

"It's like they're gouging people. ... It's like they're just trying to take advantage of them in that situation."

—Storefront borrower, Birmingham, AL

Lenders tend not to compete on price, often all charging the same amount in a given market,[60] but they instead compete on customer service, seeking to maintain long-term relationships with borrowers. Payday loan advertisements promote "outstanding customer service,"[61] "fast, friendly service,"[62] "courteousness,"[63] "smiling,"[64] and "dedication to our customers."[65]

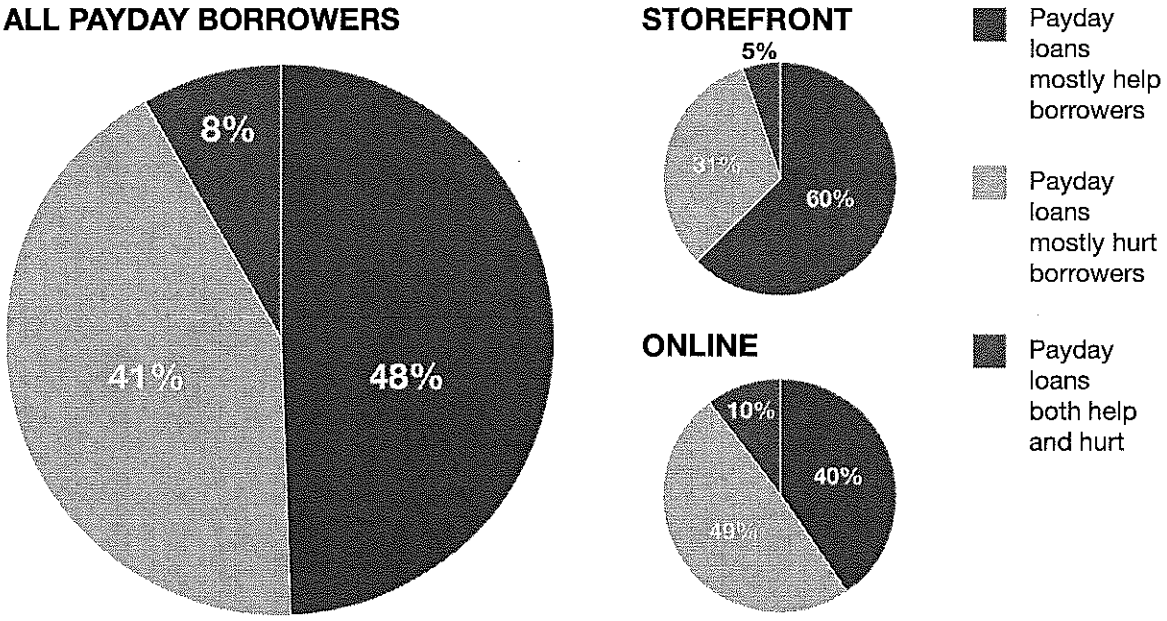
Borrowers Mixed on Whether Loans Help More Than Hurt

Borrowers are torn about whether payday loans mostly help or mostly hurt them, with slightly more saying that the loans help. In focus groups, most who talked about the loans being helpful spoke of the relief they felt when they were able to get a loan. In contrast, most of those who talked about the loans hurting concentrated on the difficulty of paying off the debt and the length of time it took to get out of a loan that had been advertised as lasting for two weeks.

These feelings also correspond to respondents' attitudes about their own financial situations, with those who have more frequent trouble meeting expenses more likely to say the loans hurt.

EXHIBIT 16:

SLIGHTLY MORE SAY LOANS HELP THAN HURT



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Overall, do you think that (online payday loans/payday loans) MOSTLY help borrowers like you or MOSTLY hurt borrowers like you?" (IF "BOTH," ASK:) "I know it can be hard to say, but generally do you think they MOSTLY help or MOSTLY hurt borrowers?" "Payday loans both hurt and help" was a volunteered response and not read aloud. Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"So they're quick and they'll dish out the money to anybody, but do not rub that lamp the wrong way because you do not want to see that genie, forget it."

—Online borrower, Manchester, NH

"I just think that loan kind of, it didn't help. I mean, it helped, but it didn't in the long run."

—Online borrower, New York

"It was a short-term fix that I'm continually paying off."

—Online borrower, Manchester, NH

"I'm no better off than I was when I first applied, I'm actually worse off, because I'm deeper in debt than I was when I first started."

—Online borrower, Manchester, NH

HOW BORROWERS DESCRIBE PAYDAY LOANS

As a focus group exercise, borrowers were asked for a word or phrase to describe payday loans. They used more negative terms than positive ones, but some focused on the loan being helpful when they were in a tight spot.

Interestingly, most borrowers did not disagree with others who offered opposing terms. This exercise revealed borrowers' conflicted feelings, including appreciation for credit in a tough time while also feeling trapped by the difficulty of repaying the loan.

Among the descriptions respondents used are:

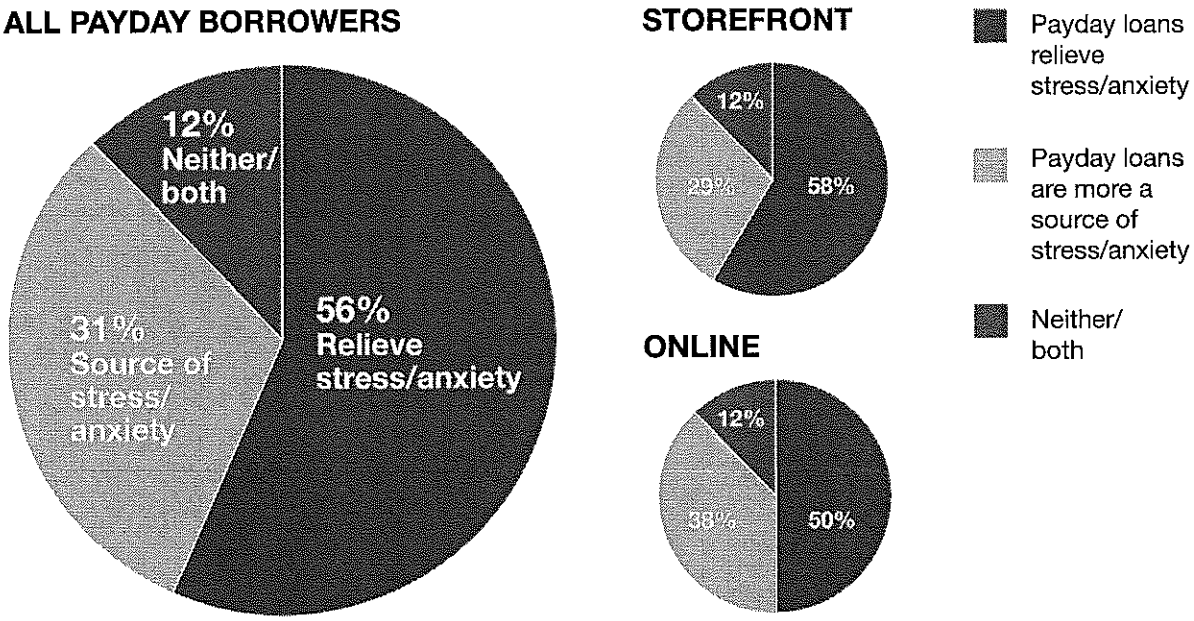
- Convenient
- Rip off
- Evil
- Never-ending
- Money hungry
- Lifesaver
- Should be abolished
- Takes advantage
- Emergency rescue
- Friendly
- Helpful
- Good in an emergency, but dangerous
- Predatory
- Sweet and Sour: Sweet when they give it to you, sour when you've got to pay it back
- Simple
- Desperate
- Helpful but very dangerous
- Tempting
- Expensive
- Panic
- Mistake
- Scary
- Too easy
- Accessible

More Say Loans Relieve Stress and Anxiety Than Cause It

More borrowers describe the loans as relieving—rather than causing—stress and anxiety, although online borrowers and those who report having trouble meeting their expenses more than half the time are more closely divided on this issue.

EXHIBIT 17:

MORE SAY LOANS RELIEVE STRESS AND ANXIETY THAN CAUSE IT



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "(Have/Was) the (online payday loan(s)/payday loan(s) (been) more a SOURCE of stress and anxiety or more something that has RELIEVED stress and anxiety?" "Neither/both" was a volunteered response and not read aloud. Data for storefront and all payday borrowers do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It's good because it's there when you need it, but it's not good if you don't have the strategy down. You have to pay it back right away, and then if you can pay it back right away, why would you go and get it to begin with?"

—*Storefront borrower, Chicago*

"All I know is I got the money that I needed to pay the rent that I needed to pay. And so, you know, it's ... a Catch-22."

—*Online borrower, New York*

"You pay it off, and then you panic because you know you have to go back, and you don't want to because you're going to lose the money, and you try to think of other options first, and if you don't have any, then you're right back in the same boat pretty much, panic, you know."

—*Former storefront borrower, Manchester, NH*

"That's where I go if I'm in a panic, the payday loans."

—*Online borrower, Manchester, NH*

PROFILES OF 'SATISFIED' CUSTOMERS

In a questionnaire as part of Pew's focus groups, the following borrowers all described themselves as "satisfied" with payday loans, as are most payday borrowers, according to industry surveys. To understand more thoroughly the experiences of these borrowers, and what it means to be satisfied with a payday loan, several quotes from each borrower are included below. Names have been changed to protect their privacy.

CHRISTINE (ALABAMA STOREFRONT BORROWER)

- Satisfaction level: "Very satisfied."
- Words to describe payday loans: "Emergency rescue."
- "I met a girl that worked at a payday loan store. Her kids go to school with my kids, and we were at a football game. And I had some medical bills that needed to be paid, and so I asked her about it. I always use her, and we've become friends, so, I mean, it's all pleasant."
- "I think they are fairly trustworthy. I mean, I think you have to use your own personal judgment about which one you use and the relationship you develop with the people there, because like you say, when you walk in, you deal with the same person every time. So in that aspect, it's trustworthy, but I also think they take advantage in the high interest rates."
- "So I went and got one for like $300. And I carried it for a couple of months ... and then paid it off with the income tax refund."
- "I don't use it as a longer term, but, I mean, I've kept it for longer than two weeks. I mean, I kept one for two months. I've kept one for six months."

ROBERT (ILLINOIS STOREFRONT BORROWER)

- Satisfaction level: "Very satisfied."
- Words to describe payday loans: "Expensive, yeah. But convenient."
- "[It's] going to be that emergency help you need right now."
- "You can show them the paycheck, but they don't know what are you spending on your expenses outside of that money."
- "They closed my bank account that I had. I wasn't paying them back in full at the particular time, and I kept trying to delay them, and giving them partial payment, and they just went in, and they took their money. Which caused me to default, and I was behind in a lot of other areas, and I wasn't able to take care of that particular area."

PROFILES OF 'SATISFIED' CUSTOMERS

CORI (CALIFORNIA BANK DEPOSIT ADVANCE BORROWER)

- Satisfaction level: "Very satisfied."
- "It was the holidays and I just need some extra cash to get gifts and help out with Christmas dinner and do my part. It just seemed like a good option."
- "But then it started the cycle. Because once you do it once, then it takes that money out of your paycheck, and my paychecks were pretty well budgeted to the dollar, so once they take that money back out to pay off the advance, then I'm short again. So, then I have to do it again to keep up with my regular bills."
- "I got to the point that I couldn't do any more direct deposit advances, and I had to go to the [payday loan] store."
- "I paid back the payday lending store. My sister helped me do that and then she also helped me get caught up. Then once I was able to cash out my PTO (paid time off from work), I was able to pay her back and get myself on track. So I was living back within my biweekly paycheck means."

MATTHEW (NEW YORK ONLINE BORROWER)

- Satisfaction level: "Somewhat satisfied."
- Words to describe loans: "Expensive." "Helpful."
- "I don't want to go to my brother. I don't want to go to my sister, you know. And it's for me. I don't have to go talk to nobody. I just, online, boom."
- "I don't think it's the best way. It's not. But my options are limited."
- "So I wound up probably paying a fortune. ... I think I took like $300. So they charged me every month, $30 on each $100. So you can pay $90 in three, four months, and you haven't even touched the principal yet. So that's why, again, I'm not going to cry over it because I knew the options and the choices, and they're what I made. But on the other hand, it's a pretty expensive way to get a few extra dollars."

7 Payday Customers Want Changes and More Regulation but Expect to Borrow Again if Loans are Available to Them

"I don't want to do it again. I don't want to, but I don't know, so I can't say I won't do it again because I might need to."

—Online borrower, New York

Borrowers' feelings about payday loans are somewhat complicated, but a general consensus emerges on three points:

(1) Borrowers want changes to how payday loans work.

(2) They want payday loans to be more regulated.

(3) Even if neither (1) nor (2) occurs, they will continue to use payday loans if they are in an especially difficult situation and the loans are available.

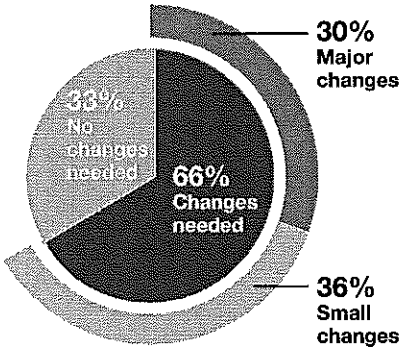
Although these findings provide only general feelings rather than specific solutions, they demonstrate that borrowers are not satisfied with the status quo and invite government oversight as part of the solution.

By a 2-1 Margin, Borrowers Want Changes to Payday Loans

Overall, borrowers are divided into three fairly even groups as to whether there should be major changes, small changes, or no changes to payday loans. Pew is conducting further research on the nature of changes that borrowers want to see.

EXHIBIT 18:

MOST WANT CHANGES TO PAYDAY LOANS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Which of the following best describes your view? 1. (Online payday loans/Payday loans) should be kept as they are now with no changes 2. There should be small changes to (online payday loans/payday loans) 3. There should be major changes to (online payday loans/payday loans)." Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

By an Almost 3-1 Margin, Borrowers Want More Regulation

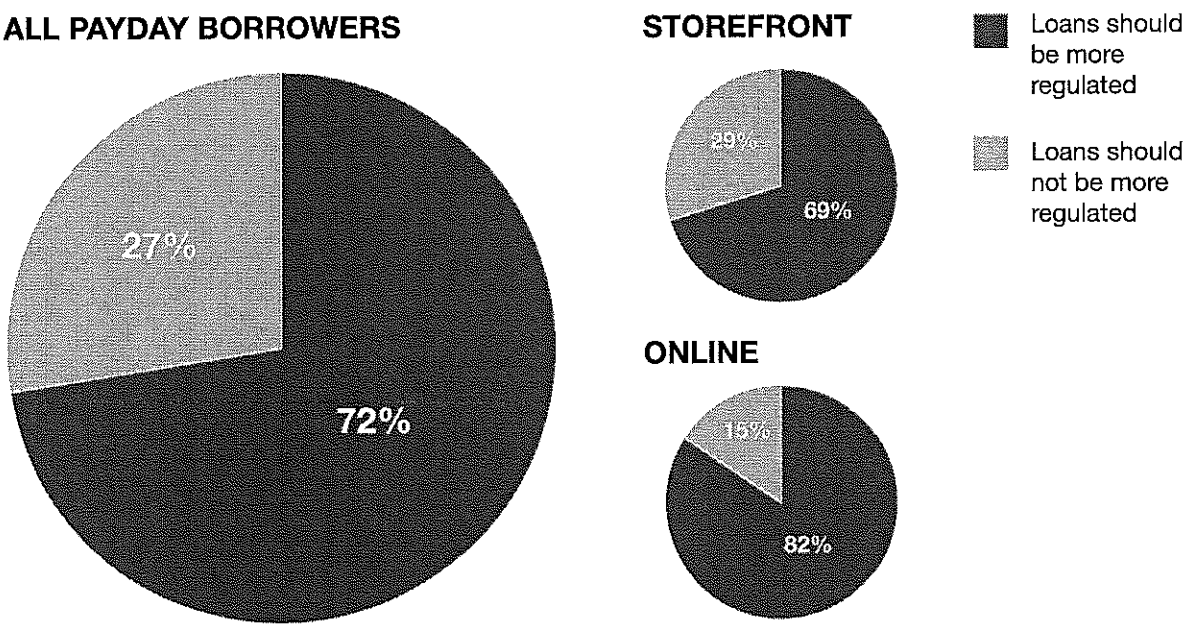
Borrowers hold divergent views on many aspects of payday lending and its impact on them, but there is strong consensus for more regulation of payday loans across key payday borrower groupings, including:

- Those who have trouble meeting their expenses, and those who do not.
- Those who describe their financial situation as good, and those who describe it as bad.
- Those who say the loans mostly help, and those who say they mostly hurt.

Online borrowers are even more adamant than storefront borrowers, preferring greater regulation by a 5-1 margin.

EXHIBIT 19:

BORROWERS FAVOR MORE REGULATION



NOTE: Data represent percentage of payday borrowers who express the listed opinion. Respondents were asked: "Which of these statements comes closer to your point of view? 1. (Online payday loans/Payday loans) should be more regulated. 2. (Online payday loans/Payday loans) should not be more regulated." Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

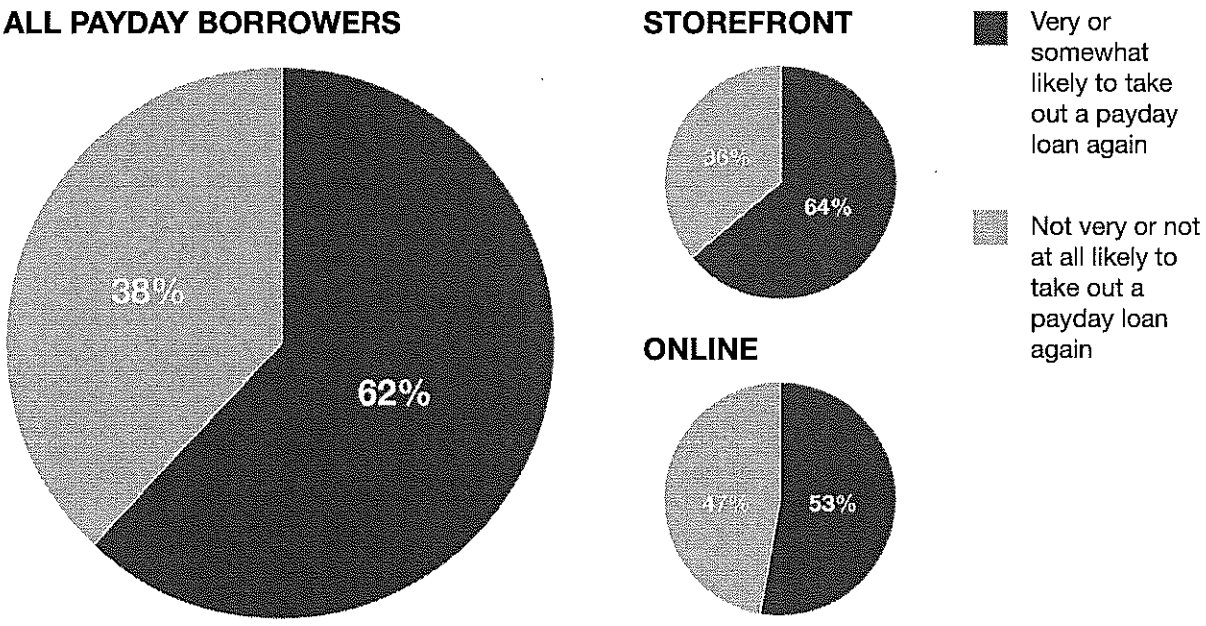
SOURCE: Pew's safe small-dollar loans research project, 2013.

3 in 5 Are Likely to Use Loans Again Regardless

Despite this desire for more regulation and changes to how payday loans work, 3 in 5 borrowers say they are likely to use the loans again if they are in a financial bind. Only one-fifth of borrowers say they are "not at all likely" to take out another loan. In focus groups, even borrowers who were unhappy that their payday loan debt had lasted much longer than expected thought they might use payday loans again with a better outcome. More storefront than online borrowers said they were likely to take out another payday loan. The tension between borrowers wanting changes and regulation, and the likelihood that they will use the loans again, is consistent with previous research that most borrowers would use the loans again, but few would do so without hesitation.[66]

EXHIBIT 20:

MAJORITY SAY THEY LIKELY WOULD TAKE ANOTHER PAYDAY LOAN



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "If you find yourself in a financial bind again, how likely is it that you would take out (an online payday/a payday) loan?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"I still would rather go to them than my family, and so I feel like they need me, I need them at some point in time. You never know where you're going with this economy being the way it is. I think that they should redo, you know, their interest rates and their rules and all of that."

—*Storefront borrower, Birmingham, AL*

"If I had to get a loan out, I would go to one."

—*Storefront borrower, Birmingham, AL*

"When you need it, you've got to get it."

—*Storefront borrower, Birmingham, AL*

Some Are Relieved When Payday Stores Are Gone

Pew's research has shown that potential borrowers tend not to use payday loans when storefronts are not available in their communities. In states without payday stores, just 5 percent of would-be borrowers sought loans online or elsewhere, and the remaining 95 percent elected not to use payday loans at all.[67] Previous research conducted in North Carolina, where a state law eliminated payday loan stores, similarly found that people had not sought out payday loans elsewhere when the stores closed, and those who had previously borrowed from payday storefronts "were glad they no longer had the temptation."[68]

Participants in Pew's focus group of 10 former storefront borrowers in New Hampshire expressed similar feelings. Although payday stores once operated there, they are no longer available because of a change in state law.[69] Participants acknowledged that they had used the loans when they were in the state, but they had not gone online to borrow after the storefronts closed. Instead, these former borrowers mostly expressed relief, but some acknowledged they would probably use the stores if they returned to the state.

"I think they need to find other ways to help people out than just make it so easy to do that, because that's why people do it."

—Former storefront borrower, Manchester, NH

"I'm glad they're gone. I hope they never come back."

—Former storefront borrower, Manchester, NH

"[Now that payday lenders are gone] you can't get stuck in it."

—Former storefront borrower, Manchester, NH

"Just keep them out, we don't need them."

—Former storefront borrower, Manchester, NH

"Because there's too many little things to worry about now, you know. They're out, leave them out, and you know what I mean? Then you don't have to worry about it."

—Former storefront borrower, Manchester, NH

Conclusion

Understanding why people choose expensive credit products that they will have difficulty paying back, and how they eventually do pay them back, is vital for any effort to improve the utility and transparency of payday loans as well as other small-dollar credit products. One reason people choose payday loans, instead of cutting back on expenses or using informal options, is that they perceive the loans as affordable because lenders sell them as a short-term fix. The information provided describes just two weeks of indebtedness, although most borrowers end up having a loan out for far longer. Borrowers have conflicting desires—they want to receive a cash infusion but do not want to create ongoing debt—and a payday loan's short repayment term makes it seem as if both these desires can be met. The loan's unaffordable lump-sum repayment structure effectively means that borrowers pay only interest, so the principal is not reduced; this structure makes predicting the ultimate duration and cost of the loan extremely difficult.

The loan is packaged as a two-week product that is described as safe and preferable to costly options such as overdrafts. Borrowers tend to focus on the loan's advertised price, a fee they can afford, and not the impact that a lump-sum repayment will have on their monthly budget. The more than $400 required to repay an average loan is so incompatible with the $50 that the average payday customer can afford that the customer ends up re-borrowing repeatedly, paying a fee every two weeks to take the same money back out to cover basic expenses.

Proponents of payday lending tend to talk about overdrafts as the primary alternative to a payday loan; borrowers instead mostly describe their alternatives as taking on long-term debt, cutting back on expenses, or borrowing from family or friends. But even within this narrow range of options, it is nearly impossible to comparison shop, because a payday loan's ultimate cost and duration are vastly different from the stated loan terms.

The implication of a payday loan's unaffordability for most borrowers is that when people choose a payday loan instead of other options, they often end up turning to those very same options in order to pay back the payday loan. Among those who choose a payday loan, most overdraft their bank accounts anyway. Further, 27 percent of payday borrowers say a withdrawal by a payday lender has caused an overdraft, while others borrow from family or friends to pay off the loans, or use them long term. These findings indicate that many of the potential benefits—avoiding other debt, fees, or cutting back—do not materialize. Payday loans end up leaving borrowers in the same financial bind in which they started, despite having spent $520 annually on average.

This inconsistency is reflected in the sentiments of payday borrowers, who describe themselves as "satisfied" but are also deeply conflicted. They express relief upon receiving credit during a tough time, appreciation for friendly and respectful service, and say they might use payday loans again if they are in a difficult-enough situation. But they also state that the loans take advantage of them, need changes, and should be more regulated.

Federal regulators, including the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and especially the Consumer Financial Protection Bureau, have the authority to regulate the payday loan market. This ongoing series by The Pew Charitable Trusts, *Payday Lending in America*, presents in-depth findings to help identify the features of a safe and transparent marketplace for consumer financial services, to inform efforts to protect consumers from harmful practices, and to promote safe and transparent small-dollar credit.

Methodology

Opinion Research

Findings in this report are based on a survey conducted among storefront payday loan borrowers and online payday loan borrowers. The sample for this survey was compiled over the course of eight months of screening on a nationally representative weekly survey. Borrower quotations in this report come from a series of 10 focus groups with small-loan borrowers, as described below.

Survey Methodology

Social Science Research Solutions (SSRS) omnibus survey

The Pew Safe Small-Dollar Loans Research Project contracted with SSRS to conduct the first-ever nationally representative in-depth telephone survey with payday loan borrowers about their loan usage. To identify and survey a low-incidence population such as payday loan borrowers, SSRS screened 1,000 to 2,000 adults per week on its regular omnibus survey, using random-digit dialing (RDD) methodology, from August 2011 to April 2012. The term "omnibus" refers to a survey that includes questions on a variety of topics. This survey took steps to minimize payday loan borrowers' denial of their usage of this product, because the omnibus survey included mostly nonfinancial questions purchased by other clients, and the payday loan questions were asked after other, less sensitive questions, giving interviewers a chance to establish a rapport with respondents.

The first phase of the research, to identify payday borrowers, asked respondents to the omnibus survey whether they had used a payday loan. If respondents answered that they had, they were placed in a file to be re-contacted later. Once the full-length survey was ready to field, in order to maximize participation, people who had used a payday loan were then given the full-length survey and paid an incentive of $20 for participating. Because of their relative scarcity, online payday loan borrowers were given an incentive of $35 for participating.

Respondents were told about the compensation only after having indicated that they had used a payday loan. Further, online payday loan borrowers who were

identified during the early months of screening were sent a letter with a $5 bill informing them that they would be re-contacted to take the full-length survey. The second phase of the research involved re-contacting all respondents who answered that they had used a payday loan and immediately giving the full-length survey to anyone newly identified in the weekly omnibus survey as a payday loan borrower.

Sample and Interviewing

In the first phase of the survey, the Pew Safe Small-Dollar Loans Research Project purchased time on SSRS's omnibus survey, EXCEL, which covers the continental United States. Analysis of the incidence of payday borrowing was conducted after 33,576 adults had been screened and answered a question about payday loan usage. An additional 16,108 adults were screened in order to find a sufficient number of storefront payday loan, online payday loan, and auto-title loan borrowers to complete a 20-minute survey about their usage and views, for a total of 49,684 screens to complete the research. The sampling error for those incidence estimates from the omnibus survey of borrowers is plus or minus 0.24 percentage points.

In the second phase, a total of 451 adults completed the full-length storefront payday loan survey, and 252 adults completed the full-length online payday loan survey, for a total of 703 payday borrowers. The sampling error for the full-length survey of payday borrowers is plus or minus 4.2 percentage points. The sampling error for the full-length survey of storefront payday loan borrowers is plus or minus 4.6 percentage points, and it is plus or minus 6.2 percentage points for the full-length survey of online payday loan borrowers.

EXCEL is a national weekly, dual-frame bilingual telephone survey. Each EXCEL survey consists of a minimum of 1,000 interviews, of which 300 interviews are completed with respondents on their cellphones and at least 30 are conducted in Spanish, ensuring unprecedented representation on an omnibus platform. Completed surveys are representative of the continental United States population of adults 18 and older. EXCEL uses a fully replicated, stratified, single-stage, random-digit-dialing (RDD) sample of land-line telephone households and randomly generated cellphones. Sample telephone numbers are computer-generated and loaded into online sample files accessed directly by the Computer-Assisted Telephone Interviewing (CATI) system. Within each sample household, a single respondent is randomly selected. Further details about EXCEL and its weighting are available at www.pewtrusts.org/small-loans. The proportion of storefront to online borrowers was weighted to the ratio at which they occurred naturally in the omnibus. Including 252 online borrowers

reflects an oversample of 147 online borrowers, and the online borrower results have been weighted down accordingly so they would not have disproportionate influence over the full results.

Question Wording—Omnibus Survey

Wording for demographic and other questions is available at www.pewtrusts.org/small-loans.

Screening Phase (measuring incidence and compiling sample for callbacks):

- In the past five years, have you used payday loan or cash advance services, where you borrow money to be repaid out of your next paycheck?
- And was that physically through a store, or on the Internet?

Re-contact Phase (calling back respondents who answered affirmatively, and identifying additional borrowers to take the full-length survey immediately):

In the past five years, have you or has someone in your family used an in-person payday lending store or cash advance service?

Question Wording—Full-Length Survey of Storefront and Online Payday Loan Borrowers

The data from the nationally representative, full-length survey of 451 storefront payday loan borrowers and 252 online payday loan borrowers are based on responses to the following questions, which Pew designed with assistance from SSRS and Hart Research Associates. All other questions from this survey are being held for future release. The sample for this telephone survey was derived from the RDD omnibus survey. All questions also included "Don't know" and "Refused" options that were not read aloud.

How would you rate the condition of your personal economic situation these days? Is it … (READ LIST)? (ENTER ONE RESPONSE)

1 Very good
2 Fairly good
3 Fairly bad
4 Very bad

How often, if ever, do you have trouble meeting your regular monthly bills and expenses—do you have trouble with this every month, most months, about half the time, less than half the time, or do you never have trouble meeting your regular monthly bills and expenses?

1 Every month
2 Most months
3 About half the time
4 Less than half the time
5 Never

Thinking back now to (that FIRST/the) time you took out (an online payday loan/a payday loan), which of the following best describes what specifically you needed the money for? (READ LIST. ACCEPT ONE RESPONSE.) (IF MORE THAN ONE, ASK:) Well, if you had to choose just one, which best describes what specifically you needed the money for?

1 To pay rent or a mortgage
2 To pay for food and groceries
3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs
4 To pay an unexpected expense, such as a car repair or emergency medical expense
5 To pay for something special, such as a vacation, entertainment, or gifts
6 (DO NOT READ) Other (SPECIFY)

And was that primarily a personal or family expense, or was that primarily for a business that you own or operate?

(INTERVIEWER NOTE: If "BOTH," PROBE—) If you had to choose just one, would you say it was primarily for personal or for business reasons?

1 For personal or family reasons
2 For business I own or operate
3 (DO NOT READ) Both

When you took out (that FIRST/the) (online payday loan/payday loan), would you say the terms and conditions of the loan were very clear, somewhat clear, somewhat confusing, or very confusing?

1 Very clear
2 Somewhat clear
3 Somewhat confusing
4 Very confusing

Please tell me whether you have or have not used each of the following methods to pay back (an online payday loan/a payday loan). How about (INSERT)?

Have you used this method or not?

1 Have used

2 Have not used

a. Friends or family helped pay it off

b. Took out another short-term loan of any type to pay it off

c. Got a loan from a bank or credit union to pay it off

d. Had or saved enough money to pay it off

e. Used a tax refund to pay it off

f. Pawned or sold items to pay it off

g. Used a credit card to pay it off

Are you currently employed? (IF "NO," ASK:) Are you a student, a homemaker, retired, or unemployed?

1 Yes, employed

2 Student

3 Homemaker

4 Retired

5 Unemployed

6 (DO NOT READ) Volunteer

7 (DO NOT READ) Disabled

(ASK ONLY OF EMPLOYED STOREFRONT BORROWERS)

Are you self-employed or a small business owner, or not?

1 Yes, self-employed

2 No, not self-employed

3 (DO NOT READ) Both, self-employed/small business owner and work for someone else

How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?

_____ ($0 to $1,000)

Overall, do you think that (online payday loans/payday loans) MOSTLY help borrowers like you or MOSTLY hurt borrowers like you? (IF "BOTH," ASK:) I know it can be hard to say, but generally do you think they MOSTLY help or MOSTLY hurt borrowers?

1 Mostly help

2 Mostly hurt

3 (DO NOT READ) Some of both/ neither

(Have/Was) the (online payday loan(s)/ payday loan(s)) (been) more a SOURCE of stress and anxiety or more something that has RELIEVED stress and anxiety?

1 More a source of stress and anxiety
2 More something that has relieved stress and anxiety
3 (DO NOT READ) Neither/both

I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash, and short-term loans of any kind no longer existed. How about (INSERT)?

a. Borrow from family or friends
b. Borrow from your employer
c. Sell or pawn personal possessions
d. Delay paying some bills
e. Cut back on expenses such as food and clothing
f. Take out a loan from a bank or credit union
g. Use a credit card

Would you use this option or not?

1 Yes, would use
2 No, would not use

Which of the following best describes your view? (READ LIST. ACCEPT ONE RESPONSE.)

1 (Online payday loans/Payday loans) should be kept as they are now with no changes
2 There should be small changes to (online payday loans/payday loans)
3 There should be major changes to (online payday loans/payday loans)

(Asked of storefront borrowers only)

I'm going to read you several things that some people have told us happened to them. For each one I read, please tell me whether it has happened to you. How about had a payday lender attempt to make a withdrawal that overdrew your bank account? Has this happened to you or not?

1 Has happened
2 Has not happened
3 (DO NOT READ) Does not apply

(Asked of online borrowers only)

I'm going to read you several things that some people have told us happened to them. For each one I read, please tell me whether it has happened to you. How about had an online payday lender make a withdrawal that overdrew your bank account? Has this happened to you or not?

1 Has happened
2 Has not happened
3 (DO NOT READ) Does not apply

Which of these statements comes closer to your point of view?

(READ STATEMENTS)

1 (Online payday loans/Payday loans) should be more regulated

2 (Online payday loans/Payday loans) should not be more regulated

If you find yourself in a financial bind again, how likely is it that you would take out (an online payday loan/a payday loan)? Is it very likely, somewhat likely, not very likely, or not at all likely?

1 Very likely

2 Somewhat likely

3 Not very likely

4 Not at all likely

Have you ever felt you were in such a difficult situation that you would take (an online payday loan/a payday loan) on pretty much any terms offered, or have you never felt that way?

1 Yes, have felt that way

2 No, have not felt that way

How much do you rely on (online payday lenders/payday lenders) to give you accurate information—completely, somewhat, not much, or not at all? (ENTER ONE ONLY)

INTERVIEWER NOTE: ONLY READ IF RESPONDENT VOLUNTARILY ASKS A QUESTION SUCH AS, "WHAT KIND OF INFORMATION?" Say: "Information about the terms of the loan, including how much you pay in interest or fees, and when and how you will need to repay the loan."

1 Completely

2 Somewhat

3 Not much

4 Not at all

Some people say (online payday loans/payday loans) take advantage of borrowers, while other people do not think (online payday loans/payday loans) take advantage of borrowers. What do you think, do (online payday loans/payday loans) take advantage of borrowers or not?

1 (Online payday loans/payday loans) take advantage of borrowers

2 (Online payday loans/payday loans) do not take advantage of borrowers

3 (DO NOT READ) Some of both/neither

I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used (INSERT) in the past year?

1 Yes, used

2 No, have not used

a. A personal checking or savings account at a bank or credit union

b. A credit card

c. A prepaid card that works like a debit card but is not attached to an actual bank account

d. Overdrafting on your checking account (IF NECESSARY: Overdrafting is when your checking account balance becomes negative because more money has been withdrawn than was in the account)

(ASK ONLY OF THOSE WHO HAVE USED A CREDIT CARD IN THE PAST YEAR)

In the past year, have you maxed out or been at the top of your credit limit on any of your credit cards?

1 Yes, have maxed out

2 No, have not maxed out

(ASK ONLY OF THOSE WHO HAVE NOT USED A CREDIT CARD IN THE PAST YEAR)

Have you not used a credit card in the past year because you do not want one, because you think you would not be approved to get one, you are already making payments on one, or did you apply for one and were turned down? (ENTER ONE ONLY)

1 Do not want one

2 Would not be approved for one

3 Already making payments on one

4 Applied and was turned down

5 (DO NOT READ) Have credit card, but haven't used it in past year

6 (DO NOT READ) None of these

Focus Group Methodology

On behalf of the Safe Small-Dollar Loans Research Project, Hart Research Associates and Public Opinion Strategies conducted eight two-hour focus groups, with two groups per location in New York City; Chicago; Birmingham, AL; and Manchester, NH. Those groups were conducted during weekday evenings from Sept. 7, 2011, through Sept. 19, 2011. The Safe Small-Dollar Loans Research Project conducted two additional groups in San Francisco on Nov. 16, 2011. All quotations come from these 10 focus groups.

Endnotes

1 The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), available at: http://www.pewstates.org/research/reports/who-borrows-where-they-borrow-and-why-85899405043.

2 CashNetUSA. https://www.cashnetusa.com/payday/articles/safe-secure-payday-loans-best-found-online.html.

3 Jamie Fulmer's presentation on behalf of the Consumer Financial Services Association available at: http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf.

4 Fisca website: http://www.fisca.org/Content/NavigationMenu/AboutFISCA/FAQs/default.htm.

5 See note 3, above.

6 The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), p. 9.

7 These figures are from Pew's first report in this series, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012). The data for online borrowers have not been previously published.

8 Center for Financial Services Innovation. "A Complex Portrait—An Examination of Small-Dollar Credit Consumers." 2012. Available at: http://cfsinnovation.com/system/files/A%20Complex%20Portrait-%20An%20Examination%20of%20Small-Dollar%20Credit%20Consumers.pdf.

9 Industry analyst Stephens Inc. in its 2011 report estimates that borrowers do not become profitable for lenders until they have borrowed four or five times. Robert DeYoung and Ronnie J. Phillips of the Federal Reserve Bank of Kansas City Economic Research Department also conclude that "the profitability of payday lenders depends on repeat borrowing." http://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf. An analysis of North Carolina data found that 73 percent of lender revenue came from borrowers using seven or more loans per year. Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," Economic Development Quarterly (2003), www.ccc.unc.edu/abstracts/0203_Payday.php. See also: The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), p. 15.

10 Pew's first report in this series, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), found that borrowers are indebted for an average of five months, using eight loans (based on state regulatory data) that last 18.2 days (based on the Annual Report from Advance America, the largest storefront lender, which industry analysts use as a proxy for the storefront payday lending industry).

11 "Oklahoma Trends in Deferred Deposit Lending, 2011." 2011. http://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

12 See note 11, above.

13 See note 9, above.

14 "Florida Trends in Deferred Presentment." 2010. https://www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf. "Oklahoma Trends in Deferred Deposit Lending, 2011." 2011. http://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

15 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. June 2009. http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

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20 See note 9, above. Most borrowing occurs in rapid succession (see note 15, above).

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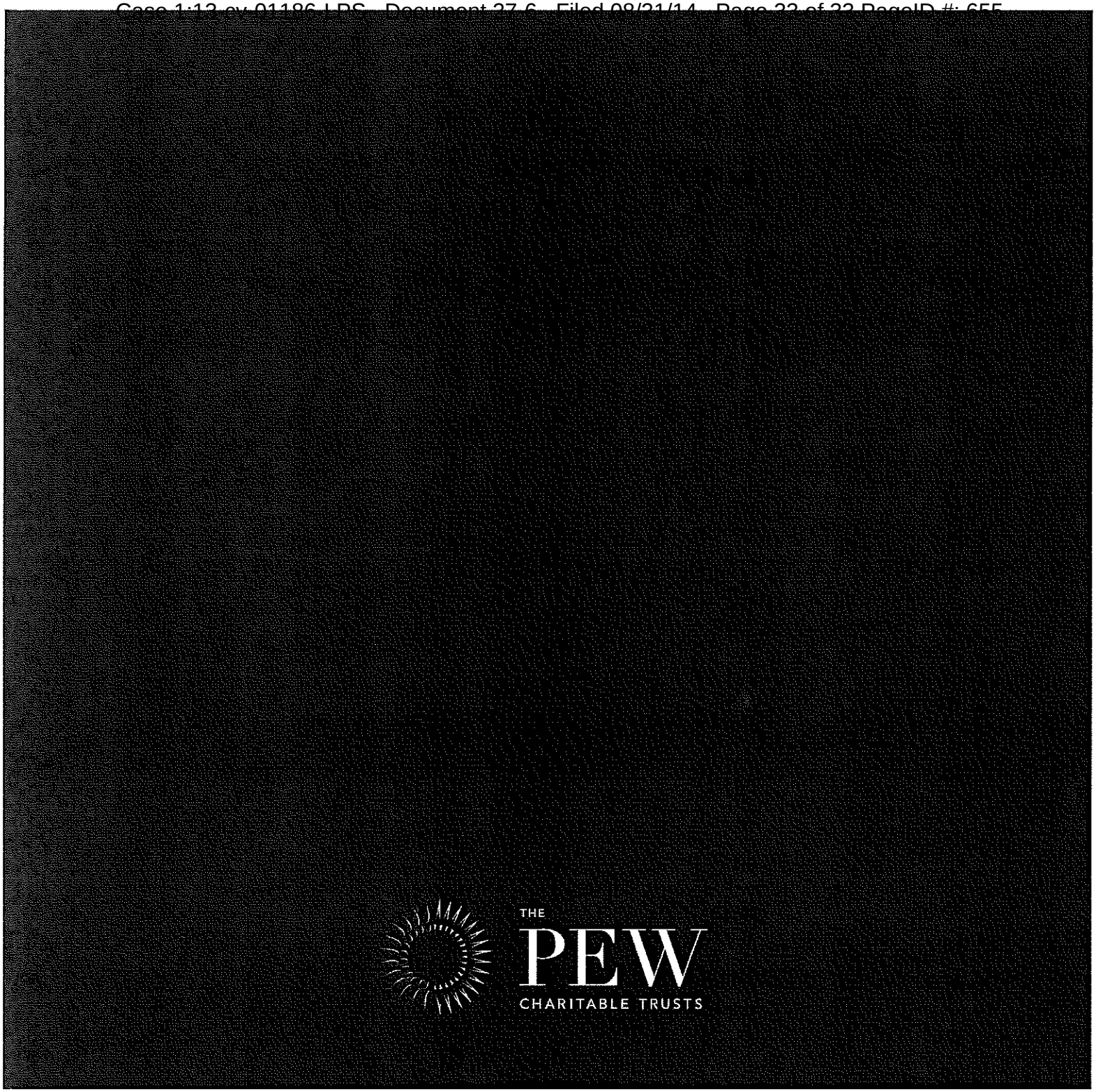
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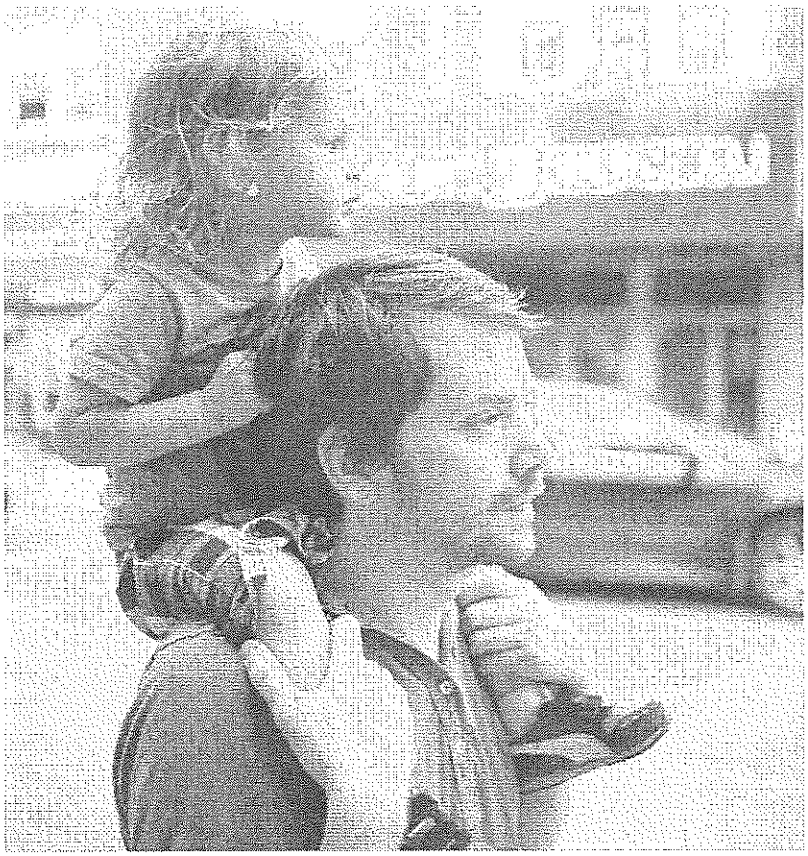
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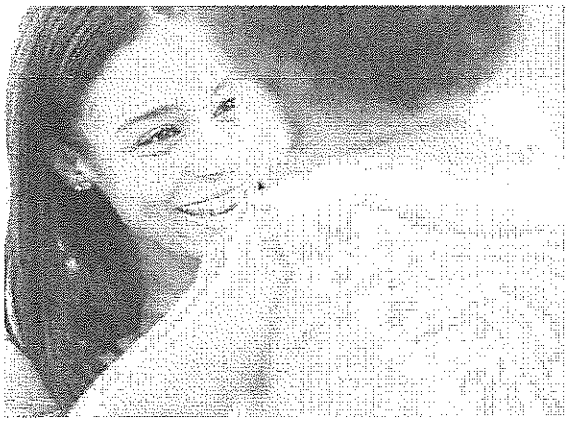
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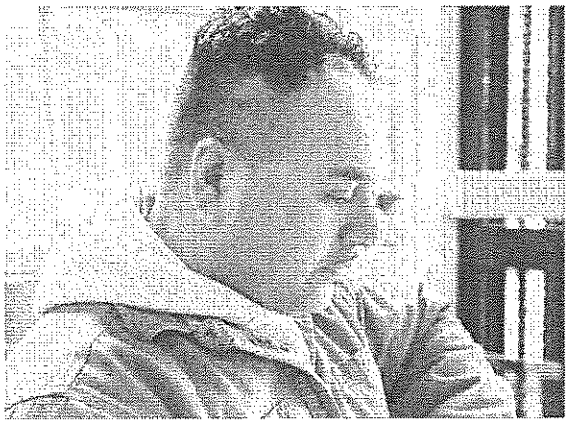
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Exhibit E

A report from THE PEW CHARITABLE TRUSTS | Oct 2013







Report 3 in the *Payday Lending in America* series

Payday Lending in America: **Policy Solutions**

The Pew Charitable Trusts

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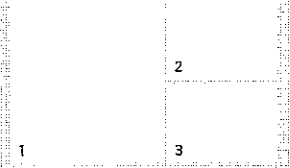
The report benefited from the insights and expertise of five external reviewers: Glenn Firebaugh, professor of sociology and demography, The Pennsylvania State University; Timothy Guinnane, professor of economic history, Yale University; Mike Mokrzycki, independent survey research expert; Alan M. White, professor of law at the City University of New York; and Lauren E. Willis, professor of law, Loyola Law School (Los Angeles). Although they have reviewed the report, neither they nor their organizations necessarily endorse its findings or conclusions.

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For further information, please visit:

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The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

About the *Payday Lending in America* series

The following report is the third in a series on payday lending. The first two reports detailed fundamental problems with the loans, which are due in full on the borrower's next payday. In reality, however, the loans' ultimate cost and duration bear little resemblance to advertised terms. This wide gap between the loans' packaging and borrowers' experience is endemic with lump-sum repayment payday loans.

That research showed that those who take out short-term, small-dollar loans routinely struggle to keep up with living expenses. Most often, they use the loans to pay rent, utility bills, and other routine obligations (as opposed to spreading the cost of purchases over time, which is a more traditional use of credit). Repeat borrowing is the norm, because customers usually cannot afford to pay the loans off on payday and cover their other expenses, so they repeatedly pay fees to renew or reborrow the money for an average of five months of the year.

Lenders depend on this repeat borrowing, because they would not earn enough revenue to stay in business if the average customer paid off the loan within a few weeks. They offer these loans to almost anyone with a checking account and a source of income—without assessing the borrower's ability to repay the loan—in exchange for the right to take full repayment directly from the borrower's checking account on his or her next payday. This ability to collect payment before the customer pays other bills, such as rent or utilities, is unique to payday lenders, and it allows them to thrive even as they make loans to borrowers who cannot afford them.

This report discusses an alternative small-dollar loan product: one repaid in affordable installments over time. This type of loan was ubiquitous in the United States for most of the 20th century. Beginning in the early 1990s, new state laws allowed for today's payday loans, on which a lump-sum payment is due in full on the borrower's next payday. Pew's research examines a 2010 law change in Colorado that alters this paradigm. Colorado's unique six-month installment loan includes a variety of carefully designed protections, works better for consumers than a lump-sum payday loan, and is viable for lenders. These conclusions are buttressed by extensive nationwide research that provides guidance on making the small-dollar loan marketplace more safe, transparent, and predictable, as well as opinion research on how consumers want to see it change.

Contents

1 Overview

3 Selected findings from previous *Payday Lending in America* reports

4 Key findings from this report

4 The current payday lending problem

How payday lending became a problem **5**
The history of installment loans replacing lump-sum repayment loans **6**

7 Section 1: Colorado's move from conventional to installment payday lending

7 A dramatic change to the state's payday loan law

Colorado's situation before the law change **7**
Colorado's policy choices **8**
The Colorado policy framework **11**

12 The new law's impact on Colorado borrowers

Lower cost, fewer renewals **12**
Borrowers explain how affordable installments are more manageable **15**
Indirect benefits **16**

17 The impact on Colorado's marketplace

Payday loan storefront consolidation **17**
Access to credit **18**
Efficiency gains under the new law **18**
Change in market share **19**
Substantial adjustments for lenders **21**

22 Section 2: Strong support for replacing lump-sum payday loans

22 Overwhelming borrower preference for affordable installment loans

Payday borrowers explain why installment payments work better for them **23**

25 Bank, credit union, and regulatory support for installment lending

26 Section 3: Ensuring affordability
The limited benefits of access to credit **26**
The role of underwriting in the small-dollar loan market **27**
The 5 percent affordability threshold **29**

33 Section 4: Important considerations for payday loan reform

33 Ensuring successful installment loan markets
Lender incentives to refinance installment loans create risk of financial harm **33**
How Colorado lawmakers addressed the refinancing problem **35**
An installment *option* is insufficient **36**
Installments do not guarantee affordability—ability to repay is essential **38**

38 Pricing, repayment, and disclosure issues
Complexity could be a cost of compromise **38**
Weak price competition creates a need to limit interest rates **39**
Safeguards are needed for loan collateral and automated payments **40**
Risk of unnecessarily long loan terms must be contained **42**
Financial education and disclosure cannot solve the lump-sum lending problem **42**

44 Conclusion and initial policy recommendations
Limit payments to an affordable percentage of a borrower's periodic income **44**
Spread costs evenly over the life of the loan **44**
Guard against harmful repayment or collection practices **45**
Require concise disclosures that reflect both periodic and total costs **46**
Continue to set maximum allowable charges on loans for those with poor credit **46**
Borrowers want regulators to act **47**
The limited benefits of access to credit **47**

48 Methodology
Opinion research **48**
Survey methodology **48**
Focus group methodology **50**
Colorado interview methodology **50**
Colorado lender location methodology **52**

53 Appendix A: Loans Consume One-Third of Biweekly Income in Conventional Payday States

54 Endnotes

Exhibits

Exhibit 1: Loan Payments More Affordable Under Revised Colorado Law **9**
Exhibit 2: Increased Transparency Under Installment Law **12**
Exhibit 3: Revised Colorado Payday Law Leads to Lower Cost, Fewer Renewals **13**
Exhibit 4: Only 18 Percent of Loans Are Repaid Within 1 Month **14**
Exhibit 5: Colorado Borrowers Describe Impact of Smaller Payments **15**
Exhibit 6: NSF Fees Lower Under Revised Colorado Payday Installment Law **16**
Exhibit 7: Colorado Law Change Leads to Storefront Consolidation **17**
Exhibit 8: Colorado Borrowers Alike Before and After Law Change **19**
Exhibit 9: Colorado Payday Loan Stores Still Widely Available After Law Change **20**
Exhibit 10: Overwhelming Borrower Support for Requiring Installment Payment Structure **22**
Exhibit 11: Lender Costs Driven by Overhead More Than Losses **28**
Exhibit 12: Conventional Payday Loans Consume One-Third of Income **30**
Exhibit 13: Installment Structures Can Improve Affordability **31**
Exhibit 14: Lenders Charge More When Permitted by States **40**
Appendix A: Loans Consume One-Third of Biweekly Income in Conventional Payday States **53**

Overview

About 20 years ago, a new retail financial product, the payday loan, began to spread across the United States. It allowed a customer who wanted a small amount of cash quickly to borrow money and pledge a check dated for the next payday as collateral. Twelve million people now use payday loans annually, spending an average of $520 in interest to repeatedly borrow an average of $375 in credit. In the 35 states that allow this type of lump-sum repayment loan, customers end up having to borrow again and again—paying a fee each time. That is because repaying the loan in full requires about one-third of an average borrower's paycheck, not leaving enough money to cover everyday living expenses without borrowing again.

In Colorado, lump-sum payday lending came into use in 1992. The state was an early adopter of such loans, but the situation is now different. In 2010, state lawmakers agreed that the payday loan market in Colorado had failed and acted to correct it. Legislators forged a compromise designed to make the loans more affordable while granting the state's existing nonbank lenders a new way to provide small-dollar loans to those with damaged credit histories. The new law changed the terms for payday lending from a single, lump-sum payment to a series of installment payments stretched out over six months and lowered the maximum allowable interest rates.

As a result, borrowers in Colorado now pay an average of 4 percent of their paychecks to service the loans, compared with 36 percent under a conventional lump-sum payday loan model. These loans remain costly—with fees and interest, the average annual percentage rate is 129 percent—but individual borrowers are spending 42 percent less money than they did under the old law. Payday lenders in Colorado opposed the state's move toward installment lending with affordable payments, yet after considerable storefront consolidation, credit remains widely available. The Colorado law has transformed a payday lending business with low-volume stores into one that serves more customers at each location, with borrowers spending less on loans annually.

Such a solution to the problems in today's payday loan markets—requiring loans to have affordable payments that pay down principal as well as interest—follows the path taken a century ago by the Russell Sage Foundation and an industry trade group, the American Industrial Lenders Association. They partnered to create the Uniform Small Loan Law, which was eventually adopted by a majority of states. But the protections that law provided were largely undone by the introduction of the lump-sum repayment payday loan in the early 1990s. There is growing recognition of the need to shift back to affordable lending policies for *all* small-dollar loans.

People who use payday loans are struggling financially, and they usually have trouble covering ordinary living expenses from month to month. Most are paying bank overdraft fees, most carry credit card or other debt, and almost all have credit scores that are at the lowest end of the scale. Policy discussion in recent years has focused on whether payday loan customers need more access to credit, and what rate of interest is appropriate for such loans. These are valid questions, but there is insufficient evidence to know whether consumers are better off with or without access to high-interest loans (even if the loans have affordable payments). There is, however, sufficient evidence to conclude that conventional lump-sum payday loans harm consumers compared with loans that have affordable payments. It is clear that the lump-sum payday loan has inherent structural flaws that make it unaffordable and dangerous for consumers, and that new policies to eliminate this failed product are warranted. Thus, policymakers in the 35 states that now have conventional payday lending should act urgently. They may elect to prohibit high-cost payday loans altogether (as 15 states have done), or permit them with substantial reforms.

Colorado lawmakers recognized the danger of lump-sum payday lending and made two judgments that shaped their response. First, they decided to allow payday lenders, who had been operating in their state for nearly 20

years, to continue making small loans to those with poor credit histories. This decision led lawmakers to continue allowing interest rates that significantly exceeded the state's traditional usury rate limit. Second, they resolved to transform the loans into installment products that fit more easily into consumers' budgets compared with conventional payday loans. Combined with significant safeguards that protect consumers from unscrupulous practices, this focus on affordability transformed payday lending in Colorado.

Nonetheless, the Colorado law has some considerable shortcomings: It allows interest rates that may be substantially higher than those needed to sustain profitable small-dollar lending, and its overly complicated fee structure makes comparison shopping difficult and price competition unlikely. Further, it is possible that eliminating high-cost lending entirely in Colorado would have served consumers better. But there are many important lessons in the Colorado example. The law change improved payday lending, demonstrating the viability of requiring affordable installments and comprehensive consumer safeguards.

Although credit can be useful for consumers, this report does not determine whether or not borrowing addresses the needs of those who are chronically unable to meet expenses, or exactly what rates of interest are appropriate for small-dollar loans, and there is little research that answers these important questions. Instead, this report shows how small-dollar loans can work better for borrowers while allowing lenders to recoup costs that compensate them for the risk of providing credit to those with poor credit histories. Drawing from the Colorado example and other research, this report's findings demonstrate that small-dollar lending can fit better into a borrower's budget when loans are due in installments based on ability to repay—that is, to make required loan payments and meet other financial obligations without having to borrow again or draw from savings.

Simply adding installment payment plans to payday loans is not enough, however, because installment loans carry significant risks of their own. Small-dollar loan markets generally lack price competition, so the cost of borrowing becomes unnecessarily high in states that do not limit interest rates. Further, when the law allows installment loans to include fees and charges that are front-loaded, data indicate that lenders encourage borrowers to refinance repeatedly, a process known as loan flipping. And although automated repayment plans have certain benefits, the use of postdated checks and electronic access as loan collateral puts consumers at risk of losing control over their checking accounts and being harmed by unscrupulous lenders who abuse the system. This report provides evidence of these consumer risks and advice on how policymakers can control them.

To address the problems caused by unaffordable small-dollar loans, policymakers should prohibit payments that exceed the borrower's ability to repay. The recommendations at the end of this report include a benchmark for ensuring affordability: limiting most loan payments to 5 percent of a borrower's paycheck (individual gross income). They also promote crucial protections against harmful installment loan practices such as loan flipping and aggressive collection techniques.

Consumers want policymakers to act: By a 3-to-1 margin, payday loan borrowers support more regulation of this market. New findings in this report show that 8 in 10 borrowers favor a requirement that payments take up only a small amount of each paycheck, and 9 in 10 favor allowing borrowers to pay back loans in installments over time.

Federal regulators are beginning to respond. Recently, the Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency called on banks that offer payday loans to underwrite them to ensure that borrowers have the ability to repay them while covering other expenses.[1] The Consumer Financial Protection Bureau, which oversees both bank and nonbank lenders, released a white paper on payday loan products, concluding that "the potential consumer harm and the data gathered to date are persuasive that further attention is warranted to protect consumers" and stating its intention to "use its authorities to provide such protections."[2]

Decisive action is required from federal regulators and also from policymakers in the 35 states that permit lump-sum payday lending. Once small-dollar loans have affordable payments and safeguards in place, state lawmakers may reasonably choose to cap interest rates at or below 36 percent APR if they wish to eliminate payday loans, or above this threshold if they want small loans to be widely available to those with poor or damaged credit histories.

Selected findings from previous *Payday Lending in America* reports

- Twelve million people use payday loans annually. The average loan size is $375.
- Although a payday loan is characterized as a short-term solution for unexpected expenses, the reality is different. The average borrower is in debt for five months during the year, spending $520 in interest to repeatedly reborrow the loan. Sixty-nine percent of first-time borrowers use the loan for recurring bills, and just 16 percent deal with an unexpected expense.
- Most payday loan borrowers have trouble meeting monthly expenses at least half the time.
- Payday loans are unaffordable. The average borrower reports being able to afford $50 per two weeks to a payday lender, but only 14 percent can afford the more than $400 needed on average to pay off the full amount of these lump-sum repayment loans.
- Forty-one percent of borrowers have needed a cash infusion, such as a tax refund or help from family or friends, to pay off a payday loan.
- If payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions.
- In states that enact strong legal protections for borrowers, the result is a large net decrease in payday loan usage. Rates of online borrowing are similar in states with payday loan storefronts and those with none.
- Payday loans do not eliminate overdraft risk. A majority of borrowers overdraw their bank accounts as well.
- A majority of borrowers say payday loans take advantage of them, and a majority also say they provide relief.
- By almost a 3-to-1 margin, borrowers favor more regulation of payday loans.
- Previous reports in the *Payday Lending in America* series, plus videos and other materials, are available at www.pewtrusts.org/small-loans.

Key findings from this report

- **Most small-dollar loan borrowers can afford to put no more than 5 percent of their paycheck toward a loan payment and still be able to cover basic expenses.** Survey and market data show that monthly loan payments exceeding 5 percent of a borrower's individual gross monthly income are unaffordable. Higher payments should be prohibited unless lenders demonstrate, through rigorous underwriting, that borrowers can afford more than that amount.
- **In the 35 states that allow lump-sum payday loans, repayment of these loans requires approximately one-third of an average borrower's paycheck.** In Colorado, where lawmakers required that loans be repayable in affordable installments, payments take up only 4 percent of a borrower's paycheck on average.
- **Safeguards are needed to create successful small-dollar loan markets.** Ensuring that borrowers can repay loans in installments over time will help alleviate the harms of payday lending. But unless policymakers also ensure that loans are structured according to the borrower's ability to repay—and protect against lender-driven refinancing, noncompetitive pricing, excessively long loan lengths, and abusive repayment or collection practices—consumers will remain at risk.
- **These safeguards can be applied in a way that works for lenders. Payday lenders continue to operate in the wake of a recent law change in Colorado, but borrowers are spending less, and payments are far more affordable.** The 2010 state law change required payday lenders to allow borrowers to pay back loans in installments over time with the option to pay them off early without penalty.
- **Payday borrowers strongly support requiring the loans to have affordable installment payments.** Eight in 10 favor a requirement that payments take up only a small amount of each paycheck, and 9 in 10 favor allowing borrowers to pay back loans in installments over time.
- **Policymakers should act now to eliminate the lump-sum payday loan in the 35 states where it currently thrives.** The Consumer Financial Protection Bureau and other policymakers should take steps to make all small-dollar loans safer and more affordable by instituting the following requirements:
    - Limit payments to an affordable percentage of a borrower's periodic income. (Research indicates that monthly payments above 5 percent of gross monthly income are unaffordable.)
    - Spread costs evenly over the life of the loan.
    - Guard against harmful repayment or collection practices.
    - Require concise disclosures that reveal both periodic and total costs.
    - States should continue to set maximum allowable charges on loans for those with poor credit.

The current payday lending problem

Payday loans offer small amounts of cash ($375 on average) to people who have an income source and a checking account. In exchange, lenders charge a fee and have the right to withdraw repayment in full from the borrower's checking account on his or her next payday.

Payday loans are advertised as a two-week product, but borrowers end up in debt for an average of five months of the year.[3] The reason for this disconnect between packaging and usage is that the average loan requires a repayment of more than $400 in two weeks, whereas the average borrower can afford only $50. When the loan

is due, customers can afford to renew or reborrow the loan for a fee ($55 on average at payday loan stores), but they cannot afford to retire the debt in a lump-sum payment. The unusual ability that payday lenders have to collect payment before the customer may choose to pay other bills such as rent or utilities allows these lenders to thrive even as they make loans to people who cannot afford them.

As a result, to pay off a loan, 41 percent of borrowers eventually need a cash infusion, such as borrowing from family or friends or using a tax refund. Twenty-seven percent say a withdrawal by a lender has caused an overdraft in their bank account, and some make arrangements with other creditors, work more hours, or cut back further on expenses to pay off the loans.[4]

Frequently, the alternatives borrowers use to retire payday loan debt were available to them *instead* of using the loans in the first place. But desperation or unrealistic expectations, fueled by the product's unsustainable promise of debt lasting only weeks, often make comparisons with more transparent alternatives—and the fundamental decision about whether to borrow in the first place—difficult.[5] Long-term debt and high costs are the rule rather than the exception: Only 3 percent of lump-sum payday loans go to customers who use just one or two per year, and more borrowers use 17 or more loans in a year than use just one.[6] The payday loan, whether offered by a bank,[7] a storefront lender,[8] or an online lender,[9] simply does not work as advertised for the vast majority of borrowers.

Furthermore, the industry's profitability relies on this repeated usage. Industry analysts estimate that customers do not become profitable to lenders until they have borrowed four or five times.[10] When Washington State enacted a cap of eight loans per borrower per year, for example, a major lender in the state said it could not operate profitably under such a limit.[11] Researchers at the Kansas City Federal Reserve found that "the profitability of payday lenders depends on repeat borrowing,"[12] a sharp contrast to official statements from the industry that payday loans are not meant as a long-term solution.[13]

Thus, heavy usage is not a function of overall demand for payday loans but rather of indebtedness caused by unaffordable loan terms, with 76 percent of loans being renewals or quick reborrows.[14] Lump-sum repayment loans are causing borrowers to be indebted far longer and at a far higher cost than advertised. Significantly, the conventional payday loan business model predicts, encourages—in fact, requires—such chronic usage.

How payday lending became a problem

In the early 1990s, states began to allow an experiment with payday loans, at the behest of industry advocates who argued that a new type of small-dollar loan due in full on the next payday would improve borrowers' ability to manage their cash flow. Lawmakers authorized such loans as a special carve-out to otherwise applicable state lending laws, including restrictions on interest rates and fees. Today, 71 percent of the U.S. population lives in states that authorize high-interest payday lending (14 states and the District of Columbia do not have payday lending stores).[15] Twelve million people use the loans annually, spending an average of $520 in interest to repeatedly borrow an average of $375 in credit.[16]

The problems associated with payday loans have caught the attention of researchers, advocates, and policymakers in recent years, but these problems existed at another time when lump-sum repayment loans were widespread—the early 20th century in the United States. This context is especially important because at that time a solution emerged to the chronic indebtedness caused by unaffordable loan terms—allowing borrowers to repay the loans in installments, with each payment reducing the principal.[17] This experience in the first half of the 1900s has enormous and clear implications for the modern payday lending market. (For more on the history of payday and installment lending, see the box on page 6, "The history of installment loans replacing lump-sum repayment loans.")

The history of installment loans replacing lump-sum repayment loans

In the early 20th century, high-interest credit in the United States was readily available from lenders, and often due on the borrower's next payday.[18] A number of consumer finance experts have written about this period.[19] One author notes that the standard "practice was to require the whole amount to be repaid at the end of the week, [and] the consumer found this hard to do. . . . So he renewed the loan each week by paying a fee."[20] Others describe repaying these loans as "daunting,"[21] explaining that repeated borrowing "almost inevitably results,"[22] because this structure means that the loans are "for too short a period of time, making the payments too high"[23] and thus will "keep the borrower in debt by encouraging renewals."[24] One financial writer describes such lenders' practices: "Short maturities are preferred since those will be harder to repay, and renewal and refinancing charges will build up the 'take.' . . . Interest for the [lenders] becomes almost an annuity."[25] Another notes that those making these loans were "more concerned in collecting the interest than the principal."[26] These analysts recognized that many borrowers could afford to pay only the fee to reborrow, and thus could be in debt for extended periods and still owe as much as they did when they first took the loan.[27]

Around the same time, the Russell Sage Foundation and its expert in the field of small credit, Arthur Ham, recognized the problem with these high-interest, lump-sum repayment loans.[28] A group of unlicensed lenders that offered the loans formed a trade association with the goal of becoming licensed to make small-dollar loans at higher rates than the 6 to 8 percent annualized interest state laws typically permitted at the time.[29] To raise allowable interest rates and end unlicensed lending, this group of lenders and the foundation partnered to create the Uniform Small Loan Law—model legislation that was eventually passed by 34 states to permit licensed lenders to make installment loans.[30]

Legislators enacted the USLL to make small credit affordable, in reaction to the pervasiveness of unaffordable loans from unlicensed lenders, estimated to be used by as many as one in five workers in larger cities.[31] The Russell Sage Foundation and the lenders association agreed upon 42 percent (or 3.5 percent per month) as the annualized interest rate to be permitted for loans of $300 or less. Some states permitted somewhat lower interest rates and still saw a successful market for small credit.[32]

One author explained: "The provision in the law that loans be scheduled for repayment in equal monthly payments was intended to offer the consumer a regular program of amortization, tailor-made for his family budget."[33] A 1938 piece about the impact of the USLL argued, "Insistence upon planned, orderly liquidation of the loan is one of the hallmarks of the honest lender."[34]

This background on the USLL is relevant for improving the contemporary small-credit market, but consumers today, including payday loan borrowers, have had vastly more access to formal credit products, and have dramatically more debt, than their counterparts in the past.[35] Most payday loan borrowers have credit card debt,[36] many are experienced with forms of credit including mortgages and auto loans,[37] and most have recently experienced an overdraft on their bank accounts.[38] The specific dollar and interest figures in the USLL also have limited relevance. Adjusted for inflation, the $300 loans covered by this law in 1916, when it was first drafted, are equivalent to approximately $6,400 in 2013 dollars.[39] Today, consumers (including most payday loan borrowers) use lower-cost credit cards as a primary source of small-sized and midsized credit. The USLL's protections were largely undone by the carve-outs from existing state laws granted to payday lenders in the early 1990s.

Section 1: Colorado's move from conventional to installment payday lending

A dramatic change to the state's payday loan law

In 2010, Colorado lawmakers agreed that the state's 18-year experiment with payday lending had led to unintended and harmful consequences. They dramatically changed the state's payday loan law, shifting from allowing lump-sum repayment loans due in full on the borrower's next payday to requiring that borrowers be allowed at least six months to repay the loans in installments. This major change provided a research opportunity to study the small-dollar loan market and its impact on borrowers before and after the law change. (Throughout this report, the term *small-dollar loan* is used to refer to any cash loan of several thousand dollars or less, whether it is a conventional payday loan due in one lump-sum payment, or repayable in amortizing installments over time, as offered in Colorado, by consumer finance companies, and by some credit unions and banks.)

To understand the impact of the new Colorado law, Pew researchers took a three-step approach:

- Analyzing the annual payday loan data published by the state attorney general's office before and after the law change.[40]
- Conducting four focus groups in Denver and Colorado Springs with 45 borrowers who had used the loans since the law change, many of whom previously used conventional two-week payday loans as well.
- Conducting in-depth interviews in Colorado with 33 people who influenced the law or had seen its impact firsthand, including state senators and representatives, payday lenders, consumer advocates, religious leaders, lobbyists, credit counselors, direct service providers, and legislative staff. The interviews ranged in length from 15 minutes to more than two hours, and 29 participants gave permission for the interviews to be recorded; researchers took notes in the other four. Unless otherwise cited, all quotes about Colorado for the remainder of this report were taken from these interviews and focus groups. All participants were granted confidentiality.

Colorado's situation before the law change

Until August 2010, Colorado, like 35 states today, had conventional payday loans due in full on the borrower's next payday, usually in about two weeks. These loans first emerged in the state in 1992 and were quickly recognized by regulators as extensions of credit under the Uniform Consumer Credit Code, entitling the lender to collect a finance charge.[41] The legislature authorized their exemption from the state's usury interest laws under the Colorado Deferred Deposit Loan Act, enacted in 2000.[42]

Regulatory data from the state demonstrate that borrowers there had the same problems with the loans that borrowers in other states have today—spending far more on the loans than the initial price tag, ending up indebted for months after taking out loans described as lasting two weeks, and being unable to retire their debt without borrowing again soon after.[43] One elected official in Colorado described the business model before the law change as "burn and churn and just keep getting them to pay the fees." A credit counselor described the problems that existed under the old law: "We were working with hundreds of families who were getting in the payday loan cycle . . . that would also spin out their credit cards, it would also spin out their medical bills, and then they'd stop paying their rent on time. . . . And so there was a domino effect."

Colorado previously allowed for a $75 charge per pay period for someone borrowing $500 (similar to what many other states currently allow),[44] and 96 percent of loans were made for the maximum fee permitted.[45]

Consumer advocates, lawmakers, and others in Colorado were concerned about this situation and eager to change the law, focusing especially on ending the repeat borrowing caused by the loans' unaffordable lump-sum structure. One borrower who used loans before the law change explained: "I was taking it out to pay . . . my rent and then when I went . . . my next payday to go pay it off, well then I was $350 short. But I needed that money, so I retook it out. Well, it seemed like every time I'd go pay it off, I'd have to take it right back out. So I did that for about a year."

A social service provider told a similar story about clients she saw before the law change: "People, families, would come in, and they would sort of be caught up in this cycle of debt, and they couldn't get out of it." Because the loans were unaffordable, another Colorado social service provider said borrowers "didn't know how long it would take them or how much it would cost them to pay that back."

In focus groups, borrowers who used the loans before the law change described how they eventually paid them off: "Basically, what I did was worked it out with some other bills. Skipped those . . . skip a credit card payment here and there just to gather that cash to pay that off and get them off your back." Another explained, "[I]f I did not get my income tax [refund] at that time to be able to pay it all back, I probably would have gotten stuck in just paying the interest on and on and on."

Colorado also allowed subprime small installment loans, but at lower interest rates, and the loans required traditional underwriting. Few such loans were made annually, with lenders instead opting to make the higher-interest, higher-payment payday loans.[46]

> "The interests of the business and the interests of the individual were moving in opposite directions [under the old payday loan law]. We wanted one that bent those curves back a little bit by saying the businesses do better when the person actually has a route out of debt as opposed to a route deeper in debt.
>
> —*Colorado elected official*

Colorado's policy choices

By 2008, consumer advocates[47] and many state lawmakers in Colorado agreed that conventional payday loans were harmful to consumers, and that the market was not price competitive.[48] Concerned lawmakers supported a bill that would cap the annual interest rate on payday loans at 45 percent, the state's traditional criminal usury rate limit,[49] with no other fees allowed.[50] Many of the bill's supporters expressed a desire for payday lenders to leave the state, and businesses offering lump-sum payday products argued that they could not survive at that price point. Traditional two-week payday lending from storefronts does not exist in states with double-digit caps on interest rates, although some credit unions, a few banks,[51] and consumer finance companies make small installment loans to customers with poor credit in some of those states.[52]

The 2008 bill to repeal payday lenders' exemption from the state's interest rate cap did not pass.[53] In 2010, a similar bill was introduced.[54] A small group of state senators agreed that there were major problems with conventional payday loans, but wanted nonbank small-dollar lending to continue. One senator described that group's mind-set as, "how [could] we put some controls around it, but maintain the business because I felt it served a legitimate purpose?" These legislators insisted that lenders be given a chance to offer a more affordable

product to consumers, and the resulting compromise was made to garner their votes.[55] (See box on page 11, "The Colorado policy framework.")

At these senators' behest, the bill was amended, replacing the two-week product with a six-month product with no prepayment penalty.[56] The new product would allow an interest rate of 45 percent annually, plus an "origination" fee, and a monthly maintenance fee that would begin at the end of the loan's second month. The origination fee was refundable on a pro-rata basis for loans that were repaid early (for example, repaying the loan in half the time allotted would result in a refund of half the origination fee). This policy ensured that lenders could not fully earn the origination fee immediately at the outset of the loan, so they had no incentive to encourage borrowers to refinance and generate new origination fees.

Exhibit 1

Loan Payments More Affordable Under Revised Colorado Law

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
Maximum loan size	$500	$500
Average annual percentage rate paid	319%	129%
Amortization (payments reduce principal over time)	No	Yes
Deferred presentment loan collateral (postdated check or authorization to debit bank account)	Yes	Yes
Amount due on next payday ($500 loan)	$575	$61
Cost to borrow $500		
For 2 weeks	$75	≈$10
For 3 months	$450	≈$125
For 6 months	$975	$290
For 12 months	$1,950	$580

Note:

Before law change refers to 2009, and after law change refers to 2012. Some numbers have been rounded and all estimates assume a borrower is paid biweekly. Pew's calculations are based on the Colorado Deferred Deposit Loan Act. Cost to borrow for six months and 12 months (equal to two six-month loans) after the law change, and amount due on next payday after the law change, come from Advance America's website. According to Colorado examiner data, lenders have not made loans lasting longer than about seven months.

Sources: Advance America, 2013. Colorado Office of the Attorney General, 2010, 2011, and 2012. Colorado Deferred Deposit Loan Act Rev. Stat. 5-3.1-101 et. seq.

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This new law is complicated, with fees and interest resulting in a contracted effective annual percentage rate typically around 200 percent (effective APR is a measure of cost including interest and fees). People borrowing $500 would pay approximately $290 in finance charges if they kept the loan out for the full six months, billed by the lender as approximately $65 in interest, $75 in origination fees, and $150 in monthly maintenance fees. Someone who makes biweekly payments would repay the loan in 13 installments of just under $61 each.[57]

In practice, state regulatory data show that the average loan is repaid in just over three months and carries a 129 percent APR. Because of the fee structure, a borrower who repays in that time spends less and has a lower interest rate than someone who keeps a loan out for the full six months.[58] The average contracted loan term is just over six months, and the longest is just over seven months.[59] Lenders fully earn the origination fee after six months, and thus there is little incentive to extend loan terms beyond that.

Undoubtedly, these loans are expensive. For those who qualify, credit card cash advances (around 24 percent interest plus fees of up to 4 percent), bank or credit union installment loans (APRs of about 18 to 42 percent, including fees), and consumer finance company loans (averaging approximately 60 percent APR, though for somewhat larger amounts) cost substantially less.[60] But for those using conventional payday loans before the law change, the interest rates of Colorado payday installment loans are comparatively lower—and far lower than those of payday loans in other states.[61] More important, the loans' required payments are far more closely tailored to borrowers' ability to repay, with $61 being a more manageable amount out of a biweekly paycheck (gross individual income) than the $575 required for a $500 loan before—and borrowers are spending far less overall. (See Exhibit 2.)

Interestingly, Colorado did not adopt certain strategies used in other states that similarly tried to preserve payday lending while mitigating its associated harms. Fourteen states have a tracking database in which every payday loan is entered,[62] and in most of these states this information is used to ration how many loans and how much money a person can borrow at a time or in a year, or to impose a "cooling-off" period between loans.

> The law that was passed . . . is not as comprehensive as we wanted it to be. It was a big compromise.
>
> —*Social service provider*

> I'm certainly not a payday lender advocate and honestly would have been fine with seeing them go away altogether. But we were trying to pass a bill that would still be meaningful to the borrowers in our state. . . . We thought this would definitely address that debt cycle. No more balloon payment every two weeks; six months to have some time to get yourself in order and pay back.
>
> —*Consumer advocate*

> We [wanted] there to be a short-term loan package that's available, but we [wanted] it to have a reasonable payback time. We want you to not be able to create an entrapment system that we know is going to make you real revenue from the actual third or fourth turnover in the loan, not from the first one.
>
> —*Colorado elected official*

The Colorado policy framework

As indicated by the roll-call votes in 2010, a majority of state legislators in Colorado agreed that conventional, lump-sum payday lending had failed. The state senators who provided the decisive votes for the final law articulated the following principles in interviews with Pew:

- Payday loans had failed to work as hoped, creating ongoing debt and costing borrowers far more than the stated price tag, and the law authorizing them should be repealed.
- Because Colorado had an existing infrastructure of nonbank lenders, they would be given a chance to provide an alternative small-dollar installment loan that could better serve consumers, even if the loans were far more expensive than mainstream credit products.
- All small-dollar payday installment loans in Colorado would amortize to a zero balance over equal installment payments—over a period long enough to make each payment affordable to the consumer.
- The state's traditional usury rate cap would be acknowledged, but additional fees would be permitted to help nonbank small-dollar lenders stay in business.
- Consumers could choose to repay the loans early without penalty.

Some states with loan-rationing strategies have decreased the volume of borrowing,[63] and have saved consumers money and protected them against some of the financial harm from the long-term use of payday loans. But such measures do not address the loans' fundamental unaffordability. Furthermore, rationing amounts to a tacit admission that the lump-sum repayment payday loan is fundamentally broken or harmful. Rationing requires a database to track and limit loan usage, yet state-administered databases are not typical for other financial products. Instead, credit decisions are generally left to borrowers and lenders, and state governments rarely limit usage or control borrowing behavior.

Colorado legislators explicitly rejected loan rationing, electing instead to address the fundamental unaffordability of the loan rather than preserving the product's unaffordable structure and then trying to mitigate its harm through limiting the number of loans or renewals. One elected official explained the government's intentions in replacing the old law: "They get a loan, two weeks they have to pay $575 back. Well, they didn't have the money to begin with. What changed in two weeks to allow them to deal with that? Nothing. So then they were caught in a cycle. So making it more affordable and allowing them to pay it over six months . . . was key to being able to solve the cycle of debt."

An additional reason for rejecting a loan-rationing approach was a dislike of databases to track loan usage. One elected official said: "People in Colorado don't like those things [databases]. . . . To me, that's like, 'the government wants to know what?' " Another elected official said: "I'm opposed to that kind of micromanagement from the government." A consumer advocate agreed that opposition to a database was widespread: "There's absolutely no support in our legislature for a database from either side. In fact, we had a database built into the bill in '08 initially, and it caught as much flak from people on the left as it did on the right. It was an absolute nonstarter, which was also the problem with the loan restriction bill that caused a great difficulty, and we had to have a database for that in order to make it work."

Officials in Colorado decided to focus on fixing the problems that existed with the product, rather than leaving it intact and placing behavioral constraints on the borrower.

The new law's impact on Colorado borrowers

Lower cost, fewer renewals

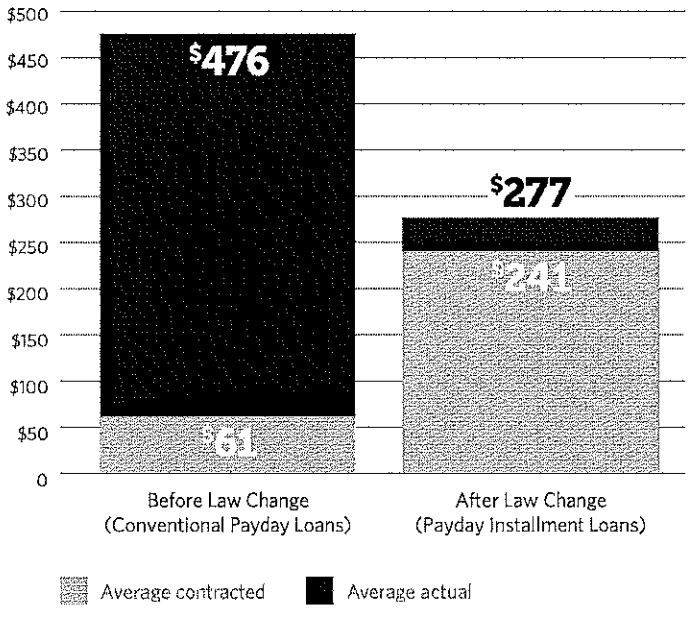
In 2012, the most recent year with data available, borrowers cumulatively spent 44 percent less than they had in 2009 under the conventional payday loan model, saving $41.9 million.[64] Meanwhile, there were no similar declines in other states that published data and did not change their laws.[65] Even with the loans' lower costs, borrowers on average received more credit: 7½ months in 2012, compared with five months in 2009. Additionally, the loan's stated cost for a six-month term gave borrowers a far more representative statement of their likely spending, as shown in Exhibit 2, enabling them to make a more informed decision about whether to borrow.

There were 15 percent fewer borrowers in Colorado in 2012 compared with 2009 (and similar declines did not take place in other states without law changes).[66] One factor that is not primarily responsible for the decline is a lack of access to stores. As shown in Exhibit 9, few stores in the state before the law change closed without one nearby remaining open. Approximately 82 percent of Colorado residents had a payday lender within five miles of their home before the law change, compared with 77 percent after the change.[67] The decline in stores is explained by areas that had many payday lending stores now having fewer, such as a Denver-area zip code that had seven locations and now has three.[68]

It is unclear whether the 15 percent decline in borrowers happened because the ultimate cost of the loan immediately became far more transparent and thus fewer people decided to borrow; because lenders slightly raised borrowing standards; because borrowers who had been unable to retire their debt now had a means to do so and have not continued to borrow; or a combination of these. One lender said a small portion of his borrowers now saw that a $500 loan would cost them $290 or so over six months, and hesitated to borrow. He also said of

Exhibit 2

Increased Transparency Under Installment Law



Under the old law, the average contracted cost represented 13% of fees actually paid. Under the new law, this cost represents 87% of fees actually paid.

Note:

Before law change refers to 2009 and after law change refers to 2012. Indebtedness figures are calculated using the 2009 average loan cost and number of loans (7.84) and the 2012 average loan cost and number of loans (2.3, based on 2011 data because a 2012 figure has not been published).

Sources: Colorado Office of the Attorney General, 2010, 2012, and 2013.

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a few of his long-time customers: "There are people who I never thought would be out of the cycle of debt, I never see anymore." He attributed this to the lower payments under the new law. (See Exhibit 3.)

Exhibit 3

Revised Colorado Payday Law Leads to Lower Cost, Fewer Renewals

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)	Difference
Average loan size	$368[a]	$389	6%
Cost			
Average annual percentage rate paid	319%	129%	-60%[b]
Amount spent per borrower annually[c]	$476[a]	$277	-42%
Total spent on payday loans by borrowers	$95.1 million[a]	$53.2 million	-44%
Usage			
Loans per borrower in past year	7.84[d]	2.3	-71%
Average loan duration	18.91 days	98.90 days	423%
Average days of credit used[e]	148	227	53%
Percentage of loans that are renewals or taken out the same day a previous loan is paid back	61%	30%	-51%

Note:

Before law change refers to 2009, and after law change refers to 2012. Figures for average number of loans used in past year and percentage of loans that are renewals or taken out the same day a previous loan is back are from 2011 because more recent data are unavailable.

a In inflation-adjusted terms, $368.09 in 2009 dollars is equivalent to $393.92 in 2012 dollars, $95.1 million in 2009 dollars is equivalent to $101.8 million in 2012 dollars, and $476 in 2009 dollars is equivalent to $509.41 in 2012 dollars, using the U.S. Bureau of Labor Statistics inflation calculator.

b While this decline in APR is dramatic, it somewhat understates the difference between the cost of the loans before and after the law change. APR is calculated based on the borrower's outstanding balance. Because the balance never declines on single-repayment payday loans, they are somewhat more expensive compared with installment loans than their APR would indicate. For example, a 400% APR lump-sum repayment loan is more than three times as expensive as a 200% APR six-month installment loan. If borrowers used a $500 lump-sum payday loan for six months that had a standard 400% APR, they would pay about $1,000 in interest. If they used a $500 installment loan for six months that had a 200% APR, they would pay about $300 in interest. Thus, an amortizing loan with an APR of half a lump-sum repayment loan will cost substantially less than half as much.

c These figures are calculated using the 2009 average finance charge ($60.74) and the average number of loans (7.84) and the 2012 average finance charge ($120.62) and 2011 average number of loans (2.3).

d In the first half of 2010, before the law change, the average number of loans used in the past year was 8.5.

e These figures are calculated using the 2009 average loan duration (18.91 days) and number of loans (7.84), and the 2012 average loan duration (98.90 days) and 2011 average number of loans (2.3).

Sources: Colorado Office of the Attorney General, 2010, 2012, and 2013. U.S. Bureau of Labor Statistics, 2013.

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> I don't hear the same stories that I heard prior to the law . . . of consumers who have been harmed by payday lending.
>
> —*Colorado elected official*

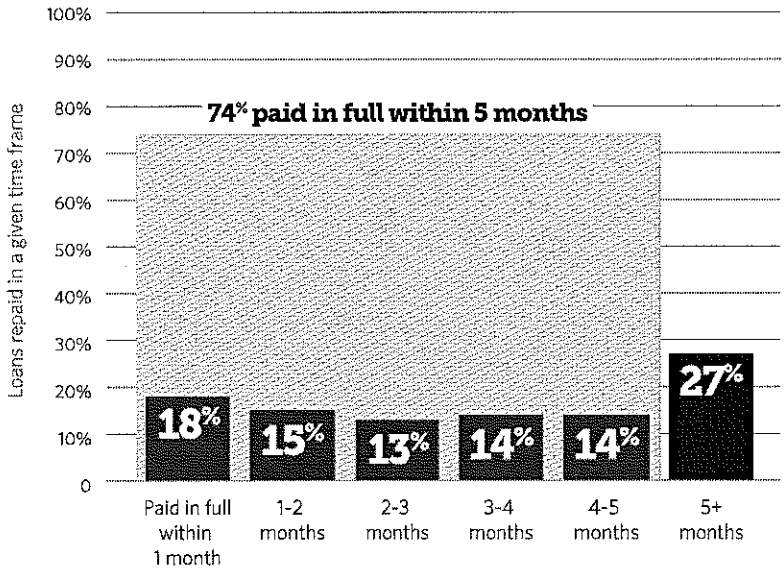
> For us, [the problem] was really the debt cycle, the rolling over. Again, it wasn't an emergency source of cash when people are taking out 12 loans a year, clearly. So . . . we've seen the number of loans go down. . . . Right there, that debt cycle and that phantom demand is gone. Now it's real demand. People who really need a loan are taking them, and we're seeing them pay them back. So we think that it's been addressed.
>
> —*Consumer advocate*

As demonstrated in Exhibit 3, the new loans have lower APRs, and borrowers are spending far less on them annually. If lawmakers had permitted higher rates or fees, the new installment structure would not have necessarily saved borrowers money. If the law had allowed fees and interest that were twice as high (so loans' effective APR averaged 258 percent instead of 129 percent), the same borrowing patterns would have resulted in average annual loan costs of $554—more than before the law change. Alternatively, if lawmakers had required lower interest rates, and lenders had continued to operate, the same borrowing patterns would have resulted in lower costs. This data point indicates the importance of the interest rates that state lawmakers permit if one of their goals is to reduce the total cost of borrowing.

Colorado borrowers are permitted to repay their installment loans at any point without a prepayment penalty. But only 18 percent of loans are repaid within one month, even though borrowers could save substantially on interest

Exhibit 4

Only 18 Percent of Loans Are Repaid Within 1 Month



The average loan is repaid in just over 3 months

Note:

Numbers add to greater than 100% because of rounding. Under the new law, 3.36% of all payday loans were charged off as losses within six months from origination in 2011. According to Colorado examiner data, lenders have not made loans lasting longer than about seven months.

Sources: Colorado Office of the Attorney General, 2012 and 2013.

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and fees,[69] indicating that this choice is not viable because it requires such a large payment. At the same time, nearly three-quarters of loans are paid off before the sixth month, indicating that this becomes more feasible as the principal declines. On average, loans are paid off in just over three months. (See Exhibit 4.)

Borrowers explain how affordable installments are more manageable

Pew conducted four two-hour focus groups with people in Colorado who have used payday installment loans from storefronts. Many had also used lump-sum repayment loans before the law change. They were asked to compare repaying a $500 loan before the law change, when a $575 payment was required, and after the law change, when a payment of approximately $61 was required. A few borrowers said they could afford to repay either loan, and a few could not afford either. Most could afford the smaller payment but not the larger one. (See Exhibit 5.)

Exhibit 5

Colorado Borrowers Describe Impact of Smaller Payments

Colorado's revised payday installment law allows a $61 biweekly payment on a $500 loan, while the previous law allowed a $575 repayment

Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
Borrowers' Descriptions of the Impact of a Lump-Sum Repayment on Their Budgets	Borrowers' Descriptions of the Impact of an Installment Repayment on Their Budgets
Eats up my paycheck	Would be a bill I could manage
Stressful	Easier
Difficult	Doable
Tough to pay all my bills	Relief
Does not work	An inconvenience but workable
Based on my previous experience, vicious cycle	I'm left with a couple hundred
Ramen (for a) couple weeks	Manageable
Depletes my paycheck	Gives me room to breathe
There is no way	Fits right in where I could pay other bills as well
Decimates my budget	Comfortable

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Indirect benefits

Although the law change in Colorado undoubtedly makes payday loans more transparent and affordable for borrowers, preliminary evidence shows the change to affordable installment payments provides benefits in other areas of customers' financial lives.

Credit counselors in Colorado emphasized that, under the previous law, they regularly made arrangements with lenders on behalf of clients that allowed them to repay loans over several months, similar to the loan term in the new law. "So we were pre-negotiating payment arrangements before it was the law," one credit counselor said.

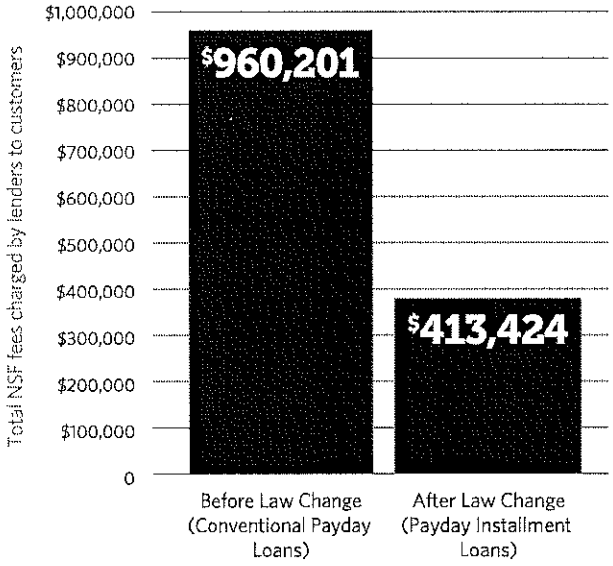
Under the new law, counselors say they are not servicing clients with payday loan debt to the same extent, which they attribute to the new loan structure. "I think it's better to have the option to stretch it out over a longer time than not, just because it takes it off the front burner," one counselor said. "They can keep up with their basic expenses, such as rent. It doesn't end up being an eviction notice." Another counselor said the new law provides borrowers with "an outlet valve" to retire their debt.

Another indirect benefit is borrowers spending less on non-sufficient funds (or NSF) fees. Banks and credit unions charge these fees when a customer's check or electronic debit is declined. If a lender tries to cash a borrower's check or to debit an account for payment and there are insufficient funds, lenders can also charge an NSF fee. The new law permits lenders to charge only one per loan. This protection discourages the repeated presentment of checks or electronic debits, which can trigger fees and checking account problems.[70] Because lenders can charge borrowers only one NSF fee, this restriction encourages them to work with those who are struggling rather than repeatedly presenting postdated checks or attempting to debit accounts. Lender-originated NSF fees have decreased by 57 percent since the law change.[71]

It remains unclear whether the decline in such fees under the new law is a result of lenders being permitted to charge only one NSF fee per loan (with borrowers using fewer loans), or a result of the loans' increased affordability. But in either case, there is an indirect benefit of borrowers spending less on these fees. (See Exhibit 6.)

Exhibit 6

NSF Fees Lower Under Revised Colorado Payday Installment Law



-57% Difference in total NSF fees charged by lenders before and after law change

Note:

Non-sufficient funds (NSF) fees are charged by lenders to customers when a check or electronic debit is declined. Banks and credit unions also charge NSF fees when a check or electronic debit is returned for insufficient funds. Before law change refers to 2009, and after law change refers to 2012.

Sources: Colorado Office of the Attorney General, 2010 and 2013.

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The impact on Colorado's marketplace

More efficient lending is evident in Colorado today, with lenders adjusting their business models to survive in the new marketplace for payday installment loans. This section examines changes in the market under the new law.

Payday loan storefront consolidation

Colorado's law change has resulted in substantial storefront consolidation, with 53 percent fewer payday loan stores in the state in mid-2013 than at the conclusion of 2009. (See Exhibit 7.)

Exhibit 7

Colorado Law Change Leads to Storefront Consolidation

Revised law brings efficiency as lenders cut costs and increase volume per store

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)	Difference
Total number of individual consumers to whom loans were made in year[a]	279,570	238,014	-15%
Number of licensed locations	505	238	-53%
Borrowers per store[b]	554	1,000	81%

Note:

Before law change refers to 2009, and after law change refers to number of licensed locations in the second quarter of 2013 and number of individual consumers in 2012 because more recent data are unavailable.

a Because a database is not in place, these figures count a customer who borrows from multiple lenders as multiple customers (both before and after the law change).

b Borrowers per store are calculated by dividing the number of total borrowers by the number of stores. The after law change figure relies on the number of stores reported by the Office of the Attorney General during the second quarter of 2013, and uses the number of borrowers from 2012, because a 2013 figure is not yet available. If the 2012 figure on number of stores is used (287), the result is 829 borrowers per store, because consolidation was in an earlier phase.

Sources: Colorado Office of the Attorney General, 2010 and 2013.

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There have not been similar declines in states without law changes,[72] suggesting the consolidation in Colorado is largely a result of the new law. Payday loan storefronts that have remained open are each serving far more customers than before the change. Academic research using data from other states before the Colorado law change identified this phenomenon of lower interest rate limits leading to consolidation and higher volume per store.[73] Colorado has also had this experience.

Lenders still operating in the state say one reason some colleagues have left Colorado is that they can charge more in other states or online. A lender described being approached by consultants and others serving the industry who encouraged him to become an online lender after the law change. Another lender noted that several licensed lenders making loans online in Colorado before the change have stopped because "they can put their money in more profitable states." He summed up the thinking of his counterparts who have closed locations as "'why not put it in another state, where we make more money?'"

Generally, small-dollar lending remains more profitable (on a per-customer basis) in the 35 states that continue to allow conventional short-term payday lending than in Colorado.[74]

> All the doomsday scenarios haven't come to pass, so I think that's been a pretty good metric for success.
>
> —*Colorado elected official*

> Certainly, when you drive down the streets, you still see the signs up. And there are enough of them up there, so they're still obviously [doing] a reasonable business.
>
> —*Colorado elected official*

Access to credit

State regulatory data provide further evidence of the limited impact of consolidation on access to credit, showing a decline of only 15 percent in the number of borrowers overall.[75] Borrowers in Pew's Denver and Colorado Springs focus groups did not report additional difficulties in traveling to or receiving credit from payday lending stores since the new law took effect, and noted that there were still many stores they could use. Payday loans remain readily available from storefronts, as demonstrated by systematic plotting of all stores in the state before and after the law change; in some instances, there are still multiple payday lenders on the same block and in the same shopping center.[76]

Because the payday loan product in Colorado shifted dramatically, from a two-week, lump-sum repayment loan to a six-month installment loan at a lower interest rate, it is important to investigate whether a different type of borrower is using the new product. Data from the Colorado attorney general's office demonstrate that borrowers before and after the law change are quite similar. These demographic data, in combination with the small decline in borrowers, suggest that the new law has not substantially reduced access to credit for payday borrowers. (See Exhibit 8.)

Exhibit 9 plots payday loan stores before and after the new law took effect. As the map demonstrates, few stores closed without one nearby remaining open. Instead, the decline in the number of stores resulted in decreased density of payday loan stores in areas that had many. As a result, geographic access to payday loan stores has been largely unaffected, despite the substantial consolidation.

Efficiency gains under the new law

Since Colorado's new law was implemented, the payday lending industry there has become more efficient than it was previously, or than it is in other states. Nationally, payday storefronts make only about 10 to 13 loans per day,[77] and most of these are renewals or quick reborrows by repeat customers.[78] In other states, payday loan storefronts serve approximately 500 unique customers per year,[79] whereas in Colorado stores now serve nearly twice as many customers as before. Lenders report that with fewer storefronts serving more customers each, revenue per store is about the same as it was before the law change, as of early 2013. Regulatory data corroborate this observation.[80] The Colorado law has transformed a payday lending business with low-volume stores into one that serves more customers at each location, with borrowers spending less annually on loans.

Exhibit 8

Colorado Borrowers Alike Before and After Law Change

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
Gross monthly income (mean)	$2,458[a]	$2,477
Gross monthly income (median)	$2,199[a]	$2,140
Age	38	37
Average time at current job	3.5 years	3.6 years
Female	55%	52%
Married	35%	35%

Note:

Before law change refers to 2009, and after law change refers to 2011, because 2012 demographic data are unavailable.

a In inflation-adjusted terms, $2,458 in 2009 dollars is equivalent to $2,577 in 2011 dollars, and $2,199 in 2009 dollars is equivalent to $2,306 in 2011 dollars using the U.S. Bureau of Labor Statistics inflation calculator.

Sources: Colorado Office of the Attorney General, 2010 and 2012. U.S. Bureau of Labor Statistics, 2013.
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Change in market share

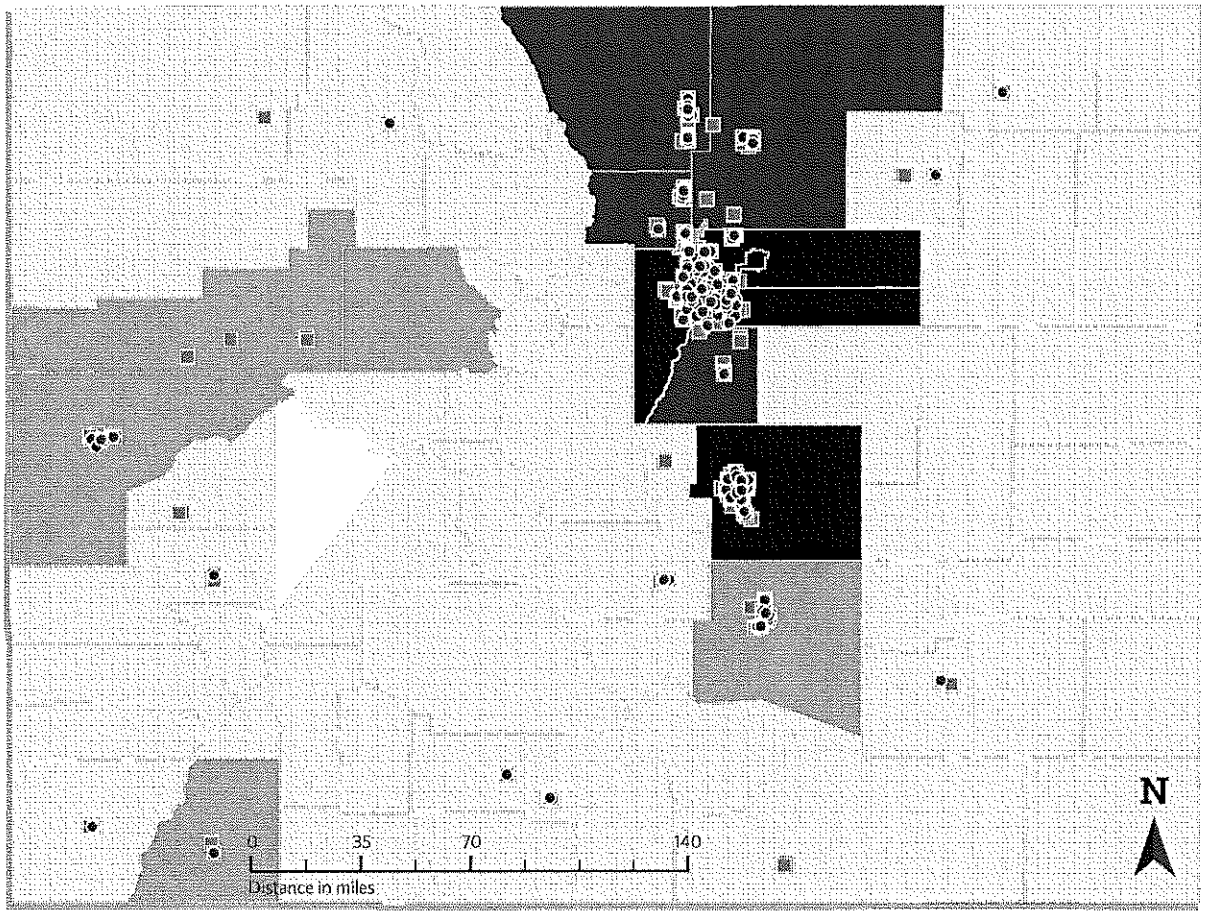
Since the new law went into effect, larger operators have increased their market share in the state. Before the change, seven of the largest operators[81] owned 59 percent of Colorado stores.[82] By the end of 2011, their market share was 69 percent,[83] and more recent data indicate that figure has risen to 73 percent.[84]

Several lenders believe this change occurred because larger lenders could afford to operate at slimmer margins and benefit from economies of scale. One lender said: "It's just the reality of how deep the pockets are or how shallow the pockets are, to be able to make it work." Large lenders have fewer stores than before the law change, but their decline has been outpaced by small operators, who have left the market or who also have fewer stores.

Additionally, large lenders that do not offer check cashing have experienced a 55 percent decline in store count since 2009, much higher than the 17 percent decline for large lenders that offer check cashing. This stark difference suggests that at the lower prices now permitted for payday loans, firms whose revenue comes from multiple products have fared better. Similarly, in Oregon, which requires among the lowest interest rates in states where payday lenders operate, the market is dominated by companies that also provide check cashing and other alternative financial services.

Exhibit 9

Colorado Payday Loan Stores Still Widely Available After Law Change



- Location open after law change (Aug. 1, 2013)
- Location open before law change (April 1, 2010)

Percent of total population by county

<1 1-4 4-8 8-12

Note:

Methodology is available on page 52. Before the law change, 82% of the population lived within five miles of a payday lender, compared with 77% afterward. Similarly, 93% of the population lived within 20 miles of a payday lender before the law change, compared with 91% afterward.

Sources: Colorado Office of the Attorney General, 2013, U.S. Census Bureau, 2011, Yahoo, Inc., 2013.

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Substantial adjustments for lenders

The Colorado law has clearly benefitted borrowers, but lenders have had to make significant changes to their business model. In addition to storefront consolidation, several lenders whom Pew interviewed described laying off employees, dealing with lower income themselves, and struggling to gain stability operating under a new set of laws. One said: "We had to lay off . . . employees, renegotiate our leases. Essentially, we had to reduce our overhead by 60 percent, and we had to double our customer count [per store]." Another noted, "To make the same amount of money, you have to have double the volume."

Lenders reported that revenue per store had recovered to previous levels, but profitability had not yet stabilized as they adjusted to the new law. Several lenders said they carry more risk under this loan structure, and now have somewhat higher losses than before the law change. They attributed this shift to there being six months (rather than two weeks) for something to happen that could result in nonpayment. Lenders' loss rates on payday loans nationally are about 3 percent of dollars lent,[85] and in Colorado lenders said their losses were now somewhat higher. Published data on loss rates in Colorado are not available. While not directly comparable, data from the Colorado attorney general's office indicate that 3.36 percent of loans were charged off as delinquent within six months of origination in 2011, and another 6.28 percent remained open with borrowers behind schedule on payments.[86] The other 90 percent of loans were paid in full or were being paid as agreed.[87] Data from the attorney general's office indicate that the number of annual defaults per borrower declined 30 percent under the new law.[88]

Despite concerns about losses, lenders have tightened standards only very modestly. One described customers as having "D or F" credit both before and after the law change. The only changes his company made were to avoid people who had four or more lenders already making withdrawals from their checking account, or people with four or more overdrafts in the past month. Another lender had slightly raised requirements for income and employment longevity. Other lenders Pew interviewed had not made these small changes, and none had begun underwriting in the way that conventional lenders do for more traditional products, such as home mortgages, auto loans, or credit cards.[89] Instead, Colorado payday installment lenders continue to offer loans based on the consumer's income and possession of a checking account that can be accessed to collect payments via electronic debit or postdated check. Accordingly, evidence suggests that the new law has not substantially reduced access to credit for payday borrowers.

Although lenders continue to operate in Colorado, they are not pleased with the law change. In addition to experiencing reduced profitability per customer, lenders had to adapt their computer systems, with one noting that initially "there were no software companies that could calculate the rate." Those with fewer stores have laid off employees and adjusted to earning less. One lender described earning far more in the years before the law change, and said his upper-tier borrowers now have higher incomes than he does.

As another lender said, "We, as an industry, weren't opposed to a longer-term product. But, you know, it has to be viable for us to be able to deliver it." The new Colorado product has proved viable for lenders since its implementation in 2010. But it cannot sustain the number of stores that existed in the state before, so lenders have struggled to reach a new equilibrium as consolidation has continued.

Section 2: Strong support for replacing lump-sum payday loans

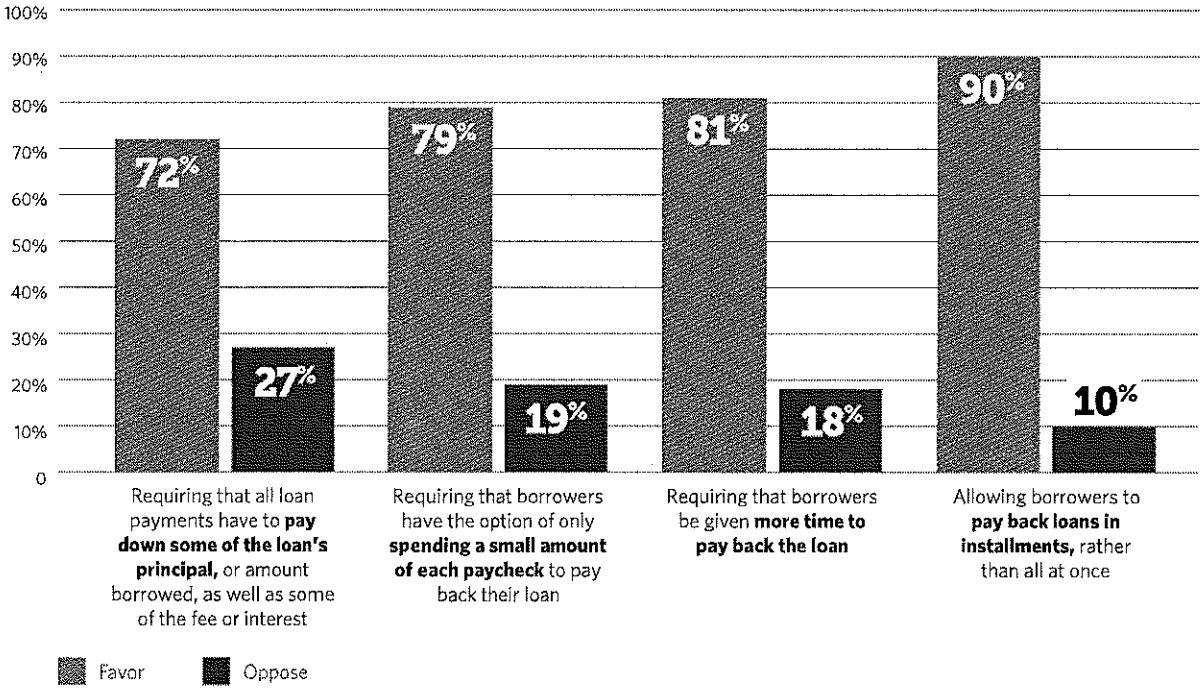
Overwhelming borrower preference for affordable installment loans

Pew conducted 14 focus groups in seven locations around the United States to learn about borrowers' experiences using various types of small-dollar loans. Borrowers of conventional payday loans embraced several changes that would make the loans more transparent and predictable.

Pew then tested reaction to specific changes in a nationally representative telephone survey of payday customers.[90] Seventy-two percent said they wanted more regulation of payday loans, and by a 2-to-1 margin they wanted changes in how the loans work. Pew also asked about four policy changes that could be enacted. All received overwhelming support from borrowers.

Exhibit 10

Overwhelming Borrower Support for Requiring Installment Payment Structure



Note:

Data represent percentage of payday borrowers who gave the listed answer. Results are based on 703 interviews conducted from December 2011 through April 2012. Respondents were asked: "Now I'm going to read you some ideas for how payday loans could be changed or modified. After I read each idea, tell me whether this sounds like something you would favor or oppose. How about ...? Do you favor or oppose this?" Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart.

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Payday borrowers explain why installment payments work better for them

The following quotes come from borrowers in focus groups held around the United States:
Source: The Pew Charitable Trusts, 2013

Paying principal as well as interest

> I mean, if you pay it in small amounts over time, and all you're doing is paying toward the interest, then there's no point to that.
>
> —*Colorado Springs borrower*

> I wish they'd start going [after] the principal right at the start.
>
> —*New York online borrower*

> Otherwise, you never get it paid off, if you're paying interest, interest, interest.
>
> —*New Hampshire former storefront borrower*

Having more time to repay

> You have that option. You could pay it over time or pay it as much as you want, but it's still a benefit of knowing on payday, I just borrowed $500, so when payday comes, I don't have to worry about going to the bank and they're taking the $500 out.
>
> —*San Francisco borrower*

> If they took out 100, I wouldn't be in any hole, any financial stress. [Installment loans] give you time. That's the best thing: time to pay it.
>
> —*San Francisco borrower*

> Give people a little breathing room and the opportunity to get ahead.
>
> —*Denver borrower*

Limiting payments to a percentage of paycheck

> You know on payday, I'm not going to get there, and I just look at my paystub and it says $798, but then, when I get to the bank, it says $232.
>
> *—San Francisco borrower*

> You need that money from the next paycheck that is coming, but they take it all and then you're going to have to find another way to get the money from somewhere to cover that amount.
>
> *—San Francisco borrower*

> Then I [would not be] stressed out about renewing, like to try to figure out how I am going to make up all that extra money. Whereas if they are just taking out a little bit, I can kind of work around it a little bit better—eat cheaper or maybe I do not drive so many places to waste gas money.
>
> *—Denver borrower*

Paying in installments

> When I went to get that payday loan, I absolutely needed that money that moment. Okay? That's not to say that when they snatch the whole $500 back, at that date, it won't still put me in a hole. I was surprised when [the credit union] said I could make payments. I didn't even believe it. I smiled. I said, 'Really?'
>
> *—San Francisco borrower*

> It allows that person to still have money at the end of that pay period versus having to get that entire amount back. You can see yourself sacrificing $100 or $125 versus . . . $500.
>
> *—Birmingham, AL, borrower*

> It's hard to come up with $500. It's a lot easier to come up with . . . a smaller amount more frequently, every paycheck.
>
> *—Chicago borrower*

Bank, credit union, and regulatory support for installment lending

Some banks, credit unions, and regulators have similarly pointed to installment lending as the only viable way to provide small-dollar loans that consumers can repay as scheduled. The Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and National Credit Union Administration have emphasized the importance of amortization in creating safe consumer loans in the credit card market.[91]

In 2008, the FDIC created the two-year Small-Dollar Loan Pilot program to explore the feasibility of offering safe and affordable small-dollar loans at banks. The result was a model that banks can use to create a small-dollar loan product, including a minimum 90-day term and maximum annual percentage rate of 36 percent. Although the model included several important features, participating bankers felt the longer loan term was most important "because it provides more time for consumers to recover from a financial emergency than the single pay cycle for payday loans, or the immediate repayment often required for fee-based overdrafts."[92] (As discussed in the next section, the FDIC and Office of the Comptroller of the Currency recently announced proposed guidance that strongly favors the use of affordable installment loan structures.)

Liberty Bank in New Orleans participated in the program and initially offered a loan term of three pay periods, but borrowers had difficulty repaying the loans and renewed them repeatedly. To avoid this loan churning, Liberty Bank increased its term to a minimum of six months, and found that most borrowers needed at least 90 days to repay a loan.[93]

Other banks and credit unions have experimented with versions of small-dollar loans, such as the KeyBasic Line of Credit from KeyBank that can be paid back in installments for up to 60 months.[94] In an interview with *American Banker*, an executive from the bank commented on the long-term repayment schedule: "While theoretically people could go for [five years], it's really about saying that we're not going to take a huge chunk of somebody's pay to force them to pay it."[95]

Similarly, credit unions frequently offer loans with longer terms to create affordable installment payments. North Side Community Federal Credit Union in Chicago offers a six-month loan term.[96] Credit unions in Pennsylvania offer loans with a 90-day repayment term,[97] and loans promoted by the National Federation of Community Development Credit Unions have repayment terms of three months to a year.[98]

Section 3: Ensuring affordability

Pew's second report in this series found that on average, payday borrowers can afford $50 per two weeks toward servicing small-loan debt—enough to renew or reborrow a loan, but not enough to repay the $400 or so typically required to pay it off[99] (as shown in Exhibits 12 and 13, lump-sum payday loans require approximately one-third of a typical borrower's paycheck). Thus, the loans become essentially interest-only, and the loan balance does not decline until a borrower can find a lump sum to pay it off, often a windfall or other loan.[100]

This phenomenon plays out even in states that technically prohibit renewals or have brief "cooling-off" periods, because borrowers cannot afford to meet their obligations after repaying a lump-sum loan and thus quickly take another one. Research sponsored by both consumer advocates and the payday lending industry finds that lump-sum repayments, rather than high interest rates, lead to repeat borrowing.[101] This occurs because the lump sum exceeds the borrower's ability to repay; in other words, typical payday loans are *unaffordable.* The term *ability to repay* is used in this report to mean that a loan payment fits into borrowers' budgets while still allowing them to cover basic expenses without having to borrow again or draw from savings.

Borrowers say the primary reason an installment loan works better than a lump-sum repayment loan is simply that they can afford the payments. A sustainable installment loan is one in which each payment reduces the principal, in affordable increments, so the balance has been reduced to zero at the end of the loan term. At that point, the customer can choose whether to borrow again.

The limited benefits of access to credit

Rather than being "thin file" or "no file" consumers who are creditworthy but lack access to mainstream credit, most payday loan borrowers are "thick file" consumers who have substantial experience with debt. More than half of payday loan applicants carry credit card debt, two in five payday borrowers own homes (many with mortgages), and many also hold student loans, auto loans, and other debt.[102] Typical payday loan applicants have poor credit scores in the low 500s,[103] indicating an assessment by credit reporting agencies that payday borrowers are already overburdened with debt and/or struggling to meet financial obligations.

Fifty-eight percent of payday loan borrowers have trouble paying their bills at least half the time, and 7 in 10 use loans to cover ordinary living expenses, such as rent or utilities.[104] Payday borrowers' having little discretionary income helps explain why 79 percent in Pew's survey support limiting the size of a loan repayment to a small amount of each paycheck.

Whether it is wise to use short-term credit to cope with persistent cash shortfalls is debatable, and policymakers surely will continue to examine the merits of promoting credit for consumers who are already indebted and struggling to make ends meet—especially when that credit comes at significantly higher cost than mainstream products. It is entirely possible that consumers who are already struggling with debt have financial problems that cannot be solved by obtaining more credit. But for those who use credit, requiring loans to have affordable installment payments that predictably amortize to a zero balance can avoid creating an unsustainable reliance on getting new loans to deal with shortfalls caused by repaying old ones. Thus it becomes clear why 90 percent of payday borrowers in Pew's survey favor allowing the loans to be repaid in installments.

Some consumers will struggle to repay any type of loan. In Pew's survey, one in five said they could not afford anything toward the repayment of a loan, which raises questions about whether they should choose *any* loans.

But for the two-thirds of borrowers who *can* afford to make some payment (though less than the full amount due on a typical lump-sum repayment payday loan), a well-designed installment loan is affordable, and a lump-sum loan is not. For the remaining 14 percent of payday borrowers who say they can afford more than $400 out of their monthly budget to pay back their loans, they may choose to repay small-dollar installment loans quickly (like the 18 percent of Colorado borrowers who repay the loans within one month; see Exhibit 4).

Although the net benefit of using high-cost credit to deal with persistent cash shortfalls is not clear, it is clear that if high-interest loans are permitted, consumers fare better with amortizing installment credit than lump-sum repayment credit.

Although the net benefit of using high-cost credit to deal with persistent cash shortfalls is not clear, it is clear that if high-interest loans are permitted, consumers fare better with amortizing installment credit than lump-sum repayment credit.

The role of underwriting in the small-dollar loan market

Most traditional lenders, including nonbank consumer finance companies that make installment loans of up to several thousand dollars,[105] perform underwriting to determine what payments are affordable based on an analysis of the borrower's income and expenses.[106] Banks, credit unions, specialized auto and mortgage lenders, and others traditionally engage in a similar process to assess what a borrower can afford.

Payday lenders are unique because they do not use traditional underwriting to determine whether the borrower has the ability to repay the loan while fulfilling other obligations.[107] They focus primarily on the ability to collect repayment, using leverage based on a deferred presentment (holding the borrower's postdated check or having electronic access to the borrower's checking account).[108]

Recently, the Office of the Comptroller of the Currency and the FDIC expressed concern that some of the nation's largest banks are providing payday loans, also known as deposit advance loans, without engaging in a proper underwriting process. Like payday loans, deposit advances are lump-sum loans; they are repaid out of the borrower's next direct deposit, and borrowers tend to use them repeatedly because they cannot repay them without taking another to cover expenses.

In a statement of proposed guidance from April 2013, the agencies found that a bank offering deposit advance loans "does not analyze the customer's ability to repay the loan." They further found that: "The decision to advance credit to borrowers, based solely on the amount and frequency of their deposits, stands in contrast to banks' traditional underwriting standards for other products, which typically include an assessment of the ability to repay the loan based on an analysis of the

borrower's finances." In response, these regulators concluded that banks should underwrite small-dollar loans based on "the customer's ability to repay a loan without needing to borrow repeatedly from any source, including reborrowing, to meet necessary expenses."[109] This kind of underwriting is important because it requires lenders to assess a borrower's inflows and outflows to determine what residual income is available for loan payments.

It is clear that assessing a borrower's ability to repay must take place to ensure that small-dollar loans are affordable. Banks are experienced in underwriting loans, and many can leverage existing infrastructure to conduct sound underwriting of small-dollar loans. Similarly, many nonbank lenders, such as state-licensed consumer finance companies, have significant experience underwriting such loans.

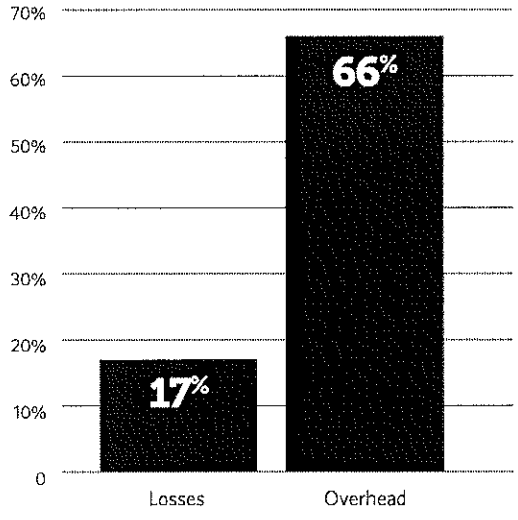
For conventional payday lenders, the transition to proper underwriting will be difficult. Their business model avoids almost entirely this cost of ensuring ability to repay, relying instead on a loan structure that gives the lender the right to collect the loan in full directly from the borrower's checking account on his or her next payday. The transition to underwriting would add complexity and cost to a payday lender's business model,[110] which is already characterized by high overhead costs.[111] (See Exhibit 11.) These costs include storefront locations that average only 10 to 13 loans per day and serve only about 500 unique customers per year.[112] Less detailed information is available for online lenders, but costs include expensive customer acquisition through lead generators,[113] celebrity endorsements, and television commercials to create demand.

Payday loan interest rates are not high simply because lenders must compensate for high losses; they are high primarily because of overhead. Although payday borrowers generally have a damaged credit history, two-thirds of revenue covers storefront and corporate overhead and only one-sixth covers losses. This dynamic helps explain why lenders do not assess ability to repay: Underwriting reduces losses, which are already low, but can increase costs, which are already high.

Exhibit 11

Lender Costs Driven by Overhead More Than Losses

Payday lender expenses as a percentage of revenue



Storefront lenders spend four times more on overhead than on losses

Note:

54% of revenue is used to cover storefront overhead, while 12% is used to cover corporate overhead. As classified in Advance America's 10-K, storefront overhead comprises: salaries and related payroll costs; occupancy costs; center depreciation expense; advertising expense; and other center expenses. Corporate overhead comprises: general and administrative expenses; legal settlements; corporate depreciation and amortization expense; interest expense; loss on disposal of property and equipment; loss on impairment of assets; minus interest income.

Sources: 2011 Annual (10-K) Report from Advance America, the largest storefront lender in the United States, 41.

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The 5 percent affordability threshold

In the vast majority of cases, lump-sum payday loans will not meet any rational ability-to-repay test, requiring lenders instead to provide installment loans that borrowers can pay off over time. But converting a payday loan to an installment loan will not by itself ensure that the payments are affordable. As explained below, four separate data sources suggest that small-dollar loans are not affordable, on average, if payments take more than 5 percent of a borrower's paycheck (for example, a monthly loan payment should not take more than 5 percent of a person's gross monthly income). All figures below refer to individual income unless otherwise noted.[114]

- **Survey data.** In Pew's nationally representative survey of payday loan borrowers, average borrowers said they could afford $50 per two weeks out of their paycheck toward payday loans. Comparing this figure with their self-reported income[115] reveals that 54 percent of borrowers can afford 5 percent of their income or less toward payday loan debt. The median borrower can afford 5 percent.
- **Existing installment lending market data.** Consumer finance companies are state-licensed nonbank lenders that offer money to low- and moderate-income borrowers via installment loans that are underwritten to assess borrowers' cash flows. Pew reviewed a sample of these loans made by more than a dozen companies. The loans ranged in size from several hundred dollars to several thousand dollars. Pew cannot independently assess these loans' affordability, but these data reveal what payments exist in a small-loan market with traditional underwriting.[116] For 76 percent of installment loans in this sample, monthly payments equaled 5 percent or less of borrowers' monthly income.[117] Eighty-six percent of loans had monthly payments that consumed 2 to 7 percent of a borrower's monthly income, and a majority had monthly payments consuming 3 to 6 percent of a borrower's monthly income. Additionally, a consumer finance company reviewed its complete customer files for Pew and found that only one in seven loans had payments greater than 10 percent of a customer's income, with most between 4 and 8 percent.
- **Conventional payday loan fee arrangements.** Conventional, storefront lump-sum repayment payday loans carry an average fee of $55. This fee, which customers pay each time they reborrow, is approximately 5 percent of an average payday user's $1,192[118] gross biweekly income.[119] As detailed in Pew's previous research, borrowers can generally afford to pay this fee, but not the principal in a lump sum to retire their debt.
- **Colorado payday installment loans.** The monthly payment charged under Colorado's new law for a $500 loan is about $131.[120] The average monthly income of a Colorado payday loan borrower is $2,477 ($29,724 annually), according to state regulatory data.[121] Thus, a monthly payment on a $500 payday installment loan in the state takes up approximately 5 percent of a borrower's gross monthly income. The average actual loan size of $389 requires a monthly payment of about $105, or 4 percent of a borrower's monthly income on average.[122]

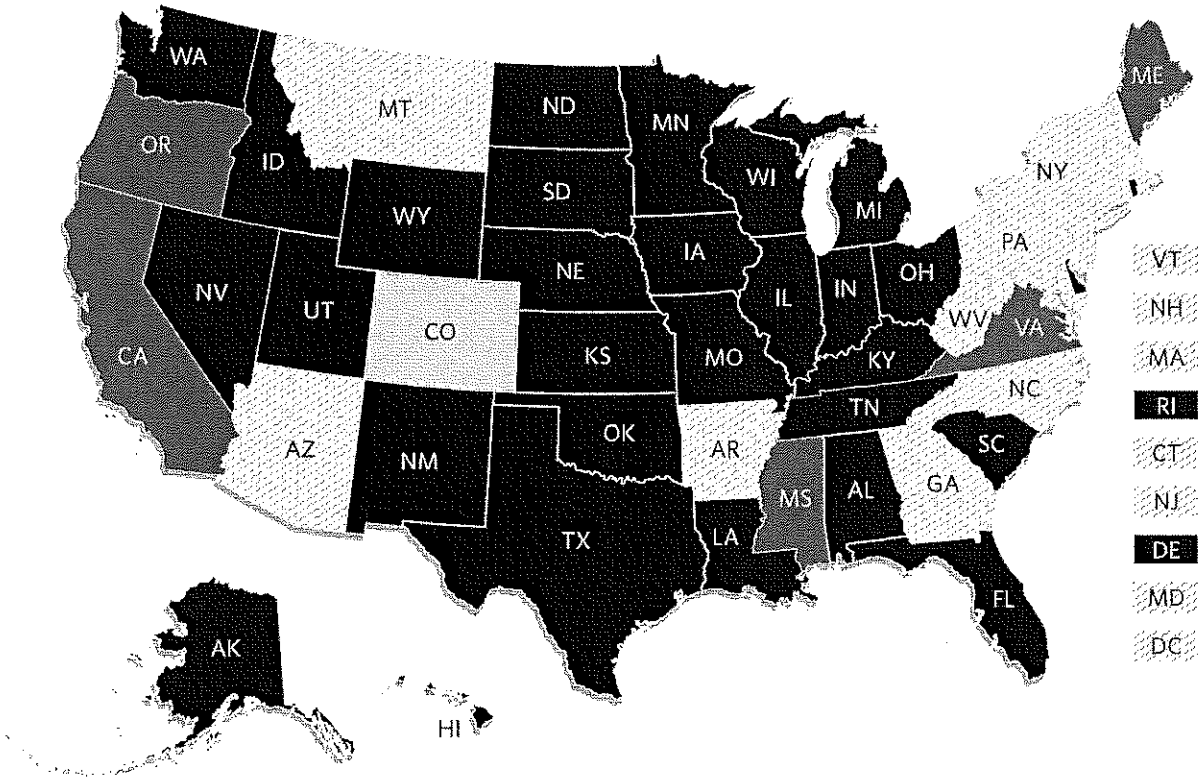
These findings suggest that any loan requiring payments of more than 5 percent of the borrower's paycheck should be treated as unaffordable, unless thorough underwriting demonstrates otherwise.

Data suggest that a loan requiring monthly payments equaling more than 5 percent of monthly gross income would exceed a typical borrower's ability to repay. The same would be true for a loan requiring biweekly payments in excess of 5 percent of the borrower's biweekly income.

Conventional payday loan payments typically take one-third of a borrower's gross income, an amount that far exceeds this affordability threshold. (See Exhibits 12 and 13.) A few states, such as Oregon and Virginia, have statutes that give borrowers about a month on average to repay the loans. Such laws lower the fraction of a paycheck that a loan takes, but the one-month repayments in each exceed $400, far beyond the $100 per month that the average borrower can afford.

Exhibit 12

Conventional Payday Loans Consume One-Third of Income



Percent of biweekly gross income that an average payday loan consumes

- 30-39% (30 states)
- 16-29% (5 states)
- 4% (1 state)
- Do not allow high-interest payday loans (15 states)

Note:

State-by-state data on the percentage of a borrower's paycheck a payday loan takes up are available in Appendix A. Calculations are based on $1,192 biweekly gross income for the median payday loan borrower (paid biweekly), who earns $31,000 annually per the Federal Reserve's Survey of Consumer Finances, and borrows an average $375 payday loan. More detailed information on borrower income is included in endnote 115. A limitation of this analysis is that median payday borrower income likely varies by state, but a national figure is applied to all states because sufficient uniform state-by-state income data for borrowers are unavailable. Fees were calculated using representative terms shown on lender websites. If Advance America makes loans in the state, those terms were used. If not, Check 'n Go was used. In Oregon, where neither of these companies offers loans, ACE Cash Express was used. These companies were chosen because they are among the largest payday lenders in the United States, according to industry analyst Stephens, Inc. In California, payday borrowers may borrow only up to $255 at a time from a lender ($300 minus an immediate $45 fee). In Louisiana, lenders may not charge additional fees for loan proceeds above $350, and thus do not lend more than this amount. In Maine, lenders may not charge more than $25 per loan and do not lend more than $300. Mississippi, Oregon, and Virginia require longer than average minimum loan terms, which usually results in terms covering two pay periods for a borrower, lowering the portion of each paycheck consumed by a loan. In Colorado, the minimum term is six months. Although some states offer payday installment loans as well, this map includes data for lump-sum repayment loans if those are available. For a summary of state payday lending law, see: http://www.pewstates.org/research/data-visualizations/state-payday-loan-regulation-and-usagerates-85899405695.

Sources: Federal Reserve Survey of Consumer Finances, 2012. Advance America, 2013. Check 'n Go, 2013. ACE Cash Express, 2013.

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Exhibit 13

Installment Structures Can Improve Affordability

A 5 percent affordability threshold takes a strikingly smaller portion of a borrower's paycheck than a conventional lump-sum repayment

Policy	Percent of Biweekly Income	Amount Due on Payday
Conventional lump-sum loan repayment		
36% APR	32%	$380
130% APR ($5 per $100)	33%	$394
261% APR ($10 per $100)	35%	$413
391% APR ($15 per $100)	36%	$431
521% APR ($20 per $100)	38%	$450
1 loan at a time[a]	36%	$431
8 loans maximum per year[a]	36%	$431
Cooling-off period between loans[a]	36%	$431
Installment loan repayment		
30-day minimum[a] (2 installments)	18%	$216
6-month minimum (Colorado)	4%	$47
10% of biweekly income	10%	$119
5 percent affordability threshold	**5%**	**$60**

Note:

Calculations are based on $1,192 biweekly gross income for the median payday loan borrower (paid biweekly), who earns $31,000 annually per the Federal Reserve's Survey of Consumer Finances, and borrows an average $375 payday loan. More detailed information on borrower income is included in endnote 115. A limitation of this analysis is that median payday borrower income likely varies by state, but a national figure is applied to all states because sufficient uniform state-by-state income data for borrowers are unavailable.

a Assumes fee of $15 per $100 borrowed.

Sources: Federal Reserve Survey of Consumer Finances, 2012. Colorado Office of the Attorney General, 2012. Washington State Department of Financial Institutions, 2012. Veritec Solutions, LLC Illinois Report, 2013.

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In Colorado, officials elected not to require extensive underwriting for certain loans of $500 or less. Instead, they created tight restrictions on the loan that functionally established a no-cost, synthetic form of underwriting—requiring a six-month repayment term, a maximum loan size of $500, and interest and fee caps that together effectively limit periodic payments to amounts that roughly equal 4 percent of the average borrower's periodic

A 5 percent affordability threshold establishes a benchmark for identifying potentially unaffordable loans as they emerge in the market.

income for an average loan. That law ensures that loans can be paid back in smaller increments without creating underwriting costs for lenders.

A 5 percent affordability threshold establishes a benchmark for identifying potentially unaffordable loans as they emerge in the market. Requiring thorough underwriting to assess ability to repay is the best way of ensuring affordability, as bank regulators have proposed for deposit advance loans.[123] If payday lenders could underwrite easily and without significant expense, requiring this assessment would have little downside. But because of cost and current capabilities, some lenders (especially nonbank lenders) will struggle to perform thorough underwriting. Concerned policymakers may choose to require strict underwriting standards for small-dollar loans that pose the greatest risk to consumers, with more lenient underwriting standards for other types of loans. A 5 percent affordability threshold suggests an appropriate rule of thumb to help identify the small-dollar loans that pose the most risk to consumers. Such a threshold requires little or no additional documentation because lenders already require proof of income.

Section 4: Important considerations for payday loan reform

Evidence points to several issues that policymakers must address when considering reforms to conventional payday lending. One category of reforms should deal with making sure there are successful installment loan markets for small-dollar borrowers. Specifically, policymakers should consider:

- Lender incentives to refinance installment loans create risk of financial harm.
- An installment *option* is insufficient.
- Installments do not guarantee affordability.

Policymakers should also consider issues of pricing, repayment, and disclosure. Specifically:

- Complexity could be a cost of compromise.
- Weak price competition creates a need to limit interest rates.
- Safeguards are needed for loan collateral and automated payments.
- Risk of unnecessarily long loan terms must be contained.
- Financial education and disclosure cannot solve the lump-sum lending problem.

In this section, we will consider these issues in turn.

Ensuring successful installment loan markets

Previous sections identified several benefits to installment repayment plans, but they can be achieved only if sound policies are in place.

Lender incentives to refinance installment loans create risk of financial harm

When lenders can earn nonrefundable fees for originating loans, or when they can front-load interest during the beginning of the repayment period, they have incentive to encourage customers to refinance, or flip, loans. *Flip* is used to describe reborrowing that a lender encourages, whereas *renew* and *reborrow* have been used in this series to describe additional borrowing caused by an inability to cover expenses after repaying a loan.

Loan refinancing can give borrowers access to additional credit when they want it. Take, for example, a borrower in the third month of a six-month installment loan. The borrower might be eligible to refinance the loan because she has paid down some of the principal. Refinancing would provide her with cash in hand. But it would also extend her indebtedness by pushing back the loan's payoff date.

If lenders can use refinancing to earn more fees immediately, or if they can calculate interest to earn a disproportionately high share of revenue during the loan's first few months, they have an incentive to flip loans. This flipping places borrowers at risk of financial harm because of the new fees, interest payments, and additional months of debt. Excessive refinancing also can mask delinquencies, because if borrowers are unable to afford loan payments, lenders can effectively let them skip a payment by agreeing to extend the duration of their loan, a process known as re-aging loans.[124]

There are two lender incentives to encourage refinancing that can cause borrowers financial harm.

Origination fees create the risk of harmful loan flipping

When small loans carry an origination fee, lenders can earn a substantial portion of revenue at the outset of the loan, creating a strong incentive to encourage borrowers to refinance or pay it off and reborrow quickly so the lender earns another origination fee.[125] As a result, refinancing is common in small-loan markets that allow an origination fee to be earned in full when the loan is made.[126]

Lenders may rely on origination fees to provide a measure of predictability in their revenue streams in the event that borrowers repay the loans early. Yet since most small-dollar loan borrowers cannot pay the loans off quickly, lenders can rely on their paying interest charges for several months (as in Colorado, where the average borrower carries a loan for more than three months even though money is saved by paying off earlier). And although lenders might legitimately employ such fees as compensation for the cost of opening new loans (as "origination fee" suggests), policymakers must be aware of the strong link between origination fees and loan flipping.[127]

In this market, lenders' desire to supplement interest income by adding origination fees seems minor compared with the significant risk that loan flipping poses to consumers and the marketplace. Accordingly, policymakers should limit the use of origination fees in small-dollar loan markets. Possible approaches include limiting fees to a nominal amount,[128] restricting the number of fees to one per borrower in a year, or, as Colorado lawmakers have done and as Pew recommends, requiring any fees to be spread evenly over the life of the loan, so they would be refunded on a pro-rata basis if loans are refinanced or repaid early.

Front-loading of interest also creates the risk of harmful loan flipping

In some states, lenders are allowed to use accounting methods that overweight the accrual of interest charges during the loan's early months, meaning that initial payments include a relatively high proportion of interest revenue for lenders, and payments in later months have relatively low interest revenue.[129] Such front-loading methods, often known as the "rule of 78s" or "sum of digits," incentivize refinancing because lenders earn far more interest income at the outset of the loan than they would using the standard actuarial method of calculating interest used for other financial products, such as mortgages or auto loans.

When lenders can book much of the interest revenue during the early months of a loan, they have an incentive to flip loans into new ones, so that more of these lucrative early months occur. This can lead to practices that entice borrowers to refinance loans to receive a fresh infusion of cash, despite the costly net impact of front-loaded interest payments. The harm to borrowers who refinance or pay off their loan early is that more interest and less principal are paid than would be paid under a conventional method of calculating interest.[130] Lawmakers sometimes address this problem by requiring lenders to use the standard actuarial method.[131] Pew recommends this approach as well.

Of course, lenders have a natural incentive to encourage repeat business. Default risk is higher with new borrowers than with existing customers. It also generally costs lenders far more to acquire a new customer than to keep an existing one, giving them an incentive to extend their relationships with customers, as is true with other businesses. If a borrower can pay off a loan and cover other expenses, and then chooses to borrow again, this dynamic might pose no problem. But when a lender maintains a long-term relationship with a borrower by encouraging frequent refinancing, the borrower does not receive the benefits of a nominally closed-end loan. In such cases, a gap between packaging and experience emerges and leads a borrower to spend more and stay in debt longer than the loan's initial terms stated.

In sum, consumers can be harmed by small-dollar installment loans in the absence of regulations that eliminate

lender incentives to flip loans. When lenders earn origination fees fully at the start of each loan, they have an incentive to boost revenue by steering borrowers to refinance the loans, which raises borrower cost and extends the term of indebtedness. Similarly, when interest front-loading applies, lenders earn a disproportionate amount of interest income in the early months of the loan, creating an incentive to encourage refinancing.

How Colorado lawmakers addressed the refinancing problem

As part of the state's 2010 payday loan reform, several lawmakers agreed on the goal of authorizing loans that would not encourage refinancing or penalize borrowers for repaying early. They required that fees and interest be spread evenly over the life of the loan or back-loaded instead of front-loaded.[132] The new law eliminated fee-seeking incentives for loan flipping by requiring that the origination fee be refundable on a pro-rata basis whenever loans are refinanced or repaid early.

When the law was enacted, some lenders contended that origination fees were not refundable, and several state officials and advocates noted that these lenders encouraged borrowers to refinance while keeping the entire origination fee for the prepaid loans.[133] But after the Colorado attorney general's office ruled that the origination fee was indeed refundable on a pro-rata basis,[134] the incentive for lenders to steer borrowers to prepay and reborrow disappeared. Neither state officials nor advocates report that loan flipping has persisted.

Similarly, Colorado does not permit interest on loans to be front-loaded, requiring that interest rates are calculated using the standard actuarial method.[135] To further guard against loan churning, Colorado lawmakers required that loans refinanced during the six-month term not carry additional origination or monthly maintenance fees. Thus, any lender who refinances a loan is entitled only to the 45 percent annualized interest, creating a strong disincentive to flip loans.[136]

By preventing the front-loading of fees and interest, Colorado lawmakers ensured that borrowers are not penalized for repaying early and lenders do not have an incentive to refinance. Thus the interests of the borrower and lender are better aligned.

> The reason for that [disallowing front-loading of fees] was obviously . . . [because we didn't] want to create an incentive where all you're doing is getting one vendor to roll in your loan to another loan. And so the ability to pay off without having incentive to refinance was the goal.
>
> —*Colorado elected official*

> Without the refundability [of the origination fee], then the bill really wouldn't have had any meaning.
>
> —*Colorado consumer advocate*

> Some of the industry kept operating with the opinion that the origination fee was not refundable upon prepayment and was . . . encouraging their customers to prepay and take out a new loan and not rebate the origination fee.
>
> —*Colorado government official*

An installment *option* is insufficient

It is reasonable to ask whether consumers and lenders should have the option to choose between an installment loan and a conventional payday loan, but merely providing an installment option is not effective. A core problem with conventional payday loans is that they fail to work as advertised. They put borrowers in unaffordable loans requiring an unknown number of months (not weeks) to repay, and enable lenders to offer two-week loans although they generate profits only when borrowers carry the loans for several months. The most direct way to redress this harm is to eliminate the lump-sum loan model, shifting to an installment loan that reflects these underlying realities.

Moreover, evidence indicates that merely providing an installment option does not alleviate the problems associated with lump-sum repayment loans. The reason is twofold: Lenders still have an incentive to steer borrowers to more profitable lump-sum loans, and the lump-sum repayment loan structure hides from borrowers the ultimate cost and duration of debt.

Regulatory data demonstrate that very few payday borrowers receive installment repayment plans even when they are available[137]—even though the payday industry's trade associations call for participating lenders to offer an installment option to customers who continually reborrow.[138] In Washington State, lenders are required to allow borrowers to convert conventional payday loans to installment loans at no additional cost at any point in the loan process, even immediately after borrowing, yet only 10 percent of loans are converted to an installment plan.[139] Similarly, in Colorado before the law change, only 4.6 percent of loans were converted to installment loans under the extended repayment plan that lenders were required to offer.[140]

Data published in state reports from Florida, Michigan, and Oklahoma show even fewer borrowers taking advantage of such payment options.[141] In Texas, where payday lenders are permitted to make both installment and payday loans, the conventional lump-sum repayment predominates.[142] Consequently, customers repeatedly borrow.[143]

Lenders have little incentive to help borrowers choose more affordable installment loan alternatives when they are paying the fixed costs of the lump-sum payday loan model, and when both they (and their competitors) have the option to promote higher-revenue lump-sum loans.[144] Academic research also notes that even when regulations mandate lower-cost options as the default, financial services providers who benefit from consumers choosing higher-cost options have been successful in selling higher-cost products.[145] Payday lenders have resisted efforts to promote installment loans to repeat borrowers in states that have attempted to allow both models to coexist.[146]

Borrowers, meanwhile, tend to take the standard loan option. As found repeatedly in behavioral economics research, standard (or "default") options matter tremendously, with people overwhelmingly choosing the default option provided.[147] The loan structure as presented is an especially "sticky default" from which few borrowers stray.[148] Borrowers' heavy reliance on payday lenders for accurate information could be influencing their decision to take out a loan they cannot afford. The packaging, or default structure, also strongly influences how they pay back the loan.

In Pew's focus group exercises, lump-sum repayment loans' lower price tag and shorter advertised duration attracted borrowers at first because it was difficult to compare these loans with installment loans that had more realistic terms—higher overall costs compared with the two-week loan, reflected in longer repayment times. In Colorado focus groups, many participants said a two-week loan initially looked more appealing than

an installment loan because it had a lower advertised price, and they thought they could get cash quickly without ending up in longer-term debt with another bill to pay.

Even those who had been in long-term, conventional payday loan debt before the law change were tempted by the idea of quick cash without long-term debt—even though these conflicting desires cannot realistically be met, and those in other states who use two-week loans end up in debt for an average of five months. They focused on the seemingly affordable price tag for a two-week loan, and not the impact on their budget when a lump sum would be taken out two weeks hence. This was a difficult comparison to make in the controlled and low-pressure environment of a focus group, and would likely be harder in a storefront when customers are coping with an inability to pay a bill[149] (especially if a lender has incentive to steer customers to the more profitable loan).

Focus group participants next completed a budgeting exercise, in which they wrote down the amount of their paycheck, then subtracted the amount due for a $500 loan under each type of product structure ($575 on the next payday for a conventional payday loan, about $61 for a Colorado payday installment loan). After comparing the amounts left over to the size of their regular bills, many soon explained that paying back $575 at once would lead them to reborrow, and they could afford only the terms set out in the installment product. Several participants said they had no idea how long it would take them to be able to make a $575 payment.

Similarly, one Colorado lender said some borrowers used to come in regularly and pay $75 per two weeks to borrow $500. After the law change, borrowers saw that a $500 loan would now cost them $290 over six months, and some expressed hesitation. The lender was surprised at first, reminding borrowers that they often used loans for extended periods, paying him $300 every two months, or $900-plus for six months—three times the amount due under the revised Colorado law. Under the lump-sum structure, the two-week fee was clear, but the amount the borrower would eventually spend was not. One of the foremost achievements of Colorado's installment lending law is that it has reduced the significant information gap between borrowers and lenders by making the loan's ultimate duration and cost more transparent.

One of the foremost achievements of Colorado's installment lending law is that it has reduced the significant information gap between borrowers and lenders by making the loan's ultimate duration and cost more transparent.

In sum, the confusing and problematic nature of lump-sum repayment loans, combined with research showing that consumers overwhelmingly choose the default options provided to them, demonstrate that it is not sufficient to offer an installment *option*. Lenders should be required to provide loans only in accordance with the borrower's ability to repay.

In most cases, that will require mandatory installment payments, though borrowers may choose to repay early without penalty.

Installments do not guarantee affordability—ability to repay is essential

Installment loans that amortize function more predictably for borrowers and solve many of the problems caused by lump-sum repayment loans, but an installment structure alone is insufficient if the payments are unaffordable. In Texas, installment loans are offered, but a $500 loan there typically requires biweekly payments of $150 (about $300 monthly),[150] far more than an average payday borrower can afford.[151]

Whenever installment loans require payments beyond borrowers' ability to repay, they are at risk of not being able to cover other expenses. That is particularly true when the lender retains the ability to demand instant payment through a postdated check or electronic access to the borrower's checking account (see "Safeguards are needed for loan collateral and automated payments," page 40). Policymakers must ensure that loans are structured to be repaid according to borrowers' ability to pay them back while meeting other obligations, without having to borrow again to make ends meet.

Pricing, repayment, and disclosure issues

Any attempt to reform the payday lending model must include regulation to ensure a safe and transparent marketplace.

Complexity could be a cost of compromise

Political and other considerations could lead lawmakers to authorize installment loan structures with multiple layers of fees and interest charges. Colorado provides an instructive example of an attempt to accommodate industry and advocate interests by acknowledging a traditional state interest rate cap of 45 percent per year, but allowing for additional fees to increase lender revenue (to a maximum, fee-inclusive APR of about 200 percent). This was done to meet lawmakers' goal of helping the state's nonbank small-loan lenders stay in business while offering a better product.

The political rationale for the compromise was evident in Pew's conversations with legislators, who believed that lenders needed more revenue than a flat 45 percent annual rate on a $500 loan would allow, but acknowledged that a law that explicitly permitted interest rates with "these huge numbers" would have been difficult to pass. Some stakeholders not involved with payday lending on a day-to-day basis mistakenly thought of the new law as offering loans with a 45 percent APR, reinforcing the political appeal of an interest-plus-fees combination, rather than a fee-inclusive, explicitly high annual percentage rate.

Such compromise might be politically helpful, but it comes with the added cost of complexity, making it difficult to program lender computer systems, write consumer disclosures, or ensure borrowers' comprehension of loan terms. Lenders, advocates, and others agree that Colorado's law is far more complicated than a simple interest rate would have been.

In the Colorado focus groups, borrowers were unaware of the three separate charges allowed by the new law—interest, origination fees, and monthly maintenance fees—and instead focused on how much their required regular payments were. They did not know the loans' annual interest rates, although borrowers in states that have conventional payday loans rarely know these, either.[152] This complicated pricing system caused problems

for lenders, who reported initial difficulties switching over their computer systems, and who say they struggle to explain the three types of charges to customers.

In one important way, Colorado avoided the complexity that has arisen in installment loan markets where ancillary products, such as credit insurance, are prevalent. Such products increase a loan's cost, and frequently are not disclosed as part of its stated APR. Colorado prohibited any additional fees, other than one NSF fee for a bounced check or its electronic equivalent.

Weak price competition creates a need to limit interest rates

Nearly all states have set maximum interest rate limits for some types of loans. All 13 original colonies did so.[153] Today, 46 states and the District of Columbia set limits on the interest rates that may be charged on at least one type of small-dollar loan.[154] Even in the 35 states that allow high-interest, lump-sum payday loans, 28 limit the permissible charges.[155] In other words, small-dollar loan markets normally operate with state-mandated price limitations.

Conventional lump-sum payday loan markets

Previous research finds that payday borrowers do not focus primarily on price when taking out a loan, but rather on convenience and speed.[156] Further, demand for payday loans is not sensitive to price.[157] The United Kingdom's Office of Fair Trading conducted a review of the payday lending industry in that country, which also uses lump-sum repayments. Among its findings: "A significant proportion of payday borrowers have poor credit histories, limited access to other forms of credit and/or a pressing need of money at the point of taking out a loan. As such they may be focused on the speed and convenience of the loan rather than its price. Price insensitivity among consumers is likely to weaken price competition, thereby enabling lenders to raise their prices without losing business."[158] In such circumstances, setting maximum allowable rates can ensure that borrower costs resemble those in a marketplace with price competition.[159]

Payday loan prices vary between states but rarely within states. Prices are determined by individual state laws, and large companies offer the same loan at vastly different prices in different states.[160] In states where conventional payday loans are offered, lenders generally do not compete on price; they tend to cluster prices at the maximum allowed, and then compete on customer service and location.[161] As shown in the accompanying exhibit, a similar pattern emerges for payday lenders that also make installment loans. These lenders charge less in Colorado and Illinois, which require lower interest rates on payday installment loans, and more in the states that allow higher prices. There is little evidence of firms lowering prices to compete for customers—the expected result in a well-functioning marketplace as described in classical economic theory. (See Exhibit 14.)

Traditional (non-payday) installment loan markets

Similarly, a large majority of states set maximum allowable charges on traditional (non-payday) consumer installment loans, which typically are amortizing unsecured loans for amounts of several hundred dollars up to a maximum of $25,000. Consumer installment loans are commonly provided by non-depository financial institutions through their retail storefronts, and are available in almost every state (although consumer access to these loans varies widely, many finance companies serve those with poor or fair credit histories).[162] Compared with payday loans, consumer installment loans have lower interest rates and longer loan lengths, and they are underwritten by lenders to evaluate the borrower's ability to repay. Each state has laws to govern consumer installment loans, so interest and loan terms vary across the country.

For consumer installment loans, 39 states and the District of Columbia mandate a statutory interest rate limit of 36 percent or less. But some states allow lenders to charge additional fees for loan origination, maintenance, and other services, which can create an effective APR that is 100 percentage points or more above the statutory interest rate limit. Effective APRs on loans from installment lenders in Texas generally vary from 58 to 157 percent,[163] and in South Carolina from 43 to 130 percent.[164] In North Carolina, where fees are more constrained, most rates fall below 32 percent, but lenders are permitted to sell ancillary products such as credit insurance, which substantially increase the cost of the loan.[165] To ensure that consumer installment loans do not extend indefinitely, some states impose a maximum loan term in addition to a rate cap.[166] According to recent research, the typical amount of a consumer finance company's installment loan is about $1,000, with a term of 12 months and an APR around 60 percent.[167]

Exhibit 14

Lenders Charge More When Permitted by States

State	Typical APR of an Installment Loan From a Payday Lender (%)
Colorado	129
Illinois	234
Delaware	388
Missouri	389
New Mexico	389
Wisconsin	382
South Carolina	341
Texas	585

Note:

Colorado and Illinois set lower price limits on the rates that may be charged for these types of installment loans than the other states listed. In states where regulatory reports are unavailable, loan costs advertised by Advance America, the largest storefront lender in the United States, are used for the states where they offer installment loans, and assume a borrower receives the lowest rate available by agreeing to authorize electronic debit. These states are Delaware and Wisconsin (AdvanceAmerica.net accessed Oct. 22, 2013). In the other states, Advance America does not advertise in-store installment loans on its website. In Missouri, New Mexico, and South Carolina, its online affiliate CashNetUSA advertises installment payday loans and that information is used (CashNetUSA.com accessed Oct. 22, 2013). In Texas, neither of these lenders advertises installment payday loans, so data from the second-largest lender in the country are used, ACE Cash Express (ACECashExpress.com accessed Oct. 22, 2013).

Sources: Colorado Office of the Attorney General, 2013. Veritec Solutions Illinois Report, 2012. Advance America, 2013. CashNetUSA, 2013. ACE Cash Express, 2013.

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Safeguards are needed for loan collateral and automated payments

Payday loans are sometimes referred to as "deferred presentment" or "deferred deposit" loans because lenders might require a check, postdated for the borrower's next payday when the loan is due, as collateral or security. Some lenders use the electronic equivalent: authorization to debit a borrower's account when payment is due. Similarly, banks typically retain this right when making deposit advance loans. The legal privilege to establish such a deferred presentment interest is unique to the payday lending market.

Postdated checks and electronic access as loan collateral

For payday lenders, the right to collect payment from a customer's checking account limits credit risk and the need to underwrite. (Even if borrowers cannot afford to pay both the loan and other financial obligations, deferred presentment lenders can leverage their access to borrower checking accounts to collect ahead of other creditors.) It can also reduce the difficulty, time, and cost that would normally be associated with formal debt collection.

But deferred presentment creates substantial risk for borrowers. Critics contend that "paper or electronic check holding are the modern equivalent of several practices that the Federal Trade Commission banned over 25 years ago as unfair trade practices," including wage assignments.[168] When a lender has the power to withdraw funds from borrowers' checking accounts on payday, borrowers lose control over their income. This extraordinary arrangement allows payday lenders to collect fees to renew or repeat loans for months while the borrowers cannot afford both the lump-sum repayment and other financial obligations, such as rent or mortgage payments.

For these reasons, deferred presentments are typically authorized, if at all, only for small loans that are understood to serve urgent liquidity needs.[169] Of the 36 states in which deferred presentment loans are available, 27 set the maximum term length at no more than six months, and 21 set the maximum loan amount at $500 or less.[170] Recognizing the potential risk to military service members that such an arrangement poses, the Military Lending Act of 2007 declared it unlawful for lenders to use "a check or other method of access to a deposit, savings, or other financial account maintained by the borrower, or the title of a vehicle as security for the obligation."[171]

In Colorado, lawmakers chose to allow lenders operating under the payday installment loan law to keep this kind of deferred presentment loan collateral, but with three crucial protections in place. First, the law limits the loan to $500. Second, it limits the size of the payments to about $61 per two weeks. Third, Colorado permits lenders to charge only one NSF fee per loan, limiting their incentive to repeatedly attempt to withdraw money from a checking account with insufficient funds and instead work with a borrower who has difficulty making loan payments.

Automated electronic repayment

In the case of installment loans, borrowers sometimes have the option of establishing a plan for automatic electronic repayment. Borrowers can benefit from the convenience of these plans, and lenders can achieve better performance and efficiency. Conceptually, electronic repayment plans differ from deferred presentment arrangements because borrowers can cancel the plans and retain control over the inflows and outflows of their checking accounts. But some lenders steer borrowers to use electronic payments,[172] unscrupulous lenders have not honored borrowers' requests to cancel them,[173] and there can be lag time between the request and when it takes effect,[174] demonstrating that safeguards are needed to protect against aggressive or fraudulent practices.

Lenders value electronic payment plans, as evidenced by their charging higher interest rates for loans that do not grant them the right to withdraw payments automatically from the borrower's bank account.[175] After reviewing the results of its 2008 small-dollar loan pilot program, the FDIC noted that "pilot bankers in general believed that automatic repayments can improve performance for all credit products, not just small-dollar loans."[176] Ideally, lenders would leverage the benefits of direct debit to improve access to credit for consumers with damaged credit histories and reduce the cost of loans.[177]

Yet there is evidence that unscrupulous lenders[178] can abuse the privilege of electronically debiting checking accounts, leading to excessive withdrawals[179] and to borrowers incurring fees or struggling to pay other bills.[180]

To help ensure the integrity of the electronic payments system, and to protect consumer checking accounts and income streams, the Electronic Fund Transfer Act generally prohibits lenders from requiring consumers to repay loans electronically. Consumers also have the right to cancel recurring electronic payments.[181] But when lenders act aggressively to collect payment electronically, they can undermine these protections.

Some banks have recognized the need to take action to protect checking account customers. Reports have shown that consumers are incurring multiple NSF fees because of aggressive and potentially unlawful lender tactics. One bank customer described being charged more than $1,500 in fees by her bank, after six online payday lenders tried to withdraw money from her account 55 times in a month.[182] In response, her bank (JPMorgan Chase) has announced its intention to change policies relating to abusive merchants, such as some online payday lenders, by limiting the number of NSF fees that one merchant can trigger to one per month.[183] Working through the associations that operate the electronic payments network, banks are also evaluating new rules to protect consumers and the system against what are known as "high-risk originators," particularly online payday lenders. These rules might include holding banks accountable for abuse of the electronic payment system by payday lenders with merchant accounts at those banks.[184]

Risk of unnecessarily long loan terms must be contained

Even with affordable installment payments, lenders have an incentive to increase revenue by setting up loans with unnecessarily long terms. For example, in Colorado a $375 loan has periodic payments that are affordable for most borrowers (about $47 biweekly). But if legislators had not limited the fees that can be charged after six months, lenders could require longer loans—with a smaller share of each payment reducing the principal owed—to earn more revenue. Thus, if a loan required monthly payments of the same amount over 12 months instead of six, borrowers would end up repaying twice as much (or three times as much if loans lasted 18 months). Outside Colorado, some lenders have used excessive loan durations to increase the long-term costs paid by borrowers, especially online. One major online lender's loans require monthly payments of $150.72 for 12 months, so that a person who receives $500 will pay back $1,808.64.[185] Another offers loans with 47 required payments of $294.46, so that a borrower who receives loan proceeds of $2,525 will pay back $13,839.62.[186]

Pew recommends that lawmakers monitor and respond to signs of excessively long loan terms—for example, by considering establishing a maximum term. Any such term should take into account a borrower's financial capability, measured by income or ability to repay, as well as the size of the principal.[187] Colorado has demonstrated that even at high interest rates, six months is generally long enough to pay back $500. For consumer finance company loans at high interest rates, approximately one year is usually long enough to repay $1,000.[188] One scalable method to estimate maximum loan duration (in months) would be to divide the loan's principal by the borrower's average daily income.[189]

Financial education and disclosure cannot solve the lump-sum lending problem

Financial education and disclosures are important tools for helping people decide whether a product that many successfully use is appropriate for them. Public explanations and advice on the terms and conditions for a home mortgage, student loan, auto loan, or credit card are commonplace. Many people use these products successfully and as advertised. Some do not, and financial education and disclosures can help consumers avoid the downsides of these products. In contrast, payday loans are not used successfully on a short-term basis by many people, and if they were, the industry would not be profitable.[190]

Neither disclosures nor financial education can solve the problems caused by lump-sum repayment payday loans because their structure hides the most common outcome—repeated reborrowing of the original loan.

Although financial education and disclosure cannot solve the problems with lump-sum payday loans, they will be an important component in a properly functioning marketplace for installment loans. When designed to avoid the pitfalls discussed earlier in this section, such loans can be used successfully by many people, but they will not be appropriate for some. In that case, financial education and clear disclosures can help people decide *whether they should borrow and if so, whether such products are a good choice for them* and *how to use those products successfully.*

One method for measuring the value of financial education and disclosures will be whether consumers comparison-shop and seek out lower prices for loans. If loan pricing is complex, with multiple elements, as it is in Colorado, it will be more difficult to comparison-shop, as research in other markets has documented.[191]

In developing a system from scratch, a clearer one than Colorado's would have simple pricing based solely on an interest rate, or an interest rate plus a standard fee, so it would be easier for consumers to compare costs. Price shopping is a prerequisite for competition to develop, because lenders only have an incentive to charge less if they can gain customers by doing so. It is unclear whether such competition will emerge in an installment small-dollar loan market with clear disclosures, but uniformly stated and transparent pricing improves the likelihood of competition.

Conclusion and initial policy recommendations

Pew's research conclusively shows that payday loans are unaffordable for most borrowers. The loans require payments equal to one-third of a typical borrower's income, far exceeding most customers' ability to repay and meet other financial obligations without quickly borrowing again. Payday lenders have a unique legal power to withdraw payment directly from borrowers' checking accounts on their next payday, prompting those without enough money left for rent or other bills to return to the lenders, repay the loans, and pay an interest-only fee to quickly reborrow, resetting the due date to the next payday. This extraordinary form of loan collateral allows lenders to thrive even as they make loans to those who cannot afford them. The average borrower is in debt for nearly half the year, and the vast majority of lender revenue comes from those who borrow consecutively. Payday lenders achieve profitability only when the average borrower is in debt for months, even though the product is promoted as a short-term bridge to the next payday. These facts demonstrate a significant market failure.

Decisive action is required from the Consumer Financial Protection Bureau and other federal regulators, and from policymakers in the 35 states that now permit lump-sum payday lending. Pew recommends the following for all small-dollar consumer cash loans:

1. Limit payments to an affordable percentage of a borrower's periodic income

Research indicates that for most borrowers, payments above 5 percent of gross periodic income are unaffordable.

- **Any small-dollar cash loan should be presumed to be unaffordable, and therefore prohibited, if it requires payments of more than 5 percent of pretax income** (for example, a monthly payment should not take more than 5 percent of gross monthly income). Lenders should be able to overcome this presumption only by demonstrating that a borrower has sufficient income to make required loan payments, while meeting all other financial obligations, without having to borrow again or draw from savings.

This 5 percent affordability threshold, which is based on survey research and analysis of market data, is a benchmark that policymakers can use to identify small-dollar loans that pose the most risk of harm or unaffordability. It generally will result in installment loans that have terms of months, rather than weeks, but the loan duration can be self-adjusting depending on the income of the borrower. It is also flexible enough to accommodate various policy choices regarding maximum loan size, duration, or finance charge. Normal supervision can assess compliance, so this recommendation does not necessitate a database. Borrowers will remain responsible for deciding how many loans to take and how often to use them.

For calculation purposes, required payments would include principal, interest, and any fees. To discourage loan splitting or other methods of frustrating this policy, payments from all loans by a given lender should be considered together. Examiners should treat frequent refinancing or "re-aging" of loans as evidence of unaffordability and poor underwriting.

2. Spread costs evenly over the life of the loan

It is important to prevent front-loading of fees and interest on installment loans. Experience shows that front-loading practices make the early months of the loan disproportionately more profitable for lenders than the later months, creating incentives for them to maximize profit by encouraging borrowers to refinance loans before they are fully paid off (a process known as loan "flipping" or "churning").

- **If fees other than interest are permitted, require them to be earned evenly over the life of the loan.** Any fees, including origination fees, that lenders fully earn at the outset of the loan create a risk of loan flipping. Therefore, fees should be refundable to the borrower on a pro-rata basis in the event of early repayment.
- **Require all payments to be substantially equal and amortize smoothly to a zero balance by the end of the loan's term.**
- **Prohibit accounting methods that disproportionately accrue interest charges during the loan's early months.** Such front-loading schemes, often known as the "rule of 78s" or "sum of digits" methods, encourage loan flipping, because a lender earns far more interest income at the outset of the loan than in later months.

3. Guard against harmful repayment or collection practices

Payday and deposit advance lenders have direct access to borrowers' bank accounts for collecting loan repayment. Lenders use this access to ensure that they are paid ahead of other creditors, an advantage that allows them to make loans without having to assess the borrower's ability to repay the debt while also meeting other obligations. Although this arrangement shields the lender from certain risks and may facilitate lending to those with poor or damaged credit, it comes at the cost of making consumers vulnerable to aggressive or unscrupulous practices. High rates of bounced checks or declined electronic payments are indicators of such practices. Borrowers lose control over their income and are unable to pay landlords or other creditors first.

- **Treat deferred presentments as a dangerous form of loan collateral that should be prohibited or strictly constrained.** Deferred presentment or deferred deposit loans require borrowers to give the lender the right to withdraw payment from the borrower's bank account. This requirement is fulfilled through a personal check that is postdated to the borrower's next payday or through a non-revocable electronic debit authorization. Because of the inherent dangers, state laws generally authorize deferred presentments only for loans that are understood to serve short-term, urgent liquidity needs. Of the states that have deferred deposit loans, a majority set the maximum term at six months or less, and a majority set the maximum loan amount at $500 or less.

  Policymakers may reasonably choose to prohibit deferred presentments if they do not want payday lenders to operate. If allowed, deferred presentments should never apply for more than six months or for loans of more than $500.
- **Prevent unscrupulous lenders from abusing the electronic payments system, and make it easier for consumers to cancel electronic payment plans.** Some installment lenders establish automatic repayment plans using electronic payment networks. Although this mechanism can help lower the cost of small-dollar loans and make loan management more convenient, evidence shows that it also exposes consumers and their checking accounts to significant risk. Regulators should establish a balance between lender and borrower interests, especially in cases—such as online lending markets—where there is evidence of aggressive lending or collections behavior. Pew recommends making it easier for consumers to stop automatic withdrawals, placing limits on the number of NSF fees that borrowers may pay, and closing the electronic payments system to merchants that abuse it (as evidenced by repeated attempts to withdraw funds from borrower accounts, excessive use of NSF fees, or other aggressive behavior). These goals may be accomplished through regulatory action and stronger oversight of the electronic payments system by the banks that operate it.
- **Monitor and respond to signs of excessively long loan terms.** Some high-interest installment payday lenders set excessively long loan terms, with only a small portion of each payment reducing the loan's balance. Therefore, policymakers should consider establishing maximum loan terms. These should take into account a

borrower's financial capability, measured by income or ability to repay, as well as the size of the loan principal. Colorado demonstrates that for average payday borrowers, six months is long enough to repay $500, and in consumer finance installment loan markets, approximately one year is usually sufficient to repay $1,000.

4. Require concise disclosures that reflect both periodic and total costs

Research shows that small-dollar loan borrowers focus on the periodic cost of borrowing but often struggle to evaluate overall cost, making it difficult to compare other loan options or to decide whether to borrow, adjust budgets, or take other actions. All loan offers should clearly disclose:

- The periodic payment due.
- The total amount to be repaid over the life of the loan.
- The total finance charges over the life of the loan.
- The effective annual percentage rate, or APR, of the loan.

These four numbers should be displayed clearly, and with equal weight, to encourage borrowers to consider both periodic and long-term costs. To facilitate comparison shopping, all loan costs should be stated as interest, or interest plus a standard fee. If a fee is permitted in addition to interest, it should be included in the calculation of finance charges and APR, based on the loan's stated term. As with other consumer financial products such as credit cards, regulators should require simple, standardized disclosures showing maximum allowable charges at the time of application as well.

5. Continue to set maximum allowable charges on loans for those with poor credit

Research shows that lenders generally do not compete on price in these markets serving those with poor credit, which is why almost every state has laws that set maximum allowable rates on small-dollar loans. Without regulations, prices reach levels that are highly disproportional to lender cost, or far higher than necessary to ensure access to credit. Colorado's payday loan law shows it is possible to ensure widespread access to loans of $500 or less for people with poor credit histories, at prices far lower than those charged for conventional payday loans. It is also possible that such credit could be available at rates lower than the average APR of 129 percent in Colorado. In states that have permitted higher interest rates than this, storefronts have proliferated, with no obvious additional benefit to consumers.

States may reasonably choose to set maximum annualized interest rates of 36 percent or less if they do not want payday lenders to operate. States may also reasonably choose to allow interest rates higher than 36 percent if they do want payday lenders to operate. But even when regulations require all loans to have affordable repayment structures, there is insufficient research to know whether consumers will fare best with or without access to high-interest installment loans. Thus Pew does not recommend law changes in the 15 states that do not have payday lending, because such a change may not benefit consumers. In the 35 states that have conventional lump-sum payday lending, lawmakers should require loans to have affordable payments and then set maximum annualized interest rates according to whether they want payday lenders to operate.

These recommendations are intended to apply to all consumer cash loans of several thousand dollars or less, regardless of provider type (bank, nonbank) or product type (payday loan, installment loan, cash advance), exclusive of loans secured through pledge or deposit of property. They are based on findings documented in Pew's Payday Lending in America *series, available at: www.pewtrusts.org/small-loans.*

Borrowers want regulators to act

A nationally representative survey conducted by Pew shows that, by a 3-to-1 margin, payday loan borrowers want more regulation of this market. Eight in 10 favor a requirement that payments take up only a small amount of each paycheck, and 9 in 10 favor allowing borrowers to pay back loans in installments over time.

The limited benefits of access to credit

In circumstances where people are using credit to pay other debts and obligations, it is unclear whether promoting more access to credit is, on net, beneficial as a way to manage expenses or harmful as another burden for people who are already struggling financially. What is clear, however, is that a loan that is used to make ends meet creates danger if it requires payments that exceed a borrower's ability to repay. Payday loans, which typically require one-third of a borrower's biweekly income, *greatly exceed* most borrowers' ability to repay. That is why there is a need for immediate policy change to eliminate unaffordable small-dollar loan payments.

These recommendations are not an endorsement of high-cost credit or a promotion of credit as a means to address persistent cash shortfalls. Instead, they are intended to help policymakers address the problem of unaffordable small-dollar loans in the 35 states that have lump-sum payday lending, while allowing for the evolution of more beneficial and affordable products among the nation's banks and other lenders. That is why, in addition to providing a benchmark for identifying potentially harmful or unaffordable loans, policymakers should define rules for safe and transparent installment lending, collections, disclosures, and pricing.

Methodology

Opinion research

Nationally representative findings in this report are based on a survey conducted among storefront payday loan borrowers and online payday loan borrowers. The sample for this survey was compiled over the course of eight months of screening on a nationally representative weekly survey. Borrower quotations in this report come from a series of 14 focus groups with small-loan borrowers. Quotes from people other than borrowers come from 33 individual interviews conducted with those who influenced the Colorado law and who have seen its impact firsthand. Methodology for these three opinion research components is described below.

Survey methodology

Social Science Research Solutions omnibus survey

The Pew safe small-dollar loans research project contracted with Social Science Research Solutions to conduct the first-ever nationally representative, in-depth telephone survey with payday loan borrowers about their loan usage. To identify and survey a low-incidence population such as payday loan borrowers, the research firm screened 1,000 to 2,000 adults per week on its regular omnibus survey, using random-digit dialing, or RDD methodology, from August 2011 to April 2012.

The term *omnibus* refers to a survey that includes questions on a variety of topics. This survey took steps to minimize payday borrowers' denying using the loans. The omnibus survey included mostly nonfinancial questions purchased by other clients, and the payday loan questions were asked after less sensitive questions, giving interviewers a chance to establish a rapport with respondents.

The first phase of the research, to identify payday borrowers, asked respondents as part of the omnibus survey whether they had used a payday loan. If respondents answered that they had, they were placed in a file to be contacted later. Once the 20-minute survey was ready to field, in order to maximize participation, people who had used a payday loan were then given the 20-minute survey and paid an incentive of $20 for participating. Because of their relative scarcity (under a quarter of borrowers), *online* payday loan borrowers were given an incentive of $35.

Respondents were told about the compensation only after having indicated that they had used a payday loan. Further, online payday loan borrowers who were identified during the early months of screening were sent a letter with a $5 bill informing them that they would be contacted to take the 20-minute survey. The second phase of the research involved contacting respondents who answered that they had used a payday loan and immediately giving the 20-minute survey to anyone newly identified in the weekly omnibus survey as a payday loan borrower.

Sample and interviewing

In the first phase of the survey, the Pew safe small-dollar loans research project purchased time on Social Science Research Solution's omnibus survey, EXCEL, which covers the continental United States. Analysis of the incidence of payday borrowing was conducted after 33,576 adults had been screened and answered a question about payday loan usage. Demographic analysis is based on the 1,855 payday loan borrowers who were identified as part of this nationally representative sample. In order to find enough people who had used storefront payday loans, online payday loans, and auto-title loans to complete a 20-minute survey about their usage and views, an additional 16,108 adults were screened using these weekly omnibus surveys. In total, 49,684 people were

screened to complete the research. The sampling error for incidence estimates from the omnibus survey of borrowers is plus or minus 0.24 percentage points. Results from the survey of auto-title-loan borrowers have not yet been published.

All borrowers identified were asked to complete the 20-minute survey. In the second phase, 451 adults completed the 20-minute survey on storefront payday loans, and 252 adults completed the 20-minute survey on online payday loans, for a total of 703 payday borrowers. The sampling error for the 20-minute survey of payday borrowers is plus or minus 4.2 percentage points. The margin of error is based on a standard 95 percent confidence interval.

EXCEL is a national weekly, dual-frame bilingual telephone survey. Each EXCEL survey consists of a minimum of 1,000 interviews, of which 300 are completed on respondents' cellphones and at least 30 are conducted in Spanish, ensuring unprecedented representation on an omnibus platform. Completed surveys are representative of the continental United States population of adults 18 and older. EXCEL uses a fully replicated, stratified, single-stage, random-digit-dialing (RDD) sample of landline telephone households and randomly generated cellphones.

Sample telephone numbers are computer-generated and loaded into online sample files accessed directly by the Computer-Assisted Telephone Interviewing, or CATI, system. Within each sample household, a single respondent is randomly selected. Further details about EXCEL and its weighting are available at www.pewtrusts.org/small-loans. The proportion of storefront to online borrowers was weighted to the ratio at which they occurred naturally in the omnibus. Including 252 online borrowers reflects an oversample of 147 such borrowers, and the online borrower results have been weighted down accordingly so they would not have disproportionate influence over the full results.

Wording of questions in the omnibus survey

Wording for demographic and other questions is available at www.pewtrusts.org/small-loans.

Screening phase—measuring incidence and compiling sample for callbacks:

- "In the past five years, have you used payday loan or cash advance services, where you borrow money to be repaid out of your next paycheck?"
- "And was that physically through a store, or on the Internet?"

Re-contact phase—calling back respondents who answered affirmatively, and identifying additional borrowers to take the 20-minute survey immediately:

- "In the past five years, have you or has someone in your family used an in-person payday lending store or cash advance service?"
- "In the past five years, have you or has someone in your family used an online payday lender or cash advance service?"

Wording of questions in 20-minute survey of storefront and online payday loan borrowers

The data from the nationally representative, 20-minute survey of 451 storefront payday loan borrowers and 252 online payday loan borrowers are based on responses to the following questions, which Pew designed with assistance from Social Science Research Solutions and Hart Research Associates. The wording of the questions is included here only for those whose answers are included in this report. The wording for previously reported results was included in the first two publications in this series. The sample for this telephone survey was derived

from the RDD omnibus survey. All questions also included "Don't know" and "Refused" options, which were not read aloud.

INSERT "online payday loans" IF Q.1a = 1

INSERT "payday loans" IF Q.1b = 1

(SCRAMBLE ITEMS)

"Now I'm going to read you some ideas for how [online payday loans/payday loans] could be changed or modified. After I read each idea, tell me whether this sounds like something you would favor or oppose. How about (INSERT)? Do you favor or oppose this?" (GET ANSWER, THEN ASK: "And would you say you strongly [favor/oppose] or somewhat [favor/oppose]?"

1 Strongly favor

2 Somewhat favor

3 Somewhat oppose

4 Strongly oppose

D (DO NOT READ) Don't know

R (DO NOT READ) Refused

a. Requiring that all loan payments have to pay down some of the loan's principal, or amount borrowed, as well as some of the fee or interest

b. Requiring that borrowers be given more time to pay back the loan

c. Allowing borrowers to pay back loans in installments, rather than all at once

d. Requiring that borrowers have the option of only spending a small amount of each paycheck to pay back their loan

Focus group methodology

On behalf of the safe small-dollar loans research project, Hart Research Associates and Public Opinion Strategies conducted eight focus groups, with two groups per location in New York City; Chicago; Birmingham, AL; and Manchester, NH. Those groups were conducted during weekday evenings Sept. 7-19, 2011.

Additionally, the project conducted two groups in San Francisco on Nov. 16, 2011, two groups in Colorado Springs on Feb. 6, 2013, and two groups in Denver on Feb. 7, 2013. All focus groups were two hours, and all borrower quotations come from these 14 focus groups.

Colorado interview methodology

The project conducted 33 interviews with people who influenced the Colorado law or who have seen its impact firsthand. These interviews ranged in duration from 15 minutes to more than two hours. Participants included state senators, state representatives, payday lenders, advocates, religious leaders, lobbyists, credit counselors, and legislative staff who worked on the law. Unless otherwise cited, all quotes in this report about Colorado come from these interviews and focus groups. All participants were granted confidentiality. Twenty-nine consented to having the interviews recorded, and interviewers took notes in the other four. Thirty interviews were conducted in

person and three by phone. All nonborrower quotes in this report come from these interviews unless otherwise noted.

Question wording

1. Introduction
    a. "Pew is a nonprofit organization doing research on small-dollar lending. We are interested in how the Colorado law is playing out."
    b. "I'm recording the interview for transcription purposes, but you will not be identified by name. Quotes from the interview may be used in a future Pew report. All participants will be identified by a title such as: Colorado government official, Colorado payday lender, Colorado payday borrower, Colorado advocate, Colorado credit counselor, and so on. Is that all right?"
    c. "Of course you may decline to answer any questions, and dozens of other people are also taking part in these interviews."
2. "Tell me a little about how you interact with payday lending, so how you see payday lending play out on a day-to-day basis in your work life?"
3. Can you describe the new law to me?"
    a. "What features of the law are important?"
    b. "How do you know?"
4. "How well is the new payday loan law working overall? "
    a. 'What tells you that?"
5. "Anything else positive about the new law, or benefits that it has had?"
6. "Anything else negative about the new law, or downsides that it has had?"
7. "As far as you can tell, is it working for both lenders and borrowers?"
    a. "Who else is impacted by the payday loan law?"
8. Ask only lenders:
    a. "Has the new law caused hardships for you? What are they?"
    b. "How about for other lenders?"
    c. "Have employees been laid off? Stores closed?"
    d. "Have you had to deny people credit under the new law who would have gotten it under the old law?"
    e. "Have more people had to borrow online, or not from storefronts, since the new law went into effect?"
9. How did the old payday loan law in Colorado work?
    a. "What were the benefits and drawbacks? What told you that?"

10. "What is the biggest difference between the old and the new law in terms of the impact they have had?"
11. "Can you think of any areas of life that have been improved because of the law?"
12. "People in other states and at the federal level are asking about how well the new payday lending law is working in Colorado. What would you tell them?"
    a. "Would you recommend other states or the federal government implement Colorado's law?"
13. "What improvements would you like to make to the payday loan law here?"
14. "Are there any stories or anecdotes you can share to illustrate how the law is working?"
15. "Anything else you would like to share?"
16. "Can you recommend anyone else I should speak with about the payday loan law, either in person or by phone?"
    a. "Can I tell them you recommended I get in touch?"

Colorado lender location methodology

To assess how the 2010 Colorado law affected access to credit, Pew researchers plotted the payday loan stores that existed before the law change (on April 1, 2010), and after the change (on Aug. 1, 2013). The primary source of data originates from the Colorado Office of the Attorney General's 2013 record of supervised lenders. A supervised lender is any non-depository company or individual that conducts consumer credit transactions (primarily payday loans, traditional consumer loans, second mortgages, and personal loans). As of June 2013, the list consisted of approximately 7,089 lenders that have operated or are currently operating in Colorado. The lender's street address was the unit of analysis because the data showed that what often appeared to be a closure of a location was actually the sale of the business to another lender or a transfer between franchisees and corporate entities.

The data set was then parsed to identify payday loan storefronts based on publicly available information. The location information was paired with geographic coordinates obtained from Yahoo's geocode services, which uses NAVTEQ geographic data. The matching was done via a third-party API application. The data were split into two categories: locations that were operating before the law change and locations operating after the change (in all, there were 433 payday lending locations in the data set). The data were transferred to a GIS application, matched to county-level 2010 census data, and analyzed.

To specifically evaluate the impact of the 2010 law change on the distance Colorado residents travel in order to take out a payday loan, the distance between licensed lending locations and population centroids was measured. The distance between these two points was calculated using the Haversine formula, which results in a "straight as the crow flies" measurement that does not take into account barriers to travel. Population information comes from the 2010 census, available at http://www.census.gov/geo/reference/centersofpop.html.

Appendix A

Loans Consume One-Third of Biweekly Income in Conventional Payday States

State	Percentage of a Borrower's Biweekly Gross Income Consumed By a Loan Payment (%)
Alabama	37
Alaska	37
California[a]	25
Colorado[b]	4
Delaware[c]	38
Florida	35
Hawaii	36
Idaho	38
Illinois[c]	36
Indiana	36
Iowa	36
Kansas	36
Kentucky	37
Louisiana[d]	34
Maine[e]	27
Michigan	36
Minnesota	32
Mississippi[f]	19
Missouri[c]	38
Nebraska	37
Nevada	37
New Mexico[c]	36
North Dakota	38
Ohio	34
Oklahoma	36
Oregon[f]	16
Rhode Island	35
South Carolina[c]	36
South Dakota	38
Tennessee	36
Texas[c]	38
Utah	37
Virginia[f]	20
Washington	36
Wisconsin[c]	39
Wyoming	34

Note:

Calculations are based on $1,192 biweekly gross income for the median payday loan borrower (paid biweekly), who earns $31,000 annually per the Federal Reserve's Survey of Consumer Finances, and borrows an average $375 payday loan. More detailed information on borrower income is included in endnote 115. A limitation of this analysis is that median payday borrower income likely varies by state, but a national figure is applied to all states because sufficient uniform state-by-state income data for borrowers are unavailable. Fees were calculated using representative terms shown on lender websites. If Advance America makes loans in the state, those terms were used. If not, Check 'n Go was used. In Oregon, where neither of these companies offers loans, ACE Cash Express was used. These companies were chosen because they are among the largest payday lenders in the United States, according to industry analyst Stephens, Inc. Although some states offer payday installment loans as well, this map includes data for lump-sum repayment loans if those are available.

a In California, payday borrowers may only borrow up to $255 at a time from a lender ($300 minus an immediate $45 fee).

b In Colorado, the minimum term is six months.

c These states allow high-interest, small-dollar installment loans from payday lenders as well as single-repayment loans. Data for single-repayment loans are included here.

d In Louisiana, lenders may not charge additional fees for loan proceeds above $350, and thus do not lend more than this amount.

e In Maine, lenders may not charge more than $25 per loan, and do not lend more than $300.

f Mississippi, Oregon, and Virginia require longer-than-average minimum loan terms, which usually results in terms covering two pay periods for a borrower, lowering the portion of each paycheck consumed by a loan.

For a summary of state payday lending law, see: http://www.pewstates.org/research/data-visualizations/state-payday-loan-regulation-and-usage-rates-85899405695.

Sources: Federal Reserve Survey of Consumer Finances, 2012. Advance America, 2013. Check 'n Go, 2013. ACE Cash Express, 2013.

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Endnotes

1 Office of the Comptroller of the Currency, "Proposed Guidance on Deposit Advance Products" (April 22, 2013), http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-11a.pdf; Federal Deposit Insurance Corp., "Proposed Guidance on Deposit Advance Products" (April 22, 2013), http://www.fdic.gov/news/news/press/2013/pr13031a.pdf; and Board of Governors of the Federal Reserve System, "Statement on Deposit Advance Products" (April 25, 2013), http://www.federalreserve.gov/bankinforeg/caletters/CALetter13-07.pdf. While the Federal Reserve did not formally join this guidance, it too has recognized the "significant consumer risks" associated with short-term, small-dollar loans.

2 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

3 The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 13, http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf.

4 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 35–38, http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf.

5 Ibid., 19–29. The report discusses six reasons why people use payday loans they cannot afford: desperation; perception (that loans do not create ongoing debt, for example); reliance on lenders for accurate information (when lenders sell payday loans as two-week products even though borrowers end up indebted for five months, on average); focusing on the periodic finance fee, which is typically affordable (while the lump-sum repayment on the next payday is not); trust in the lender or the regulatory structure; and temptation (some describe payday loans as "too easy" in situations where they are facing constant cash shortfalls).

6 Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending* (2011), http://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

7 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products.* The median bank deposit advance customer uses 14 advances in a year.

8 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products.* The median storefront payday loan customer uses 10 loans in a year.

9 "Frequently Asked Questions," AmeriLoan, last modified September 2013, accessed April 2013, https://mobile.ameriloan.com/?page=info_faq. Link is to an archived site with the previous repayment schedule, but terms have been updated on AmeriLoan's main FAQ page to reflect a new payment plan, https://ameriloan.com/?page=info_faq#15. Some online lenders, such as AmeriLoan, have essentially acknowledged as much, setting up loans to automatically renew rather than withdraw the full amount owed. Before recent changes to repayment terms that require the loans to be paid in full on a borrower's next payday, borrowers were automatically renewed: "Online customers are automatically renewed every pay period. Just let us know when you are ready to pay in full, and we will deduct your loan plus fees from your bank account." And "FAQ's," Payday Accelerated, accessed Sept. 20, 2013, http://paydayaccelerated.com/Questions.aspx: "Your repayment is the best part. The minimum required payment will be deducted from your bank account. You get cash when you need it most and repay when you have it! Still a little short on payday? No problem! Online customers are automatically refinanced for the first four pay periods. After that, we will debit your account the finance charge plus a $50 principle reduction per pay period until the loan is paid in full."

10 David Burtzlaff and Brittny Groce, *Payday Loan Industry* (Stephens Inc., 2011), 15. Stephens estimates that borrowers do not become profitable for lenders until they have borrowed four or five times.

11 Seeking Alpha, "Advance America, Cash Advance Centers' CEO Discusses Q2 2011 Results—Earnings Call Transcript," last modified July 29, 2011, accessed Sept. 20, 2013, http://seekingalpha.com/article/283283-advance-america-cash-advance-centers-ceo-discusses-q2-2011-results-earnings-call-transcript?part=single.

12 Robert DeYoung and Ronnie J. Phillips, "Payday Loan Pricing," (Federal Reserve Bank of Kansas City, Economic Research Department, February 2009), 7, http://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

13 Community Financial Services Association of America, "Is a Payday Advance Appropriate for You?" accessed Sept. 20, 2013, http://cfsaa.com/what-is-a-payday-advance/is-a-payday-advance-appropriate-for-you.aspx.

14 Leslie Parrish and Uriah King, *Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume* (Washington: Center for Responsible Lending, 2009), 12, http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf. Table 6 notes that both 76 percent of loans and 76 percent of loan volume are renewals or quick reborrows.

15 The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, 20.

16 Ibid., 9.

17 Erica Field and Rohini Pande, "Repayment Frequency and Default in Microfinance: Evidence from India," *Journal of the European Economic*

Association 6, no. 2-3 (2008): 501-509, doi: 10.1162/JEEA.2008.6.2-3.501. It is worth noting that of course this solution is not unique to the United States. In developing countries today, there is a clear parallel with microfinance lenders. While the lower interest rates charged by these organizations have received much notice, a universal feature is that they are repayable in small installments, every week or sometimes every other week. Microfinance repayment schedules are discussed in this journal article.

18 Robert Mayer, *Quick Cash: The Story of the Loan Shark* (DeKalb: Northern Illinois University Press, 2010).

19 Robert Mayer, "Loan Sharks, Interest-Rate Caps, and Deregulation," *Washington and Lee Law Review* 69, no. 2 (2012), http://scholarlycommons.law.wlu.edu/wlulr/vol69/iss2/10. The author identified many of the primary sources cited in this section in his paper.

20 Morris R. Neifeld, *Neifeld's Manual on Consumer Credit* (Easton: Mack Publishing Co., 1961), 336.

21 Lendol Calder, *Financing the American Dream* (Princeton, NJ: Princeton University Press, 1999), 17.

22 Neifeld, *Neifeld's Manual*, 388.

23 Donald Tyree, *The Small-Loan Industry in Texas* (Austin: Bureau of Business Research, University of Texas, 1960), 59. The author quotes an assistant attorney general of Texas.

24 Neifeld, *Neifeld's Manual*, 388.

25 Ira Cobleigh, *How and Where to Borrow Money* (New York: Avon Books, 1964), 109.

26 Gerald W. Gibbs, *The Complete Guide to Credit and Loans* (New York: Playboy Paperbacks, 1982), 65.

27 Neifeld, *Neifeld's Manual*, 409. Neifeld made this point clearly in 1961, writing: "The inherent defect in the salary-buying scheme of loan and the flipping type of loan is the fact that the whole indebtedness matures at one time. Almost invariably, repayment of the loan or appreciable reduction of the principal is beyond the ability of the borrower. Through necessity the borrower must continue to renew the loan each payday upon payment of interest with little or no reduction of the amount of the original loan. A Good law should contain some compulsory provision for the amortization of small loans in monthly or shorter installments."

28 Calder, *Financing the American Dream*, 124.

29 Bruce G. Carruthers, Timothy Guinnane, and Yoonseok Lee, "Bringing 'Honest Capital' to Poor Borrowers: The Passage of the U.S. Uniform Small Loan Law, 1907-1930," *Journal of Interdisciplinary History* (Winter 2012), 393-418.

30 Elisabeth Anderson, "Experts, Ideas, and Policy Change: The Russell Sage Foundation and Small Loan Reform, 1909-1941," *Theory and Society* 37, no. 3 (2008): 271-310, http://www.jstor.org/stable/10.2307/40211037. Interest rates on small loans were set by state governments, rather than the federal government. The Uniform Small Loan Law was model legislation that the coalition encouraged states to pass, and a majority did so.

31 Calder, *Financing the American Dream*, 118.

32 Anderson, "Experts, Ideas, and Policy Change," 271-310.

33 Neifeld, *Neifeld's Manual*, 336.

34 Charles A. Gates, "The Social Worker in the Service of the Small Loan Business," *Annals of the American Academy of Political and Social Science* 196 (1938), 223, http://www.jstor.org/stable/1021721.

35 Calder, *Financing the American Dream*.

36 Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, "Payday Loan Choices and Consequences," *Vanderbilt Law and Economics Research Paper*, no. 12-30 (2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160947.

37 Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," George Washington University School of Business (2009).

38 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products*. This research finds most bank deposit advance customers overdraft their accounts. The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 33. Most traditional payday loan customers overdraw their checking accounts as well.

39 "CPI Inflation Calculator," U.S. Bureau of Labor Statistics, accessed Sept. 1, 2013, http://www.bls.gov/data/inflation_calculator.htm. Calculations performed using this inflation calculator.

40 There is no database in place in Colorado, so these data are provided by lenders to the Colorado Office of the Attorney General. State-employed examiners also compile data by reviewing lender records of individual borrowers.

41 Paul Chessin, "Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act," *Denver University Law Review* 83 (2005), 392-400, http://www.law.du.edu/images/uploads/denver-university-law-review/v83_i2_chessin.pdf.

42 Ibid.

43 Colorado Office of the Attorney General, *2009 Deferred Deposit Lenders Annual Report* (2009), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/2009DDLComposite.pdf.

44 The Pew Charitable Trusts, "State Payday Loan Regulation and Usage Rates," last modified July 19, 2012, http://www.pewstates.org/research/data-visualizations/state-payday-loan-regulation-and-usage-rates-85899405695.

45 DeYoung and Phillips, "Payday Loan Pricing"; and Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2008*, http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/DDLASummary2008rev.pdf: "In 2008, 96.37% of payday loans were written (contracted) at the maximum amount permitted in terms of the finance charge allowed by the law."

46 Colorado Office of the Attorney General, *2009 Small Installment Lenders Annual Report* (2009), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/2009SILComposite.pdf. In Colorado in 2009, 15,399 small installment loans were made to 9,047 customers.

47 The consumer advocates' coalition, Coloradans for Payday Lending Reform, was largely organized by the Bell Policy Center and Colorado Progressive Coalition.

48 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2008*.

49 Chessin, "Borrowing from Peter to Pay Paul," 423.

50 This bill was the one initially supported by the coalition known as Coloradans for Payday Lending Reform. The champion of this bill and eventually the compromise bill in the Colorado House of Representatives was Rep. Mark Ferrandino.

51 See Federal Deposit Insurance Corp., "Small Dollar Loan Pilot Program Participants," accessed June 1, 2013, http://www.fdic.gov/smalldollarloans/participants.html, for a list of banks that participated in the FDIC's small-dollar loan pilot program; and Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles*, (the Annie E. Casey Foundation, 2005), http://www.aecf.org/upload/publicationfiles/fes3622h334.pdf for a discussion of early low-cost small-loan providers.

52 North Carolina Office of the Commissioner of Banks, *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly* (2011), http://www.nccob.gov/Public/docs/Financial%20Institutions/Consumer%20Finance/NCCOBReport_Web.pdf. For example, North Carolina caps interest rates on small loans below 36 percent, and consumer finance companies operate in the state. But North Carolina also allows for ancillary fees that can substantially increase the loan's cost.

53 Tim Hoover, "House Passes Payday Loan Cap," *Denver Post* (Feb. 26, 2008), http://www.denverpost.com/headlines/ci_8362972; Tim Hoover, "Senators Back Cap on Payday Lending," *Denver Post* (March 26, 2008), http://www.denverpost.com/headlines/ci_8696455; and Tim Hoover, "Effort to Cap Interest on Payday Loans Dies," *Denver Post* (April 23, 2008). http://www.denverpost.com/newsheadlines/ci_9018827. A rate cap bill that Rep. Mark Ferrandino championed passed the House of Representatives in 2008 by a vote of 33–30, but a different version passed the Senate, 19–16, and the bills eventually died in committee.

54 The 2008 and 2010 bills initially capped interest rates at 36 percent but were amended to raise the cap to 45 percent annualized interest.

55 Tim Hoover, "Payday-Loan Change OK'd," *Denver Post* (May 5, 2010), http://www.denverpost.com/headlines/ci_15018282; and Peter Marcus, "New Payday Lending Measure Backed" (May 3, 2010), http://statebillnews.com/2010/05/hb10-1351-new-payday-lending-measure-backed/. The 2010 bill passed the Senate by one vote, 18-17, and the House by one vote, 33-32.

56 Interviews with people working inside and outside of government to shape the law indicated that the chief of staff to Senate Democrats at this time developed the terms and structure of Colorado's new loan.

57 Administrator of the Colorado Uniform Consumer Credit Code, *Colorado Payday Lending Demographic and Statistical Information: July 2000 through December 2011* (2012), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/Demo%20%26%20Stat%20Info%202000-2011.pdf. Although the revised law permits lenders to make single-payment loans, 99.9 percent of lenders choose monthly, semimonthly, or biweekly installments, or a combination of these. The number of installments varies depending on the loan contract and payment schedule.

58 Office of the Colorado Attorney General, *2012 Deferred Deposit/Payday Lenders Annual Report* (2013), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/2012%20DDL%20Composite.pdf.

59 The longest term in the Colorado examiner data from the attorney general's office is 222 days. Examiner data are on file at The Pew Charitable Trusts.

60 The Pew Charitable Trusts, *A New Equilibrium* (2011), for credit card data, http://www.pewhealth.org/uploadedFiles/PHG/Content_Level_Pages/Reports/Report_Equilibrium_web.pdf. Pew's analysis of credit union and bank installment loan data relies on *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program* and the National Federation of Community Development Credit Unions' *Borrow & Save: Building Assets With a Better Small Dollar Loan*, http://cdcu.coop/wp-content/uploads/2013/03/Borrow-and-Save-Final-July-30-2013.pdf. Consumer finance company installment loan estimates are based on the statement of Thomas Durkin at the Federal Reserve Bank of Philadelphia's Small-Dollar Credit: Products, Economics, and Regulation Conference (July 12, 2013).

61 Office of the Colorado Attorney General, *2012 Deferred Deposit/Payday Lenders Annual Report* (2013), http://www.

coloradoattorneygeneral.gov/sites/default/files/uploads/2012%20DDL%20Composite.pdf; and Office of the Colorado Attorney General, *2009 Deferred Deposit/Payday Lenders Annual Report* (2010), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/2009DDLComposite.pdf. These comparisons can be made by reviewing state regulatory data from 2012 with the analogous data from 2009.

62 Veritec Solutions LLC, "State Links," accessed Sept. 1, 2013, https://www.veritecs.com/StateLinks.aspx. These databases are operated by Veritec Solutions, and a list of these states is posted on Veritec's website.

63 Washington State Department of Financial Institutions, *2009 Payday Lending Report* (2010), http://www.dfi.wa.gov/cs/pdf/2009-payday-lending-report.pdf; and *2012 Payday Lending Report* (2013), http://www.dfi.wa.gov/cs/pdf/2012-payday-lending-report.pdf. Washington has enacted a limit of eight loans per borrower per year; from 2009 to 2012, the number of locations dropped by 66 percent, loans made dropped by 72 percent, the number of borrowers declined by 42 percent, and the amount spent by borrowers declined by 54 percent. The number of borrowers per location in 2012 was 1,165, more than double the national average. The average loan duration increased to 26.7 days in 2012 from 19.6 days in 2009, which is likely a result of the no-cost payment plan that a borrower can request at any time. It is difficult to compare borrower outcomes in Washington and Colorado because Washington has had a much steeper drop in the number of borrowers; also, Washington's eight-loan cap is binding for the 28 percent of borrowers who reach it, while Colorado's limitations are not binding.

64 Although borrowers spent less, they did not receive less credit. The median loan amount was $400 (in nominal dollars) in 2009 and 2011.

65 Oklahoma borrowers spent $54.3 million on payday loans in 2011 and the same amount in 2009. The nominal amount of dollars advanced via payday loans in California was $3.28 billion in 2011 (at 411 percent APR) and $3.09 billion in 2009 (at 414 percent APR), indicating that consumers spent slightly more in 2011. In Florida, consumers spent $267 million on payday loans in 2011 and $236 million in 2009. All data come from state regulatory reports, and 2011 data are used because 2012 state data are unavailable for some states. The corresponding 2009–11 spending decline in Colorado was from $95.1 million to $54.6 million.

66 For example, in Oklahoma the number of borrowers increased 3.3 percent from 2009 to 2011 (from 113,576 to 117,335). In Florida, the number of borrowers is not disclosed in the state regulatory report, but the number of loans increased by 11 percent from 2009 to 2011 (from 6.2 million to 6.9 million). In California, the number of borrowers increased by 11 percent from 2009 to 2011 (from 1,567,188 to 1,738,219). The 2011 data are used because complete 2012 data are unavailable from some of these states. Colorado experienced an 11 percent decline in borrowers from 2009 to 2011.

67 Similarly, before the law change (April 1, 2008), 93 percent of the population lived within 20 miles of a payday lender. After the law change (Aug. 1, 2013), 91 percent live within 20 miles of a payday lender. The methodology section contains more details.

68 The ZIP code used in the example is 80214, covering the western edge of Denver and the immediately adjoining suburbs.

69 In Colorado, the interest and origination fee are spread evenly over the life of the loan, while the monthly maintenance fee does not take effect until the end of the second month. If the borrower pays back the loan before the end of the second month, no monthly maintenance fee is paid, meaning the loan's fees are effectively backloaded.

70 Dennis Campbell, Francisco de Asis Martinez-Jerez, and Peter Tufano, "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures" (2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873.

71 These figures substantially understate the impact of the law change on the bank fees that borrowers pay, because they would owe NSF fees to their bank as well as the lender, and these figures do not capture the overdraft fees that borrowers pay, which are paid only to the bank and do not show up in the lender-provided state regulatory data.

72 Advance America, Cash Advance Centers Inc., Annual Report (Period Ending 12/31/11), 5, http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNYS:AEA&ft=&d=c12cd1f791e34bf03980d4825adc1730. Advance America's 2011 Annual Report (10-K) states that "regulatory changes occurring in Arizona, Colorado, and Washington caused us to close or consolidate our centers in these states in the last two years." There has been a 20 percent decline in the number of payday loan stores throughout the country since 2009. That figure is somewhat inflated by several states that have eliminated payday lending altogether since 2009, such as Arizona, which had 603 stores in 2009. Colorado's rate of consolidation during this period was much greater than the country's overall and that of states without law changes. State regulatory reports provided by Veritec Solutions LLC for 2009 and 2011 show that the number of storefronts in Oklahoma and California decreased 6.5 percent and 3 percent, respectively, while Florida experienced an increase of roughly 6.4 percent. Washington, like Colorado, made a major change to its law, imposing an eight-loan per borrower per year cap, and also saw a large decrease in the number of storefronts. Virginia made major changes to its payday loan law in 2009 and also experienced a large decline in the number of store locations. Missouri, without a law change, experienced a 19 percent decline in the number of stores, and this may have been a result of oversaturation: In 2009, Missouri had 22 stores per 100,000 residents, while Colorado had 10 stores per 100,000 residents. Colorado had also experienced an 18 percent decline in storefronts from 2007 to 2009. Nationally, there was a 5 percent drop during those years, and Colorado's may have been greater because of the extended payment plan required under its previous law change. It is also possible that factors other than changes in the law have played a role in the decline in payday lending stores in Colorado.

73 Robert B. Avery and Katherine A. Samolyk, "Payday Loans versus Pawn Shops: The Effects of Loan Fee Limits on Household Use" (2011), http://www.frbsf.org/community-development/files/2-avery-paper.pdf; and Mark J. Flannery and Katherine A. Samolyk, "Scale Economies at Payday Loan Stores" (2007). This paper accurately forecast Colorado's experience: "By setting a binding ceiling equal to the minimum average cost, regulators could induce more payday loans from each surviving firm. If demand is very inelastic, reducing the maximum fee may have little effect on the total number of loans taken. However, social costs are lower because the ceiling reduces the number of store locations and hence the fixed costs of providing payday loans. This exercise in microeconomic theory indicates that policy makers can rely on competition to drive profits to zero, but the surviving stores will not necessarily operate at the lowest possible cost (price). A higher rate ceiling means that each store needs to attract fewer customers to cover its fixed operating costs. Reducing the fee ceiling will lower the number of payday stores, but perhaps leave the number of payday loans relatively unaffected."

74 Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending*. For example, in Oklahoma regulatory data from 2011, the average consumer spent $465.87 (8.8 loans with an average fee of $52.94 per loan), while the average Colorado borrower spent $282 in 2011. Many states permit higher fees than does Oklahoma, and lenders charge higher fees in those states. Complete 2012 data are not available from most states.

75 Office of the Colorado Attorney General, *2012 Deferred Deposit/Payday Lenders Annual Report*; and Office of the Colorado Attorney General, *2009 Deferred Deposit/Payday Lenders Annual Report*. These comparisons can be made by reviewing state regulatory data from 2012 and the analogous data from 2009.

76 In June 2013, a short stretch of West Alameda Avenue in Lakewood had four payday lenders, as did a three-mile stretch of nearby Wadsworth Boulevard. In the Denver suburb of Federal Heights, the shopping hub around Pecos Street and West 84th Avenue had four payday lenders.

77 Ernst & Young, *The Cost of Providing Payday Loans in a US Multiline Operator Environment* (2009), 23, http://www.fisca.org/content/navigationmenu/resources/formediapolicymakers/informationkit/fisca_final_09.03.09_sent_to_client.pdf; and Advance America, Cash Advance Centers Inc., Annual Report (Period Ending 12/31/11), 5. These calculations are based on a report published by Ernst & Young on behalf of Financial Service Centers of America, or FiSCA, a trade association for payday lenders, showing that the average FiSCA member store makes 3,093 loans per year. By comparison, the largest storefront lender, Advance America, made 4,087 loans per store in 2011 (10,561,000 loans made by 2,584 stores). Payday lenders are typically open daily except Sunday, or about 313 days per year. Dividing the number of loans made per year by 313 yields these figures of 10 to 13 loans per day.

78 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products*, Figure 5; and Parrish and King, *Phantom Demand*.

79 Advance America, Cash Advance Centers Inc., *2011 Annual Report*. This report notes that an average customer takes out eight loans per year, implying that a store serves about 511 unique customers (based on 4,087 loans per store). 2011 state regulatory data from Florida show a similar result, with approximately 526 customers per store (1,490 locations serving just over 784,000 customers), and fewer in Oklahoma.

80 In 2009, Colorado borrowers spent $95.1 million on payday loans at 505 locations ($188,000 of revenue per location). In 2012, they spent $53.2 million on payday loans at 287 locations ($185,000 of revenue per location).

81 Burtzlaff and Groce, *Payday Loan Industry*, 15. The largest operators are those identified by Stephens Inc. as being in the Top 15 nationally by store count, and also being listed in the Colorado attorney general's report as being in the Top 10 by store count in Colorado. Seven companies make up this group.

82 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2009*.

83 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2011*.

84 The 2013 market share figure is calculated using licensee lists obtained from the Colorado Office of the Attorney General. The lists were updated Feb. 15, 2013.

85 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 18. Also Advance America, Cash Advance Centers Inc., "Form 10-K (Annual Report)" (2012). This report from Advance America, the largest storefront lender, provides an approximate loss rate, which is calculated by dividing the "provision for doubtful accounts" by the "aggregate principal amount of cash advances originated." This calculation of $107,911,000 divided by $3,965,225,000 yields an estimated loss rate of 2.72 percent. Borrowers may renew or reborrow a loan, or experience temporary defaults by bouncing checks and incurring nonsufficient funds fees while still paying back a loan eventually. Advance America has made this point explicitly, stating, "97 percent of our customers pay us back." http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf.

86 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2011*, 15.

87 Bhutta, et al., "Payday Loan Choices and Consequences." Despite the relatively low loss rates on any individual payday loan, previous

research has found that approximately half of payday borrowers default on a loan within two years. Even with the more affordable payments in Colorado, it is unclear whether that figure will decline. It is worth remembering that payday loan borrowers after the law change look very similar to those before, meaning they likely still have deeply damaged credit histories. Bhutta, et al. found the average credit score in their payday borrower data set was a very poor 513.

88 The number of defaults per borrower per year has declined from 0.49 in 2009 to 0.34 in 2012 (30 percent). The number of defaults has also decreased in absolute terms, from 137,813 in 2009 to 81,580 in 2012. Because average borrowers now have loans out for 7½ months of the year instead of five, the number of defaults per borrower per month of credit used has declined from 0.100 in 2009 to 0.045 in 2012 (55 percent). But it is unclear if this decline is real or if it is an artifact of lenders only reporting a maximum of one default per loan, with borrowers using fewer loans. Relative to the number of loans issued, the default rate has of course increased dramatically under the new law, but this is almost inevitable now that so many fewer loans are issued, and they last more than five times as long. On each loan, borrowers have more time to default, and there is more time for a shock to occur that might result in nonpayment, such as a job loss. A similar number of defaults when borrowers are using fewer loans produces artificially inflated default-to-loan ratios. This phenomenon can be illustrated by presenting two hypothetical loan scenarios. In the first, a borrower uses one yearlong loan and defaults once at some point during the year (whether or not the borrower catches up on payments and continues to repay the debt). In the second, a borrower uses 26 two-week loans, and similarly, defaults once during the year. The first loan scenario will show a default-to-loan ratio of 100 percent, while the second will show a default-to-loan ratio of 4 percent, even though under each scenario a borrower has received credit for the same duration and defaulted the same number of times. Similarly, under the previous Colorado law, someone who borrowed the average number of times and defaulted once would have a default rate of 13 percent (1/7.84). Under the new law, someone who borrowed the average number of times and defaulted once would have a default rate of 43 percent (1/2.3).

89 Federal Deposit Insurance Corp., *Risk Management Examination Manual for Credit Card Activities* (March 2007), http://www.fdic.gov/regulations/examinations/credit_card/pdf_version/ch7.pdf. FDIC discussion of traditional underwriting.

90 The Pew Charitable Trusts, "Pew Payday Lending Methodology," modified July 2013, http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Methodology.pdf.

91 Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corp., and Office of Thrift Supervision, "Credit Card Lending: Account Management and Loss Allowance Guidance" (2003), http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030108/attachment.pdf; Office of the Comptroller of the Currency, "Comptroller Dugan Expresses Concern about Negative Amortization" (Dec. 1, 2005), http://www.occ.gov/news-issuances/news-releases/2005/nr-occ-2005-117.html; and National Credit Union Administration, "Final Rule—Part 701, Short-term, Small Amount Loans" (October 2010), http://www.ncua.gov/Legal/Documents/Regulatory%20Alerts/RA2010-13.pdf: "The loan must be amortized in such a way that allows the borrower to repay the loan in the given term. FCUs must structure the payments so that the borrower is paying a portion of the principle and interest in equal or near-equal installments on a periodic basis over the course of the loan."

92 Federal Deposit Insurance Corp., *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program* (2010), http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/smalldollar.html.

93 Ibid.

94 The interest varies from prime plus 15.99 percent up to prime plus 19.99 percent, and there is a $25 annual fee. In addition, borrowers can use the line of credit to cover overdrafts on their KeyBank checking accounts at a cost of $10 per automated transfer, but there is no cost if the borrower initiates a transfer. The line of credit ranges from $250 to $1,500, with minimum monthly payments of the greater of $20 or a portion of the principal plus interest and fees. This information is based on conversations with KeyBank representatives.

95 Jeff Horwitz, "KeyBank's Small Loan Formula Avoids Payday Problems," *American Banker*, accessed July 2, 2012, http://www.americanbanker.com/issues/177_127/keybank-small-loan-formula-avoids-payday-problems-1050591-1.html.

96 North Side Community Federal Credit Union, "Other Loans," accessed Sept. 1, 2013, http://www.northsidecommunityfcu.org/other_loan_products_servic.html.

97 Pennsylvania Credit Union Association, "Credit Union Info," accessed Sept. 1, 2013, http://www.pacreditunions.com/betterchoice.html.

98 National Federation of Community Development Credit Unions, *Borrow & Save.*

99 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 14.

100 Ibid., 37.

101 Susanna Montezemolo, *Payday Lending Abuses and Predatory Practices*, (Center for Responsible Lending, 2013), 5, http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf; and Marc Anthony Fusaro and Patricia J. Cirillo, *Do Payday Loans Trap Consumers in a Cycle of Debt?* (2011), 24, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1960776. This industry-sponsored paper found that even customers who receive a free first loan end up renewing or reborrowing seven times on average after the first loan.

102 The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, 35; and Gregory Elliehausen, *An Analysis of Consumers' Use of Payday Loans* (2009), http://www.approvedcashadvance.com/docs/GWUAnalysis_01-2009.pdf.

103 Bhutta, et al., "Payday Loan Choices and Consequences."

104 The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, 14; and The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 10.

105 Center for Financial Services Innovation, *2011 Underbanked Market Sizing Study* (2012), http://www.cfsinnovation.com/system/files/CFSI_2011_Underbanked_Market_Sizing_Study_November_2012.pdf. These are companies that make unsecured installment loans to borrowers, but are not banks or credit unions. Such companies frequently are members of trade associations such as the American Financial Services Association or the National Installment Lenders Association. This report estimated the consumer installment loan industry's revenue at $4.4 billion in 2011.

106 North Carolina Commissioner of Banks, *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly* (2011), http://www.nccob.org/Public/docs/Financial%20Institutions/Consumer%20Finance/NCCOBReport_Web.pdf: "They look at credit reports, but often disregard the credit score, instead looking more closely at particular lines. Underwriting places heavy emphasis on analyzing ability to repay, and closely examines income and employment."

107 Some providers have begun to create automated underwriting models that assess more than just whether someone has a checking account and an income stream, but do not engage in an assessment of all of the borrower's expenditures and liabilities to assess their cash flow or ability to pay the loan without having to borrow again to meet other expenses.

108 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products*: "Lenders may instead rely on their relative priority position in the repayment hierarchy to extend credit without regard to whether the consumer can afford the loan. This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses."

109 Office of the Comptroller of the Currency, "Proposed Guidance on Deposit Advance Products"; and Federal Deposit Insurance Corp., "Proposed Guidance on Deposit Advance Products."

110 Chuck Cole, presentation, California Assembly Banking and Financial Institutions Committee, Sacramento (March 4, 2013); and California Senate Bill 318 (amended April 1, 2013), http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0301-0350/sb_318_cfa_20130415_124240_sen_comm.html. California Senate Bill 318 suggested allowing lenders to charge a fee of $30 "to help offset the significant costs of underwriting."

111 Mark J. Flannery and Katherine Samolyk, "Payday Lending: Do the Costs Justify the Price?" FDIC Center for Financial Research Working Paper no. 2005/09 (2005), http://ssrn.com/abstract=771624.

112 Ernst & Young, *The Cost of Providing Payday Loans*, 23. Advance America, Cash Advance Centers Inc., Annual Report (Period Ending 12/31/11), 5. These calculations are based on a report published by Ernst & Young on behalf of FiSCA, a trade association for payday lenders, showing that the average FiSCA member store makes 3,093 loans per year. By comparison, the largest storefront lender, Advance America, made 4,087 loans per store in 2011 (10,561,000 loans made by 2,584 stores). Payday lenders are most commonly open every day except Sunday, or about 313 days per year. Dividing the number of loans made per year by 313 yields these figures of 10 to 13 loans per day. Advance America also notes that an average customer uses eight loans per year, implying a store serves about 511 unique customers. State regulatory data from Florida show a similar result, with approximately 526 customers per store (1,490 locations serving just over 784,000 customers), and fewer in Oklahoma.

113 Burtzlaff and Groce, *Payday Loan Industry*, 15.

114 Pew's benchmark is based on individual income largely because payday lenders today rely on individual income when offering a loan.

115 This figure is based on household income, not individual income, although Pew's survey data show only 33 percent of payday loan borrowers are married, and another 14 percent are living with a partner, so the differences between household and individual income may be somewhat smaller for payday borrowers than for the general population. Additionally, averaging individual income figures released by states (average monthly gross of $2,477 in Colorado, $2,426.97 in Illinois, and $2,821.98 in Washington) yields a very similar result of $30,904 annual gross individual income, or a biweekly paycheck of $1,189. Because Illinois has two different types of payday loans, the income figure for all small loan customers is used.

116 North Carolina Commissioner of Banks, *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly*, 19. While these loans generally carry much lower interest rates than payday loans, that is not because the borrowers are particularly good credit risks. Data compiled by Equifax Analytical Services for the North Carolina Commissioner of Banks revealed that the average credit score of a consumer finance customer in North Carolina was 578, and most had annual personal income between $20,000 and $40,000.

117 Proprietary data on file at The Pew Charitable Trusts.

118 Federal Reserve Board, *Survey of Consumer Finances* (2012), http://www.federalreserve.gov/econresdata/scf/scf_2010.htm; Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2011*; Washington State Department of Financial Institutions, *2011 Payday Lending Report* (2012), http://www.dfi.wa.gov/cs/pdf/2011-payday-lending-report.pdf; and Veritec Solutions LLC, *Illinois Trends Report: All Consumer Loan Products Through September 2012* (2013), http://www.idfpr.com/News/DFI/IL_Trends_Report%20since%20Inception%20through%209-30-12%20final.pdf. This figure is based on

household income, not individual income, although Pew's survey data show only 33 percent of payday loan borrowers are married, and another 14 percent are living with a partner, so the differences between household and individual income may be somewhat smaller for payday borrowers than for the general population. Additionally, averaging individual income figures released by states (average monthly gross of $2,477 in Colorado, $2,426.97 in Illinois and $2,821.98 in Washington) yields a very similar result of $30,904 annual gross individual income, or a biweekly paycheck of $1,189. Because Illinois has two types of payday loans, the income figure for all small loan customers is used.

119 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 14. Borrowers can afford to renew or reborrow loans, but not to repay them without borrowing again. This phenomenon explains why loss rates on these loans are only 3 percent, but three-quarters of loans are just renewals or quick reborrows of previous loans.

120 Cash America International, "Colorado Deferred Deposit Loans Rates/Fees," accessed September 2013, http://www.cashamerica.com/LoanOptions/CashAdvances/RatesandFees/Colorado.aspx. Calculation is based on the total payment amount of $788.74 divided by six months.

121 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2011*, 6.

122 This monthly income of $2,477 is the average, or mean. The $2,140 monthly income of a median borrower is lower ($25,680 annually), and if this figure were used instead of the mean, then a payment on a $500 loan would take up 6 percent of the borrower's income, and a payment on a $389 loan would take up 5 percent.

123 Office of the Comptroller of the Currency, "Proposed Guidance on Deposit Advance Products"; and Federal Deposit Insurance Corp., "Proposed Guidance on Deposit Advance Products."

124 Federal Reserve Board of Governors, "Expanded Guidance for Subprime Lending Programs" (Jan. 31, 2001), http://www.federalreserve.gov/boarddocs/press/boardacts/2001/20010131/attachment.pdf. Bank regulators count "loan flipping" as an element of predatory lending. This guidance was jointly signed by the OCC, the Federal Reserve Board, the FDIC, and the OTS and defined "loan flipping" as "inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced" and explaining that "predatory lending" typically involves loan flipping, and/or "making unaffordable loans based on assets of the borrower rather than on the borrower's ability to repay an obligation," and/or "engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower."

125 Colorado Office of the Attorney General, *"State of Colorado v. Security Finance Corp. of Colorado,"* filed June 9, 2008, http://www.coloradoattorneygeneral.gov/sites/default/files/press_releases/2010/05/18/securityfinancecomplaint.pdf. For example, see the Colorado attorney general's complaint against Security Finance, which resulted in a settlement, alleging that "Security Finance's business model is to continually flip (refinance) loans after or as close as possible to sixty days (prior to August 2007) or four months (after August 2007) of the previous loan or refinance to maximize the number and amount of acquisition charges it earns and to prevent consumers from paying off their loans or refinances as scheduled."

126 North Carolina Commissioner of Banks, *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly*, 47.

127 Federal Reserve Board of Governors, "Expanded Guidance for Subprime Lending Programs."

128 The Pew Charitable Trusts, *A New Equilibrium*. The median fee for cash advances on credit cards is 4 percent (banks) or 2 percent (credit unions).

129 National Consumer Law Center, *The Cost of Credit: Regulation, Preemption, and Industry Abuses*, 5.6.3.3 (2005). NCLC's manual and accompanying supplement book discuss the "rule of 78s," or "sum-of-digits" method, which allows the front-loading of interest.

130 Indiana Department of Financial Institutions, "What Is the Rule of 78s?" accessed Aug. 15, 2013, http://www.in.gov/dfi/2409.htm.

131 15 USC § 1615, "Prohibition on use of 'Rule of 78's' in connection with mortgage refinancings and other consumer loans," http://www.law.cornell.edu/uscode/text/15/1615. Lawmakers sometimes prohibit the "rule of 78s" by requiring use of the "actuarial method." See, e.g., (" ... the creditor shall compute the refund based on a method which is at least as favorable to the consumer as the actuarial method," where actuarial method is defined as "the method of allocating payments made on a debt between the amount financed and the finance charge pursuant to which a payment is applied first to the accumulated finance charge and any remainder is subtracted from, or any deficiency is added to, the unpaid balance of the amount financed").

132 Colorado's law also backloads one type of fee, the monthly maintenance fee. By allowing the monthly fee to apply only after the first two months of the loan term, the law actually creates an incentive for borrowers to repay their loans within the first two months (only about 33 percent of borrowers have done so to date; see Exhibit 4 of this report).

133 Office of the Colorado Attorney General, "Attorney General Announces Settlement Against EZPawn Colorado Inc. and EZMoney Colorado Inc." (April 2, 2013), https://www.coloradoattorneygeneral.gov/press/news/2013/04/02/attorney_general_announces_settlement_against_ezpawn_colorado_inc_and_ezmoney.

134 Mary C. Geesling, "Refunds of Origination/Acquisition Fees Upon Prepayment of a Payday Loan" (Aug. 12, 2011), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/Refunds%20of%20OriginationAcquisition%20Fees%20Upon%20Prepayment%20of%20a%20Payday%20Loan%20Memo.pdf.

135 Colorado Uniform Consumer Credit Code 5-3.1-105, http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/UCCC%202012.pdf: "If the loan is prepaid prior to the maturity of the loan term, the lender shall refund to the consumer a prorated portion of the annual percentage rate based upon the ratio of time left before maturity to the loan term"; And Colorado Uniform Consumer Credit Code 5-2-201: "With respect to a supervised loan or a consumer credit sale, except for a loan or sale pursuant to a revolving account, a supervised lender or seller may contract for and receive a finance charge, calculated according to the actuarial method ... "

136 Colorado Uniform Consumer Credit Code 5-3.1-108 (2), http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/UCCC%202012.pdf: "Upon renewal of a deferred deposit loan, the lender may assess an additional finance charge not to exceed an annual percentage rate of forty-five percent. If the deferred deposit loan is renewed prior to the maturity date, the lender shall refund to the consumer a prorated portion of the finance charge based upon the ratio of time left before maturity to the loan term." Note, however, that if a customer takes out a new loan after fully repaying a previous one, lenders again earn origination and maintenance fees on that loan.

137 Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (2007), 14, http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf. Original source material is state regulatory information from Florida, Michigan, Oklahoma, and Washington.

138 Community Financial Services Association of America, "CFSA Member Best Practices," accessed September 2013, http://cfsaa.com/cfsa-member-best-practices.aspx.

139 Washington State Department of Financial Institutions, *2011 Payday Lending Report*, 7.

140 Administrator of the Colorado Uniform Consumer Credit Code, *Payday Lending Demographic and Statistical Information: July 2000 through December 2009*. This report notes that in the wake of the 2007 law requiring an extended payment plan after the "fourth, or subsequent, consecutive loan," lenders found workarounds in order to avoid offering the plans. Changes implemented by lenders included "cooling-off" or "waiting" periods after the third loan (or sometimes every loan), or denying the borrower a new loan if they chose a payment plan. Thus, while measures of indebtedness fell, only 4.6 percent of all loans were converted into a payment plan compared with the 33 percent that were eligible for the plans.

141 King and Parrish, *Springing the Debt Trap*, 14. The 2007 regulatory data from these three states show fewer than 3 percent of eligible borrowers utilizing such plans.

142 Office of Consumer Credit Commissioner, *Credit Access Business Update to the House Pensions, Investments and Financial Services Committee* (2013), 5, http://www.legis.state.tx.us/tlodocs/83R/handouts/C2702013042914301/1b32f392-d511-466e-8dd4-61418a8da5e3.PDF.

143 Veritec Solutions LLC, *Illinois Trends Report: All Consumer Loan Products Through September 2012* (2013), http://www.idfpr.com/News/DFI/IL_Trends_Report%20since%20Inception%20through%209-30-12%20final.pdf. Illinois is an exception to this trend, but lawmakers there have placed substantially more constraints on lump-sum repayment loans than on payday installment loans.

144 Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products*. Seventy-five percent of fees are paid by those using 11 or more loans per year. DeYoung and Phillips, *Payday Loan Pricing*. The authors conclude that "the profitability of payday lenders depends on repeat borrowing."

145 Lauren E Willis, "When Nudges Fail: Slippery Defaults," *University of Chicago Law Review*, forthcoming; Loyola-LA Legal Studies Paper no. 2012-32 (Sept. 6, 2012), http://ssrn.com/abstract=2142989.

146 King and Parrish, *Springing the Debt Trap*, 14. Note 49 of *Springing the Debt Trap* describes tactics used by lenders to avoid offering installment repayment plans under a previous Colorado law that required such plans after four consecutive payday loans.

147 Raj Chetty et al., "Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark," *National Bureau of Economic Research* (November 2012). For example, the authors classify approximately 85 percent of people as "passive savers" who are heavily influenced by defaults as to whether to use a retirement savings account, but not by tax incentives to save. John Beshears et al., "The Importance of Default Options for Retirement Savings Outcomes," *National Bureau of Economic Research* (January 2006), http://www.nber.org/papers/w12009. According to Beshears et al., "recent research has highlighted the important role that defaults play in a wide range of settings: organ donation decisions (Johnson and Goldstein 2003; Abadie and Gay 2004), car insurance plan choices (Johnson et al. 1993), car option purchases (Park, Jun, and McInnis 2000), and consent to receive e-mail marketing (Johnson, Bellman, and Lohse 2003)." The authors also find that defaults have "tremendous influence" on "savings plan participation, contributions, asset allocation, rollovers, and decumulation."

148 Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir, *Behaviorally Informed Financial Services Regulation* (New America Foundation, 2008). The authors discuss the use of "sticky" defaults to improve policy in the financial services area.

149 Anandi Mani, et al., "Poverty Impedes Cognitive Function," Science 341, no. 976 (2013). Recent research found that people experiencing

a cash shortage, or who are primed to think about financial difficulty, perform poorly on tests, as compared with otherwise similar people (or themselves), in more financially comfortable situations. This finding suggests financial decision-making may be even more difficult in such circumstances.

150 PL$, "Texas Fee Schedule," accessed June 2013, http://www.plshome.com/loans/payday-loans. These loan data come from PL$, a large payday lender offering installment loans in Texas. Data can be found by clicking on Texas Fee Schedule and downloading the PDF of the company's loan rates in Texas. Also, "TX CSO Payday Installment Fee Schedule," ACE Cash Express, accessed June 2013, https://www.acecashexpress.com/-/media/Files/Installment/LicenseRates/TX_FeeSchedule.pdf. ACE is the second-largest payday lender by store count and requires similar payments.

151 The average household income of a payday loan borrower is $31,000, and the average payday borrower can afford a biweekly payment of $50 (or a monthly payment of $100). Additionally, averaging individual income figures released by state (average monthly gross income of $2,477 in Colorado, $2,426.97 in Illinois, and $2,821.98 in Washington) yields a similar result of $30,904 annual gross individual income, or a biweekly paycheck of $1,189. The average individual income of installment loan borrowers in an industry data set reviewed by Pew was $26,000.

152 Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit in America: An Analysis of Customer Demand," Credit Research Center, Georgetown University (2001), http://faculty.msb.edu/prog/CRC/pdf/mono35.pdf.

153 Christopher Lewis Peterson, " 'Warning: Predatory Lender'—A Proposal for Candid Predatory Small Loan Ordinances," *Washington and Lee Law Review* 69, no. 2 (Dec. 13, 2011), http://ssrn.com/abstract=1971971.

154 According to a Pew analysis of state loan laws, 43 states and the District of Columbia set maximum interest rates for payday loans. Of the remaining seven, Texas sets maximum interest rates for pawn shop loans: http://www.occc.state.tx.us/pages/int_rates/pRate12.pdf; Nevada sets maximum interest rates for pawn shop loans: http://www.leg.state.nv.us/NRS/NRS-646.html#NRS646Sec050; and Delaware also sets maximum interest rates for pawn shop loans: http://delcode.delaware.gov/title24/c023/sc02/index.shtml. Forty-two states and the District also set maximum interest rates on consumer finance installment loans. (The eight that do not are Delaware, Idaho, Missouri, Nevada, New Mexico, South Dakota, Utah, and Wisconsin.)

155 The seven that do not set maximum allowable charges on lump-sum payday loans are Delaware, Idaho, Nevada, South Dakota, Texas, Utah, and Wisconsin. State laws are available at http://www.pewstates.org/research/data-visualizations/state-payday-loan-regulation-and-usage-rates-85899405695.

156 Rob Levy and Joshua Sledge, "A Complex Portrait: An Examination of Small-Dollar Credit Consumers," Center for Financial Services Innovation (2012), http://www.cfsinnovation.com/content/complex-portrait-examination-small-dollar-credit-consumers.

157 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*, 20–21. Pew found 37 percent of borrowers said they have been in such a difficult situation that they would have taken a payday loan "on pretty much any terms offered." Elliehausen and Lawrence, "Payday Advance Credit in America"; and Avery and Samolyk, "Payday Loans Versus Pawn Shops." The last two papers also discuss price insensitivity.

158 Office of Fair Trading, "Final decision on making a market investigation reference" (June 2013), http://www.oft.gov.uk/shared_oft/markets-work/payday-MIR.pdf.

159 Lauren Willis, "The Virtues of Price Caps," *Credit Slips* (March 14, 2013), http://www.creditslips.org/creditslips/2013/03/the-virtues-of-price-caps.html. Law professor Lauren Willis has suggested, "Given that price competition is not working, ideally a price cap would be set to what price competition would have produced—something close to an efficient lender's average cost."

160 DeYoung and Phillips, "Payday Loan Pricing." This fact can also be observed in the rates posted for various states on the websites of the largest payday lenders.

161 Ibid.

162 Based on Pew's analysis of state lending laws and markets. Many consumer finance companies are members of the American Financial Services Association.

163 Texas Office of Consumer Credit Commissioner, Texas Finance Code Chapter 342, Subchapter F Rate Chart (2012), http://www.occc.state.tx.us/pages/int_rates/Ratechart_4.pdf.

164 South Carolina State Board of Financial Institutions, Annual Report 2011-2012 (2012): 62, http://www.bofi.sc.gov/Annual%20Reports/BOFI2012AnnualReport.pdf.

165 North Carolina Office of the Commissioner of Banks, *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly*, 6. "Credit insurance (Credit life, credit accident and health, credit unemployment, and credit property insurance) may be sold with the loans. Neither the premiums charged nor any benefits to the lender count toward the limit on permitted fees."

166 Based on Pew's analysis of state lending laws. These maximum allowable loan lengths vary across states from 12 months for smaller loans to several years for larger loans.

167 Thomas Durkin, presentation, Federal Reserve Bank of Philadelphia's Small-Dollar Credit: Products, Economics, and Regulation Conference, Philadelphia (July 12, 2013).

168 National Consumer Law Center, "Stopping the Payday Loan Trap" (2010), 15, http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf. For the Federal Trade Commission's Credit Practices Rule, see 49 Fed. Reg. 7740 (March 1, 1984), codified at 16 CFR Part 444.

169 District of Columbia Official Code § 26-301, http://dccode.elaws.us/code?no=26-3&e=8: " ... in the event of a need for emergency cash"; Texas Administrative Code, Rule § 83.604, http://info.sos.state.tx.us/pls/pub/readtac$ext.TacPage?sl=R&app=9&p_dir=&p_rloc=&p_tloc=&p_ploc=&pg=1&p_tac=&ti=7&pt=5&ch=83&rl=604: "This cash advance is not intended to meet long-term financial needs. This loan should only be used to meet immediate short-term cash needs"; Louisiana Office of Financial Institutions, "Deferred Presentment and Small Loans (Payday Loans) Frequently Asked Questions for Consumers," http://www.ofi.state.la.us/Payday%20Consumer%20FAQ.htm: "Payday loans are not intended to meet your long-term financial needs. The long-term use of payday loans may cause financial hardship"; and Michigan Act 244 of 2005, "Deferred Presentment Service Transactions Act," Article 3, 487.2151, Sec. 31,http://www.legislature.mi.gov/(S(g1oqis3o4gwwxezsoslhsd55))/printDocument.aspx?objectName=mcl-Act-244-of-2005&version=txt: "A deferred presentment service transaction is not intended to meet long-term financial needs."

170 The Pew Charitable Trusts, "State Payday Loan Regulation and Usage Rates," modified July 2013. Maximum size of deferred presentment loans varies as follows: $300 (one state); $350 (two states); $500 (18 states); $550 (two states); $600 (two states); $700 (one state); $1,000 (two states); $1,500 (one state). Two states set a maximum loan size based only on consumer income.

171 John Warner National Defense Authorization Act for Fiscal Year 2007, Sec. 670 § 987, http://www.gpo.gov/fdsys/pkg/BILLS-109hr5122enr/pdf/BILLS-109hr5122enr.pdf; and Jean Ann Fox, *The Military Lending Act Five Years Later*, (Consumer Federation of America, 2012). See report for a detailed discussion of the Military Lending Act's protections and impact.

172 CashNetUSA, "How It Works," accessed July 29, 2013, http://www.cashnetusa.com/how-it-works.html. For example, one of the largest online payday lenders, CashNetUSA, makes it far more difficult for borrowers to receive funds and repay loans who do not agree to ACH payments and explicitly states, "The ACH Authorization can only be revoked after we have received payment in full of the amount owed."

173 Federal Trade Commission, "Online Payday Loans." The FTC discusses recent lawsuits against online payday lenders for alleged violations of federal laws.

174 *Baptiste and Brodsky v. JP Morgan Chase Bank*, filed Oct. 1, 2012. http://www.nedap.org/documents/Baptistev.ChasecomplaintFINAL.pdf. This is a complaint in a high-profile case of withdrawals by online payday lenders resulting in large bank fees for borrowers.

175 Advance America, accessed Sept. 1, 2013, http://www.advanceamerica.net. For example, in Delaware, Advance America charges 387.9 percent APR for loans that permit them to electronically debit the account, but 448.74 percent APR for loans that do not. In Wisconsin the corresponding figures are 381.62 percent APR and 439.26 percent APR.

176 Federal Deposit Insurance Corp., *A Template for Success*. In 2008, the FDIC launched a two-year pilot program to assess if financial institutions could offer affordable small loans in place of high-cost alternatives. All participating banks performed underwriting and many used credit reports to determine loan amounts and ability to pay. Even with a streamlined underwriting process, approximately three-quarters of banks offered to auto debit loan payments from the customer's account, and some offered interest rate discounts for this option. As the FDIC study noted, features of success included longer loan terms and strong underwriting criteria, as well as the ability to auto debit.

177 Caroline Glendinning and Peter A. Kemp, eds., *Cash and Care: Policy Challenges in the Welfare State* (September 2006). "The ability to collect loan repayments either through direct deduction or more certain method of direct debit would significantly reduce the costs of lending for commercial, credit providers. Credit unions and other not-for-profit lenders would also benefit from these methods of collecting payments, as they would reduce their costs and make financial sustainability more attainable."

178 Federal Trade Commission, "Online Payday Loans," accessed Sept. 1, 2013, http://www.consumer.ftc.gov/articles/0249-online-payday-loans. The FTC discusses recent lawsuits against online payday lenders for alleged violations of federal laws.

179 *Baptiste and Brodsky v. JP Morgan Chase Bank*. This is a complaint in a high-profile case of withdrawals by online payday lenders resulting in large bank fees for borrowers.

180 The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* 35–38.

181 15 USC § 1693k and 1693e, "Compulsory use of electronic fund transfers," http://www.law.cornell.edu/uscode/text/15/1693k.

182 Jessica Silver-Greenberg, "Dimon Pledges to Change JPMorgan's Practices on Payday Loans," *The New York Times* (Feb. 26, 2013), Business Day, U.S. edition. After facing criticism for failing to protect its customers from payday lenders that aggressively used the electronic payments system to withdraw funds from JPMorgan Chase customer accounts, CEO Jamie Dimon pledged to revise the company's practices on payday loans.

183 Chris Cumming, "JPM Chase Changes Policy in Response to Payday Loan Criticism," American Banker (March 20, 2013). JPMorgan Chase

has announced its intention to charge "customers only one 'returned item fee' per month even when a lender tries to charge an account more than once." According to bank officials interviewed by Pew, as much as 30 percent of online payday lender electronic debit requests to banks are "representments," or debits that occur after an initial debit was declined for insufficient funds. By comparison, these officials indicated that banks treat representment rates of greater than 1 percent as a sign of potential malfeasance or noncompliance, and most merchants fall well under that threshold.

184 NACHA, the organization that oversees the automated clearinghouse for electronic payments, operates under bylaws voted on by member banks and other institutions. According to representatives of member banks that spoke with Pew in June 2013, NACHA is evaluating a rule change that would penalize banks that help unscrupulous lenders abuse the power to electronically debit consumer bank accounts within the NACHA network.

185 Western Sky, "Rates," accessed Sept. 2, 2013, http://www.westernsky.com/General/Rates.aspx; and Danielle Douglas, "Payday lender Western Sky Financial to stop funding loans on Sept. 3," *The Washington Post*, Business (Aug. 26, 2013). Western Sky recently announced that it would cease to fund loans.

186 CashCall, "Now Let's Talk Numbers," accessed Sept. 11, 2013, http://www.cashcall.com/Rates/CurrentRates.aspx?tab=2.

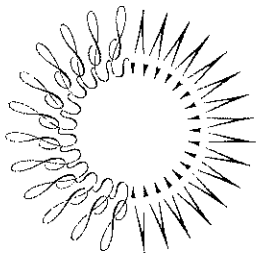
187 Maximum terms that fail to account for a borrower's income are likely to limit the size of loan available to low-income borrowers and allow unnecessarily long terms for middle-income borrowers.

188 Thomas Durkin, presentation, Federal Reserve Bank of Philadelphia's Small-Dollar Credit: Products, Economics, and Regulation Conference, Philadelphia, July 12, 2013. Consumer finance company installment loan estimates are based on the statement of Thomas Durkin, who noted that a typical consumer finance company installment loan amount is about $1,000, with a term of 12 months and an APR around 60 percent. Industry representatives and analysts have confirmed these figures in meetings with Pew. Regional Management Corp., Annual Report (Fiscal Year 2012), http://quote.morningstar.com/stock-filing/Annual-Report/2012/12/31/t.aspx?t=XNYS:RM&ft=10-K&d=fefbb7596975e37168ee08086e1ad0df. Installment lender Regional Management's annual report (10-K) indicates its average small installment loan was for $1,179 and 17 months.

189 One effective option for establishing a maximum loan length is to account for the loan's size and the borrower's income by dividing the loan's principal by the borrower's daily income (annualized income divided by 365). This resulting figure provides a reasonable maximum number of months that a loan should last. Assuming an average loan ($375) and borrower ($31,000 annual income), that will result in a loan term of 4.4 months (375/84.93). This formula works for loans smaller than this and those substantially larger, and for a wide range of incomes. Using this formula for a $500 loan and a low-income borrower ($18,000 annually) and a high-income borrower ($48,000 annually), results in loan terms of 10.1 months and 3.8 months, respectively. Of course, virtually any interest rates are possible under such a scenario, depending on the borrower's ability to pay. Slightly longer terms will be appropriate for repayments that consume less than 5 percent of a borrower's paycheck.

190 Burtzlaff and Groce, *Payday Loan Industry*, 15. Stephens Inc., in its 2011 report, estimates that borrowers do not become profitable for lenders until they have borrowed four or five times. DeYoung and Phillips, "Payday Loan Pricing." DeYoung and Phillips also conclude that "the profitability of payday lenders depends on repeat borrowing." An analysis of North Carolina data found that 73 percent of lender revenue came from borrowers using seven or more loans per year. Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly* (2003), 22, http://ccc.unc.edu/contentitems/payday-lending-a-business-model-that-encourages-chronic-borrowing/. The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, 15.

191 Susan E. Woodward and Robert E. Hall, "Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence," *National Bureau of Economic Research* (May 2010), http://www.nber.org/papers/w16007.pdf.



THE PEW CHARITABLE TRUSTS

Exhibit F

Returning Customer Login (https://apply.acecashloans.com/lending/installment-loans/login)

Email Address Password

Apply Now for an Installment Loan

* All fields are required

First Name

Last Name

Phone Number State

Email Address

Terms, Conditions and Privacy Policy (/privacy-policy?device=partial)

Please select the state above for license and rates.

What are our online customers saying?

"I would definitely get another loan from here or recommend my friends to get one" Jan. 2013

"It was a great experience, ACE has excellent customer service." Feb. 2013

"I have used ACE several times and it has been a breeze. I have had excellent experiences. Thank you" March 2013

"ACE is a lifesaver - thank you for being there in my time of need" April 2013

Personal Loans

Repay Over Time, Not All at Once

Fast, Secure, and Easy

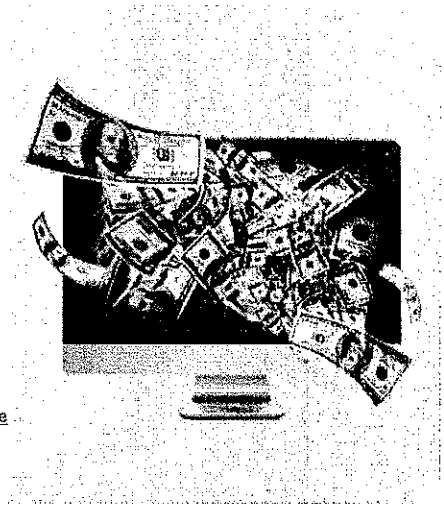
Instant Loan Decision

Risk Free Guarantee

Apply Now!

(https://apply.acecashloans.com/lending/installment-loans/)

CA, DE, MO, NM, OH, SD, and TX only



Quick Money **Easy Application** **Loans Up to $2000[3]**

Cash deposited overnight [2]

Make sure you have your driver's license and banking information handy while completing the application, as you will need this information. Your cash should be deposited overnight. [2]

(https://apply.acecashloans.com/lending/installment-loans/) Apply Now!

Fast Cash	Safe and Secure	A Trusted Partner
Instant loan decision	Secure Application	More than 40 years of trust
Loans from $200 - $2,000 [3]	Easy Application	More than 1,500 locations
Cash deposited overnight [2]	No Faxing Required	Dependable quality service

Application (https://apply.acecashloans.com/lending/installment-loans)

Get an instant decision in just a few minutes.[1]

Login (https://apply.acecashloans.com/lending/installment-loans/login)

Manage your existing loan account by logging in.

FAQs (/installment/StateServiceRedirect?service=[E7759C98-07D0-4B7B-ADFB-9B543CAEFE36]&type=StateServiceFaqPageIter)

Find answers to common questions about online loans.

Licenses and Rates

(/Services/StateServiceRedirect

service={E7759C98-07D0-

4B7B-ADFB-

9B543CAEFE36}

&type=StateServiceLicensePage

View our state license and short term lending rates.

1. Rates and terms will vary depending upon the state where you reside. Loans in California are made or arranged pursuant to Department of Business Oversight California Finance Lenders License. Loans in Texas arranged by ACE Credit Access LLC and made by, and subject to the approval of, an unaffiliated third party lender. Loans in Ohio arranged by FSH Credit Services LLC d/b/a ACE Cash Express, CS.900100.000, and made by, and subject to the approval of, an unaffiliated third party lender. All loans subject to approval pursuant to standard underwriting criteria. Loans should be used for short-term financial needs only, and not as a long-term solution. Customers with credit difficulties should seek credit counseling.
2. All loans subject to approval pursuant to standard underwriting criteria. Loan funding requires verification of application information. Depending on ability to verify this information, loan funding may be extended up to two days. In-store cash pickup is subject to approval pursuant to standard underwriting criteria.
3. Personal loan amounts range from $200 - $2,000 in every state except California. The minimum and maximum loan amount in California is $2,500. Loans in California will be arranged or made pursuant to Department of Business Oversight California Finance Lenders License # 603 F796.

Our credit decision on your application may be based in whole or in part on information obtained from a national database including, but not limited to Clarity Services, Inc., P.O. Box 5717, Clearwater, Florida 33758, (866) 390-3118 and/or FactorTrust, Inc., P.O. Box 3653, Alpharetta, Georgia 30023, (678) 306-2260.

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FISCA (http://www.fisca.org/)

(http://ushcc.com/)

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ACE Cash Express

- Payday Loans
- Prepaid Debit Cards
- Title Loans
- Auto Insurance
- Tax
- All Services

Store locator ZIP code Find

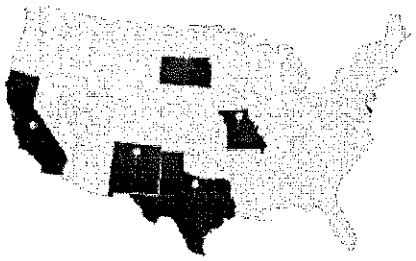
» Home » Uncategorized » **ACE Installment Loans are now available in more states!**

ACE Installment Loans are now available in more states!



Megan | September 17, 2013 | 0 Comments

Exciting news! ACE's latest loan product, Installment Loans, is now available in four more states. What was once limited to Texas and Delaware customers is now offered in California, Missouri, New Mexico, and South Dakota.



Installment Loans are our newest and most flexible product. An Installment Loan gives you more time to repay than a Payday Loan. Instead of paying off your loan on your next payday, you will be able to repay over time. With loan amounts up to $2,000* and a quick and easy application process, an ACE Installment Loan is a convenient and timely way to borrow the cash you need.

ACE Cash Express has proudly served over 38 million customers since 1968. We are pleased to offer our customers convenient ways to help them when they need it. If Installment Loans are not available yet in your state, check back soon – your state might be next!

Tags: announcement, Installment loan

Category: Uncategorized

Leave a Reply

Name (required)

Email (required; will not be published)

Website

Exhibit G

ACE CASH EXPRESS, INC. INSTALLMENT LOAN AGREEMENT

Lender: ACE Cash Express, Inc. 1231 Greenway Drive, Suite 600 Irving, TX 75038 1-866-355-6815 support@acecashexpress.com	**Loan Number:** 2000025801029 **Borrower:** ROSALYN JOHNSON 102 W 23RD ST WILMINGTON, DE 19802 302-416-5073
Agreement Date: 6/16/2013 **Projected Funding Date:** 6/18/2013	**Maturity Date:** 8/23/2013

In this Installment Loan Agreement, which includes the Truth in Lending Act Disclosure Statement, the Arbitration Agreement (if you do not reject it), the Payment Election and Authorization Form and ACE's Privacy Notice (collectively, this "Agreement"), "you" and "your" mean the Borrower named above. "We," "our," "us," "ACE" and "Lender" refer to ACE Cash Express, Inc. and/or its assignee. "Loan" refers to the loan we are making to you, described below. The ANNUAL PERCENTAGE RATE and/or FINANCE CHARGE stated below are based on an estimate that Loan funds will reach your account on the Projected Funding Date set forth above. Banking delays or holidays, or delays in making contact with you to verify the information you have provided to us may cause the Loan funds to reach your account later. We will begin accruing the Finance Charge on your Loan on the date the Loan funds are credited to you.

TRUTH IN LENDING ACT DISCLOSURE STATEMENT

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you.	The amount you will have paid after you have made all payments as scheduled.
391.83%	$200.38	$ 450.00	$ 650.38

Payment Schedule: Five installment payments payable on the dates and in the amounts set forth below.

Number of Payment	Payment Date	Total Due
1	6/28/2013	130.08
2	7/12/2013	130.08
3	7/26/2013	130.08
4	8/9/2013	130.08
5	8/23/2013	130.06

Delinquency Charge: If a payment is late, you will be charged 5% of the unpaid portion of the payment.
Security Interest: Lender has a security interest and other rights in the electronic fund transfer ("EFT") authorization set forth in the Payment Election and Authorization Form.
Prepayment: If you pay off early, you will not have to pay a penalty.
Additional Information: You should see the remaining provisions of this Agreement for any additional information about nonpayment, default, required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate.

Itemization of Amount Financed of $450.00
$ 450.00 Amount given to you directly
$ 0.00 Amount paid on your existing ACE loan
$ 450.00 Amount Financed

Promise to Pay; Interest Accrual; Method of Payment.
You promise to pay us or to our order the Amount Financed of $ 450.00 plus interest at the rate of 399.00% per annum until paid in full. Your payments are due in the amounts and on the dates shown in the Payment Schedule above. You may prepay in full or in part at any time without penalty. We compute simple interest on the actual days the Amount Financed is advanced and unpaid, treating each day as 1/365th (or 1/366th, as applicable) of a year. If you make a payment early, less interest is owed, and if you make a payment after it is due, more interest is owed. Payments shall be applied first to accrued interest and then to principal. Any adjustment in the amount of interest will be made to the final payment, which means that your final payment may be higher or lower than the scheduled amount depending upon your actual payment history. You will make your payments (1) by mailing your payments to us at Installment Loans at ACE Cash Express,1231 Greenway Drive, Suite 670, Irving, TX 75038, so that they are received on or prior to the dates they are due, or (2) to the extent you elect to make periodic electronic payments on the Payment Election and Authorization Form that you electronically sign in connection with this Loan Agreement, by us initiating, on each due date, an electronic fund transfer to your bank account under the terms set forth in the Payment Election and Authorization Form. In the event of your default and acceleration of your Loan, we may initiate an electronic fund transfer to your bank account under the terms set forth in the Payment Election and Authorization Form for all remaining amounts due and owing under this Loan Agreement.

Prepayment.
You have the right to prepay this Loan in full by paying all outstanding principal plus accrued interest through the date of prepayment. To prepay the Loan, send an email or fax stating that you want to prepay to txwebmail@acecashexpress.com or 1 (866) 355-6818 and include your name, address, and Loan number. Upon receiving your email or fax, we will submit an EFT to your Account in accordance with the terms of your Payment Election and Authorization Form for all outstanding principal plus accrued interest. If such EFT is returned, your Loan will not be prepaid and you will be liable for your remaining payments on their due dates. Alternatively, you may request prepayment by calling us at 1 (866) 355-6815 between 8:00 a.m. and 8:00 p.m. Eastern Time with your Loan number and payment information handy. Upon receiving your request, we will submit an EFT to your Account in accordance with the terms of your Payment Election and Authorization Form or seek payment by another method that we may permit and that you request for all outstanding principal plus accrued interest.

Delinquency Charge; Returned Item Charge.
If you fail to make any payment on or before its due date, you agree to pay ACE a delinquency charge equal to 5% of the unpaid amount. If any payment you make to us is dishonored, you may be charged an additional fee of up to the lesser of $25.00 or the maximum allowed by law. We will assess only one returned item fee per installment of this Loan.

Security Interest in Electronic Payment Authorization.
You hereby grant us a security interest in the authorization for EFTs set forth in the Payment Election and Authorization Form.

Notice and Cure.
Prior to initiating a lawsuit or arbitration regarding a legal dispute or claim relating in any way to this Agreement or Loan (as more fully defined in the Arbitration Agreement, a "Claim"), the party asserting the Claim (the "Claimant") shall give the other party (the "Defending Party") written notice of the Claim (a "Claim Notice") and a reasonable opportunity, not less than 30 days, to resolve the Claim. Any Claim Notice to you will be sent by mail or email to the applicable address you have provided on your Application (or any updated address you have subsequently provided to us). Any Claim Notice to us shall be sent by mail, ACE Cash Express, Inc., 1231 Greenway Drive, Suite 600, Irving, Texas 75038, attention General Counsel. Any Claim Notice you send must provide your Loan Number, mailing address and telephone number. Any Claim Notice must explain the nature of the Claim and the relief that is demanded. The Claimant must reasonably cooperate in providing any information about the Claim that the Defending Party reasonably requests.

Entire Agreement.
This Agreement includes, and incorporates by reference, the Arbitration Agreement (if you do not reject it), the Truth in Lending Act Disclosure Statement, the Payment Election and Authorization Form and ACE's Privacy Notice. This Agreement, including the portions of this Agreement incorporated by reference, constitutes the sole agreement between you and ACE with respect to the subject matter of this Agreement.

Credit Reporting.
You authorize us make inquiries concerning your credit history and standing. We may report information about your Loan to credit bureaus. Late payments, missed payments or other defaults on your Loan may be reflected in your credit report. If you believe that any information about your Loan that we have furnished to a consumer reporting agency is inaccurate, or if you believe that you have been the victim of identity theft in connection with any Loan made by us, write to us at ACE Cash Express, Inc., 1231 Greenway Drive, Suite 600, Irving, Texas 75038, attention General Counsel. In your letter (i) provide your name and Loan number, (ii) identify the specific information that is being disputed, (iii) explain the basis for the dispute and (iv) provide any supporting documentation you have that substantiates the basis of the dispute. If you believe that you have been the victim of identity theft, submit an identity theft affidavit or identity theft report.

Truthfulness of Application.
You represent that every statement made in your Application for credit is true, complete and correct and that you are at least 18 years of age. YOU EXPRESSLY AUTHORIZE US TO ATTEMPT TO CONFIRM ANY STATEMENT MADE IN THE APPLICATION WITH YOUR EMPLOYER OR OTHER THIRD PARTIES.

Telephone Recording.
You understand and agree that we may monitor and/or record any of your phone conversations with any of our representatives.

Automatic Reminders.
We may use automated telephone dialing, text messaging systems and electronic mail to provide messages to you about payment due dates, missed payments and other important information. The telephone messages are played by a machine automatically when the telephone is answered, whether answered by you or someone else. These messages may also be recorded by your answering machine. You give us your permission to call or send a text message to any telephone number you have given us and to play pre-recorded messages or send text messages with information about your transaction over the phone. You also give us permission to communicate such information to you via electronic mail. You agree that we will not be liable to you for any such calls or electronic communications. You understand that, when you receive such calls or electronic communications, you may incur a charge from the company that provides you with telecommunications, wireless and/or Internet services. You agree that we have no liability for such fees.

Certain Communications.
Any communication with us required or permitted under the Federal Bankruptcy Code must be in writing, must include your account number, and must be sent to ACE Cash Express, Inc., 1231 Greenway Drive, Suite 600, Irving, Texas 75038, attention General Counsel.

Assignment.
We may assign or transfer the Loan Agreement or any of our rights hereunder.

WAIVER OF RIGHT TO TRIAL BY JURY.
YOU AND WE ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL RIGHT BUT MAY BE WAIVED IN CERTAIN CIRCUMSTANCES. TO THE EXTENT PERMITTED BY LAW, YOU AND WE KNOWINGLY AND VOLUNTARILY WAIVE ANY RIGHT TO TRIAL BY JURY IN THE EVENT OF LITIGATION ARISING OUT OF OR RELATED TO THIS AGREEMENT. THIS JURY TRIAL WAIVER SHALL NOT AFFECT OR BE INTERPRETED AS MODIFYING IN ANY FASHION ANY ARBITRATION AGREEMENT TO WHICH YOU AND WE ARE SUBJECT, WHICH CONTAINS ITS OWN SEPARATE JURY TRIAL WAIVER.

Payment of Disputed Balance.
If you wish to make payment in satisfaction of a disputed balance, you must send it to ACE Cash Express, Inc., 1231 Greenway Drive, Suite 600, Irving, Texas 75038, attention General Counsel, along with a letter of explanation.

Bankruptcy.
You represent that you are not contemplating bankruptcy and that you have not consulted with an attorney regarding bankruptcy in the past six months.

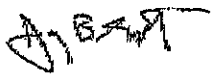
Governing Law.
This Agreement (but not the Arbitration Agreement) shall be governed by the substantive laws of the State of Delaware.

Condition to Our Disbursing Loan Proceeds.
To complete your transaction with us, you must electronically sign this Agreement by clicking the "I Agree" button below. You agree that for security purposes, our agent may attempt to contact you at one or more of the phone numbers you provided on your application. We disburse the proceeds of your Loan if and only if we are able to verify the information in your application (including by making contact with you). If we are unable to make contact with you or verify your application information, we may refuse to disburse your Loan proceeds. You represent and warrant that you will be available to speak with our agent at the phone numbers you provided, and acknowledge that we have provided disclosures to you based on your representations to us. Following our verification, we will then disburse the proceeds of your Loan by depositing the proceeds from this Loan Agreement into the bank account listed on the Payment Election and Authorization Form, unless such proceeds are applied to any outstanding obligation to us. Alternatively, you have the option of coming into any ACE store where we will make the amount of the Loan immediately available to you upon your presentation of a current government-issued identification card with your photograph. We will begin accruing the Finance Charge on your Loan on the date the Loan funds are credited to you.

Returned Payments.
If a payment on this Loan is not honored or is returned unpaid, you will owe us the amount of the payment, plus any returned payment fee, even if we have marked the Loan as satisfied. Also, if this Loan refinances a prior loan made by us, you promise that any payment you made on the prior loan will be honored and not returned unpaid. If you break this promise, you will be in default on this Loan, and we will have the right to declare immediately due and payable the entire outstanding principal balance of this Loan (the "Accelerated Balance"). You will then owe us the Accelerated Balance on this Loan and the amount of the returned payment and any returned payment fee on the prior loan.

Intending to be legally bound, ACE caused this Agreement to be signed on its behalf.

ACE Cash Express, Inc.



Jay Shipowitz, President

BY CLICKING "I AGREE" BELOW, YOU ACKNOWLEDGE THAT YOU HAVE READ, UNDERSTAND AND AGREE TO BE BOUND BY THE TERMS ABOVE. IF YOU REJECT THE PROPOSED TERMS BY CLICKING "I DO NOT AGREE," YOU WILL NOT BE PERMITTED TO OBTAIN CREDIT FROM US.

Name on Application: ROSALYN JOHNSON

I Agree

Date of Agreement: 6/16/2013

PAYMENT ELECTION AND AUTHORIZATION FORM

Financial Institution ("Depository"):	TD BANK, NA
Acct. No. ("Account"):	4255092903
Routing/ABA No.:	31201360

EFT Authorization for Entire Balance if You Default and, Upon Your Election, All Installment Payments. By giving us the information set forth above, you authorize ACE Cash Express, Inc. (or its agents or assigns) ("ACE"), (a) in the event of your default under your Installment Loan Agreement with ACE, and (b) to the extent you elect below to make installment payments on your Installment Loan Agreement, upon the due date of each installment payment, to initiate one or more EFTs to the Account at the Depository on the date of such payment or default or thereafter in order to obtain payment of the amounts due and owing to ACE or its assigns under your Installment Loan Agreement (including any returned payment fee and/or late fee), as such agreements may be renewed or extended from time to time. You may be charged a returned payment fee and/or late fee in the event your EFT is rejected and you authorize us to add such fees to any re-initiated transfer (as permitted) or to initiate a separate single EFT to your account in the amount of such fees. In the event that we make an error in processing an EFT, you further authorize us to initiate an electronic credit or debit entry, as necessary, to correct the error.

Authorization to Vary Amount of EFT for Final Installment. If you elect to make your installment payments by EFT, you have the right to receive written notice of all varying transfers. To exercise this right, please send a written request to us at Installment Loans at ACE Cash Express,1231 Greenway Drive, Suite 670, Irving, TX 75038. Unless you exercise this right, you authorize us to vary the amount of the EFT for your final installment payment, without providing you written notice, such that the EFT may be at least 50% of the scheduled final payment and no more than 110% of the scheduled final payment.

Modified EFT Payments. Instead of or in addition to any EFTs described above, you authorize us to process any EFTs you subsequently confirm by phone, e-mail or text message.

Authorization to Create Remotely-Created Checks ("RCCs") Six Months After Default. In the event that you default and we are not able to obtain payment of the amounts due under your Installment Loan Agreement (the "Default Balance") by the method you specify in this Authorization or by contacts with you, you authorize us to collect the Default Balance by creating and depositing and/or presenting for payment, starting approximately six months after the date of default, one or more RCCs drawn on the Account. In the event that any such RCC is returned unpaid, we will stop depositing or presenting RCCs to the Account pursuant to this Authorization.

Termination of Authorizations; Reinitiation of EFTs; Network Rules. You understand and acknowledge that you may terminate this authorization to obtain payment by EFT ("EFT Authorization") by notifying ACE in writing at the following address: 1231 Greenway Drive, Suite 600, Irving, Texas 75038, Attention: General Counsel, in such time as to afford ACE and your bank a reasonable opportunity to act on your request. The EFT Authorization will remain in full force and effect until the earlier of the following occurs: (i) you satisfy all of your payment obligations under your Installment Loan Agreement, and (ii) you provide ACE notice of your termination of this EFT Authorization as described above. You understand and agree that in the event that any EFT or RCC authorized in accordance with this Authorization is rejected, ACE may attempt up to two more times to initiate such EFT or RCC. You acknowledge that the initiation of EFTs and RCCs to the Account must comply with U.S. law and applicable network rules.

Bank Fees. You understand that the Depository may impose additional fees in connection with returned or rejected EFTs and RCCs, and you agree that we do not have any liability regarding any such fees except as provided below. IN THE EVENT THAT YOU DO NOT HAVE SUFFICIENT FUNDS IN YOUR ACCOUNT TO COVER THE AMOUNT OF ANY EFT OR RCC AUTHORIZED ABOVE, PLEASE CONTACT US AT LEAST TWO BUSINESS DAYS IN ADVANCE OF OUR INITIATING THE EFT OR CREATING THE RCC SO THAT WE CAN STOP THE EFT OR RCC AND ARRANGE FOR AN ALTERNATIVE METHOD OF REPAYMENT. IN THE EVENT THAT ANY RCC WE PRESENT IS RETURNED UNPAID, WE WILL REDUCE THE AMOUNT YOU OWE UNDER THE INSTALLMENT LOAN AGREEMENT BY THE GREATER OF THE FOLLOWING: $30 OR THE FEE, AS SHOWN ON YOUR BANK STATEMENT PROVIDED TO US, THAT YOUR BANK CHARGED YOU FOR RETURNING OUR RCC.

Periodic Payment Election

[X] CHECK HERE IF YOU WANT TO AUTHORIZE ACE TO INITIATE ELECTRONIC PAYMENTS BY EFT, AS SET FORTH ABOVE, FOR YOUR INSTALLMENT PAYMENTS.

By checking this box and signing below, you authorize ACE to initiate an EFT to your checking account, as set forth above, for each installment payment due on your Installment Loan Agreement. You understand that this is voluntary and that ACE has not conditioned an extension of credit on your repayment by preauthorized electronic payments. You may cancel this authorization or the authorization for any individual electronic payment by notifying ACE orally or in writing at least three business days before the scheduled date of the transfer. You may also call 877 876 2274 to determine whether the transfer occurred.

[ ] CHECK HERE IF YOU DO NOT WANT TO AUTHORIZE ACE TO INITIATE ELECTRONIC PAYMENTS BY EFT, AS SET FORTH ABOVE, FOR YOUR INSTALLMENT PAYMENTS AND YOU INSTEAD WANT TO MAKE PAYMENTS BY MAIL.

By checking this box and signing below, you do not authorize ACE to initiate an EFT to your checking account, as set forth above, for each installment payment due on your Installment Loan Agreement. You will be required to mail your payments to Installment Loans at ACE Cash Express, 1231 Greenway Drive, Suite 670, Irving, TX 75038, with the requirement that such payment be received on the applicable payment date pursuant to your Installment Loan Agreement.

BY CLICKING "I AGREE" BELOW, YOU ACKNOWLEDGE THAT YOU HAVE READ, UNDERSTAND AND AGREE TO BE BOUND BY THE TERMS ABOVE. IF YOU REJECT THE PROPOSED TERMS BY CLICKING "I DO NOT AGREE", YOU WILL NOT BE PERMITTED TO OBTAIN CREDIT FROM US.

Name: ROSALYN JOHNSON

I Agree

Date of Agreement: 6/16/2013

CONSENT TO ELECTRONIC DISCLOSURE

By consenting to the electronic delivery of disclosures, you agree that ACE Cash Express, Inc. ("ACE") may provide electronically any and all communications concerning its decisions on your application (the "Application"), the terms of any agreement that may be provided to you, and ACE's privacy policy and notice (the "Disclosures"). The Disclosures may include, in addition to other things, disclosures pursuant to: (1) the federal Equal Credit Opportunity Act and Regulation B; (2) the federal Fair Credit Reporting Act; (3) the federal Truth in Lending Act and Regulation Z; (4) the federal Electronic Funds Transfer Act and Regulation E; (5) the federal Gramm-Leach-Bliley Act; and (6) any other applicable federal, state or local law or regulation. Your consent applies not only to the Application and any resulting agreement but also to any payment plan or other ancillary agreement related to your agreement and to any future transaction with ACE. To electronically receive, view and save or print the Disclosures, you must have a personal computer equipped with Microsoft Internet Explorer 7.0, Google Chrome 13.0, Firefox 5.0, Safari 4.0 or any later version of these programs, Adobe Reader 6 or later version; and either a printer, a hard drive or other storage device. Prior to submission of your application, you may withdraw your consent to electronic disclosures by exiting this website. You agree that any email address you provide with your Application may be used to provide you with Disclosures and other documents with respect to your transaction with ACE, and you agree to notify ACE of any changes to your email address either in writing or via email at least five (5) days before the change.

You have the option to receive any information that ACE has provided to you electronically in paper form at no cost to you by contacting ACE in writing at 1231 Greenway Drive, Suite 600, Irving, Texas 75038 and including your name, address, and most recent Transaction Number. You may also withdraw your consent to electronic disclosures by contacting ACE in the same manner. If you withdraw your consent to electronic disclosures, ACE may elect to terminate its relationship with you.

BY CLICKING "I AGREE" BELOW, YOU ACKNOWLEDGE THAT YOU HAVE READ, UNDERSTAND AND AGREE TO BE BOUND BY THE ABOVE CONSENT. IF YOU DO NOT AGREE, YOU WILL NOT BE PERMITTED TO ENTER INTO A TRANSACTION.

Name: ROSALYN JOHNSON

I Agree

Date of Agreement: 6/16/2013

PLEASE REVIEW AND DECIDE WHETHER TO EXECUTE THE ARBITRATION AGREEMENT BELOW BY E-SIGNING BELOW.

ARBITRATION AGREEMENT

This Arbitration Agreement provides that, unless prohibited by applicable law, upon the election of either customer ("you") or ACE Cash Express, Inc. ("ACE") whose address is 1231 Greenway Drive, Suite 600, Irving, Texas 75038, or certain related parties (as described below), any legal dispute between you and us will be resolved by binding arbitration. In arbitration, a dispute is resolved by an arbitrator instead of a judge or jury. Arbitration procedures are simpler and more limited than court procedures. (Solely for the purposes of this Arbitration Agreement, the terms "we," "us" and "our" refer herein to ACE and all other parties described under the caption "Coverage and Definitions" below.)

Right to Reject Arbitration Agreement: YOU MAY REJECT THIS ARBITRATION AGREEMENT BY CLICKING "I DO NOT AGREE" AT THE END OF THIS ARBITRATION AGREEMENT. YOU MAY ALSO REJECT THIS ARBITRATION AGREEMENT BY SENDING US A NOTICE ("REJECTION NOTICE") THAT IS RECEIVED WITHIN THIRTY (30) DAYS AFTER THE DATE OF YOUR APPLICATION. THE REJECTION NOTICE MUST INCLUDE YOUR NAME, ADDRESS, TELEPHONE NUMBER AND THE DATE OF YOUR APPLICATION AND MUST EITHER BE MAILED OR SENT BY MESSENGER SERVICE (SUCH AS FEDERAL EXPRESS) TO ACE CASH EXPRESS, INC., 1231 GREENWAY DRIVE, SUITE 600, IRVING, TEXAS 75038, ATTENTION: GENERAL COUNSEL. IF YOU REJECT ARBITRATION, NEITHER YOU NOR WE WILL HAVE THE RIGHT TO REQUIRE ARBITRATION OF SOME OR ALL CLAIMS (AS SUCH TERM IS DEFINED BELOW). REJECTION OF THE ARBITRATION AGREEMENT WILL NOT AFFECT ACE'S WILLINGNESS TO PROVIDE YOU WITH A LOAN, NOR WILL IT AFFECT THE TERMS OF YOUR WRITTEN INSTALLMENT LOAN AGREEMENT WITH ACE (THE "LOAN AGREEMENT"). ANY REJECTION OF ARBITRATION WILL APPLY ONLY TO THIS ARBITRATION AGREEMENT (AND NOT TO ANY PRIOR OR SUBSEQUENT ARBITRATION AGREEMENT).

Coverage and Definitions: This Arbitration Agreement benefits and is binding upon: (1) you and ACE; (2) any company that owns or controls ACE (a "Parent Company"); (3) any company that is controlled by a Parent Company and/or ACE; (4) any person or company that has or acquires a financial interest or rights under the Loan Agreement, and (5) with respect to any of the foregoing, any heirs, assigns, personal representatives, officers, directors, owners, shareholders, principals, agents, attorneys, lenders, sureties, or insurers. Also, if either you or we elect to arbitrate any Claim you bring against us, the persons who may benefit by this Arbitration Agreement include any other persons or companies you make a Claim against, in the same proceeding. "Claim" means any legal dispute between you and us that has anything at all to do with: (1) your application for a loan, this Arbitration Agreement, the Loan Agreement, any payment plan agreement related to your Loan Agreement and/or ACE's privacy policy and notice; (2) the servicing or collection of amounts due under the Loan Agreement; or (3) any related advertising, promotion, disclosure or notice. This includes a dispute about whether this Arbitration Agreement is valid or enforceable, about when it applies and/or about whether a dispute is arbitrable. It includes disputes about constitutional provisions, statutes, ordinances, regulations, compliance with contracts and wrongful acts of every type (whether intentional, fraudulent, reckless or negligent). This Arbitration Agreement applies to actions, omissions and events prior to, on or after the date of this Arbitration Agreement. It applies to disputes involving requests for injunctions and/or other equitable relief. However, notwithstanding any language in this Arbitration Agreement to the contrary, the term "Claim" does not include any dispute about the validity, effect or enforceability of the prohibitions against class proceedings, private attorney general proceedings and/or multiple-party proceedings described under the caption "Prohibition Against Certain Proceedings" (the "Class Action Waiver"), and any such dispute shall be resolved by a court and not by an arbitrator or arbitration administrator.

"Administrator" means JAMS, 620 Eighth Avenue, 34th Floor, New York, NY 10018, www.jamsadr.com; the American Arbitration Association (the "AAA"), 1633 Broadway, 10th Floor, New York, NY 10019, www.adr.org; or any other company selected by mutual agreement of the parties. If both JAMS and AAA cannot or will not serve and the parties are unable to select an Administrator by mutual consent, the Administrator will be selected by a court. You get to select the Administrator if you give the other parties written notice of your selection with your notice that you are electing to arbitrate any Claim or within 20 days after any other party gives you notice that such

party is electing to arbitrate any Claim. If you do not select the Administrator on time, we will select the administrator. Notwithstanding any language in this Arbitration Agreement to the contrary, no arbitration may be administered, without the consent of all parties to the arbitration, by any Administrator that has in place a formal or informal policy that purports to override the Class Action Waiver.

Important Notice: IF YOU OR WE ELECT TO ARBITRATE A CLAIM, YOU WILL NOT HAVE THE RIGHT TO PURSUE THAT CLAIM IN COURT OR HAVE A JURY DECIDE THE CLAIM. ALSO, YOUR ABILITY TO OBTAIN INFORMATION FROM US AND TO APPEAL IS MORE LIMITED IN AN ARBITRATION THAN IN A LAWSUIT. OTHER RIGHTS THAT YOU WOULD HAVE IF YOU WENT TO COURT MAY ALSO NOT BE AVAILABLE IN ARBITRATION.

"Prohibition Against Certain Proceedings": IF YOU OR WE ELECT TO ARBITRATE A CLAIM: (1) NO PARTY MAY PARTICIPATE IN A CLASS ACTION IN COURT OR IN CLASS-WIDE ARBITRATION, EITHER AS A PLAINTIFF, DEFENDANT OR CLASS MEMBER; (2) NO PARTY MAY ACT AS A PRIVATE ATTORNEY GENERAL IN COURT OR IN AN ARBITRATION; (3) CLAIMS BROUGHT BY OR AGAINST YOU MAY NOT BE JOINED OR CONSOLIDATED WITH CLAIMS BROUGHT BY OR AGAINST ANY OTHER PERSON; AND (4) THE ARBITRATOR SHALL HAVE NO AUTHORITY TO CONDUCT A CLASS-WIDE ARBITRATION, PRIVATE ATTORNEY GENERAL ARBITRATION OR MULTIPLE-PARTY ARBITRATION.

Initiating Arbitration Proceedings: A party asserting a Claim must first comply with the paragraph captioned "Notice and Cure; Special Payment." Additionally, a party electing arbitration must give written notice of an intention to initiate or require arbitration. This notice can be given after the beginning of a lawsuit and can be given in the papers filed in the lawsuit. If such a notice is given, unless prohibited by applicable law, any Claim shall be resolved by arbitration under this Arbitration Agreement and, to the extent consistent with this Arbitration Agreement, the applicable rules of the Administrator that are in effect at the time the Claim is filed with the Administrator. A party who has asserted a Claim in a lawsuit may still elect arbitration with respect to any Claim that is later asserted in the same lawsuit by any other party. The arbitrator will be selected in accordance with the Administrator's rules. However, unless all the parties agree otherwise, the arbitrator must be a lawyer with more than 10 years of experience or a retired judge. We will not elect to arbitrate an individual Claim that you bring in small claims court or an equivalent court. However, we may elect to arbitrate a Claim that is transferred, removed or appealed to any different court.

Arbitration Location and Costs: Any arbitration hearing that you attend will take place in a reasonably convenient location for you. If you object to the fees charged by the Administrator and/or arbitrator, we will consider in good faith any reasonable written request for us to bear the fees charged by the Administrator and/or arbitrator. Also, we will pay any fees or expenses we are required to pay by law or required to pay so that a court will enforce this Arbitration Agreement. Each party must pay for that party's own attorneys, experts and witnesses, provided that we will pay all such reasonable fees and costs you incur if you are the prevailing party and/or where required by applicable law and/or the Administrator's rules.

Applicable Law: You and we agree that the Loan Agreement and this Arbitration Agreement involve interstate commerce, and this Arbitration Agreement is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. 1 et seq. (and by Texas law to the extent state law governs the enforceability of this Arbitration Agreement under section 2 of the FAA). The arbitrator must follow, to the extent applicable: (1) the substantive law related to any Claim; (2) statutes of limitations; and (3) claims of privilege recognized at law. Upon the timely request of any party to an arbitration proceeding, the arbitrator must provide a brief written explanation of the basis for the award. The arbitrator will determine the rules of procedure and evidence to apply, consistent with the arbitration rules of the Administrator and this Arbitration Agreement. In the event of a conflict between this Arbitration Agreement, on the one hand, and any other agreement between you and us or the rules or policies of the Administrator, on the other hand, this Arbitration Agreement shall govern. The arbitrator will not be bound by federal, state or local rules of procedure and evidence or by state or local laws concerning arbitration proceedings.

Getting Information: In addition to the parties' rights to obtain information under the Administrator's rules, any party may submit a written request to the arbitrator seeking more information. A copy of such request must be provided to the other parties. Those parties will then have the chance to object in writing within 30 days. The

objection must be sent to the arbitrator and the other parties. The arbitrator will decide the issue in his or her sole discretion within 20 days thereafter.

Effect of Arbitration Award: Any court with jurisdiction may enter judgment upon the arbitrator's award. The arbitrator's decision will be final and binding, except for any appeal right under the FAA and except for Claims involving more than $50,000. For these Claims, any party may appeal the award to a three-arbitrator panel appointed pursuant to the Administrator's rules. That panel will reconsider from the start any aspect of the initial award that any party asserts was incorrectly decided. The decision of the panel shall be by majority vote and will be final and binding, except for any appeal right under the FAA. Unless applicable law (or the paragraph captioned "Corrective Action; Survivability and Severability of Terms") requires otherwise, the costs of an appeal to an arbitration panel will be borne by the appealing party, regardless of the outcome of the appeal. However, we will consider in good faith any reasonable written request for us to bear the cost. Also, we will pay any fees or expenses we are required to pay by law or required to pay so that a court will enforce this Arbitration Agreement.

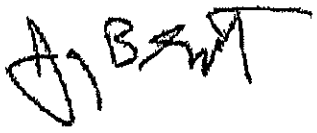
Power to Bind: ACE promises that it has the right and power to sign this Arbitration Agreement on behalf of all of its related parties as set forth above and will ensure that all of such related parties comply with this Arbitration Agreement.

Corrective Action; Survivability and Severability of Terms: A party must be given written notice and a reasonable opportunity of at least 30 days to remedy any circumstances that might preclude arbitration of a Claim. This Arbitration Agreement shall survive: (1) termination or cancellation of the Loan Agreement and/or any repayment thereunder; and (2) the bankruptcy of any party. If any portion of this Arbitration Agreement other than the Class Action Waiver is deemed invalid or unenforceable, the remaining portions shall nevertheless remain in force. If a determination is made that the Class Action Waiver is unenforceable, only this sentence of the Arbitration Agreement will remain in force and the remaining provisions shall be null and void, provided that the determination concerning the Class Action Waiver shall be subject to appeal. This Arbitration Agreement can only be amended or supplemented by written agreement.

Notice and Cure; Special Payment: Prior to initiating litigation or arbitration regarding a Claim, the party asserting the Claim shall give the other party or parties written notice of the Claim (a "Claim Notice") and a reasonable opportunity, not less than 30 days, to cure the Claim. Any Claim Notice to you shall be sent in writing by mail or by messenger service to the address you have provided on your application (or any updated address you have subsequently provided). Any Claim Notice to us shall be sent by mail or by messenger service to ACE Cash Express, Inc., 1231 Greenway Drive, Suite 600, Irving, Texas 75038, Attention: General Counsel. Any Claim Notice you send must be signed by you and provide your name, address, telephone number and email address. Any Claim Notice must explain the nature of the Claim and the relief that is demanded. The party giving a Claim Notice must reasonably cooperate in providing any information about the Claim that the other party or parties reasonably request and must give the other party or parties a reasonable opportunity to respond to the demand for relief. **If we refuse to provide you with the relief demanded in any Claim Notice you send us in accordance with this paragraph and an arbitrator subsequently determines that you were entitled to such relief (or greater relief), the arbitrator shall award you at least $5,100 (not including any arbitration fees and attorney's fees and costs to which you may be entitled).**

Intending to be legally bound, ACE caused this Agreement to be signed on its behalf.

ACE Cash Express, Inc.



Jay Shipowitz, President

BY CLICKING "I AGREE" BELOW, YOU ACKNOWLEDGE THAT YOU HAVE READ, UNDERSTAND AND AGREE TO BE BOUND BY THE TERMS OF THE ARBITRATION AGREEMENT ABOVE. IF YOU REJECT THE ARBITRATION AGREEMENT (SEE "RIGHT TO REJECT ARBITRATION AGREEMENT" ABOVE), CLICK THE "I DO NOT AGREE" BUTTON.

Name: ROSALYN JOHNSON

I Agree

Date of Agreement: 6/16/2013

PURSUANT TO TITLE 5 OF THE DELAWARE ADMINISTRATIVE CODE, SECTION 2203(1.0), ACE IS OBLIGATED TO PROVIDE YOU WITH A COPY OF THE FOLLOWING REGULATION OF THE OFFICE OF THE STATE BANK COMMISSIONER OF DELAWARE:

Title 5 Banking 2203 Licensed Lenders Regulations Itemized Schedule of Charges

1.0 Notification - Every licensee shall furnish to every applicant, a copy of this regulation at the time when such application is made. Posting of this regulation in the office of the licensee in a place both prominent and easily visible to all potential applicants shall satisfy this requirement. An explanation as to the contents and limitations contained herein shall satisfy this requirement when transactions occur telephonically. An informational screen containing these limitations with an affirmative acknowledgement by the consumer, prior to application, shall satisfy this requirement for internet transactions.

2.0 Interest

2.1 A lender may charge and collect interest in respect to a revolving credit plan or closed end loan at such daily, weekly, monthly, annual, or other periodic percentage rate or rates as the agreement governing the plan or loan provides, or as established in the manner provided in such agreement. Periodic interest may be calculated on a revolving credit plan using any balance computation method provided for in the agreement governing the plan. Periodic interest may be calculated on a closed end loan by way of simple interest or such other method as the agreement governing the loan provides.

2.2 If the agreement governing the revolving credit plan or closed end loan so provides, the periodic percentage rate or rates of interest may vary in accordance with a schedule or formula. Such periodic percentage rate or rates may vary from time to time as the rate determined in accordance with such schedule or formula varies and such periodic percentage rate or rates, as so varied, may be made applicable to all or any part of the outstanding unpaid indebtedness or outstanding unpaid amounts. In the case of revolving credit, such rate shall become applicable on or after the first day of the billing cycle that contains the effective date of such variation. In the case of closed end loan transactions, such rate may be made applicable to all or any part of the outstanding unpaid amounts on and after the effective date of such variation. Without limitation, a permissible schedule or formula hereunder may include provisions in the agreement governing the revolving credit plan or closed end loan agreement for a change in the periodic percentage rate or rates of interest applicable to all or any part of outstanding unpaid indebtedness or outstanding unpaid amounts, whether by variation of the then applicable periodic percentage rate or rates of interest, variation of an index or margin or otherwise, contingent upon the happening of any event or circumstance specified in the plan or agreement, which event or circumstance may include the failure of the borrower to perform in accordance with the terms of the revolving credit plan or loan agreement.

3.0 Additional Fees and Charges; Limitations - If the agreement governing the plan or loan so provides, in addition to, or in lieu of, interest at a periodic percentage rate or rates permitted by Chapter 22, Title 5 of the Delaware Code, the licensee may charge and collect the following fees and charges, subject to the limitations provided below, in respect to revolving credit plans or closed end loans:

3.1 Revolving Credit - with respect to a borrower, a lender may charge, collect, or receive one or more of the following fees and charges under plans subject to the provisions of Subchapter II, Chapter 22, Title 5 of the Delaware Code:

3.1.1 periodic charges - a daily, weekly, monthly, annual or other periodic charge in such amount or amounts as the agreement may provide for the privileges made available to the borrower under the plan;

3.1.2 transaction charges - a transaction charge or charges in such amount or amounts as the agreement may provide for each separate purchase or loan under the plan;

3.1.3 minimum charges - a minimum charge in such amount or amounts as the agreement may provide for each daily, weekly, monthly, annual or other scheduled billing period under the plan during any portion of which there is an outstanding unpaid indebtedness under the plan;

3.1.4 fees for services rendered or reimbursement of expenses - reasonable fees for services rendered or for reimbursement of expenses incurred in good faith by the licensee or its agent in connection with such loan, including

without limitation, commitment fees, official fees and taxes, premiums or other charges for any guarantee or insurance protecting the licensee against the borrower's default or other credit loss, or costs incurred by reason of examination of title, inspection, recording and other formal acts necessary or appropriate to the security of the loan, filing fees, attorney's fees and travel expenses. In the event a borrower defaults under the terms of a plan, the licensee may, if the borrower's account is referred to an attorney (not a regularly salaried employee of the licensee) or to a third party for collection and if the agreement governing the revolving credit plan so provides, charge and collect from the borrower a reasonable attorney's fee. In addition, following a borrower's default, the licensee may, if the agreement governing the plan so provides, recover from the borrower all court, alternative dispute resolution or other collection costs (including, without limitation, fees and charges of collection agencies) actually incurred by the licensee;

3.1.5 overlimit charges - a charge in such amount or amounts as the agreement may provide, for each daily, weekly, monthly, annual or other scheduled billing period under the plan during any portion of which the total outstanding indebtedness exceeds the credit limit established under the plan;

3.1.6 delinquency charges - a late or delinquency charge upon any outstanding unpaid installment payments or portions thereof under the plan which are in default; provided, however, that no more than 1 such late or delinquency charge may be imposed in respect of any single such installment payment or portion thereof regardless of the period during which it remains in default; and provided further, however, that for the purpose only of the preceding provision all payments by the borrower shall be deemed to be applied to satisfaction of installment payments in the order in which they become due;

3.1.7 returned check charges - a returned check charge may be assessed to consumers, in such amount or amounts as the agreement may provide, provided the amount(s) of such charges are customary and reasonable for checks that are returned unpaid;

3.1.8 termination fees - a charge in such amount or amounts as the agreement may provide to terminate a revolving credit plan;

3.1.9 charges incurred in connection with real estate secured transactions - in the case of revolving credit secured by real estate such additional charges as outlined in item 3.3 of this regulation may also be collected within the limitations stated therein.

3.2 Closed End Credit - with respect to a borrower, a lender may charge, collect, or receive one or more of the following fees and charges for loans subject to the provisions of Subchapter III, Chapter 22, Title 5 of the Delaware Code:

3.2.1 fees for services rendered or reimbursement of expenses - reasonable fees for services rendered or for reimbursement of expenses incurred in good faith by the licensee or its agent in connection with such loan, including without limitation, commitment fees, official fees and taxes, premiums or other charges for any guarantee or insurance protecting the licensee against the borrower's default or other credit loss, or costs incurred by reason of examination of title, inspection, recording and other formal acts necessary or appropriate to the security of the loan, filing fees, attorney's fees and travel expenses. In the event a borrower defaults under the terms of the loan, the licensee may, if the borrower's account is referred to an attorney (not a regularly salaried employee of the licensee) or to a third party for collection and if the agreement governing, or the bond, note or other evidence of, the loan so provides, charge and collect from the borrower a reasonable attorney's fee. In addition, following a borrower's default, the licensee may, if the agreement governing , or the bond, note or other evidence of, the loan so provides, recover from the borrower all court, alternative dispute resolution or other collection costs (including, without limitation, fees and charges of collection agencies) actually incurred by the licensee;

3.2.2 deferral charges - a deferral charge may be assessed to a borrower in accordance with an agreement to permit the borrower to defer installment payments of a loan;

3.2.3 delinquency charges - if the agreement governing the loan so provides, a late or delinquency charge may be imposed upon any outstanding unpaid installment payment or portions thereof under the loan agreement which are in default; provided, however, that no more than 1 such delinquency charge may be imposed in respect of any single such installment payment or portion thereof regardless of the period during which it remains in default; and provided further that no such delinquency charge may exceed 5% of the amount of any such installment or portion thereof in default;

3.2.4 returned check charges - if the agreement governing the loan so provides, a returned check charge may be assessed to consumers, for checks that are returned unpaid provided the amount(s) of such charges are customary and reasonable;

3.2.5 charges incurred in connection with real estate secured transactions - in the case of closed end credit secured by real estate such additional charges as outlined in item (3)(c) of this regulation may also be collected within the limitations stated therein.

3.3 Real Estate Secured Transactions - with respect to a borrower, a lender may charge, collect, or receive one or more of the following fees and charges subject to the limitations herein, for loans subject to the provisions of Subchapters II (Revolving Credit) and III (Closed End Credit), Chapter 22, Title 5 of the Delaware Code when such loans are secured by real estate:

3.3.1 loan origination points - points charged to the borrower on the lender's behalf for any purpose other than to reduce the periodic interest rate applicable to the mortgage loan may not exceed 10% of the principal amount of the loan. Such points may be deducted from the gross proceeds of the loan. For purposes of this regulation "gross proceeds" is the amount financed as defined in Federal Reserve Regulation Z;

3.3.2 loan discount points - points charged to the borrower as a function of rate for the purpose of reducing the periodic interest rate applicable to the mortgage loan. Such points may be deducted from the gross proceeds of the loan;

3.3.3 property appraisal fees - property appraisal fees shall be limited to the amount paid to a third party for such appraisal and shall be limited to those amounts that are customary and reasonable;

3.3.4 credit report fees - credit report fees shall be limited to the actual cost of the report if paid to a third party, not an employee of the lender or affiliate. Such amounts shall be customary and reasonable;

3.3.5 mortgage loan broker compensation fees - mortgage loan broker compensation may be deducted from the gross proceeds of the loan. Such amounts shall reasonably reflect the value of the goods, services and facilities provided;

3.3.6 tax certification and service fees - fees for agreements to provide certification of the current tax status of the property as well as fees for ongoing monitoring and notice to the lender of all tax and improvement lien payments as they become due shall be limited to those amounts actually expended for such purposes. Such amounts shall be customary and reasonable;

3.3.7 flood hazard certification or determination fees - determination fees may be charged for determining whether the property is or will be located in a special flood hazard area. This fee may also include the cost of life-of-loan monitoring. Such amounts shall be customary and reasonable;

3.3.8 title abstract/search/examination and title insurance premiums - title insurance and/or cost of a title certificate, search, examination and binder shall be limited to those amounts actually expended for such purposes. Such amounts shall be customary and reasonable and may, at the borrower's discretion, include owner's coverage in addition to lender's coverage;

3.3.9 legal fees - legal fees incurred in securing or closing a loan shall be limited to amounts actually paid to an attorney not in the employ of the lender, its parent, or affiliate, and such charges shall not exceed those which are customary and reasonable;

3.3.10 recording/satisfaction fees - recording/satisfaction fees shall be limited to those actually expended by the lender to any governmental authority for protection of interest in collateral tendered. The State Bank Commissioner may approve the payment of alternative fees for this purpose provided the amount of said fee (payable by the borrower) shall not exceed the amount which would be payable to any governmental authority for protection of interest in collateral tendered;

3.3.11 property survey fees - property survey fees to obtain a drawing that delineates the exact boundaries of a property, including lot lines and placement of improvements on the property, shall be limited to those amounts actually expended for such purposes. Such amounts shall be customary and reasonable;

3.3.12 pest inspection fees - pest inspection fees to cover inspections for termites or other pest infestation on the property shall be limited to those amounts actually expended for such purposes. Such amounts shall be customary and reasonable;

3.3.13 fees incidental to loan closing - other fees and charges including but not limited to: odd days interest, hazard and mortgage insurance premiums, escrow reserves, lender's inspection fees, mortgage insurance application fees, assumption fees, underwriting fees, document preparation fees, settlement or closing fees, notary fees, funding fees, fees for lead based paint or other inspections and overnight mail fees may be charged and such amounts shall be customary and reasonable;

3.3.14 prepayment penalties - a charge in such amount or amounts as the agreement so provides imposed in connection with the payoff and termination of a revolving credit plan or closed end loan secured by real estate;

3.3.15 notwithstanding the provisions of item 3.3 of this regulation, Licensed Lenders who are making mortgage loans pursuant to the rules, regulations, guidelines and/or loan forms established by the State of Delaware or federal governmental or quasi-governmental entity (including, without limitation: the Federal Housing Administration, the Department of Veterans Affairs, the Farmers Home Administration, the Government National Mortgage Association, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation) shall be permitted to charge and collect any fees, charges or sums prescribed to be charged and collected in connection with a mortgage loan originated pursuant to a lending program conducted or supervised by any such entity.

BY CLICKING "I AGREE" BELOW, YOU ACKNOWLEDGE THAT YOU HAVE RECEIVED A COPY OF THE REGULATION ABOVE. IF YOU DO NOT AGREE, YOU WILL NOT BE PERMITTED TO OBTAIN A LOAN.

Name on Application: ROSALYN JOHNSON

I Agree

Date of Agreement: 6/16/2013

Rev. 01/2012

FACTS **WHAT DO THE ACE CASH EXPRESS COMPANIES DO WITH YOUR PERSONAL INFORMATION**

Why? Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.

What? The types of personal information we collect and share depend on the product or service you have with us. This information can include:

- Social Security number and checking account information
- transaction history and income
- credit history and assets

How? All financial companies need to share customers' personal information to run their everyday business. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons the ACE Cash Express Companies choose to share; and whether you can limit this sharing.

Reasons we can share your personal information	Do the ACE cash Express Companies share?	Can you limit this sharing?
For our everyday business purposes – such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or report to credit bureaus	Yes	No
For our marketing purposes – to offer our products and services to you	Yes	No
For joint marketing with other financial companies	Yes	No
For our affiliates' everyday business purposes – information about your transactions and experiences	Yes	No
For our affiliates' everyday business purposes – information about your creditworthiness	Yes	Yes
For our affiliates to market to you	Yes	Yes
For nonaffiliates to market to you	Yes	Yes

To limit our sharing

- Call 800-224-4338 – our menu will prompt you through your choice(s)

Please note:

If you are a *new* customer, we can begin sharing your information 30 days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice.

However, you can contact us at any time to limit our sharing.

Questions? Call 800-224-4338

Who are we	
Who is providing this notice?	Check-cashing, payday advance providers, vehicle secured credit providers, creditors, and financial service providers operating under the ACE Cash Express name as set forth below
What do we do	
How does ACE Cash Express protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does ACE Cash Express collect my personal information?	We collect your personal information, for example, when you ▪ apply for a loan or make a wire transfer ▪ apply for insurance or show us your government issued ID ▪ pay your bills We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit only ▪ sharing for affiliates' everyday business purposes – information about your creditworthiness ▪ affiliates from using your information to market you ▪ sharing for nonaffiliates to market you State laws and individual companies may give you additional rights to limit sharing. See below for more on your rights under state law.
What happens when I limit sharing for an account I hold jointly with someone else?	Your choices will apply to everyone on your account.
Definitions	
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *Our affiliates include financial companies operating under the ACE or ACE Cash Express name.*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *Nonaffiliates we share with can include lenders; banks; collection agencies; check-cashers; tax preparers; brokers; pawnbrokers; rent-to-own, mortgage and insurance companies; and retailers.*
Joint Marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *Our joint marketing partners include lenders; banks; tax preparers; brokers; pawnbrokers; mortgage companies; and retailers.*

Other Important Information

Notice to California Residents

Pursuant to state law, we may not share information we collect about you with affiliated or non-affiliated third parties, except in the limited circumstances permitted under state law, or if you give us your permission.

California Civil Code Section 1798.83, also known as S.B. 27, allows California residents to request certain information regarding our disclosures in the prior calendar year, if any, of personally identifiable information to third parties for their own direct marketing purposes. To make such a request, please contact us at 1-800-224-4338 or ACE Cash Express, Inc., 1231 Greenway Dr., Suite #600, Irving, TX 75038.

Provided by the following companies: ACE Cash Express, Inc., ACE Credit Services, LLC, ACE Cash Express Insurance Services LLC, ACE Minnesota Corp., ACE Virginia Title Loans LLC, ACE South Carolina LLC, ACE Cash Express Title Loans LLC, ACE Finance Company LLC, ACE Credit Access LLC and FSH Credit Services LLC.

Exhibit H

Office of Inspector General

June 2006
Report No. 06-011

Challenges and FDIC Efforts Related to Predatory Lending

AUDIT REPORT

Office of Audits

OIG

Office of Audits

Report No. 06-011
June 2006

Challenges and FDIC Efforts Related to Predatory Lending

Background and Purpose of Audit

Predatory lending typically involves imposing unfair and abusive loan terms on borrowers, and statistics show that borrowers lose more than $25 billion annually due to predatory practices. Predatory lending can be detrimental to consumers and increases the financial and reputation risk for financial institutions. Characteristics potentially associated with predatory lending include, but are not limited to, (1) abusive collection practices, (2) balloon payments with unrealistic repayment terms, (3) equity stripping associated with repeat refinancing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan.

The FDIC is responsible for evaluating FDIC-supervised financial institutions' compliance with federal consumer protection laws and regulations, including several that address predatory lending. To evaluate compliance, the FDIC conducts examinations of institutional practices regarding fair lending, privacy, and other consumer protection laws.

The objective of this audit was to determine the challenges faced and the efforts taken by the FDIC to identify, assess, and address the risks posed to FDIC-supervised financial institutions and consumers from predatory lending practices. We also gained an understanding of the efforts taken by the other federal banking regulators to address predatory lending.

To view the full report, go to www.fdicig.gov/2006reports.asp

Results of Audit

The FDIC faces significant challenges associated with identifying, assessing, and addressing the risks posed to FDIC-supervised institutions and consumers by predatory lending. Specifically, (1) each loan transaction must be viewed in its totality to determine whether it may be predatory; (2) FDIC-supervised institutions can have direct or indirect involvement in predatory lending; and (3) nontraditional mortgages and other loan products are now available that contain terms that may be viewed as appropriate for some borrowers, but predatory for others. Further, the FDIC must ensure that its efforts to combat predatory lending do not limit consumer access to legitimate sources of credit.

FDIC guidance issued to examiners, FDIC-supervised financial institutions, and consumers addresses predatory lending. However, the guidance does not formally articulate a supervisory approach to address predatory lending and was not issued for the explicit purpose of identifying, assessing, and addressing the risks that such lending practices pose to institutions and consumers. Further, certain characteristics potentially indicative of predatory lending were not covered. The lack of an articulated supervisory approach and gaps in coverage could result in increased risk that predatory lending practices occur, are not detected, and harm institutions and consumers.

Recommendations and Management Response

The report recommends that the FDIC describe in policy its overall approach to addressing predatory lending and review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address the risks associated with predatory lending. Additionally, the report identifies for the FDIC's consideration other federal banking regulatory agencies' actions to identify, assess, and address predatory lending.

FDIC management agreed with the recommendations. The FDIC will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. Based on that review, the Corporation will also develop additional guidance to address predatory lending, if necessary.

TABLE OF CONTENTS

BACKGROUND	1
RESULTS OF AUDIT	2
CHALLENGES RELATED TO PREDATORY LENDING	3
Transactions Must be Viewed in Totality	3
Direct or Indirect Institutional Involvement	4
Variety of Loan Products	4
Maintaining Consumer Access to Credit	4
FDIC EFFORTS TO ADDRESS PREDATORY LENDING CHALLENGES	5
FDIC Guidance Related to Predatory Lending	5
Guidance to FDIC Examiners	7
Guidance to FDIC-Supervised Institutions	11
Consumer Education	12
Conclusion and Recommendations	13
ISSUES FOR CONSIDERATION	14
Jointly Issued Guidance	14
Individual Regulatory Guidance	15
Conclusion	17
CORPORATION COMMENTS AND OIG EVALUATION	17
APPENDIX I: OBJECTIVE, SCOPE, AND METHODOLOGY	18
APPENDIX II: CONSUMER PROTECTION LAWS	24
APPENDIX III: CHARACTERISTICS POTENTIALLY ASSOCIATED WITH PREDATORY LENDING	26
APPENDIX IV: INFORMATION PROVIDED BY OTHER FEDERAL REGULATORY AGENCIES	28
APPENDIX V: CORPORATION COMMENTS	31
APPENDIX VI: MANAGEMENT RESPONSE TO RECOMMENDATIONS	37

TABLES

Table 1: OIG Analysis of Coverage for Characteristics Potentially Associated With Predatory Lending 6

Table 2: Analysis of Reputational Risk for FRB-Supervised Financial Institutions 17

ACRONYMS

AMTPA	**Alternative Mortgage Transaction Parity Act**
ANPR	**Advance Notice of Proposed Rulemaking**
ARM	**Adjustable Rate Mortgage**
CRA	**Community Reinvestment Act**
CRC	**Consumer Response Center**
DSC	**Division of Supervision and Consumer Protection**
ECOA	**Equal Credit Opportunity Act**
ED	**Examination Documentation**
FCRA	**Fair Credit Reporting Act**
FDCPA	**Fair Debt Collection Practices Act**
FFIEC	**Federal Financial Institutions Examination Council**
FHA	**Fair Housing Act**
FIL	**Financial Institution Letter**
FRB	**Federal Reserve Board**
FTC	**Federal Trade Commission**
GAO	**Government Accountability Office**
GLBA	**Gramm-Leach-Bliley Act**
HOEPA	**Home Ownership and Equity Protection Act**
HUD	**Department of Housing and Urban Development**
NCUA	**National Credit Union Administration**
OCC	**Office of the Comptroller of the Currency**
OIG	**Office of Inspector General**
OTS	**Office of Thrift Supervision**
RESPA	**Real Estate Settlement Procedures Act**
ROE	**Report of Examination**
TILA	**Truth in Lending Act**

Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits
Office of Inspector General

DATE: June 7, 2006

MEMORANDUM TO: Sandra L. Thompson, Acting Director
Division of Supervision and Consumer Protection

FROM: Russell A. Rau [Electronically produced version; original signed by Russell A. Rau]
Assistant Inspector General for Audits

SUBJECT: *Challenges and FDIC Efforts Related to Predatory Lending*
(Report No. 06-011)

This report presents the results of the subject FDIC Office of Inspector General's (OIG) audit. Although there is no universally accepted definition, predatory lending typically involves imposing unfair and abusive loan terms on borrowers, often through aggressive sales tactics; taking advantage of borrowers' lack of understanding of complicated transactions; and outright deception. The objective of this audit was to determine the challenges faced and efforts taken by the FDIC to identify, assess, and address the risks posed to institutions and consumers from predatory lending. Also, we gained an understanding of the efforts taken to address predatory lending by the Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), Federal Reserve Board (FRB), Federal Trade Commission (FTC), and Department of Housing and Urban Development (HUD). Appendix I of this report discusses our objective, scope, and methodology in detail.

BACKGROUND

According to the Center for Responsible Lending, which is a research and policy organization whose main components include legislative and policy advocacy, borrowers lose more than $25 billion annually due to predatory mortgages, payday loans, and lending abuses involving overdraft loans, excessive credit card debt, and tax refund loans. Predatory lending can be detrimental not only to consumers but also to financial institutions because such practices could (1) lead to a high volume of foreclosures, which are costly to the mortgage holder; (2) undermine the reputation of financial institutions and the public's trust in the financial services industry; and (3) subject institutions that engage in or unintentionally support predatory lending to the risk of costly litigation.

Within the FDIC, the Division of Supervision and Consumer Protection (DSC) has primary responsibility for dealing with issues related to predatory lending. DSC addresses predatory lending and the effect that such lending might have on institutions and consumers as part of its safety and soundness and compliance examinations. For example, DSC examiners evaluate an institution's compliance with various consumer protection, fair lending, and privacy laws,

including the following that address predatory, unfair, abusive, or deceptive acts or practices. (See Appendix II for more details.)

- Equal Credit Opportunity Act (ECOA)
- Fair Credit Reporting Act (FCRA)
- Fair Debt Collection Practices Act (FDCPA)
- Fair Housing Act (FHA)
- Federal Trade Commission Act (FTC Act)
- Home Ownership and Equity Protection Act (HOEPA)
- Real Estate Settlement Procedures Act (RESPA)
- Truth in Lending Act (TILA)

DSC has issued guidance to examiners, financial institutions, and consumers regarding issues related to predatory, unfair, abusive, or deceptive acts or practices. Further, the FDIC's national Consumer Response Center (CRC), established in July 2002, receives, investigates, and responds to complaints involving FDIC-supervised institutions and answers inquiries from consumers about consumer protection laws and banking practices. For the period January 1, 2003 through November 7, 2005, CRC identified 23 possible predatory lending complaints and inquiries. In response, CRC investigated or referred complaints to the responsible federal banking regulator as deemed appropriate, or otherwise disposed of the complaints. More specifically:

- eight complaints were investigated by the FDIC, and no evidence was found that the financial institution violated a consumer protection law or regulation;

- seven complaints were referred to other agencies because those circumstances did not involve FDIC-supervised institutions;

- four inquiries were information requests from consumers about payday or predatory lending;

- two complaints were investigated by the FDIC, and the Corporation did not intervene due to litigation between the consumer and the financial institution; and

- two complaints were not investigated by the FDIC because the consumer did not provide enough information about the nature of the complaint.

RESULTS OF AUDIT

Overall, we found that the FDIC faces significant challenges associated with identifying, assessing, and addressing the risks posed to FDIC-supervised institutions and consumers by predatory lending. Specifically, (1) each loan transaction must be viewed in its totality to determine whether it may be predatory; (2) FDIC-supervised institutions can have direct or indirect involvement in predatory lending; and (3) nontraditional mortgages and other loan products are now available that contain terms that may be viewed as appropriate for some

borrowers but predatory for others. Further, the FDIC must ensure that its efforts to combat predatory lending do not limit consumer access to legitimate sources of credit.

FDIC guidance issued to examiners, FDIC-supervised financial institutions, and consumers addresses predatory lending. However, the guidance does not formally articulate a supervisory approach to address predatory lending and was not issued for the explicit purpose of identifying, assessing, and addressing the risks that such lending practices pose to institutions and consumers. Further, certain characteristics potentially indicative of predatory lending were not covered. The lack of an articulated supervisory approach and gaps in coverage could result in increased risk that predatory lending practices occur, are not detected, and harm institutions and consumers. Therefore, the FDIC needs to clarify for examiners and institutions its overall approach to addressing predatory lending and enhance guidance to bring increased attention to associated characteristics.

Additionally, this report identifies for the FDIC's consideration other federal banking regulatory agencies' actions to identify, assess, and address predatory lending.

CHALLENGES RELATED TO PREDATORY LENDING

The following discusses in detail significant challenges that the FDIC faces with respect to combating predatory lending.

Transactions Must be Viewed in Totality

Identifying or recognizing predatory lending in a specific loan transaction can be a challenge because each loan transaction must be viewed in its totality, including the associated marketing practices, terms of the agreement, various parties involved in the loan transaction, and financial sophistication of the parties involved. As a result, there is no simple "checklist" to follow in identifying predatory lending.

Additionally, borrowers can be susceptible to predatory lending practices in several phases of the loan transaction as described below.

- Marketing Phase. Lenders may employ aggressive marketing techniques that target specific borrowers or communities.

- Loan Underwriting Phase. Lenders may require borrowers to pay additional fees or accept additional and unnecessary services or products in order to receive a loan.

- Loan Execution Phase. Lenders may suggest refinancing, or "flipping" a loan (at an additional fee) without economic gain for the borrower.

When used in an unfair, abusive, or deceptive manner and depending on the circumstances faced by the specific borrower and the borrower's financial sophistication, the activities could, in fact, be predatory.

Direct or Indirect Institutional Involvement

A financial institution's involvement in predatory lending is not always obvious because such involvement may be direct or indirect. Direct involvement might involve a financial institution extending predatory loans to borrowers or using a network of loan brokers that have access to subprime lenders. A financial institution's indirect involvement in the predatory lending process—knowingly or unknowingly—may result from acquiring or forming subsidiaries that specialize in subprime lending, lending to subprime lenders, servicing loans, investing in asset-backed securities, or participating in the securitization process. Accordingly, determining an institution's involvement in predatory lending is difficult for FDIC examiners.

Variety of Loan Products

The fixed-rate mortgage is now just one of an array of loan products. Such loan products include: (1) no-money-down loans; (2) adjustable rate mortgages (ARM) with negative amortization and interest-only options; and (3) Option-ARMs, which give borrowers increased options in repaying the mortgage. Regulatory experience with nontraditional mortgage lending programs has shown that prudent management of these programs requires increased attention to product development, underwriting, compliance, and risk-management functions. Further, although these loan products may be appropriate for certain consumers, the federal regulatory agencies are concerned that these products and practices are being offered to some borrowers who may not otherwise qualify for traditional fixed-rate or ARM loans and may not fully understand the associated risks.

Maintaining Consumer Access to Credit

It has been widely recognized that there is a close relationship between predatory lending—which is detrimental to the consumer—and subprime lending—which has a legitimate place in the financial services industry, in that subprime lending serves the market of borrowers whose credit histories would not permit them to qualify for a conventional "prime" loan. This challenge is evidenced in testimony by the Comptroller of the Currency before the Committee on Banking and Financial Services, U.S. House of Representatives, May 24, 2000:

> While we clearly need to address real abuses that exist, particularly in connection with home-secured loans, we also need to preserve and encourage consumer access to credit, meaningful consumer choice, and competition in the provision of financial services to low- and moderate-income families. Determining how to draw the line between predatory and legitimate credit practices in a way that will both combat abuses and advance these other objectives is a major challenge.

Further, as many as 12 million households either have no relationship with traditional financial institutions or depend on "fringe lenders," such as pawnshops, payday lenders, and rent-to-own stores, for their credit needs. Such fringe lenders, which remain largely unregulated, frequently

charge excessively high fees and can expose borrowers to predatory, unfair, abusive, or deceptive acts or practices.[1]

Thus, in combating predatory lending, the FDIC's challenge lies in preventing the unintended consequence of limiting consumer access to legitimate credit sources.

FDIC EFFORTS TO ADDRESS PREDATORY LENDING CHALLENGES

The FDIC has taken action to address significant challenges related to predatory lending by providing guidance in various forms to examiners, FDIC-supervised institutions, and consumers. However, the guidance does not formally articulate the Corporation's overall supervisory approach for addressing predatory lending and is contained in multiple policies, procedures, and memoranda. Generally, this guidance was not issued for the explicit purpose of addressing predatory lending. In addition, the guidance covers many, but not all, of the characteristics often associated with predatory lending. Consequently, predatory lending may not receive sufficient attention, which increases the risk that such practices could occur, may not be detected, and may harm institutions and borrowers.

FDIC Guidance Related to Predatory Lending

The FDIC has provided guidance related to predatory lending to examiners in safety and soundness and compliance examination policies and procedures and Regional Directors Memoranda and to institutions the FDIC supervises in financial institution letters (FIL).[2] The FDIC has also provided guidance to consumers on predatory lending through its adult education program—*Money Smart*—and the *FDIC Consumer News* publication. However, we found that the FDIC's guidance did not articulate the overall supervisory approach for identifying, assessing, and addressing predatory lending and either varied or did not explicitly cover some predatory lending characteristics, depending on the source of the guidance.

Numerous lending characteristics, when considered either individually or in combination, could indicate whether predatory lending has occurred. Our research identified 21 characteristics that are potentially associated with predatory lending. Some of these characteristics are not prohibited by law, but may be predatory if they are determined to be associated with unfair, abusive, or deceptive lending practices. Table 1 shows the characteristics identified by our research and indicates whether there is some coverage in established FDIC guidance.

[1] FDIC Banking Review, 2005, Volume 17, No. 1, *Limited-Purpose Banks: Their Specialties, Performance, and Prospects.*

[2] FILs may announce new regulations, special alerts concerning entities operating illegally as financial institutions, new FDIC publications, or a variety of other matters.

Table 1: OIG Analysis of Coverage for Characteristics Potentially Associated With Predatory Lending[a]

Characteristic	Examination Guidance[b]		FILs	*Money Smart*
	Safety and Soundness	Compliance		
The "✓" indicates that guidance included some coverage of the characteristic.				
Abusive Collection Practices	✓	✓	✓	✓
Balloon Payments With Unrealistic Repayment Terms		✓	✓	✓
Encouragement of Default in Connection With Refinancing				
Equity Stripping Associated With Repeat Refinancing and Excessive Fees			✓	✓
Excessive Fees not Justified by the Costs of Services Provided and the Credit and Interest Rate Risks Involved	✓	✓	✓	✓
Excessive Interest Rates That May Involve "Steering" a Borrower to a Higher-Cost Loan	✓	✓	✓	✓
Fraud, Deception, and Abuse	✓	✓	✓	✓
High Loan-to-Value Ratio That May Negatively Impact a Borrower's Ability to Avoid Unaffordable Debt	✓		✓	✓
Lending Without Regard to Ability to Repay	✓	✓	✓	✓
Loan Flipping Without Economic Gain for the Borrower, Resulting in Equity Stripping	✓	✓	✓	✓
Mandatory Arbitration Clauses			✓	
Payday Lending	✓	✓	✓	✓
Pre-payment Penalties That May Trap Borrowers in High-Cost Loans		✓	✓	✓
Refinancing of Special Mortgages Without Economic Gain for the Borrower, Resulting in Equity Stripping				
Refinancing Unsecured Debt Without Economic Gain for the Borrower, Resulting in Equity Stripping				
Repetitive Refinancing Without Economic Gain for the Borrower, Resulting in Equity Stripping		✓	✓	✓
Single-Premium Credit Insurance That is Added to the Total Loan Amount and Increases the Total Interest Paid		✓	✓	✓
Spurious Open-End Loans		✓	✓	
Steering Borrowers Who Qualify for Lower-Cost Loans to Higher-Cost Financing			✓	
Subprime Lending Within Which Predatory Lending Generally Occurs[c]	✓	✓	✓	✓
Yield-Spread Premiums With Incentives to Steer Borrowers into Higher-Cost Loans		✓	✓	

Source: OIG review of DSC guidance provided to examiners, FDIC-supervised financial institutions, and consumers.

[a] Appendix III provides details on the characteristics that may be predatory if they are determined to be associated with unfair, abusive, or deceptive lending practices.

[b] Examination guidance includes examination policies, procedures, and Regional Directors Memoranda.

[c] According to the DSC *Risk Management Manual of Examination Policies*, there is not a universal definition of a subprime loan in the industry, but subprime lending is generally characterized as a lending program or strategy that targets borrowers who pose a significantly higher risk of default than traditional retail banking customers.

Coverage of the lending characteristics in Table 1 can vary depending on their nature, and certain characteristics may appropriately lend themselves to being covered under one type of examination (e.g., safety and soundness or compliance) in comparison to another. As a result, we fully recognize that there may be legitimate reasons why certain characteristics may not be included in a particular form of guidance. However, three of the characteristics were not explicitly covered by any of the guidance—specifically, (1) encouragement of default, (2) refinancing of special mortgages, and (3) refinancing unsecured debt.

There may be other lending characteristics associated with predatory lending practices that are not included in Table 1. Further, we recognize that defining lending practices that constitute predatory lending is not easy and that consideration must be given to the context in which lending practices occur. Some lending practices may be abusive in the context of high-cost loans; others may be unacceptable in all contexts; and others, not necessarily abusive for all high-cost borrowers, may be abusive for a particular borrower due to deception. We discuss, in detail, coverage of the characteristics by the various forms of FDIC guidance in the following sections of the report.

Guidance to FDIC Examiners

The FDIC conducts and provides guidance on examinations to determine the safety and soundness of financial institutions and whether institutions are complying with consumer protection laws and regulations. DSC's examination guidance does not articulate the FDIC's overall supervisory approach for addressing predatory lending. Further, the FDIC's safety and soundness examination and compliance examination guidance addresses many, but not all of the potentially predatory lending characteristics that our research identified.

Safety and Soundness Examination Guidance

We found that DSC's safety and soundness examination guidance covered the following characteristics.

Subprime Lending Examination Documentation (ED) Module

- Abusive collection practices.
- Excessive fees not justified by the costs of services provided and the credit and interest rate risks involved.
- Excessive interest rates that may involve "steering" a borrower to a higher-cost loan.
- Fraud, deception, and abuse.
- Lending without regard to ability to repay.
- Loan flipping without economic gain for the borrower, resulting in equity stripping.

- Subprime lending within which predatory lending generally occurs.

Residential Real Estate Lending ED Module

- High loan-to-value ratio that may negatively impact a borrower's ability to avoid unaffordable debt.

Payday Lending Guidance

- Payday lending (a particular type of subprime lending) guidance also includes guidance on lending without regard to the ability to repay and information on various consumer protection laws, including the TILA, ECOA, FCRA, FDCPA, and FTC Act.[3]

As of September 30, 2005, the FDIC reported 91 (about 2 percent) of the 5,257 FDIC-supervised institutions as subprime lenders based on aggregate credit exposure in subprime loans equal to or greater than 25 percent or more of Tier 1 capital. As a result, use of the *Subprime Lending ED Module* and coverage of the seven characteristics noted above could be limited to a small number of FDIC-supervised institutions.

In addition to the subprime, residential real estate, and payday lending guidance, we found that the *Mortgage Banking ED Module* does not specifically reference any of the characteristics but does contain the following step in the *Internal Controls* section of the segment entitled, *Core Analysis Procedures*, as shown below:

> Evaluate the bank's process for ensuring compliance with predatory lending laws, including:
>
> - the strategy for handling loans originated and serviced in various jurisdictions;
> - procedures to confirm compliance with predatory lending laws and regulations; and
> - risk controls that are in place to prevent predatory servicing practices.

The extent to which examiners would perform this step depends upon whether the financial institution being examined is classified as a mortgage banker. As of September 2005, the FDIC classified 376 (about 7 percent) of its supervised institutions as mortgage bankers, which are defined as institutions that deal in mortgages with brokers originating loans and then selling them to investors. Further, although the module directs examiners to evaluate the bank's procedures for confirming compliance with predatory lending laws and regulations, the module does not specify the laws and regulations the examiners should use to make the evaluation. However, DSC officials stated that the ED modules resulted from an interagency effort by the FDIC,

[3] The FDIC's subprime lending and payday lending guidance also provides information on the FDIC's expectations for prudent risk-management practices for those lending activities. At the time the FDIC released its payday lending guidance in March 2005, the Corporation reported that 12 FDIC-supervised institutions were engaging in payday lending.

Federal Reserve Board, and Conference of State Bank Supervisors and that because those procedures are used by state examiners and federal examiners, it is not practical for the module to document every applicable state and federal law and regulation. In addition, DSC officials stated that ED modules are an examination tool that focuses on risk management practices and guides examiners to establish the appropriate examination scope. In addition, the modules:

- incorporate questions and points of consideration into examination procedures to specifically address a bank's risk management strategies for each of its major business activities and

- direct examiners to consider areas of potential risk and associated risk control practices to facilitate an effective supervisory program.

Further, DSC officials stated that the Subprime Lending and Mortgage Banking ED Modules are supplemental modules or reference modules to be used in conjunction with core ED modules. Examiners are not required to duplicate efforts already addressed in core procedures or elsewhere, since ultimately, the conclusions will be brought forward to the Core Analysis Decision Factors.

The safety and soundness examination guidance did not cover the following characteristics:

- balloon payments with unrealistic repayment terms;

- encouragement of default in connection with refinancing;

- equity stripping associated with repeat refinancing and excessive fees;

- mandatory arbitration clauses;

- pre-payment penalties that may trap borrowers in high-cost loans;

- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;

- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping;

- repetitive refinancing without economic gain for the borrower, resulting in equity stripping;

- single-premium credit insurance that is added to the total loan amount and increases the total interest paid;

- spurious open-end loans;

- steering of borrowers who qualify for lower-cost loans to higher-cost financing; and

- yield-spread premiums with incentives to steer borrowers into higher-cost loans.

Lacking coverage of certain characteristics could be significant because predatory lending may cause safety and soundness problems. For example:

- **Balloon Payments With Unrealistic Repayment Terms.** A financial institution may structure loans with initial low monthly payments but include a balloon payment that the borrower cannot afford in an attempt to trap the borrower into refinancing and paying additional fees at the end of the loan term. However, if the borrower is unable to restructure the loan and the collateral value declines, the institution is left without adequate sources of repayment for the loan. Higher loan losses could lead to safety and soundness concerns.

- **Refinancing Unsecured Debt Without Economic Gain for the Borrower, Resulting in Equity Stripping.** A financial institution that engages in refinancing unsecured debt, using a borrower's home as collateral, may eventually incur higher loan losses. Borrowers may continue to incur additional unsecured debt and may default on the loan. If a borrower defaults, the institution is dependent upon the collateral for any recovery on the loan. The bank would absorb foreclosure costs and any decline in collateral value. An institution that makes a loan to a consumer based predominantly on the liquidation value of the borrower's collateral, rather than on determination of the borrower's repayment ability, may be engaging in a fundamentally unsafe and unsound banking practice. This practice increases not only the risk to the bank that the loan will default but also the bank's potential loss exposure upon default.

Compliance Examination Guidance

Compliance examination procedures include guidance for examiner use in determining compliance with a number of consumer protection laws and regulations, including HOEPA, TILA, RESPA, and the FTC Act. Examiners use these procedures if the examiner decides, through the risk-focused compliance examination process, to test the bank's compliance with a particular law or regulation. Noncompliance can result in civil liability and negative publicity as well as the FDIC's imposition of formal or informal actions to correct noncompliance. Further, it is important to note that the FDIC can rely on the FTC Act as authority for issuing enforcement actions against financial institutions for unfair, abusive, and deceptive acts or practices, which could include any or all of the characteristics potentially associated with predatory lending that our research identified.

The FDIC's compliance examination procedures include reference to many of the characteristics that we identified in conducting the audit but do not cover the following:

- encouragement of default in connection with refinancing;

- equity stripping associated with repeat refinancing and excessive fees;

- high loan-to-value ratio that may negatively impact a borrower's ability to avoid unaffordable debt;
- mandatory arbitration clauses;
- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;
- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping; and
- steering of borrowers who qualify for lower-cost loans to higher-cost financing.

Further, of those characteristics, neither the compliance nor safety and soundness examination guidance covered: (1) encouragement of default in connection with refinancing; (2) equity stripping associated with repeat refinancing and excessive fees; (3) mandatory arbitration clauses; (4) refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping; (5) refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping; and (6) steering of borrowers who qualify for lower-cost loans to higher-cost financing. These characteristics could cause detrimental consequences such as defaults and foreclosures to borrowers. Although we did not identify specific coverage of the seven characteristics in compliance examination guidance, as noted earlier, those characteristics could indicate noncompliance with the FTC Act if the loan was made in an unfair, abusive, or deceptive manner.

On June 17, 2005, the FDIC issued examination guidance entitled, *Procedures for Determining Compliance With the Prohibition on Unfair and Deceptive Acts or Practices found in Section 5 of the Federal Trade Commission Act*. The purpose of that guidance is to strengthen the FDIC's ability to apply Section 5 of the FTC Act, which prohibits such acts or practices. In addition, although examination guidance states that most banking organizations do not engage in unfair or deceptive acts or practices, advances in banking technology and changes in the lending organizational structure have contributed to financial institutions' participating in non-banking activities and provided the ability to structure complex financial products and sophisticated marketing methods. The pace and complexity of these advances have increased the potential risk for consumer harm. However, the examination guidance does not specifically address predatory lending practices.

Guidance to FDIC-Supervised Institutions

The FILs issued to FDIC-supervised institutions include information on all of the characteristics that we identified except for the following:

- encouragement of default in connection with refinancing;
- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping; and

- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping.

Encouragement of default may influence a borrower to breach an existing loan to subsequently refinance all or part of a loan, which could result in higher loan balances and additional interest and fees. In addition, encouraging a borrower to use equity in a residence as collateral to refinance unsecured debt, such as credit card debt, could jeopardize the borrower's equity in the residence and could, ultimately, result in the borrower losing the residence. Refinancing special mortgages could also negatively affect terms that may have been favorable to the borrower, leaving the borrower with loan terms that do not provide a tangible economic benefit.

Enhancing the FILs to cover these characteristics would help to ensure that financial institutions protect consumers by avoiding these practices, when appropriate.

Consumer Education

The FDIC has included information related to predatory lending in its adult education program—*Money Smart*—and its *FDIC Consumer News* publication. *Money Smart* includes information on many of the characteristics that we identified but does not include coverage of the following:

- encouragement of default in connection with refinancing;
- mandatory arbitration clauses;
- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;
- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping;
- spurious open-end loans;
- steering of borrowers who qualify for lower-cost loans to higher-cost financing; and
- yield-spread premiums with incentives to steer borrowers into higher-cost loans.

The FDIC created *Money Smart* as a training program to help adults outside the financial mainstream enhance their financial management skills and create positive banking relationships. Ten comprehensive modules comprise the *Money Smart* curriculum and cover basic financial topics to help consumers understand banking basics. The modules include information on bank services, credit, budgeting, savings, credit cards, loans, and homeownership. The program also provides information in the following areas to assist consumers in avoiding predatory lending:

- loan payment decisions,
- loan rejection,

- predatory lending and TILA,
- predatory loan offers,
- predatory lending tactics, and
- what to do if consumers believe they are victims of a predatory loan.

Information on predatory lending also addresses mortgage loans, credit cards, and installment loans. The program is available through the Internet, classroom instruction, or CD-ROM and is available in multiple languages, including Spanish, Korean, Chinese, Vietnamese, and Russian.

The *FDIC Consumer News* provides practical guidance on how to become a smarter, safer user of financial services. The Summer 2002 edition of the *FDIC Consumer News* article entitled, *High-Cost "Predatory" Home Loans: How to Avoid the Traps*, advised consumers that:

> . . . something is robbing homeowners of money and putting many of these same families at risk of *losing* their homes. . . . There is no clear-cut definition of a predatory loan, but many experts agree that it is the result of a company misleading, tricking and sometimes coercing someone of taking out a home loan (typically a home equity loan or mortgage refinancing) at excessive costs and without regard to the homeowner's ability to repay. Victims who have trouble repaying a predatory loan often face harassing collection tactics or are encouraged to refinance the loan at even higher fees.

The publication also acknowledged some of the consumer protection laws, including TILA and HOEPA.

FDIC guidance to consumers could be enhanced to provide coverage on the seven characteristics not already addressed to make consumers better aware of the potential negative effects of predatory lending.

Conclusion and Recommendations

FDIC officials have stated that federally insured depository institutions have a good record of avoiding involvement in predatory lending practices. Those financial institutions, which are banks, thrifts, or credit unions, are subject to federal and state oversight and supervision, unlike most subprime lenders. Further, financial institutions' regulatory agencies have stated that their monitoring and examination activities have revealed little evidence of predatory lending practices by federally regulated depository institutions. However, as consumers enjoy more access to credit from a wider variety of sources, opportunities have expanded for predatory lending. Education is one way to help people achieve financial literacy and avoid abusive loans, but supervision and oversight should also play an important role in preventing predatory lending practices.

The FDIC has recognized the importance of its role in this regard by establishing a strategic goal to ensure that consumers' rights are protected and by responding to consumer complaints and inquiries related to predatory lending. The FDIC has also taken steps to provide guidance to its examiners, FDIC-supervised financial institutions, and consumers on many of the characteristics related to predatory lending. However, the Corporation could bring more attention to combating

predatory lending by establishing and articulating its overall supervisory approach for identifying, assessing, and addressing the risks associated with predatory lending and ensuring that characteristics of predatory lending are addressed in examiner, institution, and consumer guidance.

We recommend that the Director, DSC:

(1) Describe in policy the FDIC's overall supervisory approach to predatory lending.

(2) Review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address the risks associated with predatory lending.

ISSUES FOR CONSIDERATION

The FDIC and some members of the Federal Financial Institutions Examination Council (FFIEC)[4] have addressed predatory lending in various ways. These include jointly issued guidance, performance measurement, consumer information on predatory lending, and assessment of risk associated with predatory lending. Appendix IV contains supplemental information from some of the other federal banking regulatory agencies regarding their efforts related to predatory lending.

Jointly Issued Guidance

The FFIEC members have jointly issued guidance to examiners, financial institutions, and consumers on supervisory and consumer issues related to some predatory lending characteristics. For example, the FFIEC issued guidance and examination procedures on subprime lending in January 2001 and on fair lending in August 2004. Further, the FFIEC members issued guidance to consumers entitled, *Putting Your Home on the Loan Line is Risky Business*.[5] The brochure provides information on the following:

- Groups targeted by abusive lenders or contractors—homeowners with low incomes or credit problems and the elderly.

- Steps consumers can take to protect themselves, including:

    - considering multiple options for sources of credit;
    - contacting several lenders for possible credit;

[4] The FFIEC, which consists of all federal financial institution regulatory agencies, is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the FDIC, OTS, OCC, FRB, and National Credit Union Administration (NCUA). The FFIEC makes recommendations to promote uniformity in the supervision of financial institutions. The scope of our audit did not include the NCUA.

[5] The following agencies also participated in the issuance of the consumer brochure: HUD, Department of Justice, Federal Housing Finance Board, FTC, and Office of Federal Housing Enterprise Oversight.

- comparison shopping for loan terms, conditions, payment options, points, fees, and penalties; and
- understanding consumer rights and cancellation options.

- Contact information for federal banking regulatory agencies, the Department of Justice, HUD, Federal Housing Finance Board, and Office of Federal Housing Enterprise Oversight.

In addition, in March 2004, the FDIC and FRB jointly published guidance for state-chartered institutions on unfair or deceptive acts or practices prohibited by Section 5 of the FTC Act. This guidance explains how institutions could avoid engaging in practices that might be viewed as unfair or deceptive.

Individual Regulatory Guidance

The individual members of the FFIEC have issued guidance to their examiners and supervised institutions.

Office of Thrift Supervision Guidance

OTS has issued examination-scoping guidance and a *Strategic Plan* that specifically addresses predatory lending. The OTS Examination Scope Worksheet, which examiners use to determine whether a specific issue should be included in the examination scope, includes a line item for an assessment of predatory lending issues. Further, the OTS *Strategic Plan* includes a performance goal to maintain a thrift industry that effectively complies with consumer protection laws. As stated in the plan, one of the strategies OTS uses for achieving performance is to "conduct examinations with a top-down, risk focused approach that promotes comprehensive compliance management including the establishment of adequate internal controls to ensure regulatory compliance and to avoid predatory practices."

Office of the Comptroller of the Currency Guidance

OCC has issued industry guidance addressing predatory lending.

- In February 2003, OCC issued two advisory letters related to predatory lending to the national banks and operating subsidiaries it supervises. The advisory letters:

  - describe loan attributes that are often considered predatory and establish standards for policies and procedures for monitoring loan transactions to avoid making, brokering, or purchasing loans with such attributes;

  - state OCC's position that predatory lending will affect a national bank's Community Reinvestment Act (CRA) rating;[6] and

[6] On July 19, 2005, the federal banking agencies approved CRA final rules, effective September 1, 2005. Those rules include clarification on when discrimination or other illegal credit practices by a bank or its affiliate will adversely affect an evaluation of the bank's CRA performance.

  - clarify ways in which predatory lending practices can create legal, safety and soundness, and reputational risks for national banks.

- In January 2004, OCC issued a rule adopting anti-predatory lending standards that expressly prohibit national banks from (1) making consumer and mortgage loans based predominantly on the bank's realization of the foreclosure value of the borrower's collateral, without regard for the borrower's ability to repay, and (2) engaging in unfair and deceptive practices within the meaning of Section 5 of the FTC Act.

- In September 2004, OCC issued an advisory letter alerting national banks regarding OCC's concerns about certain credit card marketing and account management practices. These practices may entail unfair or deceptive acts or practices and may expose a bank to compliance and reputational risks.

- In February 2005, OCC issued guidelines on national bank residential mortgage lending standards to further the OCC's goal of ensuring that national banks do not become involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The guidelines are enforceable pursuant to the process provided in Section 39 of the FDI Act and Part 30 of OCC regulations. The new guidelines incorporated key elements of the OCC's February 2003 advisory letters.

Federal Reserve Board Guidance

The FRB has issued examination guidance on assessing financial institutions' risks related to predatory lending. FRB's *Risk-Focused Consumer Compliance Supervision Program*, dated December 2003, states that FRB examiners evaluate consumer compliance risks during specialized consumer compliance examinations. The consumer compliance risk profile incorporates an assessment of operational, legal, and reputational risks arising from a bank's consumer compliance activities.

In evaluating reputational risk during safety and soundness examinations, examiners are to determine whether the bank's risk is "low," "moderate," or "high" in accordance with FRB guidance. In addition, examiners assign a trend indicator of "increasing," "stable," or "decreasing." The risk assessment considers the (1) level of inherent risk involved in each of the bank's significant business activities and (2) strength of risk management systems in place to control the level of risk in these activities. Table 2 on the next page shows that FRB examiners consider the level of reputational risk specifically related to predatory lending for FRB-supervised financial institutions.

Table 2: Analysis of Reputational Risk for FRB-Supervised Financial Institutions

Reputational Risk		
Low	**Moderate**	**High**
Business strategy and/or bank products unlikely to raise concern regarding predatory lending and/or unfair and deceptive acts or practices.	Business strategy and/or bank products may raise concern regarding predatory lending and/or unfair and deceptive acts or practices.	Business strategy and/or bank products likely to raise serious concern regarding predatory lending and/or unfair and deceptive acts or practices.

Source: FRB *Risk-Focused Consumer Compliance Supervision Program*, dated December 2003.

Conclusion

It is not our intention to conclude on whether one agency's approach to addressing predatory lending is better than another. We recognize that the OCC and OTS supervisory approaches to predatory lending are based, in large part, on their authority to charter and supervise institutions whose operations are largely defined and bound by federal statutes and regulations. Unlike the OCC and OTS, the FDIC is not a chartering authority and shares regulatory oversight of the institutions it supervises with the appropriate state supervisor that can address predatory lending through applicable state and local laws and regulations. Nevertheless, the FDIC should consider the merits of the other federal banking regulatory agencies in establishing the Corporation's supervisory approach to this important issue. Additional information on OTS and OCC predatory lending efforts is in Appendix IV.

CORPORATION COMMENTS AND OIG EVALUATION

A draft of this report was issued on February 24, 2006. On June 1, 2006, the Acting Director, DSC, provided a written response to the draft report. The DSC response is presented in its entirety in Appendix V. A summary of management's response to the recommendations is in Appendix VI.

In its response to recommendations 1 and 2, DSC stated that it agreed with the recommendations and would develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. Based on that review, DSC will also develop additional enhanced guidance to address predatory lending, if necessary. DSC agreed to complete these actions by December 31, 2006. These agreed-upon actions meet the intent of our recommendations, which will remain open for reporting purposes until we have determined that the actions have been completed and are effective.

In addition to addressing the recommendations in the draft report, DSC's response provided an overview of its past and ongoing efforts to address predatory lending, including (1) examination guidance and training, (2) enforcement policy, (3) speeches and testimony, and (4) financial education.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The overall objective of this audit was to determine the challenges faced and efforts taken by the FDIC to identify, assess, and address the risks posed to institutions and consumers from predatory lending. As part of this objective, we contacted other federal regulators to determine the policies, procedures, and guidance the banking regulators, FTC, and HUD had issued to address these risks. We performed our audit from April 2005 through January 2006 in accordance with generally accepted government auditing standards.

Scope and Methodology

To achieve the objective, we interviewed FDIC officials in:

- DSC's headquarters in Washington, D.C., responsible for conducting safety and soundness and compliance examinations of FDIC-supervised financial institutions.

- DSC's Kansas City Regional Office, CRC, responsible for investigating consumer complaints about FDIC-supervised institutions and for responding to consumer inquiries about consumer laws and regulations and banking practices. We obtained information on policies and procedures related to consumer complaints and inquiries and statistics on the number of complaints and inquiries received since 2003 that related to predatory lending.

- The Office of Ombudsman, which acts as a liaison for the banking industry and the general public, to facilitate the resolution of problems and complaints in a fair, impartial, and timely manner.

In addition, we reviewed:

- Prior audit reports and various articles related to predatory and subprime lending.

- FDIC regulations and DSC policies and procedures manuals, including related examination procedures for safety and soundness and compliance examinations; and FILs used to provide guidance and announce new regulations and special alerts to FDIC-supervised institutions.

- Literature and the training modules for, and performance measures related to, the FDIC's *Money Smart* program.

- The FDIC's *2005-2010 Strategic Plan*, *2005 Annual Performance Plan*, and the FDIC/DSC 2004 Business Line Objectives to determine whether the Corporation had developed performance measures related to consumer protection, in general, and predatory lending, in particular.

- Information obtained during interviews with other federal banking regulatory agencies, FTC, and HUD and those agencies' respective Web sites on:

    - examination policies and procedures and
    - information provided to examiners, financial institutions, and consumers.

During the audit, we coordinated with the other FDIC OIG Office of Audits directorates, Office of Investigations, and Office of Counsel and GAO to determine whether there were prior or ongoing audits, studies, or investigations related to predatory lending. Regarding congressional issues or interests related to predatory lending, we coordinated with the FDIC OIG Office of Management and Congressional Relations. We did not consider any pending legislation that might relate to predatory lending.

We gathered data on the federal banking regulatory agencies' policies and procedures related to predatory lending, including examination guidance and information provided to FDIC-insured financial institutions; policies and procedures for handling consumer complaints; policies and procedures related to cited violations and enforcement and/or supervisory actions; and training. We coordinated this aspect of our review through the respective federal agency Inspector General organizations.[7]

In addition, we reviewed congressional testimony related to predatory lending and reports issued by GAO, HUD and Treasury, OCC, Freddie Mac, the Center for Responsible Lending, and the FDIC on payday and subprime lending and identified a set of 21 characteristics sometimes associated with predatory, unfair, abusive, and deceptive acts or practices. Because there is no specific definition for predatory lending, we used those characteristics in reviewing DSC policies, examination procedures (safety and soundness and compliance), FILs, and Regional Directors Memoranda to develop a matrix on the extent of coverage the FDIC's guidance provides on those characteristics. Appendix III provides a list of the characteristics and their definitions.

Compliance With Laws and Regulations

We reviewed the DSC *Compliance Examination Manual* and compliance examination procedures to identify guidance for examiners on consumer protection laws that relate to predatory and subprime lending. We identified the following laws related to predatory and subprime lending.

- Equal Credit Opportunity Act,
- Fair Credit Reporting Act,
- Fair Debt Collection Practices Act,
- Fair Housing Act,
- Federal Trade Commission Act,

[7] We coordinated meetings with FRB and FTC program officials through their respective Offices of Inspector General. Our contact with HUD, OCC, and OTS was limited to meetings with their OIG officials and review of information obtained from their agency Web sites.

- Home Ownership and Equity Protection Act,
- Real Estate Settlement Procedures Act, and
- Truth in Lending Act.

Appendix II provides details on the requirements of each law. During this audit, we did not contact any state regulatory agencies to determine their efforts to identify, assess, and address predatory lending or financial institutions' compliance with state laws regarding predatory lending. We also did not determine whether the FDIC reviews its supervised financial institutions for compliance with state predatory lending laws.

DSC officials provided a sample of reports of examination (ROEs) that included instances in which DSC cited financial institutions for noncompliance with some consumer protection laws. We reviewed those ROEs solely to familiarize ourselves with how DSC addresses noncompliance with consumer protection laws. We did not review the ROEs or any applicable examination work papers to determine the extent of coverage of predatory lending characteristics during safety and soundness or compliance examinations.

In April 1975, the FDIC complied with the FTC Act in establishing a separate office to receive and respond to complaints about financial institutions that it supervises. In addition, effective July 1, 2002, the FDIC centralized its consumer affairs function with the establishment of the CRC within DSC. The CRC receives, investigates, and responds to complaints involving FDIC-supervised institutions and answers inquiries from consumers about consumer protection laws and banking practices. We did not identify any instances of FDIC noncompliance with pertinent laws and regulations.

Reliance on Computer-based Data, Government Performance and Results Act, Fraud and Illegal Acts, and Internal Control

Validity and Reliability of Data from Computer-based Systems

We did not use any computer-based data for evaluative purposes. Although we obtained information from DSC's automated Specialized Tracking and Reporting System (STARS) on the number and type of consumer complaints and inquiries regarding predatory lending, we did not rely on this information to achieve our audit objective. Accordingly, we did not conduct any independent testing of computer data.

Performance Measures

The Government Performance and Results Act of 1993 directs Executive Branch agencies to develop a strategic plan, align agency programs and activities with concrete missions and goals, manage and measure results to justify appropriations and authorizations, and design budgets that

reflect strategic missions. In fulfilling its primary supervisory responsibilities, the FDIC pursues two strategic goals:

- FDIC-supervised institutions are safe and sound, and
- consumers' rights are protected, and FDIC-supervised institutions invest in their communities.

The FDIC's Strategic Plan is implemented through the Corporation's *Annual Performance Plan*. The annual plan identifies performance goals, indicators, and targets for each strategic objective. In reviewing the FDIC's *Strategic Plan* and *Annual Performance Plan*, we did not identify any strategies or performance goals directly related to predatory lending.

Fraud and Illegal Acts

The objective of this audit did not lend itself to testing for fraud and illegal acts. Accordingly, the survey and audit programs did not include specific audit steps to test for fraud and illegal acts. However, we were alert to situations or transactions that could have been indicative of fraud or illegal acts, and no such acts came to our attention.

Internal Controls Reviewed

During the audit, we gained an understanding of relevant control activities related to examinations by reviewing DSC policies and procedures as presented in *DSC's Compliance Examination Manual*, *Risk Management Manual of Examination Policies*, safety and soundness examination documentation modules, and Regional Director Memoranda.

Summary of Prior Audit Coverage

GAO Audit

In January 2004, GAO issued Audit Report GAO-04-280 entitled, *Federal and State Agencies Face Challenges in Combating Predatory Lending*. Chairman and Ranking Minority Member, Special Committee on Aging, U.S. Senate, requested that GAO evaluate issues related to predatory home mortgage lending. GAO's report discusses (1) federal laws related to predatory lending and federal agencies' efforts to enforce them; (2) actions taken by states to address predatory lending; (3) the secondary market's role in facilitating or inhibiting predatory lending; (4) ways in which consumer education, mortgage counseling, and loan disclosures may deter predatory lending; and (5) the relationship between predatory lending activities and elderly consumers.

FDIC OIG Audits

The FDIC OIG conducted three previous audits related to fair lending, subprime lending, and consumer protection but has not conducted any previous audits specifically related to predatory lending.

On March 26, 2002, the OIG issued Audit Report 02-009, *The Division of Compliance and Consumer Affairs' Risk-Scoping Process for Fair Lending Examinations*, on the fair lending examination risk-scoping process as conducted by the Division of Compliance and Consumer Affairs.[8] The audit focused on the FDIC's application of the *FFIEC Interagency Fair Lending Examination Procedures* and did not directly relate to the scope of our audit.

On March 18, 2003, the FDIC OIG issued Audit Report 03-019, *The Division of Supervision and Consumer Protection's Examination Assessment of Subprime Lending*, in which the OIG concluded that:

- DSC had taken reasonable steps to ensure that institutions (1) effectively manage risks associated with subprime lending programs and price loans based on risk, (2) establish adequate allowance levels to cover loan and lease losses, and (3) maintain capital levels that reflect the additional inherent risks associated with subprime lending.

- Interagency policies and procedures for examinations of subprime banks provided examiners with the necessary guidance to identify and assess the condition of subprime loan programs in insured institutions, and the examiners adequately implemented this guidance. The procedures specifically addressed the management of risk associated with subprime lending programs, stressed the need for banks' risk management programs to address loan pricing, and set forth the requirements for calculating and maintaining adequate allowances for loan and lease losses and capital levels.

- FDIC examiners conducted pre-examination planning that included steps to look for indications of subprime lending programs and generally followed the interagency subprime lending examination procedures involving examinations of capital levels during onsite examinations. In addition, DSC maintained a quarterly database to assist in monitoring the condition of FDIC-insured institutions with subprime lending programs. Further, examiners noted that institutions had implemented corrective actions as a result of DSC examination findings related to the banks' subprime lending activities, including requirements for maintaining adequate levels of capital and adequate allowances to cover loan and lease losses.

The OIG reported that existing guidance may not have been sufficient for ensuring that models used by banks to estimate the creditworthiness of credit applicants made correct predictions. As a result, there was a potential for a lack of consistency in onsite examinations of banks with subprime lending programs, particularly with regard to allowances for losses and capital-level

[8] Effective June 30, 2002, the FDIC's Division of Supervision and Division of Compliance and Consumer Affairs merged to form the new DSC.

calculations. Also, in order for lenders to appropriately stratify the additional default risk and price the subprime products accordingly, constant monitoring and testing of credit scoring models were required to ensure that projected results were in line with actual performance. The FDIC agreed with the OIG's observations and planned to offer additional training for a select group of specialists on custom credit scoring.

On September 23, 2005, the FDIC OIG issued Audit Report 05-038 entitled, *Division of Supervision and Consumer Protection's Risk-Focused Compliance Examination Process*. The OIG concluded that DSC examiners generally complied with the policies and procedures related to risk-scoping compliance examinations and that the Risk Profile and Scoping Memorandums prepared by examiners provided an adequate basis for planned examination coverage. The examiners (1) reviewed bank policies, procedures, disclosures, and forms for compliance with consumer protection laws and regulations for each examination reviewed and (2) planned for transaction testing or spot checks in all compliance areas over the course of two consecutive examinations – a period of 2 to 6 years, depending on an institution's size and ratings. Additionally, examiners conducted transaction testing or spot checks in those areas for which apparent violations had been found at previous compliance examinations. However, the OIG found that examination documentation did not always show the transaction testing or spot checks conducted during the onsite portion of the examinations, including testing to ensure the reliability of the institutions' compliance review functions. Examiners also did not always document whether the examination reviewed all the compliance areas in the planned scope of review. As a result, DSC could not assure that the extent of testing was appropriate except for those areas in which examiners had identified violations and included them in ROEs. We recommended that DSC clarify and reinforce requirements that examiners adequately document the scope of the work performed, including transaction testing and spot checks of the reliability of the institutions' compliance review functions, during the onsite portion of compliance examinations.

DSC concurred with the recommendation and issued Regional Directors Memorandum No. 2005-035, *DSC's June 2003 Revised Compliance Examination*, which included guidance on:

- documenting changes in the scope of an examination,
- documenting spot checks of regulations,
- providing cross-checks to additional information available in *Examiner Summaries*, and
- providing descriptions of examination procedures used to conduct the examination.

We also reviewed the joint HUD and Treasury predatory lending report, *Curbing Predatory Home Mortgage Lending*, dated June 2000. The report proposed a four-point plan to address predatory lending practices—(1) improving consumer literacy and disclosures, (2) prohibiting harmful sales practices in the mortgage market, (3) restricting abusive terms and conditions on high-cost loans, and (4) improving market structure as it relates to CRA credit to banks and thrifts.

APPENDIX II

CONSUMER PROTECTION LAWS

Equal Credit Opportunity Act (ECOA) – ECOA prohibits discrimination based on race, color, religion, national origin, sex, marital status, and age in any aspect of a credit transaction. The FRB issued Regulation B, which describes lending acts and practices that are specifically prohibited, permitted, or required under ECOA.

Fair Credit Reporting Act (FCRA) – FCRA requires that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner that is fair and equitable to the consumer with regard to confidentiality, accuracy, relevancy, and proper utilization of information. On July 19, 2000, the FFIEC issued revised examination procedures to incorporate changes made to the FCRA as a result of the Gramm-Leach-Bliley Act (GLBA).[9]

Fair Debt Collection Practices Act (FDCPA) – FDCPA protects reputable debt collectors from unfair competition and encourages consistent state action to protect consumers from abuses in debt collection. On September 5, 1997, the FFIEC issued revised guidance to incorporate changes made to the FDCPA by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). EGRPRA amended the FDCPA by requiring debt collectors to inform debtors that they are attempting to collect a debt and that any information obtained could be used for that purpose.

Fair Housing Act (FHA) – The FHA prohibits discrimination based on race, color, religion, national origin, sex, familial status, and handicap in residential real-estate-related transactions, including making loans to buy, build, repair, or improve a dwelling. Lenders may not discriminate in mortgage lending based on any of the prohibited factors.

Federal Trade Commission Act (FTC Act) – The FTC Act authorizes the FTC to prohibit and take action against unfair or deceptive acts or practices in or affecting commerce. On March 11, 2004, the FDIC and FRB issued standards that will be considered by the agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices described in the FTC Act as they apply to acts and practices of state-chartered banks.

Home Ownership and Equity Protection Act (HOEPA) – Congress enacted HOEPA in response to evidence of abusive mortgage lending, particularly lending that involves excessive interest rates and fees. HOEPA identifies a class of high-cost mortgage loans and requires that consumers who enter into these transactions be provided with additional disclosures intended to facilitate comparison with other loan products. HOEPA restricts the use of certain loan terms associated with abusive lending and authorizes FRB to issue regulations that prohibit specific types of mortgage lending practices found to be abusive. On December 20, 2001, FRB amended

[9] In addition to reforming the financial services industry, GLBA addressed concerns relating to consumer financial privacy. Title V of the GLBA established major privacy provisions under Subtitles A and B. Subtitle A provides a mechanism to protect the confidentiality of a consumer's nonpublic personal information. Subtitle B prohibits "pretext calling," which is a deceptive practice used to obtain information on the financial assets of consumers. Criminal penalties and regulatory and administrative enforcement mechanisms are established to help prevent this practice.

the provisions of Regulation Z that implement HOEPA. The amendments restrict certain unfair practices and strengthen HOEPA's prohibition against extending credit without regard to a borrower's ability to repay it.

Real Estate Settlement Procedures Act (RESPA) – RESPA requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The Act also protects borrowers against certain abusive practices, such as kickbacks, and places limitations upon the use of escrow accounts. HUD promulgated Regulation X, which implements RESPA.

Truth in Lending Act (TILA) – TILA requires meaningful disclosure of credit and leasing terms so that consumers will be able to more readily compare terms in different credit and lease transactions. TILA also protects the consumer against inaccurate and unfair credit billing, credit card, and leasing transactions. FRB issued Regulation Z, which implements TILA. The regulation requires accurate disclosure of true cost and terms of credit. The regulation also regulates certain credit card practices, provides for fair and timely resolution of credit billing disputes, and requires that a maximum interest rate be stated in variable rate contracts secured by the consumer's dwelling.

CHARACTERISTICS POTENTIALLY ASSOCIATED WITH PREDATORY LENDING

Characteristic	Definition of Characteristic
Abusive Collection Practices	Attempting to collect debt through harassment or abuse, improper communication, false or misleading representations, or furnishing deceptive forms.
Balloon Payments	Loans with balloon payments are structured so that monthly payments are lower, but one large payment (the balloon payment) is due when the loan matures. Predatory loans may contain a balloon payment with unrealistic repayment terms, which the borrower is unlikely to be able to afford, resulting in foreclosure or refinancing with additional high costs and fees. Sometimes, lenders market a low monthly payment without adequate disclosure of the balloon payment. Balloon payments disguise the true, higher-than-expected cost of the loan.
Encouragement of Default	Encouraging a borrower to breach a contract and default on an existing loan prior to and in connection with the consummation of a loan that refinances all or part of the existing loan.
Equity Stripping	Repeat financings where the equity is depleted as a result of financing excessive fees.
Excessive Fees	Abusive loans may include fees that greatly exceed the amounts justified by the costs of the services provided and the credit and interest rate risks involved. Lenders may add these fees to the loan amounts rather than requiring payment up front, so the borrowers may not know the exact amount of the fees they are paying.
Excessive Interest Rates	Mortgage interest rates can legitimately vary based on the characteristics of borrowers (such as creditworthiness) and of the loans themselves. However, in some cases, lenders may charge interest rates that far exceed what would be justified by any risk-based pricing calculation, or lenders may "steer" a borrower with an excellent credit record to a higher-rate loan intended for borrowers with poor credit histories.
Fraud, Deception, and Abuse	Predatory lenders may perpetrate outright fraud through actions such as inflating property appraisals and doctoring loan applications and settlement documents. Unscrupulous lenders often prey on certain groups—the elderly, minorities, and individuals with lower incomes and less education, with deceptive or high-pressure sales tactics.
High Loan-to-Value Ratio	These loans effectively prohibit homeowners from selling their homes or filing bankruptcy to escape unaffordable debt, without losing their home.
Lending Without Regard to Ability to Repay	Loans may be made without regard to a borrower's ability to repay the loan. In these cases, the loans are approved based on the value of the asset (the home) that is used as collateral. In particularly egregious cases, monthly loan payments have equaled or exceeded the borrower's total monthly income. Such lending can quickly lead to foreclosure of the property.
Loan Flipping	Mortgage originators may refinance borrowers' loans repeatedly in a short period of time without any economic gain for the borrower. With each successive refinancing, these originators charge high fees that are folded into the loan balance and "strip" borrowers' equity in their homes.
Mandatory Arbitration Clauses	Mandatory arbitration clauses limit homeowners' choices for dispute resolution, thereby preventing victims of predatory lending practices from suing for damages.

Case 1:13-cv-01186-LPS Document 27-11 Filed 08/21/14 Page 31 of 42 PageID #: 781

Characteristic	Definition of Characteristic
Payday Lending	Payday loans are small-dollar, unsecured, short-term advances that have high fees relative to the size of the loan. When used frequently or for long periods, the total costs can rapidly exceed the amount borrowed.
Pre-payment Penalties	Penalties for prepaying a loan are not necessarily abusive, but predatory lenders may use them to trap borrowers in high-cost loans.
Refinancing of Special Mortgages	Special subsidized mortgages that contain terms favorable to the borrower are refinanced with a loan that does not provide a tangible economic benefit to the borrower relative to the refinanced loan.
Refinancing Unsecured Debt	The process of using an individual's home as collateral to refinance unsecured debt such as credit cards or medical debts. This process can be disadvantageous because creditors of unsecured debt can rarely take a borrower's property for nonpayment. However, creditors who refinance unsecured debt using a home as collateral can take the home for nonpayment.
Repetitive Refinancing	Repeatedly refinancing a loan within a short period of time and charging high points and fees with each refinancing. The repeated refinancing has the effect of stripping the homeowner's equity from the home by increasing the amount borrowed in each refinancing without providing any benefit to the borrower.
Single-Premium Credit Insurance	Credit insurance is a loan product that repays the lender should the borrower die or become disabled. In the case of single-premium credit insurance, the borrower pays the total premium upfront rather than on a monthly basis because it is added to the amount financed in the loan. The process of adding the full premium to the amount of the loan unnecessarily raises the amount of interest borrowers pay. Therefore, single-premium credit insurance is generally considered inherently abusive.
Spurious Open-End Loans	The lender is allowed to avoid the more comprehensive disclosures required by closed-end credit and thereby avoid any chance of the homeowner asserting the right of rescission, avoiding the restrictions under the HOEPA, regardless of the cost of the loan.
Steering	The process of referring borrowers who qualify for lower-cost financing to high-cost lenders. Subprime lenders will charge prime borrowers who meet conventional underwriting standards higher rates than necessary.
Subprime Lending	Subprime borrowers typically have weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. Such borrowers may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Generally, predatory mortgage lending occurs in the subprime market.
Yield-Spread Premiums	The payment a mortgage broker receives from a lender based on the difference between the actual interest rate on the loan and the rate the lender would have accepted on the loan given the risks and costs involved. The higher the actual loan rate compared with the acceptable loan rate, the higher the yield-spread premium. Yield-spread premiums provide incentives for mortgage brokers to steer borrowers into higher-cost loans.

Source: OIG review of congressional testimony related to predatory lending and reports issued by GAO, HUD and Treasury, OCC, Freddie Mac, the Center for Responsible Lending, National Consumer Law Center, and the FDIC on payday and subprime lending.

Case 1:13-cv-01186-LPS Document 27-11 Filed 08/21/14 Page 32 of 42 PageID #: 782

APPENDIX IV

INFORMATION PROVIDED BY OTHER FEDERAL REGULATORY AGENCIES

This appendix contains chronological information related to actions taken by OTS and OCC to address predatory lending. The appendix includes (1) information discussed in detail in our report in the section entitled, *Issues for Consideration*, and (2) supplemental information provided by OCC and OTS that was not included in our review of the agencies' efforts to address predatory lending and, therefore, was not verified during the audit. (The supplemental information is excerpted and shown in italics below.)

OTS

OTS has issued examination-scoping guidance and a *Strategic Plan* that specifically addresses predatory lending. The OTS Examination Scope Worksheet, which examiners use to determine whether a specific issue should be included in the examination scope, includes a line item for an assessment of predatory lending issues. Further, the OTS *Strategic Plan* includes a performance goal to maintain a thrift industry that effectively complies with consumer protection laws. As stated in the plan, one of the strategies OTS uses for achieving performance is to "conduct examinations with a top-down, risk focused approach that promotes comprehensive compliance management including the establishment of adequate internal controls to ensure regulatory compliance and to avoid predatory practices."

> *OTS received numerous comments from financial institutions and other interested parties when OTS issued an ANPR [Advance Notice of Proposed Rulemaking] on "Responsible Alternative Mortgage Lending" in April 2000. (65 Fed. Reg. 17811 (April 5, 2000)). OTS's rule, created during a high interest rate environment when many state laws prohibited ARMS, granted state-chartered thrifts and non-depository institutions preemption under the Alternative Mortgage Transaction Parity Act from state laws on alternative mortgages. Over the years, this preemption frustrated the states from enforcing consumer protections relating to prepayment penalties and late charges. OTS addressed the issue in September 2002 in its final rulemaking on the Alternative Mortgage Transaction Parity Act (AMTPA).*
>
> *In addition, OTS has taken a number of affirmative steps to stop or prevent institutions from offering loans with predatory characteristics. These actions include directing institutions (and requiring them through normal and formal enforcement actions) to close certain types of lending programs and directing certain institutions to divest their thrift charters. OTS also makes referrals concerning possible Equal Credit Opportunity Act violations by mortgage brokers and others to the Federal Trade Commission and Department of Justice, and discrimination complaints to Department of Justice and the Department of Housing and Urban Development.*

APPENDIX IV

In addition to the interagency guidance noted previously, OTS has issued guidance on title loan programs and payday lending[10] in CEO [Chief Executive Officer] Letters 131 and 132. This guidance states that OTS will closely review the activities of savings associations engaged in title loan programs and payday lending to ensure that they are following prudent, non-abusive lending practices.

OCC

The OCC conducts risk-based consumer compliance reviews that require examiners to determine the quantity of risk inherent in the bank's products and services associated with consumer protection laws and regulations, including those addressing predatory lending and unfair or deceptive acts or practices. Consumer complaint data are reviewed and analyzed for early warning indicators of potential unfair, deceptive, abusive, and predatory practices. Examiners also evaluate the adequacy of the financial institution's risk management practices used to identify, measure, monitor, and control the institution's compliance and reputation risk. If the quantity of risk is high and exposes the institution to significant risk or the compliance management system is inadequate to address the quantity of risk identified, examiners may expand their review to ensure the institution is in compliance with applicable laws and regulations.

In December 2004, OCC issued revised risk-based Retail Lending Examination Procedures. Minimum examination procedures are used in all banks, and they may indicate the need for more extensive review of all or parts of a bank's retail lending activities. As part of the minimum examination procedures, examiners determine whether the bank's lending activities include indicators of predatory lending, such as whether underwriting policies provide appropriate guidance on assessing that the borrower's capacity to repay the loan is based on a consideration of the borrower's income, financial resources, and debt service obligations, and whether the bank's policies and procedures provide adequate guidance to avoid discriminatory, unfair, deceptive, predatory, and abusive lending practices. If examiners determine that supplemental examination procedures are necessary, those procedures include assessments that identify predatory lending practices.

- *In July 2000, the OCC issued an advisory letter addressing abusive lending practices. The advisory letter identified a number of practices that may indicate that an institution may be engaging in abusive lending and violations of fair lending statutes and other consumer protection provisions.*

- *In November 2000, the OCC issued an advisory letter alerting national banks to concerns raised by title lending arrangements with third parties. Such arrangements raise significant consumer protection concerns, because of the high cost of the loan, and may involve abusive lending and collection practices.*

[10] A title loan is a short-term consumer loan made to an individual secured by clear title to the borrower's vehicle. Payday loans are small-dollar, short-term loans that borrowers promise to repay out of their next paycheck.

- *Also in November 2000, the OCC issued an advisory letter to ensure that any national bank that engages in payday lending does so in a safe and sound manner and does not engage in abusive practices that would increase the compliance, legal, and reputational risks associated with payday lending and could harm the bank's customers.*

- *In March 2002, the OCC issued an advisory to inform national banks and their operating subsidiaries about the risks present in engaging in lending and marketing practices that may constitute unfair or deceptive acts or practices, and to help national banks to avoid being placed in jeopardy of penalties, judgments, and harm to their reputations that can result from such practices.*

- In February 2003, OCC issued two advisory letters related to predatory lending to the national banks and operating subsidiaries it supervises, as discussed earlier in this report.

- In January 2004, OCC issued a rule adopting anti-predatory lending standards that expressly prohibit national banks from making consumer and mortgage loans based predominantly on the foreclosure value of the borrower's collateral and engaging in unfair and deceptive practices, as discussed earlier in this report.

- *In April 2004, the OCC issued an advisory letter intended to help national banks identify risks that are presented by secured credit cards and to provide guidance on how to address such risks, so that national banks that elect to offer secured credit cards do so in a safe and sound manner that treats customers fairly and promotes responsible credit access.*

- In September 2004, OCC issued an advisory letter alerting national banks regarding OCC's concerns about certain credit card marketing and account management practices, as discussed earlier in this report.

- In February 2005, OCC issued guidelines for national bank residential mortgage lending standards to further the OCC's goal of ensuring that national banks do not become involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices, as discussed earlier in this report.

The OCC has used its 12 U.S.C. [United States Code] *§ 1818 enforcement authority to bring actions against national banks that have engaged in unfair or deceptive acts or practices. These enforcement actions include two predatory mortgage lending cases and several cases involving credit card issuers that engaged in unfair or deceptive acts or practices. The enforcement actions have resulted in over $300 million in relief for consumers.*

CORPORATION COMMENTS

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Supervision and Consumer Protection

DATE: June 1, 2006

TO: Stephen M. Beard
Deputy Assistant Inspector General for Audits

FROM: Sandra L. Thompson [Electronically produced version; original signed by Sandra L. Thompson]
Acting Director

CONCUR: John F. Bovenzi [Electronically produced version; original signed by John F. Bovenzi]
Deputy to the Chairman and Chief Operating Officer

SUBJECT: Draft Report Entitled *Challenges and FDIC Efforts Related to Predatory Lending* (Assignment No. 2005-023)

This memorandum represents the Division of Supervision and Consumer Protection (DSC) response to the draft report entitled, *Challenges and FDIC Efforts Related to Predatory Lending*. (Assignment No.2005-023) ("Draft Report") prepared by the FDIC's Office of Inspector General (OIG). The objective of the OIG audit, started on March 2, 2005, was to determine challenges faced and efforts undertaken by the FDIC to identify, assess, and address the risks posed to institutions and consumers by predatory lending. The OIG also reviewed the efforts taken by the other federal banking regulators to address predatory lending.

The Draft Report recognizes the significant supervisory challenges attendant to predatory lending and identifies certain characteristics that are potentially indicative of predatory lending activities. The Draft Report recommends that the FDIC 1) clarify its overall approach to predatory lending, and 2) review existing guidance to identify gaps in examiner coverage of predatory lending. DSC agrees with these recommendations and will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. DSC will also review existing examiner guidance and, if necessary, develop additional guidance to address predatory lending. These actions will be completed by year-end.

Overview

The FDIC ensures that the 5,000 banks under its supervision engage in safe and sound lending, adhere to consumer protection laws, and invest in their communities. Predatory lending often involves both borrower deception and poor underwriting standards. The FDIC thus views predatory lending as a major consumer protection challenge and a significant safety and soundness concern. FDIC efforts to address predatory lending have been in place formally since 1999 and include: examiner guidance in both the risk management and compliance disciplines; enforcement policy; public policy advancement through speeches and testimony; and active financial education and other outreach activities.

APPENDIX V

Examination Guidance and Training

Predatory lending is most often associated with abusive lending practices in the subprime mortgage market. In 2001, the banking agencies jointly issued *Expanded Examination Guidance for Subprime Lending Programs*. The expanded guidance, which supplements previous subprime lending examination guidance issued in 1999, was developed to strengthen the examination and supervision of institutions with significant subprime lending programs. Moreover, this expanded examination guidance formed the basis of an interagency predatory lending examination strategy for risk management and compliance examinations. The FDIC took a leadership role to ensure the examination guidance distinguished between well-managed and responsible subprime lending programs and subprime lending programs that involved predatory practices. The examination guidance provides a useful overview of the issue of predatory lending in the subprime mortgage market and reflects the approach of the agencies to the issue. It states, in part:

> The term subprime is often misused to refer to certain "predatory" or "abusive" lending practices. The Agencies have previously expressed their support for lending practices designed to responsibly service customers and enhance credit access for borrowers with special credit needs. Subprime lending that is appropriately underwritten, priced, and administered can serve these goals. However, the Agencies also recognize that some forms of subprime lending may be abusive or predatory. Some such lending practices appear to have been designed to transfer wealth from the borrower to the lender/loan originator without a commensurate exchange of value. This is sometimes accomplished when the lender structures a loan to a borrower who has little or no ability to repay the loan from sources other than the collateral pledged. When default occurs, the lender forecloses or otherwise takes possession of the borrower's property (generally the borrower's home or automobile). In other cases, the lender may use the threat of foreclosure/repossession to pressure the borrower for payment. Typically, predatory lending involves at least one, and perhaps all three, of the following elements:
>
> - Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
> - Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced ("loan flipping"); or
> - Engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower.
>
> Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent. Further, examiners should refer any loans with the aforementioned characteristics to their Agency's respective consumer compliance/fair lending specialists for additional review.

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In addition to the 2001 guidance, the FDIC has issued guidance on matters related to predatory lending, whether or not labeled as such.[1] In 2004, to make certain that the industry understood our concerns, the FDIC and Federal Reserve Board jointly issued detailed guidance about how to avoid unfair or deceptive practices. And, in June 2005, the FDIC issued examination procedures intended to ensure that FDIC examiners have the tools necessary to evaluate compliance with the FTC Act.

The FDIC has also recently worked closely with the other financial regulatory agencies to develop guidance for banks about non-traditional mortgage products. As the Draft Report recognizes, these products pose a supervisory challenge because they, "...may contain terms that are appropriate for some borrowers but predatory to others".[2] The proposed guidance addresses both safety and soundness and consumer protection concerns.

Both compliance and risk management examiners at the FDIC have received training in the last several years on issues and activities associated with predatory lending. The training highlighted issues raised by consumer organizations, findings by several government studies, and unfair and deceptive practices found by the federal banking agencies. As a result of this training, examiners have a heightened awareness of predatory lending concerns and are prepared to address them by applying both consumer protection laws and safety and soundness standards. Additionally, in 2002, the FDIC established a Fair Lending Examination Specialist Program that assigned an expert Fair Lending Examination Specialist to each Regional and Area Office to assist compliance examiners in conducting fair lending examinations. These examinations include consideration of discriminatory lending and certain predatory lending activities, such as discriminatory pricing and steering.

Enforcement Policy

The FDIC has vigorously enforced existing consumer protection and fair lending laws and regulations, including the Home Ownership and Equity Protection Act of 1994, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Housing Act, the Equal Credit Opportunity Act, the Community Reinvestment Act, and the Federal Trade Commission Act (FTC Act). These authorities provide the FDIC with a range of tools to address predatory lending practices.

The Draft Report states there is no universally accepted definition of predatory lending.[3] In a report issued in June 2000, HUD and the Treasury Department explained that "... the predatory nature of many loans typically is not the result of a single term or characteristic, but a

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1 See, e.g., Interagency *Guidelines for Subprime Lending*, published by the FDIC through FIL -20-99, and Interagency *Expanded Guidance for Subprime Lending Programs*, published by the FDIC through Financial Institution Letter (FIL) 9-2001.

2 Draft Report at p. 3.

3 Draft Report at p.1.

3

series of characteristics that in combination impose substantial hardship on the borrower".[4] We agree with the Draft Report that identifying or recognizing predatory lending in a specific loan transaction can be a challenge because each loan transaction must be viewed in its totality, including the associated marketing practices, terms of the agreement, various parties involved in the loan transaction, and financial sophistication of the parties involved. As a result, there is no simple "checklist" to follow in identifying predatory lending.[5]

In view of this challenge, we agree with the Draft Report that Section 5 of the FTC Act is an important tool to use where otherwise lawful loan features are included in transactions in an unfair and deceptive way. These features include balloon payments, high loan to value loans, prepayment penalties, mandatory arbitration clauses, high cost ancillary products such as single-premium life insurance, and high cost fees financed into the loan. While subprime lending is a legal activity, some consumers accept subprime products because they have been misled about whether they qualify for products with prime rates and terms or about the features of the subprime loans. As the Draft Report states:

> [T]he FDIC can rely on the FTC Act as authority for issuing enforcement actions against financial institutions for unfair, abusive, and deceptive acts or practices, which could include any or all of the characteristics potentially associated with predatory lending that our [OIG] research identified during this audit.[6]

Although the FDIC to date has not identified violations involving unfair or deceptive practices in mortgage lending by FDIC supervised institutions, we have taken enforcement action against institutions that violated the FTC Act in a different context involving other credit products. OIG staff reviewed compliance examination reports that documented our action.[7] The FDIC is prepared to extend enforcement of the FTC Act to mortgage lending.

Public Policy: Speeches & Testimony

The FDIC has also made its concerns about predatory lending known in numerous speeches and testimony by FDIC officials since 2000. These include speeches before forums sponsored by the National Association of Affordable Lenders, the National Congress for Community and Economic Development, America's Community Bankers and others, and testimony before Congress. These public statements of policy addressed the different types of predatory practices discussed in the Draft Report, in addition to others, and laid out strategies to identify and prevent predatory lending. The collected speeches and testimony provided guidance not only to the industry, but also communicated the FDIC perspective on predatory lending to examiners as well.

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4 See "The National Predatory Lending Task Force, Curbing Predatory Home Mortgage Lending: A Joint Report, U.S. Department of Housing and Urban Development and U.S. Department of Treasury" (June 2000). (HUD/Treasury Report).

5 Draft Report at p. 3.

6 Draft Report at p. 11 (emphasis added).

7 Id. at p.21.

Financial Education

In addition to our supervisory programs, the FDIC's ongoing public awareness and education initiatives play an important part in combating predatory practices and complement our supervisory programs. As acknowledged in the Draft Report, the FDIC has long recognized the value of consumer education as an additional tool in combating predatory lending abuses. The FDIC's award-winning *Money Smart* financial education program and the *FDIC Consumer News* play an important role in the FDIC's efforts to provide helpful free information to the public, financial institutions and our examination staff.

The FDIC's financial education program is primarily focused on helping low- and moderate-income adults develop money-management skills. Two versions are available for free–one for classroom use (in English, Spanish, Chinese, Korean, Vietnamese, and Russian), the other for computer-based, self-paced learning (in English and Spanish). Classes are offered through an extensive network of *Money Smart* "partners," including financial institutions, non-profit organizations and government agencies. Since 2001, about 495,000 people have taken *Money Smart* classes and 95,000 new banking relationships have been established.

In addition, FDIC Community Affairs staff have hosted or participated in numerous anti-predatory lending conferences and forums that promote the use of *Money Smart* and other means to prevent predatory lending or correct its effects on low and moderate-income individuals and others.

Conclusion

In summary, predatory lending harms individuals and communities and raises risk management and consumer compliance concerns for financial institutions. Predatory loans can have a negative impact on a bank's Community Reinvestment Act evaluation. The loans may violate fair lending laws and other consumer protection laws, resulting in legal or regulatory action. Questionable loan underwriting and the risk of litigation raise additional safety and soundness concerns. For these reasons, the FDIC maintains a strong supervisory strategy developed over several years to combat predatory lending in the financial system through vigorous safety and soundness and compliance examination and enforcement, industry outreach and adult financial education programs. The development of an articulated overall supervisory approach to predatory lending, based on a review of existing supervisory polices and practices that address predatory lending, as recommended by the OIG Draft Report, will enhance the FDIC's efforts in this area. We will complete this task by year-end.

5

APPENDIX V

OIG Recommendation

"Describe in policy the FDIC's overall supervisory approach to predatory lending."

DSC Response

The FDIC agrees that it will be beneficial to articulate an overall supervisory approach as stated above to address any predatory lending practices that FDIC examiners may find. By year-end, DSC will develop a formal policy statement describing its approach to combating predatory lending.

OIG Recommendation

"Review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address predatory lending."

DSC Response

The Draft Report suggests that we consider the approaches of the other agencies. The supervisory approaches of the OCC and OTS to predatory lending are based, in large part, on their authority under the National Bank Act and Home Owners Loan Act to supervise institutions pursuant to federal law. The FDIC has worked closely with state supervisors to take action to address activities that violate state anti-predatory lending laws. As explained above, the FDIC has also required banks subject to its supervision to correct unfair and deceptive acts or practices under the FTC Act and disengage from unsafe or unsound lending practices.

The Federal Reserve Board, which also works with state authorities, mentions predatory lending as a potential risk to be considered when evaluating reputation risk during examinations. FDIC examiners undertake a similar risk assessment, although the guidance does not use the phrase "predatory lending." Under the FTC Act examination guidance issued in June 2005, FDIC compliance examiners must consider the risks for unfair or deceptive acts or practices when they develop a risk profile for an institution. To assess this risk, examiners evaluate: consumer complaints received by the bank or the FDIC; whether the bank's product lines are high risk; the quality of the bank's compliance management system; and the bank's past performance.

We will carefully review any overall supervisory strategy in use by the other agencies with an eye to enhancing the FDIC's strategy as the OIG suggests. By year-end, DSC will complete the recommended review and determine whether any new or enhanced policy or guidance is necessary in light of the strategy statement developed in response to Recommendation 1.

6

MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Open or Closed[b]
1	DSC will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices.	December 31, 2006	NA	Yes	Open
2	DSC will review existing predatory lending guidance and, if necessary, develop additional guidance to address predatory lending.	December 31, 2006	NA	Yes	Open

[a] Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits, or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Once the OIG determines that the agreed-upon corrective actions have been completed and are effective, the recommendation can be closed.

Case 1:13-cv-01186-LPS Document 27-11 Filed 08/21/14 Page 42 of 42 PageID #: 792

Exhibit I

Comments to the
Federal Deposit Insurance Corporation
and
Office of the Comptroller of the Currency, Treasury

Proposed Guidance on Deposit Advance Products
FDIC: 78 Federal Register 25268 (April 30, 2013)
OCC: 78 Federal Register 25353 (April 30, 2013); Docket ID OCC 2013-0005

by

AARP[1]
Center for Responsible Lending[2]
Consumer Federation of America[3]
Leadership Conference on Civil and Human Rights[4]
NAACP[5]
National Consumer Law Center (on behalf of its low income clients)[6]
National Council of La Raza[7]

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[1] **AARP** is a nonprofit, nonpartisan organization, with a membership of more than 37 million, that helps people turn their goals and dreams into real possibilities, strengthens communities and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.

[2] **The Center for Responsible Lending** (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund. SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded SHFCU to expand Self-Help's mission.

[3] **Consumer Federation of America** is an association of nearly 300 non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, education and advocacy.

[4] **The Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goal of a more open and just society – an America as good as its ideals. The Leadership Conference is a 501(c)(4) organization that engages in legislative advocacy. It was founded in 1950 and has coordinated national lobbying efforts on behalf of every major civil rights law since 1957.

[5] **The NAACP**, founded in 1909, is the nation's oldest and largest civil rights organization. From the ballot box to the classroom, the thousands of dedicated workers, organizers, leaders and members who make up the NAACP continue to fight for social justice for all Americans.

[6] Since 1969, the nonprofit **National Consumer Law Center®** (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

[7] **The National Council of La Raza** (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300

I. Introduction

We write to thank the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) for the proposed guidance addressing bank payday lending,[8] particularly the underwriting requirements and limits on repeat loans. These critical provisions address a central problem with payday lending: lenders' failure to verify the borrower's ability to repay the loan, and meet other expenses, without reborrowing, leading to a destructive cycle of repeat loans that trap borrowers in long-term debt.

This proposed guidance is urgently needed. The great majority of banks do not offer payday loans, but we are aware of at least six that do. Four are supervised by the OCC: Wells Fargo Bank, U.S. Bank, Bank of Oklahoma and its bank affiliates,[9] and Guaranty Bank. Two are supervised by the Federal Reserve Board (FRB): Fifth Third Bank and Regions Bank.

Though the number of banks making payday loans remains small, there are clear signals that bank payday lending will grow rapidly without strong action by all the banking regulators. In mid-2011, Fiserv, Inc., a provider of bank payday software, reported that its "pipeline" was "extremely strong" and that it had "some very nice mid-tier signings."[10] Fiserv was promising that a bank's revenue from the product would be "greater than all ancillary fee revenue combined" within two years.[11]

But recent research has left no doubt that fees generated by bank payday loans are earned through unsafe and unsound banking practices and at great consumer harm to consumers. Bank payday lenders, like other payday lenders, do not assess the borrower's ability to repay the loan, and meet other expenses, without reborrowing, resulting in a cycle of repeat loans: The Consumer Financial Protection Bureau (CFPB)'s analysis of thousands of bank payday loans

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affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families. Founded in 1968, NCLR is a private, nonprofit, nonpartisan, tax-exempt organization headquartered in Washington, DC, serving all Hispanic subgroups in all regions of the country. It has regional offices in Chicago, Los Angeles, New York, Phoenix, and San Antonio and state operations throughout the nation.

[8] Federal Deposit Insurance Corporation, Proposed Guidance on Deposit Advance Products, 78 Fed. Reg. 25268 (April 30, 2013); Department of the Treasury—Office of the Comptroller of the Currency, Proposed Guidance on Deposit Advance Products; Withdrawal of Proposed Guidance on Deposit-Related Consumer Credit Products, 78 Fed. Reg. 25353 (April 30, 2013).

[9] Bank of Albuquerque, Bank of Arizona, Bank of Arkansas, Bank of Kansas City, Bank of Texas, and Colorado State Bank and Trust.

[10] Fiserv Investor conference webcast, October 11, 2011, *available at* http://investors.fiserv.com/events.cfm.

[11] Fiserv, Relationship Advance program description, *retrieved from* http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

found that banks put borrowers into an average of 14 loans annually and keep them indebted for a significant portion of the year.[12] Fourteen percent of borrowers took out an average of 38 loans averaging $200 each in one year, paying from $570 to $760 in interest.[13]

The fundamental structure of payday loans—a very high cost and short loan term with a balloon repayment—coupled with a lack of traditional underwriting makes repeat loans highly likely. Borrowers already struggling with regular expenses or facing an emergency expense with minimal savings are typically unable to repay the entire lump-sum loan and fees and meet ongoing expenses until their next payday. Consequently, the borrower often must take out another loan before the end of the pay period to meet other expenses, becoming trapped in a cycle of repeat loans.

We appreciate the Agencies' explicit recognition of the "shared characteristics" of bank payday lending and traditional payday lending and note that it is appropriate that this proposed guidance is intended to supplement the Agencies' existing guidances addressing payday lending.[14]

Failure to verify the borrower's ability to repay the loan poses clear safety and soundness risk to banks, as supported by a wide range of regulatory precedent. It is inconsistent with fundamental safe and sound lending practices; it exposes banks to legal risk, including, as the Agencies highlight, risk of violating provisions prohibiting unfair, deceptive, and abusive practices and the Equal Credit Opportunity Act; and it poses reputational risk, as evidenced by widespread opposition to bank payday lending.

Bank payday lending poses these risks in part because it causes severe harm to banks' customers. Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.

Senior Americans receiving Social Security benefits make up over a quarter of bank payday borrowers. At a time when older Americans have already experienced severe declines in wealth resulting from the Great Recession, banks take these borrowers' benefits for repayment before they can use those funds for healthcare, prescription medicines, or other critical expenses. The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.

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[12] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 34, April 24, 2013, *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf [hereinafter CFPB Findings].

[13] The CFPB found that for the 14% of borrowers who borrowed over $9,000 in one year, the median number of loans was 38 and the median size was $200. *Id.* at 34. We computed the total interest paid as $570 to $760, assuming a fee range of $7.50 per $100 borrowed to $10 per $100 borrowed based on the fees currently charged by banks making payday loans.

[14] FDIC: 78 Fed. Reg. 25268-70; OCC: 78 Fed. Reg. 25353-54.

Payday lending also has a particularly adverse impact on African Americans and Latinos, as a disproportionate share of payday borrowers come from communities of color, who are already overrepresented among unbanked and underbanked households.

Preventing the cycle of debt and its resulting harms is essential. Thus, we strongly support the Agencies' proposed underwriting and related requirements in combination, including (1) requiring that banks verify the borrower's ability to repay the loan and meet expenses without reborrowing based on an analysis of the customer's inflows and outflows, and (2) limiting the number of bank payday loans banks can extend to each customer.

Other pernicious elements of bank payday lending are its cost and the bank's repaying itself first directly from the borrower's next deposit. Bank payday loans average 225% to 300% annual percentage rate (APR)—extraordinary by any measure. The Agencies' proposal underscores that fees must be based on safe and sound banking principles; clearly, these loans' current fees are not. We urge the Agencies to clarify that safe and sound banking principles require that interest and fees be reasonable and, consistent with the FDIC's affordable small loan guidelines, should not exceed 36% APR, subject to more restrictive state laws. We also urge the Agencies to prohibit banks from requiring that the loans be automatically repaid from incoming deposits as a condition of making a loan, which denies borrowers control of their checking account and discourages sound underwriting.

In the last two years, we are aware of no additional banks entering the high-cost payday lending market. This is thanks in large part to the Agencies' refusal to condone this product: the OCC's not finalizing its 2011 proposed guidance,[15] the OCC's 2012 testimony before the House of Representatives calling payday loans "unsafe and unsound and unfair to consumers" and noting that profitability "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt";[16] and the FDIC's 2012 announcement of its investigation into bank payday lending and longstanding leadership on responsible small dollar lending.[17]

Today, by proposing guidance explicitly requiring verification of ability to repay without reborrowing, the Agencies are bringing much-needed clarity to the marketplace for the banks

[15] The undersigned groups were among those who urged the OCC to withdraw its 2011 proposed guidance (76 Fed. Reg. 33409, June 8, 2011) out of concern that it would have resulted in additional banks beginning to make payday loans. Concurrent with the issuance of the current proposed guidance, the OCC withdrew the previous proposed guidance. 78 Fed. Reg. 25353.

[16] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 1, 5.

[17] Letter from FDIC to Americans for Financial Reform, May 29, 2012, *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Bank-DDA-FDIC-OC12-65R-1.pdf, also noting that the FDIC was "deeply concerned" about payday lending by banks.

they supervise while protecting the safety and soundness of those institutions and the consumers who bank with them.

Recommendations

With respect to the Agencies' proposal, we recommend the following:

- Preserve the proposed underwriting and related requirements *in combination*, including:
    - requiring that banks determine the borrower's ability to repay the loan without reborrowing, based on an analysis of the customer's inflows and outflows; and
    - limiting the number of bank payday loans.
- Clarify that safe and sound banking principles require that interest and fees be reasonable; consistent with the FDIC's affordable small loan guidelines, cost should equate to no more than 36 percent in annualized interest rate terms, subject to more restrictive state laws.
- Advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.
- Conduct prompt and vigilant examination of banks' compliance with the guidance and take swift enforcement action to address any noncompliance.
- Work with the CFPB to encourage improvements to existing consumer regulations, including the annual percentage rate (APR) disclosure under the Truth in Lending Act (TILA) and protections against mandatory automatic repayment under the Electronic Fund Transfer Act (EFTA).

II. Ability to repay is a fundamental principle of sound lending that payday lenders, including banks making payday loans, are violating.

A. Payday loans are made without regard to the borrower's ability to repay the loan, leading to a cycle of debt.

Payday loans are made without regard to the borrower's ability to repay the loan.[18] The lender instead relies on its ability to seize the borrower's incoming direct deposit, which serves as

[18] As the Agencies note, the decision to make a bank payday loan is "based solely on the amount and frequency of their deposits," standing "in contrast to banks' traditional underwriting standards . . . which typically include an analysis of the borrower's finances." FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354. The CFPB also recently recognized that payday loans involve "very limited underwriting." CFPB Findings at 6.

collateral.[19] It would be inaccurate to conclude that lenders do assess ability to repay because they typically have the ability to collect the loan proceeds from the borrower's direct deposit. As discussed below, regulatory precedent makes clear that lending with regard to ability to repay means determining the borrower can repay the loan *from sources other than the collateral*; in the payday loan context, that means that the borrower can *both* repay the loan *and* meet other obligations *without reborrowing*. Thus, repeat loans are evidence of disregard for ability to repay.

1. Repeat loans are evidence of disregard for ability to repay.

The Agencies note that "[d]eposit advance loans that have been accessed repeatedly or for extended periods of time are evidence of 'churning' and inadequate underwriting."[20] The CFPB's recent analysis notes that "a pattern of sustained use may indicate that a borrower is using payday loans to deal with expenses that regularly outstrip their income."[21]

The banking regulators have long recognized that serial refinancings are an indication that lenders are not assessing a borrower's ability to repay the loan, both in the context of payday lending specifically and more broadly. The FDIC's existing payday loan guidelines, which this proposed guidance supplements, describe concerns with "payday loans to individuals who do not have the ability to repay, or that may result in repeated renewals or extensions and fee payments over a relatively short span of weeks." The FRB's 2009 rules under the Home Ownership and Equity Protection Act (HOEPA) note that "[l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings."[22]

The banking regulators have also long recognized that a payday loan taken out within a short time of repaying another one is the economic equivalent of a refinancing (where the borrower uses the proceeds from a new loan to pay off an existing loan) or a rollover (where the borrower pays the finance charge essentially to extend the loan term).

The FDIC's 2005 payday loan guidelines note that "[w]here the economic substance of consecutive advances is substantially similar to 'rollovers' - without appropriate intervening 'cooling off' or waiting periods - examiners should treat these loans as continuous advances . . . ."[23] The OCC's 2000 payday loan guidelines note that payday loans are repaid when the

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[19] FDIC: 78 Fed. Reg. 25272, n.22; OCC: 78 Fed. Reg. 25356, n.22 (citing 2001 Interagency Subprime Guidance noting that lenders should determine ability to repay from sources other than the collateral pledged, "in this case the borrower's direct deposit").

[20] FDIC: 78 Fed. Reg. 25272; OCC: 78 Fed. Reg. 25356.

[21] CFPB Findings at 24.

[22] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44542 (July 30, 2008).

[23] FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

borrower "'roll[s] over' the loan by renewing the old loan (or taking out another loan)," essentially equating the two.[24] The CFPB's supervision manual for small dollar, short-term loans explains that back-to-back transactions may occur where a borrower is asked to repay one loan before opening a new loan, while noting that a pattern of these, like rollovers and refinancings, "may constitute sustained use."[25] And the CFPB's white paper defines "sustained use" in terms of loans that occur the same day a previous loan was closed "*or soon after.*"[26]

The regulators have also typically contrasted loans made based on the value of the underlying collateral (and that are thus frequently refinanced) with loans made with regard to a borrower's ability to repay the loan, indicating that these practices are mutually exclusive. The 2001 Interagency Expanded Guidance on Subprime Lending Programs (2001 Interagency Subprime Guidance), which the current proposal supplements, describes that abusive lending practices occur when "the lender structures a loan to a borrower who has little or no ability to repay the loan from sources other than the collateral pledged."[27] As the Agencies note in the current proposal, in the case of bank payday lending, the collateral is the customer's incoming deposit.[28] The OCC's 2000 letter on abusive lending practices, which is applicable to payday loans,[29] discusses collateral or equity stripping as "reliance on . . . collateral, *rather than* the borrower's independent ability to repay. . . ."[30] The OCC's 2003 letter on abusive and predatory lending does the same.[31]

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[24] OCC Advisory Letter, Payday Lending, AL 2000-10 (Nov. 27, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf [hereinafter OCC 2000 Advisory Letter on Payday Lending].

[25] CFPB Supervision and Examination Manual, Small-Dollar, Short-Term Lending, Version 2 (October 2012), , at 12.

[26] CFPB Findings at 24.

[27] Interagency Expanded Guidance or Subprime Lending Programs, FIL 9-2001, January 31, 2001. The FDIC's 2005 payday loan guidelines also notes that it clarifies previously issued guidance, including the 2001 Expanded Subprime Guidance; the 2001 Expanded Subprime Guidance also contemplates equity stripping outside the context of mortgage lending, noting that lenders may make a loan to a borrower who has little or no ability to repay other than from the collateral pledged, then take possession of the borrower's home or automobile upon default.

[28] FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[29] The OCC's 2000 Advisory Letter on Payday Lending states that the OCC's 2000 Advisory Letter on Abusive Lending Practices is applicable to payday lending.

[30] OCC Advisory Letter on Abusive Lending Practices, AL 2000-7 (June 25, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf (emphasis added).

[31] OCC Advisory Letter, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, AL 2003-2 (Feb. 21, 2003), *available at* http://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-8-advisory-ltr-2003-2.pdf [hereinafter OCC 2003 Letter on Predatory and Abusive Lending Practices]: "When a loan has been made based on the foreclosure value of the collateral, rather than on a determination that the borrower has the capacity to make the scheduled payments under the terms of the loan, based on the borrower's current and expected income, current

Thus, there is ample precedent for concluding that reliance on collateral, and the repeat loans such reliance generates, is a clear evidence of inability to repay.

2. The data on bank payday lending make clear repeat loans are typical.

The data on bank payday loans make clear that repeat loans, or "churning," are typical, confirming that lenders are not verifying borrowers' ability to repay. The CFPB's recent analysis of thousands of bank payday loans found a median number of advances per borrower of 14, with extremely high numbers of advances for many borrowers.[32] Fourteen percent of borrowers who took out more than $9,000 in loans over 12 months took out a median of 38 advances.[33]

The CFPB further found that borrowers were indebted an average of 112 days during the year, with borrowers with $9,000 or more in loans spending an average of 254 days in debt.[34] And it found an average of only 13 days between "advance balance episodes,"[35] indicating that bank payday loans do not typically sustain borrowers through even a single pay cycle. For those with more than $9,000 in loans, the average number of days between episodes was six.[36]

These findings are consistent with CRL's recent analysis of bank payday loans, which found that the median bank payday borrower took out 13.5 loans in 2011 and was in bank payday loan debt at least part of six months during the year—that is, a typical borrower had one or more bank payday loans outstanding at some point during six discrete calendar months during the year.[37] The mean number of loans was 19, far higher than the median, because over a third of borrowers had more than 20 loans.[38]

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obligations, employment status, and other relevant financial resources, the lender is effectively counting on its ability to seize the borrower's equity in the collateral to satisfy the obligation and to recover the typically high fees associated with such credit."

[32] CFPB Findings at 34.

[33] *Id.* at 33-34.

[34] *Id.* at 37.

[35] *Id.* at 40. The CFPB defines "advance balance episode" as the consecutive days during which a consumer has an outstanding deposit advance balance. *Id.* at 27.

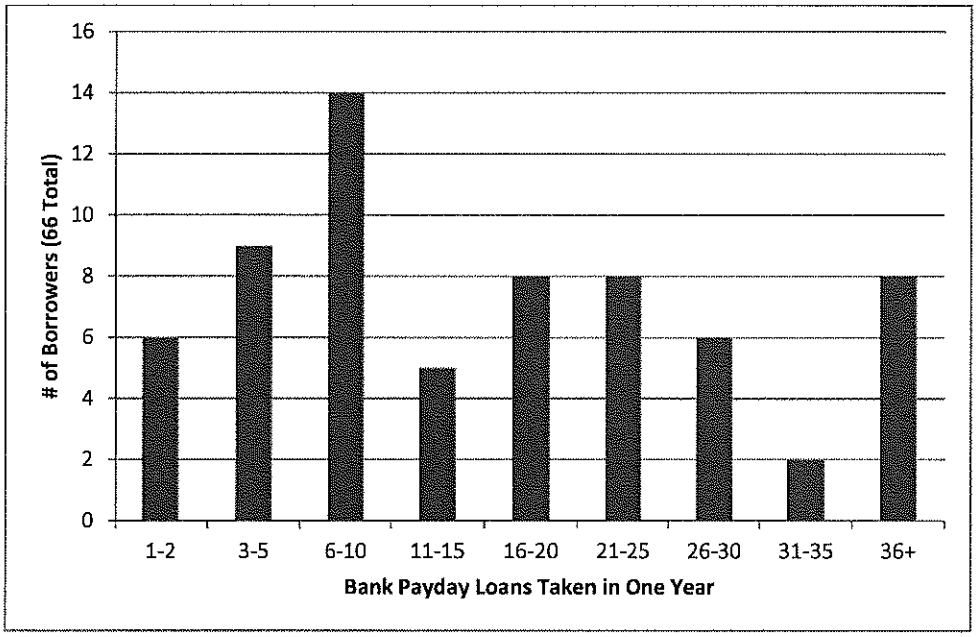
[36] *Id.* at 40.

[37] Rebecca Borné and Peter Smith, *Triple Digit Danger: Bank Payday Lending Persists* (March 21, 2013), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/Triple-Digit-Bank-Payday-Loans.pdf [hereinafter CRL, *Triple Digit Danger*].

[38] *Id.*

As Figure 1 illustrates, CRL found that many borrowers take out twenty, thirty, or more loans annually:[39]

Figure 1: Bank Payday Loans Taken in One Year



Source: CRL report, *Triple Digit Danger* (March 2012) (based on analysis of Lightspeed checking account data)

These data clearly refute banks' claims that these products are meant for occasional use to manage a short-term cash shortfall and not as long-term credit.[40] We are aware of no data on bank payday lending inconsistent with the data above.

3. Ineffective safeguards do not prevent the cycle of debt.

Banks often point to "safeguards" they have in place to ensure that borrowers do not become trapped in long-term debt, including installment plans and ineffective cooling-off periods.[41] The data discussed above clearly demonstrate that these "safeguards" are not effective. As the Agencies note, banks that offer installment plans impose obstacles to qualifying for them.[42] For

[39] *Id.*

[40] Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use. For an example from each of these banks, *see* Appendix.

[41] In the payday lending context, a "cooling-off" period is a period following repayment of one payday loan during which the lender will not extend the consumer another payday loan.

[42] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

example, Wells Fargo Bank's "payment plan" (which allows payments in $100 increments rather than balloon repayments) is available only to customers who have already been in balloon payment loans in three consecutive months and have at least $300 in bank payday debt outstanding.[43]

Banks' cooling-off periods allow borrowers to become mired in a cycle of debt before the cooling-off period is triggered. Wells Fargo Bank's cooling-off policy, for example, allows six consecutive months of loans until a one-month cooling-off period.[44] After six consecutive months with loans, a borrower will typically have paid hundreds of dollars in fees and still owe the original principal on the loan. By contrast, if provided an affordable loan at the outset, after six months the borrower would have been finished, or be well on the way toward, paying off the loan. Thus, a cooling-off period is not a substitute for a meaningful determination of the borrower's ability-to-repay at the outset.

These bank "safeguards" are the same ones that non-bank payday lenders have long touted but that have proven ineffective in that context as well.[45]

B. Lending without regard to ability to repay is a safety and soundness issue.

Regulatory precedent has long clearly established that lending without regard to ability to repay is a safety and soundness issue. Other troubling characteristics of consumer lending practices have also been addressed on safety and soundness grounds. This has been true even when a product has proven profitable to banks in the short-term.

1. Banking regulators have long cautioned that collateral-based lending—that is, lending without regard for ability to repay—is a safety and soundness issue.

The OCC, FDIC, and FRB have consistently addressed collateral-based lending—that is, lending without regard for ability to repay—on safety and soundness grounds.[46] As the Agencies'

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[43] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[44] *Id.*

[45] CRL examined millions of loans across several states that adopted similar "best practices" to ostensibly reform payday loans. Nevertheless, there was no measureable reduction in repeat borrowing. For example, over 60 percent of all loans from these states go to borrowers with 12 or more transactions in a year. *See generally*, Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are the only proven reform*, December 13, 2007, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf [hereinafter CRL, *Springing the Debt Trap*].

[46] For CRL's issue brief discussing how bank payday lending poses safety and soundness risk and relevant regulatory precedent, *see* Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products*, January 24, 2013, *available at* http://rspnsb.li/Yqd0uH.

current proposal notes, the 2001 Interagency Subprime Guidance cautioned that "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."[47]

The OCC's 2000 payday loan guidelines, which explicitly applies to both payday lending done directly by banks and programs operated by third parties,[48] cautioned: "[M]ultiple renewals without principal reduction . . . are not consistent with safe and sound banking principles."[49]

In 2007, the agencies issued a statement on subprime mortgage lending, again emphasizing, as a risk management practice, the need to assess the borrower's ability to repay the loan rather than relying predominantly on collateral: "[I]nstitutions should ensure they do not engage in . . . [m]aking loans based predominantly on the foreclosure or liquidation value of a borrower's collateral rather than on a borrower's ability to repay the mortgage according to its terms."[50]

2. Banking regulators have long addressed concerns with consumer lending products on safety and soundness grounds.

The regulators have addressed troubling characteristics of a range of consumer lending products on safety and soundness grounds, even when those practices were generating significant profits for the bank.

In the early 2000s, both the OCC[51] and the FRB[52] took enforcement actions against subprime credit card companies citing safety and soundness concerns, even as the companies were

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[47] 2001 Interagency Subprime Guidance, cited in the current proposals at FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[48] *Id.* at 5 ("The OCC will closely review any payday lending activities conducted directly by national banks, as well as any payday lending or financing activities conducted through arrangements with third parties.").

[49] OCC's 2000 Advisory Letter on Payday Lending, at 3.

[50] Department of the Treasury-Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Interagency Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569, 37573 (July 10, 2007).

[51] In 2000, the OCC took enforcement action against Providian, requiring that it pay customers at least $300 million in the agency's largest ever enforcement action at the time. Comptroller John Hawke stated: "'When a bank engages in unfair or deceptive marketing practices, it damages its most precious asset -- the trust and confidence of its customers . . . . That relationship of trust and confidence is central to the bank's safe and sound operation. We will not tolerate abuses that breach that trust through unfair and deceptive practices . . . . This settlement . . . ensures that, going forward, Providian will conduct its business in a way that both respects the interests of its customers and protects the safety and soundness of the bank.'" OCC News Release 2000-49, *Providian to Cease Unfair Practices, Pay Consumers Minimum of $300 Million Under Settlement with OCC and San Francisco District Attorney* (June 28, 2000), *available at* http://www.occ.gov/static/news-issuances/news-releases/2000/nr-occ-2000-49.pdf.

[52] In 2003, the FRB took enforcement action against First Premier on safety and soundness grounds, while noting that the bank must comply with the Board's applicable guidance related to subprime lending. *Written Agreement by and among United National Corporation, Sioux Falls, South Dakota; First PREMIER Bank, Sioux Falls, South*

recording record profits generated by these products.[53] The high fee-generating practices like those the regulators addressed at these credit card companies share stark similarities with bank payday loans—they are profitable to the bank, but largely because they trap borrowers in debt.[54]

3. Disregarding ability to repay, and the churning it results in, also poses safety and soundness risk through reputational risk and legal risk.

a. Reputational risk

The OCC's supervision manual describes reputation risk as "the risk arising from negative public opinion," which affects the bank's relationships and "may expose the institution to litigation, financial loss, or a decline in its customer base." It "includes the responsibility to exercise an abundance of caution in dealing with customers and the community."[55]

The FRB's supervision manual defines reputational risk similarly, as "the potential that negative publicity . . . will cause a decline in the customer base, costly litigation, or revenue reductions."[56]

Bank payday lending poses severe reputational risk to the few banks engaging in it.[57] Payday loans generally are unpopular and, increasingly, illegal. They are prohibited or significantly

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Dakota; PREMIER Bankcard, Inc., Sioux Falls, South Dakota; and the Federal Reserve Bank of Minneapolis, Federal Reserve Board (Sept. 25, 2003), at 3, *available at* http://www.federalreserve.gov/Boarddocs/Press/enforcement/2003/20030925/attachment.pdf.

[53] *See, e.g.*, PR Newswire, *Providian Financial Corporation Announces Record Earnings in the Second Quarter Fueled by 50% Growth in Revenues and Customers*, July 22, 1998 (noting record earnings and projected increases going forward).

[54] The founder of Providian, for example, said in 2004: "It didn't require a lot of investigation to see that the people who paid in full every month were not profitable"; the most lucrative customers were the "revolvers," who routinely carried high balances, but were unlikely to default. Robin Stein, *The Ascendancy of the Credit Card Industry*, PBS Frontline, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html (quoting Andrew Kahr, founder of Providian). The CFPB recently noted that credit losses for bank payday loans appear lower than for storefront payday loans, the latter averaging 5 percent according to industry data. CFPB Findings at 7.

[55] OCC, Bank Supervision Process, Comptroller's Handbook, at 121 (September 2007), *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

[56] Federal Reserve System's Commercial Bank Examination Manual, Examination Strategy and Risk-Focused Examinations, at 4.5 (April 2011), *available at* http://www.federalreserve.gov/boarddocs/supmanual/cbem/cbem.pdf. The OCC's supervision manual's definition is similar: "Reputation risk is the risk arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with customers and the community." OCC, Bank Supervision Process, Comptroller's Handbook (September 2007) at 121, *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

restricted in 18 states and the District of Columbia, and the numbers have been growing. Some states have never allowed these loans to be part of their small loan marketplace, while several have prohibited or significantly restricted them in recent years.[58] Since 2007, seven states and the District of Columbia have enacted or enforced meaningful reform to address payday lending[59]—while no state without payday lending has authorized it since 2005. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected payday lending, despite payday industry campaigns costing tens of millions of dollars.[60] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for laws that do not allow high-cost payday lending.[61]

It is not surprising, then, that payday lending by banks has been met with opposition from virtually every sphere— the military community,[62] community organizations,[63] civil rights

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[57] A 2007 article on reputational risk by a FRB staff provided only a few examples of practices posing reputational risk; payday lending was one of them: "There is also a stigma attached to institutions involved with payday lending." William J. Brown, Federal Reserve Board Enforcement Specialist, *Understanding Reputational Risk: Identify, Measure, and Mitigate the Risk*, 4th Quarter 2007, *available at* http://www.phil.frb.org/bank-resources/publications/src-insights/2007/fourth-quarter/q4si1_07.cfm.

[58] High-cost single-payment payday loans are not authorized by law in the following states/jurisdictions: Arkansas, Arizona, Colorado, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. Although interest rate caps vary by state, most are about 36 percent APR. In a few instances, payday lenders attempt to circumvent state protections by structuring their loans to operate under other loan laws not intended for very short-term, single payment loans.

[59] The seven states are Arkansas, Arizona, Colorado, New Hampshire, Ohio, Oregon, and Montana.

[60] In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

[61] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for a 36 percent annual rate limit on payday loans. Recently in Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. *See* Jason Hancock, *Coalition to rally for payday lending reform,* Iowa Independent (Jan. 26, 2011), *available at* http://iowaindependent.com/51369/coalition-to-rally-for-payday-lending-reform; Ronnie Ellis, *Payday Lenders Targeted for Interest Rates*, The Richmond Register (Feb. 8, 2011), *available at* http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates; Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House*, WHSV.com (Jan.18, 2011), *available at* http://www.whsv.com/home/headlines/Virginia_Payday_Lending_Bill_Dies_in_Senate_Survives_in_House_114169549.html.

A 2009 national survey found that three out of four Americans who expressed an opinion thought Congress should cap interest rates; 72 percent thought the cap should be no higher than 36 percent annually. Center for Responsible Lending, *Congress should cap interest rates: Survey confirms public support for cracking down on high-cost lending* (March 2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf.

[62] *See, e.g.*, Testimony of Steve Abbot, former President of the Navy-Marine Corps Relief Society, Before the U.S. Committee on Banking, Housing and Urban Affairs (Nov. 3, 2011) (noting bank payday loans among the "most

leaders,[64] socially responsible investors,[65] state legislators,[66] and members of Congress[67]—which has resulted in widespread negative publicity.[68]

In North Carolina, a state that does not permit payday lending, public outcry and state attorney general opposition led Regions Bank to stop making its payday loans there in January.[69] North

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egregious trends"), http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=ca463f82-0902-4a6d-9a08-d8b7e6860fe0; Comments of Michael Archer, Director of Military Legal Assistance, Marine Corps Installations East, to CFPB (April 4, 2012): "Most ominously, a few large banks have gotten into the business of payday loans through the artifice of calling the loans open ended credit" http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0056.

[63] Hundreds of groups have urged the prudential regulators to stop banks from trapping borrowers in payday loans. Letters from approximately 250 groups to FDIC, OCC, FRB and CFPB, March 13, 2013 (http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2013/03/Bank-Payday-Sign-On-Letter-3-13-13-Final.pdf) and February 22, 2012 (http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Dear-Regulators.pdf). Thousands of individuals and many community groups filed comments with the OCC urging that Wells Fargo's Community Reinvestment Act rating be negatively impacted because it makes payday loans. The comment filed by CRL and NCLC is available here: http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment_wells-nov-29-2012_final.pdf.

[64] *E.g.*, Letter from Benjamin Todd Jealous, President and Chief Executive Officer, NAACP, to FDIC, OCC, FRB, and CFPB opposing bank payday lending (Feb. 21, 2013).

[65] For proxy year 2013, investors filed shareholder resolutions with the four largest banks making payday loans expressing concern about the product and requesting data, which none of the banks agreed to provide. Wells Fargo (http://www.onlineethicalinvestor.org/eidb/wc.dll?eidbproc~reso~10525); Fifth Third Bank (http://www.trilliuminvest.com/resolutions/payday-lending-fifth-third-bancorp-2013/); Regions Bank and U.S. Bank (http://www.calvert.com/sri-resolutions.html).

[66] *E.g.*, "Legislative Black Caucus slams Regions Bank over payday-style loans," Raleigh News and Observer "Under the Dome," Oct. 11, 2012, *available at* http://projects.newsobserver.com/under_the_dome/legislative_black_caucus_slams_regions_bank_over_paydaystyle_loans#storylink=cpy#storylink=cpy (quoting letter from N.C. Senator Floyd McKissick, Jr., chairman of the N.C. Legislative Black Caucus, to Regions Bank, which stated: "We are deeply concerned about recent reports of Regions Bank offering its 'Ready Advance' payday loans in North Carolina . . . . High-cost, short-term balloon loans like these sharply increase the financial distress of families under economic strain"); Letter from Arizona Democratic Caucus to the prudential banking regulators, February 2012 (noting that Arizona "has spent countless state resources to study and understand the effects of [payday lending], and ultimately outlaw payday lending entirely" and calling on federal regulators to "take immediate action so that meaningful reforms taking place in Arizona and throughout the country in the name of consumer protection will not be undermined.").

[67] In January 2013, several Senators wrote the FRB, OCC, and FDIC urging action to address bank payday lending (http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-regulators-to-act-to-stop-abusive-bank-payday-lending). In April 2013, House members did the same (http://democrats.oversight.house.gov/images/stories/Bank%20payday_Letter%20to%20Prudential%20Regulators.pdf).

[68] For documentation of recent opposition to bank payday lending by community leaders and state and local officials, *see* Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns*, CRL Issue Brief, March 7, 2013, *available at* http://rspnsb.li/10wra0y.

Carolina Attorney General Roy Cooper said the following when discussing Regions Bank's product: "Payday loans are like a consumer needing a life preserver being thrown an anvil."[70]

Bank payday lending has motivated "move-your-money" campaigns.[71] It has led groups managing programs aiming to bring people into the banking mainstream to establish policy that excludes banks that make high-cost payday loans from the program.[72] Multiple lawsuits involving bank payday loans have been filed.[73] And in light of growing regulatory scrutiny of bank payday lending, and payday lending generally, there is clear risk that regulatory action against the product, on a safety-and-soundness or a consumer protection basis, will cause banks to lose substantial revenue associated with it. Indeed, the CFPB recently noted that it "expects" to use its authorities to provide protections against harm caused by sustained use of payday loans, whether offered by non-bank payday lenders or by banks.[74]

b. Legal risk

The Agencies discuss a variety of legal risks payday lending poses in their proposal. We underscore here the risks of violating (1) federal and state provisions prohibiting unfair and deceptive acts or practices and (2) the Equal Credit Opportunity Act (ECOA). Unfair and deceptive acts or practices typically stem from causing consumer harm which, as we discuss in Part III below, bank payday lending clearly causes. ECOA prohibits creditors from discriminating on the basis of, among other characteristics, race, color, or age.[75] Discrimination

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[69] D. Ranii, *Regions Bank stops offering controversial loans in N.C.,* Raleigh News and Observer (Jan. 17, 2013), *available at* http://www.newsobserver.com/2013/01/17/2614414/regions-bank-stops-offering-controversial.html#storylink=cpy.

[70] D. Ranii, *Regions Bank assailed for payday-style loan*, Raleigh News and Observer (Sept. 18, 2012, *available at* http://www.newsobserver.com/2012/09/18/2352194/regions-bank-assailed-for-payday.html.

[71] *See, e.g.*, Green America's "Break up with your mega bank" campaign focused on bank payday lending: http://breakupwithyourmegabank.org/. In addition, a 2012 North Carolina poll found that 93 percent of respondents were less likely to use a bank that makes payday loans that violate North Carolina law. North Carolina Justice Center, *Regions Bank Halts Illegal Payday Lending in North Carolina* (Jan. 16, 2013), *available at* http://www.ncjustice.org/?q=consumer-and-housing/media-release-regions-bank-halts-illegal-payday-lending-north-carolina (citing Public Policy Polling poll conducted on behalf of CRL, Sept. 2012).

[72] In 2012, "Bank On" Savannah (Ga.) adopted as policy that participating banks may not make deposit advance products in excess of 36% APR. Agreement on file with CRL. Relatedly, Cities for Financial Empowerment, the organization that supports cities in implementing "Bank On" programs to bring people into the banking mainstream, has written to the prudential regulators expressing serious concerns about bank deposit advance programs (http://cfefund.org/sites/default/files/Deferred%20Deposit%20Advances.pdf).

[73] Three class action lawsuits have been filed against Fifth Third Bank within the last year: *Klopfenstein v. Fifth Third Bank*, S.D. Ohio (Aug. 3, 2012); *Laskaris v. Fifth Third Bank*, S.D.Ca. (Feb. 12, 2013); *Jesse McQuillen v. Fifth Third Bank*, W.D. Ky. (May 7, 2013).

[74] CFPB Findings at 44.

[75] 15 U.S.C. 1591 *et seq.*

can be proven through overt evidence of discrimination, evidence of disparate treatment, or evidence of disparate impact.[76] Given the impact payday lending has on communities of color and older Americans discussed in Part III.E below, banks making payday loans are at significant risk of being found in violation of this law.

As collection and analysis of bank payday loan data continues to become more robust, the likelihood that violations of the law will be identified and acted upon only increase.

III. The cycle of debt, and resulting extraordinarily high accumulated fees, causes severe consumer harm, contributing to safety and soundness risk.

Bank payday lending poses the safety and soundness risk discussed above in part because it causes severe harm to banks' customers. Research on the payday lending industry demonstrates that the cycle of debt—which the data increasingly show is typical, including for bank payday loans—causes severe harm. Payday lenders themselves, including banks making payday loans, have long acknowledged that repeat loans are harmful. Further, regulatory precedent has long provided that repeat payday loans cause harm, that loan churning generally causes harm, and that other analogous practices cause harm. Certain subsets of the population are particularly at risk to the harms caused by bank payday lending: older Americans, communities of color, and military servicemembers.

A. Research makes clear that repeat payday loans cause severe harm.

There is a growing body of evidence that the cycle of debt resulting from making payday loans without regard to the borrower's ability to repay causes severe harm—that is, it leaves borrowers worse off than if they had never taken out a payday loan in the first place.

Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.[77]

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[76] Interagency Task Force on Fair Lending, Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266 (Apr. 15, 1994), *available at* www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf (noting that the courts have recognized those three methods of proving lending discrimination under the ECOA). Regulation B under ECOA also recognizes that the legislative history of ECOA indicates Congress intended an "effects test" concept. 12 C.F.R. § 1002.6. The CFPB recently reaffirmed the disparate impact test and confirmed it would be applying it in its supervisory examinations. CFPB Bulletin 2012-04 (Fair Lending) (April 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

[77] *See* the following studies for discussions of these negative consequences of payday lending: Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), *available at* www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; Sumit Agarwal, Paige Skiba, and Jeremy Tobacman. *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), *available at* http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf; Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873; Brian T.

This is unsurprising in light of the financial strain the cycle of debt has been shown to have on borrowers over time. CRL research published in 2011, which tracked borrowers over a two-year period, found that the typical non-bank payday borrower take out loans for more and more over time as they are driven deeper into debt and that nearly half of borrowers (44 percent)—after years of cyclic debt—ultimately default.[78] Previous CRL research has found that the typical borrower will pay back $793 in principal, fees, and interest for the original $325 borrowed.[79]

Other studies support CRL's findings. For example, in his book on the history of the payday lending industry, Professor Robert Mayer finds that one in four payday borrowers ultimately default, concluding that these borrowers "flounder and drown, but in most cases not before they have generated more in fee income than must be written off in principal."[80]

Another study of a large Texas-based payday lender found a 54 percent default rate for payday borrowers who took out loans on a bi-weekly basis; the study concluded that by the time the borrower defaults, he or she will have serviced that payday loan five or six times and have paid over 90 percent of the amount of the principal in fees and interest alone.[81]

A real-life case study from our database of bank payday borrowers provides an example of the harm caused to one borrower over the course of a six-month period:

Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, University of Chicago Business School (November 15, 2007), *available at* http://insight.kellogg.northwestern.edu/index.php/Kellogg/article/the_real_costs_of_credit_access; and Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans" (April 1, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

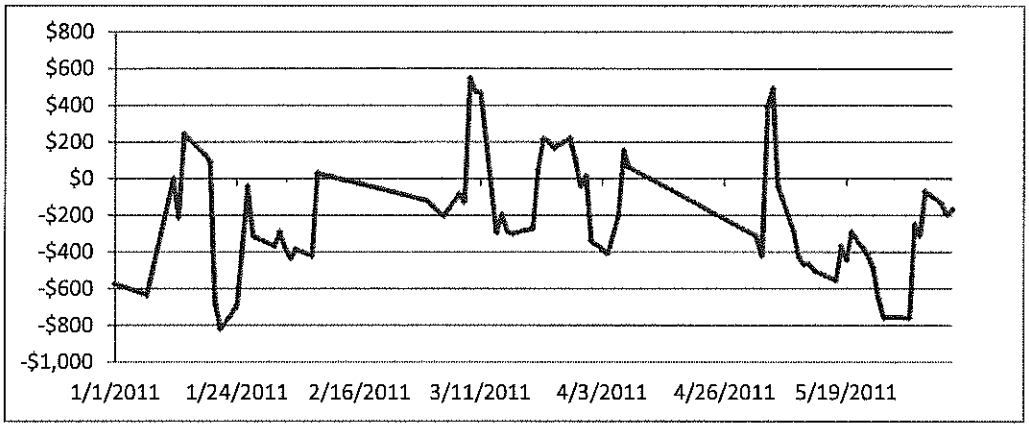
[78] CRL's analysis of Oklahoma payday lending data showed that payday borrowers were loaned greater amounts over time (i.e., an initial loan of $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half of borrowers (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf [hereinafter CRL, *Payday Loans, Inc.*]. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

[79] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year* at 6, Center for Responsible Lending (Nov. 30, 2006), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf.

[80] Robert Mayer, *Quick Cash: The Story of the Loan Shark* at 152-53, Northern Illinois University Press (2010).

[81] Paige Marta Skiba and Jeremy Tobacman, *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default*, Vanderbilt University Law School and University of Pennsylvania (Aug. 21, 2008), *available at* http://www.law.vanderbilt.edu/faculty/faculty-personalsites/paige-skiba/publication/download.aspx?id=1636.

Figure 2: Melinda's Checking Account Balance – January to June 2011



Melinda is a 33-year-old residing in Texas. During the five-and-half-months during which she provided her account information to Lightspeed, Melinda had 19 bank payday loans, typically grouped into clusters of 2-3 loans extended over the course of a few days each month. The median loan size was only $100, yet Melinda paid $233.50 in fees. She also incurred 21 overdraft fees during this period. At the end of the period, her account remained in the red.

B. Payday lenders themselves have long acknowledged that repeat payday loans cause harm.

Payday lenders themselves have long acknowledged that long-term use of what is intended to be a short-term product is harmful. Every bank of which we are aware making payday loans cautions that these loans are not intended for repeat or long-term use.[82] And the Community Financial Services Association of America (CFSA), the payday industry's trade group, stated 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."[83]

Yet even as they purport to discourage long-term use, payday lending industry representatives have often acknowledged that repeat borrowing not only occurs but is encouraged.[84] Payday

[82] *See* Appendix.

[83] *Your Guide to Responsible Payday Advances,* Community Financial Services Association of America, *viewed at* www.cfsa.net/downloands/Your_Guide_to__Responsible_Use _of_Payday_Advances_English.pdf (viewed on 3/31/11).

[84] Several examples are cited in CRL, *Springing the Debt Trap*, at 11-12, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf: "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); "We saw most of our customers every month—a majority came in every month" (Rebecca Flippo, former payday lending store manager, Henrico County, VA); "This industry could not survive if the goal was for the customer to be 'one and done.' Their survival is based on the

lenders also frequently offer the borrower's first loan for free or at a discount, further exposing that repeat loans are expected.[85]

C. Research demonstrates that bank payday borrowers are more likely to incur overdraft fees.

Banks have pitched their payday loans as a way for customers to avoid overdrafts and associated overdraft fees.[86] The Agencies note, however, that weak underwriting associated with bank payday lending increases the risks that the borrower's account will become overdrawn and overdraft fees will be incurred.[87] Indeed, the CFPB's analysis found that 65 percent of bank payday borrowers incurred overdraft fees, which was more than three-and-a-half times the portion of customers eligible for a bank payday loan who did not take one out.[88]

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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).

Wells Fargo has also on occasion acknowledged that "[m]any [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken." Wells Fargo insider quoted in David Lazarus, *120% rate for Wells' Advances*, San Francisco Chronicle, Oct. 6, 2004.

Payday industry researchers and analysts have noted the same: "The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers" (Michael Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly*, Vol. 17, No. 1 (February 2003); "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" (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).

[85] 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. CRL, *Payday Loans, Inc.* at 12. Offering a free first loan gives demonstrates industry's confidence that borrowers will need to return often for new loans once the payday lending cycle begins, making up for an initial "discount" many times over.

[86] CFPB Findings at 40; Burbach, K., Hargarten, J., Heskett, C., & Schmickle, S., *Big Banks' quick-cash deals: Another form of predatory lending?* MinnPost (Feb. 4, 2013); Wells Fargo Bank's comment to CFPB (Apr. 23, 2012) (noting: "[The deposit advance loan] allows a customer to quickly move money into their checking account when needed to help cover an unexpected expense or bill . . . . they can avoid higher cost overdraft fees . . . ."); Wells Fargo Bank's 2012 product agreement (providing a chart comparing borrowing $300 for 30 days as costing $22.50 with the deposit advance (payday loan) product versus $70 with overdraft (assuming two overdraft items at $35 each) and also stating: "If you find yourself in a situation where the funds in your . . . checking account may be insufficient to cover checks or other items that will post to your deposit account, you may choose to advance from [the direct deposit advance] service to avoid the overdraft . . . . The Direct Deposit Advance service is an expensive form of credit, and while the advance fee may be lower than an overdraft or insufficient funds fee, you may want to consider speaking with a banker regarding overdraft protection options that may be available to you.").

[87] FDIC: 78 Fed. Reg. 25270; OCC: 78 Fed. Reg. 25355.

[88] CFPB Findings at 41. CRL's previous research had found similar results—that nearly two-thirds of bank payday borrowers also incurred overdraft fees, and these borrowers were two times more likely to incur overdraft fees than bank customers as a whole. CRL, *Triple Digit Danger*.

The CFPB further found that a quarter of the bank payday borrowers most heavily steeped in the cycle of debt incurred an average of 18 or more overdraft or non-sufficient funds fees during the 12-month period.[89]

These findings are consistent with what consultants selling bank payday loan software have promised banks: that payday lending will result in little-to-no "overdraft revenue cannibalization."[90] The findings also confirm prior research finding that non-bank payday loans often exacerbate overdraft fees, leading to checking account closures.[91]

D. Federal regulators have long cautioned that repeat payday loans, lending without regard to ability to repay more generally, and high fees due within a short period, cause consumer injury.

Regulators have long cautioned that long-term use of payday loans causes injury. The FDIC's 2007 affordable small loan guidelines caution that "the inability to repay these short-term, high-cost credit products often leads to costly renewals and *exacerbates a customer's difficulties in meeting cash flow needs.*"[92] In its warning to national banks considering partnering with payday lenders, the OCC stated that repeatedly renewing a payday loan either through extending a loan directly or through a series of back-to-back transactions was an exceedingly expensive and unsuitable way to borrow over the long term.[93] The National Credit Union Administration (NCUA) has also concluded that extensive use of payday loans is harmful.[94]

The CFPB has also recently discussed the harm that debt traps cause, noting that they "can turn short-term credit into long-term debt that deepens people's problems and leaves them worse off. . . . For a certain subset of borrowers, the fees will pile up and people will ultimately end up worse off than before taking the first loan."[95]

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[89] CFPB Findings at 42.

[90] Fiserv, Relationship Advance program description, retrieved from http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

[91] Center for Responsible Lending, *Payday Loans Put Families in the Red* (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

[92] FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 (June 19, 2007), *available at* http://www.fdic.gov/news/news/financial/2007/fil07050a.html [hereinafter FDIC Affordable Small Loan Guidelines].

[93] OCC Advisory Letter on Payday Lending.

[94] National Credit Union Administration, *Short-Term, Small Amount Loans*, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

[95] Prepared Remarks of Richard Cordray, Director of the CFPB, to National Association of Attorneys General. February 26, 2013, *available at* http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-national-association-of-attorneys-general/.

More generally, federal regulators have found that lending without regard to ability to repay and equity stripping cause harm. In 2009, the FRB found that lending without regard to a borrower's ability to repay a higher priced or HOEPA mortgage loan caused substantial injury.[96] It found that [l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings . . . that actually . . . convert borrowers' equity into fees for originators without providing borrowers a benefit."[97] It also noted that lending without regard to ability to repay could cause "serious emotional hardship."[98] Similarly, the OCC's 2003 letter addressing predatory and abusive lending cautioned that "[e]quity stripping practices will almost always involve substantial consumer injury."[99]

Banking regulators have found in other contexts that fees required to be repaid over a short period of time increase potential injury. For example, the FRB, Office of Thrift Supervision (OTS), and NCUA noted that the potential for injury caused by high-cost subprime credit cards increases when deposits and fees are charged to the account in the first billing cycle rather than over a longer period of time: "[C]onsumers who open a high-fee subprime credit card account are unlikely to be able to pay down the upfront charges quickly."[100] Also in the high-cost credit card context, those agencies determined that costs above a reasonable threshold cause substantial consumer injury.[101] Payday loans are similar in that they require very high fees to be repaid in very short order.

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[96] It found substantial injury even if allowing refinancing into a loan with a lower payment was an option, noting that refinancing can slow the rate at which the consumer is able to pay down the principal and build equity. 73 Fed. Reg. 44541.

[97] 73 Fed. Reg. 44542.

[98] *Id.* The CFPB's Supervision and Examination Manual notes that "[e]motional impact and other more subjective types of harm also will not ordinarily amount to substantial injury. Nevertheless, in certain circumstances . . . emotional impacts may amount to or contribute to substantial injury." CFPB Supervision and Examination Manual, Version 2 (Oct. 2012), CFPB Consumer Laws and Regulations—UDAAP, at 2.

[99] OCC 2003 Advisory Letter on Predatory and Abusive Lending at 6.

[100] Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury, and National Credit Union Administration, Unfair and Deceptive Acts and Practices, Final Rule, 74 Fed. Reg. 5498, 5539 (Jan. 29, 2009).

[101] The FRB, OTS and NCUA concluded that upfront security deposit and fees exceeding 50% of the initial credit limit caused substantial consumer injury. They further determined that such costs exceeding 25% of the initial credit limit must be charged to the account over six months. 74 Fed. Reg. 5538.

E. Payday lending by banks has a uniquely harmful impact on certain segments of the population.

1. A large portion of bank payday borrowers are older Americans receiving Social Security benefits.

Senior Americans are at particular risk of harm from bank payday loans. CRL's recent analysis of bank payday loans found that more than one-quarter of bank payday borrowers are Social Security recipients.[102] This finding was consistent with CRL's previous analysis of 2010 loans, which found that nearly one-quarter of all bank payday borrowers were Social Security recipients.[103]

Many senior Americans are financially vulnerable. The Great Recession led to a 13 percent decrease in net worth for households headed by someone age 65 or older from 2005 to 2010.[104] Coupled with declines in the value of their largest assets—homes and retirement assets—many older Americans struggle with limited incomes. More than 13 million older adults are considered economically insecure, living on $21,800 a year or less.[105] People over age 55 make up the fastest-growing segment of people seeking bankruptcy protection.[106]

The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.[107] Benefits that have been distributed by paper check, often to those most financially vulnerable, are now directly deposited to checking accounts or prepaid cards. As part of the new rule, the Treasury Department prohibited government deposits to prepaid cards that allow payday loans out of concern that credit products would siphon off exempt benefits.[108] However, benefits

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[102] CRL, *Triple Digit Danger.*

[103] Rebecca Borné, Joshua Frank, Peter Smith, and Ellen Schloemer, *Big Bank Payday Loans: High interest loans through checking accounts keep customers in long-term debt* (July 2011), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[104] U.S. Census Bureau, *Net Worth and Asset Ownership of Households* (2005 and 2010), *available at* https://www.census.gov/hhes/www/wealth/wealth.html

[105] National Council on Aging, *A Blueprint for Increasing the Economic Security of Older Adults: Recommendations for the Older Americans Act* (March 2011), *available at* http://www.ncoa.org/assets/files/pdf/Blueprint-White-Paper-web.pdf.

[106] Brandon, E. *More Seniors Declaring Bankruptcy in Retirement.* US News and World Report (Nov. 17, 2010), *available at* http://money.usnews.com/money/blogs/planning-to-retire/2010/11/17/more-seniors-declaring-bankruptcy-in-retirement.

[107] Department of the Treasury, Interim Final Rule, Federal Government Participation in the Automated Clearing House, 75 Fed. Reg. 80335, 80338 (2010).

[108] The Treasury Department rule states: "In order to prevent Federal payments from being delivered to prepaid cards that have payday lending or 'account advance' features, we are prohibiting prepaid cards from having an attached line of credit if the credit agreement allows for automatic repayment of a loan from a card account triggered

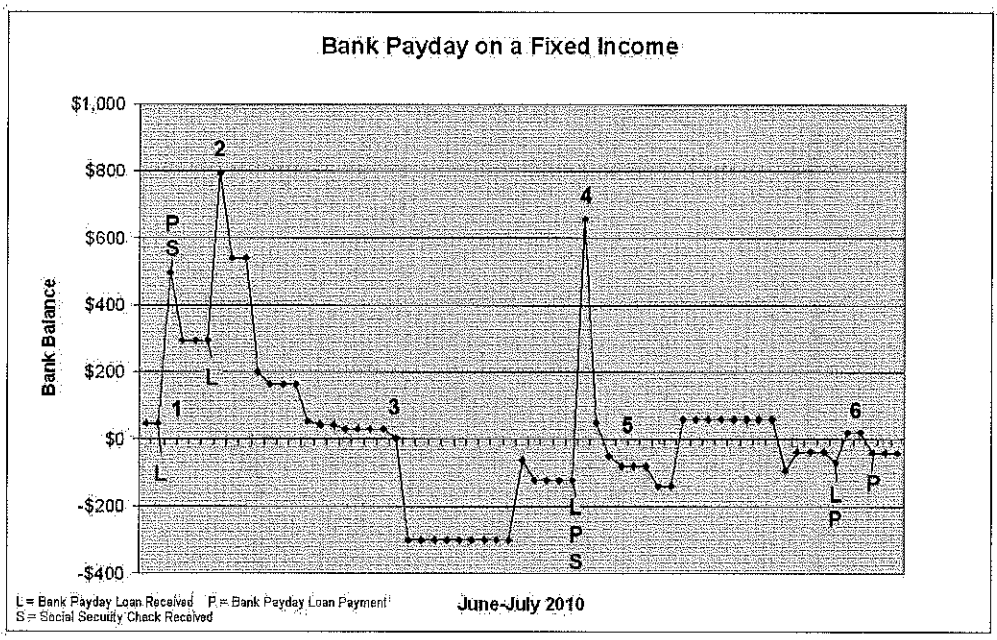
deposited into traditional checking accounts remain at risk to bank payday loans, where banks repay themselves the loan amount before any other expense or creditor.[109]

Figure 3 below demonstrates the impact that bank payday loans have on a Social Security recipient in CRL's 2010 database, whom we call Alice. Alice's primary source of income is Social Security. The figure maps two months of her checking account activity and demonstrates how bank payday loans only make it more difficult for Alice to use her Social Security income for the bills and other expenses for which it is intended. The line on the graph represents Alice's account balance. It goes up when she receives a direct deposit or other deposit or when a payday loan or overdraft loan are extended on her account. It goes down when checks, bill payments, debit card transactions, or other withdrawals are posted to the account, or when the bank collects the payday loans (after a direct deposit is received) or overdrafts and related fees.

by the delivery of the Federal payment into the account. Our intention is that this restriction will prevent arrangements in which a bank or creditor 'advances' funds to a cardholder's account, and then repays itself for the advance and any related fees by taking some or all of the cardholder's next deposit." 75 Fed. Reg. 80338.

[109] In its discussion, Treasury cited Regulation E's prohibition on compulsory electronic repayments as the comparable protection on traditional checking accounts, *id.*, but this prohibition is typically not read to apply to single-payment loans, as bank payday loans typically are. Thus, federal benefits direct deposited to traditional checking accounts remain vulnerable to bank payday loans.

Figure 3



1: Bank payday loan takes balance up to $500.
2: Alice receives June Social Security Check, and bank uses deposit to pay off first bank payday loan. Alice then takes out second bank payday loan, reaching her highest balance for the two-month period.
3: Several large bills and payments put Alice on the verge of overdraft, and the payback for the payday loan is about to come due.
4: July's Social Security Check and a new bank payday loan bring Alice's account balance to positive for only a few days.
5: More bills and the payday loan repayment take her right back into overdraft.
6: Small bills and payday loan fees and repayments offset small deposits, transfers, and bank payday loans, and Alice begins August in the red.

This graph demonstrates that bank payday loans only briefly increase Alice's account balance. Several days later, when the principal and fees ($10 per $100 borrowed in this case) are collected in one lump sum, Alice's account balance drops dramatically and overdraft fees soon follow. At the end of a two-month period during which Alice spent 47 of 61 days in payday loan debt, she is again left with a negative balance, in an immediate crisis, in need of another loan.

In CRL's recent report on bank payday loans, we also highlighted the story of another senior borrower, whom we called Annette. Annette is a 69-year-old, disabled widow who lives on a fixed income in California. More than two years ago, she found herself unable to afford the fees for smog repair and registration for her truck. Her bank, Wells Fargo, suggested that she take out a Direct Deposit Advance. In the 26 months since, from January 2011 through February 2013, Wells Fargo has made 25 advances to Annette, and she has paid over $900 in fees. This is in spite of a "continuous use" policy the bank claims prevents extended indebtedness. As of the publication of our report in March, Annette remained stuck in a cycle of debt.[110]

[110] Source: Andrea Luquetta, California Reinvestment Coalition, as included in CRL, *Triple Digit Danger.*

2. Banks harm communities of color by making payday loans.

Banks making payday loans have promoted their products as providing access to credit in communities that have few other options. But it is a false choice to say that the communities represented by several of the undersigned groups must decide between dangerous, wealth-stripping credit and none at all. Allowing the spread of high-cost credit discourages development of responsible products and entrenches a two-tier financial system: one group of consumers who can access a mainstream financial system and another group of consumers who are further marginalized and relegated to predatory lenders selling risky products.

Americans have lost income and wealth over the past decade, and the declines have been greatest for people of color. Today, white non-Hispanic families earn an average of $55,000 annually, while African Americans and Latinos earn $32,000 and $39,000, respectively.[111] The foreclosure crisis, with its devastating impact on communities of color, is exacerbating already dramatic wealth disparities.[112]

Surveys repeatedly find that borrowers of color are disproportionately detached from the traditional banking system. A recent FDIC study found that 21 percent of African American and 20 percent of Latino households are unbanked, compared to 4 percent of white households.[113] These 2011 disparities had not improved since the FDIC's 2009 survey.

Payday lending has a history of disparate impact on communities of color. A disproportionate share of payday borrowers come from communities of color,[114] and research has found that

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[111] U.S. Census Bureau, *Quick Facts*, 2011.

[112] Rakesh Kochhar, Richard Fry and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics*, Pew Research Center, Social and Demographic Trends (July 26, 2011), *available at* http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[113] 2011 FDIC National Survey of Unbanked and Underbanked Households at 14 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf.

[114] Amanda Logan and Christian E. Weller, *EZ Payday Loans: Who Borrows From Payday Lenders? An Analysis of Newly Available Data*, Center for American Progress (March 2009), summary of findings at page 1 (finding, based on the FRB's Survey of Consumer Finances conducted in 2007 and released in 2009 payday borrowers are more likely to be minorities); The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* at 9 (July 2012) (finding that, after controlling for other characteristics, payday loan usage was 105% higher for African Americans than for other races/ethnicities); California Department of Corporations, *Payday Loan Study* (updated June 2008), *available at* http://www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf (finding that, although they represent about one-third of the overall state population, over half of California payday borrowers are African American and Latino); Skiba and Tobacman, *Do Payday Loans Cause Bankruptcy?, supra* (analysis of a database of a large Texas-based payday lender finding that African Americans (who make up approximately 11 percent of the total adult population) made up 43 percent of payday borrowers and Latinos (who make up approximately 29 percent of the total adult population) made up 34 percent of payday borrowers).

payday lenders target these communities.[115] This disparity is even more significant since African Americans and Latinos are much less likely to have a checking account than whites—a basic requirement of getting a payday loan—which would lead one to believe that the concentration of payday lenders should be lower than in white neighborhoods.

By making payday loans, banks increase the ranks of the unbanked and underbanked among communities of color, both by the direct harm the loans cause members of these communities[116] and by the negative impact these products have on the communities' trust in banks.[117]

By making payday loans, banks also undermine the Community Reinvestment Act, the objective of which is to ensure that financial institutions meet the banking needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods and individuals.[118] This legal obligation is considered a *quid pro quo* for the valuable public benefits financial institutions receive, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window.[119] Making payday loans contradicts this

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[115] Wei Li, Leslie Parrish, Keith Ernst, and Delvin Davis, *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (March 26, 2009), *available at:* http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf (finding that payday lenders in California are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos compared with white neighborhoods, draining nearly $247 million in fees from communities of color, and that even after controlling for income and a variety of other factors, payday lenders were 2.4 times more concentrated in African American and Latino communities); Delvin Davis, Keith Ernst, Uriah King, and Wei Li. *Race Matters: The Concentration of Payday Lenders in African-American Communities in North Carolina.* Center for Responsible Lending (March 2005) *available at* http://www.responsiblelending.org/north-carolina/nc-payday/research-analysis/racematters/rr006-Race_Matters_Payday_in_NC-0305.pdf (finding that, even when controlling for a variety of other factors, African-American neighborhoods had three times as many payday lending stores per capita as white neighborhoods in North Carolina in 2005); Assaf Oron. *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State,* Department of Statistics, University of Washington (March 2006) (concluding based on a study of Washington State payday lenders that "payday businesses do intentionally target localities with a high percentage of African Americans.").

[116] The FDIC found that for 9.5 percent of previously banked households who were now unbanked, the bank closed their account, and nearly half of those were closed due to overdrafts. 2011 FDIC National Survey of Unbanked and Underbanked Households at 14, 27. As discussed earlier, bank payday borrowers are more likely to incur overdraft fees than customers as a whole.

[117] Another 8.2 percent of previously banked households listed not liking dealing with banks or not trusting banks as the reason they were now unbanked. *Id.* at 27. A recent Pew study found that some bank payday borrowers mistakenly believed that bank payday loans were safer or more regulated than other payday loans because they were offered by a bank. The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans, available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Small_Dollar_Loans/Pew_Choosing_Borrowing_Payday_Feb2013.pdf, at 28 (February 2013). The contrast between this expectation and the typical experience—a long-term, high-cost debt trap—likely further damages trust of banks.

[118] 12 U.S.C. 2901 *et seq.*

[119] FRB Chairman Ben S. Bernanke, "The Community Reinvestment Act: Its Evolution and New Challenges," Speech at the Community Affairs Research Conference, Washington, D.C. (March 30, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm#f2.

obligation: CRA requires that banks serve communities' credit needs,[120] but the data show that these loans do the opposite, leading to repeat loans that not only leave borrowers' needs unmet but leave them affirmatively worse off than before the lending began.

3. Bank payday lending puts military service members and their families at risk.

Members of the military are also vulnerable to bank payday lending, even as they are protected by the Military Lending Act (MLA) from other payday loans. The 2006 MLA stemmed from Department of Defense and base commander concern that troops were incurring high levels of high-cost payday loan debt, which was threatening security clearances and military readiness.[121] At that time, the President of the Navy-Marine Corps Relief Society testified:

> "This problem with . . . payday lending is the most serious single financial problem that we have encountered in [one] hundred years."[122]

Congress then prohibited making payday loans to service members and their families, but banks structure their loans in a way that attempts to evade this law,[123] even making payday loans on military bases.[124]

We were encouraged by the OCC's testimony before Congress last year highlighting the importance of MLA in protecting members of the military and their dependents by "restricting the cost and terms of . . . abusive credit products." [125]

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[120] 12 U.S.C. 2901.

[121] U.S. Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (2006), *available at* www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf.

[122] Testimony of Admiral Charles Abbot, US (Ret.), President of Navy-Marine Corps Relief Society, Hearing before the Senate Banking, Housing and Urban Affairs Committee, 109th Cong. (2006).

[123] The regulation under the law covers only "closed-end" loans. 32 CFR 232.3(b). Banks categorize their payday loans as "open-end" instead, even though the due date for the loan, much like a closed-end loan, is fixed as the next deposit date or, at the latest, after 35 days.

[124] Jean Ann Fox, *The Military Lending Act Five Years Later*, Consumer Federation of America, May 29, 2012, at 58-60, *available at* http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf.

[125] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 5.

IV. We support the Agencies' proposed underwriting and related guidelines taken in combination.

A. The proposed underwriting and related guidelines, in combination, help ensure borrowers can repay the loan and meet expenses without reborrowing.

In light of the risks posed by lending without regard to ability to repay and the harm caused by repeat payday loans, we support the Agencies' proposed underwriting and related guidelines which, in combination, help ensure that borrowers can afford the loan and meet ongoing expenses without reborrowing. As the weakening or the omission of any single criterion could render the guidelines as a whole ineffective, we urge that the Agencies preserve them in their entirety.

We elaborate here on two provisions in particular: (1) determination of the borrower's ability to repay the loan by analyzing the borrower's inflows and outflows; and (2) the limit on the number of loans that may be made.

B. Requiring determination of the borrower's ability to repay the loan is necessary and appropriate.

1. Analyzing inflows and outflows is necessary, as the data clearly indicate that assessment of inflows alone results in high numbers of repeat loans.

Payday lenders, including banks making payday loans, have typically approved loans based on the expectation that the borrower's gross inflows on payday, or upon receipt of public benefits, will cover repayment of the loan.[126] While this approach often ensures the lender's ability to *collect* the loan proceeds, the data on repeat use make clear that this approach fails to ensure the borrower's ability to *repay* without reborrowing.

Thus, it is necessary and appropriate that the Agencies propose requiring that lenders analyze the borrower's inflows and outflows to determine ability to repay the loan without reborrowing. As the Agencies note, underwriting for other credit products typically entails this analysis.[127] The Agencies propose consideration of the customer's inflows and outflows over no less than the preceding six consecutive months. This is an appropriate time period and should be no less. The Agencies also emphasize that the bank consider the net surplus or deficit at the end of each month, without relying on a six-month average. This too is appropriate, as larger one-time inflows could significantly skew a six-month average that would not reflect the borrower's ongoing financial capacity.

[126] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

[127] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

2. There is clear precedent for regulators and Congress requiring a determination of ability to repay.

Years of regulatory guidance, advisory letters, and rules, as well as a growing body of federal legislative precedent, explicitly require that a lender determine the borrower's ability to repay a loan, and that the determination be based on income and obligations.

As applicable to all loans, the 2001 Interagency Subprime Guidelines provide that loans to borrowers who do not "demonstrate" the capacity to repay are unsafe and unsound.[128] The OCC's 2003 letter addressing predatory and abusive lending states in strong terms that "disregard of basic principles of loan underwriting," which the OCC describes as failing to determine ability to repay, "lies at the heart of predatory lending."[129]

In the credit card context, the 2009 Credit Card Act explicitly required that lenders "consider[] the ability of the consumer to make the required payments under the terms" of the account.[130] The FRB interpreted this provision to require that the lender consider ability to repay "based on the consumer's income or assets *and* current obligations."[131]

In the mortgage context, since 1994, the Home Ownership and Equity Protection Act has prohibited making high-cost HOEPA loans without regard to the borrower's repayment ability,[132] "including the consumers' current and expected income, *current obligations*, and employment." In 2009, the FRB expanded this provision to a lower cost category of loans than "high-cost" loans, called "higher priced mortgages" (essentially subprime loans), and required verification of income, assets and obligations for both high-cost and higher-priced loans.[133] The 2010 Dodd-Frank Act extended an ability-to-repay requirement to all mortgage loans, requiring "a reasonable and good faith determination based on verified and documented information,"[134]

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[128] Interagency Expanded Guidance for Subprime Lending Programs, 2001: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."

[129] OCC 2003 Advisory Letter on Predatory and Abusive Lending.

[130] 15 U.S.C. 1665e.

[131] 12 CFR 226.51(a) (emphasis added).

[132] 15 U.S.C. 1639(h): Prohibition on extending credit without regard to payment ability of consumer. A creditor shall not engage in a pattern or practice of extending credit to consumers under [high-cost] mortgages . . . based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment."

[133] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44546 (July 30, 2008).

[134] 15 U.S.C. 1639c(a)(1).

including, among other items, expected income, current obligations, debt-to-income ratio or residual income, and other financial resources other than the consumer's equity.[135]

Thus, explicitly requiring an ability-to-repay determination, and requiring that it be based on income and expenses, is consistent with a range of existing credit regulation.

C. Limiting the number of payday loans is necessary and appropriate.

As discussed earlier, payday lenders, including banks making payday loans, assert that these loans are intended for occasional use, but the data indicate they are used on a sustained basis. The regulators' proposal that these loans be limited, consistent with previous regulatory action, helps to ensure that these loans are provided as intended.

1. The limit of one loan per month and a full statement period between loans helps to ensure that loans are used as marketed—on an occasional basis.

As discussed in Part II, a payday loan made within a short period of repayment of another loan is effectively a renewal or a refinance. Thus, the Agencies' proposed limit of one loan per statement period and a break of one statement period is essentially a prohibition on renewals and refinances, consistent with regulatory precedent previously cited that advises against them. It also helps to ensure that loans are used as marketed—on an occasional basis.

To be effective, it is important that the provision limits loans to no more than one per statement period (typically, approximately one month) and that the period of the required break between loans be at least one statement period (again, approximately one month), as the Agencies propose. Further, we support the FDIC's clarification that this provision should be applied in combination with its existing indebtedness limit for payday loans (discussed in part IV.C.2. below) across all lenders, bank or non-bank, requiring that banks review customers' account activity to identify payday loan activity with other lenders.[136]

Most borrowers take out a payday loan to meet recurring expenses.[137] A recent Pew study found that 53% borrowed to pay "a regular expense, such as utilities, car payment, credit card bill, or prescription drugs;" 10% borrowed to pay mortgage or rent; and 5% borrowed for food and groceries.[138] As most recurring expenses are on a monthly billing cycle, a month is the minimum

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[135] 15 U.S.C. 1639c(a)(3).

[136] 78 Fed. Reg. 25272, n.22.

[137] The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf, at 14 (July 2012) (69% of the 450 borrowers surveyed took out their first loan to pay recurring expenses).

[138] *Id.*

period of time over which a borrower's ability to repay, and meet ongoing expenses, should be assessed.

Further, the experience at the state level demonstrates that renewal bans that allow a loan to be extended too soon after another is repaid are ineffective at stopping the cycle of debt.[139] Payday lenders often support these measures but routinely circumvent them by having borrowers pay off their loan and then take out another shortly thereafter. This process is termed a "back-to-back" transaction.[140] Because these types of transactions technically do involve paying off the loan, they are typically not considered renewals under state laws prohibiting renewals. Some state laws require a "cooling-off" period of a business day or two between each loan, or after a certain number of consecutive loans.[141] But this period is far too short to stop the cycle of debt.[142]

2. There is clear precedent for limiting the number of payday and other relatively short-term loans.

Regulatory precedent, including long-standing guidance by these Agencies which the current proposed guidance is intended to supplement, is consistent with limiting the number of payday loans a bank may make to a customer.

Eight years ago, the FDIC issued payday loan guidelines, applicable to loans made through bank partnerships with non-bank payday lenders and by banks directly,[143] advising: "When a customer has used payday loans more than three months in the past 12 months . . . an extension of a payday loan is not appropriate under such circumstances."[144] Assuming a typical loan term of approximately two weeks, this indebtedness limit equates to approximately six loans per year. Those guidelines also provided that lenders establish "appropriate 'cooling off' or waiting periods between the time a payday loan is repaid and another application is made."[145]

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[139] CRL, *Springing the Debt Trap*, n.42.

[140] The CFPB recently found that the majority of payday loans made to borrowers with seven or more loans over twelve months were nearly continuous, i.e., taken out shortly after the previous loan was repaid. CFPB Findings at 25. This is true even though most states limit technical renewals.

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

[142] The Department of Defense's 2006 report addressing predatory lending highlighted that "[e]ven when the [payday loan] transactions are separated by a couple of days or a week, the borrower is still caught in the cycle of debt." U.S. Department of Defense, "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," Aug. 9, 2006, *available at* http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

[143] FDIC 2005 Payday Lending Guidelines ("Examiners should apply this guidance to banks with payday lending programs that the bank administers directly or that are administered by a third party contractor.").

[144] FDIC 2005 Payday Lending Guidelines.

[145] *Id.*

Thirteen years ago, the OCC's payday lending advisory letter advised: "[m]ultiple renewals—particularly renewals without a reduction in the principal balance, and renewals in which interest and fees are added to the principal balance, are an indication that a loan has been made without a reasonable expectation of repayment at maturity." It specifically advised that banks have no more than one payday loan outstanding to a borrower at any one time.[146]

When the National Credit Union Administration authorized small dollar loans at up to 28% APR in 2010, it explicitly limited these loans to three every six months, or six over a twelve-month period.[147]

D. The Agencies should preserve the other proposed underwriting-related provisions so that they are at least as strong as proposed.

The Agencies' proposal also includes requirements that the duration of the customer's relationship with the bank be sufficient to prudently underwrite the loan, no less than six months; that credit limits not be increased without a full underwriting reassessment and only upon request from the borrower; and that ongoing customer eligibility be reassessed no less than every six months, with a particular emphasis on repeat overdrafts and other credit obligations.[148] We support these requirements and urge that they be finalized at least as strong as proposed.

V. The Agencies should clarify that safe and sound banking principles require that interest and fees be reasonable, not to exceed 36 percent in annual percentage rate terms.

Cost is a critical element of any credit product, and bank payday loans are extraordinarily high-cost by any measure. Banks impose fees in the range of $7.50 to $10 per $100 borrowed for bank payday loans.[149] CRL's latest analysis of checking account data for the year 2011 found that the average bank payday loan term is 12 days—that is, the bank repays itself from the borrower's next direct deposit an average of 12 days after extending the credit.[150] The CFPB similarly found that the typical period during which a bank payday borrower had an outstanding advance balance was 12 days.[151]

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[146] OCC 2000 Advisory Letter on Payday Lending.

[147] NCUA, Short-Term, Small Amount Loans, 75 Fed. Reg. 58285, 58287. The minimum loan term for these loans is one month.

[148] FDIC: 98 Fed. Reg. 25272 ; OCC: 98 Fed. Reg. 25357.

[149] While it continues to charge $10 per $100 borrowed, as it did in 2011, during a borrower's first year of payday loan use, Regions Bank. FRB-supervised, recently began charging $7 per $100 borrowed under certain circumstances for customers whose first Regions payday loan was taken out at least one year prior (Regions Ready Advance Account Agreement and Disclosures, 2013).

[150] CRL, *Triple Digit Danger*. The median loan term was found to be 12 days; the mean loan term was14 days.

[151] CFPB Findings at 28.

This cost and loan term translates to an annual percentage rate ranging from 225% to 300%, an extremely high cost for credit, particularly since the lender virtually guarantees repayment by putting itself first in line when a direct deposit hits the account.

The Agencies advise that fees be "based on safe and sound banking principles;" clearly, these loans' current costs are not. The Agencies do not, however, elaborate on what fee size is safe and sound. We urge the Agencies to be as explicit as the FDIC was in its 2007 Affordable Small Loan Guidelines, advising that loans not exceed an annualized interest rate of 36 percent, subject to more prescriptive restrictions under state law.[152] Even if banks continue to assert that their payday loans are open-end, they can measure the cost in annualized interest rate terms based on the average number of days their payday loans are outstanding, as the CFPB did in its discussion of deposit advance products in its recent white paper.[153]

VI. The Agencies should advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.

Banks typically require repayment of bank payday loans through electronic payment of the fee and the loan amount from the next direct deposit,[154] ensuring their own ability to collect the loan but not the borrower's ability to repay it. Indeed, relying on this "priority position," as the recently CFPB noted, creates a disincentive against ensuring the borrower has the ability to repay the loan without reborrowing.[155] It also denies the borrower the ability to make a measured decision about the order in which to pay debts and expenses.[156]

Mandatory automatic repayment runs counter to long-standing principles found in the Credit Practices Rule's prohibition on irrevocable wage assignments;[157] the Truth in Lending Act's protections against a lender offsetting outstanding balances on credit cards against the borrower's

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[152] For information on the history of, rationale for, and growing momentum for a 36% APR cap, *see* Lauren Saunders, *Why 36%: The History, Use, and Purpose of the 36% Interest Rate Cap*, National Consumer Law Center (April 2013), *available at* http://www.nclc.org/images/pdf/pr-reports/why36pct.pdf.

[153] CFPB Findings at 27-28.

[154] 78 Fed. Reg. 26268; OCC: 78 Fed. Reg. 26353.

[155] CFPB Findings at 44. *See also* National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones That Don't* (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf, at 15-17.

[156] *Id.* ("This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses.")

[157] 12 CFR 227.13 (Regulation AA).

deposits with that lender;[158] and Treasury's rule regarding delivery of Social Security benefits to prepaid debit cards.[159]

It also wholly undermines an intention of the EFTA, which prohibits creditors from conditioning an extension of credit on the consumer's repayment of that debt by "preauthorized electronic fund transfer."[160] Banks have ignored this prohibition as it technically applies to transfers authorized to recur at "substantially regular intervals," and bank payday loans are nominally structured as single-payment loans.

In light of the safety and soundness and consumer protection implications of requiring mandatory automatic repayment, the Agencies should prohibit banks from doing so, regardless of whether the loan is recurring or single-payment, and particularly when that repayment is triggered by the borrower's deposit.

VII. The Agencies should perform prompt and vigilant examination and enforcement.

The Agencies caution that they will take "appropriate supervisory action" to address unsafe and unsound practices associated with bank payday lending and to prevent harm to consumers they cause.[161] Given the small number of banks making payday loans, the Agencies should be able to promptly and thoroughly examine banks' compliance with this guidance. They should vigilantly assess compliance with the underwriting and related requirements and take swift enforcement action if necessary. The Agencies should also continue to watch closely for any potential new entrants into the high-cost payday lending market.

VIII. The Agencies should work with the CFPB to encourage strengthening existing consumer financial regulations.

A. Cost of credit disclosures under the Truth in Lending Act should allow for meaningful comparison across products.

Bank payday loans currently carry no annual percentage rate (APR) disclosure because banks classify their loans as "open-end" credit, even though the due date for the loan is fixed as the next deposit date or, at the latest, 35 days.[162] This omission limits consumers' ability to compare the cost of a bank payday loan to other forms of credit that do require APRs, including credit card purchases, credit card cash advances, overdraft lines of credit, and other small dollar loans.

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[158] 15 U.S.C § 1666h.

[159] 75 Fed. Reg. at 80338. *See also* Part III.E.3, *supra*.

[160] 15 U.S.C. § 1693k; Reg. E, 12 C.F.R. § 205.10(e)(1). That ban applies to transfers from one account to another account at the same institution, even though such transfers are otherwise outside of the scope of the EFTA.

[161] FDIC: 98 Fed. Reg. 25271; OCC: 98 Fed. Reg. 25356.

[162] Some bank payday loan products may carry a double-digit APR disclosure of, e.g., 21 percent, in addition to the fee per $100, but by far the most substantial portion of the cost is the fee charged per dollar borrowed.

It also encourages banks to disclose pricing that may appear cheaper than it is (e.g., $1 per $10 borrowed) or that is likely to mislead consumers in comparisons to other products (e.g., 10% of the amount borrowed). This is inconsistent with the principle of transparency so critical in credit markets, and the Agencies should work with CFPB to address it.

B. The Electronic Fund Transfer Act should ensure that lenders cannot require automatic repayment as a condition of receiving a loan.

As discussed earlier, a technicality has thus far allowed banks to skirt the protections against mandatory automatic repayment intended by the EFTA. The Agencies should work with CFPB to close the loophole in EFTA that has both encouraged lenders to require mandatory automatic repayment for single-payment loans and, conversely, encouraged lenders to make single-payment loans rather than installment loans. Together, the agencies should ensure that the law provides borrowers the ability to make a meaningful decision about the order in which to repay debts and other expenses.

Conclusion

The need for strong regulatory action is certain: The data make clear that banks are lending without regard to ability to repay, and regulatory precedent makes clear that lending without regard to ability to repay is unsafe, unsound, and harmful to banks' customers.

The work of the Agencies has been instrumental in temporarily curbing the spread of bank payday lending. But clarity in the marketplace is needed. The current proposed guidance, which provides clear underwriting expectations and limits on repeat loans, is critical to stop the cycle of debt at banks making these loans and to ensure that no additional supervisees begin trapping borrowers in payday loans going forward. For the Agencies to do less would increase safety and soundness risk at the banks the Agencies supervise and harm the customers whose deposits those banks hold.

We thank you for your responsiveness to this critical issue. Please do not hesitate to contact us if you have any questions about our comments.

APPENDIX

Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use:

OCC-supervised:

Wells Fargo Bank: "The Direct Deposit Advance service may be helpful if you are experiencing a financial emergency and need money on a short-term basis . . . . Advances are intended to assist with short-term cash needs and are not recommended as a solution for your long-term financial needs."[163]

US Bank: "Checking Account Advance is a loan product designed for short-term credit needs. We do not recommend ongoing use of the Checking Account Advance service."[164]

Bank of Oklahoma: "The service is designed to help our customers meet their short-term borrowing needs, but is not intended to provide a solution for longer-term financial needs."[165]

Guaranty Bank: "This service . . . is designed to help our customers meet their short term needs and is not intended to provide a solution for longer-term financial needs or recurring expenses that you can plan for."[166]

FRB-supervised:

Fifth Third Bank: "[Early Access is a] line of credit used to assist our customers with short-term, financial emergencies or unexpected financial needs."[167]

Regions Bank: "Ready Advance is an open-end credit plan that is designed to provide you with funds when you have an emergency or other unexpected expense. Ready Advance is not intended for customers who need to repay an extension of credit over an extended period of time. Ready Advance should not be used for planned purchases, discretionary spending, or regular monthly expenses."[168]

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[163] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[164] U.S. Bank Checking Account Advance, Summary of Key Features, https://www.usbank.com/checking/caa/agreement.html (last visited February 26, 2013).

[165] Fast Loan Terms and Conditions, 2011, *available at* https://www.bankofoklahoma.com/sites/Bank-Of-Oklahoma/asset/en/theme/default/PDF/Bank%20of%20Oklahoma%20FastLoanSM%20Terms%20and%20Conditions.pdf (last visited February 25, 2013).

[166] Guaranty Bank Easy Advance Line of Credit Agreement and Disclosures, as of December 12, 2012, *available at* http://www.guarantybanking.com/ContentDocumentHandler.ashx?documentId=183421.

[167] Fifth Third Early Access, Summary of Key Features, https://www.53.com/doc/pe/pe-eax-tc.pdf (last visited February 26, 2013).

[168] Regions Ready Advance Account Agreement and Disclosures, http://www.regions.com/personal_banking/ready_advance_tc.rf (last visited February 26, 2013).

Exhibit J

IN THE UNITED STATES DISTRICT COURT
FOR THE STATE OF DELAWARE

ROSALYN JOHNSON, on behalf of herself and all others similarly situated,	)	
Plaintiffs,	)	C.A. No. 1:13-v-01186-LPS
v.	)	
ACE CASH EXPRESS, INC.	)	CLASS ACTION
Defendant.	)	

SECOND AMENDED CLASS ACTION COMPLAINT[1]

Plaintiff ROSALYN JOHNSON, on behalf of herself and all others similarly situated, alleges as follows:

Nature of Action

1. This is an action seeking ~~temporary, preliminary and~~ permanent injunctive relief, recovery of compensatory, consequential, and punitive damages, reasonable attorneys' fees and costs, and other relief arising from defendants' wrongful and unconscionable conduct, including breaches of the duty of good faith and fair dealing, and violations of 6 Del. C. § 2513 (the "Delaware Consumer Fraud Act") by ACE CASH EXPRESS, INC. (the "Defendant").

2. Plaintiff is a borrower who took a loan~~loans~~ from Defendant under unconscionable terms and conditions. Defendant advertises and markets these loans as "fast, secure and easy" that is "convenient." At the same time, Defendant further and expressly advises that its product is for "short-term financial needs only, and not as a

[1] A blackline comparing the amended complaint to this second amended~~original~~ complaint is attached hereto as Exhibit J. ~~1. Otherwise, the exhibits referenced herein are identical to the exhibits attached to the original complaint and are incorporated by reference.~~

long-term solution."~~"payday loans," or easy (instant approval!) short-term credit to cover an unexpected emergency expense or a temporary cash flow problem, like a car repair or medical bill.~~ In reality, however, Defendant preys on poor and unsophisticated borrowers, who do not understand the financial or legal implications of these loans.~~loans, and who can never repay the loan in two weeks.~~ Further, Defendant never has the intention of making a short-term loan. Rather than providing a quick "solution," Defendant intends to burden borrowers with expensive, long-term debt, enforced by unconscionable terms and conditions, which they know borrowers will have little or no ability to understand or repay. As a result, Plaintiff, and thousands of similarly situated borrowers, suffers injury, harm, loss and damage.

3. As an example, Plaintiff borrowed $450.00 from Defendant. The yearly interest rate or cost of this loan: 387.85%~~389.16%~~ or $200.38,~~$270.89,~~ assuming the loan could be paid off in full; within two~~six~~ months. Late payments are subject to a delinquency charge of 5% of the unpaid amount. Additionally, Defendant forced Plaintiff to grant them a secured lien on her bank account, and authorization for Defendant to make automatic withdraws, and release important rights of due process, including the right to a jury trial, or judicially monitored discovery.

4. This loan threatens~~Plaintiff struggled to make the payments under the loan. The final payment, scheduled to be made on June 14, 2013, which was automatically withdrawn from Plaintiff's bank account by Defendant, caused an overdraft on Plaintiff's bank account. In order to avoid overdraft fees and cover other expenses, Plaintiff then entered into a new loan with Defendant for $450, starting the vicious cycle again. The~~

~~financial burden caused by the payments on these loans is harming~~ Plaintiff's ability to pay rent, purchase food, and otherwise cover basic living expenses.

The Parties

5. Plaintiff ROSALYN JOHNSON is a natural person residing at 102 W. 23RD Street, Wilmington, Delaware 19802. She incurred a loan from ACE CASH EXPRESS, INC., on or about ~~March 28, 2013 and a second loan from ACE CASH EXPRESS, INC., on or about~~ June 16, 2013.

6. Defendant ACE CASH EXPRESS, INC. is a foreign corporation registered to do business in Delaware, which may be served with process at the offices of its registered agent for service of process in Delaware, The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801. ACE CASH EXPRESS, INC. does business in Delaware at 1901 West 4th Street, Wilmington, DE 19805, 14 Marrows Road, Suite B, Newark, DE 19713, 2504 Kirkwood Highway, Wilmington, DE 19805, 38223 DuPont Boulevard, Unit 7, Selbyville, DE 19975, 22978 Sussex Highway, Seaford, DE 19973, 3209 Miller Road, Unit H, Wilmington, DE 19802, and 833 North Market Street, Wilmington, DE 19801.

Jurisdiction and Venue

7. This Court has exclusive jurisdiction over this civil action pursuant to 28 U.S.C. § 1332(d)(2) because the controversy exceeds the sum of $5,000,000, exclusive of interest and costs, and the Plaintiff is a citizen of a State different than one of the defendants, and Plaintiff believes there are more than a 100 class members.

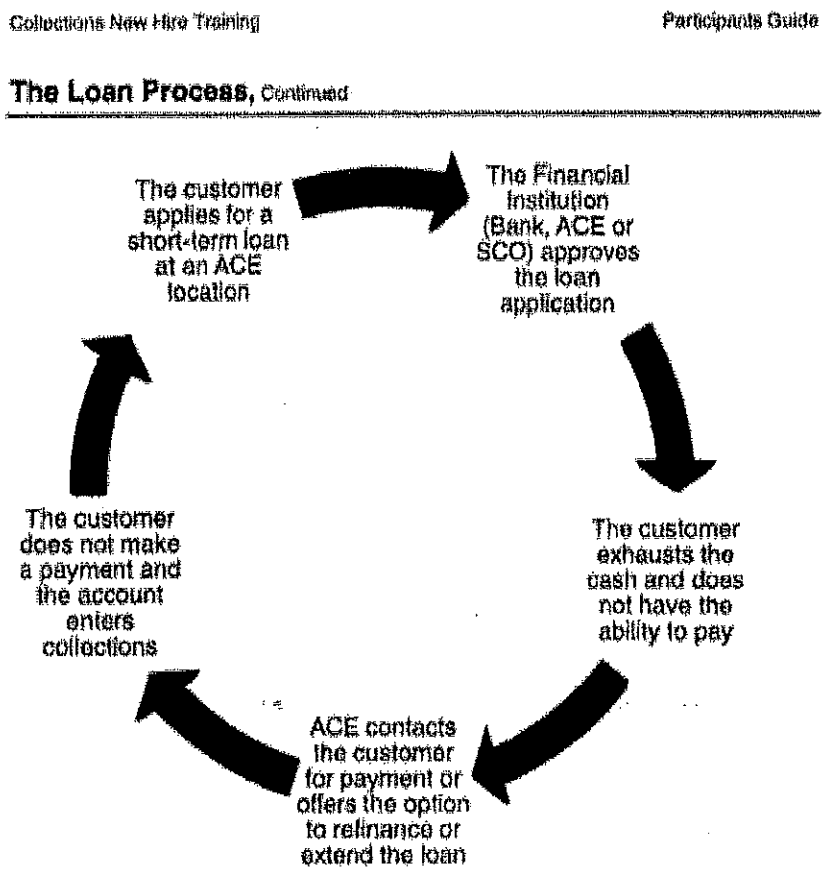
8. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391(b)(2) as a substantial part of the events giving rise to Plaintiff's claims occurred in this judicial district.

Background

9. Defendant is engaged in the business of marketing, advertising, and making short term loans, including "payday and installment loans." Defendant regularly advertizes, markets and makes these "~~payday~~ loans" within the State of Delaware.

10. ~~Payday loans are small dollar credit products that typically range from $100 to $500.~~ Plaintiff borrowed $450 from Defendant in ~~March 2013 and another loan of $450 from Defendant in~~ June 2013. As was the case with Plaintiff, Defendant's loans are secured by a lien on, and electronic access to, the borrower's bank account.

11. In entering the installment loan with Plaintiff, the Defendant expressly stated that it was intended to be used for "short-term financial needs only, and not as a long-term solution." Secretly, however, Defendant knows this is not a "short-term solution" and their business model is based on pushing customers into a cycle of debt. Defendant's own internal manual indicates that Defendant relies on trapping its customers in a cycle of "short-term" loans:



Copy attached as Exhibit A.

12. These "installment loans" issued by Defendant are simply an end-run on attempts by the General Assembly to regulate the payday loan industry. However, the effect of these "installment loans," on consumers is really no different from a "payday loan." The only difference is that by morphing these loans into "installment loans," Defendant avoids the very regulations designed to protect consumers. See Exhibit B at p. 585-591.

~~11. Payday loans are typically advertised and marketed as short-term loans to be paid in full, with interest, on the borrower's next payday. If the borrower cannot pay off the full loan, plus interest, however, the borrower must pay an onerous interest charge, a fee to extend the due date, or take out a new loan to cover the expenses.~~

~~12.~~13. Prominent organizations such as the Pew Charitable Trusts and the Insight Center for Community Economic Development have studied the effects of payday lending, and published findings concluding that the practice has a harmful effect not only on borrowers' finances and credit, but on the broader economy. An in-depth study published by the Pew Charitable Trusts in 2012 discussed the payday loan industry and the effects of such loans on borrowers and society. The study found that, while payday loan companies market their products as "payday," or short-term loans, the average initial loan is rolled over again and again, and remains open for five months of the year. Researchers found that payday lenders build their business models on the premise that borrowers cannot repay the loans in a two-week period, and that the loans become extremely profitable (to the lender) when it becomes a long-term debt. Researchers at the Federal Reserve Bank of Kansas City concluded that, "the profitability of payday lenders depends on repeat borrowing." A copy of the Pew Charitable Trusts report is attached hereto as Exhibit C.~~A.~~ A second report was issued in February 2013. A copy is attached as Exhibit D. A third report was issued in October 2013. A copy is attached as Exhibit E.~~B.~~

~~13.~~14. Costly debt terms drain borrowers' limited cash needed to cover basic living expenses such as rent and food. Costly debt also impairs a borrower's ability to save, invest or otherwise spend on worthwhile consumer goods. Onerous debt terms also

increase the chances that a borrower will file for personal bankruptcy. Indeed, at least fifteen states have banned payday lending, and Congress has prohibited payday lenders from targeting members of the military.

Defendant's Practices

~~14.~~15. For years, Defendant has marketed, advertised and made short-term ~~"payday~~ loans~~"~~ to residents of Delaware, including Plaintiff.

~~15.~~16. Defendant aggressively markets and advertises these loans as short-term credit solutions, quick access ("Easy Application" "Quick Money") to cash. (See Exhibit ~~F to pay for an unanticipated expense, such as a car repair bill, overdue utility bill or emergency travel expenses. (See Exhibit C~~ hereto.)

~~16.~~17. For years, Defendant has derived substantial revenues and profits from short-term~~payday~~ loans in Delaware. Payday loans are only profitable to the lender when the short-term loan becomes a long-term obligation. As shown in Exhibit A, there~~This~~ is direct evidence that while Defendant markets and advertises the loans as short-term credit, its actual business model and intent is to induce the borrower to extend the initial loan into a long-term, and unduly expensive loan. As a result of the policies and practices of Defendant, borrowers are routinely trapped in products that cause harm, including financial loss, hardship, and damage to personal credit.

~~17.~~18. Defendant intends to induce borrowers to enter into short-term loans, knowing that borrowers will be unable to pay off the loan in a short period of time, and extends the terms of the loans. As noted in the February 2013 Pew report, lenders such as Defendant "rely on borrowers to use the loans for an extended period of time . . . in

order to be profitable. . . ." (Exhibit D ~~Yet lenders continue to structure their loans as a two-week fixed-fee product." (Exhibit B~~ at 19.)

~~18.~~19. Defendant's representations and statements about the easy and quick access, instant approval, and the short-term nature of the loans are intended to induce borrowers, including Plaintiff, to enter into a loan agreement with Defendant.

~~19.~~20. Instead of disclosing that borrowers, including Plaintiff, would likely need extended terms to make her repayment obligations, Defendant remained silent, and induced borrowers, including Plaintiff, to borrow under expensive, onerous, and unconscionable terms.

~~20.~~21. Defendant conceals its true business models from borrowers, deceptively marketing its ~~payday~~ loans as short-term solutions even though defendant makes such loans with the expectation that borrowers will become saddled with a longer-term debt, structured in such as way as to make repayment all but impossible.

~~21.~~22. Defendant hides the fact that Defendant intends, and expects borrowers, including Plaintiff, to repay the loan on extended payment terms and pay interest rates exceeding 300% of the principal amount of the loan.

~~22.~~23. There is no limit to the amount that a borrower will pay unless and until the borrower repays the loan in full, including interest and any and all other fees pursuant to the terms of the loan document. Initial short-term obligations stretch into never ending cycle of inescapable debt.

~~23.~~24. Defendant never discloses that the overwhelming majority of their borrowers will never be able~~meet the two-week term~~ to repay the loan, and are forced, at substantial, undue and unconscionable cost, to extend the terms of the loan or take a new

loan. Defendant is silent on these known facts, which are material to any borrower making a decision to take a loan from Defendant.

~~24.~~25. Defendant entered into an agreement with Plaintiff knowing that the overwhelming majority of Defendant's borrowers are unable to pay loans within the initial terms~~,a two-week period,~~ at substantial and undue cost to borrowers.

~~25.~~26. Defendant entered into an agreement with Plaintiff remaining silent on its expectation that Plaintiff would repay the loan together with onerous, expensive and unconscionable interest.

~~26.~~27. Defendant preys on borrowers who can be induced, like Plaintiff, to enter into an unconscionable loan, knowing that the borrowers are at a significant disadvantage to negotiate fair terms.

~~27.~~28. Defendant knowingly uses its significant leverage to induce borrowers, including Plaintiff, to enter into loans with excessive, onerous and unconscionable terms. Indeed, the interest and penalties of borrowers' loans, including Plaintiff's loan, dwarf the principal amount of the loans.

~~28.~~29. Additionally, on a "take-it-or-leave-it basis," Defendant uses its significant leverage to cause borrowers, including Plaintiff, to accept onerous, outrageous and unconscionable boilerplate terms, including terms that significantly, if not wholly, impaired Plaintiff's rights to due process under law. For instance, buried in the Plaintiff's loan document with Defendant are references to Plaintiff's purported waiver of a right to jury trial, waiver of a right to a public, civil proceeding in a court of competent jurisdiction, and waiver of a right to judicially-monitored discovery, and an opt-out deadlines and rescission rights. The meaning of these terms, and the implication of

agreeing to these terms are incomprehensible to a layperson, and particularly borrowers who typically use such~~"payday~~ loans.~~"~~ Plaintiff never understood the implication of these terms.

~~29.~~30. Defendant knowingly exploits its sophistication and its counterparty's equal lack of sophistication, lack of understanding and lack of bargaining ability, to impose unconscionable loan terms and unconscionable purported waivers of due process rights.

Defendants' Contract is Unconscionable

~~30.~~31. Plaintiff's loan documents evidence on their face a gross imbalance in the parties' respective rights and obligations, and an exploitation of an underprivileged, unsophisticated borrower.

~~31.~~32. The Delaware Chancery Court, in the context of reviewing a contract under the uniform commercial code, has considered ten factors as an aid to determine whether a contract is unconscionable and unenforceable:

> 1. The use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide standards offered on a take it or leave it basis to the party in a weaker economic position.
>
> 2. A significant cost-price disparity or excessive price.
>
> 3. A denial of basic rights and remedies to a buyer of consumer goods.
>
> 4. The inclusion of penalty clauses.
>
> 5. The circumstances surrounding the execution of the contract, including its commercial setting, its purpose and actual effect.
>
> 6. The hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract.

7. Phrasing clauses in language that is incomprehensible to a layman or that divert his attention from the problems raised by them or the rights given up through them.

8. An overall imbalance in the obligations and rights imposed by the bargain.

9. Exploitation of the underprivileged, unsophisticated, uneducated and the illiterate.

10. Inequality of bargaining or economic power.

Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448 at * 4-5 (Del. Ch. 1990)

~~32.~~33. The Delaware Supreme Court has held that a contract is unconscionable if it is "such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other" or "whether the provision amounts to taking of an unfair advantage by one party over the other." See Tulowitzki v. Atlantic Richfield Co., 396 A.2d 956, 960 (Del. 1978); see also, Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448, *4-5 (Del. Ch. 1990).

~~33.~~34. While not all of the factors are necessary to find unconscionability, all of the above factors are present with respect to the payday loans at issue in this case.

Allegations Specific To
Plaintiff ROSALYN JONES

~~34.~~35. Plaintiff incorporates by reference the foregoing paragraphs as if fully set forth herein.

~~35.~~36. Plaintiff ROSALYN JONES entered into loan agreement with Defendant ACE CASH EXPRESS, INC. on or about June 16, 2013.~~on or about March 28, 2013. A true and correct copy of the loan agreement is attached hereto as Exhibit D. ROSALYN JONES entered a second loan agreement with Defendant ACE CASH EXPRESS, INC.~~

~~on or about June 16, 2013.~~ A true and correct copy of the loan agreement is attached hereto as Exhibit G.~~E.~~

~~36.~~37. Plaintiff borrowed $450 to cover a ~~short-term~~ cash flow problem. At the time she borrowed the principal, she did not understand fully the financial or legal terms of her loan document, contained in a 17-page, single-spaced document written in what appears to be 10-point font. She did not understand that she had a right of rescission, or a right to decline ACH authorization. She did not understand that she was committing to mandatory arbitration unless she opted out. She did not understand how to opt out of the arbitration clause. She had no knowledge of her legal rights, or the statutory obligations of the Defendants.

~~37.~~ Plaintiff is locked in a~~Plaintiff made the first four payments due under her loan. When Defendant took what was to be the fifth and last payment, Plaintiff had insufficient funds in her bank account and it caused an overdraft on her bank account. As a result, Plaintiff obtained a new loan from Defendant to cover the overdraft and other expenses.~~

38. ~~Plaintiff has been unable to repay the first loan in the short-term manner advertised. She is now locked into a new~~ long-term obligation with exorbitant interest rates, penalties and terms.

Class Certification Allegations

39. This action is brought and may properly be maintained as a class action pursuant to Fed. Civ. P. R. 23. Plaintiff is typical of members of the Class (hereinafter, the "Class"), Plaintiff brings this action on behalf of herself and all others similarly situated, as representative of a proposed Class, because the proposed Class is so

numerous that the individual joinder of all its members is impracticable, common questions of law and fact exist as to all members of the proposed Class, and Plaintiff's claims are typical of the claims of the members of the proposed Class.[2]

~~**Irreparable Harm to Plaintiff**~~

~~40. Plaintiff incorporates by reference the foregoing averments as if fully set forth herein.~~

~~41. Without immediate injunctive relief, Plaintiff will be irreparably harmed by the unconscionable terms and conditions of Defendant's loan.~~

~~42. If Defendant is permitted to continue to enforce their unconscionable terms, which include automatically withdrawing $130.08 every two weeks from Plaintiff's bank account, Plaintiff will face grave financial harm, including possible default on financial obligations such as rent, food and other important costs of living.~~

~~43. While the compensatory damages (for excessive interest, penalties) are possible to quantify, consequential damages resulting from Defendant's continued imposition of unconscionable interest and penalties, and Defendant's continued draw on Plaintiff's bank account, are impossible to quantify with any reasonable degree of certainty, and could not necessarily be remedied by a monetary judgment.~~

~~44. Further, the balance of hardships is in Plaintiff's favor. As of July 1, 2013, Plaintiff has paid Defendant an amount not less than $850.97, including interest and penalties. On the contrary, Plaintiff faces ongoing financial hardship described above.~~

[2] Plaintiff's allegations for class certification do not constitute a motion for class certification, and Plaintiffs reserve the right to file a motion for class certification at the appropriate time.

45. Plaintiff respectfully submits that the contract is unconscionable. Defendant is taking unfair advantage of Plaintiff and all others similarly situated.

46. The public interest is served if the Court enjoins enforcement of an unconscionable loan agreement. Further, enjoining Defendant from enforcing an unconscionable agreement will prevent imminent and real financial harm to Plaintiff, and allow Plaintiff to focus her limited financial resources on daily living expenses like rent and food. Finally, the Plaintiff is typical of "payday" loan borrowers and the Class in that she is the very type of unsophisticated borrower who does not understand fully the financial implications of the loan agreement and the predatory practices of the Defendant. Enjoining the Defendant from enforcing an unconscionable agreement serves the public interest because it protects Plaintiff and the Class from Defendant's predatory and unconscionable lending practices.

COUNT I
Temporary Restraining Order (TRO), Preliminary and Permanent Injunction

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47. Plaintiff incorporates by reference the foregoing averments as if fully set forth herein.

48. Defendant's loan documents evidence on their face a gross imbalance in the parties' respective rights and obligations, and the exploitation of an underprivileged, unsophisticated borrower, and the existence of an unconscionable agreement. The principal amount of Defendant's current loan to Plaintiff is $450. The principal amount of Defendant's prior loan to Plaintiff was $450. The yearly interest rate on the current loan is 397.85%. The total interest cost of the current loan is $200.38. Late payments are subject to a delinquency charge of 5% of the unpaid amount. Defendant forced Plaintiff to grant Defendant a secured lien on her bank account, and authorization to take

~~continued automatic withdraws from Plaintiff's bank account. Interest will continue to accrue until the loan is paid in full, together with all outstanding penalties.~~

~~49. Plaintiff continues to pay Defendant, and has been unable to satisfy the terms of the current loan.~~

~~50. Defendant has received payments from Plaintiff totaling an amount not less than $850.97. Defendant will suffer little, if any, harm if forced to cease taking money for actions described in this complaint.~~

~~51. Plaintiff requests that the Court enter a temporary restraining order, preliminary injunction, and permanent injunction that enjoins Defendant from collecting anything more from Plaintiff and all other Class members.~~

~~COUNT II~~
Breach of the Duty of Good Faith and Fair Dealing

~~52.~~40. Plaintiff incorporates by reference the averments set forth above as if fully set forth herein.

~~53.~~41. Defendant has failed and refused to deal fairly with Plaintiff, and with all others similarly situated, in connection with Defendant's business practices and imposing the unconscionable terms of the loan agreements.

42. In applying for a loan, the Defendant required Ms. Johnson (and all other customers) to submit an application. However, while the ability to repay is a fundamental principle of sound lending, Defendant performs no underwriting before issuing loans. Thus, while Defendant advertises that these loans are for short-term solutions, the effect of making loans where there is no demonstration of an ability to repay causes injury to Plaintiff and other consumers by forcing them into a cycle of debt. See Exhibit H at p. 7, Exhibit I at p. 3, 5, 10-11 and Exhibit A.

43. Defendant implies that it is reviewing an application and performing underwriting. In failing to do so, Defendant violates the covenant of good faith and fair dealing.

~~54.~~44. As a direct result of Defendant's breaches of their duty of good faith and fair dealing, Plaintiff, and the Class, have suffered and will suffer injury as heretofore alleged.

COUNT III
Violation of the Delaware Consumer Fraud Act

~~55.~~45. Plaintiff incorporates by reference the averments set forth above as if fully set forth herein.

46. Defendant advertises its installment loan product as a short-term solution and not intended as a long-term solution.

47. Nevertheless, Defendant's secret business model is to trap consumers, including Plaintiff, in a cycle of debt.

48. Defendant suggests that it is reviewing a loan application and implied in that is that it is confirming a borrower's ability to repay the loan.

49. In fact, Defendant performs no underwriting to determine if the borrower will be able to repay the loan, because to do so would undermine the business model.

~~56.~~50. Defendant's conduct, as alleged herein,~~above,~~ is in violation of 6 Del. C. § 2513.

~~57.~~51. Specifically, as set forth herein, Defendant has engaged in deception, fraud, false pretense, false promise, misrepresentation, concealment, suppression or omission of material facts with its customers, with the intent that their customers rely on such conduct in connection with the sale or advertisement of its products.

~~58.~~52. As a direct result of Defendant's violations of 6 Del. C. § 2513, Plaintiff, and the Class, have suffered and will suffer injury as heretofore alleged.

WHEREFORE, Plaintiff, on behalf of herself, and the Class, respectfully requests that this Court enter judgment as follows:

a. ~~a. Granting a temporary restraining order, preliminary injunction, and permanent injunction barring Defendant from taking funds from Plaintiff's bank account, and from charging Plaintiff interest and penalties;~~

~~b.~~ Entering an Order certifying the plaintiff Class, appointing Plaintiff as representative of that Class, and appointing undersigned counsel to represent that Class, all pursuant to Fed. R. Civ. P. 23;

b. Granting a permanent injunction barring Defendant from taking funds from Plaintiff and the Class's bank account, and from charging Plaintiff and the Class interest and penalties and enjoining Defendant from continuing to market and sell these loans;

~~c.~~ Awarding to Plaintiff, and all others similarly situated, damages, including compensatory damages, consequential and incidental damages, for Defendant's violation of the duty of good faith and fair dealing, and Defendants' violation of 6 Del. C. § 2513;

d. Voiding Plaintiff's loan and the loans of all others similarly situated, and awarding Plaintiff and all others similarly situated all amounts ~~Plaintiff~~ borrowed from, and paid to, Defendants pursuant to their~~her~~ loan agreements with Defendant;

e. Awarding to Plaintiff, and the Class, punitive damages for Defendant's willful bad faith conduct;

f. Awarding to Plaintiff, and the Class, pre- and post-judgment interest;

g. Awarding to Plaintiff, and the Class, all costs of this action;

h. Awarding such other and further relief as this Court deems just and appropriate.

Dated: August 21, 2014~~9, 2013~~
Wilmington, Delaware

CROSS & SIMON, LLC

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