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Payday Lending in America:
Policy Solutions

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Pew's Small-Dollar Loans Project

- *Payday Lending in America* series (3 reports)
- Research began in 2011
  - Unique, nationally representative survey of payday borrowers
  - Administrative data reviews
  - Focus groups and interviews

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Agenda

- Overview of payday loans
- Fundamental problems with payday loans
- Consumers want policymakers to act
- Pew's policy recommendations
- Research shows that safeguards can work
  - Colorado required 6-month installments, strong consumer protections
  - Borrowers spending $40 million less, with almost no reduction in access

Overview of Payday Loans

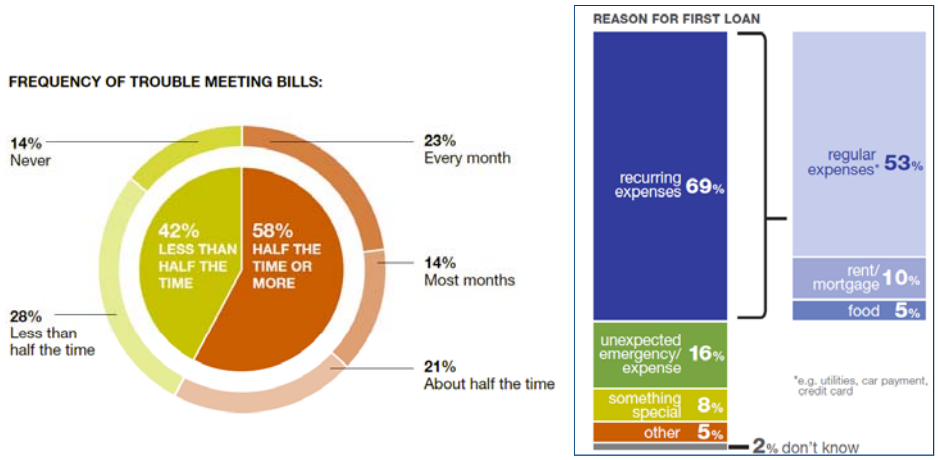
How Payday Loans Work

- Packaged as “short-term” loan for “temporary needs”
  - Obtained from storefronts, online, some banks
- Little to no underwriting
  - Borrower has an income source and checking account
- Lender can debit bank account to collect (deferred presentment)
- Short repayment period, tied to borrower pay cycle
  - If borrower cannot pay in full, pays fee to renew, or borrows again
- Avg. loan is $375
  - Fee per 2 wks: $55 store, $95 online, $35 bank

Profile of Payday Borrowers

- 12 million users per year, spending about $7.4 billion
- Have a bank account
- Have income – about $30,000 per year
- “Thick File” credit histories
  - Almost all have a credit score – low 500s
  - Most have credit cards – usually maxed out

Most Borrowers Use Payday Loans for Monthly Bills



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Fundamental Problems with Payday Loans

- *Fail to work as advertised*
- *Overwhelmingly unaffordable*

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Payday Loans Fail to Work As Advertised

- Not “short term”
  - Average borrower is in debt for 5 months of the year
  - Business model would fail if average borrower repaid as advertised
- Not for “temporary needs” or emergencies
  - Most seek help paying ordinary living expenses, like utilities or rent
- Not a fixed fee
  - Average borrower pays $520 per year
- Overwhelmingly unaffordable
  - Lump-sum repayment makes it hard to pay monthly bills

Payday Loans Are Unaffordable

A typical payday loan takes up **one-third of a borrower's paycheck**...

But most borrowers cannot afford more than **5% of their paycheck**.

Renewing is Affordable, But Paying Off is Not

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Average borrower can afford (per two weeks)

$50

→

Amount Due in Two Weeks to Pay Off a Loan of $375

$430
(principal + fee of $55)

OR

Amount to Renew or Re-borrow Loan for Two More Weeks, Without Paying Down Principal

$55

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Payday Loans Do Not Eliminate Overdraft Risk

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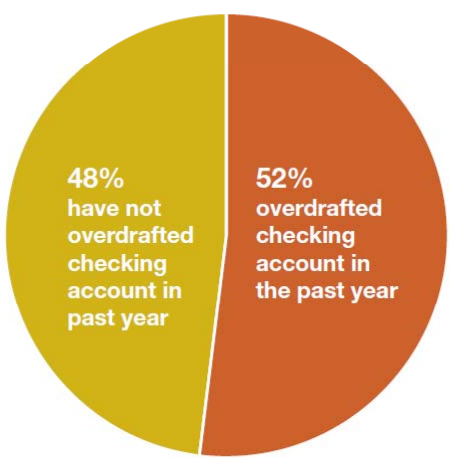

MAJORITY OF PAYDAY BORROWERS HAVE OVERDRAFTED IN THE PAST YEAR

Report:
See p.32-35

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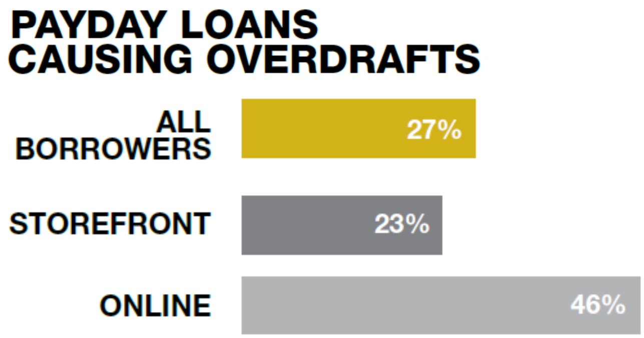
Payday Loans Do Not Eliminate Overdraft Risk



Report:
See p.32-35

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Deposit Advance Loans Do Not Eliminate Overdraft Risk

We found that deposit advance users in our sample of accounts were much more likely to have incurred an overdraft or NSF fee during the 12-month study period than eligible non-users. Notably, we found that while just 14% of eligible non-users incurred an overdraft or NSF fee during the 12 month study period, 65% of those consumers who used deposit advances had overdraft or NSF activity. Deposit advance users who incurred an overdraft or NSF fee typically incurred a greater number of fees than eligible non-users with at least one overdraft or NSF fee.

CFPB
Data

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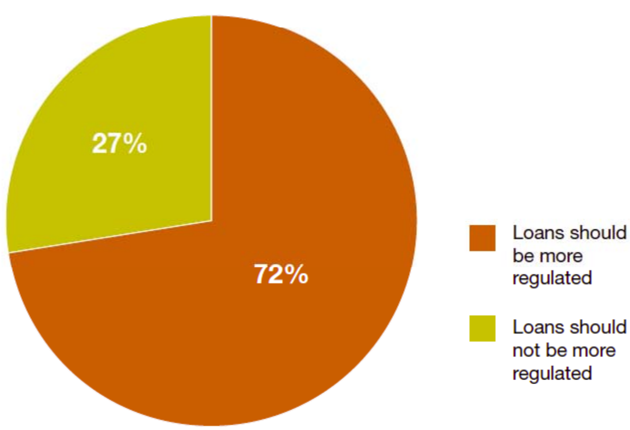
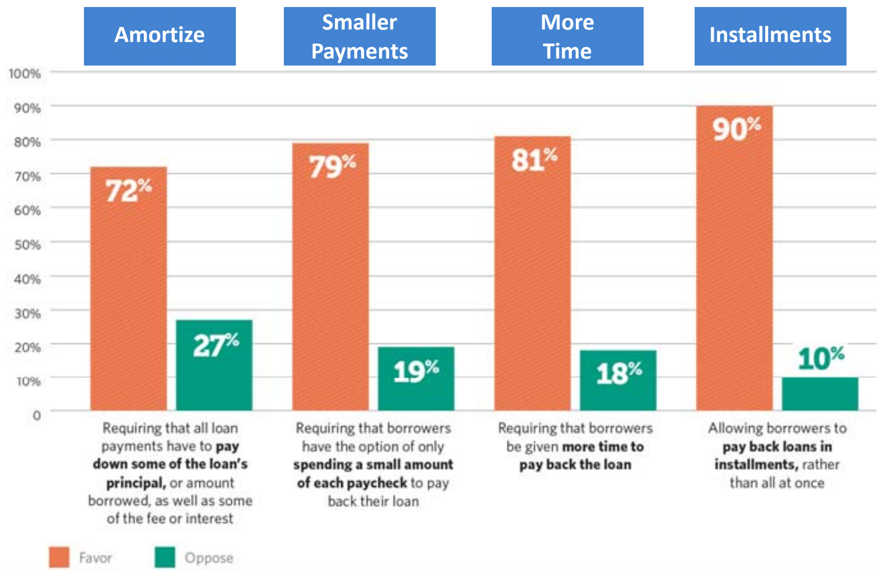
Consumers Want Policymakers to Act

BORROWERS FAVOR MORE REGULATION

ALL PAYDAY BORROWERS



Borrowers Overwhelmingly Support Requiring Installment Payment Structure



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Pew's Policy Recommendations

Decisive action is required from the Consumer Financial Protection Bureau (CFPB) and other federal regulators, and from policymakers in the 35 states that now permit lump-sum payday lending.

- To fix the payday loan problem, policymakers can choose to eliminate payday loans, or fundamentally reform them
- Pew's recommendations provide guidance on how to make small-dollar loans safer and more affordable wherever they exist

Policy Solutions Report: See Page 44

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Pew's Policy Recommendations

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1 Limit payments to an affordable percentage of a borrower's income

Monthly payments above 5 percent of monthly pretax income are unaffordable for most borrowers. Loans requiring more should be prohibited unless rigorous underwriting shows that the borrower can pay the loan while meeting other financial obligations.

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What payments result from a 5% threshold?

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	Biweekly payment
$18,000 Income	$35
$30,000 Income	$58
$48,000 Income	$92

A 5% threshold scales to accommodate different loan sizes and different income levels

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Pew's Policy Recommendations

2 Spread costs evenly over the life of the loan

Front-loading of fees and interest should be prohibited. Any fees should be paid evenly over the life of the loan, and loans should have substantially equal payments that amortize smoothly to a zero balance.

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Pew's Policy Recommendations

3 Guard against harmful repayment or collections practices

Policymakers should prevent or limit the use of postdated checks and automatic withdrawals from borrowers' bank accounts. They should also make it easier to cancel automatic electronic withdrawals and protect against excessively long loan terms.

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Pew's Policy Recommendations

4 Require concise disclosures of periodic and total costs

Loan offers should clearly disclose, with equal weighting: the periodic payment schedule, the total repayment amount, the total finance charge, and the effective annual percentage rate (APR) inclusive of all fees.

Pew's Policy Recommendations

5 Continue to set maximum allowable charges

Almost every state sets maximum allowable rates on some small-dollar loans because these markets serving those with poor credit histories are not price competitive. Policymakers may limit rates to 36 percent or less if they do not want payday lenders to operate, or somewhat higher if they do.

A Market Lacking Price Competition

How much does a $500 payday loan cost?

	Advance America	Ace Cash Express	Check into Cash	Check n Go
Florida	$55	$55	$53	$55
Michigan	$65.45	---	$65.45	$65.45
Kansas	$75	$75	$75	$75
Alabama	$87.50	$87.50	$87.50	$87.50
Nevada	$92.50	$85	$110	$125

Costs listed on company websites as of November 1, 2013

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A Market Lacking Price Competition

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

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Research Shows That Safeguards Can Work

- Case study: Colorado's 2010 payday loan reform
- Better for borrowers, viable for lenders

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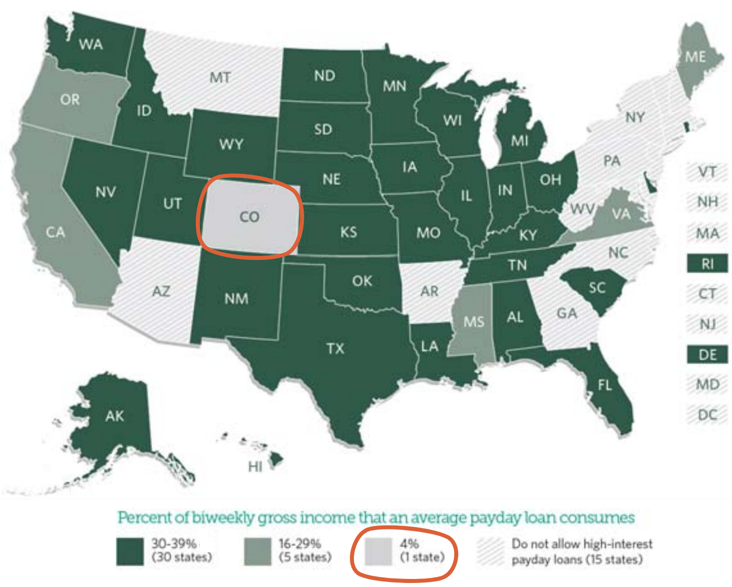
Colorado Payday Loans Became Installment Loans with Affordable Payments



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Colorado Revised Payday Loan Law (2010)

Eliminated the conventional, 2-week payday loan.

Replaced it with a 6-month installment loan featuring:

- Affordable payments
  - Average borrower pays 4% of paycheck, not one-third
- Fully amortizing loan with equal installment payments
  - No front-loading of fees or interest, can repay early w/o penalty
- High cost (average APR 129% w/ interest and fees)
- Complicated fee structure

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Lower Cost

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
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

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More Affordable Payments

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
Maximum loan size	$500	$500
Amount due on next payday ($500 loan)	$575	$61

- *Average repayment requires 4% of pretax paycheck in CO*
- *Pew recommends prohibiting loans that require more than 5% of a borrower's pretax paycheck*

Borrowers Are Spending Less

	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)	Difference
Average loan size	$368	$389	6%
Cost			
Amount spent per borrower annually	$476	$277	-42%
Total spent on payday loans by borrowers	$95.1 million	$53.2 million	-44%

Borrowers are spending $40 million less per year

Average Loan Repaid in Just Over 3 Months

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Increased Transparency Under Installment Loan Law

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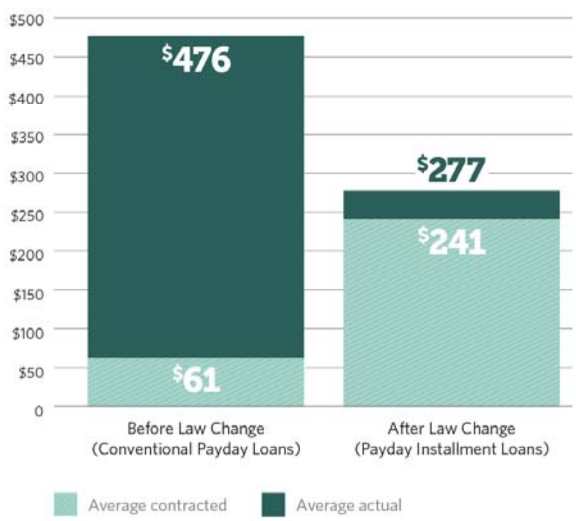

Under the old law, the average contracted cost represented 13% of fees actually paid. Under the new law, this cost represents 87% of fees actually paid.

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Installment Loans Easier to Manage

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
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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Substantial Adjustments for Lenders

- New software systems and other transition costs
- Adjusting business practices to service installment loans
- Reduced profitability per customer
  - More volume per store needed; stores have consolidated
- But little to no change in “underwriting”

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Storefront Consolidation, Higher 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	279,570	238,014	-15%
Number of licensed locations	505	238	-53%
Borrowers per store	554	1,000	81%

*Large lenders that also offer **check cashing** have consolidated much less (17%) compared to those that do not (55%)*

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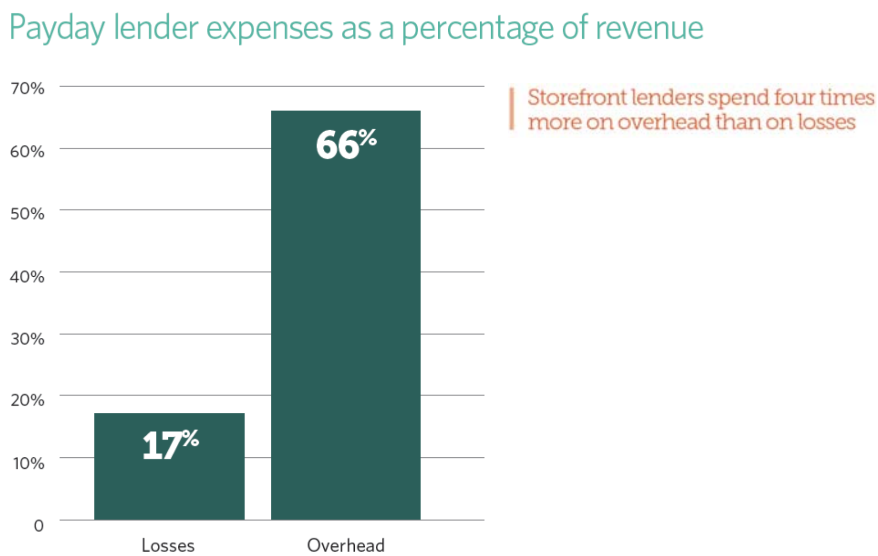
Nationwide, Overhead Drives Cost



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Stores Still Widely Available After Law Change

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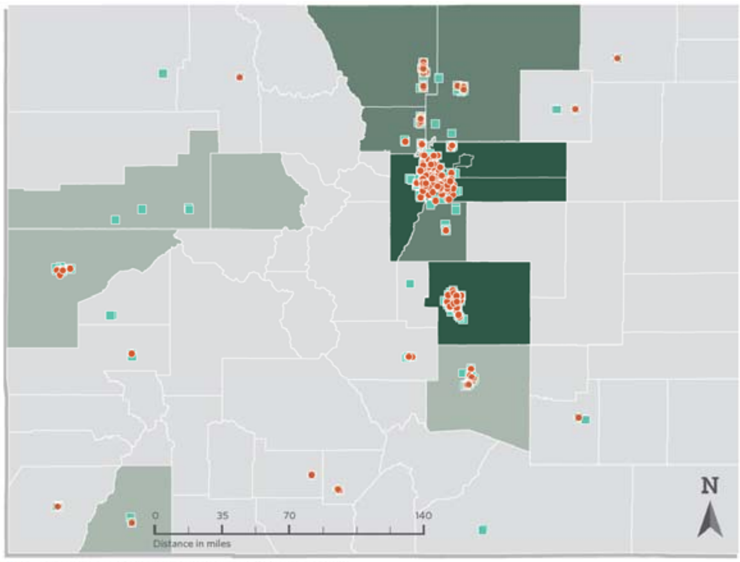

Percentage of Colorado's population that lives within 20 miles of a payday loan store

- Before the law change: 93%
- After the law change: 91%

Percent of total population by county

<1 | 1-4 | 4-8 | 8-12

● Location open after law change (Aug. 1, 2013)

■ Location open before law change (April 1, 2010)

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Same Type of Borrowers

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	Before Law Change (Conventional Payday Loans)	After Law Change (Payday Installment Loans)
Gross monthly income (mean)	$2,458	$2,477
Gross monthly Income (median)	$2,199	$2,140
Age	38	37
Average time at current job	3.5 years	3.6 years
Female	55%	52%
Married	35%	35%

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Summary – CO Case Study

- Six-month installment loans with safeguards similar to Pew's policy recommendations
- The average borrower:
  - Spending 42% less
  - Paying 4% of paycheck (compared to one-third nationally)
  - Repaying in just over 3 months
- Access to credit remains widely available

Banks & Credit Unions

Bank Deposit Advance Loans (DAP)

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 pay period	$10 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.

Report:
See p.11

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Bank Deposit Advance Loans (CFPB Data)

- 15% of eligible users took a deposit advance loan
- 18% of users are occasional (median 2 pay periods/yr)
  - Account for only 3% of all transactions
- More than half are heavy users (median 10+ pay periods/yr)
  - Account for 81% of all transactions, three-quarters of all revenue
  - Very heavy users (median 19 pay periods/yr) – 34% of transactions

CFPB Report
p.33-35

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Banks & Credit Unions Have Many Customers' Trust

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5 **Trust**

Some bank deposit advance borrowers believe that bank payday loans are safer or more regulated than other payday loans.

*"I think [it's safe] because they are through the bank and the bank has **FDIC** insurance."*

"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 the federals, they've got a lot of pressure on them to stay within the usury laws."

*"For the banks, on the door it says **FDIC** so you know it's governed."*

"…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 borrowers from a San Francisco, CA, focus group

Report: See p.28

Small-loan revenue

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Revenue from a $500, six-month loan

At 28% annualized interest (no fees): $41

At 36% annualized interest (no fees): $53

So…

1) Losses have been low at banks and credit unions that encourage electronic repayment

2) Savings component can secure a portion of the loan and help customers to begin saving

-Examples: (NFCDCU Borrow & Save, Freedom First, North Side, Better Choice PA, SECU)

3) Largest programs, such as State Employees Credit Union (NC), have kept costs down by automating the entire loan process, including any underwriting, enabling profitable lending at low interest rates

Summary of Pew's Policy Recommendations

CFPB and policymakers in the 35 lump-sum payday loan states should act now to make all small-dollar loans safer and more affordable:

1. Limit payments to an affordable percentage of a borrower's income
   - Research indicates payments above 5% gross income are unaffordable
2. Spread costs evenly over the life of the loan
3. Guard against harmful repayment or collections practices
4. Require concise disclosures of periodic and total costs
5. Continue to set maximum allowable charges

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