



Contact: Paul Leonard, California Director
Paul.leonard@responsiblelending.org, 510-379-5510

Graciela Aponte, CA External Affairs Director
Graciela.aponte@responsiblelending.org, 510-379-5518

Analysis: New State Data Show California Payday Lenders Continue to Rely on Trapping Borrowers in Debt October 9, 2014

The California Department of Business Oversight (DBO) released data on October 3, 2014 showing the extent to which repeat lending comprises the bulk of payday loan activity.¹ Over 75% of all payday loan fees are from borrowers with 7 or more payday loans in 2013. The Center for Responsible Lending's analysis of DBO's data supports the conclusion that, far from offering a quick financial fix, the industry's practices and its loans are designed to trap borrowers in long-term, unaffordable debt. Payday loans are keeping borrowers locked in a state of financial crisis, pushing safer options further out of reach.

Background: Payday Lending in California

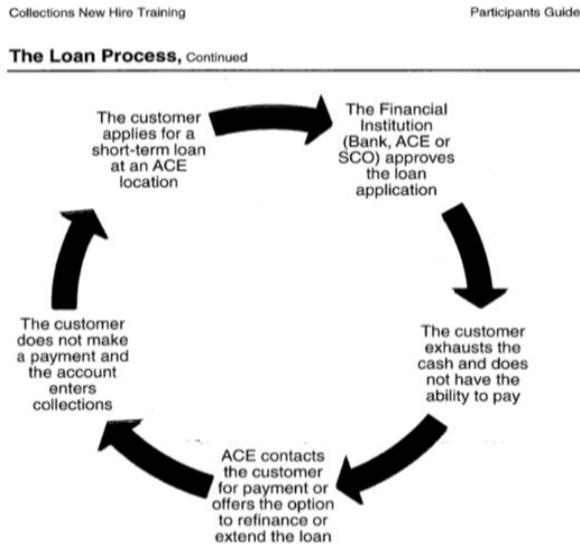
The Loan: For a two-week loan of \$255 (the maximum dollar amount allowed in California) the borrower writes a \$300 post-dated check (\$255 loan, plus \$45 interest) to the lender, providing the lender with direct access to the borrower's checking account. Payday lenders do not assess whether the loan is affordable to the borrower in light of their income and expenses. Payday lenders essentially require only proof of income (from work, Social Security or even unemployment insurance) and a checking account to qualify for a payday loan.

With direct access to the borrower's checking account, a lender can cash the post-dated check on the borrower's next payday, amounting to an annual interest rate of 459%. The payday lender is then first in line for this new income and the money is taken from the borrower's account before they can make their car payment, buy groceries or pay other bills. This practice leaves most borrowers deeper in the hole than when they started.

The high price of a payday loan and the fact the loans are made with little regard for a borrower's ability to repay virtually ensures that cash-strapped borrowers will be unable to meet their basic expenses and pay off their loan with their next paycheck.² Many are encouraged by lenders to pay off the loan by immediately taking out a new payday loan to cover expenses, again providing checking account access, and repeating the cycle over and over.

The new data shows this is no accident—payday lenders rely on the practice to generate the majority of their revenues. They admit this in private, and specifically train new employees to encourage repeat borrowing.³

Page from the ACE Cash Express New Hire Training Manual⁴



Analysis: California Department of Business Oversight Data Show Deep and Growing Debt Trap

DBO conducted a survey of payday lender licensees to assess the frequency of repeat lending of payday loans during calendar year 2013. Lenders were asked to report how many of their borrowers received 1, 2, 3 and up to 10 or more loans in each period. An analysis of the findings shows that repeat borrowers are the “bread and butter” of the payday lending business model, contradicting the industry’s marketing claims.

1. Payday lenders rely on borrowers who get stuck in a cycle of repeat borrowing.⁵

- 76% percent of all payday loan fees are due to borrowers stuck in 7 or more payday loans per year.
- 60% of payday loan fees are from borrowers with 10 or more loans in a year.

2. The long-term debt trap is the most typical borrower experience.⁶

- Borrowers taking out 7 or more loans per year accounted for 45% of borrowers.
- The “10 or more” loan category was the single largest, accounting for 29% of all borrowers. Conservatively, borrowers in this category received an average of 13 loans annually, or more than one loan per month.

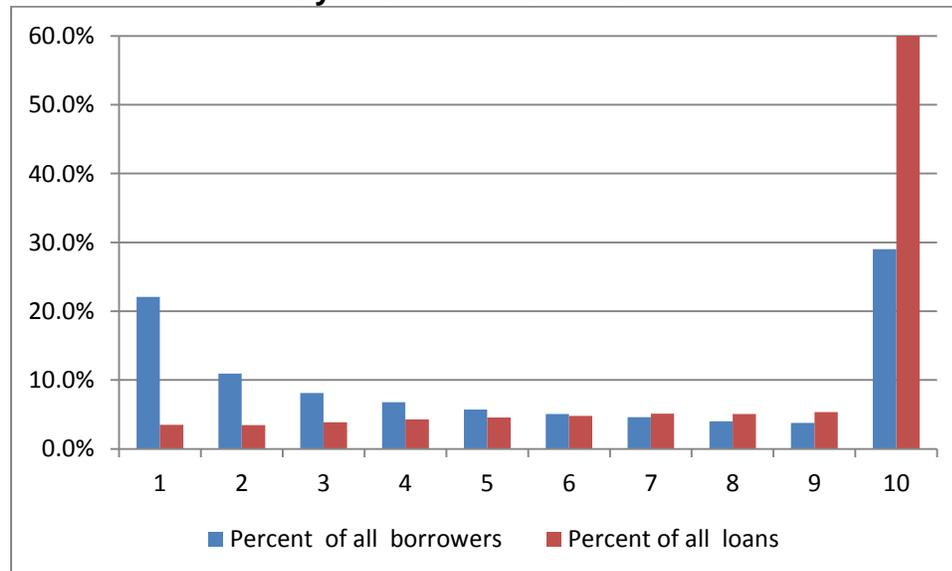
3. ***The debt trap in California is growing deeper:*** The number of borrowers with 10 or more loans in 2013 increased by 11 percent over 2012, even as the total number of payday loans declined slightly over the same period.⁷

The California regulator (formerly called the Department of Corporations) has acknowledged, “[W]hen payday loans are used for a long period of time, the fees charged can rapidly exceed the amount borrowed and can create a serious financial hardship for the borrower.”⁸ Previous research by the Center for Responsible Lending found that most repeat payday loans are taken out in rapid succession, not spread out throughout the year. According to CRL’s 2009, *Phantom Demand*, 76% of all payday loans are loans taken out within two weeks of the previous payday loan, showing that borrowers could not make it to their next payday without borrowing again.⁹ This is consistent with findings by recent research from the CFPB which found that 80% of all payday loans are followed by another loan within 14 days. This is a sign of the debt trap, not that the borrower is being extended new credit each time.¹⁰

4. ***Payday loans that are used only occasionally – as they are advertised – account for only a small portion of payday lending business.***

- Only 4 percent of all payday loan activity in 2013 was from borrowers with just one loan in 2013. These borrowers accounted for 22% of all borrowers.
- Only 15 percent of all payday loan activity in 2013 was from borrowers with 4 or fewer loans.

**California Distribution of Payday Loan Usage
Percent of Borrowers vs Percent of All Payday Loans,
By number of Transaction**



Source: CA Department of Business Oversight

Consistent with data from the CFPB and CRL analysis of data in other states, the California data provide a clear picture that payday lenders rely heavily on extensive repeat lending to its customers.

Payday Debt Trap Creates Numerous Harms

High Levels of Default Among Repeat Borrowers

A significant share of borrowers become late or default on their payday loans, triggering more fees and placing their bank account at risk. CRL research found that 37% of payday borrowers experienced default in the first year of borrowing; within the first two years, 44% did.¹¹ This finding is consistent with other research that examined data from a large Texas-based payday lender and found a 54% default rate.¹² High levels of loan churn mean that even borrowers who default often pay substantial fees, often paying the payday loan fee multiple times before ultimately defaulting.



Source: State of Lending
www.responsiblelending.org

Studies Show Payday Loans Create Cascade of Negative Financial Consequences

- **Losing bank accounts.** Researchers from Harvard Business School have shown that access to payday loans is linked to increased rates of involuntary bank account closures, which makes routine financial transactions more expensive and risky.¹³
- **Becoming delinquent on other debts.** Agarwal, Skiba, & Tobacman found that once credit card users borrowed from payday lenders, they were 92 percent more likely to become delinquent on their credit card payments.¹⁴ In addition, Melzer compared low- and middle-income households living in areas with and without storefront payday lenders. He found that people with access to the loans were 25 percent more likely to

have difficulty paying bills and 25 percent more likely to delay needed medical care. Melzer states,

I find no evidence that payday loans alleviate economic hardship. To the contrary, loan access leads to increased difficulty paying mortgage, rent and utilities bills. . . . Counter to the view that improving credit access facilitates important expenditures, the results suggest that for some low-income households the debt service burden imposed by borrowing inhibits their ability to pay important bills.¹⁵

- **Filing for bankruptcy.** Another study found that payday borrowers had nearly twice the likelihood of filing for bankruptcy compared with households of similar financial status who were denied a payday loan.¹⁶

Policy Recommendations

Federal and state policymakers can take steps to rein in predatory payday lending.

- **Make Payday Loans Affordable: Impose a Non-Predatory APR Cap.** The only proven way for policymakers to prevent predatory small loans is to enforce a comprehensive small loan law with an interest rate cap at or around 36 percent. Fifteen states and the District of Columbia have reasonable rate caps on small loans which limit payday lending.¹⁷ In these states and in the District of Columbia, small dollar credit is still available without sinking into high-cost, long-term debt.

Because the U.S. Department of Defense found predatory loans, such as 300% APR payday and car title loans, undermining our nation's military readiness, Congress enacted in 2006 a federal 36 percent rate cap for members of the military and their families. The U.S. Department of Defense recently announced proposed rules to expand this protection to a broader set of consumer credit products. Proposals to cap payday interest rates are also pending in Congress. Senator Richard Durbin (S. 673) and Representative Matt Cartwright have both introduced 36% rate cap bills (HR 5130).

- **The CFPB Can Level the Playing Field by Ensuring Small Loans are Affordable and Stopping the Debt Trap**

As part of the Dodd-Frank Act, Congress gave the Consumer Financial Protection Bureau (CFPB) explicit authority to address unfair, deceptive, and abusive payday loan practices. In addition to the CFPB's research, supervision, and enforcement actions revealing the persistent of the debt trap, the CFPB is in position to issue rules early in 2015 that have the potential to end the debt trap nationwide.

While the Dodd-Frank Act prohibits CFPB from establishing an interest rate cap, the CFPB can and should issue rules that:

1. Require lenders to take into account a borrower's ability to repay the loan when considering both income and expenses;
2. Limit the amount of time that lenders can keep borrowers in payday loan debt to no more than 90 days in a 12 month period; and
3. Restrict lenders from requiring a post-dated check or electronic access to a borrower's checking account as a condition of extending credit.¹⁸

End Notes

¹ DBO released two reports: the statutorily mandated Annual Report which provides certain aggregate data on the number of transactions, lenders and charges. [2013 Annual Report of Operation of Deferred Deposit Originators](http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/CDDTL_Annual_Report_2013.pdf), http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/CDDTL_Annual_Report_2013.pdf. The second report provides data from DBO's second annual survey of licensees for data regarding distribution of the number of loans, demographic data and several other specific subjects. Summary Report: California Deferred Deposit Transaction Law – Industry Survey, Page 6. http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2014_CDDTL_Industry_Survey_Summary_Report_Letter.pdf

² Uriah King & Leslie Parrish, *Springing the Debt Trap: Rate Caps are Only Proven Payday Lending Reform* at 7-8 (Center for Responsible Lending Dec. 13, 2007), available at <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>.

³ In addition to the data itself, industry pronouncements make this clear. For example, Dan Feehan, CEO of Cash America remarked at the 2007 Jefferies Financial Services Conference: “And the theory in the business is you’ve got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that’s really where the profitability is.” *See id.* at 1. Others in the industry have a similar analysis: “The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers,” “This industry could not survive if the goal was for the customer to be ‘one and done’. Their survival is based on the ability to create the need to return, and the only way to do that is to take the choice of leaving away.” *See id.* at 10-11. Similarly, the FDIC’s Center for Financial Research undertook a study of the industry based on payday lenders’ proprietary data, and found that the profitability of payday lending is driven by volume, and acknowledged that “... high-frequency borrowers account for a disproportionate share of a payday store's loans and profits. *See* Uriah King, et al., *Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year* at 8 (Center for Responsible Lending Nov. 30, 2006), available at http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf.

⁴ The ACE Cash Express debt trap graphic was released by federal officials investigating abusive practices at the company. The company was ultimately forced to pay \$5 million in refunds to borrowers and \$5 million in fines. <http://www.responsiblelending.org/media-center/press-releases/archives/CFPB-Finds-ACE-Cash-Express-Used-Abusive-Illegal-Tactics.html>

⁵ Center for Responsible Lending calculations based on Summary Report: California Deferred Deposit Transaction Law – Industry Survey, Page 6. The total number of loans, is assumed to be 12.2 million, as reported in the DBO 2013 Annual Report http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2014_CDDTL_Industry_Survey_Summary_Report_Letter.pdf

		Cumulative		Number of	Percent of all	Cumulative Total of Loans	Cumulative Percent of all loans	Reverse
		Percent of all borrowers	percent of all borrowers					Cumulative Percent of all loans
1	425,464	22.1%	22.1%	425,464	3.5%	425,464	3.5%	100.0%
2	210,852	10.9%	33.0%	421,704	3.5%	847,168	7.0%	96.5%
3	156,881	8.1%	41.1%	470,643	3.9%	1,317,811	10.8%	93.0%
4	130,772	6.8%	47.9%	523,088	4.3%	1,840,899	15.1%	89.2%
5	110,339	5.7%	53.6%	551,695	4.5%	2,392,594	19.7%	84.9%
6	97,495	5.1%	58.7%	584,970	4.8%	2,977,564	24.5%	80.3%
7	88,447	4.6%	63.3%	619,129	5.1%	3,596,693	29.6%	75.5%
8	76,809	4.0%	67.2%	614,472	5.1%	4,211,165	34.6%	70.4%
9	72,413	3.8%	71.0%	651,717	5.4%	4,862,882	40.0%	65.4%
10	559,535	29.0%	100.0%	7,300,950	60.0%	12,163,832	100.0%	60.0%
Total	1,929,007	100.0%		12,163,832	100.0%			

⁶ These are conservative estimates of the debt trap. The DBO survey does not take into account borrowers who use multiple lenders over the course of the year. A borrower who takes out 3 loans from one lender, might also be taking out 8 or 10 borrowers from one or more other lenders. Because each lender would report only their own data, this would under count the total number of loans for that borrower, and potentially over count the number of borrowers in the more occasional use categories.

⁷ This estimate is very conservative, since it does not adjust for the lower percentage of licensees replying to DBO's survey in 2013 (78% in 2013 vs 93% in 2012). See page 6, http://dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2013_CDDTL_Industry_Survey_Summary_Report_Letter.pdf There were 12.2 million loans in 2013, a decline of 91,194 or less than 1% Data on number of transactions comes from *DBO Annual Report 2013*, p 7.

⁹ Uriah King & Leslie Parrish, *Phantom Demand*, Short-term due date generates need for repeat payday loans, account for 76% of total loan volume. Center for Responsible Lending, July 2009. <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf>

¹⁰ Kathleen Burke, Jonathan Lanning, Jesse Leary and Jialan Wang, *CFPB Data Point: Payday Lending*, Consumer Financial Protection Bureau, March, 2014, p. 4. http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf

¹¹ Uriah King & Leslie Parrish, *Payday Loans, Inc. Short on Credit, Long on Debt* (Mar. 31, 2011), available at <http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf>.

¹² Researchers from Vanderbilt and Oxford found that over half (54%) of all payday borrowers will default in the first twelve months based on an analysis with two million observations. Paige M. Skiba, & Jeremy Tobacman, *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default* (Aug. 21, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319751.

¹³ An increase in payday lending locations in a particular county is associated with an 11% increase in involuntary bank account closures (generally due to the account being excessively overdrawn), even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. See generally Dennis Campbell, et al., Harvard Business School, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures* (Dec. 3, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873.

¹⁴ Using a database of Texas borrowers, the authors find that taking out a payday loan makes a borrower 92% more likely to become seriously delinquent (*i.e.*, 90 days or more late) on their credit card during the year. See Sumit Agarwal, et al., *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* (NBER Working Paper No. 14659) (Jan. 13, 2009), available at <http://www.nber.org/papers/w14659>.

¹⁵ See Brian T. Melzer, “The Real Costs of Credit Access: Evidence from the Payday Lending Market,” *Quarterly Journal of Economics* (2011), available at <http://qje.oxfordjournals.org/content/126/1/517.full.pdf>.

¹⁶ See Paige M. Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* (Nov. 9, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

¹⁷ Susanna Montezemolo, *The State of Lending in America & its Impact on U.S. Households: Payday Lending Abuses And Predatory Practices*, Center for Responsible Lending, September 2013, p. 13. <http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf>